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# Why 70% Tax Rates Won't Work

*Memo to Robert Reich: The income tax brought in less revenue when the highest rate was 70% to 91% than it did when the highest rate was 28%.*

By ALAN REYNOLDS

The intelligentsia of the Democratic Party is growing increasingly enthusiastic about raising the highest federal income tax rates to 70% or more. Former Labor Secretary Robert Reich took the lead in February, proposing on his blog "a 70 percent marginal tax rate on the rich." After all, he noted, "between the late 1940s and 1980 America's highest marginal rate averaged above 70 percent. Under Republican President Dwight Eisenhower it was 91 percent. Not until the 1980s did Ronald Reagan slash it to 28 percent."

That helped set the stage for Rep. Jan Schakowsky (D., Ill.) and nine other House members to introduce the Fairness in Taxation Act in March. That bill would add five tax brackets between 45% and 49% on incomes above $1 million and tax capital gains and dividends at those same high rates. The academic left of the Democratic Party finds this much too timid, and would rather see income tax rates on the "rich" at Mr. Reich's suggested levels—or higher.

This new fascination with tax rates of 70% or more is ostensibly intended to raise gobs of new revenue, so federal spending could supposedly remain well above 24% of gross domestic product (GDP) rather than be scaled back toward the 19% average of 1997-2007.

**Higher Taxes, Lower Revenues**

Individual income tax rates and revenues as a percentage of GDP

| | Lowest/highest tax rates | Revenues as a % of GDP |
|---|---|---|
| 1951-63 | 20/91% | 7.7% |
| 1964-81 | 14/70 | 8 |
| 1982-86 | 11/50 | 8.3 |
| 1988-90 | 15/28 | 8.1 |
| 1991-92 | 15/31 | 7.8 |
| 1993-96 | 15/39.6 | 8 |
| 1997-02* | 15/39.6 | 9.4 |

All this nostalgia about the good old days of 70% tax rates makes it sound as though only the highest incomes would face higher tax rates. In reality, there were a dozen tax rates between 48% and 70% during the 1970s. Moreover—and this is what Mr. Reich and his friends always fail to mention—the individual income tax actually brought in less revenue when the highest tax rate was 70% to 91% than it did when the highest tax rate was 28%.

When the highest tax rate ranged from 91% to 92% (1951-63), even the lowest rate was quite high—20% or 22%. As the nearby chart shows, however, those super-high tax rates at all income levels brought in revenue of only 7.7% of GDP, according to U.S. budget historical data.

President John F. Kennedy's across-the-board tax cuts reduced the lowest and highest tax rates to 14%

and 70% respectively after 1964, yet revenues (after excluding the 5%-10% surtaxes of 1969-70) rose to 8% of GDP. President Reagan's across-the-board tax cuts further reduced the lowest and highest tax rates to 11% and 50%, yet revenues rose again to 8.3% of GDP. The 1986 tax reform slashed the top tax rate to 28%, yet revenues dipped trivially to 8.1% of GDP.

What about those increases in top tax rates in 1990 and 1993? The top statutory rate was raised to 31% in 1991, but it was really closer to 35% because exemptions and deductions were phased-out as incomes increased. The economy quickly slipped into recession—as it did during the surtaxes of 1969-70 and the "bracket creep" of 1980-81, which pushed many middle-income families into higher tax brackets. Revenues fell to 7.8% of GDP.

The 1993 law added two higher tax brackets and, importantly, raised the taxable portion of Social Security benefits to 85% from 50%. At just 8% of GDP, however, individual income tax receipts were surprisingly low during President Bill Clinton's first term.

The Internet/telecom boom of 1998-2000 was the only time individual income tax revenues remained higher than 9% of GDP for more than one year without the economy slipping into recession (as it did when the tax topped 9% in 1969, 1981 and 2001).

Getty Images

Former Labor Secretary Robert Reich

But that was an unrepeatable windfall resulting from the quintupling of Nasdaq stocks—combined with (1) the proliferation of nonqualified stock options that have since been thwarted by the Financial Accounting Standards Board, and (2) the 1997 cut in the capital gains tax to 20%. Realized capital gains rose to 4.6% of GDP from 1997 to 2002—up from 2.5% of GDP from 1987 to 1996 when the capital gains tax was 28%.

Suppose the Congress let all of the Bush tax cuts expire in 2013, which is the current trajectory. That would bring us back to the tax regime of 1993-96 when the individual income tax brought in no more revenue (8% of GDP) than it did in 2006-08 (8.1% of GDP).

It is true that President Obama proposes raising the capital gains tax to 23.8%, which could raise more revenue than the 28% rate of 1993-96. But a 23.8% tax on capital gains and dividends would nevertheless be high enough to depress stock prices and related tax revenues.

Still, pundits cling to the myth that lower tax rates mean lower revenues. "You do probably get a modest boost to GDP from tax cuts," concedes the Atlantic's Megan McCardle. "But you also get falling tax revenue. It can't be said too often—and there you are, I've said it again."

Yet the chart nearby clearly shows that reductions in U.S. marginal tax rates did not cause "falling tax revenue." It is not necessary to argue that tax rate reduction paid for itself by increasing economic growth. Lowering top marginal tax rates in stages from 91% to 28% paid for itself regardless of what happened to GDP.

It is particularly remarkable that individual tax revenues did not fall as a percentage of GDP because changes in tax law, most notably those of 1986 and 2003, greatly expanded refundable tax credits, personal exemptions and standard deductions. As a result, the Joint Committee on Taxation recently reported that 51% of Americans no longer pay federal income tax.

Since the era of 70% tax rates, the U.S. income tax system has become far more "progressive." Congressional Budget Office estimates show that from 1979 to 2007 average income tax rates fell by

110% to minus 0.4% from 4.1% for the second-poorest quintile of taxpayers. Average tax rates fell by 56% for the middle quintile and 39% for the fourth, but only 8% at the top. Despite these massive tax cuts for the bottom 80%, overall federal revenues were the same 18.5% share of GDP in 2007 as they were in 1979 and individual tax revenues were nearly the same—8.7% of GDP in 1979 versus 8.4% in 2007.

In short, reductions in top tax rates under Presidents Kennedy and Reagan, and reductions in capital gains tax rates under Presidents Clinton and George W. Bush, not only "paid for themselves" but also provided enough extra revenue to finance negative income taxes for the bottom 40% and record-low income taxes at middle incomes.

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