Fiscal Citizenship, Progressives, and the Origins of the Modern American State

by

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ABSTRACT

In this account of the restructuring of the system of public finance of the United States at the turn of the twentieth century, Ajay Mehrotra traces the intellectual origins of the political movement for progressive income taxation. Social unrest against the “old fiscal order” of high protective tariffs constructed by Republicans in the decades following the Civil War provoked an intense political debate over income taxation. At the turn of the nineteenth century, the movement for fiscal reform was shaped by a new generation of activist academics who championed “fiscal citizenship” and progressive income taxation. Mehrotra’s study of the campaign for progressive income taxation provides new insights into the foundations of the modern American fiscal state.
In 1909, in the midst of an internecine split within the Republican Party between “Old Guard” conservatives and “insurgent” Progressives, Congress approved a resolution for a new constitutional amendment authorizing an unapportioned national income tax. This was intended to reverse the Supreme Court’s decision in *Pollock v. Farmers’ Loan & Trust Co.* (1895), which declared the income tax of 1894 unconstitutional. Having lost the political battle in Congress, conservative Republicans who opposed the tax amendment took solace in their assessment that it never would obtain the requisite number of states required for ratification. But in the wake of Woodrow Wilson’s stunning and unexpected electoral victory in November 1912, the balance of power shifted in the state legislatures. As a consequence, the Sixteenth Amendment became part of the U.S. Constitution in February 1913. Soon after, a Democrat-controlled
Congress enacted a minor income tax in October 1913 as part of major tariff reform legislation.

Looking back decades later, a generation of progressive historians would celebrate the enactment of the income tax of 1913 as the triumph of democratic politics over pro-business Republicans (Paul 1954; Blough 1952; Ratner 1942; Blakely and Blakely 1940). To be sure, there is more than an element of truth in that narrative. But the politics behind the income tax was considerably more complicated and nuanced than the progressive historians portrayed it. In his new study, *Making the Modern American Fiscal State: Law, Politics, and the Rise of Progressive Taxation, 1877–1929*, Ajay Mehrotra challenges their limited partisan perspective and offers a more sophisticated account of the intellectual origins of the political and social movements that culminated in a fundamental restructuring of our system of public finance at the beginning of the twentieth century. It is an interesting and compelling story.

Those Progressives in the Republican Party who voted for the income tax in 1913 certainly were not the direct descendants of the radical political movements of the 1880s and 1890s. To the contrary, they had their own distinct political motives and goals far removed from those of the Populists and radical agrarians of a generation before. Today we better understand the complex web of regional and economic divisions underlying the partisan politics that prevailed in the decades following the Civil War because of the contributions of contemporary
scholars in discerning the underlying voting patterns and partisan affiliations behind the cleavages that separated American voters (Bensel 1984; Stanley 1993). These divisions were reflected in the turbulent politics surrounding such issues as tariff reform, monetary policy (gold versus silver), and the enactment of a graduated income tax. The income tax of 1913 was but the final step in a longer political struggle to remake the fiscal foundations of the American state.

Following the Civil War, Republicans constructed a system of regressive tariffs that financed the national government. These protective tariffs generated significant annual budget surpluses; they also provoked political and social discontent among western and southern farmers and urban workers. The Populist Party and a host of smaller, radical agrarian parties expressed this discontent towards the end of the nineteenth century (Sanders 1990). At the close of the century, a new generation of academics trained in public finance and economics sought to give this popular discontent greater focus. As Mehrotra puts it: “Reacting to this social unrest and to the growing inequalities of the time, a new school of American political economists began to challenge the prevailing assumptions about the so-called ‘natural’ relations among state, society, and economy” (Mehrotra 2013, 410). Progressives in both major parties took advantage of the weakening of the intellectual foundations of the “old order” to advance their own political agenda.
Populists expressed their opposition to hard currency and high protective tariffs in vague and highly symbolic language. Think of the imagery in William Jennings Bryan’s famous “Cross of Gold” speech to the July 1896 Democratic National Convention in Chicago that secured for him the presidential nomination: “You shall not press down upon the brow of labor this crown of thorns, you shall not crucify mankind upon a cross of gold” (Bryan and Bryan, 1913, I, 249). The image of the American farmer and urban worker being crucified on a cross of gold by the moneyed men of the Northeast evoked powerful emotions and reactions but lacked substance and detail. That would be supplied by the academic reformers who crafted a new language to give voice to the populist impulse for fiscal reform—much as economist Thomas Piketty has articulated and given substance to the nebulous grievances of the recent “Occupy Wall Street” protest movement (Piketty 2014). The academic reformers of the early twentieth century employed the tools of the new disciplines of economics and public finance. Among these were Richard Ely of the University of Wisconsin and Henry Carter Adams of the University of Michigan. But the most prominent and influential of these “visionaries of the new fiscal order” was surely Edwin R. A. Seligman, a professor of political economy at Columbia University and a central figure in Mehrotra’s intellectual history.

Seligman is familiar to contemporary students of public finance, who still benefit from reading his masterful history of income taxation, *The Income Tax: A
Study of the History, Theory, and Practice of Income Taxation at Home and Abroad. Seligman revised the book in 1914 to include a chapter on the politics behind the adoption of the Sixteenth Amendment and the enactment of the 1913 federal income tax (Seligman 1914). Seligman graduated from Columbia University in 1879 and then studied in Germany before returning three years later to Columbia, where he earned a law degree and a doctorate before accepting a position there teaching political economy. In the academy, he trained a generation of economists in fiscal and tax policy, including his prize student, Robert Murray Haig. Beyond his work teaching graduate students, Seligman was a founder and president of the American Economic Association and editor of and contributor to the Political Science Quarterly. In this influential journal, he advanced the case for progressive income taxation and promoted the new science of public finance (Seligman 1893; Seligman 1894). Seligman was much more than a disinterested academic cloistered on the Morningside Heights campus, however. As Mehrotra explains, he also played an active and influential role in the political debate over tariff reform and income taxation. Congressional leaders would carefully study his popular and professional writings on taxation. Senators William Borah and Cordell Hall, perhaps the most learned legislators on matters of public finance, would quote from Seligman’s treatise on the floor of the Senate during the critical debates that led to the enactment of the income tax of 1913, while Oscar Underwood did the same during the debate in the House (Mehrotra 2013, 277–78,
282, 288). While Seligman’s active role in the political world has largely been neglected by tax historians, Mehrotra makes a convincing case that more than any other individual, Seligman shaped the new vision of the American fiscal state, urging Congress to use its new power of income taxation to promote a “well regulated” and just society.

Political scientists have focused on the role of interest groups and political parties in the restructuring of the fiscal foundation of the American state (Bensel 1984; Sanders 1990). The tax historians of the 1940s and 1950s attributed this change to the ideology of Populists and Progressives. Still other scholars have stressed the geographic cleavages behind the politics and voting patterns of America in the late nineteenth century (Stanley 1993). Mehrotra gives us more than an account of the regional and economic divisions and ideology behind the politics surrounding tariff policy and the income tax; he provides a comprehensive intellectual history of the campaign for a progressive income tax that introduces us to this group of activist academics who cultivated the progressive vision of public finance at the turn of the twentieth century. From Mehrotra’s history, we realize that previous accounts have given insufficient attention to the influence of ideas and the role of progressive academics in shaping political outcomes.

A fundamental premise of these academic reformers was their rejection of the fiction of a social contract in which taxes are the *quid pro quo* for
protection—the “classical benefits” theory of taxation holding that citizens paid taxes in exchange for government-provided “benefits” such as protection and a legal system. Instead, they developed a broader vision of “fiscal citizenship.” As Mehrotra explains, central to their understanding of fiscal citizenship was the requirement that policymakers use taxation to reallocate the burden of taxation “across both class and geographical regions, promoting a new social democratic sense of citizenship” (Mehrotra 2013, 8). The citizenry would be educated and encouraged to accept that all citizens should pay taxes based on their “ability to pay.” Seligman carried this vision of fiscal citizenship to the extreme: “We pay taxes not because we get benefits from the state, but because it is as much our duty to support the state as to support ourselves or our family; because, in short, the state is an integral part of us” (Seligman 1895, 72). As Mehrotra puts it, Seligman “went well beyond traditional social contract rationales” and classical liberal political thought to develop his concept of the taxpayer’s “faculty” to support an organic state (Mehrotra 2013, 113). No doubt, some will recoil at Seligman’s vision of fiscal citizenship and his tendency to slip into Hegelian state-worship. Notwithstanding the unattractiveness of some aspects of Seligman’s political vision, Mehrotra demonstrates the importance of this concept in the efforts of these academics to cultivate popular support for progressive income taxation.
In Mehrotra’s account of the birth of the modern American fiscal state, a second group of actors also play an important role in institutionalizing the new fiscal order. Prominent Wall Street lawyers who served in the U.S. Treasury Department during and after the First World War were responsible for designing and implementing the new tax regime. As Mehrotra aptly puts it, they were the “bricklayers of the modern fiscal polity” (Mehrotra 2013, 33). It was Treasury Secretary Andrew Mellon who hired those “bricklayers.” During his long tenure as secretary during successive pro-business Republican administrations, Mellon brought top professionals to work with him at Treasury while simultaneously fending off attempts to use his department as a dumping ground for patronage appointments. Ever since, Treasury has played a critical role in defending the integrity of the federal tax system against partisan politics and pork-barrel tax legislation. Sadly, that tradition has weakened in recent decades. When conservative Republicans returned to power following the war, it was Mellon who thwarted attempts by the Old Guard to repeal the income tax. While Mellon himself championed a pro-business agenda of rate reduction (“tax normalcy”) that reduced the top marginal rate to 25 percent, he opposed repealing the income tax altogether. As a consequence, conservative attempts in the 1920s to replace the income tax with a national sales tax failed. In an interesting aside, Mehrotra observes the irony that the failure of conservatives to replace the income tax with a national sales tax may well have doomed attempts by Democrats decades later
to bring a Value Added Tax (or VAT) to the United States. Ninety years later, the United States remains wedded to the revenue from the income tax and without a VAT.

Mehrotra gives us a powerful and intelligent history of the transformation of the American system of taxation that challenges the tax histories of the 1940s and 1950s in which the enactment of the income tax of 1913 is portrayed as the triumph of democracy in America. His account of the role played by the academic economists and the lawyers in the Treasury Department in the development of the American fiscal state is both original and provocative. Yet it is not entirely convincing on all accounts. For all the sound and fury surrounding the battle for the Sixteenth Amendment, the Progressives gave us only a modest income tax of one percent, with a six-percent surtax imposed on a handful of super wealthy taxpayers.¹ The new income tax was only slightly redistributive and contributed only a minor (16 percent) share of the revenue of the national government as late as 1916.² Was this really a fiscal “revolution”? 

Rather than the triumph of democracy or a fiscal revolution, historian Robert Stanley has argued that the enactment of the income taxes of 1894 and 1913 were the result of a strategic decision by “centrist” political leaders in both of the major political parties to accept a minor income tax to deflate and defuse the more radical proposals from the Populists and agrarian parties on the left demanding significant wealth redistribution (Stanley 1993). According to Stanley,
moderate Democrats and Republicans were willing to accept a mildly progressive income tax precisely because they understood that it would not effect any significant redistribution of wealth. In retrospect, we know they were correct. Even now, when the rate structure of the modern income tax is far more steeply graduated than that of the taxes enacted in 1894 and 1913, it still creates only a minimal redistribution of income, leaving largely intact the extant distribution of wealth.

If the Progressive campaign for fiscal reform produced only a minor income tax, what then was responsible for transforming the federal income tax into the robust source of federal revenue it is today, capable of financing an activist American state with the most powerful military apparatus in the world? Some scholars argue that it was not Populist politics, progressive ideology, or reformist academics but rather the First World War. (Pollack 2009; Bank, Stark, and Thorndike 2008) With the outbreak of the conflict in Europe, international trade decreased and revenue from customs duties declined. When America entered the war in April 1917, pressure for revenue to support the military campaign dramatically increased. Along with public borrowing, the income tax emerged as the primary source of federal revenue to support the war effort. Congressional policymakers quickly learned that minor changes to the income tax laws could produce dramatic increases in revenue. The personal exemption was lowered while marginal tax rates were increased. During the height of the war in
1918, the top marginal rate soared to 77 percent on income in excess of $1 million, and revenue from the wartime income tax and excess profits tax soared, supplying 63 percent of federal receipts. In that same year, revenue from the tariff and all other excise taxes declined to 29 percent of federal receipts. The progressive income tax had supplanted the regressive system of tariffs as the principal source of revenue for the American state. This was not an historical aberration. Indeed, military conflict, not partisan politics or progressive impulses, has been the prime force behind the success of income taxation.

In describing the rise and development of the state in early modern European, Charles Tilly famously wrote: “War made the state, and the state made war” (Tilly 1975, 42). We might add an addendum to Tilly’s pithy aphorism: To wage war, a state needs a stable and fruitful source of revenue, and the income tax is the ideal tax for a modern state with a modern economy. As Tilly himself put it: “European states generally moved toward a system of collecting taxes in money, paying for coercive means with the money thus collected, and using some of the coercive means to further the collection of taxes” (Tilly 1990, 84). John Brewer has likewise focused on the relationship between war and state building in the history of the development of the modern English state (Brewer 1989). Other scholars have found much the same relationship between war, taxation, and state building during critical periods of American political development (Pollack 2009). For example, the first national income tax in the United States was enacted
during the fiscal crisis occasioned by the American Civil War. During the war, policymakers quickly abandoned the flat 3 percent rate enacted in 1861 in favor of a progressive rate structure that reached 10 percent on income in excess of $25,000. Similarly, the income tax of 1913 was a minor impost when enacted but was transformed by revenue pressures experienced during the First World War. While rates were reduced by conservative Republicans during the period of retrenchment of the 1920s, the nation again turned to the income tax to finance the Second World War (along with massive public borrowing). During the war, the maximum marginal rate reached an historic high of 93 percent. The wartime rate structure was largely retained during the Cold War to finance the powerful American military.

Mehrotra is familiar with the argument that the most significant expansions of the revenue powers of the American state have occurred during sustained periods of war. Politics and ideology shape the design of the income tax, but war has been responsible for the most significant structural changes to the tax regime. Mehrotra also is familiar with Stanley’s argument that acceptance of the income tax was the “centrist” response to radical pressures for the redistribution of wealth. Indeed, he acknowledges the power of both these arguments even while focusing his attention on the role that ideas and academics played in the campaign to reform the old fiscal order of regressive taxation. Is this a contradiction? Not really. In fact, one of the great virtues of Mehrotra’s study is
that he offers a way to reconcile these seemingly conflicting perspectives. If centrist political leaders accepted a mildly progressive income tax to forestall more radical attacks on the existing order, they certainly were pushed in that direction by the clamor of Populists, Progressives, and reform-minded economists such as Seligman. The progressive income tax was included on the platforms of the radical third parties, but it was not as high a priority as tariff reduction. The income tax actually made it onto the political agenda of Congress and became enshrined in the Constitution only as a result of the sustained efforts of progressive reformers and activist academics. Only after the relatively minor income tax was enacted in 1913 did policymakers recognize that it was a fruitful source of revenue to finance the war effort. Thereafter, major structural changes were made to the federal income tax during the financial crisis occasioned by the prolonged war in Europe.

In *Making the Modern American Fiscal State*, Mehrotra shows us how Progressives in both major parties and academic reformers challenged and undermined the intellectual premises of the old fiscal order. The enactment of the income tax of 1913 was but the first step in the reconstitution of the fiscal foundation of the American state. Our engagement in successive world-wide military conflicts brought major structural changes to the income tax and transformed it from a symbolic tax favored by Progressives and reformist academics into the most important fiscal tool of the modern American state.
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ENDNOTES

1 The income tax of 1913 was comprised of a “regular” tax of 1 percent on income between $3,000 and $20,000, with a graduated surtax that reached 6 percent on income in excess of $500,000.


3 *Id.*