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THE NIXON, FORD, AND CARTER ERA TAX POLICIES

Introduction

This paper estimates the effect of the Nixon, Ford, and Carter era tax policies on the U.S. economy and the federal budget. It seeks to explain why the tax cuts during the 1969-1980 period had a mixed record in improving the performance of the economy, and how the tax system interacted with inflation to undermine the growth of investment and wages.

The study utilizes a model driven by the impact of marginal tax rate changes on incentives to work, save, and invest. This approach can distinguish tax changes that make it more rewarding to produce goods and services from tax changes that merely "throw money from the top of the Washington Monument". The incentives approach is consistent with how labor and capital markets and the production process operate in the real world. It is also consistent with the analytical methods taught in business schools to the people who decide how much and what type of capital to create.

This is in contrast to Keynesian models which focus mainly on the dollar amount of a tax change, under the erroneous assumption that taxes affect the economy by altering disposable income and "aggregate demand", and that the form of the tax and its impact on the supplies of labor, capital, and output are irrelevant. In practice, initial Keynesian demand effects of a tax change are offset by changes in federal borrowing or spending, leaving only the incentive effects of the tax change, if any, to alter behavior.

A more complete description of the model and the economics behind at can be found in the appendix to the first paper in this series, The Economic Effects of the Kennedy and Johnson Tax Policies.[1]

[1] See Stephen J. Entin, "Economic Consequences Of The Tax Policies Of The Kennedy And Johnson Administrations," *IRET Policy Bulletin*, No. 99, September 6, 2011, available at http://iret.org/pub/BLTN-99.PDF.

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The Nixon/Ford/Carter Era Economy

Over the twelve years from 1969 through 1980, there were three recessions. From cycle to cycle, there was an upward drift in the unemployment rate and inflation rate, and an upward trend to interest rates as inflation rose. (Chart 1.) Real wages, incomes, and GDP grew over the period, but more slowly than in the Eisenhower, Kennedy, and Johnson years. It was the era of increasing economic "malaise".

President Richard Nixon took office in January, 1969. By the late 1960s, Congress and the President were faced with financing the ongoing Vietnam War, the Great Society program, and recently-enacted Medicare. Deficits and inflation were rising. In 1968, the Congress and President Johnson had enacted a temporary 10 percent income tax surcharge for 1968 and 1969. The Federal Reserve was fighting the increase in the rate of inflation by tightening credit and slowing the growth of the money supply. A recession began in December of 1969 and bottomed out in November of 1970, marking the end of the economic expansion triggered by the Kennedy tax cuts.

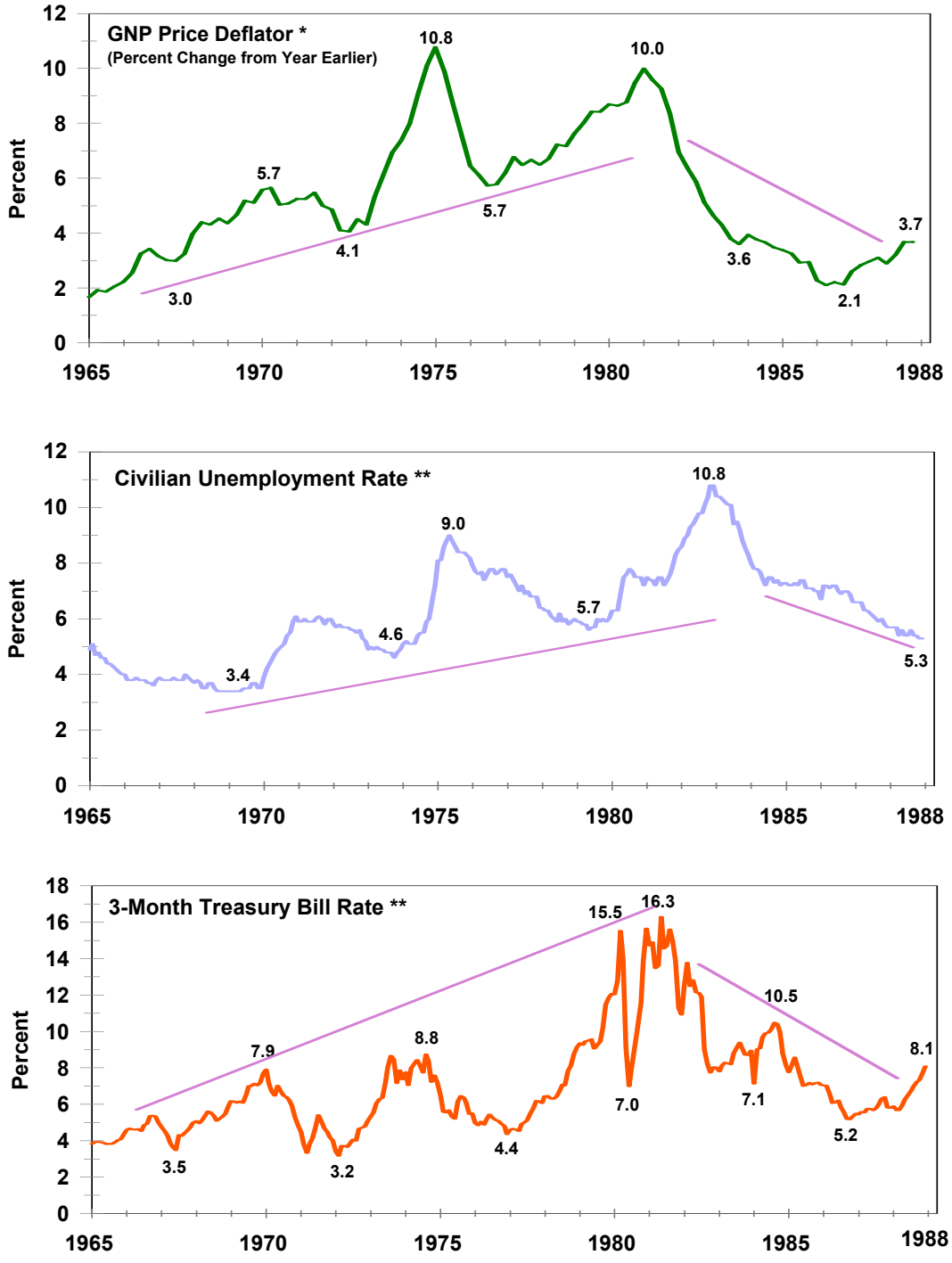
In response to the recession, the Federal Reserve allowed double digit increases in the supply of money and credit in 1971-72. The Nixon Administration devalued the dollar and severed the link between the dollar and gold, freeing the Federal Reserve to continue monetary easing. Monetarist economists warned that excessive money creation would reinvigorate inflation.

To counter the inflation, and forestall the Federal Reserve from tightening monetary policy, the Administration proposed and Congress enacted a program of wage and price controls. It began with a ninety day wage and price freeze on August 15, 1971, followed by four "phases" with varying degrees of price adjustment through early 1984. Milton Friedman described the exercise of letting the money supply grow too fast while trying to impose a price freeze as trying to contain a pot that is boiling over by putting on the lid and turning up the heat.

The price control program led to serious economic complications and labor unrest. When the price controls were phased out, the full extent of the inflation became apparent. The cheapened dollar contributed to the formation of OPEC and the rise in world oil prices in the mid-1970s (the first "oil shock"). Inflation jumped to double digits in 1974. President Nixon resigned on August 8, 1974 as a result of the Watergate scandal.

Vice President Gerald Ford assumed the presidency upon Nixon's resignation. Ford attacked inflationary psychology with his "WIN" program (Whip Inflation Now), but his jawboning was no barrier to money-driven price hikes. Ford rejected an early attempt to adjust the tax code for inflation in 1976. Rising tax rates due to inflation and belated Federal Reserve efforts in 1973 and 1974 to rein in the inflation with tighter money contributed to the 1974-1975 recession and to President Ford's election defeat to Georgia Governor Jimmy Carter.

Chart 1 Inflation, Unemployment, and Interest Rates



* Quarterly data from 1965-I to 1988-IV.

* *Monthly data from January 1965 to December 1988.

The Carter Administration had some success in removing regulatory obstacles to competition and growth in the transportation sector, but it did less well in tax and spending policy. Renewed monetary expansion re-accelerated inflation. By 1979 and 1980, inflation was again in double digits. The falling value of the dollar contributed to a second "oil shock". A brief but sharp recession occurred in 1980, following President Carter's plea for people to stop using their credit cards to reduce excess "demand" in the economy.

Investment generally grew during the Carter years, but not enough to keep pace with a rapidly growing work force as the baby boomers reached working age in large numbers, and as more women participated in the labor force. Productivity and real wage growth sagged toward the end of the 1970s.

Stop-go monetary policy, lack of spending restraint, and haphazard tax changes that did not fully counter the effects of inflation on the tax system all contributed to the economic problems of the 1970s. By mid-decade, it had become apparent that inflation was harmful to production and employment because it raised tax rates on additional capital formation and hiring. This insight led to the development of newer views of how monetary and fiscal policy work and how they could be used to create steady, non-inflationary growth.

Among these new ideas was a focus on the price effects of taxation, that is, on how reductions in marginal income tax rates, and faster cost recovery rules, could lift incentives to work, save, and create capital. A second insight was that the Federal Reserve should focus on maintaining price stability, rather than accelerating growth of the money supply to stimulate the economy. Restraint of government spending and elimination of excessive regulation rounded out the new view of an ideal policy mix.

Taxes and Inflation

Throughout the 1970s, wages struggled to keep pace with inflation. Many workers received automatic cost of living increases. Other workers relied on periodic contract negotiations for wage hikes. Although many wages and salaries were adjusted for inflation, the tax code was not automatically adjusted, or indexed, for inflation. Higher nominal wages and salaries pushed taxpayers into higher income tax brackets, even without an increase in real purchasing power. Every ten percent rise in wages and prices tended to raise federal income taxes by roughly fifteen or sixteen percent. The excess five or six percent tax increase was a rise in real, inflation-adjusted revenue, rewarding Washington for letting inflation continue.

Average tax rates were held down to some extent by several legislated increases in personal exemptions and standard deductions, but after-tax wages suffered nonetheless as taxes rose as a share of income. Marginal tax rates increased over time in spite of the periodic tax reductions. The dollar amounts of taxable income at which each of the graduated marginal tax take effect were not automatically adjusted for inflation as they are today. Higher wages drove millions of taxpayers into

higher tax brackets, raising the marginal tax rates on labor and capital income, leading to reduced incentives to work, save, and invest.

Marginal tax rates, not average tax rates, determine what is left to the worker or saver after tax on an added dollar of wages and investment income. Work and saving decisions are seldom all-or-nothing. The choice is usually between incremental work or leisure, or between incremental saving or consumption, "at the margin". Rising marginal tax rates were depressing the supply of labor and capital. These factors were omitted from the prevailing Keynesian view of economics, which looked at the "income effect" of tax cuts on disposable income rather than on the "price effect" on the choices between work and leisure or investment versus consumption.

Inflation raised taxes on saving and investment in other ways. Capital gains due to inflation were taxed as if they were real gains. Any given set of capital consumption allowances (depreciation deductions) for purchases of plant and equipment and commercial and residential real estate lost value to inflation, understating business costs and overstating taxable business income. The result was an increase in effective marginal tax rates on business investment, and less capital formation. In some years, capital gains and business income were so severely overstated due to inflation that individuals and firms were paying taxes on nominal gains and profits that were actually real losses. As inflation rose, capital had to earn a higher pre-tax return (service price) to break even after taxes, depressing the desired capital stock and reducing productivity and wage growth.

Neither the Ford nor the Carter Administration was able to keep a tight rein on federal spending, and budget deficits were a constant worry. Both Administrations relied on "bracket creep" and taxation of inflated profits for additional tax revenue. Neither Administration was supportive of several bills offered in the Congress to index the income tax brackets and exemptions for inflation. Tax indexing was not enacted until 1981 under President Reagan.

Not all of the tax changes of the decade were ineffective. Depreciation reform by the Treasury in 1971, various increases in the investment tax credit, a corporate tax rate reduction and a large reduction in the top tax rate on capital gains in 1978, and some minor cuts in marginal tax rates in the Nixon and Carter years were beneficial. They eventually countered the effect of inflation on the service price of capital over the decade, although not by enough to keep investment growing in line with the working population. Individuals fared less well. By the end of the decade, marginal tax rates on wages, dividends, non-corporate business income, and interest were all higher than at the start. (See Table 1.)

Modeling the Consequences of the Nixon, Ford, and Carter Tax Changes

This section of the study simulates the tax changes of the Nixon, Ford, and Carter years using a simple model of the U.S. economy. The presentation is in four parts. Part one briefly discusses the model and some essential patterns to watch for in the results. Parts two through four describe the

Table 1
Marginal Tax Rates and Service Prices

	1968	1974	1976	1980
Weighted Average Service Price				
Corporate	15.71%	11.46%	12.64%	11.06%
Noncorporate	10.71%	9.91%	10.71%	8.36%
All business	13.89%	10.92%	11.97%	10.09%
Weighted Federal Marginal Tax Rates				
Federal Marginal Tax Rates on AGI	24.52%	26.06%	27.44%	31.32%
Federal Marginal Tax Rates on Wages	22.86%	24.48%	26.39%	30.01%
Federal Marginal Tax Rates on Dividends	38.67%	38.76%	39.58%	45.14%
Federal Marginal Tax Rates on Interest Income	24.55%	26.85%	26.89%	31.97%
Federal Marginal Tax Rates on Business Income	33.17%	34.68%	34.93%	38.15%
Federal Marginal Tax Rates on Long-term Capital Gains	12.91%	14.73%	19.76%	17.45%

Source: Calculated by author using model.

economic growth and federal budget consequences of the tax programs under the three Administrations.

Modeling methods and what to watch for in the results

What drives the model. The study takes a neo-classical view of the economy, in which decisions about work, saving, and capital formation are driven by the after-tax rewards "at the margin" for incremental amounts of these activities. Marginal tax rates and the rules that determine what income is considered taxable, such as depreciation allowances and the inclusion rate of long term capital gains alter the choices between capital formation and consumption, and between labor and leisure.

The service price of capital is the pre-tax rate of return to capital required to cover depreciation, inflation, risk, and taxes and leave an acceptable real after-tax return – about 3 percent – for the investor. A lower service price raises the equilibrium capital stock, GDP, and labor income. A higher service price does the opposite. Taxes on capital income are part of the service price. Determining if proposed tax legislation would lower or increase the service price of capital is a quick way to tell if it would strengthen or weaken the economy (absent other provisions that drastically affect labor incentives). A larger capital stock increases worker productivity and the demand for labor, driving up wages and employment.

Workers are assumed to increase labor force participation and hours worked as marginal tax rates on wages fall and after-tax wages rise; they reduce the labor supply as marginal tax rates on labor rise and after-tax earnings fall. Changes in the labor supply and the capital stock due to the initial tax changes alter production and income. The changes in income in turn raise or lower marginal tax rates and the service prices, producing further income adjustments until a new equilibrium is achieved.[2]

Presenting the results. The results tables display the effect of the tax changes being studied on GDP, private business sector output, labor and capital income, and the private business capital stock (plant, equipment, buildings, inventory). The tables also display the levels and changes in marginal individual income tax rates on AGI (adjusted gross income), wages and salaries, dividends, interest, non-corporate business income, and long term capital gains. These marginal rates are the end product of the initial tax changes and the feedback on the rates from the dynamic economic reactions. They show the new tax rate structure that is supporting the new economic equilibrium.

The dynamic changes in the service price of capital are shown for the private business sector as a whole, and for the corporate sector and the non-corporate sector. Depreciation changes and the ITC affect both sectors. Personal income tax changes affect non-corporate business income and the non-corporate service price. The corporate service price is affected by the corporate tax rate and by personal income tax changes on capital gains and dividends.

There is a lively debate as to whether tax cuts can expand the economy and taxable income by enough to bring in more, rather than less, federal revenue. That is, do they pay for themselves from the perspective of the federal budget? The real benefit to the nation from lower tax rates is higher income for the population, not an inflow of revenue to Washington. Nonetheless, the state of the federal budget and the ability to pay for federal spending programs is of concern. Therefore, the tables include the impact of the tax policy changes on the federal government budget.

The static revenue effect of the tax change is shown first (measured at the income levels in the baseline, before any economic adjustments). The dynamic revenue feedback due to subsequent changes in GDP and incomes, and the net post-adjustment revenue effects, come next. Changes in federal outlays due to changes in market wages and federal labor costs complete the budget impact calculation. The last lines of the tables compare the changes in federal revenues with the changes in GDP (pre-tax income) and after-tax incomes of the public. This is done to emphasize the total cost to the taxpayer of raising a dollar of revenue to pay for a dollar of government spending. A dollar of federal spending costs the taxpayer the dollar of tax plus the resulting loss of GDP and income. Whatever the government is spending the money on should be worth that larger amount. If not, the public is better off without it. These ratios also indicate the effectiveness of the various types of tax changes in promoting or destroying GDP and jobs.

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[2] The tax calculator and a historical tax rate parameter spreadsheet have been made available by Gary Robbins of the Data Analysis Center of the Heritage Foundation, who has also assisted with modeling advice.

Key patterns. In this and other papers of the series, the model results reveal that:

- Tax cuts that increase GDP recover a portion of their apparent static revenue cost. Tax increases that reduce GDP do not raise their full estimated static revenue. Tax cuts are not as expensive, and tax increases are not as rewarding to the government on a dynamic basis as the static numbers indicate.

- Some types of tax changes - those that apply at the margin - have much more effect on GDP than others, and their dynamic revenue reflow can be quite large. They create more growth per dollar of net tax cut, or destroy more GDP per dollar of net tax increase.

- The tax treatment of capital is especially important, because capital formation responds more sharply to tax changes than does the supply of labor. Changes in capital taxation have a greater effect on GDP, income, and employment, and generate greater revenue feedback, than changes in taxation of wages.

- Most tax changes have a moderate effect on GDP, but a few types of tax changes can have so strong an effect on income that their dynamic revenue reflow exceeds the static revenue change. That is, a particularly pro-growth tax cut can raise revenue and "pay for itself" in a federal budget sense, or a particularly damaging tax increase can lose revenue and defeat its purpose. In such cases it costs the government nothing to raise GDP and people's incomes by cutting the tax.

- Even when a tax cut does not pay for itself in the federal budget sense via major revenue reflows, it is often a very good deal for the taxpayer. In many cases, the change in GDP is significantly greater than the net tax reduction. The public has to give up a small amount of government spending to pay for a tax cut that raises after-tax income by a much larger amount, and increases total employment.

The Nixon Years

Elements of the Nixon tax changes.

The Nixon era tax changes were slightly pro-growth in and of themselves. Had they been enacted during a time of stable prices, without significant bracket creep, they would have had a small positive impact on the economy. There were two significant tax bills, the Tax Reform Act of 1969 and the Revenue Act of 1971. There was also a major overhaul of the capital consumption allowances (tax depreciation rules).

The Tax Reform Act of 1969 and the Revenue Act of 1971. The 1969 Act curbed several tax preferences for businesses and upper income taxpayers. It raised personal exemptions and the standard deductions in stages. The net effect was a sharp increase in the progressivity of the tax system. According to the Joint Tax Committee estimates, it was a net tax reduction in the long run of about $2.5 billion, consisting of $9.1 billion in tax relief for low income and single filers, offset by about

$6.6 billion in tax increases from ending the investment tax credit (ITC) and raising taxes on upper income investors.

- *Investment Tax Credit.* The 1969 Act briefly repealed the investment tax credit (ITC) for equipment (introduced by Kennedy in 1962), but the Tax Act of 1971 reinstated it and added a smaller ITC for structures.

- *Surtax.* The 1969 Act extended the Johnson individual and corporate 10% income tax surtax, originally set to expire at the end of 1969, through the first quarter of 1970 (effectively, an annualized 2.5% surtax on 1970 income), after which the surtax was allowed to lapse.

- *Personal exemptions.* The 1969 Act increased the personal exemption to $600 in 1969, to $625 in 1970, and called for further increases to $750 in later years. The 1971 Act accelerated these scheduled increases to $675 in 1971 and to $750 in 1972.

- *Standard deduction.* Prior to the 1969 Act, the ordinary standard deduction (or low income allowance) was 10% of adjusted gross income (AGI) up to a maximum deduction of $1,000. A minimum deduction was allowed equal to $200 per return plus $100 for each personal exemption. The 1969 Act raised the minimum to a flat $1,000 for 1969 and 1970 (equal to the maximum). The 1969 Act provided for future increases in the percentage standard deduction and the maximum deduction. The 1971 Act accelerated the increases in the standard deduction scheduled in the 1969 Act. The percentage standard deduction was 13% in 1970 with a maximum of $1,500 and a minimum of $1,050. In 1971, the percentage deduction was 15% of AGI, a maximum of $2,000, and a minimum of $1,300.

- *Long term capital gains.* Prior to the 1969 Act, 50 percent of an individual's long term capital gains were excluded from tax, resulting in marginal tax rates half as large as on ordinary income. There was also an alternative maximum tax rate of 25 percent on long term capital gains, which limited the capital gains tax rate for taxpayers in tax brackets over 50 percent. For example, a taxpayer in the 70 percent tax bracket might ordinarily have owed 35 percent tax on incremental long term gains, but the alternative tax held the tax to 25 percent. The 1969 Act limited the alternative 25 percent maximum tax to the first $50,000 of long term gains, raising the tax rate on gains in excess of that amount on high-bracket tax returns to as much as 35 percent. The increase was phased in over three years: 29.5 percent in 1970, 32.5 percent in 1971, and 35 percent in 1972 (exclusive of the Johnson 10 percent surtax). The excluded portion of capital gains became a preference item in the minimum tax (see the following paragraph). The corporate alternative capital gains rate was raised from 25 percent to 28 percent in 1970 and to 30 percent in 1972.

- *Minimum tax.* The 1969 Act created a minimum tax for businesses and individuals. The minimum tax was in addition to the ordinary income tax. For individuals, the rate was set at 10% with an exempt amount equal to the sum of $30,000 plus the taxpayer's ordinary income tax. It was imposed on "preference items" deducted from ordinary taxable income, primarily the excluded half

of long term capital gains. Other preferences subject to the minimum tax included investment interest in excess of investment income, various types of accelerated depreciation and amortization, tax benefits from stock options, bad debt deductions of financial institutions, depletion, and the bad debt reserves of financial institutions. Taxing the excluded portion of capital gains as a preference item did most of the economic damage from the minimum tax provision. It raised the top tax rate on long term capital gains from 35 percent to 36.5 percent.[3]

- *Lower rates for singe filers.* The 1969 Act introduced a new tax rate schedule for single filers, with a general reduction in marginal tax rates in middle income tax brackets. The lowest and very highest rates were not reduced. (See Table 2.) The objective was to narrow the tax gap between single workers and married workers. Single workers paid much higher income taxes than married workers earning the same income. Lower rates at a given income for married workers had long been allowed on the theory that they share income with their spouses. In a one-worker couple, or in a couple where the primary earner is paid much more than the secondary worker, the average income per person is less than that of the single worker.[4]

Table 2 Tax Rate Reductions for Single Filers in the 1971 Tax Act

For taxable income between $4,000 and $44,000, the act lowered marginal rates by 1 to 10 percentage points.

Previous Law Single		1971 Tax Act Single	
Brackets	Rates	Brackets	Rates
0	14%	0	14%
500	15%	500	15%
1,000	16%	1,000	16%
1,500	17%	1,500	17%
2,000	19%	2,000	19%
4,000	22%	4,000	21%
6,000	25%	6,000	24%
8,000	28%	8,000	25%
10,000	32%	10,000	27%
12,000	36%	12,000	29%
14,000	39%	14,000	31%
16,000	42%	16,000	34%
18,000	45%	18,000	36%
20,000	48%	20,000	38%
22,000	50%	22,000	40%
26,000	53%	26,000	45%
32,000	55%	32,000	50%
38,000	58%	38,000	55%
44,000	60%	44,000	60%
50,000	62%	50,000	62%
60,000	64%	60,000	64%
70,000	66%	70,000	66%
80,000	68%	80,000	68%
90,000	69%	90,000	69%
100,000	70%	100,000	70%

[3] The minimum tax of 10 percent on the half of excluded gains raised the tax rate on capital gains by only 1.5 percentage points (not 5 percentage points) due to interactions between the additional ordinary tax on the gain and the exempt amount for the minimum tax.

[4] The concern over the difference in tax between married and single workers earning the same pay is the opposite of the marriage penalty tax concerns of a later era. Between the 1980s and 2000s, as more women entered the workforce at higher levels of compensation than in previous decades, there were many more married couples with two-earners in which the spouses earned relatively similar salaries (each earning perhaps 40% to 60% of the family income). Their combined incomes put them into a higher marginal tax rate bracket than either would face alone as single individuals. Therefore, they paid higher combined taxes than two single workers with similar incomes. This marriage penalty was reduced in the 2001 tax act. In a graduated tax rate system, it is

- *50% tax rate cap on "earned income".* The 1969 Act reduced the top tax rate on wage and salary income (so-called "earned income") to 50%. The existing tax rates above 50% (54%, 58%, 62%, 68%, and 70%) remained in effect for income from saving and non-corporate businesses.

- *Excises.* The 1971 Act repealed the 7 percent automobile excise tax.

Depreciation reform. In 1971, the Treasury, on its own authority, reformed the asset lives classification for the purposes of determining the deprecation of investment. This led to the creation of the ADR system (Asset Depreciation Range) in place of the Guidelines that had been in place since 1962. Asset lives were significantly reduced in keeping with evidence that assets were becoming economically obsolete faster than previous write-off arrangements allowed for. This shift to a more favorable depreciation schedule raised the value of the capital consumption allowances, and lowered the service price of capital. The write-offs for the cost of the capital investments were still below the full cost of the investments in present value. That is, they did not equal expensing (immediate write-off of the full cost). Nonetheless, they gave a significant boost to capital formation at any given rate of inflation.

Economic and Budget Consequences of Nixon Tax Changes.

The following tables display the estimated long run equilibrium changes in the economy and the federal budget due to the Nixon business and individual tax changes. The model simulation is based on a sample of tax returns and the national income and federal budget levels of 1972, when all the tax changes were fully in place. These provide the baseline for the comparison.

Each table displays estimates of the difference between the baseline economy and one in which the Nixon tax changes had never occurred (that is, had pre-1969 tax law continued in force), after allowing time for all economic adjustments.

The Nixon tax package as a whole. Results for the entire Nixon tax package are shown in Table 3. The effects of the business changes (the ITC and depreciation reform) and the individual tax changes (which also impact non-corporate businesses) are then shown separately. (The excise tax repeal was not modeled.)

The Nixon tax rate and depreciation changes are estimated to have lifted long run equilibrium GDP by 1 percent, or $12.6 billion at 1972 income levels. Private business sector output, wages, and hours worked are estimated to be 1.1 percent higher. The equilibrium stock of private business capital would have been 2.2 percent higher, or $46.7 billion. (Private sector business output excludes general

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mathematically impossible to correct both types of discrepancies, that between single workers and one-earner couples, and that between two-earner couples and two single workers.

Table 3
NIXON - TAX PACKAGE AS A WHOLE (BUSINESS AND INDIVIDUAL)
Nixon vs. pre-Nixon Law, at 1969 Income Levels

	Nixon	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,237.9	$1,225.3	$12.6	1.0%
Private business output (less indirect taxes plus subsidies)	$869.4	$859.6	$9.8	1.1%
Compensation of employees	$596.8	$590.1	$6.7	1.1%
Gross capital income	$272.6	$269.5	$3.1	1.1%
Private Business Stocks	$2,171.1	$2,124.5	$46.7	2.2%
Wage rate $/hr	$4.96	$4.94	$0.02	0.4%
Private business hours of work (billions)	120.257	119.414	0.843	0.7%
Total government receipts ($billions)	$353.8	$363.8	-$10.0	-2.7%
Federal	$225.7	$237.3	-$11.6	-4.9%
State & local	$165.7	$164.1	$1.6	1.0%
Total Federal expenditures	$246.4	$246.0	$0.4	0.2%
Federal surplus (+) or deficit (-)	-$20.7	-$8.7	-$12.1	139.1%
Individual income tax				
Federal marginal tax rates on AGI	23.9%	25.1%	-1.2%	-4.8%
Federal marginal tax rates on wages	22.6%	23.8%	-1.2%	-5.0%
Federal marginal tax rates on dividends	34.9%	36.1%	-1.2%	-3.4%
Federal marginal tax rates on interest income	24.0%	25.6%	-1.6%	-6.3%
Federal marginal tax rates on business income	31.1%	32.2%	-1.0%	-3.2%
Federal marginal tax rates on long-term capital gains	15.6%	13.4%	2.2%	16.6%
Weighted average service price				
Corporate	13.9%	14.0%	-0.1%	-0.8%
Noncorporate	11.1%	11.3%	-0.2%	-1.6%
All business	12.9%	13.0%	-0.1%	-1.0%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$15.3	100%
"Dynamic" federal tax reflow from economic changes			$3.7	-24%
Net federal tax change after dynamic effects			-$11.6	76%
Federal outlay change if federal pay tracks private wages			$0.4	-3%
Change in federal surplus (- is larger deficit, smaller surplus)			-$12.1	79%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$12.6	$0.82	$1.08
Rise in after-tax income, total, and per $1 reduction in federal revenue		$24.2	$1.58	$2.08
Revenue loss to government from tax cut that raises after-tax income $1.			$0.63	$0.48

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

government, government enterprises, and the household and institution sectors. The private business sector is more sensitive to tax changes than the other sectors.)

Marginal tax rates on most types of income fell by roughly 3.2 to 6.3 percent. However, the minimum tax and capital gains changes increased the marginal tax rates on long term capital gains significantly. The capital gains tax increases offset some of the benefits of the faster depreciation allowances and the ITC. The net effect was a small reduction in the service price of capital, giving a small lift to capital formation. The drop in the service price was larger in the non-corporate sector than the corporate sector where it was more heavily affected by the rise in the tax rate on capital gains.

The Nixon tax cuts modestly improved the economy, and were of some benefit to the population. GDP is shown to be a percent higher long term than without the tax changes. However, the revenue reflow due solely to the higher GDP was certainly not big enough to repay the Treasury.

In static terms, the tax provisions modeled here would have cost an estimated $15.3 billion, assuming no change in the economy. The modest $12.6 billion increase in GDP returned $3.7 billion to the Treasury due to increased incomes, a scant 24 percent revenue reflow, leaving a net tax cut of $11.6 billion.

The rise in GDP of $12.6 billion was only $1.08 for each dollar of dynamic revenue loss. After-tax income rose $2.08 for each dollar that revenue fell. These are weak results. The Kennedy tax cuts returned about twice as much of their static tax cost through increases in income.[5]

The stronger economy would have affected federal outlays slightly. For the whole package, the higher wages after the tax cuts would add another $0.4 billion to the cost of federal workers and federal investment costs, for a total rise in the deficit of $12.1 billion. The rise in GDP was barely larger than the rise in the federal deficit.

The GDP responded weakly to the Nixon-era tax changes because the pieces of the tax changes were not uniform in their effects on the economy. Some cuts were strongly pro-growth with large increases in GDP per dollar of revenue loss, and some may even have recovered their full static cost. Other reductions were far less effective. At least one tax increase almost certainly lost more revenue than it raised after taking account of its toll on GDP. These are considered separately, below.

The Nixon business tax changes (Table 4). Table 4 shows results for the Nixon business tax cuts. Table 5 shows the combined effect of the individual tax changes. The totals for the parts may not exactly match the results for the total package due to interactions when they are implemented together.

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[5] See Stephen J. Entin, "Economic Consequences Of The Tax Policies Of The Kennedy And Johnson Administrations," *op. cit*.

TABLE 4
NIXON - BUSINESS TAX CHANGES (DEPRECIATION & ITC)
Nixon vs. pre-Nixon Law, at 1969 Income Levels

	Nixon	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,237.9	$1,229.0	$8.9	0.7%
Private business output (less indirect taxes plus subsidies)	$869.4	$862.9	$6.5	0.8%
Compensation of employees	$596.8	$592.3	$4.5	0.8%
Gross capital income	$272.6	$270.5	$2.0	0.8%
Private Business Stocks	$2,171.1	$2,123.9	$47.3	2.2%
Wage rate $/hr	$4.96	$4.93	$0.03	0.6%
Private business hours of work (billions)	120.257	120.091	0.166	0.1%
Total government receipts ($billions)	$353.8	$352.2	$1.6	0.5%
Federal	$225.7	$225.3	$0.4	0.2%
State & local	$165.7	$164.5	$1.3	0.8%
Total Federal expenditures	$246.4	$245.9	$0.5	0.2%
Federal surplus (+) or deficit (-)	-$20.7	-$20.6	-$0.1	0.4%
Individual income tax				
Federal marginal tax rates on AGI	23.9%	23.8%	0.1%	0.4%
Federal marginal tax rates on wages	22.6%	22.5%	0.1%	0.4%
Federal marginal tax rates on dividends	34.9%	34.7%	0.1%	0.4%
Federal marginal tax rates on interest income	24.0%	23.9%	0.1%	0.4%
Federal marginal tax rates on business income	31.1%	31.0%	0.1%	0.4%
Federal marginal tax rates on long-term capital gains	15.6%	15.6%	0.0%	0.1%
Weighted average service price				
Corporate	13.9%	14.1%	-0.3%	-1.8%
Noncorporate	11.1%	11.2%	-0.1%	-0.6%
All business	12.9%	13.1%	-0.2%	-1.4%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$1.6	100%
"Dynamic" federal tax reflow from economic changes			$2.0	-124%
Net federal tax change after dynamic effects			$0.4	-24%
Federal outlay change if federal pay tracks private wages			$0.5	-29%
Change in federal surplus (- is larger deficit, smaller surplus)			-$0.1	5%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$8.9	$5.46	-$22.82
Rise in after-tax income, total, and per $1 reduction in federal revenue		$8.5	$5.22	-$21.82
Revenue loss to government from tax cut that raises after-tax income $1.			$0.19	-$0.05

* Notes: This tax reduction raises revenue by raising GDP sharply. Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +). Dynamic revenue reflows due to the changes in GDP usually offset some but not all of static tax change. If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

About 55 percent, or $8.9 billion, of the total growth in GDP from the Nixon-era tax changes was due to the business portions of the tax cuts. These included the accelerated depreciation rules and the enhanced ITC. A bit more than half of the business-induced growth came from the acceleration of the depreciation write-offs; just under half came from the expanded ITC (not shown separately).

The business cuts were responsible for about 62 percent of the increase in the capital stock. They raised total labor compensation (pre-tax) by twice as much (.8%) as the individual income tax cuts (.4%). In some cases, tax cuts on capital formation can do more to increase the incomes of the work force than tax cuts on wages. The business cuts raised productivity and the demand for labor, and had relatively more effect on the pre-tax wage rate than on hours worked, compared to the individual cuts, which raised after-tax wages without upward pressure on pre-tax wages. After-tax incomes rose by more than these pre-tax amounts indicate.

The Nixon business cuts alone were simulated to recover 124%, or $2 billion, of their $1.6 billion static revenue loss, for a net revenue increase of $0.4 billion. (See Table 3.) An ITC and faster depreciation have powerful effects on the service price of capital, on capital formation, and on GDP and incomes per dollar of static revenue loss. GDP rose by $5.46 for each dollar of static revenue cost ($8.9 billion versus $1.6 billion). On a dynamic basis, GDP rose $22.82 for every additional dollar of revenue raised, indicating a significant rise in after-tax income. This is a dramatic example of growing revenue by growing the tax base by cutting tax barriers to investment.

The Nixon individual tax changes (Table 5). The model runs simulated the Nixon changes to the personal exemptions, standard deductions, EITC, minimum tax and capital gains, singles relief, and 50 percent tax rate cap on wage income. These individual tax changes were the bulk of the total tax package in static cost, about $13.7 billion, but they boosted GDP by less than the business cuts, only $3.8 billion (0.3 percent), or about 45 percent of the total package.

The model estimates that the individual cuts recovered only 8% of their static revenue loss. GDP and after-tax income would have risen only $0.32 and $1.32, respectively, for each dollar of net dynamic revenue loss to the government.

The weak individual results are due in large part to the rise in the tax on capital gains under the minimum tax and the removal of the 25 percent maximum tax on large gains, which offset much of the reduction in the cost of capital in the corporate sector from the faster depreciation write-offs without raising significant revenue. The other source of weakness was the high tax cost of raising exemptions and the standard deduction for a relatively small reduction in marginal tax rates and the service price of capital.

The several elements of the individual tax changes had very different consequences for the economy.

TABLE 5
NIXON - INDIVIDUAL
Nixon vs. pre-Nixon Law, at 1969 Income Levels

	Nixon	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,237.9	$1,234.0	$3.8	0.3%
Private business output (less indirect taxes plus subsidies)	$869.4	$866.0	$3.3	0.4%
Compensation of employees	$596.8	$594.5	$2.3	0.4%
Gross capital income	$272.6	$271.5	$1.0	0.4%
Private Business Stocks	$2,171.1	$2,171.5	-$0.3	0.0%
Wage rate $/hr	$4.96	$4.97	-$0.01	-0.2%
Private business hours of work (billions)	120.257	119.574	0.683	0.6%
Total government receipts ($billions)	$353.8	$365.5	-$11.7	-3.2%
Federal	$225.7	$237.7	-$12.1	-5.1%
State & local	$165.7	$165.3	$0.4	0.2%
Total Federal expenditures	$246.4	$246.4	$0.0	0.0%
Federal surplus (+) or deficit (-)	-$20.7	-$8.7	-$12.0	138.4%
Individual income tax				
Federal marginal tax rates on AGI	23.9%	25.2%	-1.3%	-5.2%
Federal marginal tax rates on wages	22.6%	23.9%	-1.3%	-5.4%
Federal marginal tax rates on dividends	34.9%	36.2%	-1.4%	-3.8%
Federal marginal tax rates on interest income	24.0%	25.8%	-1.7%	-6.7%
Federal marginal tax rates on business income	31.1%	32.3%	-1.1%	-3.5%
Federal marginal tax rates on long-term capital gains	15.6%	13.4%	2.2%	16.4%
Weighted average service price				
Corporate	13.9%	13.7%	0.1%	1.1%
Noncorporate	11.1%	11.3%	-0.1%	-1.0%
All business	12.9%	12.8%	0.1%	0.4%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$13.7	100%
"Dynamic" federal tax reflow from economic changes			$1.6	-12%
Net federal tax change after dynamic effects			-$12.1	88%
Federal outlay change if federal pay tracks private wages			$0.0	0%
Change in federal surplus (- is larger deficit, smaller surplus)			-$12.0	88%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$3.8	$0.28	$0.32
Rise in after-tax income, total, and per $1 reduction in federal revenue		$15.9	$1.16	$1.32
Revenue loss to government from tax cut that raises after-tax income $1.			$0.86	$0.76

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

- *The increases in the standard deductions and personal exemptions (Table 6)* lifted GDP by about $7.3 billion. They lowered marginal tax rates on various types of income by between 1.1% and 4.5%, but did so by taking up 80% of the static cost of the tax cut. They cost $12.5 billion in static terms, and returned only $1.8 billion or 15% of their static cost by raising GDP. They increased GDP by less than $0.60 for each dollar of static revenue cost.

- *The imposition of the minimum tax and other capital gains changes (Table 7)* raised the tax rate at the margin on capital gains by nearly 19% and reduced GDP by about $7.2 billion. That nearly wiped out the GDP increase due to the personal exemption and standard deduction increases. The minimum tax in our sample would have raised a trivial $0.2 billion from the rich in static terms, but the drop in GDP reduced other tax revenue by about $1.6 billion (677% of the projected $0.2 billion static gain), for a net revenue loss of about $1.4 billion. GDP fell $5.26 for each dollar of dynamic revenue loss to the government. The minimum tax appears to have "paid for itself" on the downside (losing more revenue than it was assumed to bring in) nearly seven times over.[6]

- *The tax rate relief for singles (Table 8)* lowered marginal tax rates on various types of income by roughly 1% to 2%, and raised GDP by about $3 billion, or by $4 for each dollar of static revenue cost. These marginal tax rate reductions are calculated to have returned 96% of their projected $0.7 billion cost. The rate cuts lowered the service price of capital by reducing taxes on dividends, capital gains, and non-corporate business income.

- *The 50% tax rate cap on earned income (Table 9)* affected a small number of filers and a small amount of income at the margin. It lifted GDP by about $0.6 billion, or by $1.04 for each dollar of static revenue loss. The 50% cap cost about $0.54 billion in static terms and returned about $0.15 billion in revenue from a higher GDP, a dynamic reflow of about 27%. The reflow on the wage tax cap was less in percentage terms than the reflow from the reduction in tax rates for singles, because the latter also reduced tax rates on business and capital income, which are more responsive to tax changes than wages and salaries.

The Ford-Era Tax Changes

The Ford Administration and the Congress did little of consequence in the tax field. Almost nothing was done to directly offset the impact of inflation on marginal tax rates. Other than the ITC increase and the prospective easing of estate taxes, there was nothing else to encourage work, hiring, or production, and therefore no lift to economic activity from fiscal policy.

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[6] The changes to the capital gains maximum tax rate cap and the minimum tax changes regarding capital gains were highly interactive, very complex, and difficult to model, especially with a small sample of high income tax returns. They are approximated in the model by a combined marginal rate increase that was less than the full effect to give a conservative estimate of the impact.

TABLE 6
NIXON - STANDARD DEDUCTION AND PERSONAL EXEMPTION
Nixon vs. pre-Nixon Law, at 1969 Income Levels

	Nixon	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,237.9	$1,230.6	$7.3	0.6%
Private business output (less indirect taxes plus subsidies)	$869.4	$863.7	$5.7	0.7%
Compensation of employees	$596.8	$592.9	$3.9	0.7%
Gross capital income	$272.6	$270.8	$1.8	0.7%
Private Business Stocks	$2,171.1	$2,146.3	$24.8	1.2%
Wage rate $/hr	$4.96	$4.95	$0.01	0.2%
Private business hours of work (billions)	120.257	119.703	0.554	0.5%
Total government receipts ($billions)	$353.8	$363.6	-$9.7	-2.7%
Federal	$225.7	$236.4	-$10.7	-4.5%
State & local	$165.7	$164.7	$1.0	0.6%
Total Federal expenditures	$246.4	$246.2	$0.2	0.1%
Federal surplus (+) or deficit (-)	-$20.7	-$9.8	-$10.9	111.7%
Individual income tax				
Federal marginal tax rates on AGI	23.9%	24.9%	-0.9%	-3.7%
Federal marginal tax rates on wages	22.6%	23.5%	-0.9%	-4.0%
Federal marginal tax rates on dividends	34.9%	35.4%	-0.6%	-1.6%
Federal marginal tax rates on interest income	24.0%	25.1%	-1.1%	-4.5%
Federal marginal tax rates on business income	31.1%	32.0%	-0.8%	-2.6%
Federal marginal tax rates on long-term capital gains	15.6%	15.8%	-0.2%	-1.1%
Weighted average service price				
Corporate	13.9%	13.9%	-0.1%	-0.4%
Noncorporate	11.1%	11.2%	-0.1%	-0.7%
All business	12.9%	13.0%	-0.1%	-0.5%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$12.5	100%
"Dynamic" federal tax reflow from economic changes			$1.8	-15%
Net federal tax change after dynamic effects			-$10.7	85%
Federal outlay change if federal pay tracks private wages			$0.2	-2%
Change in federal surplus (- is larger deficit, smaller surplus)			-$10.9	87%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$7.3	$0.58	$0.68
Rise in after-tax income, total, and per $1 reduction in federal revenue		$18.0	$1.44	$1.68
Revenue loss to government from tax cut that raises after-tax income $1.			$0.70	$0.60

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 7
NIXON - INDIVIDUAL MINIMUM TAX
Nixon vs. pre-Nixon Law, at 1969 Income Levels

	Nixon	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,237.9	$1,245.0	-$7.2	-0.6%
Private business output (less indirect taxes plus subsidies)	$869.4	$874.6	-$5.2	-0.6%
Compensation of employees	$596.8	$600.4	-$3.6	-0.6%
Gross capital income	$272.6	$274.2	-$1.6	-0.6%
Private Business Stocks	$2,171.1	$2,210.0	-$38.8	-1.8%
Wage rate $/hr	$4.96	$4.99	-$0.02	-0.5%
Private business hours of work (billions)	120.257	120.382	-0.125	-0.1%
Total government receipts ($billions)	$353.8	$356.3	-$2.5	-0.7%
Federal	$225.7	$227.0	-$1.4	-0.6%
State & local	$165.7	$166.8	-$1.1	-0.7%
Total Federal expenditures	$246.4	$246.8	-$0.4	-0.2%
Federal surplus (+) or deficit (-)	-$20.7	-$19.8	-$1.0	4.9%
Individual income tax				
Federal marginal tax rates on AGI	23.9%	24.0%	-0.1%	-0.4%
Federal marginal tax rates on wages	22.6%	22.7%	-0.1%	-0.4%
Federal marginal tax rates on dividends	34.9%	35.0%	-0.1%	-0.3%
Federal marginal tax rates on interest income	24.0%	24.1%	-0.1%	-0.4%
Federal marginal tax rates on business income	31.1%	31.3%	-0.1%	-0.5%
Federal marginal tax rates on long-term capital gains	15.6%	13.2%	2.5%	18.8%
Weighted average service price				
Corporate	13.9%	13.6%	0.2%	1.8%
Noncorporate	11.1%	11.2%	0.0%	-0.1%
All business	12.9%	12.7%	0.2%	1.2%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			$0.2	100%
"Dynamic" federal tax reflow from economic changes			-$1.6	-677%
Net federal tax change after dynamic effects			-$1.4	-577%
Federal outlay change if federal pay tracks private wages			-$0.4	-163%
Change in federal surplus (- is larger deficit, smaller surplus)			-$1.0	-414%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Drop in GDP, total, and per $1 increase in federal revenue		-$7.2	-$30.34	$5.26
Drop in after-tax income, total, and per $1 increase in federal revenue		-$5.8	-$24.57	$4.26
Revenue gain to government from tax hike that cuts after-tax income $1.			$0.04	-$0.24

* Notes: This tax increase reduces revenue by reducing GDP sharply. Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +). Dynamic revenue reflows due to the changes in GDP usually offset some but not all of static tax change. If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 8
NIXON - TAX RELIEF FOR SINGLES
Nixon vs. pre-Nixon Law, at 1969 Income Levels

	Nixon	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,237.9	$1,234.9	$3.0	0.2%
Private business output (less indirect taxes plus subsidies)	$869.4	$867.1	$2.3	0.3%
Compensation of employees	$596.8	$595.2	$1.6	0.3%
Gross capital income	$272.6	$271.8	$0.7	0.3%
Private Business Stocks	$2,171.1	$2,158.8	$12.4	0.6%
Wage rate $/hr	$4.96	$4.96	$0.01	0.1%
Private business hours of work (billions)	120.257	120.092	0.165	0.1%
Total government receipts ($billions)	$353.8	$353.4	$0.4	0.1%
Federal	$225.7	$225.7	$0.0	0.0%
State & local	$165.7	$165.3	$0.4	0.3%
Total Federal expenditures	$246.4	$246.3	$0.1	0.0%
Federal surplus (+) or deficit (-)	-$20.7	-$20.6	-$0.1	0.7%
Individual income tax				
Federal marginal tax rates on AGI	23.9%	24.2%	-0.3%	-1.1%
Federal marginal tax rates on wages	22.6%	22.8%	-0.2%	-1.0%
Federal marginal tax rates on dividends	34.9%	35.6%	-0.7%	-2.0%
Federal marginal tax rates on interest income	24.0%	24.5%	-0.5%	-2.1%
Federal marginal tax rates on business income	31.1%	31.3%	-0.2%	-0.6%
Federal marginal tax rates on long-term capital gains	15.6%	15.7%	-0.1%	-0.6%
Weighted average service price				
Corporate	13.9%	13.9%	-0.1%	-0.4%
Noncorporate	11.1%	11.2%	0.0%	-0.2%
All business	12.9%	12.9%	0.0%	-0.3%

Federal budget effects*			% of static
Revenues		$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)		-$0.7	100%
"Dynamic" federal tax reflow from economic changes		$0.7	-96%
Net federal tax change after dynamic effects		$0.0	4%
Federal outlay change if federal pay tracks private wages		$0.1	-16%
Change in federal surplus (- is larger deficit, smaller surplus)		-$0.1	20%

Comparing change in GDP to change in tax revenue*	GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue	$3.0	$4.10	$99.66
Rise in after-tax income, total, and per $1 reduction in federal revenue	$3.0	$4.14	$100.66
Revenue loss to government from tax cut that raises after-tax income $1.		$0.24	$0.01

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 9
NIXON - 50% WAGE CAP ON EARNED INCOME
Nixon vs. pre-Nixon Law, at 1969 Income Levels

	Nixon	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,237.9	$1,237.3	0.6	0.0%
Private business output (less indirect taxes plus subsidies)	$869.4	$868.9	0.5	0.1%
Compensation of employees	$596.8	$596.5	0.3	0.1%
Gross capital income	$272.6	$272.4	0.1	0.1%
Private Business Stocks	$2,171.1	$2,170.2	0.9	0.0%
Wage rate $/hr	$4.96	$4.96	0.0	0.0%
Private business hours of work (billions)	120.257	120.187	0.1	0.1%
Total government receipts ($billions)	$353.8	$353.6	0.2	0.1%
Federal	$225.7	$225.5	0.1	0.1%
State & local	$165.7	$165.6	0.1	0.0%
Total Federal expenditures	$246.4	$246.4	0.0	0.0%
Federal surplus (+) or deficit (-)	-$20.7	-$20.9	0.1	-0.7%
Individual income tax				
Federal marginal tax rates on AGI	23.9%	23.9%	0.0%	0.0%
Federal marginal tax rates on wages	22.6%	22.6%	0.0%	0.0%
Federal marginal tax rates on dividends	34.9%	34.8%	0.0%	0.0%
Federal marginal tax rates on interest income	24.0%	24.0%	0.0%	0.0%
Federal marginal tax rates on business income	31.1%	31.1%	0.0%	0.0%
Federal marginal tax rates on long-term capital gains	15.6%	15.6%	0.0%	0.0%
Weighted average service price				
Corporate	13.9%	13.9%	0.0%	0.0%
Noncorporate	11.1%	11.1%	0.0%	0.0%
All business	12.9%	12.9%	0.0%	0.0%

Federal budget effects*			% of static
Revenues		$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)		-$0.5	100%
"Dynamic" federal tax reflow from economic changes		$0.7	-127%
Net federal tax change after dynamic effects		$0.1	-27%
Federal outlay change if federal pay tracks private wages		$0.0	-1%
Change in federal surplus (- is larger deficit, smaller surplus)		$0.1	-25%

Comparing change in GDP to change in tax revenue*	GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue	$0.6	$1.04	-$3.92
Rise in after-tax income, total, and per $1 reduction in federal revenue	$0.4	$0.78	-$2.92
Revenue loss to government from tax cut that raises after-tax income $1.		$1.28	-$0.34

* Notes: This tax cut raises revenue by raising GDP sharply. Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +). Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change. If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

Elements of the Tax Reduction Act of 1975 and Tax Reform Act of 1976

- *ITC.* The 1975 Act increased the investment tax credit (ITC) from 7% to 10% through 1976. The 1976 Act extended the increase in the ITC through 1980.

- *Retroactive rebate and general tax credit.* The 1975 Act allowed a 10 percent tax rebate on 1974 tax liability, with a minimum of $100 and a maximum of $200. The rebate was limited by the amount of tax liability (it was non-refundable). It was phased out for incomes between $29,000 and $30,000. The 1975 Act also created a "general tax credit" of a flat $30 for each taxpayer, spouse, and dependent. These retroactive tax rebates for 1974 and lump sum credits for 1975 had no measurable effect on marginal tax rates on additional earnings in 1975, and thus had no effect on incentives to produce goods and services.

The 1976 Act extended the general tax credit as the greater of $35 per taxpayer, spouse, and dependents (without limit), or 2 percent of the first $9,000 in income (limit $180). The 2 percent credit had the effect of slightly lowering marginal tax rates by 2 percent of the rate in the lowest tax brackets, e.g., from 20 percent to 19.6 percent. Its economic effects were negligible.

- *Standard deduction.* The 1975 Act increased the minimum standard deduction temporarily (1975 only) to $1,900 for joint filers, and to $1,600 for single filers and heads of households. The percentage standard deduction was increased to 16% of AGI with a maximum of $2,600 for joint filers and $2,300 for single and head of household filers (also for tax year 1975 only).

The 1976 Act permanently increased the percentage standard deduction to 16 percent and raised the maximum to $2,800 for joint filers and $2,400 for single filers and heads of households. It increased the minimum standard deduction to $2,100 for joint filers and $1,700 for single filers and heads of households.

- *EITC.* The 1975 Tax Act introduced the earned income tax credit (EITC) for taxpayers with children. The credit was ten percent of the first $4,000 of a taxpayer's wages, and was phased out at a ten percent rate as income exceeded $4,000. It created an incentive to accept work for those not in the labor force and for workers earning less than $4,000. It created a disincentive to work and save for people in the phase-out range of the credit, from $4,000 to $8,000. Taken as a whole, the credit increased marginal tax rates on an income weighted basis.

- *Minimum Tax.* The 1976 Act substantially expanded the individual Minimum Tax by increasing the rate from 10% to 15% and reducing the exempt amount from the sum of $30,000 plus the ordinary

income tax to either $10,000 or half the ordinary income tax, whichever was larger. The major effect was to raise the maximum tax rate on long term capital gains from 36.5 percent to 39.875 percent.[7]

- *Long term capital gains holding period.* The 1976 Act increased the required holding period for long term capital gains from six months to one year.

- *Estate tax changes.* The 1976 Act substantially revised the estate and gift taxes. The highest rates were reduced from 77% to 70%. The previous exempt amounts for each tax were replaced with a unified credit, which was worth more to small estates than the earlier exemptions, and sheltered more estates from tax. However, estates in excess of $10 million might experience a net tax increase from the switch to the credit. The Act also repealed step-up in basis at death, replacing it with the carry-over basis of the decedent. This change was to be phased-in, affecting gains beyond the effective date of the bill. (The shift to carry-over basis was deferred in the 1978 Act and later repealed.) Tax return data indicate that, at least for the short run, the changes reduced the tax on capital. Estate tax collections are sensitive to who died in which year, and what their assets were. We note the apparent effects on capital formation and growth separately from the other tax changes.

Economic and Budget Consequences of the Ford Tax Changes.

The Ford-era tax changes were modeled as of 1976 income levels. The results compare GDP and other income and tax variables under the new tax regime to levels that would have existed under old law, assuming the economy had fully adapted to the new incentive structure.

The Ford-era income tax changes (Table 10). The personal tax changes and the increase in the ITC are estimated to have raised equilibrium GDP by 0.6%, or nearly $11 billion at 1976 income levels, and raised labor income by a similar 0.6%. Private business stocks of plant, equipment, structures, and inventory were 1.7% higher, about $60 billion. The package lowered the service price of capital by 1.1% (0.7% for the corporate sector, 1.9% for the non-corporate sector). Marginal tax rates for most types of income were reduced by the tax changes, with the exception of long term capital gains, on which the rate was driven up by the minimum tax and the cap on the 25% alternative tax.

GDP rose by a scant $1.18 for each dollar of static tax reduction, and returned only 27% of the static cost in revenue reflow from additional GDP. Nonetheless, on a dynamic after-tax basis, the public gained a dollar for each $0.38 loss in revenue by the government.

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[7] In 1976, the 15 percent minimum tax rate on the half of capital gains excluded from ordinary tax treatment added 4.875 percentage points to the ordinary 35 percent maximum tax rate on gains (not 7.5 points) due to interactions of the added ordinary capital gains tax with the exempt amount under the minimum tax.

TABLE 10
FORD: PERSONAL CHANGES AND ITC
Ford vs. pre-Ford Law, at 1976 Income Levels

	Ford	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,824.6	$1,813.8	$10.8	0.6%
Private business output (less indirect taxes plus subsidies)	$1,293.0	$1,285.0	$8.0	0.6%
Compensation of employees	$871.7	$866.3	$5.4	0.6%
Gross capital income	$421.2	$418.6	$2.6	0.6%
Private Business Stocks	$3,607.9	$3,547.5	$60.4	1.7%
Wage rate $/hr	$7.00	$6.96	$0.03	0.5%
Private business hours of work (billions)	124.592	124.415	0.177	0.1%
Total government receipts ($billions)	$513.2	$518.3	-$5.2	-1.0%
Federal	$328.6	$335.3	-$6.7	-2.0%
State & local	$245.7	$244.2	$1.5	0.6%
Total Federal expenditures	$387.0	$386.5	$0.5	0.1%
Federal surplus (+) or deficit (-)	-$58.4	-$51.2	-$7.2	14.1%
Individual income tax				
Federal marginal tax rates on AGI	27.9%	28.1%	-0.2%	-0.8%
Federal marginal tax rates on wages	26.5%	26.6%	0.0%	0.0%
Federal marginal tax rates on dividends	41.4%	41.5%	0.0%	0.0%
Federal marginal tax rates on interest income	28.0%	28.2%	-0.3%	-1.0%
Federal marginal tax rates on business income	35.5%	35.7%	-0.2%	-0.4%
Federal marginal tax rates on long-term capital gains	23.0%	19.5%	3.4%	17.5%
Weighted average service price				
Corporate	12.6%	12.7%	-0.1%	-0.7%
Noncorporate	10.7%	10.9%	-0.2%	-1.9%
All business	12.0%	12.1%	-0.1%	-1.1%
Federal budget effects*				
Revenues			$ Billions	% of static tax change
"Static" federal revenue gain (+) or loss (-)			-$9.1	100%
"Dynamic" federal tax reflow from economic changes			$2.5	-27%
Net federal tax change after dynamic effects			-$6.7	73%
Federal outlay change if federal pay tracks private wages			$0.5	-6%
Change in federal surplus (- is larger deficit, smaller surplus)			-$7.2	79%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$10.8	$1.18	$1.61
Rise in after-tax income, total, and per $1 reduction in federal revenue		$17.4	$1.91	$2.61
Revenue loss to government from tax cut that raises after-tax income $1.			$0.52	$0.38

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

Individual elements of the tax changes made the following contributions:

- *The ITC (Table 11)* increase by itself raised equilibrium GDP by 1.4%, or nearly $25 billion, lifted labor income by 1.4%, and boosted the private capital stock by 4.2%, or roughly $144 billion. The ITC increase cut the service price of capital by 2.6% (more in the relatively capital intensive corporate sector, less in the non-corporate sector). These amounts are greater than for the total set of tax changes, because the individual income tax changes raised the service price and were a net drag on output and capital formation.

The ITC increase would have recouped $5.5 billion from the higher GDP, converting a static cost of $4.0 billion into a net dynamic revenue gain of $1.5 billion, a reflow of 138% of the static cost. This is one type of tax change that fully covers its costs. GDP would have risen by nearly $25 dollars for each apparent $1 of static revenue loss. In dynamic terms, on an after tax basis, the government would have gained $0.07 in revenue for each $1 increase in after-tax income of the public.

- *The personal income tax changes as a group (Table 12)* would have reduced equilibrium GDP by 0.8%, or $14 billion at 1976 income levels, and lowered labor income by a similar 0.8%. They increased the service price of capital by 1.6% (a rise of 2.5% in the corporate sector, a decrease of 0.5% in the non-corporate sector), cutting the equilibrium capital stock by 2.4%, or $87 billion. Although individual tax revenues were reduced by the bill in static terms, the adverse incentive effects of the minimum tax and capital gains changes would have caused GDP to fall, not rise, adding to the revenue loss in dynamic terms.

- *The increase in the standard deduction by itself (Table 13)* would have raised GDP by 0.2%, or $3.5 billion, and raised labor income by a similar percent. The capital stock would have risen by a scant 0.4% due to a small reduction in the marginal tax rate on non-corporate business income and dividends. The revenue reflow from growth would have recouped only 20% of the static cost of the provision. Raising the standard deduction is an expensive and inefficient way to reduce marginal tax rates.

- *The EITC (Table 14)* is generally regarded as an incentive to work, but the model suggests it is counter-productive. It may induce some people who are not in the labor force to accept a low wage job. However, the phase-out of the credit places an additional effective tax on the added income in the phase-out range, discouraging additional work by the affected taxpayers. The net effect is calculated to be a slight reduction in hours worked. In the case of the 1975 Act, the model shows a reduction of 0.1% in GDP and pre-credit labor income.

- *The Minimum Tax changes (Table 15)* did the greatest damage to GDP of all the individual tax provisions. It reduced equilibrium GDP by 0.9%, or more than $16 billion at 1976 income levels. It trimmed labor income by a similar percent. The drop in GDP would have lowered income and marginal tax rates a bit, but the minimum tax clearly raised marginal tax rates on long term capital

TABLE 11
FORD - ITC
Ford vs. pre-Ford Law, at 1976 Income Levels

	Ford	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,824.6	$1,799.8	$24.8	1.4%
Private business output (less indirect taxes plus subsidies)	$1,293.0	$1,274.7	$18.3	1.4%
Compensation of employees	$871.7	$859.4	$12.3	1.4%
Gross capital income	$421.2	$415.3	$6.0	1.4%
Private Business Stocks	$3,607.9	$3,463.6	$144.3	4.2%
Wage rate $/hr	$7.00	$6.91	$0.08	1.2%
Private business hours of work (billions)	124.592	124.298	0.294	0.2%
Total government receipts ($billions)	$513.2	$508.1	$5.0	1.0%
Federal	$328.6	$327.0	$1.5	0.5%
State & local	$245.7	$242.2	$3.5	1.5%
Total Federal expenditures	$387.0	$385.7	$1.2	0.3%
Federal surplus (+) or deficit (-)	-$58.4	-$58.7	$0.3	-0.5%
Individual income tax				
Federal marginal tax rates on AGI	27.9%	27.6%	0.2%	0.9%
Federal marginal tax rates on wages	26.5%	26.3%	0.2%	0.9%
Federal marginal tax rates on dividends	41.4%	41.1%	0.3%	0.7%
Federal marginal tax rates on interest income	28.0%	27.7%	0.3%	0.9%
Federal marginal tax rates on business income	35.5%	35.3%	0.3%	0.8%
Federal marginal tax rates on long-term capital gains	23.0%	22.8%	0.1%	0.6%
Weighted average service price				
Corporate	12.6%	13.0%	-0.4%	-3.1%
Noncorporate	10.7%	10.9%	-0.2%	-1.5%
All business	12.0%	12.3%	-0.3%	-2.6%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$4.0	100%
"Dynamic" federal tax reflow from economic changes			$5.5	-138%
Net federal tax change after dynamic effects			$1.5	-38%
Federal outlay change if federal pay tracks private wages			$1.2	-31%
Change in federal surplus (- is larger deficit, smaller surplus)			$0.3	-7%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$24.8	$6.18	-$16.23
Rise in after-tax income, total, and per $1 reduction in federal revenue		$23.3	$5.80	-$15.23
Revenue loss to government from tax cut that raises after-tax income $1.			$0.17	-$0.07

* Notes: This tax reduction raises revenue by increasing GDP sharply. Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +). Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change. If the dynamic GDP response is very large, the revenue reflow may offset all of the static loss. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 12
FORD - PERSONAL TAX CHANGES AS A GROUP
Ford vs. pre-Ford Law, at 1976 Income Levels

	Ford	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,824.6	$1,838.7	-$14.1	-0.8%
Private business output (less indirect taxes plus subsidies)	$1,293.0	$1,303.3	-$10.3	-0.8%
Compensation of employees	$871.7	$878.7	-$7.0	-0.8%
Gross capital income	$421.2	$424.6	-$3.4	-0.8%
Private Business Stocks	$3,607.9	$3,694.9	-$87.0	-2.4%
Wage rate $/hr	$7.00	$7.05	-$0.05	-0.7%
Private business hours of work (billions)	124.592	124.702	-0.109	-0.1%
Total government receipts ($billions)	$513.2	$523.4	-$10.3	-2.0%
Federal	$328.6	$336.8	-$8.2	-2.4%
State & local	$245.7	$247.7	-$2.0	-0.8%
Total Federal expenditures	$387.0	$387.7	-$0.7	-0.2%
Federal surplus (+) or deficit (-)	-$58.4	-$50.9	-$7.5	14.7%
Individual income tax				
Federal marginal tax rates on AGI	27.9%	28.3%	-0.5%	-1.6%
Federal marginal tax rates on wages	26.5%	26.8%	-0.3%	-0.9%
Federal marginal tax rates on dividends	41.4%	41.8%	-0.3%	-0.8%
Federal marginal tax rates on interest income	28.0%	28.5%	-0.5%	-1.9%
Federal marginal tax rates on business income	35.5%	36.0%	-0.4%	-1.2%
Federal marginal tax rates on long-term capital gains	23.0%	19.6%	3.3%	16.9%
Weighted average service price				
Corporate	12.6%	12.3%	0.3%	2.5%
Noncorporate	10.7%	10.8%	0.0%	-0.5%
All business	12.0%	11.8%	0.2%	1.6%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$5.1	100%
"Dynamic" federal tax reflow from economic changes			-$3.1	60%
Net federal tax change after dynamic effects			-$8.2	160%
Federal outlay change if federal pay tracks private wages			-$0.7	14%
Change in federal surplus (- is larger deficit, smaller surplus)			-$7.5	146%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Drop in GDP, total, and per $1 increase in federal revenue		-$14.1	$2.75	$1.72
Drop in after-tax income, total, and per $1 increase in federal revenue		-$5.9	$1.15	$0.72
Revenue gain to government from tax hike that cuts after-tax income $1.			-$0.87	-$1.39

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 13
FORD - STANDARD DEDUCTION INCREASE
Ford vs. pre-Ford Law, at 1976 Income Levels

	Kennedy	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,824.6	$1,821.1	$3.5	0.2%
Private business output (less indirect taxes plus subsidies)	$1,293.0	$1,290.2	$2.8	0.2%
Compensation of employees	$871.7	$869.9	$1.9	0.2%
Gross capital income	$421.2	$420.3	$0.9	0.2%
Private Business Stocks	$3,607.9	$3,595.0	$12.9	0.4%
Wage rate $/hr	$7.00	$6.99	$0.00	0.1%
Private business hours of work (billions)	124.592	124.406	0.187	0.2%
Total government receipts ($billions)	$513.2	$516.3	-$3.1	-0.6%
Federal	$328.6	$332.1	-$3.6	-1.1%
State & local	$245.7	$245.2	$0.5	0.2%
Total Federal expenditures	$387.0	$386.9	$0.1	0.0%
Federal surplus (+) or deficit (-)	-$58.4	-$54.7	-$3.7	6.7%
Individual income tax				
Federal marginal tax rates on AGI	27.9%	28.1%	-0.3%	-1.0%
Federal marginal tax rates on wages	26.5%	26.8%	-0.3%	-1.1%
Federal marginal tax rates on dividends	41.4%	41.6%	-0.1%	-0.3%
Federal marginal tax rates on interest income	28.0%	28.3%	-0.4%	-1.3%
Federal marginal tax rates on business income	35.5%	35.8%	-0.2%	-0.6%
Federal marginal tax rates on long-term capital gains	23.0%	23.0%	-0.1%	-0.3%
Weighted average service price				
Corporate	12.6%	12.7%	0.0%	-0.1%
Noncorporate	10.7%	10.7%	0.0%	-0.2%
All business	12.0%	12.0%	0.0%	-0.1%

Federal budget effects*			% of static
Revenues		$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)		-$4.4	100%
"Dynamic" federal tax reflow from economic changes		$0.9	-20%
Net federal tax change after dynamic effects		-$3.6	80%
Federal outlay change if federal pay tracks private wages		$0.1	-2%
Change in federal surplus (- is larger deficit, smaller surplus)		-$3.7	83%

Comparing change in GDP to change in tax revenue*	GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue	$3.5	$0.80	$0.99
Rise in after-tax income, total, and per $1 reduction in federal revenue	$7.1	$1.60	$1.99
Revenue loss to government from tax cut that raises after-tax income $1.		$0.62	$0.50

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 14
FORD - EARNED INCOME TAX CREDIT (EITC)
Ford vs. pre-Ford Law, at 1976 Income Levels

	Kennedy	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,824.6	$1,825.8	-$1.2	-0.1%
Private business output (less indirect taxes plus subsidies)	$1,293.0	$1,293.9	-$1.0	-0.1%
Compensation of employees	$871.7	$872.4	-$0.7	-0.1%
Gross capital income	$421.2	$421.5	-$0.3	-0.1%
Private Business Stocks	$3,607.9	$3,610.0	-$2.1	-0.1%
Wage rate $/hr	$7.00	$7.00	$0.00	0.0%
Private business hours of work (billions)	124.592	124.697	-0.105	-0.1%
Total government receipts ($billions)	$513.2	$514.9	-$1.8	-0.3%
Federal	$328.6	$330.2	-$1.6	-0.5%
State & local	$245.7	$245.8	-$0.1	-0.1%
Total Federal expenditures	$387.0	$387.0	$0.0	0.0%
Federal surplus (+) or deficit (-)	-$58.4	-$56.8	-$1.6	2.8%
Individual income tax				
Federal marginal tax rates on AGI	27.9%	27.9%	0.0%	-0.1%
Federal marginal tax rates on wages	26.5%	26.4%	0.2%	0.7%
Federal marginal tax rates on dividends	41.4%	41.5%	0.0%	0.0%
Federal marginal tax rates on interest income	28.0%	28.0%	0.0%	-0.1%
Federal marginal tax rates on business income	35.5%	35.6%	0.0%	0.0%
Federal marginal tax rates on long-term capital gains	23.0%	23.0%	0.0%	0.0%
Weighted average service price				
Corporate	12.6%	12.6%	0.0%	0.0%
Noncorporate	10.7%	10.7%	0.0%	0.0%
All business	12.0%	12.0%	0.0%	0.0%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$1.3	100%
"Dynamic" federal tax reflow from economic changes			-$0.3	25%
Net federal tax change after dynamic effects			-$1.6	125%
Federal outlay change if federal pay tracks private wages			$0.0	1%
Change in federal surplus (- is larger deficit, smaller surplus)			-$1.6	124%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Drop in GDP, total, and per $1 increase in federal revenue		-$1.2	$0.92	$0.73
Drop in after-tax income, total, and per $1 increase in federal revenue		$0.4	-$0.33	-$0.27
Revenue gain to government from tax hike that cuts after-tax income $1.			$3.02	$3.77

* Notes: This tax reduction reduces GDP and widens the revenue loss. Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +). Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change. If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 15
FORD - MINIMUM TAX INCREASE
Ford vs. pre-Ford Law, at 1976 Income Levels

	Kennedy	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,824.6	$1,841.0	-$16.4	-0.9%
Private business output (less indirect taxes plus subsidies)	$1,293.0	$1,305.1	-$12.1	-0.9%
Compensation of employees	$871.7	$879.9	-$8.2	-0.9%
Gross capital income	$421.2	$425.2	-$3.9	-0.9%
Private Business Stocks	$3,607.9	$3,706.1	-$98.2	-2.7%
Wage rate $/hr	$7.00	$7.05	-$0.06	-0.8%
Private business hours of work (billions)	124.592	124.779	-0.186	-0.1%
Total government receipts ($billions)	$513.2	$518.5	-$5.4	-1.0%
Federal	$328.6	$331.6	-$3.0	-0.9%
State & local	$245.7	$248.1	-$2.4	-1.0%
Total Federal expenditures	$387.0	$387.8	-$0.8	-0.2%
Federal surplus (+) or deficit (-)	-$58.4	-$56.2	-$2.2	3.9%
Individual income tax				
Federal marginal tax rates on AGI	27.9%	28.0%	-0.2%	-0.6%
Federal marginal tax rates on wages	26.5%	26.7%	-0.2%	-0.6%
Federal marginal tax rates on dividends	41.4%	41.6%	-0.2%	-0.5%
Federal marginal tax rates on interest income	28.0%	28.1%	-0.2%	-0.6%
Federal marginal tax rates on business income	35.5%	35.7%	-0.2%	-0.5%
Federal marginal tax rates on long-term capital gains	23.0%	19.6%	3.4%	17.4%
Weighted average service price				
Corporate	12.6%	12.3%	0.3%	2.7%
Noncorporate	10.7%	10.7%	0.0%	-0.2%
All business	12.0%	11.8%	0.2%	1.8%

Federal budget effects*			% of static
Revenues		$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)		$0.6	100%
"Dynamic" federal tax reflow from economic changes		-$3.6	-621%
Net federal tax change after dynamic effects		-$3.0	-521%
Federal outlay change if federal pay tracks private wages		-$0.8	-143%
Change in federal surplus (- is larger deficit, smaller surplus)		-$2.2	-378%

Comparing change in GDP to change in tax revenue*	GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Drop in GDP, total, and per $1 increase in federal revenue	-$16.4	-$28.43	$5.46
Drop in after-tax income, total, and per $1 increase in federal revenue	-$13.4	-$23.22	$4.46
Revenue gain to government from tax hike that cuts after-tax income $1.		$0.04	-$0.22

* Notes: This tax loses revenue by depressing GDP sharply. Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +). Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change. If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 16
FORD - ESTATE TAX
Ford vs. pre-Ford Law, at 1976 Income Levels

	Ford	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$1,824.6	$1,816.8	$7.8	0.4%
Private business output (less indirect taxes plus subsidies)	$1,293.0	$1,287.2	$5.8	0.4%
Compensation of employees	$871.7	$867.9	$3.9	0.4%
Gross capital income	$421.2	$419.3	$1.9	0.4%
Private Business Stocks	$3,607.9	$3,562.1	$45.8	1.3%
Wage rate $/hr	$7.00	$6.97	$0.03	0.4%
Private business hours of work (billions)	124.592	124.500	0.092	0.1%
Total government receipts ($billions)	$513.2	$510.3	$2.8	0.6%
Federal	$328.6	$326.9	$1.7	0.5%
State & local	$245.7	$244.6	$1.1	0.5%
Total Federal expenditures	$387.0	$386.6	$0.4	0.1%
Federal surplus (+) or deficit (-)	-$58.4	-$59.7	$1.3	-2.2%
Individual income tax				
Federal marginal tax rates on AGI	27.9%	27.8%	0.1%	0.3%
Federal marginal tax rates on wages	26.5%	26.5%	0.1%	0.3%
Federal marginal tax rates on dividends	41.4%	41.4%	0.1%	0.2%
Federal marginal tax rates on interest income	28.0%	27.9%	0.1%	0.4%
Federal marginal tax rates on business income	35.5%	35.4%	0.1%	0.3%
Federal marginal tax rates on long-term capital gains	23.0%	22.9%	0.0%	0.2%
Weighted average service price				
Corporate	12.6%	12.8%	-0.1%	-0.9%
Noncorporate	10.7%	10.8%	-0.1%	-0.6%
All business	12.0%	12.1%	-0.1%	-0.8%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$1.4	100%
"Dynamic" federal tax reflow from economic changes			$3.1	-223%
Net federal tax change after dynamic effects			$1.7	-123%
Federal outlay change if federal pay tracks private wages			$0.4	-28%
Change in federal surplus (- is larger deficit, smaller surplus)			$1.3	-95%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$7.8	$5.65	-$4.58
Rise in after-tax income, total, and per $1 reduction in federal revenue		$6.1	$4.42	-$3.58
Revenue loss to government from tax cut that raises after-tax income $1.			$0.23	-$0.28

* Notes: This tax reduction raises revenue by raising GDP sharply. Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +). Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change. If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

gains. That, in turn, boosted the service price of capital by 1.8% (as the capital gains rate increase raised the service price in the corporate sector). Capital accumulation would have been reduced by 2.7%, or $98 billion, from this provision alone.

- *The estate tax provisions (Table 16)* are shown separately. The estate tax is a direct levy on capital formation, and very damaging due to its very high tax rates. Per dollar of tax, the estate tax has one of the highest impacts on the service price of capital. The estate tax reductions appear to have increased equilibrium GDP by 0.4%, or $7.8 billion at 1976 levels, and would have raised the capital stock by 1.3%, or about $46 billion. (This is in addition to the income tax changes discussed above.) GDP would have risen $5.65 for each dollar of static tax revenue lost. The increase in GDP would have created a revenue reflow more than twice the static cost of the tax, resulting in a net revenue gain. This is another case of a tax reduction improving the economy by enough to cover its static budget cost. This effect would have faded over time had carry-over basis been retained and come to dominate the estate tax calculation in later years , and the revenue reflow would have only slightly exceeded the static cost.

The Carter-Era Tax Changes

By 1977, the sharp rise in the inflation rate was causing considerable bracket creep, reducing incentives to work, save, and invest. Inflation was also seen to be overtaxing capital gains and discouraging investment by eroding the value of the depreciation allowances. These considerations suggested the need for something more than temporary "pump-priming" tax cuts to prop up "demand" to stimulate consumption.

Some Members of Congress proposed large across-the-board reductions in marginal tax rates to roll back some of the increases caused by the inflation (for example a thirty percent tax rate reduction was offered in the Kemp-Roth bill, introduced by Representative Jack Kemp (R-NY) and Senator William Roth (R-Delaware). Senate Budget Committee Members Roth and Orrin Hatch (R-UT) and House Budget Committee Members Marjorie Holt (R-MD) and John Rousselot (R-CA) repeatedly offered amendments to various Budget Resolutions to leave room for marginal tax rate reductions, but were voted down repeatedly.

Other Members began proposing the adjustment of the income tax brackets, standard deduction, and personal exemption for inflation (tax indexing). Among them were Senator Robert Taft, Jr. (R-OH) and Representative Clarence Brown (R-OH) in 1976, Senator Robert Griffen (R-MI) in 1977, Senators Robert Dole (R-KS) and Robert Packwood (R-OR) in 1978 and 1979, and Senator William Armstrong (R-CO) in 1980 and 1981. Indexing finally became law as part of the Economic Recovery Tax Act of 1981 under President Reagan.

Between 1976 and 1980, the Minority (Republican) Members of the Congressional Joint Economic Committee were offering a new mix of fiscal and monetary policy in the JEC's annual and

midyear reports. They proposed a gradual reduction in the growth of the money supply to fight inflation (refocusing monetary policy on its main goal of price stability), reductions in marginal tax rates and depreciation schedules to improve incentives to supply labor and capital and expand production, spending restraint to pay for the tax cuts, and a reduction in regulations that unnecessarily increased the cost of production. This was the same policy mix later adopted by Ronald Reagan.

Provisions of the Tax Reduction and Simplification Act of 1977.

The Carter Administration was not receptive to the new view of economics and taxation, but it did bring about some highly successful deregulation of the transportation industry. Unfortunately, the Carter tax policy was more of the same temporary stimulus advocated by the Ford Administration.

- *General tax credit.* In 1977, President Carter proposed a $50 rebate per taxpayer and dependent. In view of the failure of the earlier Ford rebate to accomplish anything useful, the Democratic-controlled Senate voted down the Carter rebate. The general tax credit introduced in 1976 was extended.

- *Zero bracket amount.* The standard deduction was increased from $2,100 to $3,200 for joint filers, and from $1,700 to $2,200 for single filers, and converted into a "zero bracket amount" to simplify the tax form.

Provisions of the Revenue Act of 1978.

The 1978 Act included several Congressional initiatives that reduced the service price of capital and partially offset the effect of inflation on marginal tax rates. Although the Administration was not on board, there was some growing bipartisan understanding that production incentives were needed to get the economy moving forward.

- *Corporate tax rate.* Corporate tax rates were cut, and the top corporate tax rate was reduced from 48% to 46%. The capital gains tax rate for corporations was reduced.

- *ITC.* The 10 percent investment tax credit was made permanent and the amount of a business's income it was allowed to offset was scheduled to increase gradually from 50% to 90% by 1982.

- *Changes in income tax brackets and tax rates for individuals.* By 1978, several leading Democratic Senators entertained smaller versions of marginal tax rate relief. During the debate over the Tax Act of 1978, Senators Sam Nunn (D-GA) and Lawton Chiles (D-FL) offered a mini-version of Kemp-Roth, a smaller rate reduction across the board, coupled with a cap on the growth of federal spending, in place of a smaller adjustment of rates and brackets that had passed the House. The Nunn-Chiles amendment passed the Senate. The House of Representatives took the unusual step of voting

to instruct its conferees to accept the Senate version of the bill. However, President Carter opposed the Senate measure, and the House-Senate conference endorsed the more modest House version.

In the end, the Congress passed the modest but still significant revision of the income tax structure. (See Table 17.) The number of tax brackets was reduced by merging several groups of adjacent brackets, widening the income range between marginal rate increases. The new marginal tax rates in the merged brackets were generally lower in the middle tax brackets than under old law, and equal to the rates in the old bottom brackets and the top brackets. Marginal tax rates were reduced by more than seven percent on average. Average tax rates were reduced more than the marginal rates, by more than eleven percent, due in part to increases in the zero bracket amount, personal exemption, and the EITC.

TABLE 17 Tax Rate Reductions for Joint Filers in 1978 Tax Act

Previous Law		1978 Tax Act's Rate Schedule	
Joint Brackets	Rates	Joint Brackets	Rates
0	0%	0	0%
3,200	14%	3,400	14%
4,200	15%	5,500	16%
5,200	16%	7,600	18%
6,200	17%	11,900	21%
7,200	19%	16,000	24%
11,200	22%	20,200	28%
15,200	25%	24,600	32%
19,200	28%	29,900	37%
23,200	32%	35,200	43%
27,200	36%	45,800	49%
31,200	39%	60,000	54%
35,200	42%	85,600	59%
39,200	45%	109,400	64%
43,200	48%	162,400	68%
47,200	50%	215,400	70%
55,200	53%		
67,200	55%		
79,200	58%		
91,200	60%		
103,200	62%		
123,200	64%		
143,200	66%		
163,200	68%		
183,200	69%		
203,200	70%		

- *Long term capital gains.* Another pro-growth feature of the 1978 Tax Act was the Steiger Amendment (submitted by William Steiger, R-WI). It set an effective top tax rate of 28 percent on long term gains, and excluded the gains from the Minimum Tax. The 28 percent rate was reached by an exclusion of 60 percent of long term capital gains from taxable income. With the top personal income tax rate of 70 percent at the time, and only 40 percent of the gain subject to tax, the effective top tax rate on capital gains was 28 percent. This rate was higher than the former 25% alternative maximum rate, but less than the rates approaching 40% for people subject to the old add-on minimum tax.

- *A new alternative minimum tax.* The old add-on minimum tax was replaced by a new alternative minimum tax (AMT) with a top rate of 25%. The taxpayer would pay the larger of the regular income tax or the AMT.

- *Personal exemption and standard deduction.* The 1978 Act raised the personal exemption from $750 to $1,000, where it remained until 1985. The Act raised the standard deduction (zero bracket amount) for joint filers from $3,200 to $3,400 and for single filers from $2,200 to $2,300.

- *Expansion of the EITC.* The 10% EITC was increased to apply to the first $5,000 in wages (instead of $4,000). The income level above which the credit would start to phase out was raised from $4,000 to $6,000 and the phase-out rate increased from 10% to 12.5%.

The Crude Oil Windfall Profit Tax Act of 1980.

The last tax act of the Carter years was a windfall profits tax on oil. It was enacted in response to the second oil shock, when OPEC curtailed output and sent oil prices higher. It reduced investment in the oil industry and made the country even more dependent on foreign energy. It was repealed in 1988. The 1980 act created several business energy tax credits. It also temporarily increased the $200 dividend exclusion for joint filers ($100 for singles) to $400 ($200) and extended it to cover interest. This was not a significant incentive at the margin for saving. We have not modeled this bill.

The last years of the 1970s brought further discussions of the proper role of tax policy in promoting non-inflationary growth, and led to some additional bipartisan cooperation. In 1979 and 1980, Senator Lloyd Bentsen (R-TX) proposed a major reduction in asset lives (his 10-5-3 plan for asset lives of structures, most equipment, and very short lived assets, respectively. In conjunction with Ranking Minority Member Clarence Brown (R-OH), Bentsen developed two back-to-back unanimous annual reports for the Joint Economic Committee calling for a shift to a tax policy geared to expanding the quantity of plant and equipment. The 1980 Report was titled "Plugging in the Supply Side". Bentsen's 10-5-3 plan was the model, in scaled back form, for the business provisions of Reagan's 1981 tax cut.

Economic and Budget Consequences of the Carter-era Tax Changes.

The Carter-era tax changes are modeled at 1979 income levels, after the provisions of the 1978 Act were fully effective. The changes include those of the 1977 and 1978 Tax Acts.

- *The Carter-era package as a whole (Table 18)* would have boosted GDP by 2.75% and private business output and labor income by 2.94%. The capital stock would have been increased by 8.5%. Marginal tax rates were lowered by the 1978 Act, but not by enough to keep them from rising over the decade (compare with Table 1) or even to reduce them below 1976 levels (except for long term capital gains). Nonetheless, the corporate tax rate reductions and the lower tax rates on capital gains and non-corporate business income reduced the service price of capital by an average of 4.7%. The service price of capital did end the decade lower than in 1974. The package recouped about half its $34 billion static revenue cost, and after-tax GDP rose by $5.74 for each dollar of net federal revenue loss on a dynamic basis, a good deal for the general public.

TABLE 18
CARTER - ALL CHANGES
Carter vs. pre-Carter Law, at 1979 Income Levels

	Carter	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$2,562.2	$2,493.6	$68.7	2.8%
Private business output (less indirect taxes plus subsidies)	$1,860.0	$1,806.8	$53.2	2.9%
Compensation of employees	$1,268.2	$1,231.9	$36.3	2.9%
Gross capital income	$591.8	$574.9	$16.9	2.9%
Private Business Stocks	$5,367.6	$5,016.5	$351.0	7.0%
Wage rate $/hr	$8.90	$8.75	$0.15	1.7%
Private business hours of work (billions)	142.507	140.727	1.780	1.3%
Total government receipts ($billions)	$736.5	$745.4	-$9.0	-1.2%
Federal	$492.4	$509.5	-$17.1	-3.4%
State & local	$324.6	$316.4	$8.2	2.6%
Total Federal expenditures	$518.4	$515.8	$2.6	0.5%
Federal surplus (+) or deficit (-)	-$26.0	-$6.3	-$19.7	313.4%
Individual income tax				
Federal marginal tax rates on AGI	29.7%	31.4%	-1.7%	-5.5%
Federal marginal tax rates on wages	28.4%	30.0%	-1.6%	-5.4%
Federal marginal tax rates on dividends	43.8%	44.5%	-0.7%	-1.6%
Federal marginal tax rates on interest income	29.9%	31.7%	-1.8%	-5.6%
Federal marginal tax rates on business income	37.6%	38.8%	-1.2%	-3.1%
Federal marginal tax rates on long-term capital gains	16.3%	19.9%	-3.6%	-18.0%
Weighted average service price				
Corporate	12.0%	12.6%	-0.6%	-4.9%
Noncorporate	10.1%	10.2%	-0.1%	-1.2%
All business	11.3%	11.8%	-0.4%	-3.8%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$33.9	100%
"Dynamic" federal tax reflow from economic changes			$16.8	-50%
Net federal tax change after dynamic effects			-$17.1	50%
Federal outlay change if federal pay tracks private wages			$2.6	-8%
Change in federal surplus (- is larger deficit, smaller surplus)			-$19.7	58%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$68.7	$2.03	$4.01
Rise in after-tax income, total, and per $1 reduction in federal revenue		$85.8	$2.53	$5.01
Revenue loss to government from tax cut that raises after-tax income $1			$0.40	$0.20

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

- *Corporate tax rate and ITC extension (Table 19)* by themselves accounted for 0.5% growth of GDP and business output (nearly a fifth of the total), and a 1.4% increase in the capital stock (almost a third of the total), for a tenth of the cost ($3.4 billion) of the total tax package. The corporate rate cut appears to have recouped 74% of its static cost through higher growth of GDP and resulting increases in other revenue. The cuts boosted after-tax GDP by $14 for each dollar of revenue loss.

- *Long term capital gains tax relief (Table 20)*, the Steiger Amendment, provided 0.3% growth of GDP and private business output, a tenth of the gain. Although it reduced marginal tax rates on long term gains on an income-weighted average basis, it actually raised revenue in static terms by increasing the average tax rate on long term gains for investors not subject to the minimum tax when the basic top rate rose from 25% to 28%. The static revenue gain of $0.7 billion was increased by the gains in GDP associated with the end of the old add-on minimum tax on capital gains income. The revenue reflow was nearly twice the static gain, for a net gain of $2.1 billion. This is an odd case in which a static revenue increase is associated with a rise in output and a further gain in revenue.

- *Changes in individual income tax provisions as a group (rates, brackets, exemptions, deductions, AMT, EITC, shown in Table 21)* excluding capital gains are estimated to have added 2.1% to GDP and 2.2% to private business output. They cost $31 billion on a static basis, but recovered about 41% of their cost as the GDP increased. On a dynamic basis, they raised after-tax income by about $3.82 per dollar of lost federal revenue. That figure would have been larger for the rate and bracket adjustments, and lower for the standard deduction increases. The EITC changes alone would have reduced GDP fractionally due to the disincentives in the phase-out range (not shown separately). These benefits of the Carter-era individual tax changes were largely masked by the damage to the economy of the ongoing bracket creep. The economy would have been even worse without them.

TABLE 19
CARTER - 1976 CORPORATE TAX CUT
Carter vs. pre-Carter Law, at 1979 Income Levels

	Carter	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$2,562.2	$2,550.3	$11.9	0.5%
Private business output (less indirect taxes plus subsidies)	$1,860.0	$1,851.0	$8.9	0.5%
Compensation of employees	$1,268.2	$1,262.1	$6.1	0.5%
Gross capital income	$591.8	$589.0	$2.8	0.5%
Private Business Stocks	$5,367.6	$5,291.5	$76.1	1.4%
Wage rate $/hr	$8.90	$8.86	$0.04	0.4%
Private business hours of work (billions)	142.507	142.407	0.100	0.1%
Total government receipts ($billions)	$736.5	$735.9	$0.6	0.1%
Federal	$492.4	$493.3	-$0.9	-0.2%
State & local	$324.6	$323.1	$1.5	0.5%
Total Federal expenditures	$518.4	$517.9	$0.6	0.1%
Federal surplus (+) or deficit (-)	-$26.0	-$24.5	-$1.5	6.0%
Individual income tax				
Federal marginal tax rates on AGI	29.7%	29.6%	0.1%	0.3%
Federal marginal tax rates on wages	28.4%	28.3%	0.1%	0.4%
Federal marginal tax rates on dividends	43.8%	43.7%	0.1%	0.2%
Federal marginal tax rates on interest income	29.9%	29.8%	0.1%	0.3%
Federal marginal tax rates on business income	37.6%	37.5%	0.1%	0.3%
Federal marginal tax rates on long-term capital gains	16.3%	16.2%	0.0%	0.3%
Weighted average service price				
Corporate	12.0%	12.2%	-0.2%	-1.4%
Noncorporate	10.1%	10.1%	0.0%	0.1%
All business	11.3%	11.4%	-0.1%	-0.9%
Federal budget effects*				
Revenues			$ Billions	% of static tax change
"Static" federal revenue gain (+) or loss (-)			-$3.4	100%
"Dynamic" federal tax reflow from economic changes			$2.5	-74%
Net federal tax change after dynamic effects			-$0.9	26%
Federal outlay change if federal pay tracks private wages			$0.6	-16%
Change in federal surplus (- is larger deficit, smaller surplus)			-$1.5	43%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$11.9	$3.46	$13.09
Rise in after-tax income, total, and per $1 reduction in federal revenue		$12.8	$3.72	$14.09
Revenue loss to government from tax cut that raises after-tax income $1.			$0.27	$0.07

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

TABLE 20
CARTER - STEIGER AMENDMENT
Carter vs. pre-Carter Law, at 1979 Income Levels

	Carter	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$2,562.2	$2,555.6	$6.7	0.3%
Private business output (less indirect taxes plus subsidies)	$1,860.0	$1,855.0	$5.0	0.3%
Compensation of employees	$1,268.2	$1,264.8	$3.4	0.3%
Gross capital income	$591.8	$590.2	$1.6	0.3%
Private Business Stocks	$5,367.6	$5,323.4	$44.2	0.8%
Wage rate $/hr	$8.90	$8.88	$0.02	0.2%
Private business hours of work (billions)	142.507	142.479	0.028	0.0%
Total government receipts ($billions)	$736.5	$733.5	$3.0	0.4%
Federal	$492.4	$490.3	$2.1	0.4%
State & local	$324.6	$323.7	$0.8	0.3%
Total Federal expenditures	$518.4	$518.1	$0.3	0.1%
Federal surplus (+) or deficit (-)	-$26.0	-$27.8	$1.8	-6.4%
Individual income tax				
Federal marginal tax rates on AGI	29.7%	29.5%	0.2%	0.7%
Federal marginal tax rates on wages	28.4%	28.3%	0.1%	0.4%
Federal marginal tax rates on dividends	43.8%	42.9%	0.9%	2.1%
Federal marginal tax rates on interest income	29.9%	29.5%	0.4%	1.4%
Federal marginal tax rates on business income	37.6%	37.3%	0.3%	0.9%
Federal marginal tax rates on long-term capital gains	16.3%	17.7%	-1.4%	-8.0%
Weighted average service price				
Corporate	12.0%	12.1%	-0.1%	-1.0%
Noncorporate	10.1%	10.0%	0.0%	0.4%
All business	11.3%	11.4%	-0.1%	-0.6%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			$0.7	100%
"Dynamic" federal tax reflow from economic changes			$1.4	189%
Net federal tax change after dynamic effects			$2.1	289%
Federal outlay change if federal pay tracks private wages			$0.3	45%
Change in federal surplus (- is larger deficit, smaller surplus)			$1.8	244%

* Note: This was an odd case in which the static revenue change was positive, with a rise in the average tax rate. However, marginal rates were reduced, encouraging higher GDP. The basic top tax rate on long-term capital gains rose from 25% to 28%. The marginal tax rate fell on an income-weighted basis as capital gains were removed as a preference item in the old add-on minimum tax.

TABLE 21
CARTER - INDIVIDUAL INCOME TAX PROVISIONS AS A GROUP
Carter vs. pre-Carter Law, at 1979 Income Levels

	Carter	Old Law	Difference	% Diff
Gross domestic product ($ billions)	$2,562.2	$2,510.7	$51.5	2.1%
Private business output (less indirect taxes plus subsidies)	$1,860.0	$1,819.6	$40.4	2.2%
Compensation of employees	$1,268.2	$1,240.6	$27.5	2.2%
Gross capital income	$591.8	$579.0	$12.8	2.2%
Private Business Stocks	$5,367.6	$5,124.3	$243.2	4.7%
Wage rate $/hr	$8.90	$8.81	$0.09	1.0%
Private business hours of work (billions)	142.507	140.850	1.658	1.2%
Total government receipts ($billions)	$736.5	$748.7	-$12.3	-1.6%
Federal	$492.4	$510.7	-$18.3	-3.6%
State & local	$324.6	$318.6	$6.0	1.9%
Total Federal expenditures	$518.4	$516.6	$1.8	0.3%
Federal surplus (+) or deficit (-)	-$26.0	-$5.9	-$20.1	337.9%
Individual income tax				
Federal marginal tax rates on AGI	29.7%	31.6%	-2.0%	-6.3%
Federal marginal tax rates on wages	28.4%	30.2%	-1.8%	-6.0%
Federal marginal tax rates on dividends	43.8%	45.4%	-1.7%	-3.7%
Federal marginal tax rates on interest income	29.9%	32.2%	-2.3%	-7.0%
Federal marginal tax rates on business income	37.6%	39.2%	-1.6%	-4.1%
Federal marginal tax rates on long-term capital gains	16.3%	18.8%	-2.5%	-13.2%
Weighted average service price				
Corporate	12.0%	12.3%	-0.3%	-2.8%
Noncorporate	10.1%	10.2%	-0.2%	-1.7%
All business	11.3%	11.6%	-0.3%	-2.4%
Federal budget effects*				% of static
Revenues			$ Billions	tax change
"Static" federal revenue gain (+) or loss (-)			-$31.3	100%
"Dynamic" federal tax reflow from economic changes			$13.0	-41%
Net federal tax change after dynamic effects			-$18.3	59%
Federal outlay change if federal pay tracks private wages			$1.8	-6%
Change in federal surplus (- is larger deficit, smaller surplus)			-$20.1	64%
Comparing change in GDP to change in tax revenue*		GDP Change $ Billions	Change per dollar Static	Change per dollar Dynamic
Rise in GDP, total, and per $1 reduction in federal revenue		$51.5	$1.65	$2.82
Rise in after-tax income, total, and per $1 reduction in federal revenue		$69.8	$2.23	$3.82
Revenue loss to government from tax cut that raises after-tax income $1.			$0.45	$0.26

* Notes: Most static revenue changes (+ or -) will move GDP in the opposite direction (- or +).
Dynamic revenue reflows due to the changes in GDP usually offset some but not all of the static tax change.
If the dynamic GDP response is very large, the revenue reflow may offset all of the static change. If so, the net tax change after dynamic effects would be the same sign as the GDP change, and opposite in sign from the static numbers. For that type of tax provision, a cut raises tax revenue, an increase loses revenue.

Conclusion

These simulations have looked at the effect of the Nixon, Ford, and Carter tax changes from 1969 through 1980 on the U.S. economy and the federal budget. Reductions in the corporate income tax rate, increases in the investment tax credit, and shorter write-off periods for plant and equipment have been estimated to improve economic performance with little or no cost to the federal Treasury. Increases in personal exemptions and standard deductions are seen to be far less efficient in reducing tax barriers to production. The various attempts at introducing and expanding minimum taxes have been counter-productive insofar as they have raised taxes on capital gains and depressed investment and growth. Capital gains tax rate reductions from the levels then in force seem to have increased GDP by enough to cause revenues to increase.

In the early part of the period, tax changes were enacted without a clear understanding of how they would affect the economy, and with little consideration of how they might fit into a broader economic program to deal with stagflation. Short-run Keynesian pump priming was in vogue, and there was heavy reliance on the Federal Reserve to encourage economic output by expanding the money supply to take the burden off of fiscal policy. By the end of the decade, there was more appreciation that the Federal Reserve can best serve the economy by maintaining stable prices, and that the type of tax change, not just its static revenue gain or loss, makes a difference as to how it will affect output and employment. This lesson was hammered home by the rather obvious effects of inflation on the tax system. It led to somewhat better tax policy over time, although the appreciation of the new policies was not universal.

Since that time, many of these lessons have been forgotten. Current policy seems to be based more on the Nixon and Ford era ideas of easy money and temporary tax rebates that have little or nothing to do with incentives to invest or work. These policies will not work now any better than they did then.

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