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WAR AND TAXES[†]

Steven A. Bank & Kirk J. Stark

In the early summer of 1967, veteran Washington journalist Peter Lisagor met with a senior Republican senator to discuss the deteriorating situation in Vietnam. The war had divided the country, triggering massive antiwar demonstrations in several major cities, and the senator agreed to talk only on condition of anonymity. But the topic of discussion was not troop levels or moral arguments over the U.S. presence in Indochina. Rather, the senator wanted to talk about something more mundane: taxes. As Lisagor later explained in a *Los Angeles Times* article, “Absence of Sacrifice at Home Spurs Guilt Feeling over War,” the GOP senator considered taxes a question of conscience. “I went to the beach with my son and his children a few weeks ago,” the senator explained, “and there we were, enjoying ourselves as if we didn’t have a care in the world. We had no sense of a war, no sense of sacrifice. Yet this war is already bigger than Korea. I’ll go for a tax increase now.”¹

A generation later, the senator’s question of conscience has resurfaced in public debate. On March 19, 2003, the Bush administration launched Operation Iraqi Freedom, a military campaign to overthrow dictator Saddam Hussein. Administration officials defended the action as part of a broader “war on terror,” including Operation Enduring Freedom in Afghanistan, which began shortly after the al Qaeda attacks of September 11, 2001. From that point forward, the United States has been actively waging a costly overseas military operation. Within six years, the Department of Defense had confirmed a total of 4,018 U.S. fatalities in Iraq and Afghanistan. And according to estimates from the Congressional Budget Office, by 2007, the budgetary cost of operations in the two countries exceeded \$500 billion.²

Yet despite the country’s great loss of blood and treasure, there is little sense of sacrifice on the homefront. Indeed, in its first six years, the Bush administration has requested, and Congress has approved, a series of major tax cuts.³ Lawmakers have lowered and flattened rates for the individual income tax, initiated a repeal of the estate tax, eased the burden on capital gains and corporate dividends, reduced the so-called marriage penalty, and enacted a slew of new deductions, credits and other special-interest provisions.⁴ When combined with a steady increase in military, domestic and entitlement spending, these cuts have turned a projected \$5.6 trillion surplus over the

10-year budget window into a \$2.7 trillion deficit.⁵

This contrast—between an active war effort on one hand and substantial tax cuts on the other—has no precedent in American history. Beginning with the War of 1812, special taxes have supported every major military conflict in our nation's history. Moreover, many levies have outlasted the wars they financed. Politicians like to talk about their plans for revamping the country's tax system, but important tax reform usually happens when it must, not when it should. War has been the most important catalyst for long-term, structural change in the nation's fiscal system. Indeed, the history of America's tax system can be written largely as a history of America's wars.

Enactment of the Bush tax cuts has called into question the once-axiomatic relationship between war and taxes. The historical incongruity of Congress reducing taxes while increasing spending on the war in Iraq has provided fodder to administration critics who, like the anonymous senator calling for increased taxes to pay for the war in Vietnam, have wondered publicly if the country has betrayed its tradition of wartime fiscal sacrifice. As one pundit declared in a typical statement, "in his determination to cut taxes even while waging war in Iraq, President Bush is bucking history."⁶ Yet another bemoaned, "since 9/11, our government has asked no sacrifice of civilians other than longer waits at airplane security. We've even been rewarded with a prize that past generations would have found as jaw-dropping as space travel: a wartime dividend in the form of tax cuts."⁷

Underlying these comments is an inescapable fact: the United States has a strong tradition of wartime fiscal sacrifice, and the Bush tax cuts mark an abrupt departure from that tradition. As we hope to illustrate, however, America's history of wartime taxation is not quite the heroic tale that many Bush critics seem to imply. Although taxes have typically gone up during times of war, the claim that "we have always accepted heavier burdens as the price those at home pay to support those under fire on the front" misses much of the complexity of American history.⁸ Indeed, as a nation, our commitment to wartime fiscal sacrifice has always been uneasy—and more than a little ambiguous. In some wars, political leaders have asked Americans to accept new taxes as the price of freedom and security. But in others, they have tried to delay, deny, and obscure the trade-off between guns and butter. And even when Americans have embraced the call for sacrifice, their elected representatives have often made room for self-indulgence, easing burdens for some constituents while raising them for others.

Exaggerating the American tradition of wartime fiscal sacrifice is understandable but

unfortunate. History is most usable, at least for politicians, when it can be recast as a morality play. But it is most valuable, at least for the rest of us, when it honestly probes the inconvenient truths of human nature and political struggle. In our search for the historical context of current debates, we should be careful not to compare today's policies to some cardboard cutout version of an imagined past.

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As political scientist David Mayhew recently observed, since its founding in 1789, the United States “has conducted hot wars for some 38 years, occupied the South militarily for a decade, waged the Cold War for several decades, and staged countless smaller actions against Indian tribes or foreign powers.”⁹ The cost of these activities has been immense, with important and lasting consequences for the tax system, the economy and the nation's political structure. By focusing on tax legislation, we hope to identify some of these consequences. But we are not interested in simply recounting statutory details. Rather, we hope to illuminate the politics of war taxation, with a special focus on the influence of arguments concerning “shared sacrifice” in shaping wartime tax policy. Moreover, we aim to shed light on a less examined aspect of this history by offering a detailed account of wartime *opposition* to increased taxes.

Historically, two features of wartime politics have prompted tax reform. The first is sheer necessity. There is simply no other government activity that requires as much revenue as fighting a war. Success on the battlefield requires economic resources, and taxation is the best means of marshalling those resources. While explicit taxes are not the only means of extracting resources from a nation and its people, practical limits on nontax forms of war financing (e.g., borrowing, seigniorage, conscription, expropriation) generally push tax changes onto the legislative agenda. Second, wars often create a new political atmosphere—one characterized by feelings of solidarity and shared sacrifice. Wars may foster a feeling of “civic engagement” or a “public mood” as citizens “rally 'round the flag.” Whatever term is used, war creates new political opportunities when it comes to tax policy. Taxes are never popular, but they are never more popular than during wars.¹⁰ In combination, these two features of wartime politics—fiscal necessity and political opportunity—set the stage for sweeping and durable tax reform.

The most compelling example of wartime fiscal sacrifice comes from World War II. In the months following the Japanese attack on Pearl Harbor, fiscal necessity and political opportunity converged to produce dramatic changes in the nation's tax

system.¹¹ Though authorized by the Sixteenth Amendment in 1913 and established by statute shortly thereafter, the income tax has its modern roots in the Revenue Act of 1942. That legislation, enacted less than a year after the official U.S. entry into the war, subjected millions of new taxpayers to the income tax, converting what had long been a “class tax” to a full-fledged “mass tax.”¹² More than just raising revenue for the war, the Revenue Act of 1942 gave rise to a whole new taxpaying culture. The federal government launched an all-out campaign to market the new tax changes, including Disney-produced animated shorts featuring Donald Duck touting the importance of “taxes to beat the Axis!” The campaign was a success. Asked in February 1944 whether they considered the amount of income tax they paid to be “fair,” a stunning 90 percent of Americans answered yes.¹³

The experience of World War II, so important to the image Americans have of themselves and their place in the world, has no doubt also shaped our intuitions about the American tradition of wartime fiscal sacrifice. Yet in many ways, World War II is an outlier on the continuum of war tax politics. Taking a wider historical view, beginning with the nation’s founding and continuing through the present day, we observe greater heterogeneity in the country’s willingness to accept heavier burdens of taxation during times of war. While the World War II example has parallels in certain other conflicts—most notably World War I and the Korean War—the country’s political instincts have often pushed in the opposite direction, prompting Americans and their elected leaders to resist the burdens of heavy wartime taxation.

Indeed, resistance and reluctance are recurring themes in the history of American wartime taxation. In the War of 1812, for example, congressional Republicans repeatedly balked at imposing new taxes to fund “Mr. Madison’s War,” with nearly disastrous consequences for the nation’s fiscal health. Their reluctance stemmed from a widespread conviction that the war would be quick and relatively painless. It also reflected no small amount of fear that new taxes might be politically disastrous for anyone who supported them. Either way, at this early stage in U.S. history, the evidence hardly supports our cherished image of selfless Americans rushing to shoulder their wartime fiscal burdens.

In the Civil War, politicians again resisted the need for fiscal sacrifice—at least initially. Eager to minimize internal opposition to the war, leaders of both the Union and the Confederacy predicted a short—and relatively cheap—conflict. Eschewing heavy taxes, they relied on other, less onerous forms of war finance, including loans. But as evidence of tangible sacrifice grew—through the loss of life, liberty, and property—that strategy

faltered. The demand for fiscal sacrifice grew ever stronger, with lawmakers seeking to finance the war with taxes that spread the burden equitably among the populace. Notably, this call for shared sacrifice accompanied the creation of a military draft, with political leaders linking the conscription of able-bodied men with the conscription of national wealth.

The war in Vietnam reveals a similar experience. As with the War of 1812 and the Civil War, political leaders initially hoped to avoid new war taxes. The immediate political calculus was, of course, different; Lyndon Johnson refused to ask Congress for higher taxes to fight the war because he feared doing so might endanger his cherished “Great Society” programs, especially among conservative Democrats who controlled the two congressional tax-writing committees. When he eventually did submit a surtax proposal, it was held up for almost a year because Johnson refused to agree to congressional demands for corresponding cuts in domestic spending. Again, the historical experience departs significantly from the popular notion of a country eager to put its fiscal muscle behind its military might.

By highlighting this alternative tradition of wartime finance—a tradition marked by reluctance and resistance, as well as willing sacrifice—we do not mean to minimize the burdens that previous generations agreed to bear. The United States does, indeed, have a tradition of wartime fiscal sacrifice. But this tradition has been more complex—and more hotly contested—than might seem convenient for modern critics of the war in Iraq. America’s wartime leaders, and its presidents in particular, have often been reluctant to demand much fiscal sacrifice from their fellow citizens, at least initially. Unwilling to risk domestic achievements, or fearful of eroding support for an unpopular war, they have shrunk from the tough decisions that wars invariably demand. Eventually, however, they all accepted the hard realities. Whether ardent tribunes of fiscal sacrifice (like Franklin Roosevelt) or reluctant champions of fiscal responsibility (like Lyndon Johnson), they all accepted the need for some sort of homefront sacrifice, as both an economic and moral necessity.

* * *

As we complete this manuscript in early 2008, we cannot ignore its most obvious contemporary context: is the war in Iraq somehow different from all the wars—and war taxes—that preceded it? Despite the huge expense and the lingering nature of the conflict, Congress and the president have refused to ask the American public for fiscal sacrifice in the form of higher wartime taxes. Indeed, they have reduced the overall

tax burden multiple times. What accounts for this divergence from the usual practice? In our view, three key features of the modern policymaking environment differentiate it from previous conflicts, making wartime tax *cuts* possible for the first time in American history.

First, the chief *economic* justification for wartime tax increases—fear of ruinous inflation—has been an insignificant factor during the war in Iraq. Without that economic imperative, policymakers have been free to consider unconventional wartime fiscal policies, including tax cuts. Second, significant *political* changes, including most notably the increased polarization of partisan elites, have resulted in the marginalization of deficit concerns and the corresponding decline in influence of so-called “deficit hawks.” As a result, the political constituency for pay-as-you-go war financing has been weaker in recent years than during any other military conflict in the nation’s history. Finally, the elimination of the military draft in 1972 removed one of the most compelling *moral* arguments for wartime taxes.

Inflation and
the Economic
Imperative of
War Taxes

In every major military conflict in U.S. history, policymakers have faced the war financing decision with the prospect of disastrous inflation ever present in their deliberations. No major U.S. war has been exempt from these pressures. Reliance on currency finance during the Revolutionary War led to a collapse in the new continental currency; the War of 1812 forced commodity prices sharply upward; both the Confederacy and the Union faced pressure to increase taxes to stave off inflation; and during each of the major conflicts of the 20th century, political concern over uncontrollable price increases prompted policymakers to turn to current taxation to fund a substantial share of war expenditures. As economic historian Claudia Goldin has observed, “Every major war fought by the United States has been associated with price inflation. In fact, there are no extreme price peaks [between the years 1775 and 1975] that are not accompanied or preceded by a war.”¹⁴

Given the historical record, one might even go so far as to suggest that preventing inflation has been *the core concern* of wartime tax policy in U.S. history. Over the past quarter century, however, the threat of inflation—and its corresponding influence on tax policy—has substantially abated. There are many reasons for today’s relatively benign inflation environment, including the downward pressure on prices exerted by the increased globalization of the economy. In addition, many attribute the low inflation rates of the past quarter century to the introduction of significant changes in the country’s monetary policy ushered in by Chairman of the Federal Reserve Board, Paul

Volcker, in the early 1980s.¹⁵

Whatever the reason, the political consequences of a low inflation environment are unmistakable. In the past, lawmakers who opposed wartime tax increases ran the risk of being blamed for inflation and the havoc it wreaked on the economy. Today, however, there seems to be little fear among those crafting fiscal policy that their choices might endanger price stability. In one sense, therefore, there is a very simple answer to the question of why policymakers have not raised taxes to fund the war in Iraq—because, as yet, they have not been forced to do so. Indeed, having been freed from the economic imperative of avoiding inflation, policymakers have been able to reduce taxes in the face of rising war expenditures.

A second differentiating feature of the current policymaking environment is the political marginalization of concerns about federal budget deficits in recent years. In the country's previous conflicts, there has always been a strong constituency in favor of fiscal discipline and against excessive reliance on deficit financing. Concern for budget deficits reached its peak during the Korean War, when lawmakers from both parties, having experienced high inflation during World War II, were keen to avoid what they viewed as the fiscal mistakes of the past. Recall that for the fiscal year 1951 the federal government actually recorded a budget surplus, in large measure because of the tax increases enacted via the Revenue Act of 1950 and the Excess Profits Tax Act of 1950. In today's vernacular, President Truman would be considered the ultimate "deficit hawk." In the history of American war finance, that "deficit hawk" perspective has always been given voice.

Political
Polarization
and the
Marginalization
of Deficit
Concerns

This is not to suggest that concern over budget deficits always prevailed in the formulation of tax policy during all of the country's major conflicts. Indeed, more often than not the country relied heavily on deficit financing during wartime. During World War II, for example, deficits reached as high as 30 percent of GDP, a level unlikely to ever be seen again. Yet even in World War II, policymakers took extraordinary measures to reduce the government's reliance on deficit financing. By contrast, recent tax policy has been marked by a specific rejection of deficit concerns, even as the country prepared to go to war. As Vice President Dick Cheney famously quipped in late 2002, in response to Treasury Secretary Paul O'Neill's expression of concern about the country's fiscal soundness, "Deficits don't matter. We won the midterms. This is our due."¹⁶

Why have deficit concerns played such a marginal role in the formulation of tax policy during the Bush years? What changes in American society account for the apparent decline in the influence of “deficit hawks,” who might have pushed tax policy in the traditional direction of tax increases during war? On this point, we believe some attention should be given to the very substantial political changes that the country has undergone since the mid-1970s. As political scientists have observed, the country’s political establishment has grown more polarized in the past three decades, with liberals becoming more liberal and conservatives becoming more conservative. This is not a loose “gestalt” type judgment made by pundits, but rather an empirical observation based on lawmakers’ roll call votes in Congress. Recent research undertaken by political scientists has shown that the policy positions of the average Democrat and the average Republican have become more widely separated since the mid-1970s. The result, as one recent study put it, is that “the moderates are vanishing from Congress.”¹⁷

The consequences of a more polarized political environment for war financing decisions should not be underestimated. Because deficit hawks come disproportionately from the moderate ranks in both parties, their influence has suffered a decline that roughly corresponds with the rise of partisan polarization.¹⁸ Indeed, the story of the Bush-era wartime tax cuts is perhaps best understood as the triumph within the GOP of conservative “growth hawks” over the more moderate “deficit hawks.”¹⁹ The effect has been more pronounced in the House of Representatives than in the Senate. Recall that in connection with JGTRRA 2003, moderate Republicans in the Senate, including most notably Senators John McCain, Olympia Snowe, George Voinovich, and Lincoln Chafee, were able to hold down the overall cost of the administration’s second tax cut to \$350 billion. It is noteworthy that there was no similar movement in the House, which because of redistricting is more susceptible to the polarizing trend.

In combination with the economic factor of historically low inflation rates, the political developments of increased partisan polarization and the corresponding marginalization of deficit concerns produced something of a “perfect storm” of conditions for wartime tax cuts. Any analysis of U.S. wartime tax policy would be incomplete, however, without reference to the chief *moral* argument for wartime tax increases—i.e., the U.S. taxpayers should share in the sacrifice borne by American soldiers on the field of battle.

military service and the corresponding effect on the politics of wartime tax policy. Shared sacrifice has been a major theme in the politics of wartime taxes throughout the country's history. However one feels about the costs and benefits of conscription, the drafting of ordinary citizens into military service has profoundly influenced the way the country talks about the costs of war.

Conscription adds an unmistakable moral force to the arguments of those who advocate wartime tax increases and obliges opponents of higher taxes to reframe, or perhaps even abandon, their arguments. Recall how Representative Edward Little of Kansas framed his argument at the outset of American involvement in World War I: "You promised when you conscripted the youth of this country that you would conscript the wealth as well. . . . Let their dollars die for this country too."²⁰ Truman's Treasury chief, James Snyder, issued a similar admonition to the Senate Finance Committee during the Korean War, alluding once again to the "conscription" of wealth as well as men: "You passed a bill up here to draft boys of 18, to send them to war. I think it is just as important we draft some of the profits to help pay for the expenditures." Opponents of higher wartime tax burdens have likewise reformulated their arguments to appear more sensitive to the burdens upon those drafted into military service. For example, consider Senator Russell Long's awkward argument that a "tax increase of ten times the size recommended by the president would still not begin to [equal] the sacrifice of our courageous young men fighting and dying in the swamps and jungles of Vietnam."²¹

Given the frequent invocation of conscription as a justification for wartime tax increases, it seems reasonable to conclude that Americans are more willing to accept higher taxes when those burdens are framed in the context of the sacrifices of American soldiers. If so, it would appear that the elimination of the draft in 1972 and the introduction of the All-Volunteer Force shortly thereafter worked an unexpected transformation on the politics of wartime taxation. Whereas conscription made wartime taxes more likely, or at least provided an obvious and compelling argument in their favor, the introduction of a professional volunteer military force eclipsed those arguments completely. From 1973 onward, arguments for the "conscription of wealth" simply no longer have the same moral force they once did.

To probe the issue further, consider the following thought experiment. Over the past several years, Representative Charles Rangel, a Korean War veteran, has proposed legislation to reinstitute the draft. The crux of Rangel's argument is that "military service should be a shared sacrifice" and that we should "not allow some to stay behind while other people's children do the fighting."²² The Rangel bill has never passed and,

given strong popular opposition to the draft, it is unlikely to pass anytime soon. But imagine for the moment if the Rangel bill were to pass and Congress began requiring individuals to fight in Iraq against their will. Would Congress in such circumstances enact tax cuts of the EGTRRA/JGTRRA variety? Is it possible to imagine repealing the estate tax or reducing the taxation of capital gains or dividends in an environment where Congress has mandated military service? Perhaps—in politics, one should never say never. However, we submit that debates over how to pay for war are cast in very different terms when soldiers on the frontline include not only those who have volunteered for the assignment but also those who are there under force of law.

Some may regard this as an unfortunate commentary on the politics of war financing in the 21st century. Perhaps arguments for “shared sacrifice” *should* carry as much political weight when the country’s military efforts are carried out by professional volunteers as when ordinary citizens are drafted into service. Over the past several years, however, there has been little evidence that arguments for shared sacrifice continue to resonate with the American electorate.

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Because the Bush tax cuts represent such a significant departure from the usual wartime practice of raising taxes, commentators have understandably asked whether current policies mark a break from a longstanding patriotic tradition of wartime fiscal sacrifice. Have we entered a new era of fiscal self-indulgence, where even in the face of mounting losses of blood and treasure, American voters demand fewer burdens from their government? As the analysis above suggests, we believe that strands of that mode of thinking about wartime tax policy have surfaced throughout American history.

What is different about the current period is the constellation of circumstances making possible a more extreme manifestation of our nation’s latent instinct to oppose the burdens of taxation. In combination, the three factors described above—historically low inflation rates, a political environment that has marginalized deficit concerns, and the elimination of the draft—have transformed the politics of wartime taxation in the United States. We find it noteworthy that these changes have influenced not only observed policy outcomes (wartime tax cuts rather than wartime tax increases), but also that they have begun to change how we talk about our collective responsibilities during war.

Throughout American history, lawmakers have made the case for higher taxes as an

expression of support for U.S. troops. Indeed, in every conflict we examined, support for higher taxes was viewed as a defining feature of being a "military hawk." As one GOP senator put it in January 1967, "I just don't see how we can be hawks on the war and then vote against taxes to pay for it." There is scant evidence of any remaining life in this point of view. Indeed, at times lawmakers have turned the argument upside down, arguing that only by *reducing* taxes can we truly support the troops. Speaking in April 2003, for example, Kentucky Senator Jim Bunning made the case for the administration's tax cuts, arguing that "When our troops come home, I hope they have jobs. The Reserves and Guardsmen coming back, their jobs are on the line."²³ Senator Bunning's argument stands in stark contrast to the political rhetoric of a half-century earlier, when House Speaker Sam Rayburn admonished his colleagues by noting, "I think the boys in Korea would appreciate it more if we in this country were to pay our own way instead of leaving it for them to pay when they get back."

It is of course impossible to know how events will unfold over the next several months and years. Most commentators view the elections of November 2006 as a repudiation of the administration's policies in Iraq. The fact that Democrats now control both chambers of Congress will no doubt affect the future direction of the U.S. military's role in that country, as will future changes in the White House, especially if a Democrat wins the presidency in November 2008. Even so, it is worth remembering that, with regard to the war financing question, Democrats have so far shown little interest in reversing the administration's simultaneous pursuit of war and tax cuts. Indeed, if anything, Democrats seem intent on introducing their own brand of tax cuts, even as the war in Iraq continues.²⁴ If this happens, it might signal that wartime tax cuts, which so many commentators initially decried as a historical anomaly, have found a more secure footing in American politics.

Endnotes

[†] Excerpted from STEVEN A. BANK, KIRK J. STARK, & JOSEPH J. THORNDIKE, *WAR AND TAXES* (Urban Institute Press 2008).

¹ Peter Lisagor, *Absence of Sacrifice at Home Spurs Guilt Feeling over War*, L.A. TIMES, July 9, 1967, at J3.

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¹⁰ On wartime sacrifice, see Mark H. Leff, *The Politics of Sacrifice on the American Home Front in World War II*, 77 J. AM. HIST. 1296 (1991). On civic engagement, see *id.* at 475 (citing Theda Skocpol and Robert Putnam). On the relative popularity of wartime taxes, see Naomi Feldman & Joel Slemrod, *War and Taxation: When Does Patriotism Overcome the Free-Rider Impulse?*, in *COMPARATIVE AND HISTORICAL APPROACHES TO FISCAL SOCIOLOGY: TAXATION IN PERSPECTIVE* (Isaac Martin, Ajay K. Mehrotra & Monica Prasad, eds., forthcoming).

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¹³ KARLYN BOWMAN, AMERICAN ENTERPRISE INSTITUTE, PUBLIC OPINION ON TAXES 14 (2007).

¹⁴ Claudia D. Goldin, *War*, in ENCYCLOPEDIA OF AMERICAN ECONOMIC HISTORY 935-57 (Glenn Porter ed., 1980).

¹⁵ John B. Taylor, *Changes in American Economic Policy in the 1980s: Watershed or Pendulum Swing?*, 33 J. ECON. LITERATURE 777, 780-81 (1995) (describing changes in monetary policy during Volcker years).

¹⁶ RON SUSKIND, THE PRICE OF LOYALTY: GEORGE W. BUSH, THE WHITE HOUSE, AND THE EDUCATION OF PAUL O'NEILL 291 (2004).

¹⁷ NOLAN MCCARTY, KEITH T. POOLE, & HOWARD ROSENTHAL, POLARIZED AMERICA: THE DANCE OF IDEOLOGY AND UNEQUAL RICHES 30 (2006).

¹⁸ Andrew Taylor, *The Ideological Roots of Deficit Reduction Policy*, 19 REV. POL. RES. 11, 26 (2002) (observing that "moderates of both parties are the most vocal advocates of balanced budgets today").

¹⁹ Dana Milbank & Dan Balz, *GOP Eyes Tax Cuts as Annual Events*, WASH. POST, May 11, 2003, at A1; Robert Kuttner, *What Killed Off the GOP Deficit Hawks?*, BUS. WK., Dec. 27, 2004, at 32.

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