Introduction

"The taxation system is unjust in the United States," New York City tailor Conrad Carl boldly informed national lawmakers in the summer of 1883. "It is only indirect taxes, which fall back upon the workingman.... He is the last one that they can fall back upon, and they get the taxes out of him. It is only the workingman that is the taxpayer, in my opinion, in the United States." Testifying before the U.S. Senate Committee investigating the relations between labor and capital, Carl described how the existing system of import duties and excise taxes exacerbated the already dismal daily living conditions of ordinary American workers. He explained how these indirect taxes imposed a greater financial burden on the poor than on the rich, taking more from those who had less.[1]

A tailor for nearly thirty years, Carl had witnessed firsthand how a new industrial and technological revolution (exhibited in his case with the advent of the sewing machine) had radically transformed the production process and lowered wages. He described how his meager earnings were often not enough to provide for his family, how the grueling intensity of the work day "from sunrise to sunset" left him "no time to eat dinner," how workers like him lived with their families in the squalor of "a tenement house four or five stories high," how they were able to save close to nothing from their paltry wages, and how he and other tailors could only afford "the clothing that they make – the cheapest of it."[2]

For the lawmakers gathered in New York during those late summer inquiries, Carl's testimony corroborated what they had being hearing

[1] "Testimony of Conrad Carl, New York, August 20, 1883" in U.S. Senate Committee on Education and Labor, *Report of the Committee of the Senate upon the Relations Between Labor and Capital, Vol. I* (Washington, D.C.: Government Printing Office, 1885), 413–21.

[2] Ibid., 419, 413–16.

across the country from other ordinary workers, union leaders, and social reformers. The ravages of modern urban-industrial life were taking a devastating toll on nearly all parts of American society. Although the recent upturn in the economy had quelled an earlier wave of violent and bitter industrial conflicts, the "labor question" remained on the minds of most Americans. Charged with finding ways to improve social relations between labor and capital, the Senate committee asked Carl what Congress might do to help American workers. "So long as legislation is unjust to the poor," he replied, "to tax the poor who have nothing but their daily earnings, to tax them by indirect taxes, there is no way to better the condition of the workingman."[3]

The injustice of the existing fiscal system was not limited, however, to the economic implications. Carl and others also stressed how the party politics of taxation permitted wealthy citizens to shirk their social and civic responsibilities. Carl referred obliquely to how indirect taxes in the form of import duties protected certain domestic industries from foreign competition. "The rich," he claimed, "receive donations from the State by legislation." These partisan "donations," Carl implied, were purchased by "the millionaire [who] corrupts the courts and legislation." Wealthy Americans routinely turned to the rule of law to protect their private interests, but they had little concern for the public good. As a result, they had no sense of the ethical obligation to support the commonweal. The millionaire "does not care for the law or the Constitution. He has neither a duty nor a love for the country," Carl concluded. "No wonder the rich become proud and brutal and say 'Damn the public.'"[4]

Some legislators seemed to absorb Carl's central message that "labor is the pack-horse that carries all the burden." But the moderate tone of their laconic questions suggested they were incapable – or perhaps unwilling – to change industrial conditions. Carl warned the senators that if they ignored the existing fiscal imbalances, it would be at the nation's peril. "The indirect taxes are a fraud and a crime against the workingmen, and society will have its punishment sooner or later for it," Carl admonished his audience. "When there lies so great a wrong on the bottom of society as to tax the laboring man by indirect taxes, there grows wrong after

[3] Ibid., 419. On the origins of the U.S. Senate Committee investigating industrial relations at this time, see Melvyn Dubofsky, *The State & Labor in Modern America* (Chapel Hill: University of North Carolina Press, 1994), 12–13.
[4] "Testimony of Conrad Carl," 419.

wrong, and it will grow as high as Babylon's tower if we do not go against it."[5]

The national tax system that Carl and others railed against consisted mainly of customs duties and excise taxes on alcohol and tobacco – the two dominant sources of late-nineteenth-century federal revenue. Economic experts at the time were uncertain who ultimately paid these indirect taxes, but popular perception held that ordinary consumers generally bore the brunt of these levies. The import duties that made up the tariff were identified, in particular, as unduly increasing the cost of living, or what contemporaries referred to as the "necessaries of daily life." Merchants who sold imported finished goods directly to consumers, it was believed, simply tacked the costs of customs duties on to their final prices. Meanwhile, manufacturers who used raw materials from the duty list tabulated the tariff as an additional cost of production. Regardless of what the experts might have thought, most late-nineteenth-century Americans believed that the tariff insidiously fell upon end users, that it was a hidden levy passed along to the quotidian consumers of most ordinary products.[6]

The breadth of goods that fell under the late-nineteenth-century tariff's duty list was indeed astonishing. The Tariff Act of 1883, for instance,

[5] Ibid. For more on working-class struggles in the late nineteenth century, see Rosanne Currarino, *The Labor Question in America: Economic Democracy in the Gilded Age* (Urbana: University of Illinois Press, 2011); David Montgomery, *Citizen Worker: The Experience of Workers in the United States with Democracy and the Free Market in the Nineteenth Century* (New York: Cambridge University Press, 1995).

[6] Economic and political historians have aptly demonstrated how the tariff operated to protect selected industries and how it at times raised the cost of living. Paul Wolman, *Most Favored Nation: The Republican Revisionists and U.S. Tariff Policy, 1897–1912* (Chapel Hill: University of North Carolina Press, 1992); Joanne Reitano, *The Tariff Question in the Gilded Age: The Great Debate of 1888* (University Park: Pennsylvania State University Press, 1994); John Mark Hansen, "Taxation and the Political Economy of the Tariff," *International Organization* 44:4 (autumn 1990), 527–51; Mark Bils, "Tariff Protection and Production in the Early U.S. Cotton Textile Industry," *Journal of Economic History* 44:4 (December 1984), 1033–45; Brad J. DeLong, "Trade Policy and America's Standard of Living: An Historical Perspective," in *Imports, Exports, and the American Worker*, ed. Susan Collins (Washington, D.C.: Brookings Institution, 1998); Douglas A. Irwin, "Tariff Incidence in America's Gilded Age," *Journal of Economic History* 67:3 (September 2007), 582–607; Mark Aldrich, "Tariffs and Trusts, Profiteers and Middlemen: Popular Explanations for the High Cost of Living, 1897–1920," *History of Political Economy* (forthcoming). On how the tariff was one of the many hidden powers of the national government during this period, see Brian Balogh, *A Government Out of Sight: The Mystery of National Authority in Nineteenth-Century America* (New York: Cambridge University Press, 2009), 129–32.

placed a levy on eleven different categories of products, including "Chemicals," "Earthenware and Glassware," "Metals," "Wood and Wooden Wares," "Sugar," "Cotton and Cotton Goods," "Hemp, Jute, and Flax Goods," "Wool and Woolens," "Silk and Silk Goods," "Books and Papers," and the catch-all category of "Sundries." The schedule for "Provisions" listed in the 1883 law alone consisted of such everyday necessities as "Beef and pork; Hams and bacon; Cheese; Butter; and substitutes thereof; Lard; Wheat; Rye and barley; Oats; Corn-meal; Oat-meal; Rye-flour; Potato or corn starch; Potatoes; Rice; Hay; Honey; Hops; Milk; Salmon and other fish; Pickles and sources, of all kinds; Vegetables; Vinegar; Chocolate; Dates, plums and prunes; Oranges; Lemons; Raisins," and a large assortment of nuts. Though the duty charges, or rates, were relatively low, ranging from "one cent per pound of beef and pork" to "four cents per pound of cheese," they had a significant impact on the daily cost of living.[7]

While the national tax system may have adversely affected most ordinary Americans as consumers, the state and local property tax regime took a similar toll on producers such as rural farmers and other small property holders. The general property tax that dominated nineteenth-century subnational government revenues was also a highly politicized and polarizing levy. Like the tariff, it too undermined public faith in the rule of law and the promise of social solidarity. Aimed, in theory, at taxing all property uniformly, the general property tax was extremely arbitrary in practice. Not only were wealthy property holders able to conceal and evade property tax liabilities, politically appointed or locally elected tax officials often capriciously determined property tax assessments. Illinois, for example, formally levied a general property tax in 1883 on "all real and personal property in the state," which specifically included "the value of agricultural tools, implements, and machinery." Although the law also required that all "personal property" including "all moneys, credits, bonds or stocks and other investments" be assessed at "fair cash value," such intangible assets frequently escaped assessment either because taxpayers failed to disclose their holdings or because assessors frequently looked the other way.[8]

7 Schedules A–N, Section 2502, Chapter 121, Tariff Act of March 3, 1883, *The Statutes at Large of the United States of America, Vol. XXII* (Washington, D.C.: Government Printing Office, 1883).

8 *Revised Statutes of the State of Illinois*, Chapter 120, Sections 1, 3, 25 (Chicago: Chicago Legal News Co., 1883); Clifton K. Yearley, *The Money Machines: The Breakdown and Reform of Party Finance in the North, 1860–1920* (Albany: State University of

The practical defects of the property tax had serious consequences. Farm families such as the Arnos of Oshkosh, Wisconsin, experienced first-hand how the haphazard and politically driven assessment process affected their everyday lives. As Mary Arno recounted to her mother, Augusta Hurd, in 1887, the Arnos barely had enough money from their farm earnings to pay their periodic property tax payments. Like other neighbors, they had no choice but to sell portions of their small holdings to fulfill their tax obligations. By contrast, Augusta Hurd admitted to her daughter that she had not been paying property taxes on her small rental properties because her name had somehow "slipped off" the Oshkosh assessment rolls. Similar tales throughout the country illustrated the pernicious implications of the prevailing tax system.[9]

Even during leisure activities, ordinary Americans were confronted by the taxing powers of government. When machinists or farmers sought to relax with their favorite drink or by lighting a pipe after a long day of work, they were reminded yet again of their financial obligations to the state. The tobacco they smoked, the alcohol they consumed, and even the playing cards that brought fleeting moments of enjoyment to an otherwise dreary day of toil were all subject to national taxation.[10]

By contrast, more affluent members of American society had a dramatically different experience with the existing tax system. As consumers and property holders, they too were subject to the economic obligations presented by the tariff, excise taxes, and the property tax. But because of their enhanced wealth and earning power, well-to-do Americans did not feel the same pinch of daily taxation. Unlike Carl and the Arnos, the wealthy could easily afford the indirect taxes on everyday consumption items and the direct tax on property, and still have plenty of resources available for luxury goods and contributions to savings and investments. For the truly wealthy, those who were prospering enormously from the late-nineteenth-century industrial and technological revolution, taxation was a negligible nuisance. The Rockefellers and Vanderbilts barely noticed

New York Press, 1970); Morton Keller, *Affairs of State: Public Life in Nineteenth Century America* (Cambridge, Mass.: Harvard University Press, 1977), 322–4.

9 Mary Arno to Augusta Hurd, January 3, 1887; May 14, 1894, Hurd-Arno Papers, Folder No. 21, Box 1, American Manuscript Collections, Newberry Library, Chicago, IL. See also Helen Hazen Cooperman, ed., *The Letters of Ann Augusta Jaquins Hurd and Mary Olivia Hurd Arno, 1858–1897* (Chicago: H. H. Cooperman, 1988).

10 Revenue Act of 1894, 28 Stat. 509, 522 (Schedule F, Tobacco and Manufactures of), 525–6 (Schedule H, Spirits, Wines and Other Beverages), 533 (Playing Cards).

their tax burdens, though they did everything they could to limit their national as well as state and local tax liabilities.[11]

Indeed, in some cases, wealthy Americans were practically immune to certain taxes. Because the rich held much of their wealth at the turn of the century not only in real property but also in intangible, personal property – namely, bonds, stocks, and other financial assets – they benefited from the ineffective administration of state and local property taxes. They paid few or no taxes on their concealed personal property and thus frequently dismissed public debates about fiscal problems. At the municipal level, moreover, the prevalent use of "special assessments" meant that private citizens could pay directly for "public" improvements that benefited their individual property more than the community at large.[12] With little at stake in how the public sector generated its revenue, wealthy citizens thus became increasingly disconnected from the broader political and social community of which they were ostensibly a part. They were fast becoming part of what contemporary social theorists referred to as a new "leisure class" that privileged private ambitions and consumption over public responsibilities and obligations.[13]

Within five decades, the American fiscal landscape was radically transformed. By the end of the 1920s, the late-nineteenth-century national regime of indirect, hidden, disaggregated, and partisan import duties and regressive excise taxes was eclipsed by a direct, transparent, centralized, and professionally administered, graduated tax system that dramatically altered fiscal burdens and profoundly revolutionized federal government finances. Although the 1913 federal income tax, which initiated the permanent national taxation of incomes, had high exemption levels and relatively modest rates, it soon surpassed all other levies as the main source

[11] "New York City The Paradise of Rich Men; Millions Escape Taxation at Home," *New York Herald*, February 5, 1899, 21; Ron Chernow, *Titan: The Life of John D. Rockefeller, Sr.* (New York: Random House, 2004), 107–8, 566–7; Michael McGerr, *"The Public Be Damned": The Kingdom and the Dream of the Vanderbilts*, Ch. 16 (forthcoming). On the many ways in which wealthy Americans evaded import duties, see Andrew Wender Cohen, "Smuggling, Globalization, and America's Outward State, 1870–1909," *Journal of American History* 97:2 (2010), 371–98.

[12] Robin L. Einhorn, *Property Rules: Political Economy in Chicago, 1833–1872* (Chicago: University of Chicago Press, 1991), 16–17; Stephen Diamond, "The Death and Transfiguration of Benefit Taxation: Special Assessments in Nineteenth-Century America," *Journal of Legal Studies* 12 (1983), 201–40.

[13] Thorstein Veblen, *The Theory of the Leisure Class* (New York: Macmillan Co., 1899); Richard T. Ely, *Taxation in American States and Cities* (New York: Thomas Y. Crowell & Co. Publishers, 1888), 288.

TABLE I.1. *Federal Government Receipts by Source, 1880–1930, as Percentage of Total*

	1880	1890	1900	1910	1917	1920	1930
Customs Duties	56%	57%	41%	49%	21%	5%	14%
Alcohol and Tobacco Excise Taxes	34%	35%	43%	39%	35%	7%	11%
Income Taxes	–	–	–	–	33%	66%	59%
Other*	10%	8%	16%	12%	11%	22%	16%
Total	100%	100%	100%	100%	100%	100%	100%

* Includes receipts from sales of public lands, estate and gifts taxes, stamp taxes, and "manufactures and products taxes."

Sources: Historical Statistics of the United States, Millennial Edition, ed. Susan B. Carter et al. (New York: Cambridge University Press, 2006), Table Ea588–593; *Statistical Appendix to Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1971* (Washington, D.C.: Government Printing Office, 1971), 12.

of national receipts.[14] Whereas customs duties and excise taxes together raised roughly 90 percent of federal receipts in 1880, by 1930 they generated only a quarter of total national revenue. Over the same period, taxes on individual and corporate income skyrocketed from a nonexistent source to nearly 60 percent of total federal government receipts (see Table I.1).[15]

A similar, albeit much less pronounced, shift occurred at the state and local level. There the taxation of incomes, profits, and inheritances came to challenge the dominant reliance on antiquated general property taxes. These new forms of direct and progressive taxation did not have the same overwhelming and enduring impact at the subnational level as they did at the federal. Still, these levies created an opening for state and local governments to consider other forms of taxation besides the general

[14] The 1913 income tax levied a "normal" tax of 1 percent on incomes above $3,000 for single persons ($4,000 for married couples) and had a maximum "surtax" rate of 6 percent for incomes over $5,000. Pub. L. No. 63, Statute I – 1913, Chapter 16, Sections II-A, II-C, *Statutes at Large of the United States of America from March 1911 to March 1913*, Vol. XXXVIII, Part 1 (Washington, D.C.: Government Printing Office, 1913). With these high exemption levels, the income tax in its early years touched roughly 2 percent of American households. John F. Witte, *The Politics and Development of the Federal Income Tax* (Madison: University of Wisconsin Press, 1985), 78; W. Elliot Brownlee, *Federal Taxation in America: A Short History*, 2nd ed. (New York: Cambridge University Press, 2004), 57.

[15] Susan B. Carter et al., eds., *Historical Statistics of the United States: Millennial Edition* (New York: Cambridge University Press, 2006), Table Ea588–593.

property tax. As Northern industrial states began to experiment with both new levies and innovative forms of tax administration, others took notice. Soon, these fiscal innovations spread to neighboring commonwealths and gradually influenced the national tax reform movement.

Ultimately, the turn of the century fiscal revolution was a watershed in the development of modern American public finance. The move from taxing goods toward taxing people and processes – through levies on individual incomes, business profits, and intergenerational wealth transfers – underscored the radical nature of this sea change. Despite modest beginnings, the early-twentieth-century tax laws were, as legal historian Lawrence Friedman has observed, "the opening wedge for a major transformation in American society."[16] In short, the late-nineteenth-century tax structure, which inordinately burdened everyday Americans while only marginally affecting the wealthy, was dramatically remade at the turn of the twentieth century.

The move toward a national regime of direct and progressive taxation marked the emergence of a new fiscal polity – a new form of statecraft that was guided not simply by the functional need for greater revenue but by broader social concerns about economic justice, civic identity, administrative capacity, and public power. More specifically, this new fiscal state was concerned about reallocating tax burdens across both class and geographical region, promoting a new social democratic sense of citizenship, creating a more centralized and professionally administered structure of fiscal governance, and laying the groundwork for more robust forms of government action. These objectives variously animated the different reform groups that sought to build the modern American fiscal state. Some of these aims would not be fully realized, if at all, until much later. Nonetheless, between the end of Reconstruction and the onset of the Great Depression, the central foundations of the modern American fiscal state first took shape. The aim of this book is to uncover the contested

[16] Lawrence Friedman, *History of American Law*, 3rd ed. (New York: Simon & Schuster, 2005), 430. Other economic and legal historians have recognized the significance of taxation to American state-society relations. Harry Scheiber, for instance, has included taxation, along with eminent domain and the police power, as part of the state's "trinity of powers." Scheiber, "The Road to Munn: Eminent Domain and the Concept of Public Purpose in the State Courts" *Perspectives in American History* V (1971), 329–402, 400. Likewise, J. Willard Hurst noted that the government's "powers to tax and to spend" and to control public lands were the "two principal means to affect the directions of domestic investment" and hence create a favorable environment for the release of energy. Hurst, *Law and the Conditions of Freedom in the Nineteenth-Century United States* (Madison: University of Wisconsin Press, 1956), 61–2.

roots and paradoxical consequences of this fundamental transformation in tax law and policy and to explain how and why this new fiscal polity came to be.

This great transformation in American public finance was led by a conceptual revolution. A new generation of professionally trained intellectuals, drawing on the raw social experiences of the modern industrial age and responding to the massive material inequalities of the time, changed the way that educated Americans and policymakers thought about and imagined the financial basis of government programs.[17] At the heart of this seismic shift was the idea that citizens owed a debt to society in relation to their "ability to pay." This curt yet crucial phrase encapsulated the idea that individuals who had greater economic power also had a greater social obligation to contribute to the public good – to contribute not only proportionally more but progressively more. Influential thinkers and political leaders used the keywords "ability to pay" as a cognitive map, as a type of mental frame, to illustrate the widening circle of modern associational duties and social responsibilities.

They also used "ability to pay" and similar keywords as political tools to galvanize support for the progressive tax reform movement during critical periods of crisis. "Each word has its practical cash value," pragmatist philosopher William James noted. We do things with words. And what these progressive activists sought to do with their words, as well as their actions, was to convince lawmakers, government administrators, and ordinary Americans that a new fiscal system based on the notion of taxing a citizen's "ability to pay" could transform American state and society. Ideas, in this sense, were critical weapons and blueprints for building powerful political coalitions.[18] Revenue reformers understood

[17] As Stephen Skowronek has observed, a new generation of intellectuals during this period became "America's state-building vanguard." Skowronek, *Building a New American State: The Expansion of National Administrative Capacities, 1877–1920* (New York: Cambridge University Press, 1982), 42–5. On the growing awareness of late nineteenth-century economic inequality, see James L. Huston, *Securing the Fruits of Labor: The American Concept of Wealth Distribution, 1765–1900* (Baton Rouge: Louisiana State University Press, 1998).

[18] Daniel T. Rodgers, *Contested Truths: Keywords in American Politics since Independence* (New York: Basic Books, 1987); William James, *Pragmatism: A New Name for Some Old Ways of Thinking* (1907). On the importance of economic ideas to institutional change, see Mark Blyth, *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century* (New York: Cambridge University Press, 2002); John L. Campbell, "Institutional Analysis and the Role of Ideas in Political Economy," *Theory and Society* 27 (1998), 377–409.

that "fairness" and "ability to pay" were protean concepts with multiple meanings. Their goal was to mold these words and ideas to energize a social and political movement that reflected the growing antagonism toward the prevailing fiscal order.[19]

These new notions of taxation were, of course, a product of their times. The reform-minded political economists who led the intellectual campaign for a new fiscal order harnessed increasing social frustrations to challenge the fundamental assumptions of an earlier age. Recognizing how the forces of modernity had recreated a more interdependent society, these thinkers stressed the need for greater cooperation and bureaucratic authority.[20] They sought to discredit the Victorian theories of atomistic individualism and laissez-faire political economy and constitutionalism that underpinned the existing late-nineteenth-century tax system. Chief among these outdated theories was the principle that an individual's economic obligations to the state were limited to the benefits that such individual received from the polity. Progressive tax experts targeted "benefits theory" as an obsolete principle of modern fiscal relations. They played a pivotal role in supplanting the prevailing "benefits theory" of taxation, and its attendant vision of the state as a passive protector of private property, with a more equitable principle of taxation based on one's "faculty" or "ability to pay" – a principle that promoted an active role for the positive state in the reallocation of fiscal burdens, the reconfiguration of civic identity, and the rise of administrative authority. For these reformers, the state was, as University of Wisconsin political economist and labor activist Richard T. Ely once noted, "an ethical agency whose positive aid is an indispensable condition of human progress."[21]

[19] The ability-to-pay rationale has been severely criticized by legal theorists and philosophers who have neglected to see how this principle operated historically as a political instrument rather than a coherent, air-tight political theory. For examples of some of the earliest critiques by legal scholars, see, e.g., Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938); Louis Eisenstein, *The Ideologies of Taxation* (New York: Ronald Press, 1961); Walter J. Blum and Harry Kalven, *The Uneasy Case for Progressive Taxation* (Chicago: University of Chicago Press, 1963). For more recent critiques from philosophers, see Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (New York: Oxford University Press, 2002).

[20] Thomas L. Haskell, *The Emergence of Professional Social Science: The American Social Science Association and the Nineteenth-Century Crisis of Authority* (Urbana: University of Illinois Press, 1977); Robert H. Wiebe, *The Search for Order, 1877–1920* (New York: Macmillan, 1966); Samuel P. Hays, *The Response to Industrialism, 1885–1914* (Chicago: University of Chicago Press, 1957).

[21] Richard T. Ely, "Report of the Organization of the American Economic Association," *Publications of the American Economic Association* 1 (1886), 6–7. American intellectual