Why JFK Cut Taxes

By Herbert Stein

To many Republicans the name of Nelson Rockefeller is anathema, while the name of John F. Kennedy is revered. That may seem peculiar at first glance, but it really is not. President Kennedy cut taxes. For many Republicans that is sufficient to make him a model. He now ranks up there with Andrew Mellon in the pantheon of tax-cutters; he is to taxes what G. Washington was to cherry trees.

Signed by Johnson

Of course, to say that President Kennedy cut taxes is something of a stretch. He formally proposed the tax cut in December 1962, he was assassinated in November 1963, and Congress passed the tax cut, to be signed by President Johnson, in February 1964.

But let us call it Kennedy's tax cut. Before we wrap ourselves too tightly in his mantle, we should recall a few facts:

1. When Kennedy came into office in 1961, the top marginal rate of individual income tax was 91%, compared with 39.6% today. The top corporate rate was 52%; today it is 35%, with much ampler depreciation allowances.

2. When Kennedy came into office, the unemployment rate was 6.7%. The Kennedy economists thought "full employment" was 4%. That is, they thought they were far below full employment. They thought that the economy was operating at about 9% below its potential total output, meaning the output the economy was capable of at full employment, with the existing tax rates and other structural conditions. They thought that the economy was operating below its potential because total demand was too low. Today we seem to be close to full employment, and close to today's potential output, if not there.

John F. Kennedy

3. In fiscal 1961, when Kennedy came into office, the federal deficit was about 0.6% of gross national product. But the administration believed that the budget would be in surplus, given the existing tax rates and expenditure programs, if the economy were at full employment. It believed that even with lower taxes or higher expenditures the budget would be in balance if the economy were at high employment.

4. The administration believed that there was a long-term problem of fiscal drag. It thought that in the long run the potential growth of total output was 4% a year, without counting on increased growth from tax reduction or other structural reforms. But this potential growth rate would not be achieved with the existing tax and expenditure policies, because they would yield excessive surpluses, which would depress demand. So the long-run growth problem was to get rid of these troublesome budget surpluses.

5. With some exceptions, the administration did not care much about balancing the budget, except as a useful political slogan. Walter Heller, Kennedy's chief economist, referred to balancing the budget as "the Puritan ethic," at a time when that epithet was considered dismissive.

6. Cutting taxes was not Kennedy's first choice for getting rid of those troublesome surpluses. He had plans for many expenditure increases—for defense, education, urban renewal, regional economic development, worker training and medical care for the aged. Congress did not approve any of that, except for an increase in defense spending after the Soviets put up the Berlin Wall.

7. The Kennedy administration would have liked to "get the economy moving again" by easing monetary policy. But the administration did not control monetary policy, which in any case was inhibited by the balance-of-payments deficit combined with the commitment to support the dollar exchange rate.

8. In the summer of 1962, the stock market fell sharply. That was commonly attributed to anxieties in the financial and business communities caused by the administration's heavy-handed pressure on the steel companies to roll back a price increase. The administration feared that the economy was entering another recession, which would be *its* recession. It felt the need to stimulate the economy but was blocked by Congress on the expenditure-increasing front. Moreover, it felt the need to restore confidence in the business community. So it came to the proposal of a big tax cut.

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9. The administration did not propose to couple the tax cut with a spending cut. It wanted to stimulate demand and reduce the troublesome full-employment surplus. It was the congressional leadership, notably Sen. Harry Byrd of Virginia and Rep. Wilbur Mills of Arkansas, who insisted on expenditure restraint along with the tax cut. This led to President Johnson's classic fiscal policy pronouncement to Walter Heller: "If you don't get this budget down around $100 billion, you won't pee one drop."

10. The administration recognized that tax reduction would have some beneficial incentive effects, which we would now call supply-side effects, but it insisted that the main objective was the surplus-reducing, demand-side effect.

So we got the tax cut, signed in February 1964. And we got a prolonged economic expansion. But the connection between these facts is unclear. By current measurements, the expansion began in February 1961 and continued until December 1969. That is, it began well before the tax cut and was prolonged at the end by expenditures for the Vietnam War. There were "lulls," but no recessions, in 1962 and 1966. In the middle of 1963, when the tax cut was being debated, the economic recovery became so obvious that some questioned whether the cut was really needed. That was an embarrassment to the administration. It wanted the tax cut to relieve the long-run fiscal drag, not just the immediate economic lull. Anyway, having offered the baby the candy it could not take it away. Heller rationalized the policy by saying that the improving economic prospects "offer a solid launching pad" for the tax cut. (We were big on space-age metaphors in those days.) A change in monetary policy probably had a good deal to do with the expansion. From the end of 1959 to the end of 1962, the money supply (M1, which seemed the significant measure at the time) increased at an annual rate of 1.8%. From 1962 to 1969 the annual rate of increase was 4.7%.

Erroneous Estimates

The Kennedy administration's estimates of the nation's long-run economic and fiscal position turned out to be seriously in error. The economy did not grow by 4% per annum. It grew from 1963 to 1995 by an average of 3% per annum—which is an error of 25%, not 1%. We did not face the problem of mounting full-employment surpluses that would be a drag upon the economy because they would depress demand. Instead we faced the problem of large, persistent deficits that depressed the economy by depriving it of savings for investment.

No doubt a determined econometrician can "prove" that the Kennedy-Johnson tax cut was a great success. He will have to be pretty determined. But even so, that would not make the Kennedy-Johnson tax cut a model for us. We start with much lower tax rates. We are much closer to full employment than we were, or thought we were, when Kennedy proposed the cut. We have a bigger deficit, relative to actual or potential national income. And, most important, we face frighteningly large deficits in the next generation, whereas Kennedy and Johnson thought they faced frighteningly large surpluses.

Mr. Stein told the story of the Kennedy-Johnson tax cut in his 1969 book, "The Fiscal Revolution in America," reissued earlier this year.