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# A CHRONOLOGY OF POSTWAR U.S. FEDERAL INCOME TAX POLICY

SHU-CHUN SUSAN YANG

ABSTRACT. This note provides a chronology of major tax events that involved changes in federal taxes on individual and corporate income from 1948 to 2006. For each event, the note provides background and policy motivation, major provisions, legislative timeline, and estimated revenue changes. As most tax changes were preceded by extensive legislative delays, this chronology suggests that people were likely to have foreknowledge about tax policy. It also finds that postwar income tax policy was typically motivated by one of three rationales: 1) balancing the budget or reducing deficits, 2) controlling inflation, and 3) stimulating economic activity or promoting growth.

## 1. INTRODUCTION

This note documents the legislative history of major changes in federal income on individuals and corporations from 1948 to 2006. Voluminous documentation is available that provides detailed information about U.S. economic, fiscal, or tax policy in the postwar era (for example, Stein (1969), Pechman (1987), and Steuerle (2002)). However, it is difficult for a macroeconomist to quickly obtain a sketch of postwar tax history. I focus on income taxes, because they directly affect the net rates of return of production factors, and are the main types of taxes that concern macroeconomists. In addition, income taxes have been the most important revenue source for the federal government, providing 66.4 percent of total revenue in 1950 and 58.1 percent in 2006 (Joint Committee on Taxation (2007)).

For each tax event, this note provides background information and the motivation underlying a tax policy change, traces out the timeline and length of delay of the legislative process, summarizes major income tax provisions, and finally, provides the projected revenue changes estimated by the Joint Committee on Taxation (JCT).<sup>1</sup> The chronology sheds light on the evolution of tax policy objectives over time. It also

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*Date:* October 9, 2007. Institute of Economics, Academia Sinica, ssyang@econ.sinica.edu.tw. Part of this note draws from my dissertation at Indiana University. I thank Eric Leeper for helpful comments.

<sup>1</sup>Projected revenue effects by the Joint Committee on Taxation incorporated microdynamic behavioral changes but not macrodynamics. In other words, these estimates assumed that tax policy

helps indicate the degree to which a tax change was anticipated by economic decision makers.

Assumptions on the information about taxes upon which economic agents based on their decisions are important for inference about tax effects. Yang (2005) shows that when economic agents have policy foresight, the conventional information assumption that tax changes are unanticipated is misspecified, and estimates of tax policy impact based on the conventional information can be seriously biased. However, most empirical work studying macroeconomic tax effects treats policy changes as unanticipated (for example, Blanchard and Perotti (2002) and Perotti (2004)). In addition, dynamic scoring practiced by government budgeting agencies tends to rely on models that make extreme information assumptions.<sup>2</sup> This chronology shows tax policy changes were preceded by extensive legislative delay, suggesting that people acquire information about future tax policy changes.<sup>3</sup>

In this note, I use legislative lags as a proxy for the length of tax policy foresight. This lag, unless otherwise specified, is the number of months elapsed between when a tax proposal was first announced by a President and when it was enacted. When a policy proposal was announced in a State of the Union address or other presidential speeches, the administration sent out serious messages about policy directions. For some tax events, intentions for future tax policy changes were indicated during election campaigns (for example, Presidents Reagan and George W. Bush both ran on tax reductions). For these events, the length of foresight may be longer than legislative lags calculated here.<sup>4</sup> Finally, I only trace tax bills that eventually were enacted. Although during a legislative stage, people may also respond to tax bills that did not get passed, to include all relevant tax bills in this chronology defeats the purpose of providing a concise account of major income tax events.

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changes would not have effects on macroeconomic conditions, such as GNP and aggregate employment level (see Auerbach (2005)). While these assumptions may seem unacceptable from a macroeconomist's perspective, these estimates are nonetheless valuable in providing information on the relative magnitudes across tax policy changes. Tempalski (2006) provides revenue effects of major tax bills estimated by JCT or Treasury from 1940 to 2006.

<sup>2</sup>For example, the overlapping generation model used by the JCT and Treasury assumes perfect foresight, and the MEG model used by JCT assumes that people are myopic (Joint Committee on Taxation (2005) and U.S. Department of Treasury (2006)).

<sup>3</sup>Steigerwald and Stuart (1997) find statistical evidence on the existence of tax foresight based on firms' investment decisions for several postwar tax reforms. Yang (2007) finds reduced-form evidence that financial variables, which tend to respond more quickly to news in the economy, contain information about future tax variables.

<sup>4</sup>Also, tax legislation sometimes had provisions which phased in tax changes over several years or applied tax changes retroactively; the length of policy foresight, hence, could be longer for phased-in changes, or shorter for retroactive changes than the legislative lags reported here.

This chronology takes information from several sources. The main source is *Congress and the Nation* (CQ Press (2006)). When a tax change was initiated by a President, Public Papers of the Presidents of the United States (1947-2003) are used to date a proposal or the intention to change policy when it was first revealed. When available, the projected revenue effects are obtained from JCT's website (<http://www.house.gov/jct/tableofcnts.html>).<sup>5</sup>

## 2. CHRONOLOGY

- **Revenue Act of 1948** (HR 4790; PL 80-471)
  - *Background/Motivation*: During World War II, federal taxes on individual and corporate income were raised sharply. After the tax cut contained in the Revenue Act of 1945, Congress continued its efforts to reverse the higher income tax rates enacted during the war. President Truman, however, believed in the principle of budget balancing. As inflation also became a concern of his policy agenda, he insisted on debt reduction over tax reduction.
  - *Timeline*:
    - \* Signaling of the policy change: This tax cut was not initiated by President Truman. Congress's first vetoed tax-cut bill was introduced in early 1947.<sup>6</sup>
    - \* House passage: February 2, 1948
    - \* Senate passage: March 22, 1948
    - \* Enactment: April 2, 1948, enacted by Congress over President Truman's veto
  - *Legislative lag*: 10 months, between the first tax cut bill (HR 1) vetoed by President Truman and the enactment date of HR 4790
  - *Major provisions about income taxes*:
    - \* Individual income rates were reduced, effective January 1, 1948.
    - \* The personal exemption for each taxpayer and dependent was increased from \$500 to \$600.
    - \* Married couples were permitted to split their income for tax purposes so that they could benefit from lower bracket rates.
  - *Estimated revenue change*: a loss of \$4.6 billion (28.1 billion in 2000 dollars)
- **Revenue Act of 1950** (HR 8920; PL 81-814)

<sup>5</sup>JCT has estimated revenue effects for most major tax legislation after 1980 on its website. For other legislation, I took JCT's estimates summarized in *Congress and the Nation*.

<sup>6</sup>Two tax-cut bills were vetoed by President Truman: HR 1 was vetoed on June 16, 1947, and HR 3950 was vetoed on July 18, 1947.

- *Background/Motivation*: With the onset of the Korean war in mid-1950, financing needs for defense expenditure rose abruptly.
- *Timeline*:
  - \* Signaling of the policy change: In a special message to Congress on tax policy on January 23, 1950, President Truman suggested an increase in individual and corporate income taxes to balance the budget.
  - \* House passage: June 29, 1950
  - \* Senate passage: September 1, 1950
  - \* Enactment: September 23, 1950
- *Legislative lag*: 8 months
- *Major provisions about income taxes*:
  - \* Individual income rates were restored to their 1945 levels, effective October 1, 1950.
  - \* The top corporate income rate was raised to 42 percent in 1950 and to 45 percent in 1951.
  - \* An excess profits tax was reimposed.
- *Estimated revenue changes*: a gain of \$5.5 billion (33.3 billion in 2000 dollars)
- **Excess Profits Tax Act of 1950** (HR 9827; PL 81-909)
  - *Background/Motivation*: same as the Revenue Act of 1950—to finance the war and to control deficit growth.
  - *Timeline*:
    - \* Signaling of the policy change: The idea of imposing an excess profits tax was brought up as an amendment to the Revenue Act of 1950, but President Truman preferred that the tax be deferred until 1951. In line with the resolution attached to the Revenue Act of 1950, Congress began hearings on an excess profits tax in November 1950.
    - \* House passage: December 5, 1950
    - \* Senate passage: December 20, 1950
    - \* Date of enactment: January 3, 1951
  - *Legislative lag*: 3 months, between the enactment of the Revenue Act of 1950 and the enactment of HR 9872
  - *Major provisions about income taxes*:
    - \* The top corporate income rate was raised to 47 percent, effective July 1, 1950.
    - \* It imposed an excess profits tax, effective between June 1, 1950 and June 30, 1953.
  - *Estimated revenue changes*: a gain of \$3.3 billion (20.0 billion in 2000 dollars)

- **Revenue Act of 1951** (HR 4473; PL 82-183)
  - *Background/Motivation*: At the end of 1950, inflation became a major national concern. Two goals dominated President Truman's economic policy in 1951: resource mobilization to cope with the defense needs from the Korean war and price stabilization. He hoped that raising taxes could keep the mobilization program on the a pay-as-you-go basis, and together with price, wage, and credit controls, would rein in inflation.
  - *Timeline*:
    - \* Signaling of the policy change: In the annual budget message to Congress on January 15, 1951, President Truman stated that, additional tax revenue was needed to fight inflation and balance the budget, despite the tax increases passed in 1950.
    - \* House passage: June 22, 1951
    - \* Senate passage: September 28, 1951
    - \* Enactment: October 20, 1951
  - *Legislative lag*: 9 months
  - *Major provisions about income taxes*:
    - \* The normal corporate income rate was raised from 25 to 30 percent so that the top corporate income rate, combining normal income taxes and surtaxes, reached 52 percent, effective April 1, 1951. The normal rate was scheduled to fall back to 25 percent on March 31, 1954.
    - \* Individual income rates were raised by 11 percent on the first \$2,000 of net income and by 11.75 percent on the remainder, effective November 1, 1951, and terminating December 31, 1953.
  - Estimated revenue change: a gain of \$5.7 billion (34.6 billion in 2000 dollars)
- **Extending the Excess Profits Tax Act of 1950** (HR 5898; PL 83-125)
  - *Background/Motivation*: The continued increase in deficits and inflationary pressure forced President Eisenhower to delay the tax reduction that was scheduled to occur with the expiration of the Excess Profits Tax Act of 1950.
  - *Timeline*:
    - \* Signaling of the policy change: In the May 19, 1953 radio address to the American people on national security and its costs, President Eisenhower recommended that the excess profits tax on corporations be extended to the end of 1953 in order to balance the budget.
    - \* House passage: July 10, 1953
    - \* Senate passage: July 15, 1953
    - \* Enactment: July 16, 1953

- *Legislative lag*: 2 months
- *Major provision about income taxes*:
  - \* The excess profits tax on corporations was extended from June 30, 1953 to December 31, 1953.
- *Estimated revenue change*: a gain of \$0.8 billion (4.4 billion in 2000 dollars)
- **Internal Revenue Code of 1954** (HR 8300; PL 83-591)
  - *Background/Motivation*: The extension of the normal corporate income rate, embedded in the Revenue Code of 1954, was motivated to offset revenue shortfalls resulting from the expiration of the excess profits tax. The Internal Revenue Code of 1954 was regarded as the first comprehensive revision since the enactment of the income tax in 1913.
  - *Timeline*:
    - \* Signaling of the policy change: In his annual budget message to Congress on January 21, 1954, President Eisenhower proposed to extend the top corporate income rate, combining normal income taxes and surtaxes, at 52 percent.
    - \* House passage: March 18, 1954
    - \* Senate passage: July 2, 1954
    - \* Enactment: August 16, 1954
  - *Legislative lag*: 7 months
  - *Major provision about income taxes*:
    - \* The normal corporate income rate was maintained at 30 percent until March 31, 1955.<sup>7</sup>
  - *Estimated revenue change*: The revenue gain from postponement of expiration of the normal corporate income tax rate at 30 percent raised roughly \$1.2 billion (6.5 billion in 2000 dollars).
- **Revenue Act of 1964** (HR 8363; PL 88-272)
  - *Background/Motivation*: In response to the 1960-1961 recession and the slow recovery in 1962, President Kennedy proposed a substantial tax cut to speed up the economic recovery and promote economic growth. He argued that the present tax system exerted too heavy a drag on growth.
  - *Timeline*:

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<sup>7</sup>The combined top normal-surtax corporate income rate of 52 percent was later extended until June 30, 1964 through the following bills: the Tax Rate Extension Act of 1956 (HR 9166; PL 84-458), the Tax Rate Extension Act of 1957 (HR 4090; PL 85-12), the Tax Extension Act of 1958 (HR 12695; PL 85-475), the Tax Extension Act of 1959 (HR 7523; PL 86-75), the Public Debt and Tax Rate Extension Act of 1960 (HR 12381; PL 86-564), the Public Debt and Tax Rate Extension Act of 1961 (HR 7446; PL 87-72), the Tax Rate Extension Act of 1962 (HR 11879; PL 87-508), and finally, the Tax Rate Extension Act of 1963 (HR 6755; PL 88-52).

- \* Signaling of the policy change: In his annual message to Congress on January 21, 1963, President Kennedy proposed a major reduction in individual and corporate income taxes to speed up the economic recovery.
- \* House passage: September 25, 1963
- \* Senate passage: February 7, 1964
- \* Enactment: February 26, 1964, signed by President Johnson
- *Legislative lag*: 13 months
- *Major provisions about income taxes*:
  - \* Individual income rates were reduced across the board; phased in over two stages: January 1, 1964 to December 31, 1964 and after January 1, 1965. The top rate was lowered from 90 percent to 70 percent, beginning 1965.
  - \* The corporate normal income rate was reduced from 30 percent to 22 percent, while the surtax was raised from 22 percent to 30 percent.
- *Estimated revenue change*: The revenue loss from reductions in individual income rate was about \$9.5 billion annually and from reductions in corporate rate was about \$2.2 billion annually (combined 52.9 billion annually in 2000 dollars).
- **Revenue and Expenditure Control Act of 1968** (HR 15414; PL 90-364)
  - *Background/Motivation*: The period of steady and noninflationary growth following the 1964 tax cut came to an end in mid-1965 when the U.S. involvement in Vietnam escalated. The consumer price index rose about 12 percent from 1965 to 1968. The tax increase, accompanied by a mandatory expenditure constraint, was mainly motivated to counteract the stimulative fiscal action in the massive tax cut of 1964 to control inflation.
  - *Timeline*:
    - \* Signaling of the policy change: In his annual message to Congress on January 26, 1967, President Johnson recommended an income surtax on individuals and corporations to control rising inflation and to pay for war expenses.
    - \* House passage: February 29, 1968
    - \* Senate passage: April 2, 1968
    - \* Enactment: June 28, 1968
  - *Legislative lag*: 17 months
  - *Major provision about income taxes*:
    - \* It imposed a 10-percent individual and corporate income surtaxes, effective April 1, 1968 to June 30, 1969, for individuals and January 1, 1968 to June 30, 1969 for corporations.



- *Estimated revenue change*: The revenue gain from the surtaxes was estimated to produce revenue of \$11.6 billion (46.6 billion in 2000 dollars). The mandatory spending cut was \$6 billion (24.1 billion in 2000 dollars).
- **Extending the Ten Percent Surtax** (HR 9951; PL 91-53)
  - *Background/Motivation*: To continue the efforts of combating inflation, President Johnson extended the tax increase enacted in 1968 to curtail spending by the private sector.
  - *Timeline*:
    - \* Signaling of the policy change: In a special message to Congress on fiscal policy on March 26, 1969, President Nixon proposed an extension of income surtaxes at 10 percent for another year.
    - \* House passage: May 31, 1969
    - \* Senate passage: July 31, 1969
    - \* Enactment: August 7, 1969
  - *Legislative lag*: 4 months
  - *Major provision about income taxes*:
    - \* The surtax at 10 percent on individual and corporate income was extended for six months through December 31, 1969.
  - *Estimated revenue change*: a gain of \$5.6 billion for fiscal year 1970 (21.4 billion in 2000 dollars)
- **Tax Reform Act of 1969** (HR 13270; PL 91-172)
  - *Background/Motivation*: Spurred by increased public awareness of existing tax inequities with some very high income people avoiding taxes through investing in tax-exempt securities or using tax shelters, President Nixon proposed a tax reform to improve tax equities. He also requested extension of income surtaxes to control inflation.
  - *Timeline*:
    - \* Signaling of the policy change: In a special message to Congress on reform of the federal tax system on April 21, 1969, President Nixon recommended a second extension of income surtax passed in 1968.
    - \* House passage: August 7, 1969
    - \* Senate passage: December 11, 1969
    - \* Enactment: December 30, 1969
  - *Legislative lag*: 8 months
  - *Major provisions about income taxes*:
    - \* The income surtax was extended at 5 percent from January 1, 1970 to June 30, 1970.
    - \* It increased the personal income tax exemption from \$600 to \$750, effective from mid-1970 to 1972.
    - \* It started new rates for single taxpayers.
    - \* It established individual and corporate alternative minimum taxes.

- *Estimated revenue change*: The second extension of income surtax was estimated to raise \$2 billion for fiscal 1970 (7.3 billion in 2000 dollars). The entire tax reform bill was estimated to gain \$1.9 billion for fiscal 1970 and lose \$1.6 billion for fiscal 1971.
- **Revenue Act of 1971** (HR 10947; PL 92-178)<sup>8</sup>
- **Tax Reduction Act of 1975** (HR 2166; PL 94-12)
  - *Background/Motivation*: During 1973-1974, the economy was confronted with the most serious economic downturn since the 1930s, following the worst inflation since World War II. The consumer price rose by 11.4 percent during 1974, and the unemployment rate reached 9 percent in May 1975. President Ford proposed a one-time tax rebate to stimulate the economy.
  - *Timeline*:
    - \* Signaling of the policy change: In an address to the nation on energy and economic programs on January 13, 1975, President Ford called for tax reductions to fight recession.
    - \* House passage: February 27, 1975
    - \* Senate passage: March 22, 1975
    - \* Enactment: March 29, 1975
  - *Legislative lag*: 2 months
  - *Major provisions about income taxes*:
    - \* It provided a 10 percent rebate on 1974 individual income taxes up to a maximum of \$200, and increases the standard deduction for 1975.
    - \* It allowed a \$30 credit against taxes owed on 1975 income for each taxpayer and dependent.
    - \* It reduced the normal 22 percent corporate income rate during 1975 to 20 percent on the first \$25,000 in income.
    - \* It increased the low-income allowance from \$1,300 to \$1,600 for single persons and \$1,900 for joint returns during 1975.
    - \* It increased the standard deduction for 1975.
  - *Estimated revenue change*: a loss of \$22.8 billion (60 billion in 2000 dollars)<sup>9</sup>
- **Revenue Adjustment Act of 1975** (HR 9968; PL 94-164)<sup>10</sup>

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<sup>8</sup>President Nixon signed into law of HR 10947 on December 9, 1971 with a motive to stimulate the economy. It did not change statutory income tax rates, but increased personal exemptions, raised the standard deduction, and adjusted withholding of personal taxes.

<sup>9</sup>The tax rebate in 1975 was 8.1 billion (21.3 billion in 2000 dollars).

<sup>10</sup>President Ford insisted that the tax cut extension be accompanied by an outlay constraint for fiscal 1977. The initial tax-cut extension bill, HR 5559, was vetoed by President Ford on December 17, 1975.

- *Background/Motivation*: Since the strength of the economic recovery was still in doubt and 1976 was an election year, neither President Ford nor Congress wanted the temporary tax reduction enacted in 1975 to expire at the end of 1975. President Ford, however, demanded that any tax cut extension should be packaged with a spending ceiling. A compromise was eventually reached: Congress pledged to consider offsetting spending cuts if the tax reductions were continued beyond June 30, 1976.
- *Timeline*:
  - \* Signaling of the policy change: In an address to the nation on federal tax and spending reduction on October 6, 1975, President Ford proposed tax and government spending cut to assure continued economic recovery.
  - \* House passage: October 6, 1975
  - \* Senate passage: December 19, 1975
  - \* Enactment: December 23, 1975
- *Legislative lag*: 3 months
- *Major provision about income taxes*:
  - \* The individual and corporate tax reductions provided in the Tax Reduction Act of 1975 were extended from December 31, 1975 to June 30, 1976.
- *Estimated revenue change*: a loss of \$16 billion (42.1 billion in 2000 dollars)
- **Tax Reform Act of 1976** (HR 10612; PL 94-455)
  - *Background/Motivation*: The economic recovery was halting in mid-1976 after a strong rebound in late 1975 and early 1976. The unemployment rate showed an upward trend to more than 7 percent in late 1976, and inflation was more than 5 percent in 1976. President Ford proposed tax reduction measures but also demanded government spending constraints. Congress, on the other hand, proposed a more stimulative fiscal measure, ignoring the President's request to restrict government spending.
  - *Timeline*:
    - \* Signaling of the policy change: In his annual message to Congress on January 26, 1976, President Carter proposed a tax reduction to revive the economy.
    - \* House passage: December 4, 1975
    - \* Senate passage: August 6, 1976
    - \* Enactment: October 4, 1976
  - *Legislative lag*: 8 months
  - *Major provisions about income taxes*:
    - \* It made permanent the 1975 tax law changes that raised the standard personal deduction and minimum standard deduction.

- \* It extended through 1977 the temporary 1975 law that increased the amount of corporate income exempt from the corporate surtaxes, and also reduced the normal 22 percent corporate income rate to 20 percent.
- \* It extended through 1977 a general tax credit against taxes owed equal to \$35 per individual or 2 percent of the first \$9,000 of taxable income.
- *Estimated revenue change*: a gain of \$1.6 billion for fiscal 1977 (3.7 billion in 2000 dollars)<sup>11</sup>
- **Tax Reduction and Simplification Act of 1977** (HR 3477; PL 95-30)
  - *Background/Motivation*: The combination of sluggishness and inflation continued to afflict the economy in 1977. Upon taking office in January 1977, President Carter proposed a stimulative fiscal plan intended to generate strong economic performance.
  - *Timeline*:
    - \* Signaling of the policy change: In his Economic Recovery Program message to Congress on January 13, 1977, President Carter proposed tax reductions to stimulate the economy and to reduce unemployment.
    - \* House passage: March 8, 1977
    - \* Senate passage: April 29, 1977
    - \* Enactment: May 23, 1977
  - *Legislative lag*: 4 months
  - *Major provisions about income taxes*:
    - \* It increased standard deductions effective with 1977 tax year.
    - \* It extended and expanded through 1978 the general tax credit, which was set to expire at the end of 1977 in the Tax Reform Act of 1976.
  - *Estimated revenue change*: a loss of \$34.2 billion over 1977 to 1979 (74.7 billion in 2000 dollars)
- **Revenue Act of 1978** (HR 13511; PL 95-600)
  - *Background/Motivation*: The economy grew at 5 percent over the year of 1977, a relatively solid performance compared to previous years. To help continuous economic recovery, president Carter proposed a substantial tax cut.
  - *Timeline*:
    - \* Signaling of the policy change: In the State of the Union address on January 19, 1978, President Carter proposed further tax reductions to stimulate the economy after the tax reduction passed in 1977.

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<sup>11</sup>The Tax Reform Act of 1976 contained other provisions related to tax shelters, minimum taxes, business deductions, etc. that raised revenue.

- \* House passage: August 10, 1978
- \* Senate passage: October 10, 1978
- \* Enactment: November 6, 1978
- *Legislative lag*: 10 months
- *Major provisions about income taxes*:
  - \* Individual and corporate income rates were reduced, effective January 1, 1979. It adjusted tax brackets so that taxpayers would not be pushed to a higher tax rate due to inflation-induced salary increase.
  - \* Personal exemptions were increased.
  - \* It reduced the top corporate income rate to 46 percent and established a five-tier graduated rate schedule to benefit small businesses.
  - \* It increased the amount of capital gains that could be excluded from ordinary income taxes to a 60 percent limit from 50 percent.
- *Estimated revenue change*: It was estimated to have a loss of \$18.7 billion in calendar 1979 (37.7 billion in 2000 years), with further reductions in following years.
- **Economic Recovery Tax Act of 1981** (HR 4242; PL 97-34)
  - *Background/Motivation*: By the late 1970s, the economy was hit by oil shocks and had experienced serious inflation with the annual inflation rate of 8-9 percent (based on the GDP deflator). Although Keynesian prescription of cutting taxes and increasing government spending seemed stimulative, it could also contribute to high inflation. When Reagan started his presidency in 1981, supply-side economics dominated the administration's fiscal policy, Reagan believed that government should limit its role in the economy but create an environment favorable for long-run economic growth. Instead of directly increasing consumers' purchasing power, supply-side economists argued that government should encourage investment and work, which would increase the production of goods without creating inflation.
  - *Timeline*:
    - \* Signaling of the policy change: In an address to the nation on February 5, 1981, President Reagan proposed a tax relief package.
    - \* House passage: July 29, 1981
    - \* Senate passage: July 31, 1981
    - \* Enactment: August 13, 1981
  - *Legislative lag*: 6 months
  - *Major provisions about income taxes*:
    - \* It reduced all individual rates by 5 percent effective October 1, 1981 to June 30, 1982, by 10 percent effective July 1, 1982 to June 30,

1983, and an additional 10 percent effective July 1, 1983. The top individual rate was dropped from 70 percent to 50 percent.

- \* It allowed two-earner married couples filing joint returns to deduct up to \$1,500 from income in 1982 and up to \$3,000 in 1983 and after.
- \* It reduced the lowest corporate rate gradually on the first \$25,000 of income from 17 percent to 15 percent in 1983, and from 20 percent on the next \$25,000 to 18 percent in 1983.
- *Estimated revenue change*: a loss of \$37.7 billion for fiscal 1982, and a total of \$748.7 billion from fiscal 1981 to 1986 (1.1 trillion in 2000 dollars)
- **Tax Equity and Fiscal Responsibility Act of 1982** (HR 4961; PL 97-248)<sup>12</sup>
- **Deficit Reduction Act of 1984** (HR 4170; PL 98-369)<sup>13</sup>
- **Tax Reform Act of 1986** (HR 3838; PL 99-514)
  - *Background/Motivation*: In facing the pressure to rein in deficit growth, President Reagan advocated that a structural reform, rather than a tax increase, because a simple and fair tax system could broaden the tax base, improve compliance, and provide growth incentives.
  - *Timeline*:
    - \* Signaling of the policy change: President Reagan called in his State of the Union address on January 25, 1984 for simplification of the federal tax system.
    - \* House passage: December 17, 1985
    - \* Senate passage: June 24, 1986
    - \* Enactment: October 22, 1986
  - *Legislative lag*: 9 months
  - *Major provisions about income taxes*:
    - \* The top individual income rate was reduced and the bottom rate was increased; phased in over two stages: January 1, 1987 to December 31, 1987 and from January 1, 1988; corporate income rates

<sup>12</sup>The massive tax cut enacted in 1981, combined with an increase in defense spending, made it clear that the administration could not keep the fiscal 1983 deficit below \$100 billion by the end of 1982. In the State of the Union address on January 26, 1982, President Reagan made it clear that he would not retreat from the tax cuts enacted in 1981, but vowed to close tax loopholes. The Tax Equity and Fiscal Responsibility Act of 1982 was enacted on September 23, 1982. The estimated revenue gain from fiscal 1983 to 1987 was \$241.1 billion (304.5 billion in 2000 dollars).

<sup>13</sup>As the budget continued to deteriorate, reaching a \$200 billion deficit in fiscal 1983, Congress passed the fiscal 1984 budget resolution, including reconciliation instructions calling for \$85.3 billion in deficit reductions over fiscal 1984-86. As in the Tax Equity and Fiscal Responsibility Act of 1982, most of the tax increases in the Deficit Reduction Act of 1984 came from provisions designed to shut down tax loopholes. President Reagan signed HR 4170 into law on July 18, 1984. The estimated revenue gain was \$103.2 billion (138.7 billion in 2000 dollars) from fiscal 1984 to 1989.

were also reduced, effective from July 1, 1987. It dramatically reduced the number of tax brackets from 14 (15 for single taxpayers) to two: 15 and 28 percent, effective for 1988 and later years.

- \* It increased personal exemptions gradually over three stages and the exemption amount would be indexed by inflation beginning in 1990.
- \* It increased the standard deduction, which would be indexed for inflation beginning in 1989.
- \* It repealed capital gains exclusion and taxed them at the same rates as ordinary income.
- \* It reduced the top corporate income rate from 46 percent to 34 percent, and reduced the number of brackets from five to three. These rates would be effective for taxable years beginning on or after July 1, 1987.

– *Estimated revenue change*: a loss of \$257 million over fiscal 1987-1991 (1.5 billion in 2000 dollars)

• **Omnibus Budget Reconciliation Act of 1990** (HR 5835; PL 101-508)

– *Background/Motivation*: When President Bush took office, the gross debt-output ratio had grown from 0.26 in 1980 to 0.41 in 1989. The administration was concerned that the soaring federal budget deficit could hurt President Bush’s re-election chances in 1992, and initiated a bipartisan deficit-reduction deal. Democrats refused to negotiate on reducing the deficit until Bush abandoned his “no new taxes” campaign pledge.

– *Timeline*:

- \* Signaling of the policy change: In the statement on the federal budget negotiations on June 26, 1990, President Bush indicated that a tax revenue increase was necessary to reduce deficits.
- \* House passage: October 16, 1990
- \* Senate passage: October 19, 1990
- \* Enactment: November 5, 1990

– *Legislative lag*: 5 months

– *Major provisions about income taxes*:

- \* It increased the highest individual rate from 28 to 31 percent, effective January 1, 1991, but the maximum capital gains tax rate was maintained at 28 percent.
- \* It also enacted an increase in the alternative minimum tax rate to 24 percent from 21 percent for high-income taxpayers.

– *Estimated revenue change*: a gain of \$137.2 billion over five years (168.1 billion in 2000 dollars)

• **Omnibus Budget Reconciliation Act of 1993** (HR 2264; PL 103-66)

- *Background/Motivation*: When President Clinton entered office in 1993, the gross debt-output ratio had climbed to 0.66, twice its level in 1981. Deficit reductions were his top priority, and he called for cutting almost \$500 billion from expected federal deficits over the next five years.
- *Timeline*:
  - \* Signaling of the policy change: In an address to the nation on his economic program on February 15, 1993, President Clinton proposed to raise individual and corporation taxes to reduce deficits.
  - \* House passage: May 27, 1993
  - \* Senate passage: June 23, 1993
  - \* Enactment: August 10, 1993
- *Legislative lag*: 6 months
- *Major provisions about income taxes*:
  - \* It added a new tax bracket so that the top marginal rate was 36 percent. A 10 percent surtax was imposed on taxable income above \$250,000, creating an effective top rate of 39.6 percent. These new rates were retroactive to January 1, 1993.
  - \* It created two brackets for the alternative minimum tax: 26 and 28 percent, increasing the rate from 24 percent.
  - \* It created a new fourth bracket for the corporate income rate at 35 percent. The rate increase was retroactive to January 1, 1993.
- *Estimated revenue change*: a gain of \$240.4 billion (or 255.3 billion in 2000 dollars)
- **Taxpayer Relief Act of 1997** (HR 2014; PL 105-34)<sup>14</sup>
- **Economic Growth and Tax Relief Reconciliation Act of 2001** (HR 1836; PL 107-16)
  - *Background/Motivation*: Since the federal government began running a budget surplus in 1998, Congressional Republicans had wanted to enact tax reduction legislation. Upon nomination in 2000, President Bush promoted his tax cut plan, arguing that government should put surplus money back into the taxpayers' hand. When the economy started showing signs of recession after he took office, President Bush later couched the tax cut in terms of his strategy to confront the recession.
  - *Timeline*:

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<sup>14</sup>The federal government's budget deficit dropped to \$21.9 billion for fiscal 1997 from \$290.3 billion in 1992. President Clinton reduced taxes by providing a child credit of \$400 per child for 1998 and \$500 credit per child for 1999 for middle and low income families with children under age seventeen. It reduced the top capital gains tax rate from 28 to 20 percent. It also provided education credits. The President signed into law the Taxpayer Relief Act of 1997 on August 5, 1997. The estimated revenue loss was \$95.3 billion over fiscal 1997 to 2002 (107.5 billion in 2000 dollars).



- \* Signaling of the policy change: In announcing the tax cut plan on February 5, 2001, President Bush laid out a tax cut plan to stimulate the economy during the first slowdown since 1991.
- \* House passage: May 16, 2001
- \* Senate passage: May 23, 2001
- \* Enactment: June 7, 2001
- *Legislative lag*: 4 months
- *Major provisions about income taxes*:
  - \* It replaced the five existing individual tax brackets (15, 28, 31, 36, and 39.6 percent) with six lower brackets (10, 15, 25, 28, 33, and 35 percent). These rate reductions began in 2001, fully phased in by 2006, and were scheduled to expire 2011.
  - \* It provided a tax rebate of \$300 for individuals, \$500 for single parents, and \$600 for married couples filing jointly.
  - \* The child tax credit would double to \$1,000 by 2010.
  - \* It increased the limit for individual alternative minimum tax exemptions, effective 2001 to 2004.
  - \* It provided marriage penalty relief through 2010 by increasing the standard deduction and expanding the 15 percent bracket for couples filing joint returns.
- *Estimated revenue change*: a loss of \$552.5 billion over fiscal 2001-2006 (548.4 billion in 2000 dollars) and \$1.35 trillion over fiscal 2001-2011
- **Jobs and Growth Tax Relief Reconciliation Act of 2003** (HR 2; PL 108-27)
  - *Background/Motivation*: President Bush called for another tax cut to help the recovery from the 2001 recession.
  - *Timeline*:
    - \* Signaling of the policy change: President Bush announced a plan to strengthen the American economy on January 7, 2003.
    - \* House passage: May 9, 2003
    - \* Senate passage: May 15, 2003
    - \* Enactment: May 28, 2003
  - *Legislative lag*: 4 months
  - *Major provisions about income taxes*:
    - \* It accelerated the schedule for tax reductions enacted in 2001 tax cut so that the 2006 rates became effective in 2003.
    - \* It accelerated the phased-in schedule for marriage penalty relief.
    - \* It increased the individual alternative minimum tax exemption in 2003 and 2004.

- \* It reduced tax rates on dividends and capital gains for assets held more than one year. The top rate dropped to 15 percent. For low-income taxpayers, the rate was 5 through 2007 and zero in 2008. The new rates were retroactive to January 1, 2003 and would expire at the end of 2008.
- \* It increased the standard deduction for married couples and the upper limit of the 15 percent tax bracket for couples filing jointly for 2003 and 2004. The deduction would revert to the level provided for in the 2001 law in 2005.
- \* It increased the per-child tax credit to \$1,000 from \$600 per year for each child in 2003 and 2004.
- *Estimated revenue change*: a loss of \$342.9 billion over fiscal 2003-2008 (326.8 billion in 2000 dollars) and \$350.0 billion over fiscal 2003-2013 (333.6 billion in 2000 dollars)
- **Working Families Tax Relief Act of 2003** (HR 1308; PL 108-311)
  - *Background/Motivation*: While the child tax credit was designed to help middle and low income families, many low-income families could not benefit from the credit, because it was non-refundable and some families may not owe enough tax to claim the credit. Although the House and Senate each passed their own versions of a bill (HR 1308) in June 2003, they never resolved the difference in 2003.
  - *Timeline*:
    - \* Signaling of the policy change: In his State of Union address on January 20, 2004, President Bush asked Congress to consider making permanent the temporary tax cuts, which would expire in 2011.
    - \* House passage: June 12, 2003
    - \* Senate passage: June 5, 2003
    - \* Enactment: October 4, 2004
  - *Legislative lag*: 8 months
  - *Major provisions about income taxes*:
    - \* It extended through 2010 the expanded 10 percent individual income tax bracket. The bracket amounts would be adjusted for inflation beginning in 2004.
    - \* It extended the \$1,000 child tax credit through 2009.
    - \* It extended the increased limit for the alternative minimum tax enacted in 2003 through 2005.
    - \* It extended the marriage penalty provision enacted in 2003 through 2008.
  - *Estimated revenue change*: a loss of \$132.8 billion (122.1 billion in 2000 dollars) over fiscal 2005-2009 and \$145.9 billion over fiscal 2005-2014 (134.2 billion in 2000 dollars)

- **Tax Increase Prevention and Reconciliation Act of 2005** (HR 4297; PL 109-222)<sup>15</sup>

### 3. SUMMARY REMARKS

Several observations can be drawn from the chronology in section 2.

**3.1. Policy Foresight.** Most tax legislation went through a delay exceeding one quarter. The average length was seven months between the policy announcement and enactment. The delay could be as short as two months—the Excess Profits Act of 1950, driven by emergency war financing needs, or as long as 17 months—the Revenue and Expenditure Control Act of 1968, driven by a prolonged fight between Congress and President Johnson over the size of the spending constraint attached to the tax increase bill.

During an extended legislative period, tax policy debates attracted media attention, which provided economic agents foreknowledge about tax policy. In addition, frequent phase-in schedules and sunset (or temporary) provisions in tax law (for example, the Economic Recovery Act of 1981 and the Economic Growth and Tax Relief Reconciliation Act of 2001) specified future tax changes embedded in existing law. Upon receiving tax news, forward-looking agents adjust their economic decisions, rather than wait until the enactment or implementation of a tax policy change. Econometric models, which assume unanticipated tax changes, would not attribute movements in times series to policy prior to tax variable changes recorded in data. Given the prevalence of legislative delays in making tax policy, foresight should be taken into account when projecting revenue changes or estimating tax policy effects.

**3.2. Policy Objectives.** The chronology shows that postwar tax policy changes are typically motivated by one of three rationales: balancing the budget or reducing deficits, curtailing private spending to control inflation, and stimulating economic activity during business downturns or promoting growth. Figures 1 to 3 plot the timing of tax events and several macroeconomic variables: the government defense spending-GDP ratio, the surplus-GDP ratio, inflation (the GDP price deflator), the unemployment rate, and the real GDP growth rate. Tax changes driven by the same rationale tend to cluster in time. In the early 1950s, President Truman's firm position on balancing the budget and the financing needs of the Korean war triggered a series of tax increases to control deficit growth.

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<sup>15</sup>It extended the rates on capital gains and dividends enacted in the Jobs and Growth Tax Relief and Reconciliation Act to 2010. It further increased the exemption limit for alternative minimum tax for 2006. President Bush signed HR 4297 into law on May 17, 2006. The estimated revenue loss was \$70.0 billion from fiscal 2006 to 2010 (60.1 billion in 2000 dollars).

In the early 1960s, tax policy switched from a financing role to a growth promoting role. To justify his extensive tax cut proposal, which necessarily resulted in rising deficits, President Kennedy put forth a new argument that, “...*our practical choice is not between a tax-cut deficit and budgetary surplus. It is between two kinds of deficits: a chronic deficit of inertia, as the unwanted result of inadequate revenues and a restricted economy; or a temporary deficit of transition, resulting from a tax cut designed to boost the economy, increase tax revenues, and achieve—and I believe this can be done—a budget surplus...*” (in a message to Congress on January 24, 1963). The argument bears the resemblance to the idea of the Laffer curve, long before it was popularized by Laffer (1979).

In the 1970s, tax policy further became a discretionary countercyclical tool to confront recessions. The government repeatedly resorted to stimulative tax measures in the 1970s to fight recessions. The economic rationales underlying these tax cuts, however, switched from a supply-side argument to aggregate demand management. The large-scale tax rebate, increases in standard deductions, and individual general tax credits all aimed to boost private spending and hence to strengthen domestic demand. However, the inability of these tax actions to keep inflation from rising in the late 1970s eventually gave the supply-side economists an opportunity to dominate the tax agenda in the early 1980s. Unfortunately, the massive reductions in individual and corporate income tax rates failed to generate the predicted tax revenue. Together with expansionary defense spending, the soaring deficits after the 1981 tax cut quickly changed the role of tax policy back to providing revenues and reducing deficits—by the two major deficit reduction acts in 1982 and 1984, and again in the early 1990s.

The current budget situation brought back the memory of the early-mid 1980s. The supply-side arguments dominated President Bush’s rationale for a series of tax cuts for both countercyclical reasons and growth stimulation. Yet the increasing defense expenditures and tax cuts have quickly worsened the deficit: the debt output ratio rose from 0.58 in 2000 to 0.65 in 2006 (calculated based on Table 78, Economic Report of the President (2006)).

Finally, note that although inflation now is regarded as mainly the monetary authority’s responsibility, in the early 1950s and late 1960s tax policy was used repeatedly for price stabilization. While the rationale used to justify such a policy action was to manage aggregate demand, it remains an open question whether tax policy is effective in controlling inflation. Also, it is worth exploring the mechanism through which tax policy affected the price level during those high inflation periods.

**3.3. Asymmetric Practice in Tax Policy.** Section 3.2 summarized three rationales for tax policy in the postwar era. These rationales, however, were used rather asymmetrically in terms of achieving those policy objectives. The government cut

taxes for business downturns, but had never advocated tax increases during a boom to bring the economy down to an ideal growth path (see Figure 3). Also, it raised taxes several times to control deficit growth (see Figure 1), but only advocated once to cut taxes on the grounds of budget surplus (Presidential candidate Bush in 2000). This practice makes it difficult to characterize tax policy making by a simple rule, where an instrument responds symmetrically to deviations from policy objectives.

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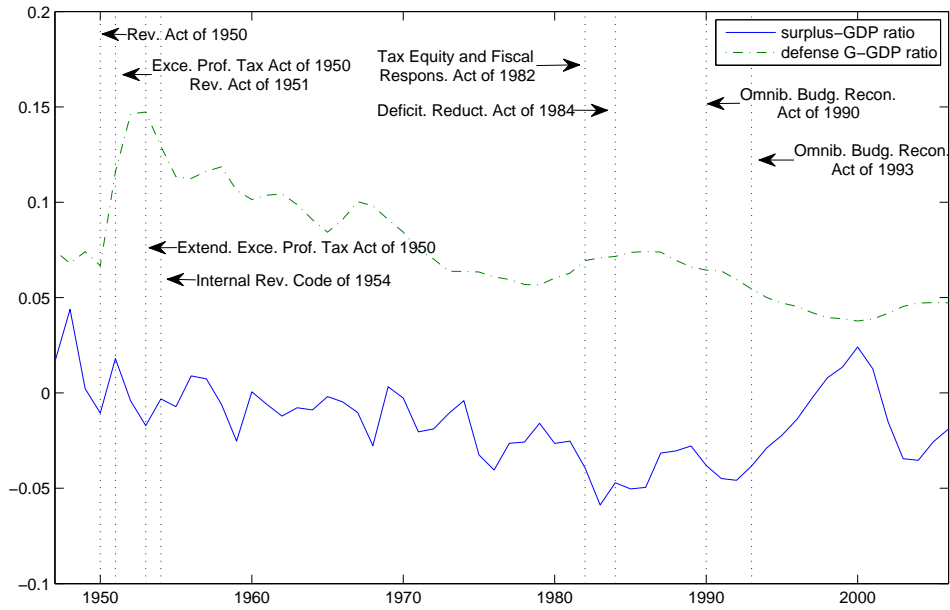


FIGURE 1. Tax events motivated by raising revenues and/or reducing deficits. Source: surplus—Table 78, Economic Report of the President (2006); defense government spending—Bureau of Economic Analysis, NIPA Table 3.9.5.

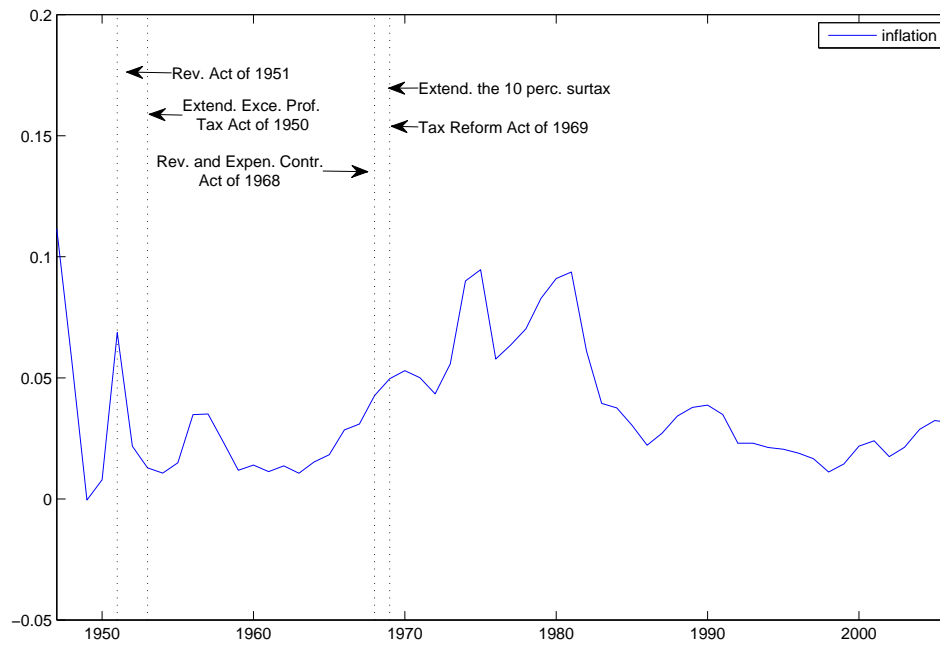


FIGURE 2. Tax events motivated by controlling inflation. Inflation is calculated based on the GDP price deflator. Source: Bureau of Economic Analysis, NIPA Table 1.1.6.



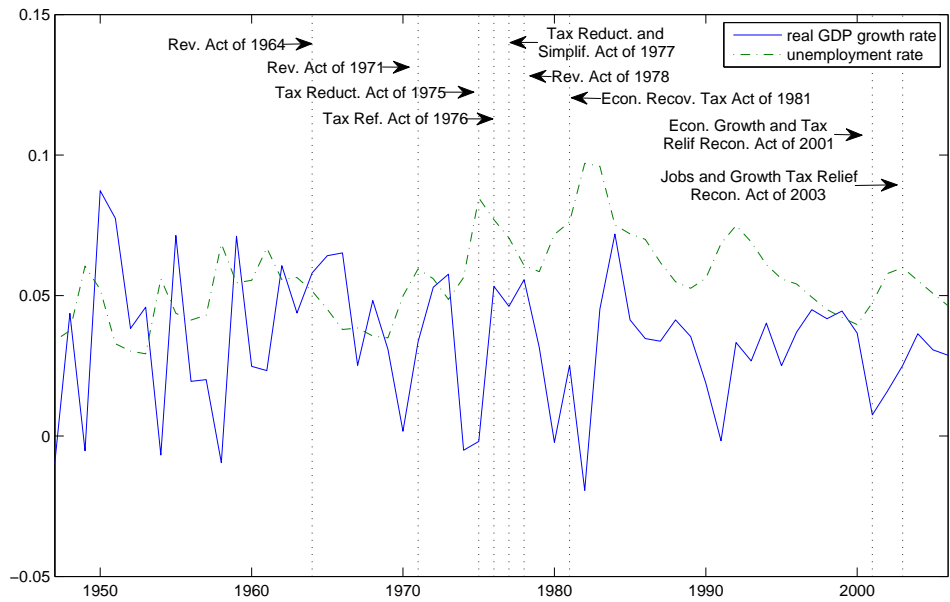


FIGURE 3. Tax events motivated by stimulating the economy. Source: GDP in 2000 chained dollars—Bureau of Economic Analysis; NIPA Table 1.1.5; unemployment rate—Bureau of Labor Statistics.