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This is the second in a series of papers from The Laffer Center assessing, and calling to account, the major academic trends in inequality research of recent years.

TAX CUTS MADE MINCEMEAT OF THE 73% TOP RATE IN THE ROARING 20s

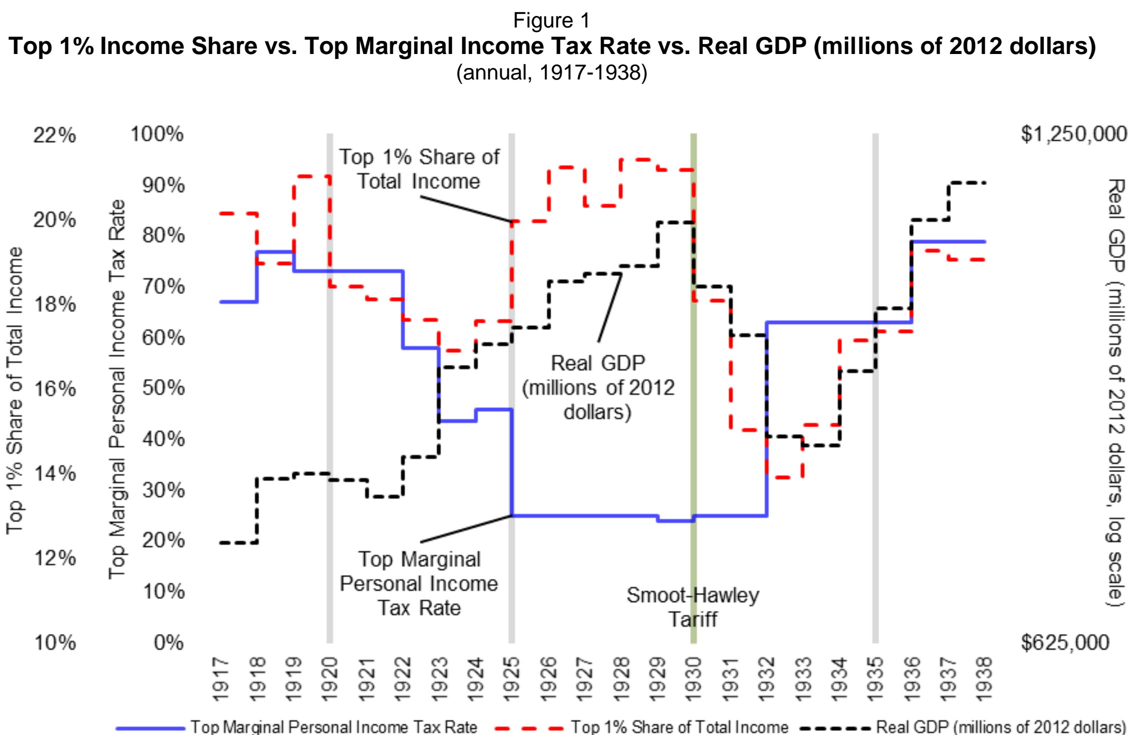
By Arthur B. Laffer, Ph.D. and Brian Domitrovic, Ph.D.

Professor Saez, the Svengali of raising tax rates on the rich, argues that a tax rate of 73% on the top 1% of income earners raises the most revenues. Somehow, he must have overlooked the 1920s when the highest tax rate was cut from exactly 73% down to 25% and revenues exploded as never before.

Not only does the period of the 1920s show that marginal tax rates much lower than 73% on the rich yield much more tax revenue to the government, but also that greater equality of income is achieved only at great cost to the economy. High tax rates on high earners, if anything, make everyone poorer.

Figure 1 shows the 1917-1938 segment of economics professors Thomas Piketty and Emmanuel Saez's famous "U"-shaped inequality curve against the top marginal income tax rate and real Gross Domestic Product (GDP) over the same time period. The evidence against high marginal tax rates couldn't be clearer. Our guess is that if all tax rates were raised to 100%, there would be perfect income equality where everyone earned nothing.

Figure 1
Top 1% Income Share vs. Top Marginal Income Tax Rate vs. Real GDP (millions of 2012 dollars)
(annual, 1917-1938)



Source: Tax Policy Center, Piketty/Saez/Zucman, MeasuringWorth

Please note in Figure 1 that as the highest personal marginal income tax rate dropped from 73% in 1921 to 25% in 1930, the share of total income earned by the top 1% of income earners rose dramatically to its highest level in U.S. history, just as Professors Saez, Piketty and Zucman wrote—low tax rates on the highest income earners, less income equality. But also note that with lower tax rates on the highest income earners, real GDP soared. The gains in total U.S. welfare, including for those below the top 1%, increased as income inequality increased and tax rates fell. And there's a lot more to this story.

In our previous paper[1] on the economics of Professor Saez, we noted that along with conceiving of the U-shaped curve with Piketty, he also contends that a highest marginal tax rate of 73% is what he calls the "Laffer rate." This view is confirmed by *The Washington Post* and is the basis upon which Harvard University's honorary degree was conferred upon him. Those on the left say high tax rates raise revenue and lead to better equality outcomes. But, as the chart above makes clear, lower tax rates in the 1920s coincided with a greater general welfare than the 1910s and 1930s, when tax rates were high.[2]

The three-year period of 1919-1921, interestingly enough, was the one solitary time when the top federal income tax rate was exactly 73%. This rate was cut four times in succession beginning in 1922—down to 25% by 1925. The result was the greatest example of a tax-revenue surge, especially from high-income sources, in the history of tax changes in this country. This example set the standard of revenue-positive results from tax-rate cuts at the top marginal bracket that other subsequent major tax cuts, such as the reductions of the 1960s and 1980s, aspired to match.

The revenue gains did not end with the high earners. The tax cuts on high earners of the 1920s prompted revenue increases across-the-board, from forms of taxation beyond the federal income tax and at all the various levels of government. From 1920 to 1929, as federal income tax rates at the top were reduced by nearly 50 percentage points, the real dollar amount of total governmental receipts in the United States rose by 43%.

The Numbers

Table 1 represents a chronology of U.S. tax policy and the U.S. economy during the decade of the 1920s.

When interpreting Table 1, note that we use the standard conventions of reporting tax rates even though tax rates are not the appropriate metric when assessing changes in reported incomes. People don't work to pay taxes, they work to earn after-tax income, and, as such, the appropriate metric when it comes to reported income should be the after-tax retention rate, or one minus the tax rate.

Average tax rates, along with income, are the appropriate metrics when assessing income tax revenues. What happens to the average tax rate when the highest tax rate changes is fascinating.

The data are clear. Table 1 shows 1920s tax data of the top 1% of earners in context.

[1] Arthur B. Laffer and Brian Domitrovic, "First in a Series 'The Laffer Curve is Alive and Well – On the Left and the Right,'" *The Laffer Center*, April 6, 2020.

[2] Emmanuel Saez, "Using Elasticities to Derive Optimal Income Tax Rates," *Review of Economic Studies* 68 (2001), 212.

Table 1

U.S. Tax Policy, Income and Tax Revenue for Top 1% of Incomes and the U.S. Economy

(annual, 1920-1929)

1	2	3	4	5	6	7	8	9	10	11	12
Tax Year	**Highest Bracket Tax Rate %**	**Top 1% Net Income 2018 $ billions**	**Top 1% Average Income Tax Rate**	**Top 1% Income Tax Revenue 2018 $ billions**	**All Returns Total Income Tax Revenue 2018 $ billions**	**Top 1% % Share of Federal Income Tax**	**Total Revenue Federal, State, & Local 2018 $ billions**	**Federal government spending 2018 $ billions**	**All Returns Total Net Income 2018 $ billions**	**Total Revenue Federal, State, & Local % of GDP**	**GDP 2018 $ billions**
1920	73.0%	$14.0	36.9%	$5.2	$13.5	38.3%	$145.4	$79.8	$297.4	17.0%	$853.5
1921	73.0%	$12.8	32.5%	$4.2	$10.1	41.1%	$150.9	$71.0	$275.4	18.1%	$833.9
1922	58.0%	$21.3	28.5%	$6.1	$12.9	47.0%	$139.4	$49.2	$319.9	15.8%	$880.2
1923	43.5%	$22.7	19.3%	$4.4	$9.7	45.0%	$145.1	$46.1	$364.9	14.6%	$996.1
1924	46.0%	$27.7	21.0%	$5.8	$10.3	56.4%	$152.7	$42.7	$376.1	14.9%	$1,025.9
1925	25.0%	$39.0	15.0%	$5.8	$10.5	55.6%	$152.4	$42.0	$313.4	14.5%	$1,050.3
1926	25.0%	$39.3	15.1%	$5.9	$10.4	57.2%	$161.4	$41.6	$311.5	14.4%	$1,119.6
1927	25.0%	$45.3	15.5%	$7.0	$12.0	58.2%	$174.9	$41.2	$326.1	15.5%	$1,130.4
1928	25.0%	$64.9	16.1%	$10.4	$17.0	61.2%	$188.0	$43.4	$369.1	16.4%	$1,143.3
1929	24.0%	$65.5	14.9%	$9.8	$14.7	66.6%	$198.3	$45.9	$362.9	16.3%	$1,213.7

Source: IRS, U.S. Census Bureau, MeasuringWorth, USGovernmentRevenue, USGovernmentSpending

The first item of interest is that as the highest marginal income tax rate (column 2) tumbled, the reported income of the top 1% of earners went up prodigiously in the 1920s (column 3). The income of the top 1% (column 3) rose from $12.8 billion (in 2018 dollars) in 1921 to $65.5 billion in 1929. That is virtually a 4.5 fold increase in reported incomes by the top 1% while total reported income rose by only 30% and GDP rose by less than 15% (columns 10 and 12). Average tax rates that applied to income of the top 1% fell by a little more than 50% (from 32.5% in 1921 to 14.9% in 1929, as shown in column 4).

The rest of the story is also interesting. Total (federal, state and local) tax revenues as a share of GDP declined slightly during the eight years from 1921 to 1929. GDP soared (it was called the Roaring 20s, after all). And all of this occurred while the highest marginal income tax rate fell from 73% to 24%.

At the outset of this period, the income tax rates affecting the top 1% were very high. In 1920-21, the 73% top rate applied to super-large taxable incomes of over $1 million (equal to some $12 million today). This 73% rate capped off a series of 56 rates beginning at 4% and rising progressively. Other marginal rates included 60% at $100,000 of taxable income, 50% at $86,000 and 40% at $66,000, all in 1920 dollars.

In 1920, as shown in Table 1, the top 1% of earners paid on average 36.9% of their income in federal income taxes. This brought in $5.2 billion in revenue (again in constant modern dollars). Then, tax rates started to fall. In 1922, the top rate dropped from 73% to 58%; in 1924, the top rate dropped to 46% (with a retroactive credit taking 1923's top rate several points lower); and in 1925, the top rate dropped to 25%, where it held for the rest of the decade. In 1929, at the end of the year, a general tax credit was applied taking that year's top rate to 24%. The number of tax brackets collapsed from an incredible 56 brackets to a still very high 23 brackets. Starting in 1925, the top rate came at $100,000 of taxable income—income that previously had been taxed at rates of 60% and above.

Tax revenues from the top 1%, also in 2018 dollars, more than doubled from $4.2 billion in 1921 to $9.8 billion in 1929 (column 5). Quite a story. This development is one of the purest examples in history of the prohibitive range of the Laffer curve for high-income earners.

The average or effective tax rate—the amount of taxes paid divided by income—declined for the top 1% over the course of the 1920s. It fell from 36.9% in 1920 to about 15% from 1925-29. However, the difference between the top statutory rate and the average top-earner rate fell, as well. In 1920, this difference was 37 percentage points; in 1929, it was only nine percentage points. This precedent prompted tax historians to marvel at the development. As economist Richard McKenzie, Gordon Tullock's collaborator, wrote in 1973:

> "The main purpose of this paper is to demonstrate that not only may statutory and effective rates differ, but that it is distinctly possible on theoretical grounds that statutory rate increases may result in lower tax collections for some groups (i.e., lower effective rates). Furthermore, I submit that this perverse effect is most likely to occur among the rich, and it may even occur when work incentives are unaffected."

The surge in tax revenues from top earners that accompanied lower average tax rates and far lower statutory tax rates was part of a larger set of positive impacts on income, tax receipts and fiscal soundness that coincided with the comprehensive income tax rate cuts in the 1920s. Federal corporate and inheritance taxes, for example, which had been introduced not long before the 1920s, farmed higher tax bases in their respective domains in the 1920s because of the sharp and sustained increase in income experienced by the top 1% of earners. Even where these rates may have stayed the same, receipts grew on account of the income that had risen as tax rates were cut in the domain of the income tax.

The sustained leap in earnings on the part of the top 1% corresponded to a comprehensive large increase in business activity, production, sales and jobs. GDP, as shown in column 12 of Table 1, went up in real terms by 38% from 1922-29—an average of 4.7% per year. Net income, as shown in column 10 of Table 1, surged from the 1921 low of $275 billion (in constant modern dollars) to an average of $365 billion in 1928-29, a gain of one-third.

As income generally increased at high rates in the 1920s and tax rates were cut sharply at the top, the tax burden shifted decisively towards the highest earners. The replacement of the maximum rate of 73% with rates one-third as high—24-25%—along with the reduction of rates and tax brackets throughout the income-tax schedule brought about conditions in which those with top incomes paid proportionately more in taxes and everyone else paid less.

As in Table 1, the share of federal income taxes paid by the top 1% of earners in 1921 (when the top tax rate was 73%) was 38.3%. As the rate cuts proceeded in the 1920s, this share rose. By 1923, it was up to 45%, and by 1929, it had gone all the way to 66.6%. By the end of the Roaring 20s, with the top tax rate on the highest earners reduced from 73% to 24%, the share of the income tax burden had shifted such that the top 1% of earners paid two-thirds of all federal income taxes.

The idea that 73% might be the revenue-maximizing top marginal income tax rate, given this history, is obviously misplaced. The evidence of the 1920s shows that 73% was actually nowhere near—indeed far above—the revenue-maximizing top rate. Clearly, 73% was not, as Saez called it, the "Laffer rate."

The National Conversation

The 1920s was a decade of income-tax cuts across the marginal rate structure, but it is important to observe that the cuts did not come all at once. The phasing in of tax cuts from 1921-25 was to be repeated with the tax rate cuts of the 1960s and 1980s, which were also phased in from 1964-65 and 1981-85, respectively. A problem that dogged all three cases was that the phase-ins naturally delayed economic activity and the fullness of the recovery. If someone believes tax rates are going to be lower next year than they are this year, they have an incentive to shift income out of this year and into next year, thus slowing growth this year and accelerating growth next year.

It is also important to note that the United States was alone, among the major former belligerents of World War I, in committing itself to reducing tax rates significantly in the early 1920s. As Saez's collaborator Thomas Piketty observed in his big bestseller, *Capital in the 21st Century*, "in France….[i]t was only after the war, in a radically different political and financial context, that the top rate was raised to 'modern' levels: 50% in 1920, then 60% in 1924, and even 72% in 1925." Great Britain too raised top income tax rates past 50% only after the war, in 1919, then raised them again in

the early 1920s to 60%. Weimar Germany upped the marginal income tax rate from sub-10% wartime levels to 40% in 1920, where it stayed until Hitler dissolved that government in 1933.[3]

Oddly enough, Piketty appears to have been so captured by his own argument that it took the ending of World War I to give governments the resolve to increase income tax rates to high levels that he wrote, erroneously, that the United States proceeded in this fashion. As he put it, "In the United States, which was…more prepared than any other country to accept a steeply progressive income tax and would lead the movement in the interwar period, it was again not until 1918-1919 that the top rate was abruptly increased, first to 67% and then to 77%." This is incorrect on two counts: the United States raised its top rate to 67% in 1917, not 1918, and the leadership it provided in the interwar period, at least through the 1920s, was in the direction of reducing tax rates—leadership that Europe forsook.[4]

The United States entered the 1920s committed to lowering tax rates, as Europe committed to raising them—and the "Roaring 20s" in turn came to America alone. The appreciation of the dollar was a particularly strong signal of the differential rates of economic growth and postwar recovery. Capital lost its preference for Europe, in favor of America, as tax rates across the Atlantic diverged.

In the late teens on into the presidential election year of 1920, a major topic of national political discussion concerned the matter of how high tax rates that had been imposed during World War I (which ended in 1918) might be adjusted without jeopardizing the ability of the federal government to pay off the debt it had accumulated during the war. This discussion was taken up roundly in Congress, in newspapers, in magazines and in political campaigns.

It may come as a surprise that major Democratic officeholders of 1919 and 1920 took up the cause of tax reduction. In 1918-1919, there was a sharp recession that coincided with the end of the war. In less than a year's time, this one recession was followed by the exceptionally sharp recession of 1920-1921. It was these back-to-back recessions that, a generation hence, convinced the economics profession as World War II was coming to a close that the nation was fated to return to the Great Depression. What the economists of the 1940s failed to see was that in 1919 and 1920, major Democrats had rallied to the idea that tax reduction was absolutely necessary to get the nation out of its recessionary spiral. And, ultimately, their vision—if under Republican auspices—prevailed.

A remarkable statement in this regard came in a speech in December 1919 given by William G. McAdoo, President Woodrow Wilson's treasury secretary through 1918 (and son-in-law, as well). Having helped Wilson jack up progressive income tax rates beyond the 60% level as the United Sates prepared to enter the war, then all the way to 79% as the United States fought in France, McAdoo realized that tax rates of this nature were destructive in peacetime. High taxes were imposed only to "lick the Kaiser," as he said in this speech, and "war taxes should now be reduced." McAdoo, who had eyes on the presidency as he spoke these words, said that the current tax law was "relentless" and reached everywhere, "whether that pocket belong[ed] to the rich or to the poor. While the poor do not pay these taxes directly, they do pay them indirectly. Because the taxes increase the price of…every article consumed or used by the people." It is a shame that McAdoo didn't also mention that taxes reduce growth, lower wages and lower employment levels.

We can listen to McAdoo deliver this speech in one of the earliest high-quality audio recordings of American political rhetoric. The recording can be accessed here at the website of the Library of Congress: https://www.loc.gov/item/2016655150/. One of the flaws, or perhaps taunts, of the speech, clearly, was its baiting of the Republicans as a do-nothing party indifferent to high tax rates. Perhaps McAdoo's speaking in this fashion in December 1919 helped to prompt the Republicans to deal with the issue of high tax rates with seriousness and gusto, as they did, in the electoral campaigns of 1920. The Republicans would sweep the federal elections that November.

The presidential election of 1920 pit Republican Warren G. Harding and his running mate Calvin Coolidge against the Democratic nominee, Ohio Governor James Cox—and his running mate and Secretary of the Navy Franklin D. Roosevelt. McAdoo himself almost scored the Democratic nomination, which Wilson himself also desired, even though he was ailing and despite the sacredness of George Washington's precedent of a two-term presidency. It is likely that had either McAdoo or Wilson won the nomination at the San Francisco convention that year (which took 44 ballots to pick Cox), and then the presidency, either of these Democrats would have pushed for tax reduction.

[3] Thomas Piketty, *Capital in the 21st Century*, trans. Arthur Goldhammer (Cambridge: Harvard University Press, 2014), 499.
[4] Piketty, *Capital in the 21st Century*, 500.

As Wilson said in his December 1919 State of the Union address:

> "Congress might well consider whether the higher rates of income and profits taxes can in peace times be effectively productive of revenue, and whether they may not, on the contrary, be destructive of business activity and productive of waste and efficiency. There is a point at which in peace times high rates of income and profits taxes discourage energy, remove the incentive to new enterprise, encourage extravagant expenditures and produce industrial stagnation with consequent unemployment and other attendant evils."[5]

Wilson's treasury secretary after McAdoo, Carter Glass, made similar points, in his November 1919 annual report:

> "The upmost brackets of the surtax have already passed the point of productivity and the only consequence of any further increase would be to drive the possessors of these great incomes *more and more* [emphasis added] to place their wealth in the billions of dollars of wholly exempt securities…issued by States and municipalities, as well as those heretofore issued by the United States. This process not only destroys a source of revenue to the Federal Government, but tends to withdraw the capital of very rich men from the development of new enterprises and place it at the disposal of State and municipal governments upon terms so easy to them…as to stimulate wasteful and non-productive expenditure by State and municipal governments."[6]

These Democratic officeholders saw what was happening to the economy as it strained, in the peacetime period of late 1918 to late 1919, under a highly progressive income tax system that featured a top marginal rate of 73%. And as their warnings brought no immediate change in policy, the economic consequences of retaining the wartime tax structure became extreme. The recession that ended in 1919 found more than a counterpart in the acute 18-month recession of 1920-21. Unemployment, not yet officially calculated, probably hit around 18% in 1921, according to modern estimates. Private investment in housing and railroads ground to a halt. There was a wave of strikes, anarchist bombings, and race riots across the period of 1919-1921; in Seattle, there was a general strike. Economic growth (in modern reconstructions) was negative by over three quarters of a percent per year from 1918 to 1921.

In the election of November 1920, Cox and Roosevelt got trounced, losing to Harding and Coolidge by a popular-vote margin of 26 percentage points, which remains a record of the past 200 years.

Harding had campaigned on returning the nation to "normalcy." Presumably, this implied, among other things, a scaling back of the novel income tax, which had only been in existence since 1913, and which only had been experimenting with rates above 15% since 1917. Clearly income tax rates had to be cut—but other priorities competed for policymakers' attention as Harding assumed office.

One problem was homegrown. The Republicans had long preferred another form of taxation, the tariff (the subject of a Laffer Associates paper last summer).[7] In 1921, as the Republicans got their first income-tax cut (taking the top rate to 58% in 1922), they shortly thereafter passed and signed into law an increased tariff, the Fordney-McCumber Tariff of 1922. Economic growth remained comparatively slow as these somewhat contradictory developments came about. As in Table 1, after the first income-tax rate cuts of the 1920s, the income of the top 1% and the tax-payment share of this group started to rise, but the big gains came later.

Once the tariff and the first round of the income tax cuts were secured, the key figure rallying the Republicans to the big-income-tax-cut cause came into his own. This was Harding's (and then Coolidge's and Hoover's) secretary of the treasury, Pittsburgh banker and industrialist Andrew W. Mellon. It is hard to imagine that any of the economic wonders of the 1920s could have occurred without him.

Ordinarily, Mellon was a reticent, non-loquacious man. He and the laconic Coolidge communicated in pauses, as it was said. But when it came time to put all priority on getting the marginal rate well below 58%, Mellon found himself as a communicator.

Most notably, Mellon wrote a book explaining his views, taking care to cite numerous examples of opinions similar to his from Democrats. He ensured that his book was distributed widely, as he sought to build a national political

[5] Quoted in Andrew W. Mellon, *Taxation: The People's Business* (New York: Macmillan, 1924), 129.
[6] Quoted in Mellon, *Taxation, 128.*
[7] Arthur B. Laffer and Brian Domitrovic, "Tariffs and the Objectives of Political Leadership", *Laffer Associates*, July 17, 2019.

consensus that would compel Congress to pass further revenue acts lowering tax rates. This book of Mellon's was the remarkable *Taxation: The People's Business* of 1924.

Taxation explicitly followed the McAdoo-Wilson-Glass line of argument and noted that the "surtaxes" on high incomes responsible for the very high top rates of the early 1920s had been imposed during the war—"during that time the highest taxes ever levied by any country were borne uncomplainingly by the American people," as Mellon wrote. He conceded that "for a short time the surtaxes yielded a large revenue," and continued:

> "But since the close of the war people have come to look upon them as a business expense and have treated them accordingly by avoiding payment as much as possible. The history of taxation shows that taxes which are inherently excessive are not paid. The high rates inevitably put pressure upon the taxpayer to withdraw his capital from productive businesses and invest it in tax-exempt securities [chiefly municipal bonds] or to find other lawful methods of avoiding the realization of taxable income. The result is that the sources of taxation are drying up; wealth is failing to carry its share of the tax burden; and capital is being diverted into channels which yield neither revenue to the government nor profit to the people."[8]

The book went over the problems that accompanied high taxes from any federal source, be they of the income, estate, corporate, or capital gains variety, smothering all defenses of the super-high rates that had come upon the U.S. tax system during the exigency period of the Great War. It quoted liberally from Wilson, McAdoo and Glass, the Democratic luminaries from the previous administration who had expressed shock at how destructive high tax rates had proven as soon as peacetime took hold in 1918. Mellon's efforts were successful. *Taxation's* publication coincided with the tax-cut bill of 1924, and then prompted the great effort Mellon desired, a law that took the top rate all the way down to 25%, which came in the form of the Revenue Act of 1926.

Decades before the Laffer curve had been named, the highest officials in the country from both parties, after World War I, looked at top income tax rates over 70% and wished, as summed up and cited by Andrew Mellon, to "consider whether the higher rates of income and profits taxes can in peace times be effectively productive of revenue, and whether they may not, on the contrary, be destructive." Select Democratic and then many Republican officials, prodded by Mellon, were sure, as Glass had said, that "the utmost brackets of the surtax have already passed the point of productivity."

Top tax rates over 70% in the late Teens and early 1920s engendered a brief bipartisan consensus (today forgotten as such) that cutting these rates would both bring in more revenue and restore vibrancy to the economy. The arguments took time and effort to make—a tariff had to be enacted to enable the cutting of income-tax rates—and the recession of the early 1920s lingered as a result. But eventually, the tax-cutting vision prevailed. The remarkable Roaring 20s that came into their own by way of the Mellon income-tax cuts remain the standard of mass prosperity in the long annals of American economic history.

Undoing "Crowding Out"

As Mellon, Wilson and Wilson's associates observed in the late 1910s and early 1920s, Americans with high income in those years were buying up state and local government bonds at a very good clip. This was because the interest of these bonds was not subject to the federal income tax (per the compromise that had produced the income tax in the first place in 1913) and federal rates affecting high income had been jacked up past the level of 70%.

All this bond buying was beginning to jeopardize not only the U.S. Treasury, but the economy at large. High-earner income in the early 1920s was coming to include a large unreported tax-free component in the form of non-federal governmental bond interest. This meant that investment preferences of high-earners had shifted from private to public outlets—quite narrow ones at that. Federal tax increases at the top had produced the dreaded "crowding out" effect. Top marginal rates that hovered near 70% had prompted private investment capital to head under the shelter of tax-free government securities.

In 1920, total government spending—combining federal, state and local outlays—amounted to $11.5 billion in current dollars and, in real terms, was more than double what it had been ten years before. The states and localities had gotten

[8] Mellon, *Taxation*, 12-13.

hooked. The new demand for their debt instruments had state and local governments spending twice as much on interest payments, in real terms, in 1923 compared to 1910.

The tax cuts that gained priority with Mellon's arrival at the Treasury in 1921 during the Harding administration—supported as these tax cuts had been by the departing Democratic administration—promised to arrest, and reverse, all these processes. Federal tax cuts decreasing the top rate were designed to achieve several goals simultaneously. They would, first, lessen the attractiveness, on the part of high earners, of state and local government bonds. They would, second, increase the attractiveness of taxable private investment vehicles as opposed to those tax-free bonds. They would, third, increase the federal tax base by drawing more capital from high-income sources into federally taxable economic activities. And they would, fourth, occasion increased economic growth on account of the greater share of private capital devoted to the private sector, to the real economy.

Precisely this series of results is what came about. Economic growth in the 1920s—as the tax cuts at the top were prepared, implemented and sustained from 1921-1929—was among the strongest and most resplendent in American history. Outside of the agricultural sector, where labor remained "sticky" on farms that had become super-productive thanks to engineering and transportation innovation, unemployment vanished to levels below what would later be called structural. The American people in general enjoyed a prosperity on a mass level unlike anything seen before. Cars, suburbs, radios, airplanes, movies, home appliances—all these fruits of private investment surged in production and abundance as the nation experienced what is now recalled as the most legendary episode in the annals of mass affluence—the Roaring 20s.

As for the fiscal status of governments at all levels in the 1920s, it improved to a level of soundness and respectability that to the modern perspective seems almost impossible. For 11 straight years from 1920-1930, the federal government of the United States ran a budget surplus. This was so even though the United States had an immense amount of debt recently obtained during World War I and tax rates were cut dramatically throughout the decade, in particular early on. There was no irony: the tax rate cuts were the key to the renewal of economic resilience that enabled the surplus.

Another effect was the reduction in federal spending. The private sector was once again taking care of the people. The boom in jobs, opportunities, livelihoods and levels of net worth dramatically lessened any obligation the federal government might think to have with respect to the income security of the population. Federal spending dropped by two-thirds over the 1920s, and every year interest payments represented a growing share of that shrinking budget. The American people looked after themselves in the Roaring 20s, and did a glorious job of it, too.

State and local spending, however, was a more ominous matter. It was about half a point higher than its historical norm at 5.2% of GDP in 1920. But then it rose beyond all precedent, crossing 8% in 1928. The big federal tax-rate cuts touched off economic growth, which in turn fed into the unadjusted state and local tax schedules. This led to a boom in state and local revenues, which was promptly filled in by spending. A lesson was there to be had. Tax-rate cuts can work so well that they must call forth further tax-rate cuts, and at all levels of government and in all corners of the tax code—lest government get large via the effects of the Laffer curve. It is interesting that one group of conservatives actually found the idea of additional government revenues resulting from tax cuts as offensive and distasteful. Their dream was to starve the beast.

Perhaps all this sounds like a world away—surpluses, surging revenue, massive economic growth, a population weaned off government and resplendently taking care of itself. Oddly enough, it sounded like a world away as early as the 1930s, when the country was mired in the Great Depression—a subject of a forthcoming paper of ours. There can be no mistake, however, that the 1920s teemed with lessons about how to pursue an enlightened tax policy and how to ensure that the American economy roars that remain relevant to this day.

At the beginning of this year, 2020, commentators noted that we should pine for a repeat of the 1920s, in terms of its economic performance. That decade had a rocky start, to be sure, but it quickly got wise about the absurdity of the high federal income-tax rates that were on the books. In our rocky start in 2020, the solution of pulling back government from its overreaching is the precedent from a hundred years ago calling out to us. As for the identification by today's academic-celebrity economists of a 73% revenue-maximizing top tax rate, it stands in defiance of the history of when that tax rate actually prevailed.

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