La plus ça change

BY ROBERT S. MCINTYRE

The Great Tax Wars

By Steven R. Weisman. Simon & Shuster, 367 pages, plus notes and index, $27.

As every schoolchild is taught, and many adults try to forget, our constitution was adopted to give the federal government the power to run a real country—and to do so, the power to tax. The debate over revenues that started then has pretty much never ended.

George Washington, who presided over the constitutional convention, knew all too well the dangers of an inadequately funded government from his travails leading the woefully underfinanced Continental Army during the revolution. As Washington's ally Alexander Hamilton put it in *Federalist No. 30* in defense of the constitution, "Money is the vital principle of the body politic; as that which sustains its life and motion . . . . A complete power, therefore, to procure a regular and adequate supply . . . may be regarded as an indispensable ingredient in every constitution."

Opponents of the constitution also understood that taxes are essential to a working national government—they simply didn't want one. Not untypical, says University of Texas law professor Calvin Johnson, was the anti-Federalist rhetoric in a "Letter from a Farmer and a Planter to the Farmers and Planters of Maryland" (1788). The writer charged that to enforce the federal tax laws, Congress would send in soldiers "to cut your throats, ravage and destroy your plantations, drive away your cattle and horses, abuse your wives, kill your infants, and ravish your daughters, . . . until you get into a good humour, and pay all that they may think proper to ask of you."

Of course, the constitution and its taxing authority were soon ratified by the states. But the founders' dream of a robust United States of America took a long time to come to fruition—because the taxing power lay largely dormant for the first 70 years after the constitution was ratified. Instead, the federal government paid for its limited activities with highly regressive consumption taxes, mainly protectionist import duties.

In *The Great Tax Wars*, Stephen R. Weisman of the *New York Times* tells how and why that changed. It's the story of the progressive federal income tax, from its temporary inception during the Civil War to its firm reestablishment in the early part of the 20th century. Anyone who wants to understand the roots of today's tax politics can learn a lot by reading this entertaining book. Until you do that, Weisman's tale is well worth summarizing here.

When the Civil War began, it was not expected to last long —"two or three months at the furthest," the *Chicago Tribune* predicted. So the fact that the Union, not to mention the Confederacy, had almost no source of revenues to pay for the war didn't seem to be important at first. Borrow the money and pay it back later was the prevailing thinking. But it soon became clear that the war would take much longer and cost much more than anyone had initially conceived.

Meanwhile, war profiteering, ever-increasing wealth concentration and the easy ability of the well-off to buy their way out of military service led to popular resentment of the rich. And so, Weisman writes, "to persuade Americans that the wealthy citizens who were prospering from the war would bear more of its cost, Congress and the President turned in 1862 to the income tax, as well as taxes on corporations. . . . [F]or the first time, taxation was also conceived and understood as an instrument that reduced inequality."

When Congress first considered raising taxes to fund the war, it looked to the familiar ones: higher tariffs and excise taxes. But "after a storm of criticism that these new steps would fall most heavily on the poor," Weisman says, it became clear that something quite different was needed. Republican Rep. Schuyler Colfax of Indiana first broached the idea of a federal income tax in the summer of 1861, soon after the devastating Union defeat at Bull Run. Soon others in Congress were touting the idea that taxes should affect people based on "their ability to bear them."

As you might expect, this was not the universal view. Thaddeus Stevens, the Pennsylvania Republican who chaired the House Ways and Means Committee, complained that it was "vicious" and "unjust" to impose "a punishment of the rich man because he is rich." Vermont Republican Justin Morrill, a leading member of Stevens's committee, warned that wealthy people might leave the country to avoid paying the tax. But the income tax had a strong philosophical ally in President Abraham Lincoln, a long-time proponent of progressive taxes, having pushed (unsuccessfully) for a graduated property tax as an Illinois state legislator. Lincoln had argued that such an approach was not only "equitable within itself," but good politics, too, since the "wealthy few . . . it is still to be remembered . . . are not sufficiently numerous to carry the elections."

Despite opposition, Congress passed a primitive income tax bill in 1862. But Lincoln's defiant Treasury Secretary Samuel Chase, who had misgivings about the income tax, chose to ignore the law, preferring to concentrate on more borrowing. When that source became difficult to tap and Union military setbacks continued, Chase talked Lincoln into printing money—"greenbacks"—despite correct fears that doing so would spur inflation.

The following year, Congress passed a more carefully thought-out income tax plan, including a new agency to enforce it. The two-rate system, taxing incomes greater than $600 at 3 percent, and more than $10,000 at 5 percent, was part of a larger revenue bill that also taxed inheritances, corporations, and various commodities. Lincoln signed the bill on July 1, 1862, and quickly hired the first commissioner of Internal Revenue.

By the end of the war, tax withholding was in place and the top income tax rate had been raised to 10 percent, to squeeze "the millionaires . . . who can afford to pay liberally of their means," as one proponent put it. The political pressure for steeper progressivity was great. "There is no tax more equal than an income tax," Rep. Morrill declared in 1863, repudiating his own earlier anti-income tax position.

As Weisman points out, "The income tax was crucial to the prosecution and winning of the Civil War." Indeed, the South's failure to implement a working income tax soon enough played a big role in its downfall. Confederate money with no revenue backing it up soon became worthless, and the South lost the ability to finance an effective rebellion.

For a while after the Civil War, the income tax remained in place to help pay off the war's huge debt. At its peak in 1867, the income tax represented a quarter of total federal revenues. But the Republican-controlled Congress soon returned to its Whiggish roots. Income taxes were gradually reduced, and in 1872, repealed, while the government reverted to high, protectionist tariffs to pay its bills. "By the end of Reconstruction, the system of high tariffs was impregnable and the income tax but a memory," Weisman writes.

Not everyone agreed with this return to regressivity. Republican Senator John Sherman of Ohio, later author of the Antitrust Act, for example, argued strenuously that it was unfair to tax the consumption of the poor and middle classes while leaving the rich alone. But for two decades after repeal of the income tax, proposals to reinstate it were ignored.

Weisman really hits his writing stride when he get to the early 1890s. By then, he notes, tariffs had jumped to "nearly 50 percent of the value of goods purchased by consumers"—an enormous burden on average Americans, but a boon to American corporations who could keep their own prices high due to the absence of price competition from abroad, making the tariff system effectively a negative tax on the wealthy.

In the 1892 elections, the voters were fed up with the GOP's corrupt corporate toadying, and they sent to the White House Democrat Grover Cleveland, who promised reform. In 1894, Cleveland joined the populist Rep. William Jennings Bryan (D-Neb.) in a fight to restore the income tax. Bryan's proposal was remarkably timid: a mere 2 percent tax, applicable to corporations and the 2 percent of the population making more than $4,000 a year.

During the congressional debate, one income-tax opponent complained that poor Americans would feel "humiliated and degraded" by not having to pay the income tax, and that it would leave only the rich with "first-class citizenship." Noting that poor Americans obviously paid far more than their fair share of tariffs, Bryan replied, "If taxation is a badge of free men, the poor people of this country are covered all over with the insignia of free men." Another spokesman for the rich contended that the 2 percent income tax would drive "rich men to go abroad and live." Bryan countered, "Of all the mean men I have ever known, I have never known one so mean that I would be willing to say of him that his patriotism was less than 2 percent deep."

The income tax bill was eventually approved by Congress, although to Cleveland's dismay, measures to cut tariffs were dropped in the Senate. But the income tax had one more hurdle to surpass: the U.S. Supreme Court.

The Supreme Court majority of the late 19th and early 20th centuries was one of the worst in American history. Its most infamous decision, *Plessy* v. *Ferguson*, established the legality of "separate but equal" facilities for blacks and whites, thereby legitimizing "Jim Crow" laws. Its 1905 decision in *Lochner* v. *New York* rejected a state law setting a 60-hour maximum work week.

In 1895, the court dealt with the newly passed income tax law, which was challenged by corporate interests. By a 5-4 vote, the court threw out the income tax as unconstitutional. There was no single majority opinion in *Pollack* v. *Farmers' Loan and Trust Co.*, but rather several opinions, offering conflicting, wholly unpersuasive legal arguments for the decision. The real rationale was simpler: the income tax, said one justice, is "an assault on capital," a "stepping-stone to . . . a war of the poor against the rich," and a path to "sure decadence." It would take two decades and a constitutional amendment to undo the Supreme Court's lawless decision.

By the early part of the 20th century, concerns about excessive concentrations of wealth and power were continuing to grow. Ironically, Theodore Roosevelt, who was number two on the extremely conservative McKinley-Roosevelt ticket that defeated Bryan in the presidential election of 1900, came to personify the Progressive campaign to change our tax policies to address those problems. In the spring of 1906, President Roosevelt proposed restoration of the federal estate tax. By the end of the year, he called for a graduated tax on income as well.

Unfortunately, Roosevelt was more talk than action when it came to taxes. But his Republican successor, William Taft, felt it was his mission to fulfill Roosevelt's goals. In 1909, Taft succeeded in enacting a 1 percent corporate income tax (called an "excise tax" to get around the *Pollack* decision), but his efforts to pass a personal income tax were thwarted by the GOP Congress. As a sop to Taft and public opinion, Congress instead approved a constitutional amendment to overrule the Supreme Court's *Pollack* decision, confidently assuming that it would fail to gain the required three-fourths support from the mostly Republican state legislatures.

A few, mostly southern states, quickly endorsed the income tax amendment, led by Alabama in the summer of 1909 and followed by Georgia, Illinois, Kentucky, Maryland, Mississippi, Oklahoma and Texas. But support in the wealthy northeast and mid-Atlantic states looked doubtful. Then Theodore Roosevelt intervened again. His decision to run against Taft for the presidency in 1912 as a "Bull Moose" split the Republican party, and "Democratic routs of previously Republican [state] legislatures . . . turned the tide [for ratification]."

Entrenched business interests fought bitterly to the end. In New York, for example, Weisman notes,

> an army of lobbyists, bankers, financiers, chambers of commerce officials and businessmen descended on . . . Albany. . . . The *Albany Evening Journal*, a Republican mouthpiece, argued that the tax would "divide the population into two classes, the class which contributes to the support of the Government, and the class which does not contribute."

"It was an absurd comment," Weisman points out, "given that the class that supposedly 'does not contribute' was actually paying most of the revenues in the federal treasury as customs duties and excise taxes."

By early 1913, 42 of the 48 states, including New York, had ratified the Sixteenth Amendment authorizing Congress to "tax incomes from whatever source derived." On his way into the White House to implement this new authority was the new Democratic president, Woodrow Wilson, who immediately called for slashing tariffs and replacing them with a progressive income tax.

The system of high, protectionist tariffs, Wilson said, "cuts us off from our proper part in the commerce of the world, violates the just principles of taxation, and makes the government a facile instrument in the hand of private interests." Wilson's Treasury Secretary William McAdoo was a wealthy businessman, but he firmly supported the President, condemning the tariff system as "a general tax on the entire population for the benefit of private industry," raising consumer prices not only on imports but on domestic products as well.

At the end of the summer of 1913, the Democratic Congress approved Wilson's tax reform program, over strenuous Republican opposition. The new law slashed tariffs from an average of 40 percent to 28 percent, and exempted many necessities entirely. To replace the revenues lost from tariff reform, it established a progressive income tax on the best-off 4 percent of the population, with rates ranging from 1 percent up to a high of 7 percent on incomes in excess of half a million dollars.

Wilson's tax changes were a huge victory for tax fairness, and the forces of conservatism were understandably not happy. The president of the American Bar Association accused Democrats of "seeking to turn back the tide of progress" and "plunge us into a sea of socialism." The National Association of Manufacturers issued stickers saying "Free Business from Political Persecution." But these rants went generally ignored.

The new income tax was propitiously timed, as it proved essential in financing the huge increase in federal spending that World War I would require. With the U.S. entry into the Great War, the federal budget jumped from less than a billion dollars in 1916 to almost $14 billion by 1918. "The income tax," Weisman notes, "was needed to finance that explosion in spending." By the end of the war, the top income tax rate had been increased to 77 percent, corporate rates were boosted sharply, and a permanent estate tax was instituted as well.

Republicans regained control of the Congress in the 1918 elections and the White House in 1920, and there Weisman ends his tale. But in his epilogue, he points out that although taxes were cut sharply after World War I, the new philosophy "that taxes ought to be borne according to the ability to pay" has proven too popular for any of Wilson's successors to abandon completely. In 1913, he notes, almost 95 percent of federal revenues had come from regressive taxes on consumer spending. By 1930, even after the tax reductions under Harding and Coolidge, two-thirds of federal revenues came from progressive personal and corporate income taxes—percentages similar to what we see today.

To be sure, the battle over just how fair taxes ought to be will never be settled conclusively, if only because far too much money is at stake. Over the past eight decades, conservative presidents and Congresses have typically pushed for less progressive tax rates and more loopholes for corporations and the wealthy, while liberals have usually pushed in the opposite direction. Tax lawyers and accountants for the rich and powerful devise complicated tax-dodging schemes—and then complain bitterly about "complexity" when their loopholes are closed. Meanwhile, the terms of the tax debate haven't changed much either. Year in and year out, the rich have been tarred as unpatriotic shirkers of their tax responsibilities or praised as the swashbuckling engines of economic growth (who unfortunately become uninspired and indolent at the thought of paying taxes).

But with all the ebbs and flows, even politicians who favor the most outrageous tax giveaways to the well-off have tended to couch their arguments in faux-populist tones. George W. Bush, for example, finds it necessary to insist—preposterously—that his recent upper-income tax cuts made the tax system more progressive and that his hatred of taxes on inherited wealth reflects his concern for small businesses and farmers.

If pressed, I could quibble that Weisman's writing is sometimes a bit drier than I'd prefer and complain that his chronology occasionally left me a little confused. But much more important, Weisman successfully gets to the heart of what the tax fights were really about from 1860 to 1920, and thereby helps us understand much better what they're about today.

On a final note, Weisman's book got me thinking about which revered presidents are depicted in the granite of South Dakota's Black Hills. There's George Washington, the father of federal taxation, there's Abraham Lincoln, who gave us our first federal income tax, and there's Theodore Roosevelt, whose zeal for reestablishing the income tax was crucial. Yeah, the tax-conflicted Jefferson is up there, too, but for what it's worth, Weisman has inspired me to view Mount Rushmore as a reasonable approximation of America's Tax Hall of Fame.

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