Another Look at Supply-Side Economics

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The supply-side economics principle of reducing high tax rates (not specifically taxes) to stimulate output by increasing incentives to produce, save and invest was accepted as economic policy by Presidents Kennedy, Reagan and, more recently, Donald Trump. During the Kennedy years (completed by President Johnson) the maximum personal tax rate was reduced from a peak war rate of 91% to 70%. For individuals in that tax bracket, take home pay tripled! So, you can see that the richest got the biggest tax cut and formed the basis for the "trickle-down economics" characterization, the idea that the middle class would eventually benefit from the richest among us spending that money and increasing workers' salaries as the economy grew. One accusation that dominated conservative thought was that such a tax rate cut would reduce government revenues, forcing the federal deficit higher, increasing interest rates and ultimately producing an economic downturn. These unfounded fears resulted in a "phase-in" of the Reagan tax rate cuts that prolonged the early-80s recession.

We can refute the claims that tax rate cuts reduce federal government revenues. The following exhibit compares the level of federal government revenues during the full implementation of the Reagan tax rate cuts and the recent and projected revenues after the Trump tax rate cuts. Why didn't tax revenues fall as predicted since tax rates were reduced? The obvious answer is that the tax rate cuts stimulated the economy and the increased tax collections during that growth period were more than able to offset the loss of tax revenues due to the tax rate cuts.