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978-1-107-09976-0 - Federal Taxation in America: A History: Third Edition

W. Elliot Brownlee

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Federal Taxation in America

This authoritative and readable survey is a comprehensive historical overview of federal taxation and fiscal policy in the United States, extending from the era of the American Revolution to the present day. W. Elliot Brownlee relates the principal stages of federal taxation to the crises that led to their adoption, including but not limited to the formation of the republic, the Civil War, World War I and II, and the challenges to government that took hold during the 1980s.

In this third edition, Brownlee adds four new chapters covering the colonial era, the American Revolution, the Civil War, the 1920s, and the post-1945 era including the tax policies of the George W. Bush and Barack Obama administrations. It features expanded discussion of government expenditures, deficits and debt, public resources, counter-cyclical fiscal policy, and state and local taxation. Its interdisciplinary interpretation makes it perfect for scholars, graduate students, and advanced undergraduate students.

W. Elliot Brownlee's books include *The Political Economy of Transnational Tax Reform: The Shoup Mission to Japan* (co-edited); *Federal Taxation in America: A Short History*; *The Reagan Presidency: Pragmatic Conservatism and its Legacies* (co-edited); *Funding the Modern American State: The Rise and Fall of the Era of Easy Finance, 1941–1995*; *Dynamics of Ascent: A History of the American Economy*; *Women in the American Economy, A Documentary History, 1675–1929* (with Mary M. Brownlee); and *Progressivism and Economic Growth: The Wisconsin Income Tax, 1911–1929*. Brownlee has held visiting professor appointments at Princeton University, the University of Tokyo, and Yokohama National University. He was a bicentennial lecturer, the U.S. Department of the Treasury, and has been a fellow at the Woodrow Wilson International Center for Scholars and the Charles Warren Center, Harvard University.

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A History

Third edition

W. ELLIOT BROWNLEE

University of California, Santa Barbara



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For Mary Margaret

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Preface

“In this world nothing can be said to be certain, except death and taxes,” wrote Benjamin Franklin in 1789. I certainly agree with him regarding what my father soothingly referred to as “eventualities.” But Franklin’s proverb breaks down as a way of understanding tax planning, the making of tax policy, and tax history. Well-trained tax attorneys can help some clients avoid paying any taxes on the wealth they accumulate in their lifetimes and then pass on that wealth tax free to the next generation. Skillful politicians and lobbyists can bring about huge shifts of income and wealth through changes in the tax system that produce winners and losers. And, while great national crises almost invariably produce seismic transitions in tax systems, the transitions often occur in ways that are very hard to predict. In two editions of *Federal Taxation in America: A Short History*, I tracked those transitions in the history of the United States and concluded that the history of taxation in the United States ought to be understood not as a process of incremental change but as a series of distinct tax regimes, each one driven by a national crisis.

Since the late 1970s, the possibility of radical reform of the federal tax system, one that would produce a new tax regime, has been a matter of intense debate. And that debate has, in fact, prompted important changes in the tax system. Of primary importance were the reforms of tax and fiscal practice undertaken during the presidency of George W. Bush and confirmed during that of Barack Obama. These reforms brought about the most significant changes in federal taxation since World War II. The reforms, I believe, have launched a new tax and fiscal regime that, for reasons discussed in this book, should be described as “retro-liberal.”

The transition to the retro-liberal regime did not take place overnight. It had roots in hostility to progressive taxation and ambitious government that dated back to World War I and even earlier. The swing toward the new regime began during the late 1970s, producing first the success of California's Proposition 13 in 1978 and President Ronald Reagan's Economic Recovery Tax Act of 1981. The victory of retro-liberalism was delayed by the ironic fact that the so-called Reagan Revolution actually strengthened the income tax that had been crafted during the two world wars and the New Deal of Franklin Roosevelt. But in the 1990s, other powerful voices began calling for replacing the progressive income tax with either a national tax on consumption or a "flat tax." In 2001 and 2003, President George W. Bush led in the enactment of dramatic tax cuts that launched the retro-liberal regime. Subsequently, during the presidency of Barack Obama, Congress made most of the cuts permanent, confirming the shift in regimes.

Two major economic traumas contributed to the victory of the new regime. The first trauma was the "Great Inflation" of the 1970s, and the second, more prolonged, was the "Great Recession," 2007–2009, and a recovery that proved agonizingly slow, particularly for middle- and low-income Americans. The bout of inflation was the most severe such episode in the United States during the twentieth century, and the downturn was the worst since the Great Depression. Both episodes signaled to many middle-class Americans that government had failed them, and tax policy seemed to add more pain to the economic crises. The economic alienation of middle-class Americans provided the political base for the success of wealthy opponents of progressive taxation and government social programs in replacing the old regime.

The emergence of a new tax regime – a system of taxation with its own characteristic tax base, rate structure, administrative apparatus, and social purposes – was nothing extraordinary. Between the Declaration of Independence and the rise of retro-liberalism, the nation had more than a half-dozen tax regimes.

There was nothing unusual, either, about such a shift having roots in earlier regimes. For example, the tax regime created during the formation of the republic between 1775 and 1789 drew heavily on experiences under the tax regimes of British America. And the adoption during World War I of a tax regime based on income taxation was influenced by a long period of political agitation and legislative experimentation, and even more fundamentally by the republican ideals of the American Revolution.

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There was nothing new about the survival of elements of the old tax regime into the new. The sequence of crisis-born regimes has lent the nation's tax system an increasingly layered, or diversified, quality. For example, the tariffs and sin taxes of the Civil War tax regime survived into the progressive tax regimes of the twentieth century.

Finally, there was nothing new about economic distress contributing to new tax regimes. For example, the increasingly severe depressions of the late nineteenth century laid much of the social groundwork for the progressive tax regimes.

What was without precedent, however, was a decisive shift to a new tax regime in the absence of a well-defined national crisis or emergency. Earlier, sweeping changes in tax regimes came during the nation's great political, economic, and existential emergencies – the American Revolution, the constitutional crisis of the 1780s, the Great Depression, and the three greatest wars. Previously, as is now more widely recognized than when I wrote the first edition of *Federal Taxation in America: A Short History*, the history of federal taxation turned on the government's need for vast new resources to meet a series of national emergencies. In contrast with earlier regimes, the retro-liberal regime was designed to contain or shrink government rather than expand it.

One of the lessons we should learn from the victory of retro-liberalism is that the meaning of "crisis" is, to a large extent, in the eye of the beholder. The politicians, publicists, and lobbyists who won public support for the introduction of the retro-liberal regime believed, or at least argued, that the adoption of the new fiscal regime was, in fact, a reaction to a crisis – an ongoing and worsening threat to liberty that they claimed was the inherent legacy of twentieth-century liberalism.

The need to understand the sources of the retro-liberal regime, its setting in a larger set of fiscal transitions, its potential significance, and the likelihood of it succeeding in a sustained way has been very much on my mind in writing this book. During the transition to the new retro-liberal tax regime, it has become abundantly clear that the development of tax regimes must be understood within the larger context of the mobilization and management of public resources, and for this reason I have enlarged my discussion of the history of government expenditures, deficits and debt, and assets. In addition, the retro-liberal attacks on government, which have focused almost entirely on institutions created since World War I, have suggested the need to pay more attention to the importance of the crises of the eighteenth and nineteenth centuries in creating fiscally powerful government in the United States. Consequently, I have expanded

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my discussion of the republican tax regimes that emerged in the eighteenth century, and of the Civil War tax regime, which bridged the republican and the twentieth-century regimes. Finally, I have expanded the coverage of the tax regime inherited from World War II, especially during the critical period since the late 1970s.

Throughout the book, I have continued my effort to seek connections between the history of tax regimes in America and contemporary tax issues. In May 2016, as I watch the presidential elections, no immediate shift in tax regime seems imminent. But the deeply unsettled condition of American politics, the prominence of issues of social distribution, and the profound crisis of the American middle-class all suggest underlying similarities to the dynamics of political change a century ago. The similarities point to the likelihood of another shift in fiscal regimes during the early twenty-first century, and a restoration of the community values lost sight of during the long swing toward retro-liberalism.

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The first edition of this book and a companion volume, *Funding the Modern American State, 1941–1995: The Rise and Fall of the Era of Easy Finance*, emerged from the Tax History Workshop I chaired at the Woodrow Wilson International Center for Scholars during 1993–1996. The goal was to set the financing of the federal government since World War II in the broader history of American government and society. The other participants in the project were Edward Berkowitz, Hugh Hecló, Carolyn Jones, Michael J. Lacey, Cathie Martin, Stanford Ross, Herbert Stein, Eugene Steuerle, and Julian Zelizer. As I wrote in the first edition of *Federal Taxation in America: A Short History*, “They brought a wealth of experience and scholarly insight to bear on the history of taxation and public finance, and I found their advice invaluable.”

Frank Smith, then Executive Editor of Social Sciences at Cambridge University Press, and Joseph Brinley, Director of the Woodrow Wilson Center Press, proposed that I write the first edition of this book and then revise it for a second. Lewis Bateman, Senior Editor for Political Science and History at Cambridge University Press, encouraged me to undertake the current edition, which is expanded significantly and slightly retitled. I am extremely grateful to have the benefit of Lew’s wisdom and experience. Cassi Roberts and Minaketan Dash expertly guided the book through production. Two anonymous reviewers helped me think about this edition’s scope and organization.

Since the second edition appeared, a great many colleagues around the world have helped me understand the long-term development and significance of tax and fiscal policy. Let me thank, in particular, Michael Adamson, Takatsugu Akaishi, Steven Bank, Stuart Brandes, Marc

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As I hope my dedication suggests, my largest debt continues to be the one I owe to Mary Margaret Brownlee.