Would a 70% Top Tax Bracket Increase Government Revenue?

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"The inherent vice of capitalism is the unequal sharing of blessings; the inherent virtue of socialism is the equal sharing of miseries."

- Winston Churchill -

In respose to former Labor Secretary Robert Reich's recent proposal that the tax rate on the rich be raised to 70% the Cato Institute's Alan Reynolds writing for the The Wall Street Journal shows that higher tax rates don't always mean more government revenue:

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

* Capital gains tax was reduced from 28% to 20% in 1997 and a new 10% bracket was added in 2001.
1987 is omitted because the 1986 Tax Reform was phased-in, and surtax years of 1969-70 are also excluded.
Sources: U.S. budget historical data

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.

I know I’ve castigated others for questioning the motives of their opponents instead of addressing the substance of their arguments, but it is hard for me to imagine that people on the left who propose confiscatory taxes on rich people do so *only* because they want to reduce deficits and stimulate jobs. If history has taught us anything, it has taught us that at least a partial motive for the left’s fanatical desire to increase the top tax rates is to reduce the gap between the wealthy and the middle-class.

Why don’t they just come out and say what they believe: The rich have too much damn money and, by golly, that’s not fair.