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Dueling Thoughts On Marginal Tax Rates

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The never ending debate about whether low marginal tax rates are good or evil rages on. Generally, I tend to get a bad case of glazed eyes whenever I delve into this morass, probably due to trying to discern the truth behind the statistical obfuscation employed by most who opine on the subject.

A case in point is offered here. It involves a post at the Atlantic by Derek Thompson who liberally quotes from an article by Bruce Bartlett. Those two strain to prove that tax cuts are deleterious to the collection of money by the federal government. On the other side of the coin is an article by Alan Reynolds of the Cato Institute which argues quite a contrary position.

Let's look first at Bartlett who does his level best to demonstrate that lowering tax rates costs us money (that's the royal us as in the government, not the plebeian us as in you and me, the saps who pay the money).

> In point of fact, this assertion is completely untrue. Federal revenues were $599.3 billion in fiscal year 1981 and were $991.1 billion in fiscal year 1989. That's an increase of just 65 percent. But of course a lot of that represented inflation. If 1981 revenues had only risen by the rate of inflation, they would have been $798 billion by 1989. Thus the real revenue increase was just 24 percent. However, the population also grew. Looking at real revenues per capita, we see that they rose from $3,470 in 1981 to $4,006 in 1989, an increase of just 15 percent. Finally, it is important to remember that Ronald Reagan raised taxes 11 times, increasing revenues by $133 billion per year as of 1988 – about a third of the nominal revenue increase during Reagan's presidency.
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> The fact is that the only metric that really matters is revenues as a share of the gross domestic product. By this measure, total federal revenues fell from 19.6 percent of GDP in 1981 to 18.4 percent of GDP by 1989. This suggests that revenues were $66 billion lower in 1989 as a result of Reagan's policies.

Bartlett is in high dudgeon because Tim Pawlenty suggested that when Reagan cut taxes revenues increased by almost 100% in the decade of the '80s. If you want to send a liberal up the wall just throw the Reagan tax cuts at them and suggest that they helped spur economic growth.

Now before we get to Reynolds' piece, note that Bartlett is talking total revenues. No insult to your intelligence intended, but total revenues are a far different thing from individual income tax revenues. Why do I mention that? Well, that's the segment that Reynolds zeros in on.

His piece isn't devoted to a defense of Pawlenty (in fact I suspect he wrote it before Pawlenty sounded off) but rather it's a rebuttal to the current rage among Progressives to really jack marginal individual tax rates to, oh say around 70%. At the risk of over-simplyfying, he posits that historically there is little difference in the feds take regardless of the number of the size or number of marginal tax rates. Here is a bit of what he has to say:

> 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.
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> 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.
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> 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.
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> 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.

He thoughtfully includes this chart:

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

Now I don’t know if tax cuts will or won’t pay for themselves. I think Pawlenty was probably doing what politicians do well – talking through his hat – but Bartlett has a real mishmash of an article which conflates numbers to prove a point. Reynolds on the other hand seems to at least present a cogent argument that the level of marginal tax rates on individual incomes is of little importance. Historically, the government gets a certain amount of vig no matter how hard it tries to extort more. I suppose there is some cold comfort in that fact.