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THE MELLON AND KENNEDY TAX CUTS: A REVIEW AND ANALYSIS

A STAFF STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON MONETARY AND FISCAL POLICY

OF THE

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LETTER OF TRANSMITTAL

JUNE 11, 1982.

Hon. HENRY S. REUSS,
Chairman, Joint Economic Committee, Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: I am pleased to transmit a Joint Economic Committee staff study entitled "The Mellon and Kennedy Tax Cuts: A Review and Analysis" prepared by Christopher Frenze of the committee staff. Many helpful suggestions by Dr. Richard K. Vedder are acknowledged by the author, as is the typing of the manuscript by Doris Irwin.

The staff study demonstrates how the strategy of cutting individual marginal tax rates across-the-board during the 1920's and 1960's generated increased saving, investment, and economic growth. The robust economic expansions fostered by the tax cuts were periods of great prosperity, low unemployment, and enhanced capital formation and productivity. Moreover, after an interim period, the expanded tax base ultimately produced more tax revenues, especially from the wealthy, than before the tax reductions. If given a chance, there is no reason the President's tax reform program can't achieve the same success. This is why it is essential that the tax cut schedule not be delayed; indeed, the 1982 and 1983 rate reductions should be advanced to provide more incentives and relief for working Americans. Any cancellation or delay of the tax cuts will amount to an enormous tax increase for the average taxpayer.

Sincerely,

ROGER W. JEPSEN,
Chairman, Subcommittee on Monetary and Fiscal Policy.

FOREWORD

By Senator Roger W. Jepsen

It has always been my view that oppressively high tax rates inhibit economic growth and prosperity by undermining incentives to work, save, and invest. Besides inducing economic stagnation, high marginal tax rates also force much economic activity underground and promote tax sheltered investments. The erosion of public morality is yet another unwelcome result of high tax rates, as economist Gunnar Myrdal has pointed out.

Recognition of the counterproductive impact of excessive taxation is even older than Justice Marshall's famous remark that "the power to tax is the power to destroy." For this reason I am somewhat amused by critics who pretend that the idea of supply side tax reduction is novel or even bizarre. Moreover, our recent economic history well illustrates the validity of Marshall's observation.

This study examines the success of the Mellon and Kennedy tax cuts in restoring incentives to work, save, and invest. Economic recovery was the objective of the Mellon and Kennedy tax reforms, both of which elicited enough increased saving, capital formation, and employment to propel the economy out of recession. Total tax revenues, after an interim period, increased after marginal tax rates were cut. Tax revenues paid by the wealthier taxpayers increased dramatically. Thus the claim that across-the-board tax cuts are exotic, untried, and radical experiments is totally invalid. They have been implemented previously by Democrats and Republicans for the same reasons, and have produced similar positive effects which benefited all Americans.

A brief digression may serve to describe certain similarities with our situation today. I share with many of my colleagues and fellow Americans the view that the inexorable climb of individual marginal tax rates over the last 10 years had reached very counterproductive levels by the late 1970's. By 1981, Federal revenues as a percentage of GNP had grown to about 21 percent. The inflation of the last decade, by pushing taxpayers into higher and higher brackets, has revolutionized the tax system, which now extracts a much higher proportion of income than would have been conceivable only a short time ago. Evidently, this trend has accelerated in recent years. Since 1977 bracket creep and other factors have pushed the personal marginal rate from 28.7 percent to over 32 percent in 1981. The trend towards higher tax rates is shown in the table on page VI.

MARGINAL AND AVERAGE TAX RATES FOR INDIVIDUAL INCOME TAX[1]

[In percent]

Calendar year	Marginal rate	Average rate
1962	24.9	12.9
1963	26.1	13.1
1964	22.7	11.9
1965	21.8	11.5
1966	22.2	12.0
1967	22.9	12.5
1968	27.0	13.8
1969	27.5	14.3
1970	24.5	13.3
1971	24.0	12.7
1972	24.4	12.5
1973	25.7	13.1
1974	26.2	13.7
1975	26.8	13.1
1976	27.8	13.5
1977	28.7	13.8
1978	29.7	14.2
1979	30.6	14.6
1980	31.4	15.3
Projected (before Reagan tax cuts):		
1981	32.2	15.9
1982	34.3	16.8
1983	36.5	17.6
1984	38.9	18.6
1985	41.1	19.4
1986	43.7	20.4

[1] As applied to adjusted gross income.

Source: Federal Reserve Bank of St. Louis Review, May 1981.

This rise in tax rates has been accompanied, as we might expect, by declining rates of saving, capital formation, productivity, and economic growth. This relationship has convinced me that tax rate cuts offer the best way to reverse our economic decline and rebuild American industry. This is why I strongly supported the "10–10–10" individual tax rate reduction of the President's initial proposal.

Compared to the 1964–65 Kennedy cuts, and especially the 1921–26 Mellon cuts—when the top rate was slashed from 73 percent to 25 percent—the proposal was pretty mild. During Congressional consideration the President's proposed 10–10–10 rate cut starting on July 1, 1981 (and retroactive to January 1, 1981), was diluted to a 5–10–10 starting on October 1, 1981. Pressures inside Congress and the Administration apparently forced the compromise, which now delays the first substantial 10 percent cut to July 1, 1982, a full year. During the third quarter of 1981, it became clear that the economy was slipping into recession. Had the full 10 percent (or a deeper) cut made effective earlier in 1981, the recession might have been avoided, or at least its severity mitigated.[1] Moreover, under the original proposal two 10 percent cuts would have become effective by now, providing a powerful antirecessionary stimulus and reducing unemployment.

Evidently it was fear of deficits that motivated opposition to the President's proposal. This is ironic, because the recession is one of the major components in the large 1982 deficit, and it has carryover effects to later years. Since the tax cuts were diluted and delayed, the recession was deeper than it would have been, shrinking the tax base and generating higher outlays (and deficits) from unemployment benefits, food stamps and welfare payments. Since every additional percentage

[1] This was the view of the Treasury Department. See Paul Craig Roberts, " 'The Stockman Recession': A Reaganite's Account," Fortune (February 22, 1982), pp. 56–70.

point increase in unemployment boosts the deficit by about $25 billion, those favoring delay of the tax cut may be fairly described as shortsighted. Recovery may be postponed until after July 1, 1982, when the 10 percent cut becomes effective; meanwhile, Federal spending may increase substantially.

In evaluating the present Administration's tax program and past experience, there are several important points to keep in mind. It will be recalled that as massive as the tax increases of 1976–81 were, over the next five years another sizable tax increase would have automatically occurred. By 1986 the individual marginal income tax rate would have jumped from 32.2 percent in 1981 to 43.7 percent, and the average tax rate from 15.9 to 20.4 percent. Furthermore, scheduled social security tax rate increases would boost the tax burden of employees and employers even more. By 1986, Federal receipts would have topped 24 percent of GNP.

Given the dismal performance of the economy as the percentage of Federal receipts to GNP climbed steadily, it seems likely that economic conditions would further deteriorate had this grown to the projected 24 percent in 1986. In any event, most economists would agree that increasing taxes during stagnation or recession makes little economic sense. Yet, though the economy has been weak since early 1979, significant increases in social security and individual marginal tax rates have taken place, and would have continued into the future if not for the 1981 Act.

With the benefit of hindsight, it is now evident that the initial 30 percent tax cut proposal would have been far superior to the 1981 Act's 23 percent cut in terms of providing needed incentives at the right time. Moreover, critics of the Administration's economic program are mistaken to link the tax cuts with the recession that began in July 1981, before enactment of the tax and spending measures. The cause of the recession must be attributed to monetary policy and high interest rates rather than nonexistent tax reductions. The problem is that the tax cut was not large enough and was not made effective soon enough. The full 10 percent across-the-board individual rate cut will come only on July 1, 1982, a year too late.

Currently the diehard advocates of the failed tax-and-spend policies of the past are trying to convince Americans that the across-the-board tax cuts of the Administration program favor the rich. These critics imply that we should remedy the "fairness" problem by rescinding the 1983 tax reduction. I think this prejudice in favor of higher taxes is fatally flawed.

As previously stated, I strongly supported the President's original proposal to cut individual marginal tax rates "10–10–10" across-the-board at the same pace over a three-year period. Under the bipartisan compromise which became the 1981 Economic Recovery Tax Act (ERTA), the 70 percent top rate was cut to 50 percent beginning January 1, 1982. This provision, proposed by key Ways and Means Committee Democrats, is estimated to reduce Federal revenue only $1.1 billion in fiscal year 1982, a good example of how high rates yield little revenue, especially compared to the great counterproductive impact they induce. Indeed, a recent study of the economic impact of marginal income tax rates above 50 percent concluded that they almost certainly *reduce* income tax revenues.[2] This reduction also effectively slashes the maximum rate for long-term capital gains from 28 percent to 20 percent, thereby increasing incentives for saving and investment. Other individual rates are pared about 23 percent across-the-board.

With ERTA, the well-to-do got virtually all of their tax cut on January 1982; the rest of us have to wait until July 1982 and July 1983. A moment's reflection will reveal how mistaken the contemporary attacks on the tax reduction schedule is. Those who advocate rescinding the 1983 tax cut are really proposing a tax increase on working Americans. The irony is that these same partisans who criticize the individual rate cuts as regressive would deprive everyone *but* the wealthy of real tax relief. Moreover, these Democratic critics belong to the same party controlling the Committee on Ways and Means, which first suggested dropping the top rate from 70 percent to 50 percent in one installment.

So the liberal Democrats first pushed quicker tax relief for the rich, then suggested rescinding the 1983 tax cuts for working Americans, and now turn around and accuse the Republicans of supporting regressive taxation. No wonder many citizens are confused about tax policy.

The history of across-the-board tax cuts is instructive. Economic recovery was the objective of the Mellon and Kennedy tax cuts, both of which elicited enough increased saving, capital formation and employment to quickly propel the economy out of recession. On the basis of past experience, several points about the impact of those two tax programs are relevant today:

Total tax revenues ultimately increased after marginal tax rates were cut. Tax revenues paid by the wealthier taxpayers increased dramatically.

Marginal rate cuts in the past have been closely followed by large increases in the rates of saving, capital formation and employment. The three-year schedule of the Reagan tax cuts is more gradual than either of the two tax cuts discussed in this paper. The evidence strongly suggests that the Reagan tax cuts should have been deeper and more rapid for maximum positive effects.

The President's initial tax proposal would have cut marginal rates evenly across-the-board and at the same pace. However, under the 1981 tax act, average taxpayers will get real tax relief only with the July 1982 and July 1983 reductions. The delay or cancellation of this schedule would amount to a large tax increase on working Americans. The net result would be a tax reform much more regressive in structure than the Mellon or Kennedy tax cuts.

The claim that across-the-board tax cuts are wild, untried and radical experiments is absurd. They have been implemented previously by Democrats and Republicans for the same reasons, and have produced similar positive effects which have benefited all Americans.

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[2] Lawrence B. Lindsey, "Alternatives to the Current Maximum Tax on Earned Income" (Cambridge, Mass.: National Bureau of Economic Research, Working Paper No. 822, December 1981).

CONTENTS

INTRODUCTION TO THE MELLON AND KENNEDY TAX CUTS

By Christopher Frenze*

Recent economic policy discussions have been largely dominated by considerations of tax policy. This paper is an historical analysis of the across-the-board tax cuts initiated in the 1920's and 1960's. For a number of reasons these experiments should frame the historical context in which evaluation of current tax policy is placed. A review of these earlier initiatives reveals that many of the same issues that preoccupied lawmakers and the public then are still very much with us today. Controversies centering on incentives, revenue effects, equity, and overall economic impact were discussed in essentially the same way as they are now.

The first section is an account of the Mellon tax cuts, the brainchild of Secretary of the Treasury Andrew Mellon, considered by some the finest public servant to fill that position since Albert Gallatin. In his writings, speeches, and his book, *Taxation: The People's Business*, Mellon outlined a rationale for tax policy that is as incisive and logical as it is relevant for our times. In his commentaries he expressed a philosophy of tax policy that is timeless and true because it focuses on the preeminently crucial factor of tax policy: human nature. A careful reading of Mellon shows how the constant of human nature may be expected to respond to the incentive structure imposed by the tax system.

High marginal income tax rates, Mellon believed, encouraged tax sheltered investments, tax exempt activities such as consumption and leisure, and a bias against saving and productive investment that was economically debilitating as well as counterproductive from the Treasury's point of view. On these premises he based the tax-cut legislation enacted between 1921 and 1926 which he predicted would lift the economy out of recession, decrease the attractiveness of tax shelters, and ultimately increase revenue to the Treasury.

Over 5 years the reduction of individual tax rates, and the top marginal rate from 73 percent to 25 percent, accomplished all the results Mellon had predicted. Moreover, despite the drastic cut in the top rates, revenues derived from the very wealthy increased dramatically. The Mellon experiment was a brilliant success, in some areas producing effects more positive than anyone, even Mellon, expected. Unfortunately, in 1929 legislation increasing tariffs was passed by the Senate (and after passage by the House in 1930, became law) which, along with other tax increases and perverse U.S. monetary policy, contributed to the deterioration of international trade and the eventual collapse of the world economy.

The second policy initiative reviewed in this paper is the Kennedy tax cuts of 1964–65. Though the rationale for this tax cut was pri-

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marily based on a Keynesian effort to stimulate demand, marginal rates were cut significantly with the prohibitive top rate chopped from 91 percent to 70 percent. Although Keynesians still assert this was entirely a demand side tax cut the drastic slashing of the top rate and the effects on saving and investment isn't consistent with this point of view. After enactment the weak economy rebounded and began a sustained recovery, the amount of saving doubled, and investment boomed. As with the earlier Mellon cuts, taxable income and revenues from the wealthy classes increased substantially. Despite their entirely different theoretical justifications both the Mellon cuts and the similar Kennedy cuts produced comparable results. But according to Ways and Means Committee Chairman Wilbur Mills, basically a fiscal conservative, he, Treasury Secretary Dillon, and President Kennedy were all aware of Mellon's successful experiment of the 1920's. In fact, Mills' reasons for the rate cuts sound as though they could have been lifted right out of some of Mellon's writings.

Above all, this study shows that the oft-repeated opinion of the pundits and liberal politicians that across-the-board tax reductions are untried, exotic, dangerous experiments is totally without foundation and reveals ignorance of American history. This approach has been tried twice before in this century with great success. In both cases saving and investment boomed, economic recovery occurred, unemployment dropped, and the amount of taxes paid—especially by the very wealthy—increased dramatically. Far from being radical the 1981–83 individual rate cuts are very mild compared to the reductions engineered by the pioneer in this area of economic policy—Andrew Mellon.

THE MELLON TAX CUTS

I. Introduction

Currently, there is widespread awareness of the counterproductive impact of high marginal income tax rates. The tax revolt of the late seventies and especially the recent political realignment have resulted in the enactment of a major tax reform featuring across-the-board cuts in individual marginal tax rates. Thus, the essential component of the Kemp-Roth bill, not long ago considered an oddity by mainstream pundits, has now become law. Nevertheless, opponents characterize this approach as a desperate gamble; an untested, radical experiment that will produce disastrous consequences. This argument is a curious one because across-the-board tax cuts have been tried twice before with very positive results. Both the 1921–26 and the 1964–65 tax cuts slashed marginal rates fairly evenly, stimulating savings, capital formation, production, and increased tax revenues.

This section examines the history and consequences of the 1921–26 rate reductions, commonly called the Mellon tax cuts. We will trace Secretary Mellon's implementation of supply-side principles of tax policy into a far-reaching tax reform program that facilitated one of the most impressive examples of real industrial and economic growth in U.S. history.

Overview of Early Income Taxation

When the income tax was enacted in 1913, individual tax rates progressed from 1 percent to 7 percent. A $3,000 exemption, a large sum at this time, excluded over 99.5 percent of taxpayers from income taxation. But the demand for revenue generated by America's participation in World War I caused the lowering of the exemption and the imposition of a second tax tier of steeply progressive wartime income surtaxes. Combined, the "normal" and surtax rates resulted in a schedule graduated from 6 percent to 77 percent.

After the cessation of hostilities, Democrat and Republican officials alike acknowledged that the high levels of war tax rates were self-defeating and economically debilitating. President Wilson's Treasury Secretary wrote in 1920:

> Since the adoption of the heavy war surtaxes in the revenue act of 1917, the Treasury has repeatedly called attention to the fact that these surtaxes are excessive; that they have passed the point of maximum productivity and are rapidly driving the wealthier taxpayers to transfer their investments into the thousands of millions of tax-free securities which compete so disastrously with the industrial and railroad securities upon the ready purchase of which the development of industry and the expansion of foreign trade intimately depend.[1]

In a message to Congress, President Wilson voiced similar views. By 1921, however, only minimal tax relief had been effected.

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[1] "Annual Report of the Secretary of the Treasury, 1920" (Washington : U.S. Government Printing Office, 1921), pp. 36–37, quoted in Bruce Bartlett, "Reaganomics" (Westport: Arlington House, 1981), p. 98.

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II. Republican Tax Policy in the 1920's

In 1921, Warren G. Harding was inaugurated president and appointed Andrew W. Mellon as Secretary of the Treasury (a position Mellon held until 1932). Secretary Mellon, along with President Harding (and later Coolidge) was determined to lift the heavy burden of war taxation paralyzing the economy. As he later observed:

> The history of taxation shows that taxes which are inherently excessive are not paid. The high rates inevitably put pressure upon the taxpayer to withdraw his capital from productive business and invest it in tax-exempt securities or to find other lawful methods of avoiding the realization of taxable income. The result is that the sources of taxation are drying up; and capital is being diverted into channels which yield neither revenue to the government nor profit to the people. . . .
>
> Upon the conclusion of the peace and the gradual removal of war-time conditions of business, the opportunity is presented to Congress to make the tax structure of the United States conform more closely to normal conditions and to remove the inequalities in that structure which directly injure our prosperity and cause strains upon our economic fabric. There is no question of the fact that if the country is to go forward in the future as it has in the past, we must make sure that all retarding influences are removed.[2]

Thus, the Mellon program was predicated on a few straightforward principles of tax policy. Mellon never tired of emphasizing the profoundly counterproductive nature of high tax rates—that they undermine the central objective of taxation—to collect sufficient funds to finance government operations. In observing that rates can be set too high or too low to achieve this end, he said, "Somewhere between the two extremes lies the belt within the bounds of which is the maximum profit. What the exact rate of maximum profit may be is a matter of judgment."[3] One of Mellon's most important aims was to eventually reduce the highest marginal rate to 25 percent, a goal achieved in 1926.

Since he viewed taxation solely as a revenue collecting device, Mellon rejected redistributionist notions of tax policy, contending that, "Taxation should not be used as a field for socialistic experiment, or a club to punish success, but as a means of raising revenue to support the government. . . . The enemies of the income tax are not those seeking to reduce its excessive rates but those who insist that the high rates, which have proven economically incorrect, will remain."[4]

In addition, Mellon was cognizant of the many ways high rates can distort resource allocation and decision-making. He often noted that over-investment in tax exempt securities encouraged State and local extravagance while diverting capital from more productive uses. And he recognized the stultifying and conservative influence introduced by high rates on investment decisions.

> To make a new venture, to start a new business, to build a new building, to construct and not just sit passive, means risk. Where that risk involves capital, the probable rate of return must compensate for the risk taken. Yet the law now says to the man of large income: "If you lose on your venture, you will pay 100 percent of the loss; if you win, the law will take 50 percent of your profit." These are not the odds which encourage adventure or the production of income which will yield its revenue to the Government.[5]

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[2] Andrew Mellon, *Taxation: The People's Business* (New York: Macmillan, 1924), pp. 13–14.
[3] "Annual Report of the Secretary of the Treasury, 1924." (Washington: U.S. Government Printing Office, 1925), p. 8.
[4] Ibid., p. 4.
[5] Ibid., p. 6.

Mellon also pointed out that to the extent higher brackets become unproductive, a larger share of the burden must fall on the lower bracket taxpayers.

Mellon's tax policy was coupled with a spending reduction program which drastically reduced federal outlays. He also observed that, "Taxation can be reduced to a point apparently in excess of the estimated surplus because by the accumulated effect of such a reduction, expenses remaining the same, a greater revenue is obtained." [6]

From these principles it is clear that, in all its essentials, Mellon's tax policy is identical to that of the contemporary supply-siders and the Reagan Administration.

Mellon naturally set forth his views on tax legislation and reform in the annual reports of the Secretary of the Treasury. Often he would comment on the detrimental effects of high tax rates and use revenue statistics to buttress his recommendations for future tax relief.

For instance, in his 1921 annual report, Secretary Mellon presented the table below in support of his case that high marginal rates were depressing the amount of taxable income reported in the upper brackets:

TABLE 1.—TABLE SHOWING DECLINE OF TAXABLE INCOMES OVER $300,000 [1]

	Number of returns		Net income		Income from dividends, interest, and investments	
	All classes	Income over $300,000	All classes	Income over $300,000	All classes	Income over $300,000
1916	437,036	1,296	$6,298,577,620	$992,972,986	$3,217,348,030	$706,945,738
1917	3,472,800	1,015	13,652,383,207	731,372,153	3,785,557,955	616,119,892
1918	4,425,114	627	15,924,639,355	401,107,868	3,872,234,935	344,111,461
1919	5,332,760	679	19,859,491,448	440,011,589	3,954,553,925	314,984,884

[1] "Annual Report of the Secretary of the Treasury, 1921" (Washington: U.S. Government Printing Office, 1922), pp. 20–21.

In the same document Mellon went on to analyze a similar trend as regards interest income:

If we take the taxable income from interest, exclusive of interest on Government obligations the decline is still more striking, the figures being as follows:

Incomes, $300,000 and over:	
1916	$165,733,900
1917	111,468,127
1918	74,610,507
1919	60,087,093
Incomes, $100,000 to $300,000:	
1916	158,870,428
1917	119,539,786
1918	91,030,392
1919	91,467,182
Incomes, $60,000 to $100,000:	
1916	93,280,583
1917	75,375,484
1918	65,784,062
1919	68,814,933

[6] "Annual Report of the Secretary of the Treasury, 1923" (Washington: U.S. Government Printing Office, 1924), p. 4.

In view of these figures, it is not clear that these high surtax rates are rapidly ceasing to be productive of revenue to the Government? And is it not equally clear that their effect has been to divert into unproductive channels not merely the income on the old investments but to force a large part of the old investment capital into unproductive channels?

To reduce the "retarding" and "counterproductive" effects of heavy taxation Mellon's program sharply slashed marginal rates in three installments. Meanwhile Federal spending was pared and Mellon set up a sinking fund to pay off the national debt.

III. The Mellon Tax Cuts

The Mellon tax cuts were known as the Revenue Acts of 1921, 1924, and 1926. The most important provisions of the acts were:

> The 1921 Revenue Act repealed the excess profits tax and increased the corporate income tax rate from 10 percent to 12.5 percent. By reducing the top marginal surtax rate from 65 percent to 50 percent, the act also lowered the combined normal and surtax maximum marginal rate from 73 percent to 58 percent.
>
> The 1924 Revenue Act cut normal tax and surtax rates, reducing the combined top marginal rate from 58 percent to 46 percent. The act also established a credit of 25 percent of normal tax on earned income.
>
> The Revenue Act of 1926 again lowered normal tax and surtax rates and reduced the maximum estate tax rate from 40 percent to 20 percent.

In evaluating the revenue acts, one should keep in mind that personal income per capita was only $667 in 1926 and a family of four would have to earn over $4,700 before subjection to income taxation.

The Revenue Act of 1921

On August 16, 1921, the House Committee on Ways and Means favorably reported the Revenue Act of 1921, H.R. 8245, which was then passed by the House on August 20, 1921. The Senate Committee on Finance favorably reported the bill on September 26, 1921, and it was passed by the Senate on November 7, 1921. After a conference committee report was issued and passed by Congress, President Harding signed the act into law on November 23, 1921.

The act increased the personal exemption from the previous $2,000 to $2,500 for married couples with joint income less than $5,000. It also doubled the credit for dependents from $200 to $400. The act left existing normal individual tax rates intact, as follows:

Normal tax rate:	*Percent*
1st $4,000 of net income in excess of certain credits	4
Over $4,000 of net income in excess of certain credits	8

In addition, the act simplified the law by eliminating the bottom surtax bracket ($5,000–$6,000), thus raising the surtax exemption to $6,000, and by consolidating the next two lowest brackets—$6,000–$8,000 and $8,000–$10,000—into one bracket to be taxed at 1 percent instead of at 2 percent and 3 percent, respectively. The other surtax rates of income classes under $20,000 were chopped by 2 percentage points (for example, the $16,000–$18,000 bracket rate was cut from 7 percent to 5 percent), resulting in surtax rate reductions ranging from 25 percent to 40 percent. Higher rates were pared by one percentage point (for example, the $40,000–$42,000 bracket rate was reduced from 19 percent to 18 percent), and the maximum surtax rate was lowered from 65 percent to 50 percent. The act established a combined normal and surtax top marginal rate of 58 percent, down from 73 percent. Furthermore, the top four surtax brackets were consolidated into one "$200,000 and over" bracket.

The act also provided for a 12.5 percent preferential tax rate for capital gains held over two years. In addition, the excess profits tax on corporations, considered discriminatory and counterproductive, was repealed. Various transportation and so-called "nuisance" taxes were likewise repealed.

The most important provisions of the act, including those relating to income taxation, were to become effective on January 1, 1922. The reaction of Ways and Means Democrats to the act may be gauged by their Minority Views included in the committee report. Their dispassionate analysis inquired:

> Why in the name of right and justice should these big profiteering corporations and the millionaires and multimillionaires who filled their rapacious maw with these fabulous billions of blood money be relieved of taxation while we not only keep but actually increase the war taxes on hundreds of thousands of small and weak corporations and keep the war income taxes on millions of our fellow citizens who and whose sons went to the trenches in defense and protection not only of their country but of the profits and wealth of these same corporations and millionaires and multimillionaires. Not one of them made a sacrifice, braved a danger, endured a hardship financially or otherwise for their country during the war but was millions richer after the war than before, without a scar or scratch. It would be a thousand times better to keep the excess profits tax and high surtaxes on under the existing law and relieve altogether the more than 4,000,000 of our less fortunate citizens whose income is under $5,000, or our more than 5,000,000 whose income is under $10,000, every dollar of which in both classes is needed for the support of themselves and their families and the education of their children.
>
> The same Republican principle of making those most able to pay pay less and those least able to pay pay more is carried out in their program to reduce the taxes on the millionaires and multimillionaires whose annual income exceeds $66,000 a year, ranging all the way from $66,000 to $10,000,000, and over, yearly.

Thus, the Democrats argued, the bill would unfairly reduce the taxes paid by those with high annual incomes. It would be a windfall for the rich.

The harsh criticism of the act as a giveaway to the rich was not to be borne out by the facts. Between 1921 and 1922 individual income taxes paid by the very wealthy [7] increased over 40 percent, from $318 million to $446 million. Moreover, their share of the total individual tax burden rose 18 percent, from 44 percent to 51.8 percent. Meanwhile, the proportion of income taxes paid by those making under $5,000 slipped from 12.9 percent to 11.1 percent. Total individual tax revenues increased about 20 percent, from $719 million to $861 million in 1922.

Mellon later used a table to illustrate the increased taxable income generated by the lower marginal tax rates applied to the higher brackets. (See Table 2 below.) This table clearly shows the marked change in the distribution of taxable income since the onset of the steeply progressive surtax schedule established by the 1917 and 1918 tax legislation. In 1916 net incomes in excess of $100,000 contributed 29.4 percent of all net incomes (taxable income) returned, but by

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[7] For our purposes, the term "very wealthy" will refer to all those reporting annual income of $50,000 or more.

1921 this percentage had dropped to 2.37 percent. After the top marginal rate was lowered to 58 percent in 1922, however, this percentage jumped to 4.18 percent, an increase of over 76 percent. The evidence is strong that the revenue legislation of 1917 and 1918 raised marginal tax rates above the range consistent with revenue maximization. The impact of the higher rates also shifted a growing share of the burden onto lower income bracket taxpayers.

TABLE 2[1].—TAX RETURNS OF THOSE WITH NET INCOME IN EXCESS OF $100,000 AND $300,000, AS COMPARED WITH TOTAL OF ALL INCOMES RETURNED, FOR THE CALENDAR YEARS IN WHICH THE TAX ACCRUES; LATEST AVAILABLE FIGURES

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Income tax maximum rate (percent)	Total amount of net income returned	Number of returns of net income in excess of $100,000	Net income returned by those returning in excess of $100,000	Percent (5) is of (3)	Number of returns in excess of $300,000	Net income returned by those returning excess of $300,000	Percent (8) is of (3)
1916	15	$6,298,577,620	6,633	$1,856,187,710	29.47	1,296	$992,972,986	15.77
1917	67	13,652,383,207	6,664	1,606,516,153	11.77	1,015	731,372,153	5.36
1918	77	15,924,639,355	4,499	990,239,425	6.22	627	401,107,868	2.52
1919	73	19,859,491,448	5,526	1,169,553,048	5.89	679	440,011,589	2.22
1920	73	23,735,629,183	3,649	727,004,763	3.06	395	246,354,585	1.04
1921	73	19,577,212,528	2,352	463,003,351	2.37	246	153,534,305	.78
1922	58	21,336,212,530	4,031	892,747,680	4.18	537	365,729,746	1.71

[1] "Annual Report of the Secretary of the Treasury, 1924," p. 9.

Economic conditions rapidly improved after the act became law, lifting the United States out of the severe 1920–21 recession. Between 1921 and 1922, real GNP (measured in 1958 dollars) jumped 15.8 percent, from $127.8 billion to $148 billion, while personal savings rose from $1.59 billion to $5.40 billion (from 2.6 percent to 8.9 percent of disposable personal income). Unemployment declined significantly, commerce and the construction industry boomed, and railroad traffic recovered. Stock prices and new issues increased, with prices up over 20 percent by year-end 1922.[8] The Federal Reserve Board's index of manufacturing production (series P–13–17) expanded 25 percent. A useful indicator of industrial strength, the physical output of raw steel produced, leaped 80 percent, from 21.6 million to 38.9 million short tons.[9] The Bureau of Mines index of physical volume of mineral production rose over 6 percent to 29 (1967=100). Even farm income rebounded from the dismal level of the previous years. Meanwhile, the money supply remained stable and the GNP price deflator decreased 8 percent.

This trend was sustained through much of 1923, with a 12.1 percent boost in GNP to $165.9 billion. Personal savings increased to $7.7 billion (11 percent of disposable income) while stock and consumer prices remained fairly stable. In the middle of 1923, the economy started into a very mild cyclical downturn that bottomed out around July of the next year.[10] Despite this, the Federal Reserve Board's index of manufacturing production registered a gain of 20 percent for 1923. The physical output of raw steel produced rose 26 percent, from 39 million

[8] Fritz Machlup, "The Stock Market, Credit and Capital Formation" (London: William Hodge and Company, Ltd. 1940), pp. 365–370.

[9] U.S. Department of Commerce, "Historical Statistics of the U.S." (Washington: U.S. Government Printing Office, 1975), p. 693.

[10] Arthur F. Burns and Wesley L. Mitchell, Measuring Business Cycles (New York: National Bureau of Economic Research, 1947), p. 532.

to 49 million short tons. The GNP deflator increased a modest 2.3 percent over the previous year.

In November of 1923 President Harding passed away and Vice President Calvin Coolidge became President. President Coolidge encouraged Mellon to continue pressing for further tax reforms.

The Revenue Act of 1924

On February 11, 1924, the Committee on Ways and Means favorably reported the Revenue Act of 1924, H.R. 6715, which was passed by the House February 29, 1924. The Committee on Finance favorably reported the measure on April 10, 1924, and the Senate passed it on May 10 of that year. After a conference committee report had been issued and passed by Congress, President Coolidge signed the act into law on June 2, 1924.

The act established a 25 percent credit on normal taxes on earned income under $10,000 and retroactively applied it to 1923 income. Though it was, of course, recognized that a short-run loss of revenue would result, the Treasury surplus was so large that immediate tax relief was deemed appropriate.

The income tax provisions of the 1924 act generally followed the precedent set in 1921—further reduction in marginal tax rates. Normal tax rates were chopped across-the-board as follows:

[In percent]

Title of tax	In effect 1921	Revenue Act of 1924
Income tax: On individuals: Normal tax rate:		
1st $4,000 of net income in excess of certain credits	4	2
Next $4,000 of net income in excess of certain credits	8	4
Over $8,000 of net income in excess of certain credits	8	6

One result of the 25 percent tax credit was to lower the effective bottom rate from 2 percent to 1½ percent. Partially for administrative reasons, this credit was applicable to the first $5,000 of any return, regardless of income classification.

In addition, the $6,000–$10,000 surtax bracket was abolished, raising the surtax exemption to $10,000. All surtax rates were slashed at least 20 percent, and some of the upper surtax brackets were redefined in such a way as to further reduce effective tax rates. The top marginal surtax rate was cut by one-fifth, from 50 percent to 40 percent. Thus the combined normal and surtax maximum rate decreased from 58 percent to 46 percent.

One provision of the 1924 act opposed by Mellon was an increase in the estate tax from 25 percent to 40 percent. In his 1924 report he included a table demonstrating the declining returns on the already "excessive" 25 percent maximum rate:

TABLE 3

In 1921 the 25 percent maximum estate tax was first fully reflected in revenue. The return from Federal estate taxes for that and subsequent years has been as follows:

1921	$154,000,000
1922	139,000,000
1923	126,000,000
1924	102,000,000

This is a clear showing of the progressive failure of a tax inherently excessive With a 40 percent maximum rate in the revenue act of 1924 we may expect an acceleration of this tendency.[11]

Mellon also opposed the inclusion of the gift tax, a provision adopted on the floor of Congress without committee consideration. Other provisions of the act repealed several nuisance taxes.

In its report on H.R. 6715, the Senate Finance Committee had this to say on fiscal year 1925 revenue estimates showing a possible deficit:

It is the opinion of the committee that this apparent deficit will be wiped out by the increase in the revenue yield of the income taxes because of the improvement of business conditions which will result from placing these taxes upon an economically sound basis.[12]

After the 1924 rate reductions became effective income revenues increased again, with the proportion paid by the very wealthy increasing from 48 percent (1923) to 62 percent (1924). The percentage of total individual income taxes paid by those earning $5,000 or less fell from 12.21 percent in 1923 to only 6.76 percent in 1924. The proportion of the population filing returns dropped from 6.94 percent to 6.56 percent. The following table shows the relative increase in the proportion of taxes paid by the five highest income classes.

TABLE 4.—PERCENTAGE OF TOTAL INDIVIDUAL INCOME TAXES PAID ON 1923-24 RETURNS

Income classes (thousands)	1923	1924	Percent increase
$100 to $150	8.4	10.75	28.0
$150 to $300	9.36	13.13	40.3
$300 to $500	4.77	6.50	36.3
$500 to $1,000	3.84	6.05	57.5
$1,000 and over	5.39	6.70	24.3
Total	31.76	43.13	35.8

The deep cuts in marginal tax rates boosted revenues produced from these five brackets almost 44 percent in just one year. Even though the act became law only in mid-year 1924, tax revenues and economic activity soon responded, reversing the 1923–24 slowdown. Between 1924 and 1925 real GNP grew 8.4 percent, from $165.5 billion to $179.4 billion. In this same period the amount of personal savings rose from an already impressive $6.77 billion to about $8.11 billion (from 9.5 percent to 11 percent of personal disposable income).

The unemployment rated dropped 27.3 percent,[13] interest rates fell, and railroad traffic moved at near record levels. From June 1924 when the act became law to the end of that year the stock price index jumped almost 19 percent. This index increased another 23 percent between year-end 1924 and year-end 1925, while the amount of non-financial stock issues leapt 100 percent in the same period. Between 1924 and 1925 the price index and GNP deflator registered no significant changes even though the money supply increased 8.11 percent. The Federal Reserve Board's index of manufacturing production grew

[11] "Annual Report of the Secretary of the Treasury." 1924, p. 12.
[12] U.S. Senate Report No. 398, 68th Congress, 1st session, p. 2.
[13] Richard K. Vedder, "The American Economy in Historical Perspective" (Belmont: Wadsworth Publishing Co., Inc., 1976), p. 367.

about 12 percent, and the physical output of raw steel produced expanded about 19.5 percent.

The economic recovery following the implementation of the 1924 Revenue Act closely resembled the earlier upturn after the 1921 Revenue Act became effective. In both instances the upturn was robust and broadly based, with real output expanding substantially without inflation.

The Revenue Act of 1926

The Committee on Ways and Means favorably reported the Revenue Act of 1926, H.R. 1, on December 7, 1925, and it was passed by the House December 18, 1925. On January 20, 1926, the Committee on Finance favorably reported the measure, which was passed by the Senate on February 12, 1926. After a conference committee report was issued and passed by each house in February, the act was signed into law by President Coolidge February 26, 1926. It was made effective retroactively to incomes earned in 1925.

H.R. 1 represented Mellon's idea of a thorough tax reform; he considered the two previous acts compromises. The act boosted personal exemptions and slashed normal tax rates in the following manner:

Title of tax	Revenue Act of 1924	Revenue Act of 1926
Income tax: On individuals:		
Personal exemptions:		
Married or head of family	$2,500	$3,500
Single	1,000	1,500
Credit for dependents	400	400
Normal tax rate (percent):		
1st $4,000 of net income in excess of certain credits	2	1½
Next $4,000 of net income in excess of certain credits	4	3
Over $8,000 of net income in excess of certain credits	6	5

In addition, H.R. 1 sharply chopped surtax rates, especially at the higher bracket levels. Again, as in the 1924 act, the redefinition and consolidation of the income classes reduced some marginal rates even more. The maximum surtax rate was lowered from 40 percent on net income over $500,000 to 20 percent on net income over $100,000. Thus the combined normal and surtax maximum marginal rate was pared 45.6 percent, from 46 percent to 25 percent.

The act also increased the estate tax exemption from $50,000 to $100,000, and cut the top rate in half, from 40 percent to 20 percent. The maximum Federal tax credit for State inheritance taxes paid was increased from 25 percent to 80 percent. Furthermore, a special 25 percent top estate tax rate was made retroactive to June 2, 1924. The gift tax was repealed. Several nuisance taxes were also cut and the corporate capital stock tax abolished. Excise taxes on mahjongg sets, cameras, tires, and the use of U.S. built boats, as well as other items, were removed. Occupational taxes on brokers and various proprietors were nullified.

The tax revenue derived from the very wealthy under the provisions of the 1926 act (calendar years 1925–26) increased substantially over 1924. Individual income tax revenues increased $30 million overall between 1924 and 1925, with the share paid by the very wealthy increasing 7 percent to almost 70 percent. Curiously, about the same amount of revenue was collected for 1926; but the proportion paid by the very wealthy increased again in 1927 to 72.8 percent. Furthermore, the percentage of tax revenues paid by those with incomes in excess of $1 million jumped from 6.7 percent in 1924 to 9.1 percent in 1925 and 11.2 percent in 1926. Meanwhile the proportion of individual income taxes paid by those earning under $5,000 dropped precipitously. This class paid 6.76 percent of 1924 income taxes, 1.89 percent of 1925 taxes, 1.82 percent of 1926 taxes, and 1.42 percent in 1927.

The enactment of the 1926 legislation helped sustain the momentum of the economic expansion. From 1925 to 1926 real GNP grew from $179.4 billion to $190 billion. The index of output per man-hour increased and the unemployment rate fell over 50 percent, from 4.0 percent to 1.9 percent. The Federal Reserve Board's index of manufacturing production again rose, and stock prices of nonfinancial issues increased about 5 percent. The physical output of raw steel produced increased and the Bureau of Mines index of physical volume of mineral production jumped 8.6 percent from 82.7 to 89.6.

IV. Review of the Mellon Program

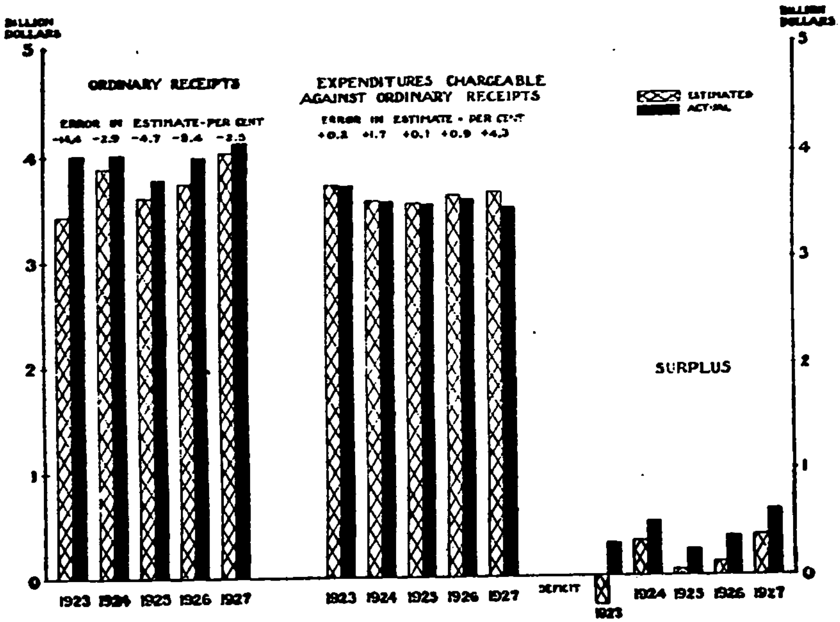
The American economy today is obviously very different from that of the 1920's with respect to financial structure, industrial organization, agricultural production, income distribution, employment, and many other factors. Nonetheless, at least one thing remains relatively unchanged—the ability of human nature to perceive and respond to economic incentives. Andrew Mellon and others, as well as the contemporary supply-siders have recognized that individual decision-making contains a rational component capable of measuring progress towards material and other objectives. In the economic sphere, relative prices exert a decisive influence on man's evaluation of alternative actions such as labor-leisure and consumption-saving. That costs unevenly imposed by taxation change relative prices and alter decision-making and incentives is hardly an earth-shaking conclusion. Opposition to this notion must rest on the principle that man is too stupid and inert to respond to reality.

Postulating cause and effect relationships in the social sciences and history can be a hazardous exercise. Unlike in the natural sciences, hypotheses in the social sciences cannot be rigorously tested by the scientific method under laboratory conditions. However, we do know a priori that by increasing the marginal after-tax returns on work effort and savings these activities always become more attractive. Consequently, we can safely say that the tax cuts at least contributed to business activity by increasing after-tax incentives for successful entrepreneurship.

However, agreement is universal that the best measure of a theory's validity is its predictive power. Perhaps the most persuasive case for the tax cuts was provided by Mellon himself. For in initiating his program and explaining its theoretical basis Mellon made a number of predictions with respect to tax revenue, economic activity, employment, and other topics. These predictions turned out as well as anyone could reasonably expect. For example, each year the Treasury projected anticipated tax revenue and expenditures for the next fiscal year. (See diagrams.) In his 1927 report he included the diagrams presented below to show trends in tax receipts and spending from 1923–27.[14]

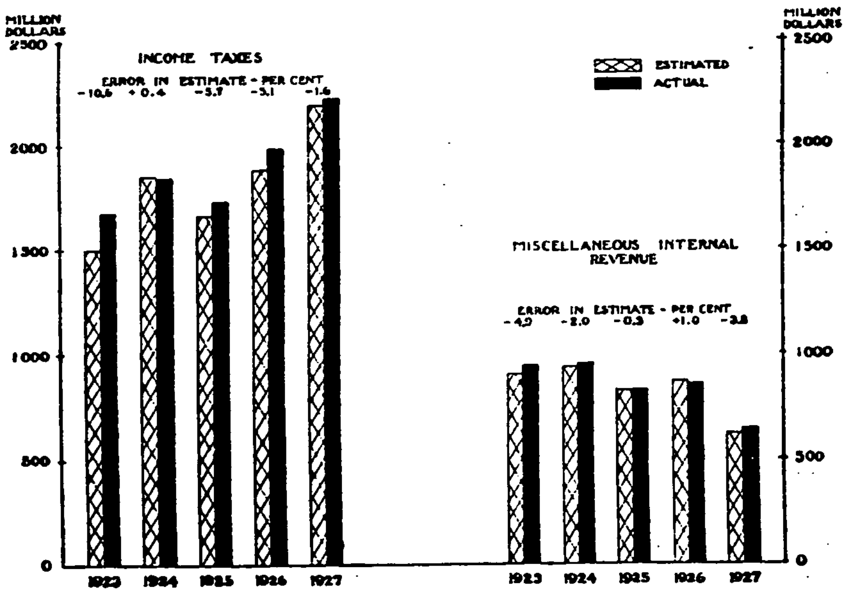
[14] "Annual Report of the Secretary of the Treasury, 1927" (Washington: U.S. Government Printing Office, 1928), p. 26.

DIAGRAM A



Estimated ordinary receipts, expenditures chargeable against ordinary receipts, and surplus or deficit, compared with actual amounts for the fiscal years 1925 to 1927.

DIAGRAM B



Estimated receipts from income taxes and miscellaneous internal revenue for the fiscal years 1923 to 1927 compared with actual receipts.

As can be readily seen at the left of Diagram B, during fiscal years 1922–27 the trend was toward increasing tax revenues. Examination of returns for incomes earned during the calendar years reveals a similar pattern. This upward trend is all the more remarkable considering the magnitude of the rate cuts. But the deep reductions in marginal rates encouraged economic growth, made tax shelters less attractive, and thus expanded the tax base, generating increased revenues.

TABLE 5.—INCREASE IN INDIVIDUAL INCOME TAX REVENUES [1]

	Income taxes returned (in millions), total	Paid by very wealthy [2]	Percent paid by very wealthy (percent)
Calendar year:			
1921	$719	$318	44.2
1922	861	446	51.8
1923	664	320	48.2
1924	704	440	62.5
1925	735	507	69.0
1926	732	514	70.2
1927	830	605	72.8
1928	1,160	909	78.4

[1] Department of the Treasury, "Statistics of Income," various years.
[2] Net incomes over $50,000 annually.

Mellon attributed the revenue growth to the increase in individual net income returned as well as the slightly higher rate imposed on corporations. As Mellon proudly pointed out, the income tax revenue estimates of the Treasury reflected over 95 percent accuracy.

In 1921, Mellon forecast that the increased taxable income and revenues produced by his reform would be derived from the wealthier taxpayers. Detailed analysis of income tax returns during the period 1922–27 indicates that the Mellon rate reductions broadened the tax base and resulted in much larger taxable incomes being reported by the well to do. For example, between 1921 and 1927 the amount of taxable income reported in the $100,000–$300,000 range jumped 358 percent, while that in the $300,000 and over category leaped an impressive 807 percent. The table below shows that between 1921 and 1927 the taxable income of all the upper brackets increased dramatically.

TABLE 6.—INDIVIDUAL INCOME TAX RETURNS SHOWING NET INCOME OF $5,000 AND OVER [1]

[Total net income reported in returns filed in each of the calendar years 1922-28 in millions of dollars—that is, 000,000 omitted—and showing percent of increase over preceding year; also percent of increase for 1928 over 1922]

Income year	1921	1922		1923		1924	
Filing year (January to December, inclusive)	1922	1923		1924		1925	
Distribution by size of net income	Millions of dollars	Millions of dollars	Percent over preceding year	Millions of dollars	Percent over preceding year	Millions of dollars	Percent over preceding year
$5,000 to $50,000	5,316.54	6,106.05	14.85	6,541.78	7.14	7,446.43	13.83
$50,000 to $100,000	582.23	805.22	38.30	833.90	3.56	1,066.78	27.93
$100,000 to $300,000	309.47	527.02	70.30	541.24	2.70	752.25	38.99
$300,000 and over	153.53	365.73	138.21	371.75	1.64	485.69	30.65
Total	6,361.77	7,804.02	22.67	8,288.67	6.21	9,751.15	17.64

TABLE 6.—INDIVIDUAL INCOME TAX RETURNS SHOWING NET INCOME OF $5,000 AND OVER—Continued

Income year	1925		1926			1927		
Filing year (January to December, inclusive)	1926		1927			1928 [2]		
Distribution by size of net income	Millions of dollars	Percent over preceding year	Millions of dollars	Percent over preceding year	Percent over amount reported in 1922	Millions of dollars	Percent over preceding year	Percent over amount reported in 1922
$5,000 to $50,000	9,040.99	21.41	9,454.23	4.57	77.82	9,528.69	.79	79.22
$50,000 to $100,000	1,418.95	33.01	1,389.34	[3] −2.09	138.62	1,527.68	9.96	162.38
$100,000 to $300,000	1,228.16	63.26	1,231.60	.27	297.97	1,416.70	15.03	357.78
$300,000 and over	1,089.60	124.34	1,152.49	5.77	650.64	1,391.89	20.77	806.59
Total	12,777.70	31.04	13,227.66	3.52	107.92	13,864.96	4.82	117.94

[1] "Annual Report of the Secretary of the Treasury, 1928" (Washington: U.S. Government Printing Office, 1929) pp. 855–856.
[2] Returns filed to Aug. 31, 1928.
[3] A minus sign (−) indicates decrease.

In greatly increasing the personal exemption and dependent credit, the 1926 Revenue Act caused a decrease of almost two million taxpayers, 44 percent of the 1924 total. By 1927, taxpayers with incomes in excess of $5,000 were paying over 98 percent of all individual income taxes. As Mellon suggested, individual income taxation had become a class tax borne almost entirely by the wealthy.

Whatever one might think about the Mellon tax cuts, they certainly were not inflationary. By encouraging increased saving, investment, and production their influence was in the opposite direction. Actually, the unprecedented rate of economic growth and real output in this period resulted in a slight decline in prices, as reflected in the item below:

Period	Tax changes	Average annual compound rate of inflation (percent)
1916 to 1919	High marginal rates imposed. Top rate increased from 7 percent (1913) to 73 percent (1919).	16.8
1921 to 1927	Marginal rates sharply cut. Top marginal rate reduced to 25 percent	−1.5

In launching his tax reduction program, Mellon considered not only the counterproductive revenue effects of high rates, but the detrimental impact on the economy and the less fortunate. Speaking of the 1920–21 depression, he said:

> If these conditions continue, our present burden of taxation must seriously increase the troubles of our people. The hardship and suffering resulting from business depression and unemployment inevitably fall most severely not upon those paying high income taxes, but upon the great body of the people of small incomes. Under our form of government there is, and very rightly so, little danger of any undue burden from the taxes imposed directly upon those of small means, but there is danger of serious hardship and suffering to them because of high prices, unemployment, and high living costs resulting from unjust or unwise tax laws. Our very best thought, therefore, should be directed to seeing that our system of taxation shall interfere to the least possible extent with the return of the country at least to such normal conditions and reasonable business activity as will prevent hardship to those least able to bear it.[15]

[15] Annual Report of the Secretary of the Treasury, 1921, p. 13.

Ultimately, economic recovery was foremost in Mellon's mind. He believed his tax cuts would revive the economy and, as discussed earlier, economic recovery did follow the tax reductions. This does not necessarily preclude the existence of cyclical and monetary factors influencing economic activity. But, for instance, the tax cuts in the depression of 1920–1921 surely facilitated recovery, just as the imposition of higher marginal rates would have impeded it.

Few would dispute the fact that the 1921–26 period was one of tremendous real economic and industrial growth. The price level remained quite stable throughout with real GNP increasing at an average annual rate in excess of 8 percent. The availability of capital for the application of new technologies and new methods of production generated an outpouring of industrial innovations and improved goods such as radios and automobiles. The table below reveals that gains in other areas were also impressive:

TABLE 7.—INDEX OF MANUFACTURING PRODUCTION BY INDUSTRY GROUP[1]

[1947=100]

Industry	1921	1927	Percentage increase
Food	31	42	35
Textiles and apparel	43	63	46
Petroleum and coal	30	45	50
Paper products	26	46	77
Transportation equipment	25	45	80
Chemicals	15	29	93
Primary metals	26	52	100
Rubber products	24	52	117

[1] U.S. Department of Commerce, "Historical Statistics of the United States". p. 668.

The enormous expansion of production in this period required additional saving for capital formation. As shown below, immediately after the 1921 Revenue Act became law the amount of saving as well as the rate of saving more than tripled. Saving continued at a healthy clip throughout the decade.

TABLE 8.—SAVING EFFECTS OF REVENUE ACTS

Year	Personal saving (billions)	Disposable personal income (billions)	Savings ratio
1921	1.59	60.2	0.026
1922	5.40	60.3	.089
1923	7.70	69.7	.110
1924	6.77	71.4	.095
1925	8.11	73.0	.111
1926	7.40	77.4	.096
1927	8.40	77.4	.108
1928	4.35	77.5	.056
1929	9.53	83.3	.114

As we have seen, Mellon and the U.S. Treasury proceeded on the assumption that the marginal rate reductions would induce economic growth and augment tax revenues derived from the wealthy. The available evidence contains nothing that contradicts their revenue projections or economic forecasts. The economic data and particularly the revenue statistics prove the outstanding success of the Republican tax policy of the era. The Mellon reforms lifted the excessive burden of taxation on moderate incomes while drawing much larger revenues from the higher brackets. The economic prosperity that followed benefited all Americans.

THE KENNEDY TAX CUTS

I. Introduction

The second example of across-the-board tax cuts was formulated during the Kennedy Administration. When John F. Kennedy was inaugurated on January 20, 1961, the economy was sliding and unemployment was almost 7 percent. Having promised to "get the country moving again" and restore economic growth, Kennedy and his advisers pondered a long-range policy for sustained economic recovery. The new President's own views on fiscal policy were basically pragmatic. According to Herbert Stein:

> The most important thing about Kennedy's ideas on fiscal policy before he became President is that they were lightly held. Kennedy has been called the first modern economist in the American Presidency. This may have been true in 1963, but it was not true on Inauguration Day. At that time Kennedy's fiscal thinking was conventional. He believed in budget-balancing. While he was aware of circumstances in which the budget could not or should not be balanced, he preferred a balanced budget, being in this respect like most other people but unlike modern economists. But if he brought into the White House no very sophisticated or systematic ideas about compensatory fiscal policy, neither did he bring with him any deep intellectual or emotional commitment to the old ideas.[1]

II. Democratic Fiscal Policy

While Kennedy's attitude towards fiscal policy was fairly conventional, his top advisers included a number of economists associated with Keynesianism. Such luminaries as John Kenneth Galbraith, Walter Heller, Paul Samuelson and others had access to the President during his tenure in office. Although their influence on specific legislation is hard to measure, a brief consideration of the current Keynesian fiscal policy is worthwhile. These ideas were particularly well represented on the Council of Economic Advisers (CEA), which then consisted of Walter Heller, James Tobin, and Kermit Gordon.

According to this view, the driving force of economic activity is aggregate demand. Since downturns are seen as the result of inadequate demand, expansionary budget policies are recommended to stabilize the chronically unbalanced private sector. Thus economic recession should generally be combated by augmenting aggregate demand by fiscal actions, typically by increasing government outlays, an action often leading to deficit spending. However, deficits resulting from tax cuts are also considered stimulative.

One innovation usually associated with then-CEA Chairman Walter Heller is the notion that a "fiscal drag" could result from the bracket creep caused by inflation or real income growth. Heller found this drag troublesome since he thought that higher marginal rates would drain revenues from aggregate demand; he was less concerned about the counterproductive incentive effects induced by high rates.

[1] Herbert Stein, *The Fiscal Revolution in America* (Chicago: Univ. of Chicago Press, 1969), pp. 374–375. For another account of the Kennedy tax cut, see Bruce Bartlett, *Reaganomics*, pp. 114–123.

This fiscal drag concept was often combined with estimates of a potential full employment level of national income to be reached through stimulative fiscal policy.

On the basis of this analysis the Eisenhower fiscal policy was condemned. As James Buchanan and Richard Wagner have observed:

> The Eisenhower budgetary policy for the recovery years of 1959 and 1960 was sharply criticized for its apparent concentration on observed rather than potential flows of revenues and outlays. By defining a target "high-employment" level of national income on a projected normal growth path, and then by projecting and estimating the tax revenues and government outlays that would be forthcoming under existing programs at that level of income, a test for hypothetical budget balance could be made. Preliminary tests suggested that the Eisenhower budgetary policies for those years would have generated a surplus at the targeted high-employment level of income. That is to say, although actually observed flows of revenues and outlays need not have indicated a budget surplus, such a surplus would indeed have been created if national income had been generated at the higher and more desired level. However, since observed national income was below this target level, and because the potential for the surplus was already incorporated in the tax-spending structure, the budget instrument itself worked against the prospect that the target level of national income could ever be attained at all. This result seemed to follow directly from the recognition that the budget itself was an important determinant of national income. Before the targeted level of income could be reached, the budget itself would begin to exert a depressing influence on aggregate demand. This "fiscal drag" was something to be avoided.
>
> From this analysis follows the budgetary precept that runs so strongly counter to ordinary common sense. During a period of economic recovery, the deliberate creation of a budget deficit, or the creation of a larger deficit than might already exist, offers a means of securing the achievement of budget surplus at high-employment income.[2]

Though there were other elements present in the early formulations of policy, the fiscal drag theory eventually emerged as the cornerstone of the CEA's approach. For balance-of-payments reasons Kennedy had to abandon the advocacy of monetary expansion adopted during the campaign. So, early on the Administration pursued the goal of more Federal spending to increase incomes and reach potential full employment—but this path was blocked by conservative opposition. A 1961 proposal for a business investment tax credit, to be coupled with targeted business tax increases, was likewise stymied by intense opposition. Though a 7 percent investment tax credit was enacted in 1962 without the tax increases, the majority of the Administration's first fiscal policy initiatives were frustrated.

III. Tax Reduction for Economic Growth

As the economy slowly recovered in 1961 and 1962, and spending increases proved to be unattainable, the earlier orientation of policy gradually gave way to support for demand stimulation through across-the-board tax cuts. This option was widely considered more conducive to broad and bipartisan support.

In the middle of 1962 a sagging stock market raised fears about the vigor of the recovery then underway. In a statement on December 14, 1962, delivered before the Economic Club of New York, President Kennedy explained the administration's current position:

> The most direct and significant kind of Federal action aiding economic growth is to make possible an increase in private consumption and investment demand—to cut the fetters which hold back private spending. In the past, this could be done in part by the increased use of credit and monetary tools—but

[2] James Buchanan and Richard Wagner, *Democracy in Deficit* (New York: Academic Press, 1977), pp. 46–47.

our balance of payments situation today places limits on our use of those tools for expansion. It could also be done by increasing Federal expenditures more rapidly than necessary—but such a course would soon demoralize both the government and the economy. If the government is to retain the confidence of the people, it must not spend a penny more than can be justified on grounds of national need and spent with maximum efficiency.

The final and best means of strengthening demand among consumers and business is to reduce the burden on private income and the deterrents to private initiative which are imposed by our present tax system—and this Administration pledged itself last summer to an across-the-board, top-to-bottom cut in personal and corporate income taxes to be enacted and become effective in 1963.[3]

Shortly thereafter, in a January 24, 1963, message to Congress, the President contended that high wartime tax rates (which then ranged from 20 percent to 91 percent) had been necessary during and immediately after World War II. Then he observed:

But it has become increasingly clear—particularly in the last five years—that the largest single barrier to full employment of our manpower and resources and to a higher rate of economic growth is the unrealistically heavy drag of Federal income taxes on private purchasing power, initiative and incentive. Our economy is check-reined today by a war-born tax system at a time when it is far more in need of the spur than the bit. . . .

The chief problem confronting our economy in 1963 is its unrealized potential—slow growth, under-investment, unused capacity and persistent unemployment. The result is lagging wage, salary and profit income, smaller take-home pay, insufficient productivity gains, inadequate Federal revenues and persistent Budget deficits. One recession has followed another, with each period of recovery and expansion fading out earlier than the last. Our gains fall far short of what we could do and need to do, measured both in terms of our past record and the accomplishments of our overseas competitors.

I am therefore proposing the following:

(1) Reduction in individual income tax rates from their present levels of 20 to 91 percent, to a range of 14 to 65 percent—the 14 percent rate to apply to the first $2,000 of taxable income for married taxpayers filing joint returns, and to the first $1,000 of the taxable income of single taxpayers;

(2) Reduction in the rate of the corporate income tax from 52 to 47 percent;

* * * * * * *

(5) Revision of the tax treatment of capital gains, designed to provide a freer and fuller flow of capital funds and to achieve a greater equity;[4]

* * * * * * *

These tax revisions would lead to the most sweeping reductions since the Mellon cuts of the Twenties. In fact, according to Ways and Means Committee Chairman Wilbur Mills, he, Treasury Secretary Dillon and President Kennedy were all aware of Mellon's successful experiment of the 1920's. Perhaps this explains Mills' rationale for the tax legislation; which departs significantly from the fiscal drag theory discussed earlier. In 1962, for example, Mills, echoing Mellon, stated:

In my opinion, our tax rates are too high. They have a strong tendency to blunt incentives and stifle economic growth. As you know, a large part of our present Internal Revenue Code, including its high rate structure, had its origin during wartime when concern over economic growth was not a factor which had to be considered, and it still persists today in virtually the same form, though its adverse impact upon incentives and economic growth and stability in a peacetime economy is becoming increasingly evident.

There is general agreement that in order for this country to maintain its economic strength domestically and to continue in its dominant position in today's world, our rate of economic growth in the next decade must exceed that of any previous decade in history. As a part of achieving this objective there must be a substantial revision of our war-engendered and revenue-inspired tax system in view of the strong doubt that such growth can be attained under our present tax

[3] The Commercial and Financial Chronicle (December 20, 1962), as quoted in Bartlett, op. cit., pp. 114–115.

[4] *Public Papers of the Presidents of the United States*, John F. Kennedy, 1963 (Washington: U.S. Government Printing Office, 1964), pp. 73–92.

system. This is particularly true under our present high rate structure which, because of its rates and the unevenness of its application. limits initiative and causes tax considerations to override business decisions which would otherwise be dictated by the signals of the marketplace.

Although it is my firm conviction that the basic purpose of taxation is to raise revenues required to meet the costs of government, gearing tax revision and reform to the objective of economic growth and stability is in no way inconsistent with this viewpoint.[5]

Although placing the major emphasis on demand stimulus, we should point out that members of the Council of Economic Advisers also recognized that lower rates were necessary to restore incentives for productive economic activities. This, however, was for them a secondary consideration.

As we shall see, the Kennedy proposal had strong supply-side effects, despite the desire to stimulate demand. The rate schedule Kennedy initially put forward would have cut tax rates on taxable incomes of joint returns below $2,000 by about 30 percent, taxable incomes between $2,000 and $100,000 by about 16 to 20 percent, and those over $100,000 by 23 percent to 29 percent. Obviously, the cuts were somewhat skewed toward the lower and upper income classes, with relatively less relief for lower middle an middle income taxpayers. One might expect a tax bill aimed at demand stimulation to provide more relief for these moderate income groups, though their reductions were still substantial.

Soon after his January 1963 speech, the President's initiative was introduced in the House of Representatives and referred to the Committee on Ways and Means. During Congressional consideration of the measure it was strongly supported by Democrats while many orthodox Republicans, mostly in the House, opposed it because it might boost Federal deficits. But Democrats on the tax-writing committees argued that in the long run revenues would increase from the rate reductions, eventually decreasing deficits. Typical was this statement contained in the Ways and Means Committee report:

As indicated by the first section of this bill, it is your committee's opinion that this bill will stimulate the economy, and—after a brief transitional period—raise revenues, rather than lower them. Moreover, it is intended that the additional revenues resulting from this bill be used first to eliminate the deficits which have been consistently plaguing the Federal Government's budget for an extended period of time, and then to reduce the public debt.

It is recognized that to many it may seem inconsistent to think of cutting taxes as a way of increasing revenues. Nevertheless, past experience demonstrates that this can happen; in fact, given today's conditions it can be expected to happen. The events of the period 1954–56 demonstrate how this can occur. In 1954 Congress allowed the individual income tax increases imposed during the Korean war to expire, made certain excise tax reductions, allowed the excess profits tax to expire and made certain other tax reductions as well. The total of these reductions amounted to about $7.4 billion. Yet, only 2 years later, in 1956, receipts were $3.2 billion above the level existing before the reductions were made. However, these reductions did not get to the root of the matter, the high World War II rates, with the result that the poor economic performance of the economy since 1956 has left a heavy mark on the Federal debt. The initial budget forecast for each of the fiscal years 1958 to 1963 was for a budgetary surplus. The actual outcome in 5 of the 6 years, however, was a deficit, averaging over $6 billion a year. The major factor accounting for each of these deficits was the failure of the economy to expand as anticipated.

Your committee's bill will stimulate the economy both by improving the environment for investment and also by increasing consumer purchasing power.[6]

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[5] The Iron Age (June 21, 1962), pp. 136–137.
[6] House of Representatives Report No. 749, 88th Congress, 1st session, pp. 6–7.

On September 13, 1963, the tax bill, H.R. 8363, was favorably reported by the Committee on Ways and Means, and passed the House on September 25, 1963. (President Kennedy was assassinated on November 22, 1963.) The Senate Committee on Finance reported the bill on January 28, 1964, and the Senate passed it February 7. After a conference report was overwhelmingly passed by both houses, it was signed into law by President Johnson on February 26, 1964.

The President's bill had been extensively revised by the Congress. A long section of tax reforms and tax increases was almost entirely eliminated. Although the new tax law closely resembled the measure passed initially by the House, the Senate had made a few significant changes, such as deleting a provision for lower capital gains tax rates. However, the deep cuts in maximum rates originally proposed by the President emerged fairly intact. The top personal tax rate was to be cut from 91 percent to 70 percent, and the highest corporate rate reduced from 52 percent to 48 percent. A schedule of the personal rate cuts appears in Table 9.

TABLE 9

Taxable income for single person	Taxable income for married couples	In percent: Existing law	In percent: January 1963 proposal	Rates in H.R. 8363: 1964	Rates in H.R. 8363: 1965
$0 to $500	$0 to $1,000	20	14	16.0	14
$500 to $1,000	$1,000 to $2,000	20	14	16.5	15
$1,000 to $1,500	$2,000 to $3,000	20	16	17.5	16
$1,500 to $2,000	$3,000 to $4,000	20	16	18.0	17
$2,000 to $4,000	$4,000 to $8,000	22	18	20.0	19
$4,000 to $6,000	$8,000 to $12,000	26	21	23.5	22
$6,000 to $8,000	$12,000 to $16,000	30	24	27.0	25
$8,000 to $10,000	$16,000 to $20,000	34	27	30.5	28
$10,000 to $12,000	$20,000 to $24,000	38	30	34.0	32
$12,000 to $14,000	$24,000 to $28,000	43	34	37.5	36
$14,000 to $16,000	$28,000 to $32,000	47	37	41.0	39
$16,000 to $18,000	$32,000 to $36,000	50	40	44.5	42
$18,000 to $20,000	$36,000 to $40,000	53	42	47.5	45
$20,000 to $22,000	$40,000 to $44,000	56	45	50.5	48
$22,000 to $26,000	$44,000 to $52,000	59	47	53.5	50
$26,000 to $32,000	$52,000 to $64,000	62	50	56.0	53
$32,000 to $38,000	$64,000 to $76,000	65	52	58.5	55
$38,000 to $44,000	$76,000 to $88,000	69	55	61.0	58
$44,000 to $50,000	$88,000 to $100,000	72	57	63.5	60
$50,000 to $60,000	$100,000 to $120,000	75	58	66.0	62
$60,000 to $70,000	$120,000 to $140,000	78	59	68.5	64
$70,000 to $80,000	$140,000 to $160,000	81	60	71.0	66
$80,000 to $90,000	$160,000 to $180,000	84	61	73.5	68
$90,000 to $100,000	$180,000 to $200,000	87	62	75.0	69
$100,000 to $150,000	$200,000 to $300,000	89	63	76.5	70
$150,000 to $200,000	$300,000 to $400,000	90	64	76.5	70
$200,000 and over	$400,000 and over	91	65	77.0	70

As can be seen in Table 9 and Table 10, the rate reductions were phased in over a two-year period: income years 1964 and 1965. Corporate income tax rates were pared in the following manner:

TABLE 10.—CORPORATION TAX REDUCTION

	Rates: Under existing law	Under H.R. 8363: 1964	Under H.R. 8363: 1965	Percentage change from existing law: 1964	Percentage change from existing law: 1965
Normal tax rate	30	22	22	−26.67	−26.27
Surtax rate	22	28	26	+27.27	+18.18
Combined rate	52	50	48	−3.85	−7.69

Effects of the Kennedy Program

What are the consequences of personal income tax reductions? It will be recalled that congressional supporters of the tax bill subscribed to the theory that rate reductions would soon stimulate economic growth and thus eventually increase revenues, but some observers doubted virtually any incentive or feedback effect. By constructing highly conjectural estimates of what tax revenues might have been without the 1964–65 cut, it is possible to arrive at estimates of "'static revenue losses" resulting from the rate reductions. This is not the place to enter into a detailed examination of the circular logic often deployed in such analyses; suffice it to say that such speculative endeavors prove nothing not already implicit in their assumptions.

Instead, in reviewing the revenue effects of the 1964–65 cut we will examine what actually happened to tax returns and revenues. First of all, it is clear that the number of returns in all but the lowest two categories increased substantially, as indicated in Table 11 below:

TABLE 11.—TAXABLE INDIVIDUAL INCOME TAX RETURNS

[Figures in thousands; income years]

	1963	1964	1965	1966	Change 1963–66 (percent)
Adjusted gross income:					
$0 to $5	21,533	19,385	19,614	19,978	−7
$5 to $10	21,693	22,468	23,011	23,358	+8
$10 to $15	5,651	6,594	7,696	9,240	+63
$15 to $20	1,235	1,457	1,757	2,224	+80
$20 to $50	1,051	1,209	1,389	1,639	+56
$50 to $100	132	159	188	218	+65
$100 to $500	28	35	44	51	+82
$500 to $1,000	.8	1.1	1.4	1.5	+88
$1,000 plus	.35	.46	.62	.63	+80
Total	51,323	51,306	53,701	56,709	+10

Source: IRS, Statistics of Income, 1963, 1964, 1965, 1966—Individual Income Tax Returns.

As with the earlier Mellon reforms, the number of increased returns were especially pronounced at the higher income levels. The 21-percentage point decrease in the top rate also reduced the attractiveness of tax sheltered vehicles for wealthy investors.

More significant still is the increase in taxes paid after the rate reductions. Many lower income taxpayers benefited greatly by the division of the bottom bracket into four brackets and by the liberal minimum standard deduction established by the 1964 Revenue Act. Tax revenues from the other income classes rose substantially between 1963 and 1966, especially from the upper income classes. Revenues in the top four income classes jumped between 45 percent and 80 percent. As indicated in Table 12, gains in the other classes, save the lowest two, made it unlikely that the act cost the Treasury significant revenues, even in the short run.

TABLE 12.—FEDERAL INCOME TAX REVENUE

[In millions of current dollars; income years]

	1963	1964	1965	1966	Change, 1963-66 (percent)
Adjusted gross income class (thousands):					
$0 to $5	$5,911	$4,668	$4,337	$4,427	−25
$5 to $10	17,305	15,944	15,434	16,240	−6
$10 to $15	9,430	9,972	10,712	12,981	+38
$15 to $20	3,497	3,709	4,189	5,296	+51
$20 to $50	6,681	6,882	7,440	8,691	+30
$50 to $100	2,920	3,204	3,654	4,229	+45
$100 to $500	1,890	2,220	2,752	3,176	+68
$500 to $1,000	243	306	408	457	+88
$1,000 plus	327	427	603	590	+80
Total	48,204	47,153	49,530	56,087	+16
Maximum marginal income tax rate (percent).	91	77	70	70	

Source: Internal Revenue Service, Statistics of Income—1963, 1964, 1965, 1966, Individual Income Tax Returns.

In fact, when testifying before the Joint Economic Committee in 1977, Walter Heller made a convincing case that the cuts "paid for themselves." In response to a question about the economic effects of the rate reduction, Heller said:

Needless to say, Senator Javits, when you talk about the tax cut of 1964, in which I have a certain paternal interest, you have to watch me pretty carefully.

Therefore, I should probably rely on the evidence that others have adduced. Arthur Okun made a detailed analysis of the impact of 1964's tax cut on the economy and in turn, of course, therefore, on revenues.

I guess if ever there was a policy measure that came out of the textbooks and, in effect, went back in in terms of confirming exactly what we had projected for it, that one comes about as close as any.

What happened to the tax cut in 1965 is difficult to pin down but insofar as we are able to isolate it, it did seem to have a tremendously stimulative effect, a multiplied effect on the economy. It was the major factor that led to our running a $3 billion surplus by the middle of 1965 before escalation in Vietnam struck us. It was a $12 billion tax cut which would be about $33 or $34 billion in today's terms and within 1 year the revenues into the Federal Treasury were already above what they had been before the tax cut.

What obscured the effect of it was the outbreak of escalation in Vietnam that superimposed on a program targeted for full employment about $20 to $30 billion of Vietnam expenditures that knocked everything valley west.

Did it pay for itself in increased revenues? I think the evidence is very strong that it did.[7]

Later, with admirable frankness, Heller analyzed the policy alternatives of tax reduction versus more public spending, stating that this question:

. . . gets into value preferences, not into economics, because you have different ways of doing this in terms of economics.

I think my value preferences show through pretty clearly. I would in this case—getting out of economics and into social preferences—prefer to have more in terms of those desperately need [sic] public-sector programs than in handing something back to the taxpayers permanently.[8]

Arthur Okun's views,[9] cited approvingly by Walter Heller above, also merit examination. He establishes a direct relationship between

[7] Congress of the United States. *The 1977 Economic Report of the President: Hearings before the Joint Economic Committee,* 95th Congress, 1st session (Washington: U.S. Government Printing Office, 1977), p. 161.

[8] *Ibid.*

[9] Arthur M. Okun, "Measuring the Impact of the 1964 Tax Reduction," in Walter Heller, ed. *Perspectives on Economic Growth* (New York: Random House, 1968), pp. 27–49.

the tax cuts and subsequent robust economic growth. After the act went into effect, Okun points out that the unemployment rate declined a full percentage point from about 5½–6 percent by the middle of 1965. In this period consumer spending and tax revenues rebounded while productivity growth rose and labor costs decreased. In the meantime, inflation as measured by the GNP price deflator was almost imperceptible, crawling at an annual rate of about 1¾ percent.

The reason for considering the appraisals of Heller and Okun is, of course, that both were intimately involved in the conception and implementation of the 1964–65 rate cuts, and naturally kept themselves informed of the results. Their analyses posted a direct causal relationship between the rate cuts and subsequent positive economic trends. It is most significant that both attributed improvements in employment, production, investment, and tax revenues to the sweeping rate cuts. It will be recalled that Heller's remarks on the positive revenue feedback effects were made in 1977.

Another view is provided by Lawrence Klein's *Econometric Analysis of the Tax Cut of 1964*,[10] published in 1969. Based on models of the Brookings Institution and the Wharton School forecasting unit, Klein estimated that the first installment of the tax cut increased GNP about $13 billion by year-end 1964 with unemployment declining between 0.5 percent (Brookings) and 0.8 percent (Wharton). Moreover, Klein's study projected only modest revenue losses. Unfortunately, this analysis is confined wholly to 1964. Though indicating slightly less response than Okun's paper, this study demonstrates that real growth and employment did increase significantly as a result of the 1964 tax cut.

One could argue that the econometric estimates discussed here are somewhat flawed by the Keynesian behavioral assumptions incorporated into the models.[11] Interestingly, after the first wave of publicity about the Kemp-Roth bill, subsequent Keynesian studies of the Kennedy tax cuts become more and more pessimistic.[12] Although conceding revenue feedbacks of 25 to 75 percent, these studies have generally reported minimal positive economic consequences, and even show some negative ones not previously identified.

Let us return briefly to the revenue question. Wilbur Mills, another public figure intimately involved with the 1964 Revenue Act, has been quoted lamenting that "Treasury wouldn't give us credit for the revenue gains." Although the Treasury estimated that the 1962–64 tax legislation would result in revenue losses of $89 billion over a six-year period starting in 1963, revenue actually increased $54 billion during this time. Furthermore, as indicated by the following item, deficits incurred between 1964 and 1966 were quite small, primarily because of strong revenue growth.

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[10] Lawrence Klein, "Econometric Analysis of the Tax Cut of 1964," in James Duesenberry, et al., eds., The Brookings Model: Some Further Results (Chicago: Rand NcNally & Co., 1969), pp. 459–472.

[11] For recent criticism of the Keynesian foundations of macroeconometric forecasting models, see Michael Evans, "The Bankruptcy of Keynesian Econometric Models," Challenge (January/February 1980), pp. 13–19; idem, "Confessions of an Economic Forecaster," New York Times (February 17, 1980); Robert E. Lucas, "Econometric Policy Evaluation: A Critique," in Karl Brunner and Allan Meltzer, eds., The Phillips Curve and Labor Markets (New York: North-Holland Publishing Co., 1976), pp. 19–46; Robert E. Lucas and Thomas J. Sargent, "After Keynesian Macroeconomics," Federal Reserve Bank of Minneapolis Quarterly Review (Spring 1979), pp. 1–16; and Congress of the United States, Forecasting the Supply Side of the Economy: Hearing before the Joint Economic Committee, 96th Congress, 2d session (Washington: U.S. Government Printing Office, 1980).

[12] Donald W. Kiefer, A Review of the Research on the Economic Effects of the 1964 Tax Cut, the 1968 Sørtax, and the 1975 Tax Cut (Washington: Congressional Research Service, 1980), pp. 12–22.

TABLE 13

[In millions]

	Receipts	Outlays	Deficit
Fiscal year:			
1964	$112,662	$118,584	−$5,922
1965	116,833	118,430	−1,596
1966	130,856	134,652	−3,796

Source: Economic Report of the President, 1981.

In any case, the views of Mills, Heller and others indicate that the possibility of tax cuts generating revenues or "paying for themselves" over time is quite reasonable, and is consistent with the revenue statistics.

The evidence also strongly supports the view that the rate cuts led to the strong recovery that began in 1964. For example, unemployment eventually dropped about 33 percent, from 5.7 percent in 1963 to 3.8 percent in 1966. The rise in the amount of personal saving was even more dramatic, doubling in just 4 years. Table 14 below also shows that after the 1968 imposition of the income tax surcharge, the percentage of disposable income saved plummeted.

TABLE 14

Year	Amount of personal saving (in billions)	Saving as a percentage of personal disposable income
1963	$21.9	5.4
1964	29.6	6.7
1965	33.7	7.1
1966	36.0	7.0
1967	44.3	8.1
1968	41.9	7.1
1969	40.6	6.4

Source: Economic Report of the President, 1981.

Moreover, the ratio of real investment to GNP jumped from 9.0 percent to 11.0 percent between 1963 and 1966, while the after-tax rate of return on stockholders' equity jumped from 6.4 percent to 9.1 percent.[13] Meanwhile, real GNP growth far outstripped its long-term trend rate of 3.6 percent. As indicated in Table 15 below, other economic indicators also registered marked improvement.

TABLE 15.—ECONOMIC INDICATORS, 1963–66

	Real GNP		GNP deflator, percent change	Productivity percent increase	Unemployment rate percent	Nonresidential fixed investment	
	Billions	Percent increase				Billions	Percent change
1963	$830.7	4.0	1.5	3.8	5.7	$73.5	3.6
1964	874.4	5.3	1.6	4.0	5.2	81.0	10.2
1965	925.9	5.9	2.2	3.8	4.5	95.6	18.0
1966	981.0	5.9	3.3	3.2	3.8	106.1	10.5

Source: Economic Report of the President, 1979.

[13] Economic Report of the President, 1981, (Washington: U.S. Government Printing Office, 1981), p. 331.

The boom in investment and business activity is also reflected in the indexes of industrial production. Total industrial production, for instance, jumped from 76.5 in 1963 to 100 in 1967. As indicated in Table 16, increases in manufacturing, mining, utilities, materials, equipment, intermediate products, and other items were also substantial.

TABLE 16.—INDUSTRIAL PRODUCTION INDEXES, MAJOR INDUSTRY DIVISIONS, 1963–67

[1967=100; monthly data seasonally adjusted]

Year	Total industrial production	Manufacturing			Mining	Utilities
		Total	Durable	Nondurable		
1963	76.5	75.8	73.1	80.0	86.4	77.0
1964	81.7	81.0	78.3	85.2	89.9	83.6
1965	89.8	89.7	89.0	90.9	93.2	88.7
1966	97.8	97.9	98.9	96.7	98.2	95.5
1967	100.0	100.0	100.0	100.0	100.0	100.0

As we have seen, the Kennedy tax cuts, like those of the Mellon period, facilitated increased saving, investment, production, employment, and ultimately, tax revenues. In both cases deep across-the-board tax cuts were prescribed as the cure for recession, and in both instances the anticipated recovery followed. The positive results of the Kennedy tax cuts demonstrate that Mellon's policy is still valid in modern times. By slashing marginal rates government can unleash strong economic forces capable of generating economic recovery, with minimal short-term revenue loss.