Troops and Tax Cuts

The Bush Administration has lately been arguing that its newest tax cut plan should be passed as a way to support the troops in Iraq (Baltimore Sun, “New Tax Cut Argument: It’s For the Soldiers”, April 2; Washington Post, “Bush Administration Using War to Justify Its Tax Cut,” Wednesday, March 26; “Snow Links Tax Cut to Supporting US Military,” Reuters World Service, April 3).

Maybe next we will be told that the estate tax should be repealed on behalf of the unemployed, or that the corporate income tax should be eliminated to help struggling single mothers. Such arguments would be hardly less plausible than the idea that a tax plan whose central element is the complete elimination of dividend taxation should be passed on behalf of the troops.

The absurdity of the argument can be shown in many ways. For example, about 99.76 percent of the tax relief from the elimination of dividend taxes would flow to civilian households; military households, who make up about 1.2 percent of the population, would share the remaining 0.24 percent of the tax cut. Alternatively, the average size of the dividend tax cut received by civilian families will be around seven times larger than the average tax cut received by military households (for details of these calculations, see http://www.econ.jhu.edu/people/ccarroll/divtaxcut.pdf).

Of course, there’s a sense in which this comparison misses the point. Only about 20 percent of families, military or civilian, receive dividend income that would be eligible for the tax cut, so calculating an average size of tax cut across all families in either category lumps together many people who will get no tax cut with a few who will get a very big one. In fact, the one percent of civilian households who stand to gain the most would get an average of about $20,000, while the remaining 99 percent of the civilian population would get an average of only about $70 each.

This highlights the key reason for the discrepancy between civilian and military households: The richest few percent of civilian households are much richer, and own vastly more stock, than the richest few percent of military households. This is partly due to the modest salaries earned even by the highest-ranking officers: Tommy Franks, head of the U.S. Central Command, a four star general (the highest rank in the regular military), and the officer in charge of U.S. troops in Iraq, earns only about $154,000 a year, while his civilian counterpart (say, the CEO of a large corporation) is likely to earn many millions a year. It is hard to accumulate enormous holdings of stock, and therefore an enormous source of dividend income, on a soldier’s pay.

Given these inconvenient facts, the Administration has resorted to other rationalizations for why the tax cut will be good for the troops. The principal line of argument has been that the tax cut will create hundreds of thousands of new jobs that will await the troops whenever their task is finished in Iraq.
This is a proposition with no foundation in either economic theory or macroeconomic experience. Indeed, the principal theoretical argument for a dividend tax cut is that it will boost saving. With the economy teetering on the brink of a possible second dip into recession, the last thing needed in the short run is a policy that will encourage saving rather than spending. In the long run, a gradual increase in the saving rate would be a good thing, but to argue that the dividend tax cut is what is needed for short term stimulus is like telling someone who is having a heart attack that he should drink green tea for his health: It may or may not be good advice, but it does nothing for the immediate problem.

Given the sacrifices that both regular service members and reservists are making during the war in Iraq, it seems only fair that if any tax cut is passed it should benefit military households more than civilians. This is all the more true because deployment can put major financial strains on military families, including extra travel, child care, international telephone bills, and other expenses, as well as the loss of income or business in their regular jobs for called-up reservists. (Not to mention the worst risk of all: that a family breadwinner might be killed in action.)

There is no technical obstacle to tax cuts that would directly target military households. Perhaps the simplest way to do this would be simply to increase the standard deduction for military households for the 2003 tax year. The fact that the Administration has made no such proposals makes it hard to resist the conclusion that the call to pass latest tax cut on behalf of the troops is an attempt to manipulate patriotism in pursuit of an agenda that has nothing to do with the welfare of service members, but everything to do with the welfare of the most generous contributors to the Republican party – the same top one percent of taxpayers who have already been the primary beneficiaries of the Administration’s first enormous tax cut, passed in 2001.

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