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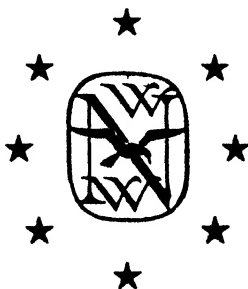
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AMERICAN
TAXATION

AMERICAN TAXATION

*Its History as a
Social Force in Democracy*

SIDNEY RATNER



New York

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To my Mother and to Louise



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Preface

The act of war and the threat of the totalitarian powers to our American way of life have brought home to us all the importance of taxes as an indispensable means of financing our defense. But in peacetime as well as in wartime taxes provide the means for maintaining civilization. This book undertakes to present a comprehensive survey of the endeavor of the American people for a century and a half to forge taxes which would be not only sources of revenue but also instruments of economic justice and social welfare. My narrative centers on those movements which brought into existence the federal income, inheritance, estate, gift, and excess-profits taxes. I have also given due attention to their chief rival, the protective tariff.

Each period in American history has had a specific pattern of its own, determined by its stage of economic development and the distribution of social and economic interests. I have striven to present the key ideas on social and tax matters as set forth in the programs and activities of the leading spokesmen and their followers in the different parties and economic groups of each period. At the same time I have tried to show the cumulative developments in tax reform in relation to general social conditions so that each phase of American tax history is seen not as an isolated episode, but as an integral part of the "American epic."

Since the power to tax, as a crucial aspect of the power to govern, depends on the living Constitution, I have given an analysis of the basic document and the varying interpretations of its tax provisions. Detailed study of debates in Congress, court decisions, and contemporary expressions of public opinion have thrown light on changing views on taxation. Specific tax legislation has been critically analyzed

in terms of the social principles, particular provisions, and economic consequences involved. An attempt has been made to indicate certain correlations between the adoption or repeal of social welfare taxation and the concentration or diffusion of wealth and income. But this is a field which requires much more extended and careful investigation than has yet been given it.

Tax problems are created by human beings in conflict among themselves about the value of certain ends and about the question of who should pay the cost in money or goods and services for these ends. The achievement of the particular objectives democratically determined upon by the vote of the people often depends largely on the wisdom with which the tax means are chosen and used.

My obligations are many and great, though I alone must be held responsible for the limitations of this work in its final form. I am indebted to the authors who have written the pioneering or definitive studies of certain aspects of my project for making my task easier than it otherwise would have been. Among these are Roy G. and G. C. Blakey, Hugh Dalton, D. R. Dewey, R. M. Haig, C. L. Harriss, W. I. King, Ferdinand Lundberg, W. C. Mitchell, Gustavus Myers, E. R. A. Seligman, W. J. Shultz, Carl Shoup, H. E. Smith, F. W. Taussig, and Max West. Professor Allan Nevins ten years ago suggested that I explore this subject and during the long incubation of this book has given most generously of his time, energy, and wide scholarship. His friendly guidance has meant much to me. Professor Harry J. Carman has been a constant source of help and encouragement. I am also grateful to Professors Merle Curti and R. M. Haig, and to the late E. R. A. Seligman for their interest in my study. I owe much to Morris R. Cohen and John Dewey. My appreciation of Horace M. Kallen's wise counsel cannot be adequately expressed. Professors Charles Beard and Edward S. Corwin, and the late Dean Howard Lee McBain advised me in my investigations of various judicial mysteries.

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I am greatly indebted to the active co-operation of librarians at the Montague Branch of the Brooklyn Public Library, the New York Public Library, and the Library of Congress, and at the libraries of Columbia University, the College of the City of New York, Cooper Union, the New School for Social Research, and Northwestern University.

SIDNEY RATNER



Introduction: Taxation as a Social Force

TAXATION has always been intimately related to democracy. Revolt against taxes imposed by oligarchies with goals opposed to those of the rising middle class in Western Europe and America led to the establishment of the first modern republics. In the history of these republics, especially that of the United States, taxation has always been a major source of conflict among different economic groups and sections. Some have sought to create and to use a tax system which would be an important instrument for concentrating wealth and income in their own hands and that of their class and section. Others have striven for a society free of glaring inequalities and have tried to develop and control a revenue system which would counteract the centralization of economic power.¹

The success or failure of these campaigns has been bound up with the fate of democracy. The value of a tax or a tax system is not to be judged merely by the dollars and cents raised by the compulsory contribution imposed on a people by a public authority. This view of taxes, solely as a means of revenue, has had wide currency. The merit of one tax program as against another, however, is to be measured in terms of all its human consequences. What sacrifices are demanded of what people? What are the effect on the distribution of wealth and income and the repercussions on the whole political, economic, and social life of the people? Taxes affect the volume of employment, the distribution of economic resources among different occupations, and the total supply of the factors entering into production. But the phase of taxation which always has most interested the common people is that

¹ Harold J. Laski, *The Rise of Liberalism* (New York, 1936), *passim*; Gaetano Mosca, *The Ruling Class* (New York, 1939).

working for or against economic equality. A high concentration of economic power has tended to be associated with the political and social rule of a business oligarchy. Democracy in both its political and economic phases has been dependent upon a sufficient diffusion of wealth and income to enable most individuals within a society to maintain their sense of independence.²

Among the taxes which have come to be regarded as pre-eminently fit for achieving and preserving the economic objectives of democracy are income, gift, inheritance, and excess-profits taxes. They have usually been justified as placing the weight of taxation on those best able to bear it or on those receiving "unearned" or "undeserved" gains. These principles of fiscal justice have been associated with the desire to minimize the existing economic inequalities and to prevent their further growth. The champions of these taxes have regarded a concern for increasing the social welfare as a legitimate objective of revenue policy. They have rejected the doctrine of certain laissez-faire economists and conservatives that taxation can be used only for the production of revenue and not for the social control of business or the redistribution of wealth and income.³

Conservatives in the past and the present have usually preferred that the federal government place its chief reliance for revenue on tariff duties and sales taxes. As the tax burden then generally falls on those with low incomes, those with high incomes and large fortunes are more easily enabled to build up their capital. The articulate or inarticulate major premise underlying their defense for such a tax system is that the benefits which the propertied classes enjoy redound to the social good because the high concentration of wealth and income promotes capital investment and business prosperity.⁴ If federal income and inheritance taxes are to be used, the preference of the conservative is for low rates and low exemptions. High progressive rates are regarded as approaching confiscation and offering an opening wedge for socialism.

One of the greatest of American tax experts, Professor T. S. Adams, once said that modern tax making was a "group contest in which powerful interests vigorously endeavor to rid themselves of present or proposed tax burdens. . . . Class politics is of the essence of taxation." . . . "In taxation," says the cynic, "let me make the deals and I

² Hugh Dalton, *Principles of Public Finance* (8th ed., London, 1934), 41ff., 189ff.

³ Harold M. Groves, *Financing Government* (New York, 1939) presents the social welfare tax point of view; Harley L. Lutz, *Public Finance* (New York, 1936) the opposed point of view.

⁴ Cf. Carl Snyder, *Capitalism the Creator* (New York, 1939).

care not who makes the ideals.'”⁵ According to this view, ideals and slogans are effective when they further the economic interest of powerful groups. The “true” explanation for the victory of the reformers who first urged the adoption of such seemingly radical measures as the income tax was that they were playing the “game of democracy,” were furthering the economic interests of the majority.

But this economic interpretation of tax history, although sound as far as it goes, does not adequately explain the inner urges and the deep-laid emotional patterns which are at the basis of the tax struggle. Each tax, unless shifted, seems to the taxpayer to involve a sacrifice of income or wealth, and this in turn seems to deprive him of goods and services which he otherwise could have obtained. In our society money is an important and often principal means for gratifying such diverse human wants and needs as food, shelter, mating, a rich family life, social prestige, the desire for power, security against want and humiliation, leisure and education. Hence, the first impulse of the taxpayer with a negative view of governmental activity, when threatened with a tax, is to resist.⁶

This resistance to taxation arises usually because the taxpayer is not conscious of or does not approve of the uses to which the tax revenue is put by the government. Actually, the burdens of a revenue system are offset by the economic benefits received from governmental expenditures, and in a socially progressive state these benefits usually equal or exceed the deprivation caused by the payment of taxes. In states ruled by classes with little concern for the common people's welfare taxes have been used to transfer wealth from the masses to the privileged groups. The historic struggle for control of the state by the middle classes in England, France, and America during the seventeenth and eighteenth centuries was inspired to some degree by their desire to secure a more equitable tax system, one in which they would not bear the major tax burden without receiving commensurate benefits. The governments which these middle classes succeeded in establishing were chiefly representative of business interests. The new ruling groups in turn attempted to obtain for themselves the maximum gain at the least cost from the services of the state they controlled. They framed their legislation generally so as to minimize governmental expenditures as well as their contributions to the state revenues.

⁵ T. S. Adams, “Ideals and Idealism in Taxation,” *American Economic Review* (March, 1928), 18: 1.

⁶ Sidney Ratner, “The Historian's Approach to Psychology,” *Journal of the History of Ideas* (January, 1941), 2: 95-109.

The farmers and workers upon whose shoulders the business groups attempted to place the tax load resisted, as best they could, the repudiation of the program of economic and social equality with which they had been won to the support of the middle classes' revolution against the landed aristocracy. The republican form of government furnished at least the basis on which the agrarian and laboring classes could build their movements for the realization of democracy as they understood it. To counteract the supremacy of both the small and the big business groups, new tax instruments were forged which would rest most heavily on those with high incomes and large fortunes. The thrust for social justice and the counterthrust for private gain have marked the conjoined spiral movements of political democracy and the concentrated economic power of big business and high finance.

On April 29, 1938, President Roosevelt stated in a notable message that the American democracy was threatened by the growth of a concentration of private economic power without an equal in history.⁷ He cited official reports showing that in 1935-36 47 per cent of all American families and single individuals living alone had incomes of less than \$1,000 for the year while at the other end of the ladder a little less than 1½ per cent of the nation's families received incomes which in dollars and cents reached the same total as the incomes of the 47 per cent at the bottom. Of the property received through inheritance, 33 per cent was concentrated in only 4 per cent of all the estates reporting to the government. One tenth of 1 per cent of the corporations in the United States owned 52 per cent of the assets of all of them. One tenth of 1 per cent of the corporations earned 50 per cent of the net income of all of them. Roosevelt attributed the decline of competition, extended unemployment, and restricted output to the domination of the American economic order by the minority controlling big business and high finance. He urged a counterattack through appropriate tax, antitrust, and other measures. The key idea behind the message was one which a noted American economist had stated at the close of the first World War:⁸

Our society will always remain an unstable and explosive compound as long as political power is vested in the masses and economic power in the classes. In the end one of these powers will rule. Either the plutocracy will buy up the democracy or the democracy will vote away the plutocracy.

⁷ *New York Times*, April 30, 1938.

⁸ Irving Fisher, "Economists in Public Service," *American Economic Review* (March, 1919, Supplement v. 9, no. 1), 16.

The rise of fascism in Europe has demonstrated the existence of a third alternative: the revolt of the lower middle class against the rule of either big business or the workers. The pursuit of narrow private and class gain to the exclusion of all other considerations resulted in the abolition of both democracy and plutocracy in nearly all of Europe. To those gifted with the capacity for sympathizing with others outside their own restricted circle and enlightened by the tragic consequences of shortsighted class conflicts, an old, yet still powerful, social principle assumes new cohesive power. If democracy survives, it will be because the greatest good of the greatest number supplants "my good, and that of my class." ⁹

In such a progressive state, as we have said, the benefits received from governmental expenditures will usually equal or exceed the deprivation caused by the payment of taxes. Taxes will pay not only for the maintenance of civil government, justice, police, the fostering of industry and commerce, but also for the expenditures designed to combat business depressions and to wage wars considered necessary or just. At this time the need for national defense against the menace of Nazi Germany makes Americans appreciate more than ever the truth of Justice Holmes's dictum: "Taxes are the price we pay for civilization."

⁹ Cf. Emil Lederer, *The State of the Masses* (New York, 1940).

The Constitution: Source of the Power to Tax

THE power to tax is an essential part of the power to govern. Hence an understanding of the Constitution framed in 1787 and put into operation in 1789 is necessary to a clear comprehension of the evolution of the present federal revenue-expenditure system and its effect upon the national welfare. The Fathers of the Constitution, as the records show, clearly viewed taxation as a means for shaping the national economy, bringing foreign nations to fair commercial terms, regulating morals, and realizing such social reforms as the abolition of slavery.¹ They empowered Congress "to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States." But they imposed such limitations as that "all duties, imposts and excises shall be uniform throughout the United States";² that direct taxes should be laid in proportion to the population, that no duties should be laid on articles exported from any state. On the other hand, no export or import duties were to be imposed by any state without the consent of Congress.³

The meaning of the terms "uniform" and "direct taxes" later became of crucial importance in determining the constitutionality of the federal income tax. Authorities now agree that the uniformity clause was intended to prevent only geographical discrimination, and not discrimination between different income classes.⁴ The framers of the Constitution and those who ratified it did not clearly and exhaustively define the term "direct taxes." All that can now be definitely estab-

¹ Walton H. Hamilton and Douglass Adair, *The Power to Govern* (New York, 1937), 121-44.

² Art. I, Sec. 8, cl. 1.

³ Art. I, Sec. 9, cls. 4, 5; Sec. 10, cl. 2.

⁴ Edwin R. A. Seligman, *The Income Tax* (New York, 1914), 531ff.

lished is that at that time import and export duties were generally considered indirect taxes, and that land and poll taxes were considered direct taxes. Since taxes on personal and corporate income, gifts, inheritances, and excess profits were not in existence in 1787, it is impossible to state dogmatically what the founders and the ratifiers of the Constitution would have thought of these taxes. We do know, however, that the direct tax provisions were designed to prevent the manufacturing states from shifting the burdens of taxation to the sparsely settled farming regions and that these direct taxes were viewed only as a last resort when indirect taxes, especially the customs duties, failed to provide sufficient revenue. It is rather ironic that the direct-tax provision should have become the means of preventing the farmers in 1895 from forcing the industrial Northeast to assume its due share of the tax burden.⁵

The spending power of Congress today has in recent years been one of the most hotly disputed subjects of political debate. The deficit spending which the Roosevelt administration inaugurated to combat the 1929 depression and the 1937 recession has made many conservatives feel that Congress's power to spend should be curtailed. These opponents of the New Deal have followed James Madison in contending that the phrase "to pay the debts and provide for the common defense and general welfare of the United States" empowered Congress to tax and to spend only to the extent necessary to carry into execution the *other* powers explicitly granted by the Constitution to the federal government. On the other hand, the New Dealers have had the authority of Alexander Hamilton and of the 1789 Congress for asserting that the tax-spending power had been granted *in addition* to the other powers. The view of such experts as Edward S. Corwin is that the general welfare clause was intended to confer upon Congress a power to provide for the general welfare through the use of money. This, they maintain, justifies the federal government in raising taxes for expenditures on any of the objects which Congress deems desirable or necessary for the general welfare.⁶

Few slogans have had as restrictive an influence on Congressional legislation as the phrase: "The power to tax involves the power to de-

⁵ Charles A. Beard, *An Economic Interpretation of the Constitution of the United States* (New York, 1935), 169-71; Irving Brant, *Storm Over the Constitution* (New York, 1936), 148-79; Seligman, *op. cit.*, 531-71.

⁶ Brant, *op. cit.*, 148-63; Edward S. Corwin, *The Constitution* (Princeton, 1937), 20-25. For the view that this clause authorizes Congress to legislate generally for the general welfare and is not confined to purely revenue matters, see J. F. Lawson, *The General Welfare Clause* (Washington, 1926).

stroy." The implication, which many have asserted, is that the primary purpose of taxation is the raising of revenue and that the taxing power cannot be constitutionally used for purposes of social regulation and control. Actually, the evidence reveals that the framers of the Constitution agreed without dispute that the taxing power could be used for purposes totally unconnected with revenue, that one of its principal objectives was the regulation of commerce, that taxes could be used to destroy commerce, that they could be used indirectly to regulate morals, and that in the absence of a special restriction linking direct taxation and Congressional representation, taxes could be used to destroy the vested property rights in slaves.

This broad view of the taxing power shocks those with vested interests, but it was the view taken by the framers of the Constitution. No argument based on history can be made against this view without a distortion of the historical record. The Tenth Amendment, reserving to the states or the people powers not delegated to the United States by the Constitution, or prohibited by it to the states, does not affect the taxing power, because that was specifically granted to Congress in the Constitution and was not reserved exclusively to the states.

The Fifth Amendment, safeguarding persons from being deprived of life, liberty, or property without due process of law, does not affect the power of Congress to tax unless the Fifth Amendment is used to nullify every power in the Constitution which adversely affects property rights.⁷ Nor was the comprehensive power of taxation given to Congress originally circumscribed by constitutional tax exemptions for the instrumentalities of state government, the salaries of state and federal judges, and the holders of state and municipal bonds. These limitations on Congress were acts of judicial legislation by the Supreme Court after the Civil War.⁸

Democracy and the Constitution

The text of the Constitution and its relation to democracy must be placed in the context supplied by the intentions of its framers and ratifiers and of those who have had the power to interpret it officially since its adoption in 1789. The Fathers of the Constitution, as Charles Beard and others have demonstrated, were for the most part men engaged in lending money on interest, speculating in public securities,

⁷ Brant, *op. cit.*, 164-79; Hamilton and Adair, *op. cit.*, 121-27.

⁸ Dep't of Justice, *Taxation of Government Bondholders and Employees* (Washington, 1938), 4ff.

and investing in western land ventures, manufactures, and shipping. They were dissatisfied with what they considered the inadequate protection given to their property interests by the Confederation and state governments. They resented the legislation passed by many state legislatures in favor of the small farming and debtor classes, and desired the removal of interstate trade barriers, the redemption of the public debt in full, and aid for domestic industry against foreign competition. Conservative in the sense that they opposed radical majority rule, they framed the Constitution so as to defend the rights of private property against popular onslaughts. To deny this would be to contradict the authorities.⁹ But to conclude from this fact that the Fathers of the Constitution did not put into the Constitution powers for a strong national government, which could be used for egalitarian as well as for conservative ends, is to commit a *non sequitur*. Whatever the conservative hopes of the Fathers were, and whatever the conservative desires of anti-New Dealers may be, the fact is that the power was put in the Constitution of 1789 for either a conservative or a radical administration to use for controlling the national economy.¹⁰

The key to the relation of democracy to the Constitution is the distinction between the Constitution in textbooks and the Constitution in action, between the Constitution formulated in the document of 1787 and its amendments, and the living Constitution. The two do not coincide. The living Constitution, the one which affects the lives of all Americans, is the sum total of all those rules accepted by the people which directly or indirectly determine the distribution and the exercise of the sovereign power in the state. These rules regulate the relations of the federal government to the state governments, of the different federal departments to one another, and of the citizens to all branches of the government. Some of these rules are to be found in the document traditionally called the Constitution. Others are contained in Congressional statutes, judicial decisions, and political conventions which reflect the dominant views of the great majority at any given time as to how political power is to be won and used. These rules are additions, in some cases contradictions, to the 1787 Constitution. Some phases of the living Constitution, like the judicial review of acts of Congress, have been used predominantly as a curb on majority rule. Others, such as the popular election of the President despite the

⁹ Beard, *op. cit.*, 324-25; Robert A. East, *Business Enterprise in the American Revolutionary Era* (New York, 1938), 261-69.

¹⁰ Brant, *op. cit.*, 132-47; Hamilton and Adair, *op. cit.*, 145ff.

Electoral College mechanism, have been the means of democratizing the conservative, republican form of government set up in 1787-89.¹¹

The important point for citizens to realize is that all constitutions and laws live only because men live and only to the extent that men will to have them live. The democracy which Americans cherish today is the product of the evolution of the American people toward the achievement of the satisfactions which the natural and social resources of the United States make possible. Mere aspiration by the common people for a fuller and richer life would be impotent without a national government endowed with powers to counteract the concentration of economic and political power in the hands of an oligarchy. The economic basis for the creation and preservation of democracy is the distribution of wealth and income among the majority of the people in such a fashion that no elite can permanently dominate the community.¹²

¹¹ Edward S. Corwin, *Court over Constitution* (Princeton, 1938), 85-128; Herbert W. Horwill, *Usages of the American Constitution* (New York, 1925), 1-25; Howard Lee McBain, *The Living Constitution* (New York, 1927), 1-33.

¹² On the nature and history of American democracy, see Charles A. and Mary R. Beard, *The Rise of American Civilization* (3 v., New York, 1926-39); Carl L. Becker, *Modern Democracy* (New Haven, 1941); Vernon L. Parrington, *Main Currents in American Thought* (3 v., New York, 1937); and Arthur Rosenberg, *Democracy and Socialism* (New York, 1939).



Early Days of the Republic: Tax Needs and Issues

THE framing and ratification of the Constitution in 1787-88 merely provided the opportunity for a great nation to develop; it did not ensure that growth. The Fathers of the Constitution knew that mere words on parchment do not create a government, and that if they wished to achieve the ends they desired they would have to gain control of the federal government. Gouverneur Morris, who wrote the final draft of the Constitution, expressed their sentiments when he said: ¹

But, after all, what does it signify that men should have a written constitution, containing unequivocal provisions and limitations? The legislative lion will not be entangled in the meshes of a logical net. The legislature will always make the power which it wishes to exercise, unless it be so organized as to contain within itself the sufficient check. Attempts to restrain it from outrage, by other means, will only render it more outrageous. The idea of binding legislators by oaths is puerile.

The Hamiltonian vs. the Jeffersonian Program

Hence the first years of the Republic represented a struggle for power between conflicting groups, a struggle that has continued in varying forms and transformations down to this day. The classical antithesis of interests in American history is that of the politico-economic philosophy of Alexander Hamilton and his party versus that of Thomas Jefferson. Hamilton represented the propertied elements

¹ Morris to T. Pickering, Dec. 22, 1814; J. Elliot, *Debates on the Constitution* (2d ed., 5 v., Philadelphia, 1866), 1: 506-07.

of his day: those which drew their wealth from commerce, financial speculation, banking, and manufacturing. Jefferson was the champion of the agricultural classes. Since the great majority of the American people were farmers at that time, he was the champion of the agrarian masses as well as of the large landowners.

Washington's first administration confirmed the lines that had already been drawn between the divergent social groups. Hamilton, as the Secretary of the Treasury, immediately proceeded to secure the enactment of measures that would mold the country in the way he desired and in the interests of the groups he favored. These measures included a funding of the entire Confederation debt, principal and interest, at face value instead of on a basis of discrimination between the original subscribers to the debt and the speculative and secondary purchases. He also secured the assumption of the state debts by the national government and wanted them funded at face value. Thirdly, he accomplished the establishment of a national bank with bank stock that should be based almost entirely on the funded government securities. The tariff was to be used to protect and encourage American manufacturers and commerce. He hoped that the public land would be disposed of in large and small quantities with securities bearing 6 per cent interest to be accepted in payment and that the federal government, through its sinking fund, would assist the security holders in keeping up the public credit by purchasing securities in the market from time to time.²

The immediate beneficiaries of these acts were the holders of federal and state securities, merchants, traders, shippers, and manufacturers. The basis for the increase of fluid capital was, in the last analysis, to come from the product of the landowning and laboring classes, through the mechanism of taxation. Hamilton replied to agrarian criticism of his measures by arguing that aids to manufacturing, commerce, and banking in the long run benefited all sections of the community. He desired to do two things: to establish a strong, stable national government, and to aid those classes which he considered to be the elite of the country, and upon whose support he thought the creation and the preservation of the national state depended. He did not shrink from winning the support of this dynamic and aggressive group through what others called an exploitation of the rest of the

² John C. Hamilton, *History of the Republic of the United States* (7 v., New York, 1857-64), v. 4-6, presents the most detailed exposition of Hamilton's plans from his own point of view. Samuel McKee, Ed., *Alexander Hamilton: Papers on Public Credit, Commerce and Finance* (New York, 1934) is the most compact source book on the subject.

community.³ He appreciated the brilliant generalization made by an English mercantilist: "There is much more to be gained by *Manufacture* than *Husbandry*; and by *Merchandise* than *Manufacture*. . . .", but exalted the role of industry in America. Both saw that the different levels of economic advancement among nations are very closely associated with the proportions in which the population is distributed among different occupations.⁴

In direct opposition to this philosophy and system of values was the Jeffersonian position. Jefferson and other spokesmen for the agricultural interests felt that agriculture was far superior to banking, commerce, and manufacturing both as an economic occupation and as a way of life, and saw no reason for either immolating themselves or allowing themselves to be exploited for the benefit of the Hamiltonian elite. They saw no reason for funding the national debt at face value or for assuming the state debt obligations, and thereby enlarging the large public debt. They did not desire to repudiate the debt, but suggested it be scaled down to the price paid by the security holders, thereby reducing the burden of the taxpayer, and at the same time doing justice to the public creditors who had purchased depreciated securities. They also considered the assumption of the state debts an undesirable increase of the national debt—by about 50 per cent—especially since northern speculators had brought out most of the South's securities, state and continental. The Bank of the United States, they considered, was both unconstitutional and socially pernicious in that it would increase the power of the holders of public funds at the expense of the agrarian classes. The protective tariff also seemed to the agrarians a device to aid the manufacturers at the expense of the consumers, the majority of whom were farmers. Their hope, which seems unfounded to both the believers in industrial capitalism and modern socialism, was that industrialism would not dominate America and could be kept in a subordinate position.⁵

The protests and arguments of the Jeffersonians were not successful, since a majority of both houses of Congress was Federalist and either holders of securities or friends of those who would benefit from the Hamiltonian system of political economy. The importance of this struggle between the agrarian and mercantile-financial interests can be

³ Charles A. Beard, *Economic Origins of Jeffersonian Democracy* (New York, 1915), 108ff.; Edward Channing, *A History of the United States* (6 v., New York, 1908-25), 3: 60ff.

⁴ Colin Clark, *The Conditions of Economic Progress* (London, 1940), 176-77.

⁵ Beard, *op. cit.*, 196-247; Arthur Rosenberg, *Democracy and Socialism* (New York, 1939), 10-21.

appreciated only when the amount of the public debt in the seventeenth century is contrasted with the prevailing estimates of the value of the landed property at the time. Some Anti-Federalists argued that the public debt was about one seventh or one fourth of the value of all the landed property in the United States. Having regard for the relative fiscal capacity of the federal government then and now, one authority contends that the federal debt was larger at the end of Washington's administration than in 1940. The agrarians therefore understood the size of the stakes and the need for preventing the "money aristocracy" from increasing its wealth through a levy on agrarian property. Hamilton and his colleagues defended themselves against these attacks by a judicious mixture of attempted refutation and vituperation. The Jeffersonians were labeled and libeled as enemies of "sound finance" and foes of property and order. They were accused of misunderstanding the benefits that would flow to all through capitalistic enterprise. Indeed, the Federalists asserted that the return of prosperity after 1789 was due to their policies. The agrarian fear that capitalism would conquer agriculture they dismissed with ridicule.⁶

The First Tariffs

The struggle over the tariff as an instrument for aiding and enriching the industrialists which has gone on for over a century and a half began in 1789. There was no dispute between North and South, the agrarian and the manufacturing interests, over resorting to the tariff as the primary means of raising revenue. The people of the United States were by their past political experience hostile to internal taxation. The local taxes fell mainly on property, export duties were not permitted, and direct taxes (poll and land taxes) could not be levied until a census had been taken. But a conflict developed in Congress between the representatives of such commercial states as Massachusetts and Pennsylvania and those from predominantly agricultural states like Virginia on the principle and application of the protective tariff. The first tariff act, that of July 4, 1789, was protectionist in intent, but primarily a revenue measure in effect. Specific duties were imposed on more than thirty kinds of commodities; ad valorem duties, varying from 7½ per cent to 15 per cent, on a few itemized articles; and a 5 per cent duty on all goods not otherwise enumerated. The average rate of duty, when reduced to an ad valorem basis, was 8½ per cent.

⁶ Beard, *op. cit.*, 132ff.; Alvin H. Hansen, *Fiscal Policy and Business Cycles* (New York, 1941), 162-65.

In the following year additional revenue was needed, and the tariff was increased. Congress directed the Secretary of the Treasury to draw up a report on how to encourage and promote such manufactures as would help to render the United States independent of other nations for essential, particularly for military, supplies. Hamilton replied in 1791 with his famous "Report on Manufactures," with its elaborate argument for protection. Although this essay became a source of inspiration for American and European protectionists, it had little, if any, effect on legislation in its own day. The moderate policy of 1789 was retained. The United States was pre-eminently an agricultural country and wanted to get its manufactured goods at the cheapest rates. The manufacturing class did not have sufficient power for several decades to win the program it wanted. Between 1794 and 1816 some twenty-five tariff acts were passed, all modifying the customs duties, but the changes were usually for the purposes of revenue or for continuing previous laws of temporary duration. By 1808 the duties had been increased until they were nearly tripled in order to meet the federal revenue needs. The whole tariff situation changed when war with Great Britain broke out in 1812.⁷

The Whiskey Rebellion

The first overt resistance by force to the Hamiltonian program occurred over a seemingly innocuous Excise Act taxing spirits distilled from grain.⁸ This Act of 1791 was designed to pay the new charges created by the assumption of the state debts and to avoid the necessity for a direct tax on lands. The New England manufacturers were able to shift the tax to the consumer. Farmers in western Pennsylvania, Maryland, Virginia, and North Carolina, however, had to bear the burden directly; they rebelled against paying the tax. Washington, spurred on by Hamilton, quelled the rebellion in the fall of 1794 in order to establish the authority of the national government and to ensure the dominance of Hamilton's fiscal policy. The final upshot of the matter was that masses of the people resented the Federalists and were drawn to the new party which Jefferson was working hard to create.⁹

⁷ Percy Ashley, *Modern Tariff History* (London, 1920), 141-49; Edward Stanwood, *American Tariff Controversies* (Boston, 1903, 2 v.), 1: 39ff.; F. W. Taussig, *Tariff History of the United States* (New York, 1931), 8-16.

⁸ 1 *U.S. Stat. at Large*, 199.

⁹ L. D. Baldwin, *Whisky Rebels* (Pittsburgh, 1939).

Federalist Internal Revenue System

The need for revenue led the Federalists to extend the internal revenue system on June 5, 1794, through an act taxing carriages, the sales of certain liquors, the manufacture of snuff, the refining of sugar, and auction sales. The tax on carriages was contested as unconstitutional and gave rise in 1796 to the extremely important decision by the United States Supreme Court in the case of *Hylton v. United States*.¹⁰ The Court decided that the tax upon carriages was not a direct tax in the constitutional sense of the term and was therefore perfectly valid. The Justices of the Court, all of whom had been either members of the Constitutional Convention at Philadelphia or members of the state ratifying conventions, were unanimous in their decision on this point and in their opinion that Alexander Hamilton, who appeared as counsel for the government, was correct in asserting that the only direct taxes contemplated by the Constitution were poll taxes and taxes on land. The following statement by Justice Chase on the question of judicial review is of great interest in the light of the Court's action in 1895: "It is unnecessary, at this time, for me to determine whether this Court constitutionally possesses the power to declare an act of Congress void, on the grounds of its being made contrary to, and in violation of, the Constitution; but if the Court have such power, I am free to declare that I will never exercise it, but in a very clear case."¹¹

Another measure which originated in the economic interests of the Federalist party and was designed to maintain the stability of the fiscal system through continued regularity of revenues was the Jay Treaty of 1795. The agrarian party, especially the southern planters, objected vehemently to the nonreturn of slaves confiscated by the British during the American Revolution, and to the necessity for paying debts to British merchants. During Jefferson's administration some ten years later, however, the federal government assumed the responsibility for the payment of debts due the British and thereby released the South from its debt burden.¹²

¹⁰ 3 *Dall.* 171; 1 *U.S. Stat. at Large*, 373.

¹¹ 3 *Dall.* 175. This statement has never been quoted, to the best of the author's knowledge, by any writer on the income tax cases.

¹² Samuel F. Bemis, *Jay's Treaty* (New York, 1923) and *Diplomatic History of the United States* (New York, 1936), 99-104.

John Adams, War with France, and War Taxes

In 1796 John Adams was elected to succeed Washington as President of the United States by the margin of three votes over the vote for Thomas Jefferson in the electoral college. Jefferson, who had resigned from Washington's cabinet as Secretary of State in 1793, became Vice-President. John Adams, although a Federalist, was not a Hamiltonian. He disapproved of Hamilton's financial system and the Federalist speculation in public credit. Although a believer in aristocracy, Adams wanted the state to protect the poor against excessive spoliation by the rich, and at the same time to defend the rights of the rich against attacks by "communistic levellers." Through his occupying this middle ground between Federalists and Republicans, as the party of Jefferson was then called, he lost the favor of both sides and consequently did not succeed in gaining re-election in 1800.¹³

During Adams's administration the revenue needs of the federal government increased from about \$5,800,000 in 1796 to \$6 million in 1797, \$7,600,000 in 1798, \$9,300,000 in 1799, and \$10,800,000 in 1800. This was due to the imbroglio with France arising out of French attacks upon American shipping in retaliation for the pro-English foreign policy of Washington and Adams. By the summer of 1798 Congress had suspended commercial relations with France, abrogated all treaties with her, and permitted American public armed ships to capture French armed vessels. The army was increased, and the navy built up and operated at a cost of about \$10 million.¹⁴

To meet the extraordinary military expenses, Congress resorted to new taxes. On July 6, 1797, a Stamp Act was passed which imposed stamp duties upon legal transactions, including a duty on receipts for legacies and probates of wills. This has been regarded as the first step in the development of the federal inheritance tax.¹⁵ But this light tax was supplemented on July 14, 1798, by the first direct tax ever imposed by the federal government. The sum of \$2 million was to be apportioned among the states. A tax was to be laid upon all dwelling houses, lands, and slaves between the ages of twelve and fifty. A progressive tax was imposed on dwelling houses, and a tax of fifty cents upon every slave. After deducting the sums thus assessed upon houses and slaves within the United States from the sum apportioned from each

¹³ Beard, *op. cit.*, 299ff.

¹⁴ *Ibid.*, 355; Bemis, *Diplomatic History*, 111-25.

¹⁵ 1 *U.S. Stat. at Large*, 527; William J. Shultz, *The Taxation of Inheritance* (Boston, 1926), 150-51.

state, the remainder was assessed upon the land according to evaluation of each lot at such a rate as would yield the given sum. The main burden of the tax was expected to fall upon the houses, but the tax did not operate according to the original estimates. Payments were so much in arrears that at the end of three years one fifth of the tax remained unpaid. The receipts amounted to \$734,000 in 1800 and \$534,000 in 1801.¹⁶

The support which the Adams administration had been able to gain in its stand against France was quickly lost when Adams supported the Alien and Sedition Acts initiated by the Federalists as a means of curbing and persecuting the Republicans. Jefferson, Madison, and other Republican leaders were able to whip up public opinion against these and other Federalist measures with the Kentucky and Virginia Resolutions of 1798 and through their campaign speeches and literature in 1800. The upshot of the great election battle of 1800 was the victory of Jefferson and his followers over Adams and the Federalists.

Jefferson in Power: Social Ends and Fiscal Means

A critical examination of the election returns shows that the division of votes on Jefferson versus Adams followed in the main the same geographical division as the votes on the ratification of the Constitution in 1788. A combination of Anti-Federalist, southern planters, small farmers, petty tradesmen, and mechanics in the towns succeeded in bringing about a political revolution for that day. Jefferson envisaged an ideal society as a democracy of small landowning farmers. He regarded the urban proletariat as incompatible with equalitarian political democracy and hoped that manufacturing and the proletariat would remain in Europe with the industrial capitalist. Although he tempered his administration to commerce and manufacture, his faith, as Beard points out, was an agrarian faith and his appeal was to the landed classes. His primary aim was to satisfy agrarian demands with only necessary or expedient compromises with the other groups. He was interested in reducing taxes and the public debt wherever possible in order to reduce the burden on the consumer and the landowner. To counteract the excessive influence and power of the First Bank of the United States, he used government deposits to aid state and local banks favorable to the Republican party. He fought against Federalist domination

¹⁶ 1 *U.S. Stat. at Large*, 597; Davis R. Dewey, *Financial History of the United States* (New York, 1939), 109-10.

of the courts by causing the abolishment of the circuit courts created in 1801 by the Federalists, and he opposed on many questions the decisions of Chief Justice Marshall of the United States Supreme Court.¹⁷

Jefferson was a pragmatic realist who never allowed his enthusiasm for an ideal to obscure for long the conditions under which an approximation to that ideal could be achieved. Hence the instruments of government created by the Federalists became in his hands tools to wield for the ends he thought both desirable and practicable. The first great measure for advancing the interests of the agrarian groups was the purchase of the Louisiana territory in 1803, at the cost of some \$15 million. Although this act seemed to be contrary to Jefferson's own principles of governmental economy, it represented a ridiculously small capital investment for the benefits it would eventually bring to the farming and other classes. Here is a case where an increase in the national debt and in taxes to pay off that debt was amply justified.

Jefferson undertook another important series of measures in line with his primary principles, the acts intended to keep the United States from going to war with Great Britain: especially, the Non-Importation Act of 1806, the Embargo Act of 1807, and the Non-Intercourse Act with Great Britain and France in 1809. Peace with Jefferson was not only a passion, but "a system." Jefferson felt that while the United States was still a young power, a period of peace would enable it to achieve the numbers and the wealth needed for successfully resisting any unwarranted aggression. Since he regarded peace as the supreme immediate objective, he was willing to aid the merchants and industrialists. His embargo policy badly damaged New England shipping but strongly encouraged New England manufactures. Although Jefferson's hopes that the Napoleonic Wars would end in Europe within a few years and that the United States could keep out of the conflict were not realized, his policy certainly was instrumental in saving the United States from an earlier and even more disastrous war than that of 1812.¹⁸

The prime fiscal objectives of Jefferson and Albert Gallatin, his noted Secretary of the Treasury, were retrenchment of expenditures and reduction of the national debt and taxes. Gallatin held that a large public debt was a menace and believed that the national safety and

¹⁷ Beard, *op. cit.*, 353ff.; Channing, *op. cit.*, 245ff.

¹⁸ Henry Adams, *History of the United States* (9 v., New York, 1889-91), v. 1-4, is the classic though hostile study of Jefferson's administrations. Cf. Gilbert Chinard, *Thomas Jefferson* (Boston, 1929), 343-464 and Joseph Dorfman, "The Economic Philosophy of Jefferson," *Political Science Quarterly* (March, 1940), 55: 98-121.

security could best be promoted by drastic reduction of the debt even at the cost of decreasing expenditures on defense. By 1807 he had succeeded in retiring all the federal debt callable by that date and had a heavy surplus on his hands.¹⁹ Jefferson intensely disapproved of Hamilton's funding system, but felt obligated not to repudiate it. As he told his friend du Pont de Nemours,²⁰

When this government was first established, it was possible to have kept it going on true principles, but the contracted, English, half-lettered ideas of Hamilton, destroyed that hope in the bud. We can pay off his debts in 15 years: but we can never get rid of his financial system. It mortifies me to be strengthening principles which I deem radically vicious, but this vice is entailed on us by the first error. In other parts of our government I hope we shall be able by degrees to introduce sound principles and make them habitual. What is practicable must often controul what is pure theory.

The public debt was reduced from about \$83 million in 1801 to \$57 million in 1809 and \$45,200,000 in 1812. This was accomplished despite the fact that on April 6, 1802, the whole system of excise duties and direct taxes which the Federalists had built up with such care and effort was abolished, with the exception of the salt tax.²¹ This was eliminated in 1807. The repeal of these internal taxes won great popular favor. For revenue Gallatin relied upon the customs receipts, land sales, and the postal services. Since American foreign trade expanded beyond all anticipations during Jefferson's administrations, the yield from the customs duties was more than enough to cover all the current federal expenses. Jefferson explained this reliance upon the tariff in a letter to a friend:²²

We are all the more reconciled to the tax on importations, because it falls exclusively on the rich, and with the equal partition of intestate's estates, constitutes the best agrarian law. In fact, the poor man in this country who uses nothing but what is made in his farm or family, or within the U.S., pays not a farthing of tax to the general government, but on his salt; and should we go into that manufacture, as we ought to do, he will not pay one cent. Our revenues once liberated by the discharge of the public debt, and its surplus applied to canals, roads, schools etc., and the farmer will see

¹⁹ Henry Adams, *Life of Albert Gallatin* (Philadelphia, 1880), is the standard biography; Chien Tseng Mai, *The Fiscal Policies of Albert Gallatin* (New York, 1930), the best study on that subject; Henry Adams, Ed., *Writings of Albert Gallatin* (3 v., Philadelphia, 1879), an indispensable reference.

²⁰ Thomas Jefferson, *Writings* (Ford, Ed., 20 v., New York, 1892-99), 8: 127.

²¹ *U.S. Stat. at Large*, 148.

²² Dumas Malone, Ed., *Correspondence Between Thomas Jefferson and Pierre Samuel du Pont de Nemours 1798-1817* (Boston, 1930), 133-34.

his government supported, his children educated, and the face of his country made a paradise by the contributions of the rich alone, without his being called on to spare a cent from his earnings. The path we are now pursuing leads directly to this end, which we cannot fail to attain unless the administration should fall into unwise hands.

The threat of war in 1807 led Jefferson to use the surplus in the Treasury for increased expenditures on national defense. This and the reduction in customs revenue which followed the imposition of the 1806-07 measures of commercial warfare led to a deficit in the budget for December, 1809, but the repeal of the Embargo Act that year and the reduction in Army and Navy appropriations saved the Treasury from further deficits²³ in 1810 and 1811.

The War of 1812 as a Tax Stimulus

Jefferson's policies were carried on by his successor, James Madison, the Father of the Constitution, who had the misfortune of serving as President while the conflict between Great Britain and the United States increased in tension and broke out into open war in 1812. The War of 1812 is important from the point of view of the social forces in action, as an effort by the agrarian classes, especially the Northwest frontiersmen and the southern planters, to use their control of government to further their interests as they saw them: the annexation of Canada; the removal of the Indian menace from the Northwest; the control of the rich fur trade with the Indians, formerly monopolized by the British; and the annexation of the East and West Floridas, then held by Spain, which was considered an ally of Great Britain. These objectives were not shared by the Federalists, the mercantile and financial groups in the Northeast who looked on Napoleon as the anti-Christ, exalted England as the conservatives' last hope, and feared the Republican administrations as ruinous to their commerce and prosperity. Despite the myth in the older school textbooks, they did not want to go to war for "Free Trade and Sailors' Rights."

The war did not result in the victories for which the War Hawks and even Jefferson had hoped. Hence the increase in the national debt necessitated by the war expenses, entailing heavier taxes, was a capital investment which brought practically no return for the financial outlay. The violation of the principle of economy of expenditure by the Republicans and the resultant taxes were due to the desire to use those taxes to advance the interests of the farming classes. They gambled

²³ Dewey, *op. cit.*, 119-23.

and lost. Their enterprise, although opposed by the business interests of the day, was a business venture carried out by and for the interests of the farmers.²⁴

The War of 1812 revealed the peril to which the federal government had exposed itself by placing its chief reliance for revenue upon the tariff. Although the customs duties were doubled in 1812, the receipts fell from \$13 million in 1813 to \$6 million in 1814 because trade with England was cut off and the British navy kept a large part of the American merchant marine from the seas. Since Congress was slow in authorizing new taxes, the Treasury depended mainly upon floating loans and issuing Treasury notes. Owing to the bitter opposition of the commercial interests in the Northeast to the war, military reversals, and bungling by the Treasury, the government received only \$34 million as measured in specie for loans of over \$80 million. The result was that the public debt rose from \$45 million in 1811 to \$100 million in 1814.²⁵

The necessities of war forced Congress to adopt new internal taxes. It levied direct taxes of \$3 million on August 2, 1813, \$6 million on January 9, 1815, and another \$3 million on March 5, 1816.²⁶ These taxes on dwelling houses, lands, and slaves were apportioned among the states on the basis of the 1810 census and were paid with a considerable degree of promptness and precision. These acts, like that of July 14, 1798, are significant in income tax history for showing the operative delimitations of the term "direct taxes." Congress also enacted duties on carriages, refined sugar, distilled spirits, licenses to distillers and retailers of spirituous liquors, auction sales, and certain other articles. These duties brought in some \$15 million by the end of 1817, but they and the direct taxes were repealed on December 23, 1817, in response to popular pressure against their retention.²⁷

If the war had not ended in December, 1815, two noteworthy tax innovations might have been adopted. On January 21, 1815, Alexander J. Dallas, the Secretary of the Treasury, unqualifiedly recommended to Congress the adoption of an inheritance tax and an income tax, which he thought might "be easily made to produce \$3 million."²⁸ This proposal by Dallas clearly indicated that the income tax was not considered by him or his contemporaries a direct tax in the constitutional sense of the term. This fact unfortunately was not uti-

²⁴ Julius W. Pratt, *Expansionists of 1812* (New York, 1925).

²⁵ Dewey, *op. cit.*, 128-37; Hansen, *op. cit.*, 168.

²⁶ 3 *U.S. Stat. at Large*, 53, 164, 255.

²⁷ 3 *U.S. Stat. at Large*, 401; Dewey, *op. cit.*, 138-42.

²⁸ *American State Papers* (Washington, 1832), 6: 885-87.

lized by the champions of the income tax in 1895 to prove the constitutionality of the tax.

An impetus had been given to the development of manufactures within the United States as a consequence of the interruption of commercial relations with England during the war. With the return of peace the American manufacturers were threatened with ruin by the flood of imported English goods. Federalists and Republicans united in extending protection to American industry by passing the Tariff Act of 1816. For the first time protection was adopted as a primary principle of the fiscal system and revenue was treated as secondary to industrial needs. The duties were moderate and not prohibitive, averaging 20 per cent, but were higher than any previous tariff. Since these increases failed to check imports, the pressure for still further increases began. The conflict between the economic interests of the commercial-industrial Northeast and the agrarian South then gained new strength.²⁹

The year after the tariff regained its central position in the federal revenue system the direct taxes and excise taxes which the war situation had induced Congress to adopt were abolished. From then to the outbreak of the Civil War the federal government made no use of excise, stamp, income, inheritance, or direct property taxes. Governmental expenses were met principally from customs duties, supplemented by the income from the sale of public lands. When the revenues for brief periods proved to be inadequate, the Treasury secured temporary loans until the return of prosperity removed their necessity. In this way internal taxes were avoided, even during the war with Mexico. During the years of peace the federal income often exceeded the expenditures down to 1857, and whatever deficits occurred were usually made up from the balance of previous years. Between 1817 and 1857 the Treasury was obliged fourteen times to issue Treasury notes or to raise loans, but the revenues in the following years restored the balance in favor of the government.³⁰

²⁹ Ashley, *op. cit.*, 151-56.

³⁰ Harry Edwin Smith, *The United States Federal Internal Tax History* (Boston, 1914), 1ff.



Jacksonian Democracy and Manifest Destiny

THE period from the end of the War of 1812 to the election of President Andrew Jackson in 1828 was principally notable for the quiet expansion and development of the American people and the American economy. Florida was bought from Spain in 1819 for some \$5,000,000. Especially after the panic of 1819 and the influx of immigrants fleeing from the disasters created by the Napoleonic Wars, pioneers streamed into the West to establish themselves on farms at the low rates the government charged for land. Roads and canals were built on a large scale; the steamboat began to dominate the coastal and inland water transportation routes. American manufactures increased in numbers, especially in New England. Finances became stabilized under the guidance of the Second Bank of the United States, established in 1816 to remedy the financial dislocations caused by the War of 1812. The population increased from about 8 million to about 12 million. Foreign and domestic trade grew as American agriculture and industry developed.¹

The harmony that seemed to prevail between Federalists and Republicans between 1816 and 1824 under the presidency of James Monroe ended when John Quincy Adams became President. The ability and good intentions of John Quincy Adams were not rewarded by success in getting Congress to enact his program for the construction of roads and canals, the building of warships, the endowment of educational institutions, the charitable treatment of Indians, and the settlement of important differences between the United States and Great Britain. Moreover, the tariff problem acted as the final dissolvent of

¹ The Conference Board, *Studies in Enterprise and Social Progress* (New York, 1939), 28, 66.

his presidential career. The protection which the 1816 tariff had extended to the textile industries was supplemented in 1818 by special duties on iron. In 1824 pressure from the industrialists in the Northeast and from the wool, hemp, and flax growers of Ohio, Kentucky, and Tennessee, and the Louisiana sugar planters led to a general revision of the tariff. The duties on woolens, iron, hemp, lead, raw wool, and the textiles were increased. The general average of the duties was a little over 30 per cent. But these increases failed to satisfy for long the tariff beneficiaries, and their agitation for higher duties, led by the woolen manufacturers, suffering from keen English competition, almost succeeded in securing a tariff revision in 1827. The conflicting presidential ambitions of Adams and Jackson then resulted in a peculiar series of political maneuvers on the tariff. Since Jackson's supporters in the South were for a reduction of duties and those in the Middle Atlantic states were protectionist, Jackson's friends in Congress, guided by Martin Van Buren, introduced a high and hampering tariff in the hope that the South and the New England manufacturers would reject it. This stratagem was intended to weaken the prestige of Adams and Henry Clay and to prevent Jackson from being committed on the protective issue. The outcome of the intrigue, however, was the passage of the most highly protective tariff law enacted before the Civil War. The average ad valorem rates on dutiable imports was nearly 49 per cent, and on free and dutiable imports together over 45 per cent. The chief objects of protection were woolens and raw wool. The reaction against the "Black Tariff" or "Tariff of Abominations" helped to elect Jackson over his rivals and led to successive reductions in the tariff duties in 1830 and 1832 and to the compromise tariff of 1833.²

Jacksonian Democracy and Economics

Jackson's election in 1828 was a triumph for western and southern farmers and eastern workers and petty tradesmen over the Hamiltonian doctrines of the manufacturers and bankers, who joined the richest southern planters in support of Adams. Unlike Jefferson, Jackson was not born to aristocracy; he achieved it by rising through his own efforts from the lower middle class to the ownership of a great plantation. He also differed from Jefferson in that he was not primarily a man of ideas and a master of rhetoric, but a man of action who gloried in battle and won popular favor through his skill as a military leader.

² Stanwood, *op. cit.*, 1: 200ff.; Taussig, *op. cit.*, 68ff.

These differences between the two great leaders of what was known first as the Republican and then as the Democratic party did not mean that their objectives were different. Jackson, like Jefferson, regarded the farmer as the pivot of democracy. The key to Democratic policy is to be found in this love and exaltation of the farming class, especially of the pioneer, and a concern for the eastern wage earners as against the employing classes. This did not imply, however, a narrow sectionalism or agrarian class attitude. Jackson understood that merchants, manufacturers, and bankers were necessary to the full development of the United States, but he refused to allow them to dominate the national economy or to build up their wealth through what he considered profiteering at the expense of the farmer and the worker.³

On fiscal questions Jackson's guiding principle was that expressed by the French economist J. B. Say: "The very best of all plans of finance is to spend little and the best of all taxes is that which is least in amount." Jackson opposed federal expenditures on internal improvements on the ground that these were matters for the states rather than for the federal government to undertake. On this subject the views of most egalitarian economists have changed since Jackson's day. But at that time liberal thinkers like Thomas Paine, Jefferson, and Jackson could uphold this principle because they believed in economic individualism. Here again Jackson's concern for the farmer is in evidence because taxes would have reduced the money capital of the farmer and hindered his activity. The Whigs, led by Daniel Webster and Henry Clay, took a position in sharp opposition to that of Jackson because they wanted to use the government money for the construction of roads and canals. These would have been of benefit to the moneyed and farming classes, but most of the burden of taxation would have fallen on the shoulders of the farmers and workers.

On the crucial question of the tariff Jackson tried to hold his supporters together by a policy of reduction which would at the same time safeguard the interests of those manufacturers facing European competition. The violent opposition of the South to the 1828 tariff found expression not only in threats of nullification and secession but also in attempts to win western support by backing the West in its public land policy. The 1832 Tariff Act removed some of the more striking objections to the 1828 tariff and restored on the whole the

³ Marquis James, *The Life of Andrew Jackson* (New York, 1938); Frederick Jackson Turner, *The United States 1830-1850* (New York, 1935), 14ff., 379ff., offer a good composite picture of Jackson and his career.

protective system to its 1824 status. But the 1832 measure was a distinctly protectionist one; it levied high duties on cotton and woolen goods, iron, and other articles, and reduced the duties on noncompetitive manufactures. The average rate on dutiable articles was about 33 per cent, and the protectionist philosophy running through the measure aroused the spirit of nullification in the South. On November 24, 1832, South Carolina passed a nullification ordinance against the 1828 and 1832 tariff laws. Although Jackson attacked this doctrine and threatened to use military force if necessary, he endeavored to conciliate the opposition by urging a drastic tariff reduction. A more moderate decrease in rates was obtained by Henry Clay's compromise tariff of 1833. This provided for a gradual reduction of all duties exceeding 20 per cent, so that after July 1, 1842, there would be uniform rates on all articles. The South had won its demands against the industrial Northeast, and South Carolina was able to claim that its threat of nullification had sufficed to bring about the redress of southern tariff grievances.⁴

Closely connected with the tariff question were the related problems arising from the rapidly mounting revenue from the sale of public lands and the disposal of the surplus in the Treasury. The annual proceeds from the sale of land had risen from \$1 million in 1811 to nearly \$5 million in 1834, \$15 million in 1835, and \$25 million in 1836. Since the revenue from both the tariff and the sale of public land was far in excess of the necessary government expenditures, those opposed to reducing the tariff were especially interested in either cutting down the revenue from the sale of public lands or in disposing of the surplus which otherwise would accumulate.

The surplus in the Treasury which had concerned Congress from 1826 on induced Jackson in 1829 to recommend an apportionment of the surplus funds among the various states since no satisfactory revision of the tariff downward seemed possible. Soon he regretted this suggestion and advised a reduction in the tariff duties and in the sale price of public lands as a means of cutting down the surplus. When in January, 1835, the national debt was paid off, the pressure for distributing the rapidly mounting surplus among the states grew more intense. In order to overcome Jackson's constitutional objections to an outright gift of federal funds, Congress passed in June, 1836, a bill providing that the money in the Treasury on January 1, 1837, exceeding \$5 million should be deposited with the various states in propor-

⁴ Turner, *op. cit.*, 397-402, 415-21.

tion to their respective representation in Congress. The Treasury paid out over \$28 million to the states before the 1837 panic forced it to call a halt.⁵

This method of disposing the federal surplus was not entirely satisfactory either to the Whigs who wanted unqualified grants to the states, or to the free-trade southern states which accepted their shares only because the North otherwise would receive them, or to those opposed to the high protective tariff, from which most of the surplus came. Although the deposits were in form a loan and could be recalled by the Treasury, everybody understood that they were outright gifts. Their principal importance today is their revelation of the negative attitude that most Americans then took toward the activities and expenditures of the federal government.⁶

Under Jackson the federal government became an instrument for the benefit of the common man. His frank acceptance of the spoils system sprang out of a desire to share the fruits of power, which had been monopolized by the Federalists and their successors, with the large mass of people who had not previously enjoyed opportunities in the government service. His eagerness to increase the territory of the United States came from the wish to increase the area in which an agrarian democracy could flourish and led to the recognition of Texas as an independent republic in March, 1837.

Jackson's dramatic opposition to a recharter of the Second Bank of the United States was the result of his belief that the bank had become an instrument of eastern and European financiers. He thought that it was being used against the interests of the small man, especially the western and southern farmer, and against the small banks in the West. Although the Bank of the United States has been ably defended as a stabilizing and nationalizing financial institution, the danger of a moneyed aristocracy establishing a financial oligarchy was grave, in the opinion of Jackson and certain modern scholars.⁷

The Panic of 1837: Causes and Consequences

The panic of 1837 began shortly after Martin Van Buren, Jackson's personal choice as his successor, assumed the presidency. The causes of the panic are too complex to be discussed here. Undoubtedly Jackson's withdrawal of government funds from the Bank of the United States, and distribution of them among the state banks, brought to a

⁵ *U.S. Stat. at Large*, 55, 201.

⁶ Dewey, *op. cit.*, 212-22.

⁷ Carl B. Swisher, *Roger B. Taney* (New York, 1935), 160ff.

head the financing of innovations through credit creation which had helped to make the eighteen-thirties one of the great eras of building construction and speculation in business and land. The distribution of the Treasury surplus early in 1837 was another inflationary factor. But the specific precipitants of the panic seemed to have been Jackson's Specie Circular of 1836—stopping sales of public lands on credit and insisting on payment in specie—and England's financial panic in 1836 and depression from 1837 to 1842. In the face of this economic crisis Van Buren adhered to the views of Jackson and Taney: that the main causes of the panic were paper money and bank credit inflation, excessive business expansion, and the growth of undesirable luxurious habits. He disclaimed all government responsibility for the hardships from which the people were suffering and concluded that it was not within the constitutional bounds of the federal government to aid business, commerce, and the unemployed. This noninterference view of the business cycle and of the role of the government followed the tradition which had grown up and on which Grant in 1873 and Cleveland in 1893 relied. The only remedies Van Buren suggested were the issuing of \$10 million in Treasury notes as an emergency measure and the creation of an Independent Treasury in 1840 for the purpose of separating the government from the banking system and establishing a safe depository for government funds. These palliatives had only a slight success, and the depression continued from 1839 until 1843. Those modern economists who accept John Maynard Keynes's theory that recovery can be initiated through government spending on construction projects would regard the longevity of this depression, during which a notable slump in construction building occurred, as a justification for a fiscal policy differing from Van Buren's deflationary, noninterventionist position. Van Buren's position may be considered an exemplification of Keynes's thesis that "soon or late, it is ideas, not vested interests, which are dangerous for good or evil," because an enlightened concern for the common man might have dictated a policy other than the one adopted.⁸

The misfortune of the Democrats led to the success of the Whig party in the election of 1840. Through a skillful campaign of "noise, nonsense and numbers," the Whigs elected William Henry Harrison, a frontier hero, as President and John Tyler, a state's rights Virginian, as Vice-President. The death of Harrison after one month in office

⁸ Reginald C. McGrane, *The Panic of 1837* (Chicago, 1924), *passim*; Turner, *op. cit.*, 454ff. Cf. John Maynard Keynes, *General Theory of Employment, Interest, and Money* (New York, 1936).

caused the plans of the Whigs to go askew. With Tyler, a Virginia "abstractionist," as President, the Whigs were not able to make the sweeping changes they had anticipated. They repealed the Independent Treasury Act in 1841, but failed to obtain a charter for a new Bank of the United States. The decline in customs duties which was caused by the depression gave the Whigs an opportunity to restore the protective system by the passage of the 1842 Tariff Act. This increased the duties, although not uniformly, to the level of the 1832 tariff. Heavier duties were laid on wool, cotton, iron, and glass and specific duties were applied more extensively than in the 1832 tariff. As a revenue measure it proved satisfactory: the public debt was reduced and the government expenses were brought within its income. The revival in the cotton and iron manufactures aided in spreading prosperity, reviving confidence, and lightening the pressure on business. But the Whigs were not able to gain their desired distributions to the states of the proceeds from the public land sales.⁹

The War with Mexico

In the election of 1844 Henry Clay and the Whig policies on the Bank, sound money, high protection, and antiexpansionism were defeated by James K. Polk, the Democratic candidate, with his vigorous espousal of a program of agrarian imperialism: the annexation of Texas and the occupation of the disputed Oregon territory in the Pacific Northwest. The lines of action initiated by Jefferson and Jackson were now carried forward in carving out a new empire for the western farmer and southern planter. Tyler, considering Polk's election a mandate for expansion, induced Congress to annex Texas through the extraconstitutional device of a joint resolution as a means of circumventing the opposition of New England. Polk, upon assuming the presidency in March, 1845, proceeded to settle the dispute about Oregon through a compromise treaty with Great Britain signed in June, 1846. He succeeded in 1848, after a two-year war with Mexico, in extending the boundaries of the United States to the Rio Grande and the Pacific Ocean. The American republic, despite the regret of many concerning the use of force in settling the disputes with Mexico over Texas and other questions, was now assured of ample room for future growth in numbers and wealth, especially of the agricultural classes.¹⁰

⁹ Turner, *op. cit.*, 481-508.

¹⁰ *Ibid.*, 522ff.; Justin H. Smith, *The War with Mexico* (2 v., New York, 1919) is the classic defense of American expansion; Albert K. Weinberg, *Manifest Destiny* (Baltimore, 1935), 167-81, the most notable recent critique.

The total cost of the Mexican War has been estimated at \$118,500,000: \$15 million for the "purchased" territory, \$3,250,000 for claims of Americans against Mexico, and \$100 million for the military expenditures. This does not include the 1,550 lives lost in battle, the 11,300 ordinary or accidental deaths, and the 3,450 wounded in battle.¹¹ The extraordinary expenses of the War and Navy Departments during the war were about \$63½ million in excess of the peace expenditures and were met by loans in the form of Treasury notes and government stock. Owing to the large Treasury surpluses for 1844-46, a net indebtedness of only \$49 million was created. From a narrow business and militaristic standpoint, even the estimated total of \$118,500,000 was a small capital outlay for the tremendous increase in national resources obtained through the new territorial acquisitions. The relative ease with which the Treasury managed its war financing, in contrast to the difficulties encountered during the War of 1812, resulted in large measure from the great increase in the national wealth and the advance in the federal government's credit. The deficits in 1847-49 totaled over \$54 million, but increased revenues led to Treasury surpluses from 1850 to 1857 which amounted to over \$54 million. An added factor in the success of the war financing was the re-establishment by the Democrats of the Independent Treasury in 1846.¹²

The Polk administration relied almost exclusively upon the issue of bonds and Treasury notes for meeting its war expenses. The Secretary of the Treasury, Robert J. Walker, however, attempted to increase the federal revenue and at the same time reduce the high rates of the 1842 tariff. In a notable report to Congress in December, 1845, he presented a powerful attack upon protectionist principles and urged a tariff designed to secure the maximum revenue consistent with moderate protection. The tariff adopted in July, 1846, was distinguished as the only tariff practically drafted by the executive. The Act divided imports into a number of classes with duties ranging from 5 to 40 per cent for the great majority of articles, and in the case of brandy and spirits to 100 per cent. The class of free articles included coffee, tea, cotton, and iron and copper ore. A duty of 30 per cent was levied on most of the articles around which the protective debate centered: manufactures of iron and other metals, wool and woollens, and manufactures of leather,

¹¹ Edward Channing, *History of the United States* (6 v., New York, 1908-25), 5: 600; Smith, *op. cit.*, 2: 318-19. The cost of the Mexican War service pensions amounted to \$50,422,229 by June 30, 1916. William H. Glasson, *Federal Military Pensions in the United States* (New York, 1918), 119.

¹² Dewey, *op. cit.*, 255-56, 267-69; Smith, *op. cit.*, 2: 253-67.

glass, and wood. Cotton goods paid a 25 per cent duty. The average rates on dutiable imports were 26 per cent. The tariff did not produce the dire results predicted by the Whigs, was a success as a revenue producer, and was accompanied by almost continuous prosperity for nine out of the eleven years during which it was in force.¹³

No attempt was made to finance the war through excise and direct taxes despite the 1798 and War of 1812 precedents. David Wilmot, author of the famous Wilmot Proviso prohibiting slavery in any territory acquired from Mexico, proposed in 1848 that \$5 million be raised annually through a tax on personal and other property, stocks, and money at interest while the Mexican War lasted and until the public debt was paid. Since this would have taxed the slave property in the South and the financial investments of the North, the measure was defeated by the large majority of 139 to 47. Antislavery men like John Quincy Adams joined such proslavery men as Robert Toombs in opposing what at that time seemed a radical economic proposal, dangerously close to a capital levy.¹⁴

Changes in American Society, 1828-50

The acceptance or rejection of any specific type of taxation depends, ultimately, on two basic factors: on the one hand, actual economic conditions and financial needs of the government, and, on the other hand, the climate of opinion, the system of social values, which determine the ends as well as the means toward their attainment which men will accept. During the period between 1828, when Jackson became President, and 1850, one of the great turning points in the conflict over the question of slavery, many changes occurred in American society which affected both these factors.

In these years the population increased from about 12 million to over 23 million. The immigration increased from about 20,000 in 1828 to almost 300,000 in 1850. This influx was to reach a peak of over 400,000 in 1854, owing to the famine in Ireland and the revolutions on the Continent. Meanwhile a notable westward movement indicated a profound transformation in the orientation of the country away from Europe and toward the West. The westward trend was aided by, and an inspiration for, improvement in the means of communication and the interregional exchange of goods. The great boom in improved highways and canals in the first two decades of the nine-

¹³ Taussig, *op. cit.*, 114ff.; Turner, *op. cit.*, 554-60.

¹⁴ *House Journal*, 30th Cong., 1st Sess., 347-48; Albert J. Beveridge, *Abraham Lincoln* (2 v., Boston, 1928), 1:437.

teenth century was succeeded by an even more remarkable boom in railroads, a development so striking that a noted economist has termed the period from the eighteen-thirties on the period of railroadization.¹⁵ Twenty-three miles of railroad in 1830 were destined to reach 9,000 miles in 1850 and 30,000 miles in 1860, a gigantic expansion of capital equipment equaled only in our own day by the automobile and electric industries.

With this marked development of population and transportation facilities went a parallel growth in the number of large cities. Their number increased from some five cities with a population of over 8,000 in the seventeen-eighties to 141 in 1850. This rise of the city was accompanied by an acceleration in the unfolding of the factory system, especially in the Middle Atlantic states, and after 1840 in the Northcentral states. Factory production in such important American industries as those using cotton, wool, or iron expanded. The telegraph also became an important link in communication. During the eighteen-forties corporations constructing railroad and telegraph systems succeeded state governments as the primary agencies for large-scale enterprises. By 1850 nearly all the larger cities were connected by wire networks. Commercial banks, investment banking, and the New York Stock Exchange came to play important roles in the economic life of this middle American period. New farming methods such as land fertilization, crop rotation, and scientific stock breeding and the invention of such agricultural machines as the cast-iron plow, the steel plow, and the reaper, not to mention Eli Whitney's cotton gin of 1793, transformed agriculture by making possible the increased production necessary for the seemingly ever-increasing population of the United States as well as the large European market. The discovery of gold in California in 1848 led to a great enlargement of the basis for bank loans and for the whole pyramid system of credit.¹⁶

While the industrial pot bubbled at each new spark of innovation, the labor movement also stirred. Small unions of shoemakers, printers, masons, mechanics, tailors, and cordwainers had been formed in the seventeen-nineties and the first two decades of the nineteenth century. But the first large trade-union was formed in 1827 in Philadelphia. It lasted only a year but was succeeded by others during the

¹⁵ Joseph A. Schumpeter, *Business Cycles* (New York, 1939), I, 325ff.

¹⁶ Walter B. Smith and Arthur H. Cole, *Fluctuations in American Business 1790-1860* (Cambridge, 1935), 37-43, 87-92; Willard L. Thorp, *Business Annals* (New York, 1926), 107-27; Robert F. Martin, *National Income in the United States 1799-1938* (New York, 1939), 8-13; National Industrial Conference Board, *Studies in Enterprise and Social Progress* (New York, 1939), 66.

boom period of the eighteen-thirties. The panics of 1837 and 1839, however, broke most of these organizations. The lure of the frontier and the competition for jobs from the large immigrant groups of the eighteen-forties may have played equally important roles in hindering the formation and consolidation of the labor unions until the period just before and during the Civil War.¹⁷

These years, moreover, saw pronounced humanitarian and social reforms in many aspects of society from penal institutions to facilities for education. The material transformation of the United States in these dynamic decades was matched by parallel changes in the life of the spirit. The dark Calvinism of the seventeenth-century Puritan had been succeeded by a rationalism in politics and religion that made Jefferson and Benjamin Franklin the compeers of the philosophers of the French enlightenment. They, in turn, were followed by a group of transcendentalist thinkers who fused mysticism with reason and criticized the defects of capitalism with its stress on materialistic rather than humane values.¹⁸

The history of economic thought in the United States still awaits an adequate treatment. Benjamin Franklin was the outstanding pre-revolutionary American writer on economics. His ideas on labor as the best measure of value, on the economy of high wages, on the value of free trade, on the influence of the frontier on wages, and other matters, are still of interest. During the American Revolution and after, two writers of ability, Pelatiah Webster and Samuel Gale, concerned themselves with sound finance. The first champion of protective tariffs for the benefit of the manufacturing industry was Tench Coxe, whose book preceded by four years Alexander Hamilton's famous "Report on Manufactures." Hamilton and Albert Gallatin in their state papers presented their economic theories with great power and effect. The writings of John Taylor, the chief theoretical opponent of Federalism, also deserve mention. After the War of 1812 the United States became more developed industrially and new works in economics gradually emerged. In 1820 Daniel Raymond propounded a strong defense of the protective system. From his works Friedrich List derived his theory of economic nationalism which had such influence in Germany. During this period of the eighteen-twenties and thirties Mathew Carey also wrote numerous essays on the desirability of the protective

¹⁷ John R. Commons et al., *History of Labor in the United States* (4 v., New York, 1918-35), 1: 108ff.

¹⁸ Carl R. Fish, *The Rise of the Common Man* (New York, 1927), 137ff.; Ralph H. Gabriel, *The Course of American Democratic Thought* (New York, 1940), 3ff.

system. Although a considerable number of other writers of some power and originality, such as John McVickar, J. N. Cardozo, Thomas R. Dew, William Beach Lawrence, Thomas Cooper, Francis Bowen, and George Tucker, produced volumes that attracted attention in their day, the writer in the middle period who gained the greatest reputation, international as well as national, was Henry C. Carey, the son of Mathew Carey. An ardent protectionist, he vehemently criticized the doctrines of the classical school on labor, rent, wages, and the tariff. His views strengthened the economic nationalism of the Whigs in America and gained adherents in Germany and in Italy.

In sharp contrast to the views expounded by both the agrarian and capitalistic economists were the writings on socialism by L. Byllesby and Thomas Skidmore in the late eighteen-twenties. Francis Wright, Robert Dale Owen, G. H. Evans, William Maclure, Stephen Simpson, Seth Luther, and Ely Moore made the labor movement a subject of wide interest in the eighteen-twenties and thirties. In the eighteen-forties Albert Brisbane, Parke Godwin, and Horace Greeley attracted a considerable following for Fourierism and Associationism movements. Interest in the communist movement (Utopian as opposed to the Marxian type) was kept alive by the Brook Farm publication, *The Harbinger*, and by J. M. Horner's and J. A. Collins's volumes.¹⁹

American Equality and State Inheritance Taxes

The nature of American civilization in this transitional period, its distinctive cultural pattern, its dominant emphases, and operative system of values can perhaps best be briefly presented as seen through the eyes of that most penetrating and gifted of foreign explorers of the American scene, Alexis de Tocqueville. During his visit to the United States in 1831-32 he wrote his impressions of America in uncensored letters and notes, which only recently have been given to the world and were the basis for his magnificent *Democracy in America*. To Tocqueville, trade was the national passion, and the American people were a merchant people devoured by the thirst for riches. He found it difficult to understand how a society formed of people drawn from all nations, having different languages, beliefs, and opinions, could be a hundred times happier than a country like France and could be tied together by the common pursuit of individual interests. He explained the lack of social revolutionary tension by the opportuni-

¹⁹ See Edwin R. A. Seligman, *Essays in Economics* (New York, 1925), 122-61; and the pertinent articles in Allen Johnson and Dumas Malone, Eds., *Dictionary of American Biography* (20 v., New York, 1928-37), for further leads.

ties open to almost every man to create for himself a career and a happy existence. He marveled at the instability of the American, the way he constantly changed his home and continually ventured upon new enterprises. Change seemed to the American a natural state of man because everything about him was constantly changing: laws, opinions, public officials, fortunes, and the very land itself.

This restlessness of the American impressed Tocqueville because it indicated the absence of the rigid customs and traditions prevalent in Europe. The reasons for this he expounded in a remarkable passage: ²⁰

However powerful and impetuous the flow of time here, imagination anticipates it and is already taking possession of a new universe. The tableau is not big enough for it. There is not a country in the world where man more confidently seizes the future, where he so proudly feels that his intelligence makes him master of the universe, that he can fashion it to his liking. It's an intellectual movement which can only be compared to that which led to the discovery of the new world three centuries ago; and one can really say that America has been discovered a second time. And let it not be supposed that such thoughts rise only in the minds of philosophers. They are as present to the artisan as to the speculator, to the farmer as to the city dweller. They inhere in all objects, they are a part of every sensation. They are palpable, visible, in a way felt; perceived by all the senses.

Born often under another sky, placed in the middle of an always moving scene, himself driven by the irresistible torrent which draws all about him, the American has no time to tie himself to anything, he grows accustomed only to change, and ends by regarding it as the natural state of man. He feels the need of it, more, he loves it; for the instability, instead of meaning disaster to him, seems to give birth only to miracles all about him. (The idea of perfection, of a continuous and endless amelioration of social conditions, this idea is presented to him unceasingly, in all its aspects.)

The diffusion of wealth and comparative absence of sharp class cleavages and of ingrained economic inequality led Tocqueville to investigate and to reflect on the effect of inheritance laws on the concentration of wealth. He attributed to the customs and laws of inheritance part of the credit for the triumph of egalitarian principles in the United States after the American Revolution. He wrote that Americans declared: "It's the inheritance law which has made us what we are: it's the very foundation of our Republic. . . ." This made Tocqueville conclude that the equal partition of goods leads more or less rapidly, but infallibly, to the nullification of aristocratic principles

²⁰ G. W. Pierson, *Tocqueville and Beaumont in America* (New York, 1938), 119.

and to the destruction of great family dynasties. All attempts to oppose this extension of equality he deemed futile. Tocqueville learned that the reason fortunes changed hands in New England at that time with unbelievable rapidity as compared to France, was that in France the great fortunes were based on land while all those in New England were commercial.

Tocqueville somewhat exaggerated the influence of the American inheritance laws, since equal division of property was not compulsory, and the farmer had the right to give all his property, personal and real, to a single one of his children. In fact, by 1830 the lands of the estate were no longer subdivided in Massachusetts but were almost always given to the oldest son. The reason that no unpropertied and discontented class of men, disinherited by their fathers, was to be found in Massachusetts was that the younger sons went West to buy cheaper land and form new settlements.

Tocqueville discovered that Maryland, which had been very aristocratic before the American Revolution, was changed after the Revolution through the inheritance law requiring equal division. A few families, like that of Charles Carroll, managed to save their fortunes, but in general the great holdings were rapidly divided up. The result was that the great mass of citizens in Maryland had become more enlightened and were more prosperous even though there were fewer outstanding gentlemen and statesmen. In Pennsylvania an acute authority informed Tocqueville that the political effect of the law of succession, by which the property of the person dying intestate was divided equally among all his children, male and female, was altogether advantageous. It effectively prevented rich families from continuing rich through more than two generations unless the family wealth were kept up by constant industry. The consequence was that respectability and influence were possessed exclusively by the industrious and useful portion of society. Among the moderately wealthy classes each child received enough to start him on the road to wealth but not sufficient to encourage him in idleness. The law of equal division applied only to the estates of those dying intestate. The custom, however, even of those making wills, was to divide their property fairly equally. This meant that custom was prior to law in bringing about the equalitarian tendency in American society with which Tocqueville was so much impressed.²¹

In addition to the laws regulating the distribution of inheritances, whose importance Tocqueville had emphasized, several of the Ameri-

²¹ *Ibid.*, 126-28, 368-70, 425, 494-98, 533-34.

can states before the outbreak of the Civil War had enacted inheritance laws which contained the seeds of potential reformative, if not revolutionary, power.²² Pennsylvania, the home of Franklin, Albert Gallatin, and A. J. Dallas, passed in 1826 the first real state inheritance tax: a collateral tax of 2½ per cent on estates over \$250; the parents, the surviving spouse, and the direct descendants of a deceased person were exempted. Twenty years later the rate was raised to 5 per cent. In 1849 the legislature provided that the revenue from the inheritance tax should be applied to the repurchase of the state debt; stocks of domestic corporations appearing in the estates of nonresident decedents were also made subject to the tax. After 1849 little change was made in the Pennsylvania inheritance tax until 1897; the 1887 codification merely clarified its application. After 1830 a 50-cent probate fee was also levied in addition to the inheritance tax.

The second state to adopt an inheritance tax was Louisiana. In 1828 it taxed the foreign heirs 10 per cent of any property forming part of the estate of a Louisiana decedent. The act was repealed in 1830, but was re-enacted twelve years later,²³ and continued in force until 1877. Massachusetts levied a ¼ per cent probate fee in 1841 to support the probate courts, but this was abolished two years later. Strictly speaking, one should not include this statute in the list of state inheritance tax laws since a probate fee is really a charge for the cost to the government of maintaining courts which will establish the validity of the last wills and testaments of deceased persons. Inheritance taxes differ in character since they are direct taxes on the recipients of the inheritances.

As far back as 1687 Virginia had had a probate duty: a fee of 200 pounds of tobacco. But from 1843 to 1884 Virginia developed a combined system of probate fees and collateral inheritance tax. The probate fee was introduced by the 1842-43 law and was a flat 50 cents. In later years it was increased, and in 1863, owing to the financial duress created by the Civil War, was made \$2.50 irrespective of the size of the estate. The collateral inheritance tax introduced in 1844 levied a tax of 2 per cent on the shares of the indirect heirs of the de-

²² William J. Shultz, *The Taxation of Inheritance* (Boston, 1926), 98ff.; Max West, *The Inheritance Tax* (2d ed., New York, 1908), 97-114.

²³ Louisiana courts ruled that this tax did not apply to citizens of France or of Bavaria as it was superseded by federal treaties with these countries. The federal courts upheld a federal treaty with the king of Württemberg dated April 10, 1844, which provided that the citizens of each country should have a right to inherit from citizens of the other, paying no greater duties than the inhabitants of the country in which the property was located, since the tax also fell on citizens of Louisiana who inherited property while living abroad. Cf. Shultz, *op. cit.*, 99.

ceased person. Various changes were made during the next decades, culminating in a 6 per cent tax in 1869-70.

Maryland in 1845 enacted a 2½ per cent collateral inheritance tax, which it has retained with a few slight changes. North Carolina in 1847 passed a 1 per cent tax on collateral inheritances over \$300 in real estate and over \$200 in personal property. In 1855 discrimination between different classes of collateral heirs was introduced, and direct heirs were taxed for the first time in the history of American tax laws; the rates varied from 1 per cent on direct descendants and the decedent's brothers and sisters, to 2 per cent on uncles, aunts, nephews, and nieces, and to 3 per cent on all others. Although many changes in these rates occurred in later years, the tax retained its original form in general until 1847 when it was discontinued for a time. Alabama also showed its progressiveness in matters of taxation by passing in 1848 a 2 per cent collateral inheritance tax on personal and real property, and in 1849 a tax on gifts. These taxes lasted for some twenty years and were abolished only in 1868.

Out of the seven states having either probate fees or inheritance taxes, five were below the Mason and Dixon line. Only Pennsylvania among the northeastern states was bold enough to have a collateral inheritance tax. Massachusetts endured a probate fee for only three years. North Carolina has the distinction of being the first state to tax direct heirs. The receptivity of the southern planter aristocracy to advanced ideas in taxation has not received the attention it deserves.

Colonial and State Experiments with the Income Tax

The roots of the income tax movement in the United States go much farther back than those of the inheritance tax. Many Americans in the nineteen-thirties and forties, impressed by conservative attacks on radical income tax measures, have come to believe that income taxes are comparatively new and do not have roots going far back into the American past. Far from being the dangerous innovations the conservative part of the public imagined income taxes to be when the Sixteenth Amendment to the federal Constitution was adopted in 1913, these taxes can be traced back in an embryonic form to the earliest years of American colonial history.²⁴

The New England colonies introduced the ancestor of the modern

²⁴ Delos Oscar Kinsman, *The Income Tax in the Commonwealths of the United States*, publications of the American Economic Association, 3d Series, IV, No. 4 (Ithaca, 1903), 1ff.; Edwin R. A. Seligman, *The Income Tax* (New York, 1914), 367-87.

income tax, the faculty tax, within the first few years after their establishment in the New World. The colony of New Plymouth, founded by the Pilgrims in 1620, passed in 1643 the first statute taxing American colonists "according to their estates or faculties, that is, according to goods lands improoved faculties and sonall abillities." This act, however, failed to specify how people's faculties were to be measured, although it distinguished faculty and personal ability from visible property. A neighboring colony, Massachusetts Bay, established in 1629-30, passed a more comprehensive law in 1646 taxing not only personal and real estates, but also the "returns and gains" of tradesmen, artificers, and handicraftsmen. This tax was to be "proportionable unto other men for the produce of their estates."

This principle of taxation was soon adopted by other colonies. New Haven introduced in 1649, eleven years after its founding, an act taxing the profits of laborers, tradespeople, and others. Connecticut in 1650 passed a faculty tax on all "manuall persons and artists," in addition to a general property tax. Rhode Island, the haven of Roger Williams in 1636, laid down in 1673 the rule that taxes were to be assessed according to "equety in estate and strength," that is, not only according to the property, but also in proportion to the "faculty" or the "profits and gains" of the colonists. Outside New England, the only colony during the seventeenth century which adopted a faculty tax was New Jersey, acquired from the Dutch by the English in 1664. Twenty years later it levied a tax on the profits of traders, merchants, artificers, innholders, and other profitably employed non-real-estate owners. New York as a colony never had a faculty tax. Some of the southern colonies acquired a faculty tax subsequently.

During the eighteenth century the custom of taxing profits continued where it had been established and was extended to other colonies. A marked trend in this direction can be noted before the definite beginning of the American Revolution in 1775. Massachusetts made more earnest and repeated attempts to clarify and to enforce these laws than any other colony. Numerous acts were passed from 1692 onward giving increased precision and scope to its tax on the income or profit received by persons from "any trade, faculty, business or employment whatsoever." Connecticut and Rhode Island did likewise. South Carolina in 1701 and 1703, followed by New Hampshire in 1719 and by Delaware in 1752, introduced faculty taxes into their tax systems for the first time.

More than one third of the American colonies during their War for Independence passed faculty taxes designed to reach profits which

would otherwise escape contributing to state war chests. Massachusetts explicitly assessed in 1777 taxpayers not only "on the amount of their income from any profession, faculty, handicraft, trade, or employment" but also "on the amount of all incomes and profits gained by trading by sea and on shore, and by means of advantages arising from the war and the necessities of the community." Here is a neat precedent for stringent war profits taxes for the crisis the United States faces in the nineteen-forties. The state law for 1779 distinguished "the way and manner" in which incomes and profits were made as bases for different rates of taxation. The constitution adopted in 1780 incorporated the prevailing principles of taxation and provided for their continuance. Maryland inaugurated in 1777 a faculty tax, only to abolish it, however, in 1780. The third state in 1777 to tax "the profits of all faculties and professions, the clergy excepted" was South Carolina. Vermont in 1778, one year after gaining its independence, enacted a faculty tax very similar to that of Connecticut. The fifth state to levy a faculty tax in this period of struggle for national existence was Pennsylvania, the "Keystone State" of the Union. For the first time in its history it passed such an act in 1782. This act and another passed in 1785 had such low maxima that they might be termed "classified poll taxes." After the conclusion of peace between Great Britain and the United States in 1783, the one new state to experiment with the faculty tax was Virginia. But the tax there lasted only from 1786 to 1790.

During the first quarter of the nineteenth century the faculty tax gradually fell into disuse, especially as with the growing mobility of landed property, tax assessments became based on the selling value of the land rather than its annual value or products.²⁵ Rhode Island in 1776, Maryland in 1780, New Hampshire in 1794, and Delaware in 1796 were the first to abandon its use. Connecticut followed their lead in 1819; Vermont did so finally in 1850. Pennsylvania extended its faculty tax in 1799 and in 1817, but rarely enforced it and obtained extremely little revenue from it. South Carolina and Massachusetts were the two states which retained their faculty taxes up to the Civil War, although the term "faculty tax" gradually gave way to income tax. In both states the yield from the faculty tax was quite insignificant.

It is important to grasp clearly the significance of the appearance and disappearance of the faculty tax in American economic history. The faculty tax developed as an attempt to supplement the taxes on real and personal property by taxing those persons who derived their income from other sources. The tax on the earnings of the nonlanded

²⁵ Kinsman, *op. cit.*, 17ff.; Seligman, *op. cit.*, 388-406.

classes was supposed to correspond to the property or produce tax on special pieces of personalty or realty. It was not an income tax in the modern sense: a tax upon the personal income of the individual, with allowance made for indebtedness and other elements affecting the personal situation of the taxpayer. The faculty tax, used by medieval Europe as well as colonial America, was not levied on the total income of the individual and was not a tax on actual profits but on assumed profits. Owing to the fact that the faculty tax did not tax the actual profits or gains of men engaged in industry, commerce, and the professions as a part of a general tax on incomes, the faculty tax operated as an arbitrarily levied class tax on certain assumed earnings, with very little relation to the actual income. Hence, after the emergency demands of the Revolution the tax became grievous and unequal and was allowed to fall into disuse in most of the states. Since public opinion from 1895 on has become accustomed to thinking of income taxes as direct taxes, it is worth stressing that these faculty or profits taxes of the American colonies and states were not direct income taxes, and that if they are called income taxes they must be classified as indirect income taxes. American statesmen and writers of the period of the framing of the Constitution regarded these faculty taxes as indirect taxes. Nevertheless, from our vantage point, the faculty taxes, although distinct from what we call income taxes, in the evolution of our tax system offer the closest analogy to the income tax, and helped in part to bring it into being.²⁶

In the early eighteen-forties various state governments, in an effort to meet their financial needs, resorted to the income tax proper, as distinguished from the faculty tax. Many states, especially in the North, inspired by the widespread industrial expansion and commercial enterprise of the eighteen-twenties and thirties, borrowed money to invest in such internal improvements as roads, canals, and railroads, to embark on state banking schemes, especially in the South, or to engage in commercial enterprises, notably in the West. The withdrawal of the federal government under Jackson and Van Buren from internal improvements as a sphere of activity, and its distribution of \$28,000,000 surplus revenue in 1837 to the states, stimulated the state governments to an excessive spending program. The severe panic of 1837 and the minor panic of 1839 made the financial burdens of the states extremely heavy, if not impossible, to bear. A movement to have Congress assume the large state debts was vigorously pressed, but failed to win the needed votes, although many urged that the greater

²⁶ Seligman, *op. cit.*, 381-87.

part of the state indebtedness had been contracted to aid public works "calculated to strengthen the bonds of union, multiply the avenues of commerce, and augment the defences against foreign aggression." When the states faced the need for meeting their financial responsibilities on their own, several of them tried to increase their revenues, and a few turned in their dire extremity to experimenting with some form of income taxation, in the modern sense.

In the period from 1840 to 1850 six states introduced the income tax. The first was Pennsylvania; in 1840 it revived in part the faculty tax, adopted in 1782 but after 1817 allowed to be virtually a dead letter. The tax rates on salaries and on income from trades, occupations, and professions not previously taxed by the state were, however, so low that the revenue from this new tax was insignificant. Despite its ineffectiveness, the Act with slight variations remained on the statute books until 1871. Maryland followed in 1841 with a slightly higher tax rate, exempting incomes under \$500 and those derived from taxed property. The collection of the tax, however, was so lax that in 1850 the law was virtually repealed.

The recourse to the income tax in Pennsylvania and in Maryland was due primarily to fiscal needs, but in four southern states income taxation developed partly in response to revenue requirements, but even more in response to the demand for more equal taxation. The southern states during colonial times and in the early part of the nineteenth century had had a system of taxation markedly different from that of the rest of the country. Owing to the power of the large landowners, the land tax played a minor role in their state tax structures; poll taxes and duties on exports and imports had prevailed prior to 1789; after that a rather primitive system of land taxes evolved, but no general property tax developed as it had in the remainder of the country. By the early eighteen-forties the large plantation owners became conscious of the rising middle class: the cotton factors, the merchants, and the professional groups. In order to bring these important economic groups to share the burdens of taxation, the planting aristocracy contrived in some places a system of license taxes bearing on these hitherto untaxed groups. In a few cases the planters used their control of the state governments to introduce an income tax.

In Virginia a law was passed in 1843 taxing 1 per cent of the salaries and professional income over \$400 a year; there was also a 2½ per cent tax on all interest or profit from money, bonds, notes, or certificates of debt. With minor changes, these taxes continued in operation until the Civil War. Alabama also began in 1843 a series of light

taxes on professional and business income which continued down to 1862. Florida emulated Virginia and Alabama in 1845 but had such little success that ten years later it abolished the entire system. North Carolina rounded out the southern group of income tax states in 1849 with its tax on salaries and fees and on interest and profits. With slight variations these taxes continued until the Civil War caused drastic changes.

The attempts by these six states, ranging from Pennsylvania to Florida and Alabama, to solve their financial difficulties through the use of the income tax were not very successful. In no case was the revenue of great importance, and in only one case, that of Virginia, was it appreciable. The Virginia income tax yielded about \$16,000 in 1844 and \$104,000 in 1858. In no other state were these revenues even approached, although North Carolina did quite well in the first few years of the tax's operation. Hence, it is no matter for surprise that during the depression from 1839 on seven states—New York, Pennsylvania, Maryland, Indiana, Illinois, Michigan, and Arkansas—failed to pay the interest on one part or another of their indebtedness and that Mississippi and Florida repudiated completely the principal of two bond issues. Nevertheless, these income tax experiments of the eighteen-forties are important as indications of how state governments groped their way in a changing economic system to the discovery and invention of new forms of taxes which would aid in a time of need and also be instruments of social justice.²⁷

²⁷ Dewey, *op. cit.*, 217ff., 243-46; B. U. Ratchford, *American State Debts* (Durham, N.C., 1941), 73ff.; E. R. A. Seligman, *op. cit.*, 399-406; *Essays in Taxation* (New York, 1911), 16-22; William J. Shultz, and M. R. Caine, *Financial Development of the United States* (New York, 1937), 214-36.



Preserving the Union

TIMES of crisis often embolden men to create new instruments for the attainment of greatly desired ends. After the emergency has passed the instruments then forged are discovered to have lasting uses and to serve the needs of more normal times. The modern income tax sprang from the exigencies of a revolutionary France in 1793 and of an England fighting under Pitt and his successors against Napoleon's domination of Europe in the period 1798-1816. Similarly, the federal income and inheritance taxation in the United States emerged in response to the need for preserving the unity of our national existence. The rigid pattern of men's views on the proper scope of taxation was broken, and their inventive power was challenged. Out of the tragic arbitrament by force of the issues between North and South came consequences of mingled good and evil. The preservation of the Union and the emancipation of the slave are regarded as the chief fruits of the Civil War. It has not often been recognized that what at the time was a by-product of the struggle to achieve these ends became later itself a continuing means for the furtherance of social justice. One cannot grasp the significance of that turbulent period, either for that or the present generation, unless one understands the role which the federal income and inheritance taxes played in relation to the struggle against secession and slavery, and to the dramatic upsurge of American capitalism.

From 1789 to 1850 the United States had increased in population from almost 4 million to more than 23 million; in area from about 900,000 square miles to nearly 3 million square miles. The total of its exports and imports rose from about \$100 million to over \$243 million.¹ Yet, paradoxical as it seems, this almost unparalleled na-

¹ U.S. Census, *A Century of Population Growth* (Washington, 1909), 51-59, 145; National Industrial Conference Board, *Studies in Enterprise and Social Progress* (New York, 1939), 66, 79.

tional development within so brief a period of time brought with it an intensification of certain forces making for disunity as well as those making for unity. The social system of the United States was in a state of unstable equilibrium, with the balance of gravity so delicately poised that strong pressures from various quarters could unsettle it.

The Coming of the Civil War

The solidarity of the Union was threatened because the growth of national wealth and income was not shared equally by different sections of the country and because they did not have the same kind of social and economic system. By the middle of the nineteenth century, the northeastern states were developing into a predominantly mercantile and industrial capitalism. The southeastern states, although they had some experimental industrialists and a considerable number of merchants, had remained not only a predominantly agricultural section, but one which after the invention of the cotton gin in 1793 had rested its fortunes on a few staple products, especially cotton and tobacco. Differences between these two sections, however, were not only economic; they involved a whole way of life. The Northeast was evolving a civilization centered in part around the city and the factory, the capitalist and the "free" wage earner, and in part on the "free-soil" farmer, who resented and hated slavery and the slaveowner on moral, religious, and economic grounds. This was intensified when the "free-soil" farmer came into competition and conflict with the planting aristocracy over the rich soil of the trans-Mississippi West.²

These differences did not make a conflict inevitable. With wisdom and a consciousness of the costs of intransigence, individuals may create out of differences a basis for harmonious co-operation and mutual enrichment. The march of events, however, was to reveal an oscillation between compromise of differences, as in 1820 and 1850, and rigid insistence on the supremacy of sectional and class interests. The southern planting aristocracy was accustomed to political power, social prestige, and economic affluence. It used the victories it helped to win in the presidential elections of 1852 and 1856 to consolidate its strength and to make vigorous thrusts for an aggrandizement of power. Thus the Kansas-Nebraska Act of 1854 undid the Missouri Compromise and

² On the background of the Civil War, see Charles A. and Mary R. Beard, *The Rise of American Civilization* (2 v., New York, 1930), 2: 3-51; Arthur C. Cole, *The Irrepressible Conflict, 1850-1865* (New York, 1934); L. M. Hacker, *Triumph of American Capitalism* (New York, 1940); James G. Randall, *The Civil War and Reconstruction* (Boston, 1937), 3ff.

made the West, north and south of the 36' 30" line, a battleground between free soilers and champions of slavery. The Ostend Manifesto of 1854 expressed the imperialistic ambitions of many southerners. The Dred Scott Decision in 1857 revealed the Supreme Court as a champion of the South against Congressional control of slavery in the territories of the United States. The tariff was reduced in 1857 by about 25 per cent more than the 1846 rates; the free list was extended; and a considerable step was taken toward free trade. This measure enabled the planters and farmers to import manufactured goods from England at a lower cost than if they were forced to buy exclusively from northern manufacturers, and thereby aided the planters in increasing their profits. Subsidies for transatlantic steamship companies were discontinued in 1859, another blow to northern capitalist entrepreneurs. A homestead bill intended to aid the needy farmer and mechanic was vetoed by President Buchanan in 1860 because he feared it might demoralize the people and introduce pernicious social theories.

This series of developments favoring the ruling class in the South produced a series of reactions on the part of northern capitalists, workers, and farmers which equaled in intensity and matched in strength of purpose all that the South had done and was willing to do. After 1831 abolitionists like J. G. Birney and William Lloyd Garrison launched a moral crusade against the institution of slavery. The Liberty party and the Free Soil party in the eighteen-forties and early eighteenth-fifties represented the first articulate political opposition to slavery and its extension to the territories. The slogans of 1848—Free Soil to a Free People; Free Soil, Free Speech, Free Labor, and Free Men—eventually became the partial basis for the movements leading to the establishment of the Republican party in 1854 and the Republican campaign in 1856. The antislavery issue, however, was not sufficiently strong to assure victory in national elections. The Republican party had a mixed ancestry of Whigs representing the aspiring capitalists and of Democrats tired of rule by southern planters and anxious to extend the welfare and power of the free farming and wage-earning classes.

Defeated in 1856 by the Democrats, the Republicans took heart from the strong showing their candidate, Frémont, had made. Hence they were inspired in 1860 to frame a platform which would make an appeal to as many as possible of the different groups disgruntled with the policies and procedures of the southern ruling class. They were astute in choosing a candidate like Abraham Lincoln with his appeal to the common man in the West and the East. Their offering

to the farmers of pledges of no slavery and free homesteads in the territories, on the one hand, and to the capitalists a protective tariff and a Pacific railway, on the other, helped to pave the way to victory. Their success was further assured by the split within the Democratic party. The northern Democrats supported Stephen A. Douglas with his principle of squatter sovereignty, and the southern Democrats supported John C. Breckinridge, because he upheld the principle of federal protection for slavery in the territories. This division within the Democratic party aided Lincoln in winning a plurality of the popular votes and becoming President of the United States in 1861.

President of the United States in name, but not in the reality which the southern extremists created from the spring of 1861 to that of 1865. Compromises, proposed by Senator Crittenden and others, failed to bridge the gap between those desirous of dominance or secession and the Republicans who would not yield to any concession on slavery in the territories or on new slave states. The consequence was that on December 20, 1860, South Carolina, led by Robert Barnwell Rhett, started the procession of states seceding from the Union; by February 1, 1861, six other states of the Lower South had left the Union. Lincoln's conciliatory but firm inaugural address of March 4 failed to halt the movement toward disunion. The final severance between the North and the South developed after the Confederates had opened fire on Fort Sumter on April 12 and Lincoln had called out 75,000 militia on April 15.

Those two events swung Virginia and three other upper southern states to the side of the Confederacy by May 20. War, civil war, with all its terrible loss of life, happiness, and property, had become an actuality. The immensity of the struggle, the dramatic military and naval actions, the heroism of some and the cowardice of others, the tragedy of death and destruction, the now legendary and gigantic figures of Lincoln, Grant, Sherman, Robert E. Lee, Jefferson Davis, and their associates should not make one forget that "money is the sinews of war." The undramatic legislation on taxes and finance and the prosaic mechanism of production and distribution in the North and the South played a critically important role in the victory of the North and the defeat of the South.

The national wealth in 1860 was estimated at more than \$16 billion; the national income exceeded \$4 billion; the total population was above 31 million. But almost 11 out of the \$16 billion was credited to the states that remained in the Union; two thirds of the na-

tional income also went to northerners; and two thirds of the total population was in the North. The North also had the advantage of possessing the main share of the manufacturing industries in the country, of owning a billion acres of unoccupied public land north and west of the slave region, and of having the principal gold-producing regions in the West.⁸

Against these advantages of the nineteen Union states, eleven states forming the newly created Confederate States of America could count in their favor certain factors which they deemed would give them superiority in conflict. The leaders of southern secession felt their control over cotton, rice, tobacco, and naval stores would enable them to throw the northern manufacturing states into a disastrous economic crisis, and would force Great Britain and France not only to recognize their independence but also to give them aid. These engineers of disunion also projected a plan for gaining control of the Mississippi Valley and cutting off the Northeast from needed food reserves and man power. They knew of the internal conflict within the North on the question of using force to keep the South in the Union and relied on what today would be called the appeasers either to prevent the use of force against the South, or at least to prevent its being used effectively. Their hopes in this regard and their contempt for northerners as soldiers misled them so that in the end they were "hoist by their own petard."

Union War Finance

In the beginning of this four-year agony the financial situation of the federal government was so precarious as to give some warrant to the expectations of the southern extremists. The panic of 1857, the consequent sharp drop in national income, increase in current appropriations, and failure to tap new tax resources resulted in a series of Treasury deficits from 1858 on which totaled some \$50 million by the end of the fiscal year 1860. Lincoln's election in November gave a severe shock to public and private credit: southern banks promptly withdrew large deposit funds from northern banks; loans were contracted; and in a few weeks a state of panic existed. Although this ended in January, 1861, when John A. Dix succeeded Howell Cobb as Secretary of the Treasury, and vigorous loan and tariff measures

⁸ *Preliminary Report on Eighth Census*, 59ff.; Robert R. Doane, *The Measurement of American Wealth* (New York, 1933), 10-11; Conference Board, *Studies in Enterprise and Social Progress*, 66, 79.

were adopted in February and early March, Lincoln and his cabinet discovered on March 4, 1861, that the Treasury was almost empty, the various departments disorganized, customs receipts at a standstill, the debt growing, and government credit ebbing away. The public debt with which Lincoln's Secretary of the Treasury had to deal was some \$75 million, of which about \$18 million had been incurred since the start of the secessionist movement. Only about \$1,716,000 was available in the Treasury for the unprecedented financial demands which lay ahead. This financial barrier to vigorous national action was in striking contrast to the industrial development of the United States, which had continued at a constantly increasing rate despite the 1857 depression.⁴

The man chosen by Lincoln to handle the most difficult financial problems since Hamilton's day was Salmon Portland Chase. He was appointed on March 6, 1861; he objected at first to giving up the safety and security of his position as Senator from Ohio, but finally yielded, as he put it, "to take charge of the finances of the country under circumstances most unpropitious and forbidding." His reputation had been won as an outstanding lawyer in Ohio who had become the "attorney-general for runaway Negroes." Active in politics, first as a Whig, then as a member of the Liberty and Free Soil parties, and finally as a Republican, he had won a great reputation in the governorship of Ohio and later in the Senate. Although he failed to gain many votes in the Republican conventions of 1856 and 1860, the votes his friends threw to Lincoln at Chicago early in the sessions won Lincoln's favor, and resulted in the selection of Chase for the Treasury.⁵

Despite the eminent legal and political abilities of Chase, his experience in public finance had been limited, and his previous political career had never required thorough consideration of the problems of the Treasury. His appointment can be explained by the tradition which

⁴ Davis R. Dewey, *Financial History of the United States*, 262-330; W. J. Shultz and M. R. Caine, *Financial Development of the United States*, 259-332, give the best brief treatments of Civil War finance. Albert S. Bolles, *The Financial History of the United States from 1861 to 1885* (New York, 1886) is a standard full-length monograph which needs critical reinterpretation in the light of recent advances in public finance.

⁵ No adequate biography of Chase has been written so far. The best brief studies are by J. G. Randall in the *Dictionary of American Biography*, 4: 27-34; and Albert B. Hart, *S. P. Chase* (Boston, 1899). The standard full-length biographies are by J. W. Schuckers (1874) and Robert B. Warden (1874). Ellis P. Oberholtzer's *Jay Cooke, Financier of the Civil War* (2 v., Philadelphia, 1907) is also indispensable.

made political leadership the prime consideration in the selection of a Secretary of the Treasury, and by the failure of Lincoln and his advisers, military as well as civil, to anticipate how long the war was going to last and what unprecedented burdens were to be put upon the Treasury. In addition to his lack of expertness, Chase was hampered by a consuming ambition to attain the presidency and a feeling that he better than anyone else knew how to save the Union. He therefore devoted far more attention for the first nine months of his secretaryship to the military problems of the North than to his financial problems. He relied for aid in framing his financial policies on Jay Cooke, with whom he was in agreement on the advisability of depending on loans rather than on taxes to meet the extraordinary expenses entailed by the war.

Until Congress convened on July 4, 1861, in response to the summons issued by Lincoln on April 15, Chase tried to meet the military expenditures by selling government bonds and by issuing Treasury notes. He raised almost \$7½ million in bond sales and over \$7½ million in Treasury notes by July 4, 1861. In his report of July 5 Chase estimated that the sum needed for the coming year would be about \$320 million and proposed that \$240 million should be raised by loans and \$80 million by taxation. The existing tariff, the Morrill Act of March 2, 1861, would, he thought, yield about \$30 million out of the \$80 million to be secured by taxes. He expected to obtain 30 out of the other 50 millions through increases in the tariff and from sales of public lands. The remaining \$20,000,000 he proposed to raise "by direct taxes or from internal duties or excises or both." He even hoped that this taxation would not have to be imposed beyond the current year.⁶

His policy was entirely inadequate. Neither Chase nor his associates realized that bold financial measures were needed and that funds had to be supplied for a long civil war. Hence, as has already been pointed out, the chief reliance was placed upon loans, and taxation was employed in a very moderate and cautious manner. A William Pitt in a similar situation would have shown the imagination needed to propose so radical a measure as an income tax. Chase could think only of taxing in the last extremity through such devices as capitation taxes, taxes on real estate, and general taxes on personal property. These fell into the constitutional category of direct taxes; the income tax at that time was not so classed.

⁶ *Senate Ex. and Misc. Doc. No. 2, 37th Cong., 1st Sess., 1861, 1ff.*

Loans and New Internal Revenue Measures

Congress accepted Chase's suggestions concerning loans and passed the loan acts of July 17 and August 5, 1861, empowering the Secretary to borrow \$250 million in three-year, 7.3 per cent Treasury notes, or in twenty-year bonds not exceeding 7 per cent. In regard to taxation, the House Committee on Ways and Means prepared two bills, one imposing duties on tea, coffee, and sugar. The other was an internal revenue measure which levied license taxes and taxes on whisky, beer, porter, carriages, promissory notes, and bank bills. The duties on tea, coffee, and sugar were severely criticized in the lower house because they fell to a large extent upon the poorer classes. It seemed that these rates would be drastically cut; therefore the Committee announced that it would bring in a bill for direct taxation. On July 23, two days after the disastrous battle of Bull Run, a separate measure was introduced providing for a direct tax of \$30 million apportioned alike upon the loyal and the seceded states, about \$20 million falling on the former.

The plea by Thaddeus Stevens, the dictatorial chairman of the Committee, that passage of this bill, disagreeable as it might be, was necessary since "the annihilation of this government is the alternative," did not overcome all the objections. Schuyler Colfax, of Indiana, who became Vice-President of the United States in 1869, protested: "The most odious tax of all we can levy is going to be the tax upon the land of the country." In reply to the plea of urgent necessity he declared that he could not vote for a bill "that would allow a man, a millionaire, who has put his entire property into stock, to be exempt from taxation, while a farmer who lives by his side must pay a tax." Other powerful objections were made by Congressmen who feared that the greatest burden would be laid upon the West and Southwest as against the Northeast. Another factor in the opposition may have been the fear that the voters would be prejudiced against the re-election of Congressmen voting for the direct tax.

Colfax proposed that the direct tax clause be stricken out and that provision be made for a tax on stocks, bonds, mortgages, money, and interest, as well as for an income tax. He was strongly supported by F. A. Pike, of Maine, who praised an income tax upon real and personal property as far more just than the direct tax on land alone. The bill was recommitted, with instructions for amending it with a tax on "real and personal estate." But the next day the Committee on Ways and Means reported its inability to carry out the instructions of the

House in a constitutional manner. After further debate the direct tax bill was again recommitted with instructions to reduce the amount to be raised by direct taxes to \$20,000,000 and to raise such other sums as might be deemed necessary "by internal duties or direct taxation upon personal income or wealth."

On July 29 K. S. Bingham of Michigan had already argued that Congress could not constitutionally, by the direct tax section of the bill, reach incomes, but that it would be possible through the section dealing with duties or excises. Thomas M. Edwards, a New Hampshire banker, asserted the power of Congress to tax all the property of the country and wanted to know what difference it made to the House whether the tax was called direct or not. "Why should we stickle about terms? Why should we not impose the burdens which are to fall upon the people of this country equally, in proportion to their ability to bear them?" Charles A. Wickliffe of Kentucky proposed an amendment to the bill which would include a tax on personal property. After some discussion, his amendment was adopted by an overwhelming majority. On July 29, when the Committee reported the bill again, it had diminished the direct tax by one third and had included a tax of 3 per cent on all incomes over \$600 a year.⁷

The First Federal Income Tax

Justin S. Morrill, chairman of the Subcommittee on Taxation, introduced the revised measure. He was known as a founder of the Republican party in Vermont, a temperate abolitionist, a vigorous champion of the protective tariff, sound finance, and economy. His fame in later years was perpetuated by his authorship of the Land Grant Act and by his fierce attacks on the Greenbacks and Free Silver doctrines.⁸ In the early years of the Civil War he had little opportunity to exhibit his practical good sense on matters of revenue, and his intense protectionist sympathies hampered him in the framing of tax bills requiring large revenue. He believed the changes in the bill shifted the tax burden so that the landowners of the interior and western states would carry the lightest load. He stated that the income tax was to be distinguished from the direct or land tax and pointed out that per-

⁷ For a detailed treatment of the Congressional debate on the direct tax, see C. F. Dunbar, "The Direct Tax in 1861," *Quarterly Journal of Economics*, 3:444-451; Frederic C. Howe, *Taxation and Taxes in the United States under the Internal Revenue System 1791-1895* (New York, 1896), 50-89; Harry Edwin Smith, *The United States Federal Internal Tax History from 1861 to 1871* (Boston, 1914), 14-44.

⁸ Cf. George W. Atherton, *The Legislative Career of Justin S. Morrill* (circa 1900); and William B. Parker, *Justin Smith Morrill* (Boston, 1924).

sonal property could not be constitutionally reached by the methods of the direct tax. "The indirect or income tax which is to be raised by this bill will be, in my judgment, at least twice as much as what we shall raise by direct taxation." Without any other important changes, the bill as reported by the Committee was passed by the House on July 29 by a vote of 77 to 60.⁹

In the meantime an income tax had also been proposed in the Senate in connection with the tariff bill which had passed the House on July 18. Senator James F. Simmons, a Rhode Island manufacturer, when introducing the tariff bill on July 25, stated that the new import duties had better be supplemented by an income tax than by a direct tax.¹⁰

Let us tax property in the last resort, when we have to reach the poor as well as the rich, people of small means as well as those who have large; but I do not believe this country has come to a pass to be driven to a resource of extreme measures. I think, with what we can collect by a moderate duty on importations and a moderate tax on incomes exceeding one thousand dollars, we can meet all the exigencies of the public service, loaded down as it will be by this wicked rebellion!

Senator William Pitt Fessenden of Maine was one of the founders of the Republican party, a champion of the manufacturing, fishing, and shipping interests of his state, and destined to succeed Chase as Secretary of the Treasury in July, 1864;¹¹ nevertheless, he declared: "I am inclined very much to favor the idea of a tax upon incomes for the reason that, taking both measures together, I believe the burdens will be more equalized on all classes of the community, more especially on those who are able to bear them."¹²

On July 29 the Senate adopted Senator Simmons's amendment for a tax of 5 per cent on incomes over \$1,000 for persons residing in the United States, and a tax of 7.5 per cent on incomes derived from property owned in the United States by any citizen of the United States residing abroad. That portion of any person's income which was derived from the interest on the securities of the United States was, however, to be taxed only 2.5 per cent.¹³ The Conference Committee of the two houses reported back one bill which included all the

⁹ *Cong. Globe*, 37th Cong., 1st Sess., 1861, 330-31.

¹⁰ *Cong. Globe*, 37th Cong., 1st Sess., 1861, 254.

¹¹ Francis Fessenden, *William Pitt Fessenden* (2 v., 1907) is filiopietistic, but the only detailed biography. Cf. W. A. Robinson's brief sketch in the *Dictionary of American Biography*, 6: 348-50.

¹² *Cong. Globe*, *ibid.*, 255.

¹³ *Ibid.*, 314.

changes made in the tariff rates, the direct tax, and the income tax. The rate on incomes recommended by the Committee was 3 per cent on all incomes exceeding \$800, which was raised to 5 per cent on income derived from property owned by American citizens residing abroad, except for income derived from United States securities, the rate for which was 1.5 per cent. The tax was to be levied on the income for the year ending December 31, 1861, and was to be paid on or before June 30, 1862. The intention of Congress was to tax net, not gross income, but the law delegated to the Secretary of the Treasury the power to prescribe what should be assessed and what should be deducted.¹⁴

The adoption of an income tax in 1861 arose from the opposition to the scheme for a tax only on real estate. This does not mean that an income tax might not have been adopted later, even if the Constitution had not required the apportionment of direct taxes on the basis of population. But this restriction proved to be such a serious objection to imposing a federal tax on real estate and other real property that the income tax was resorted to as the only way of levying a just tax on the wealth or financial resources of each citizen. Moreover, everyone within and outside Congress agreed that a direct tax in the constitutional sense denoted only a tax on real estate and slaves or a poll tax; the income tax was universally classified as an indirect tax. Both houses of Congress refused to insert into the direct tax law any provision taxing personal property.¹⁵

Public opinion was on the whole favorable to the adoption of the income tax. As early as June 6, 1861, the *New York Times* had praised the English revenue system and had proposed a very slight tax upon incomes. The *New York Tribune* on July 17 declared: "We do not strenuously object to direct taxes, though we prefer to raise money by Excise rather than by an indiscriminate Income or Property Tax." Less inclined to taxes on the masses than the *Tribune*, the *New York Herald* was pleased to state on August 5: "Millionaires like Mr. W. B. Astor, Commodore Vanderbilt . . . and others, will henceforth contribute a fair proportion of their wealth to the support of the national government."¹⁶ The *London Times*, however, made

¹⁴ Act of August 5, 1861, 12 *U.S. Stat. at Large*, 309.

¹⁵ For varying treatments of the Civil War income taxes, see Joseph A. Hill, "The Civil War Income Tax," *Quarterly Journal of Economics* (July, 1894), 8: 416-52; F. C. Howe, *op. cit.*, 90-102; E. R. A. Seligman, *The Income Tax*, 430-81.

¹⁶ Elmer Ellis, "Public Opinion and the Income Tax, 1860-1900," *Mississippi Valley Historical Review* (September, 1940), 27: 225-42, is an excellent survey, and has furnished the author with many valuable references and leads.

a devastating criticism of the North's policy of meeting the current expenses of the year and the interest on the war debt "not by a sweeping income tax, but by heavy customs duties, aided by 'light direct taxation.'" Its conclusion on the American temperament was that "the Yankees are . . . not only capable of going to war for an idea, and that a sufficiently impracticable one, but of stinting themselves and charging their posterity for the gratification of their martial ardor."¹⁷ By January 8, 1862, however, the *New York Times* was able to assert that the income tax was "one of the most equitable and bearable taxes that can be proposed."

The Act of 1861 committed the country to the policy of taxing incomes; actually no income tax was assessed under that law. Although the tax was to be levied on the income of 1861 and paid on or before June 30, 1862, this legislation was regarded as essentially provisional and Secretary Chase took no steps toward the collection of the tax. Since Congress was to meet again in December, 1861, it was expected that it would be reconsidered and perhaps modified. Secretary Chase in his annual report to Congress in December commended the "prudent forecast which induced Congress to postpone for another year the necessity of taking steps for the practical enforcement of the law," thus affording "happily the opportunity of revision and modification." He expressed doubt as to the advisability of enforcing the income tax at all. Unlike Secretary Dallas, who dared as far back as 1815 to suggest an income tax to meet the War of 1812 expenditures, Chase seized every excuse to avoid use of the income tax. He cited the lack of statistics for estimating the probable yield from the income tax and stressed the large number of incomes exempted from taxation by the provision taxing incomes above \$800 a year. He favored increasing the direct tax so that \$20 million would be secured from the loyal states and urged putting excise duties on stills, liquors, tobacco, bank notes, carriages, legacies, deeds, and conveyances. Fearful of heavy taxation, he apologized for asking Congress to raise \$50 million in internal taxes: "The Secretary is aware that the sum is large; but . . . feels that he must not shrink from a plain statement of the actual necessities of the situation."¹⁸

The Pressure for Heavier Taxation

Chase revealed in his report of December 9 no adequate grasp of the serious financial situation, which the vigorous Confederate military

¹⁷ Cited by the *New York Times*, August 2, 1861.

¹⁸ *Treasury Report* (1861), 14-15.

attacks and the dispute with Great Britain over the Trent affair were making still graver. Three weeks after his modest request for revenue, the banks throughout the country, led by those in New York City, suspended specie payment, and were soon followed by the government. This sudden and critical shock to private and public credit made the leaders of Congress realize the immediate urgency of raising additional revenues. On January 21, 1862, Congress passed a resolution: "That, in order to pay the ordinary expenses of the Government, the interest on the national loans, and have an ample sinking fund for the ultimate liquidation of all public debts, a tax shall be imposed which shall, with the tariff on imports, secure an annual revenue of not less than one hundred and fifty million dollars."¹⁹

Congress received many memorials from individuals and private organizations asking that provision be made for securing larger revenues. The New York State Chamber of Commerce proposed that the revenue system be reorganized to produce at least \$264 million annually. The American Geographical and Statistical Society of New York asked Congress to raise \$268 million by internal taxes alone, \$20 million of which was to come from income taxes. These and other petitions indicated that many northern businessmen as well as farmers, workers, and professional people felt that the defense of the Union required heavier taxation, which they were willing to bear.²⁰

In response to the pressure of events and of these petitions, the House Ways and Means Committee produced a revenue measure which they presented to the House on March 3, 1862. The bill provided for taxes which were expected to yield about \$164 million annually, more than three times as much as Secretary Chase had asked for. The internal taxes were supposed to produce nearly \$114 million, more than twice Chase's request. The bill also included an income tax, but it was not an important item, as its yield was estimated at only \$5 million. Revenue of almost \$1 million was expected from a tax placed on all inheritances of personal property exceeding \$1,000 value.

Justin S. Morrill, in introducing this bill, stated: "The rebellion must be so ended that the principal performance can never reappear in a secession tragedy . . . but unfortunately internal duties and taxes must reappear . . . a generation must be annually taxed for this parricidal attempt to destroy the Government of our fathers." He explained the guiding principle of the internal revenue measure as the

¹⁹ 12 *U.S. Stat. at Large*, 612.

²⁰ Smith, *op. cit.*, 50-51; *Bankers' Magazine* (March, June, 1862), 16: 727, 913-16.

imposition of moderate duties upon a large number of objects rather than heavy duties upon a few. He called the income duty "one, perhaps, of the least defensible that, on the whole, the Committee of Ways and Means concluded to retain or report." His objection to it was that nearly all persons would have been already once taxed upon the sources from which their income has been derived. In his eyes the income tax was an inquisitorial one at best, but upon looking at the considerable class of state officers, and at many thousands who were employed at a fixed salary, most of whom would not contribute a penny unless called upon through this tax, the Committee thought it best not to wholly abandon it. "Ought not men, too, with large incomes to pay more in proportion to what they have than those with limited means, who live by the work of their own hands or that of their families?"²¹ He made no mention of the legacy tax, however.

The income tax portion of the bill aroused little discussion either inside Congress or among the general public. No one suggested that the provision be stricken out. On April 3 Robert McKnight of Pittsburgh, Pennsylvania, proposed an amendment to exempt from taxation income from real estate, which was exposed to the direct tax. Leary, a Baltimore lawyer, suggested an exemption for interest from securities of the United States in order to encourage future investments in them. Both amendments failed to win support. Owen Lovejoy of Illinois presented an amendment to define the word "income" as "net income," but this was also voted down.²²

The inheritance tax provision received little alteration. It was based on the suggestion in Chase's report of December 9, 1861, of a legacy and succession duty on the English model to apply to direct as well as collateral heirs, and to be graduated from .75 per cent on the direct heirs to 5 per cent on unrelated beneficiaries. John Armour Bingham of Ohio, later famous for his role in framing the due process clause of the Fourteenth Amendment, saw no reason for applying different rates to different persons and moved unsuccessfully to amend the provision by making a uniform rate of 3.5 per cent. William Paine Sheffield of Rhode Island also failed to win support for his proposal to exempt religious, charitable, and literary institutions from the tax. The one important change was made by Justin S. Morrill, who had the tax on legacies to "husband or wife" stricken out.²³

On April 8, 1862, Thaddeus Stevens, the fiery abolitionist, relent-

²¹ *Cong. Globe*, 37th Cong., 2d Sess., 1861-62, 1040, 1194-97.

²² *Ibid.*, 1530-32, 1576.

²³ *Cong. Globe*, 37th Cong., 2d. Sess., 1040, 1194-97, 1533-34.

less foe of the secessionists, and war leader of the House,²⁴ spoke in his capacity as chairman of the Ways and Means Committee. He said that if this important bill should become a law, "it will undoubtedly be a subject of comment among well-meaning people and be used as an engine of mischief by unprincipled men, who prefer the possession of power to the prosperity of their country." In conclusion he remarked:²⁵

I cannot foresee the course of the Government in dealing with this rebellion. If they should use the legitimate means in their power, I have no doubt that in ninety days the rebels might be so crippled that our army could safely be reduced to one hundred thousand men, and five sixths of the present expenses be saved. In that case I feel no hesitancy in predicting that not another dollar of taxes need ever be imposed on the people to defray our whole debt. If the Government should further determine, in accordance with the practice of nations, the dictates of wisdom and of justice, to make the property of the rebels pay the expenses of the war which they have so wantonly caused, this tax need never be collected beyond the second year.

But if the Administration should deem it wise to prolong the war, and suffer the loyal citizens to be oppressed, to show mercy to traitors, the people must expect further and heavier burdens. In selecting the objects of taxation, the committee have found it necessary to visit many articles which they would have gladly spared. They have, however, laid no burdens on those who have but small means. They have exempted property and business below the value of \$600, so that the poor man's tenement shall not be disturbed by the tax gatherer. For the same reason they have laid no poll tax. They have, no doubt, notwithstanding their best efforts, failed to equalize the burden to the extent which they desired. They have attempted to raise the largest sums from articles of luxury, and from the large profits of wealthy men. But even on these articles the tax is light compared with that of other countries. . . .

The income tax has been found very difficult to adjust so as to escape double taxation. But the committee thought it would be manifestly unjust to allow the large money operators and wealthy merchants, whose incomes might reach hundreds of thousands of dollars, to escape from their due proportion of the burden. They hope they have succeeded in excluding from this tax the articles and subjects of gain and profit which are taxed in another form.

The House did not require more urging. It had in mind Grant's victory the day before at Shiloh, the fight between the *Merrimac* and

²⁴ Cf. Alphonse B. Miller, *Thaddeus Stevens* (New York, 1939); J. A. Woodburn, *The Life of Thaddeus Stevens* (Indianapolis, 1913) and T. F. Woodley, *Thaddeus Stevens* (Harrisburg, 1934).

²⁵ *Cong. Globe*, 37th Cong., 2d Sess., 1576-77.

the *Monitor* the month before, Jefferson Davis's formal inauguration as President of the Confederate States of America on February 22, and Grant's earlier victories at Fort Henry and Fort Donelson in January. On February 25 Congress's Legal Tender Act had gone into effect, authorizing \$150 million of greenbacks as lawful money for all debts, public and private, except the tariff on goods entering the country and the government's interest on its own debt. Five hundred million dollars of bonds (familarly known as five-twenties, redeemable after five years and payable in twenty years), bearing 6 per cent interest, were to be issued for sale at market value for coin or Treasury notes; \$25 million of certificates of deposit bearing 5 per cent interest, in exchange for United States notes left on deposit not less than thirty days, and payable after ten days' notice, were also to be issued. A sinking fund was to be created.²⁶ Against such bold financial measures the internal revenue bill lost whatever radical appearance it might once have had. It passed the House easily, and was sent to the Senate, where Fessenden introduced it on April 10.²⁷

The House bill placed a tax of 3 per cent on all incomes over \$600 and also provided for a direct tax. The Senate Finance Committee left the income tax provision unchanged, but Fessenden reported on May 26 that only he favored the direct tax. During the debate the Senate voted to strike out the direct tax. Fessenden then proposed on June 2 that the rates on income be raised and made progressive. He suggested a 3 per cent tax on incomes over \$600 and under \$10,000; a tax of 5 per cent on incomes from \$10,000 to \$50,000; and one of 7.5 per cent on incomes over \$50,000. Incomes under \$600 were to be exempted. Senator Timothy Otis Howe of Wisconsin, an able lawyer, judge, and Radical Republican, was not able to carry through his objection to the lower rate on government bonds and his proposal for an amendment for an income tax to yield at least \$50 million. The Senate adopted Fessenden's amendment in order to make up the revenue lost through the proposed elimination of the direct tax. The principle of progression was not adopted for its own sake but as a by-product of the increase in the rates. Since a tax of 7.5 per cent on all income above \$600 would have been regarded as an excessive and unjust burden on the small incomes, the Senate was forced to apply higher rates to the higher incomes.²⁸

Approaching the income tax in social significance, but not in revenue

²⁶ D. R. Dewey, *Financial History*, 284ff.

²⁷ *Cong. Globe*, 37th Cong., 2d Sess., 1603.

²⁸ *Ibid.*, 2350, 2449, 2486, 2574.

yield or historical impact, was the inheritance tax. The first actual precedent for later federal legislation along this line was the tax imposed on inheritances of personal property in excess of \$1,000 value which the House and Senate passed in 1862 with amazingly little debate and only minor changes from the original committee bill. The rates provided by these sections of the Revenue Act were graduated so that brothers and sisters and those in the direct line paid .75 per cent; nephews and nieces, 1.5 per cent; uncles, aunts, and their descendants, 3 per cent; great-uncles, aunts, and their descendants, 4 per cent; and all other beneficiaries, 5 per cent.²⁹ After enactment of the internal revenue bill on July 1, 1862, the Treasury ruled that transfers of personal property intended to take effect after the death of the grantor were subject to the tax.³⁰

The disagreements between the House and Senate on the retention of the direct tax and the introduction of progressive rates in income taxation were ironed out by the Committee of Conference through a number of compromises. The direct tax was kept, but its operation was suspended for two years. This suspension proved to be a prelude to complete repeal of the direct tax in 1864. The progressive principle introduced by Senator Fessenden in the taxation of incomes was kept, but the House conferees reduced some of the rates. They succeeded in striking out the provisions imposing a tax of 7.5 per cent on income over \$50,000 and in leaving only the two grades: a 3 per cent tax on incomes from \$600 to \$10,000, and a 5 per cent tax on incomes above \$10,000. The House and Senate supported these changes by sweeping majorities.³¹

The Internal Revenue Act of July 1, 1862

On July 1, 1862, Lincoln signed the second internal revenue measure to be in force since 1817. It was a momentous legislative act in its consequences, approaching in importance such legislation as that of April 16 abolishing compensation slavery in the District of Columbia, that of May 20 giving homesteads of 160 acres to each loyal citizen desirous of having his own farm, and that of June 19 abolishing slavery in the territories.

It was the first income tax measure³² ever put into operation by

²⁹ Act of July 1, 1862, 12 *U.S. Stat. at Large*, 485-86; Smith, *op. cit.*, 98-99.

³⁰ W. J. Shultz, *Taxation of Inheritance*, 151.

³¹ *Cong. Globe*, 37th Cong., 2d Sess., 2890-91; Act of July 1, 1862, 12 *U.S. Stat. at Large*, 474.

³² Act of July 1, 1862, 12 *U.S. Stat. at Large*, 432.

the federal government. Moreover, the seemingly radical principle of progressive taxation—increasingly higher rates on the higher incomes—was adopted and applied, even if in a very moderate manner. A duty of 3 per cent was levied on “the annual gains, profits, or income of every person residing in the United States, whether derived from any kind of property, rents, interest, dividends, salaries, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever,” when the income was not in excess of \$10,000. On incomes over \$10,000 the rate was 5 per cent; an exemption of \$600 was allowed in all cases. This provision saved those living on a bare subsistence income from any tax and relieved the more fortunate from a tax on the minimum sum necessary for living.⁸³

American citizens residing abroad, not employed by the government, had to pay 5 per cent on all incomes derived from the United States. But income from the securities of the United States government was taxed only 1.5 per cent, in order to encourage their sale at that critical period in our national history.

In estimating the annual income subject to this duty, taxpayers were allowed deductions for “all other national, state, and local taxes” upon their property or other sources of income paid during the year and for all incomes taxable under other sections of the same law.⁸⁴ This prevented double taxation. The tax was to be paid on or before June 30, 1863, and every year thereafter until 1866. The delay in drafting and in putting the income tax into operation at a time when the national net debt was \$505,312,752 indicates how slow even the bolder financial leaders of Congress were in grasping the need for immediate heavy taxation. “Too little and too late” taxation measures created the financial difficulties with which the Lincoln administration was plagued for four long years.

A notable innovation introduced by the Act of July 1, 1862, was

⁸³ On the significance of this point see Paul J. Strayer, *The Taxation of Small Incomes* (New York, 1939), 21ff.

⁸⁴ A badly drawn provision in Section 91 stated that “all gains, profits or income . . . derived from any articles manufactured, upon which specific, stamp, or ad valorem duties shall have been directly assessed or paid, shall also be deducted.” This, if strictly interpreted, would have completely exempted all business incomes, most of which were derived from transactions in manufactured articles. No one seems to have tried to profit from this maladroit sentence, and the next year the words “or any other articles manufactured” were eliminated from the law. Cf. Act of March 3, 1863, 12 *U.S. Stat. at Large*, 718. The same amendatory act provided that the amount actually paid by any person for the rent of the dwelling house or estate in which he resided should be deducted from his income.

the principle of "tapping revenue at the source," which had been used by the British government since 1803.³⁵ The 3 per cent tax on salaries in excess of \$600 received by all persons in civil, military, and naval services of the United States in effect on and after August 1, 1862, was to be withheld by all paymasters and other disbursing officers of the government at the time of paying salaries. The failure of the government to increase the tax rate on its employees when the salary exceeded \$10,000 worked little injustice because very few government salaries during the Civil War exceeded this amount. As a matter of fact, after the depreciation of the greenbacks, government employees felt the burden of this tax more, perhaps, than most other people, because of the rise in the cost of living and the failure of Congress to make proportionate increases in salaries. Men, therefore, resigned their positions in Washington to accept places with private employers.³⁶

The deduction at the source principle was also applied to all railroads, which were required to withhold and to pay over to the government as a tax 3 per cent upon all interest or coupons on bonds, or dividends on stocks, whenever the interest, coupons, or dividends were payable after July 1, 1862; to all banks, trust companies, and savings institutions, and to all fire, marine, life, inland, stock, and mutual insurance companies, which were required to pay after July 1, 1862, 3 per cent on all dividends declared and paid, and on all sums added to their surplus or contingent funds.³⁷ Congress made no provision for exemptions of any kind in these taxes paid by corporations, since the tax was to be assessed in a lump sum on all money paid out as interest or dividends. No higher rate was provided for in cases where the amount paid to any person was above \$10,000. However, George S. Boutwell, the first Commissioner of Internal Revenue, ruled on May 1, 1863, that in all cases where an income exceeded \$10,000, and a deduction had been made therefrom on the ground that a portion of such income had been subject to the 3 per cent duty upon dividends or interest paid by a company or corporation, a tax of 2 per cent should be assessed on the part of the income on which 3 per cent had already been paid.³⁸

³⁵ Harrison B. Spaulding, *The Income Tax in Great Britain and the United States* (London, 1927), 229-37.

³⁶ Wesley C. Mitchell, *A History of the Greenbacks* (Chicago, 1903), 333ff.; H. E. Smith, *op. cit.*, 53ff.; Act of July 1, 1862, 12 *U.S. Stat. at Large*, 472.

³⁷ 12 *U.S. Stat. at Large*, 469-70.

³⁸ George S. Boutwell, *A Manual of the Direct and Excise Tax System of the United States* (Boston, 1863), 197; Smith, *op. cit.*, 55ff.

The tax on individuals was imposed through each person making a return of his income on a list or schedule provided by the proper internal revenue officer; in case of neglect or refusal to return such a list, the officer was to assess the income at his discretion. If the assessor or assistant assessor considered any return understated, he was permitted to increase the amount of the return; but the taxpayer might have the return reduced to its original amount by taking an oath that the statement was true. Anyone taking an oath that his income was under \$600 was to be exempt. The tax was to be a lien upon any property held by the recipient of the income, and, if not paid, the property could be taken and sold by the United States.³⁹

The income tax law was put into operation at the date scheduled in the act, but it took some time to create the mechanism necessary for this tremendous extension of the revenue system. George S. Boutwell of Massachusetts, who, as we have mentioned, was the first Commissioner of Internal Revenue, and who later was famous as a Radical Republican and as Secretary of the Treasury in Grant's administration, entered upon the duties of his office on July 17, 1862, and had nearly completed the organization of the office by the end of the year. He worked day and night in a small room in the Treasury building with three clerks borrowed from other departments. He drafted the basic rules, regulations, and blank forms and secured from Chase the authority to employ a cashier at \$1,200. This was raised later to \$1,600, but, as he later recalled, the cashier "collected and accounted for about thirty-seven million dollars [in six months] without any other security than his good name, and all for a compensation of about eight hundred dollars."⁴⁰

Boutwell had to hand down several important rulings before the tax could be properly levied.⁴¹ These illustrate the truth of the state-

³⁹ Act of July 1, 1862, 12 *U.S. Stat. at Large*, 474-75.

⁴⁰ George S. Boutwell, *Reminiscences of Sixty Years in Public Affairs* (New York, 1902), 1: 303. Boutwell resigned on March 4, 1863. His successors and the dates of their office during the operation of the income tax were: Joseph J. Lewis, March 18, 1863-June 30, 1865; William Orton, July 1, 1865-October 31, 1865; Edward A. Rollins, November 1, 1865-March 10, 1869; Columbus Delano, March 11, 1869-January 2, 1871; Alfred Pleasonton, January 3, 1871-August 8, 1871; John W. Douglass, August 9, 1871-May 14, 1875.

⁴¹ The most important rulings were: 1. The income tax was to be assessed upon the actual income of individuals, and firms, as such, were not to make returns. 2. Each member of a limited partnership, in which no dividends were paid until the partnership expired, was required to make a return on his share of the profits, on the basis of an estimated division of the profits. 3. Pensions received from the United States government were subject to the tax the same as other incomes. 4. Premiums paid for life insurance were not to be deducted from the returns of taxable income. 5. Gifts, such

ment that "the substantive law is secreted in the interstices of procedure" and that executive rulings, like judicial decisions, are often acts of legislation, concealed by the fiction that the three departments of our national government exercise completely distinct functions.⁴²

The inheritance tax, as we have noted above, was payable whenever the entire inheritance was in excess of \$1,000, without regard to the value of each share; there was no tax if the whole amount did not exceed \$1,000. No legatee was exempt from the tax except a husband or wife of the deceased. The administrator, executor, or trustee was required to make and render to the assistant assessor under oath a list of such property as he should handle and to pay the tax to the collector, before paying or distributing any part of the legacy to the legatees or inheritors. The tax was made a lien upon the property until fully paid, and the collector could require the production of any records, files, or papers which contained or were supposed to contain information with regard to the estate.⁴³

The 1862 Protective Tariff

Lincoln's call on July 1 for 300,000 additional troops was a harbinger of the increased demands the future held for the Treasury. The

as marriage fees, congregational donations to a pastor, etc., which were compensation for services rendered, were taxable. 6. Money spent in repairing old buildings, but not on permanent improvements, or on altering buildings so as to make them substantially new, could be deducted from the tax. 7. Money spent on restoring property used in business to the condition it was in before being destroyed by fire could be deducted from the profits, if uninsured; if insured, only the difference between the insurance received and the sum spent in restoration was allowed. 8. The interest from United States securities, when paid in gold, was taxed at 1.5 per cent if the gold was not subsequently sold at a premium; in the latter case the amount of profit realized was to be taxed the same as other business incomes. Cf. *U.S. Internal Revenue Decisions* (1871), 59, 60, 61, 77, 304-06; H. E. Smith, *op. cit.*, 56-58.

⁴² Morris R. Cohen, *Law and the Social Order* (New York, 1933), 112ff.

⁴³ 12 *U.S. Stat. at Large*, 486-87; G. S. Boutwell, *A Manual*, 200. Boutwell's most important rulings on the legacy tax were: 1. In case of a transfer by deed, to take effect after the death of the grantor, the personal property transferred was liable to a tax or duty, whatever its amount or value. 2. When real estate was authorized by will or deed to be sold at the death of the grantor, for the payment of debts or for distribution, the real estate was converted into personal property at the death of the testator and thus subject to the tax. 3. However slaves may have been regarded by the laws of a state previous to their emancipation, if they were liberated by the last will and testament of their masters, they were not to be treated as personal property and were not subject to the tax. 4. If authority was given by a will to sell real estate, but the legatee elected to take the land, he was not relieved from paying the legacy tax. 5. Gifts subject to annuities were to be taxed on the value of the annual payments according to approved tables of life annuities. Cf. Boutwell, *A Manual*, 200, 203-04; *U.S. Internal Revenue Decisions* (1871), 68; Smith, *op. cit.*, 100-01.

Pacific Railway Act, with its federal land grant and loan of bonds to aid the construction of a line between the Missouri River and California, and the Morrill Agricultural College Act were other demands on the national wealth at this time. Ostensibly to meet some of these additional needs, the Tariff Act of July 14, 1862, was passed. It was allegedly designed to increase duties only to such an extent as was necessary to offset the previously enacted internal taxes. As Morrill said in his speech introducing it: "It will be indispensable for us . . . to make proper reparation; otherwise we shall destroy the goose that lays the golden egg. If we bleed manufacturers, we must see to it that the proper tonic is administered at the same time."⁴⁴

This rationalization was offered in order to increase the protection of the home producer or manufacturer. If the Internal Revenue Act had not been passed a few days before, giving a good excuse for some increase of duties; if the higher taxation of purely revenue articles like tea and coffee had not been a justifiable and necessary means of increasing the government's income; if the increase of protective duties had not been defensible as a temporary means for the same end; and if the general public feeling had not been in favor of the most vigorous measures for increasing revenue, it would have been very difficult to carry through Congress a measure like the tariff of 1862. But under the circumstances then prevailing, and with the precedent created by the Morrill Tariff Act of March 2, 1861, passed at the instigation of Pennsylvania industrialists and western wool growers,⁴⁵ a decided increase of protection was easily carried. Customs duties were raised to an average of 37 per cent, and the free list established by the Morrill tariff of 1861 was cut down by nearly one half. These upward changes became the basis for the even higher duties of the 1864 tariff.⁴⁶ The importance of this type of tax as contrasted with the income tax is that the burden of the customs duty does not necessarily fall on those with the greatest ability to bear the tax and that the industrialist increases his profit at the expense of the consumer and the other producer classes in the community. Although justifiable as a war revenue measure, the protective tariff may easily be, and was, used as an instrument of aggrandizement by the industrial manufacturing interests.⁴⁷

⁴⁴ *Cong. Globe*, 37th Cong., 1st Sess., 1196; F. W. Taussig, *The Tariff History of the United States* (New York, 1931), 162ff.

⁴⁵ Richard Hofstadter, "The Tariff Issue and the Civil War," *American Historical Review* (October, 1938), 44: 50-55; Edward Stanwood, *American Tariff Controversies* (Boston, 1903), 2: 108ff.; Taussig, *op. cit.*, 155ff.

⁴⁶ Ashley, *Modern Tariff History*, 180ff.

⁴⁷ Gottfried Haberler, *Theory of International Trade* (New York, 1936), 237ff.; Jacob Viner, *Studies in the Theory of International Trade* (New York, 1937), 437ff.



The Tax Basis of Union Victory

MEANWHILE Lincoln continued the struggle to maintain successfully the experiment of popular government. He had the burning conviction that "we cannot escape history" and that the right will ultimately prevail. When Robert E. Lee's invasion of the North was checked at Antietam, Lincoln issued his preliminary Emancipation Proclamation on September 22, 1862, to take effect on January 1, 1863, declaring free all the slaves in the states under rebellion. A sharp reduction of the Republican majority in Congress in the November election, military reverses, and clashes in December between Chase and William H. Seward, the Secretary of State, only made him more determined to carry on to ultimate victory. Lincoln's reputation, after having declined to its lowest point in the spring and early summer of 1863, rose once more to public favor in July with the striking Union victories at Gettysburg and Vicksburg. Lee's second invasion of the North was now definitely halted, and the Confederacy was cut in two by the North's control of the Mississippi.

Yet Lincoln, with all his practical wisdom and extraordinary tact in guiding men and shaping the course of events, did not pretend to a mastery of public finance. He modestly said he had "no money sense," and depended on Chase to meet the war cost of \$2,000,000 a day.¹ Chase, however, was handicapped by the suspicion which had grown up between him and such Radical Republican Congressmen as Thaddeus Stevens and Benjamin Wade on war objectives. Congress also increased Chase's difficulties by its general readiness to vote large appropriations and its slowness to vote tax measures. With the aid of the more realistic Congressional leaders, Chase was able to raise enough money for the Treasury, through short- and long-term loans,

¹ Carl Sandburg, *Abraham Lincoln: The War Years* (4 v., New York, 1939), 1: 651ff.

greenbacks, and taxes, to meet on July 1, 1862, all the audited claims and still have a balance of \$13 million on hand.² But the checkered fortunes of war, with defeats or setbacks to the North outweighing notable victories until July, 1863, and the increase in war expenditures through the call of additional troops to the Union colors, soon made the winter of 1862-63 the darkest period in the financial history of the federal government.

Financial Strains and Remedies, 1862-63

This gloomy situation was gradually brightened by several drastic measures. Congress authorized the issue of another \$150 million in greenbacks by the Act of July 11, 1862. In October Chase appointed the dynamic supersalesman of banking, Jay Cooke, as the agent of the Treasury for selling the five-twenty bonds authorized by the first Legal Tender Act. Congress authorized the issue of another \$100 million in greenbacks on January 17, 1863, and then raised this amount to \$150 million in its act of March 3, 1863, which empowered Chase to borrow the hitherto unprecedented sum of \$900 million. Part of this was to be raised through greenbacks; part through the issue of one-year, two-year, and compound-interest notes; part through 6 per cent coin interest, ten-forty bonds; and part through fractional dollar notes. Finally, the National Bank Act of February 25, 1863, though opposed by Thaddeus Stevens and other Radical Republicans as a moneylender's measure, unjust to the debtor class, was passed in response to the urging of Chase and Lincoln as a device to get money to run the war and to achieve stability in currency and finance. It meant empowering local banking associations formed under federal authority to issue notes up to 90 per cent of the par value of the United States bonds they had purchased, and thereby to receive interest from the government on the bonds and at the same time to make a profit on the paper bills lent to borrowers at the current discount.³

These desperate remedies made possible a steady improvement in the credit of the government despite the enormous increase in the public debt due to the gigantic war expenditures. By July 1, 1863, the public debt was over \$1 billion, yet, strengthened by the military successes at Gettysburg and elsewhere, the confidence of the public re-

² *Report of the Secretary of the Treasury, 1862, 41-43.*

³ D. R. Dewey, *Financial History, 271-330*; Henrietta M. Larson, *Jay Cooke, 96-175*; Wesley C. Mitchell, *A History of the Greenbacks, 82-91, 100-05, 119-31*; Sandburg, *op. cit.*, 2: 191ff. See Randall, *op. cit.*, 455-58.

mained high. New military victories were won at Chickamauga and Chattanooga that fall, and political victories were won in the November state elections by the Republicans and Union Democrats. Nevertheless, more revenue had to be raised if Lincoln's words at Gettysburg about the nation having a new birth of freedom were to be realized.

Opponents of the war like the noted Copperhead Democrat, Clement L. Vallandigham, denied that the war could be carried on and asked: "Whence the money to carry it on? Where the men? Can you borrow? From whom? Can you tax more? Will the people bear it? . . ." ⁴ The answer of Chase, given in his annual report of December, 1863, to Congress was affirmative, but disappointing in its failure to realize the need for still more stringent tax measures. In order to meet an estimated total expenditure of \$750 million in 1863-64, Chase relied on ordinary receipts of \$161,500,000 and further loans of \$594 million. His only suggestion for increased taxation was that the internal revenue duties should be raised so that the yield from this source might be at least \$150 million. ⁵

Following Chase's recommendations, Congress passed the New Loan Act of March 3, 1864, providing for an issue of \$200 million of bonds bearing interest at not over 6 per cent and redeemable in a period of between five and forty years; because of the government stipulation of a minimum redemption period of ten years, the bonds were popularly called ten-forties. But the loan was not a success because Chase lowered the rate of interest from 6 to 5 per cent. Although he fell back upon short loans as a way out of his financial difficulty, both he and Congress speedily realized the need for new tax measures.

Some opposition to the 1862 income tax had been manifested by certain western and eastern manufacturers who held a meeting in Chicago on June 4, 1863. The resolutions adopted were outspoken in their criticism of the tax and included a demand that the operation of the law be suspended, so far as it affected income from stocks, until Congress assembled again. The Treasury Department refused to bow to this pressure and defended strongly the duty of the administration to enforce the statute. ⁶ In its position it was supported by various conscientious businessmen. A well-known manufacturer wrote to the *New York Tribune* on June 6, 1863, that the income tax was "eminently just, patriotic and statesmanlike," especially in view of the existing

⁴ Sandburg, *op. cit.*, 2: 125, 600ff.

⁵ *Treasury Report* (1863), 5, 10.

⁶ *Merchants' Magazine and Commercial Review* (August, 1863), 49: 151-52.

tariff protection. These views were largely shared by the merchants and importers. They regarded the federal income tax as a lesser evil than the protective tariffs the manufacturers were securing for themselves. The merchant and importing classes were the only business groups which supported the income tax consistently during the eighteen-sixties. They feared that federal reliance on the protective tariff for revenue would entrench the manufacturing interests at their expense. They were also afraid that an increasingly unbalanced budget would lead to further inflation and would drastically curtail imports.⁷

New War Taxes in 1864

On April 14, 1864, the House Ways and Means Committee reported a bill to provide additional internal revenues, in which the income tax was put at 5 per cent on all incomes over \$600.⁸ The returns of the internal revenue measure of 1862 had proved very disappointing; they had been only \$37,640,000 for the fiscal year 1862-63, instead of the \$85,456,000 which Chase had estimated. The discrepancy between these two figures was mainly attributable to the unsettled condition of business, and to the necessity for creating in a short period a completely new branch of the Treasury administration for the collection of duties. The revenue from customs duties was also seriously affected by the activities of the Confederate navy, so that the income from the new schedules of the Tariff Act of July 14, 1862, was inadequate to the financial demands.

In this bill of 1864 an attempt was made to expand the revenue structure of the government sufficiently to double the tax yield.⁹ The provision for an income tax of 5 per cent on all incomes over \$600 eliminated the moderately progressive tax principle embodied in the Act of July 1, 1862. Yet Joseph J. Lewis, the new Commissioner of Internal Revenue, in his report of November, 1863, had even suggested that there be a decided increase in the scale of graduation and

⁷ Ellis, "Public Opinion and the Income Tax," *op. cit.*, 227. See *Merchants' Magazine* (January, 1865), 52: 60, for a representative mercantile view.

⁸ *Cong. Globe*, 38th Cong., 1st Sess., 1634, 1876.

⁹ Internal Revenue Act of June 30, 1864, followed the lines of earlier legislation but made a general increase in rates. The duty on spirits was raised from twenty and sixty cents to \$1.50 and \$2.00 per gallon; the tax on smoking tobacco was more than doubled; the tax on cigars jumped from a maximum rate of \$3.50 per thousand to a maximum rate of \$40 per thousand. Similarly, license taxes were increased while specific duties on many manufactured products were doubled. The general ad valorem tax was increased from 3 per cent to 5 per cent on most articles covered in the former schedule; numerous new sources of revenue were explored and taxed. Cf. Dewey, *Financial History*, 302ff.; F. C. Howe, *Taxation and Taxes*, 63-64.

that a tax of 4 per cent be levied on incomes from \$5,000 to \$10,000, of 5 per cent on incomes from \$10,000 to \$20,000, and of 5.5 or 6 per cent on incomes over \$20,000.¹⁰

After Justin S. Morrill had presented the new measure of the Ways and Means Committee to the House, Augustus Frank, a staunch Republican and hardheaded railroad director from upstate New York,¹¹ proposed a drastic amendment to their conservative income tax provision. He recommended a duty of 5 per cent on income over \$600, of 7.5 per cent on income over \$10,000, and of 10 per cent on income over \$25,000. He said: "I think it is just, right, and proper that those having a larger amount of income shall pay a larger amount of tax. I believe . . . the larger tax we pay at this time the safer we are and the better will be the securities of the government." He denied that his proposal violated the constitutional stipulation that taxation be uniform throughout the United States and that it was wrong to discriminate between different classes of income. Against his bold proposal Thaddeus Stevens, that paradoxical synthesis of egalitarianism and capitalism, asserted that Frank's championship of a progressive income tax was "a punishment of the rich man because he is rich." Morrill in turn also declared that "people who are taxed unequally on their incomes regard themselves as being unjustly treated, and seek all manner of ways and means to evade it. This inequality [in taxation] is in fact no less than a confiscation of property, because one man happens to have a little more money than another."¹²

In reply to these two archchampions of the high protective tariff and chief opponents of a progressively higher income tax in the House, Henry L. Dawes of Massachusetts denied that making rich

¹⁰ Lewis in his report stated that "the present tax laws on the whole have been not merely endured, but welcomed by the people in a manner that is believed elsewhere unparalleled." He recommended that the income tax not be levied on the so-called dividends of life insurance companies because it was almost incapable of collection and that the provision allowing a deduction for rent paid for dwelling houses be stricken from the law and instead that all persons owning and living in a house be charged with its rental value as income. This suggestion, based on J. S. Mill's economic views, also anticipated Irving Fisher's theory of psychic incomes. (Cf. Irving Fisher, *The Nature of Capital and Income* [New York, 1906].) Lewis also proposed that the returns of income should not be open to the inspection of others than officers of revenue in order to avoid making the income tax system inquisitorial. *Report of the Commissioner of Internal Revenue for the Year ending June 30, 1863*, 3-11.

¹¹ He later became the director or president of several banks in or near Rochester, New York. Cf. *Biographical Directory of the American Congress 1774-1927* (Washington, 1928), 986, which, with the *Dictionary of American Biography* (New York, 1930), is a rich mine of information on the various public figures discussed in this volume.

¹² *Cong. Globe*, 38th Cong., 1st Sess., 1876.

men pay their share of the burdens of taxation was punishing them for their wealth, and asked whether the poor should pay the taxes for the rich. He was supported strongly by Rufus P. Spalding, a noted lawyer, War Democrat, and former member of the Ohio Supreme Court, who maintained that the higher rates on the higher incomes were really a tax on the luxuries available only to those with the higher incomes, and that they were precisely the ones best able to pay the taxes. The conservative opposition to the progressive rates on income was voted down by a large majority in the House in favor of Frank's amendment.¹³

Morrill, however, could not resist making a last ineffectual protest against this equitable measure. While closing the debate on the entire internal revenue measure on April 28, he said: ¹⁴

This provision goes upon the principle of taxing a man more because he is richer than another. The very theory of our institutions is entire equality; that we make no distinction between the rich man and the poor man. The man of moderate means is just as good as the man with more means, but our theory of government does not admit that he is better, and I regard it as an evidence of the spirit of agrarianism to present a law here which shall make any such distinction. It is seizing property of men for the crime of having too much. I can speak fairly on this subject because I do not belong to this class. We have too few rich men in the country to make a distinction that may induce them to expatriate themselves during the season of the large taxation which we are obliged to enforce.

When this bill reached the Senate, the Finance Committee slightly modified the graduated scheme proposed by Frank by reducing the upper limit from 10 per cent on incomes over \$25,000 to 7.5 per cent on incomes over \$10,000. Senator Fessenden, the chairman of the Committee, gave a telling justification of the Committee's objection "to making so very large a discrimination against property" as the House tax of 10 per cent on incomes over \$25,000. Anticipating the thesis of Carl Snyder in *Capitalism the Creator*, he argued that the tendency of our free institutions to impose the heaviest burdens upon property, especially in times of emergency, should be counteracted by a conservative sentiment to protect property from being unreasonably harshly burdened, because the accumulation of wealth through industry and business added to the national wealth and ensured prosperity.¹⁵

To this and other criticism from various men, notably John Sher-

¹³ *Ibid.*, 1876-77.

¹⁴ *Ibid.*, 1940.

¹⁵ *Ibid.*, 2513.

man of Ohio, replies were made by Lyman Trumbull and Charles Sumner. Sumner made an especially interesting defense of the justice of the progressive principle in income taxation by very apt quotations from the works of Adam Smith and J. B. Say, the French economist. Despite this counterattack, the Senate voted on May 27 in favor of Fessenden's proposed change.¹⁶

Nevertheless, the Senate reversed itself on June 6 by first voting in favor of the amendment of James F. Wilson of Iowa for a 7.5 per cent tax on all incomes over \$5,000, and then voting for the motion of James W. Grimes, a Radical Republican from Iowa, for a 10 per cent tax on all incomes over \$15,000. The explanation for this speedy change of opinion seems to be that in the interval between the first and second votes on this question Senator Grimes had succeeded in getting the Senate to suspend indefinitely the operation of the direct tax, which was to be assessed in 1865, according to the House bill. A majority of those who supported Grimes on this question afterward voted for the higher rates on incomes. They evidently had decided that the direct tax had to go and that an increase in the income tax was necessary to make up the impending loss in revenue. Another factor may have been that the Senate had gradually responded to the persuasive arguments of Sumner and the plea by Grimes that those with large fortunes and incomes could more justly pay an additional sum in taxation than those with incomes only large enough to support their families.¹⁷

The Income and Inheritance Tax Law of June 30, 1864

In the final form of the bill, as it emerged from the Committee of Conference, the radical increases in the rates introduced by Frank in the House and Grimes in the Senate were made still higher through a provision making the 10 per cent rate begin at \$10,000. This and other changes were accepted without protest by both the House and the Senate and were embodied in the Act of June 30, 1864.¹⁸ This most famous of the Civil War revenue measures provided for a tax of 5 per cent on income from \$600 up to \$5,000, of 7.5 per cent on income over \$5,000 up to \$10,000, and of 10 per cent on income over \$10,000. The rate on dividends from stocks and interest on bonds of

¹⁶ *Ibid.*, 2513-15.

¹⁷ *Ibid.*, 2759; 13 *U.S. Stat. at Large*, 304. Of the twenty-one Senators who had voted against the direct tax, only four voted against the higher income tax rates. Of the sixteen who had voted for the direct tax, only five, including Charles Sumner, voted for the higher income tax rates. See Hill, *op. cit.*, 424.

¹⁸ 13 *U.S. Stat. at Large*, 281.

banks, trust companies, savings institutions, and railroad companies, and of any stock or mutual fire, marine, life, and inland insurance company, was raised from 3 to 5 per cent. The principle of deduction at the source was extended to include a 5 per cent tax on the interest and dividends of any canal, turnpike, canal navigation, or slack-water company. The tax on the salaries of government officials was increased 2 per cent, and the paymasters were required to retain 5 per cent of all salaries over \$600 paid by them. The law of July 1, 1862, had imposed a higher rate on the income derived from property in the United States by American citizens residing abroad. This invidious distinction was now eliminated. Income from the securities of the United States government was no longer taxed at the special low rate imposed in 1862 as an incentive to their purchase; the same rates were made to apply to all incomes, irrespective of their source.

Other important changes were made. The privilege of deducting house rent was extended to all persons and not only to those paying rent.¹⁹ This exemption was an amplification of the principle of economic welfare on which income below \$600 was exempted from taxation. To countermand a ruling of the Commissioner of Internal Revenue, Congress provided that only the profits from the sale of real estate purchased within the year for which the income was estimated were to be taxed, and that the actual losses from the sale of such property might be deducted from the income. Deductions in estimating the annual income were granted for all taxes, salaries, income from dividends, or interest on securities where the tax was paid by the company. The difficult and important problem, in a predominantly rural economy, of estimating the income of farmers was met by a special provision.²⁰ Finally, the method of administering the tax was altered in order to enforce the law more effectively.²¹

¹⁹ This went contrary to Commissioner Lewis's recommendation (cited in note 10 above), the New York *Tribune's* editorial of May 31, 1864, and the House of Representatives' limitation of the house rent exemption to \$200 (*Cong. Globe*, 38th Cong., 1st Sess., 1877).

²⁰ This provided that the farmer's income included "the increased value of live stock, whether sold or on hand, and the amount of sugar, wool, butter, cheese, pork, beef, mutton, or other meats, hay and grain, or other vegetables, or other productions of the estate of such person sold, not including any part thereof unsold or on hand during the year next preceding the thirty-first of December." Cf. H. E. Smith, *op. cit.*, 62-63. Deductions were also permitted for "usual or ordinary repairs, not exceeding the average for the preceding five years"; but no deduction could "be made for any amount paid out for new buildings, permanent improvements or betterments made to increase the value of any property or estate." A consul of a foreign country, not a citizen of the United States, was exempt from income tax, provided that reciprocal privileges were conferred by the foreign governments. 13 *U.S. Stat. at Large*, 281.

²¹ Under the Act of June 30, 1864, every return was to be made under oath or

The Act of June 30, 1864, also contained some modifications in the inheritance tax of 1862, which were introduced at the suggestion of Commissioner Lewis in 1863. He reported that the legacy tax of 1862 had produced only \$56,592 in 1862 and \$311,161 in 1863, and recommended a moderate raising of the rates, an extension of the tax to transfers of real estate as well as of personal property, and a limitation to \$5,000 on the exemption of property passing to husband or wife.²² This stimulated the House Ways and Means Committee to include in its 1864 internal revenue bill a tax on succession to (or inheritance of) real estate and to increase the rates on legacies of personal property. During the long-drawn-out debates on this bill the basic principles of the inheritance tax were not disputed, since hardly anyone objected to the tax as a matter of principle, at least in the crisis of war. The differences centered mainly on rates.²³

The law as finally enacted retained the exemptions applying to inheritance of personal property, but granted none in cases of succession to real estate. The rates on both the successions and legacies were graduated according to degrees of consanguinity or blood relationship, from 1 per cent to 6 per cent.²⁴ Husband and wife were exempted from the legacy tax, but not from the succession tax, until the next year, when Congress passed an amendatory act exempting the wife from that tax and made the exemption retroactive.²⁵ An interesting executive ruling by the Commissioner of Internal Revenue was that when the successor was the husband of the deceased, he was to be considered as a stranger in blood and as subject to the 6 per cent rate.²⁶ To prevent evasion of the succession tax through the giving away of property before death, Congress provided that deeds and

affirmation; and in case a return was increased by the assistant assessor, the original return was to be accepted as true only when all deductions claimed were approved by the assistant assessor. An appeal could be taken to the assessor of the district, whose decision was final. The penalty for failure to pay the tax within thirty days after it was due, and ten days after demand by the collector, was raised from 5 per cent to 10 per cent of the amount of the tax unpaid, except in the case of deceased or insolvent persons. 13 *U.S. Stat. at Large*, 282-83.

²² *Treasury Report* (1863), 73-74.

²³ *Cong. Globe*, 38th Cong., 1st Sess., 1718; H. E. Smith, *op. cit.*, 101-02.

²⁴ Act of June 30, 1864, 13 *U.S. Stat. at Large*, 286, 388-89. The specific rates on successions and legacies were as follows: 1 per cent for lineal issue or ancestor; 2 per cent for brother or sister (except in the case of a legacy, when the rate was 1 per cent); 2 per cent for descendants of a brother or sister; 4 per cent for uncle, aunt, or descendant of the same; 5 per cent for great-uncle, great-aunt, or descendant of the same; and 6 per cent for other collateral relatives, strangers in blood, or corporations.

²⁵ Act of March 3, 1865, 13 *U.S. Stat. at Large*, 481.

²⁶ 3 *I.R.R.*, 101.

gifts, made without valuable and adequate consideration, conveying any real estate to any person, whether they purported to vest the estate either immediately or in the future, should be considered as a succession and taxed as such.²⁷

Pressure Politics and the 1864 Tariff

At the very time that these important increases in the income and inheritance taxes were being enacted, the fervent champions of domestic industry, notably J. S. Morrill and Thaddeus Stevens, put through the highest protective tariff the United States had ever had. The urgent need of the government for revenue to prosecute the war to a finish and the desire of Congress to compensate domestic producers for the heavy internal taxes imposed on them, furnished the opportunity for the protectionist spokesmen to raise the average rate on dutiable commodities from the 37.2 per cent level of 1862 to 47.02 per cent in 1864. Organizations like the National Association of Wool Manufacturers, the National Woolgrowers' Association, the New England Cotton Manufacturers' Association, the American Iron and Steel Association, and the National Manufacturers' Association had been formed during the Civil War primarily for the purposes of bringing pressure on Congress in regard to the tariff, and they succeeded in attaining their objective.²⁸

The result was a crude, ill-considered bill, marked by glaring abuses in duty rates intended to enrich special interests at the expense of the national welfare. In ordinary times it would have been rejected, but in

²⁷ 13 *U.S. Stat. at Large*, 288. Other provisions worth noting were: 1. The clause expressly providing that where real estate became subject to a trust for any charitable or public purpose it should be taxed at the maximum rate of 6 per cent. 2. The duty imposed on the administrator or executor of a legacy to make the returns and pay the taxes. 3. In the case of successions, the duty of giving notice to the assessor or assistant assessor and furnishing full accounts of the succession, required of the person liable to the tax. 4. The penalty of 10 per cent of the amount of the tax imposed for failure to furnish the proper accounts within ten days after being notified, or failure to pay the tax within ten days after notification of the assessment. An important ruling by the Commissioner was that since in law marriage is a valuable consideration, "A conveyance of real estate made in prospect of marriage, and *in consideration thereof*, does not confer a succession within the meaning of the internal revenue laws." 5 *I.R.R.*, 115; H. E. Smith, *op. cit.*, 102-04.

²⁸ Emerson David Fite, *Social and Industrial Conditions in the North during the Civil War* (New York, 1910), 168. Other business pressure groups organized to object to internal taxes and to suggest changes in the rates were the petroleum refiners, the tobacco growers in Connecticut and Kentucky, the brewers, the California Wine Growers' Association, and the Cap and Hat Manufacturers' Association in New York, as well as many local associations of manufacturers who eventually formed the National Manufacturers' Association.

the crisis of war this bill, one of the most important financial measures ever enacted in the United States, was rushed through Congress with only five days for debate upon all the complicated provisions and principles involved. Since the legal tender acts forbade the acceptance of greenbacks at the customs house, the real increase of taxation created by this tariff was greater than in the case of income and inheritance taxes (and other excises) which could be and were paid in paper money. Importers had therefore to buy goods abroad for specie, to pay duties on them in gold, and finally to sell them for paper money. The new duties directly increased the prices charged to American consumers of imported goods; the foreign producer was not forced to accept lower prices, except when a decided decline in sales impelled him to make concessions in the hope of retrieving his market. The harmful effects of this act were not to be confined, however, to the period of the war. The rates established in 1864 on the articles open to protective controversy remained practically unchanged until 1883. By then high protection was no longer a temporary expedient in a national emergency, but had become a permanent institution accepted by the ruling groups as an integral part of the American economic system,²⁹ without the offset of the Civil War income and inheritance taxes.

Emergency Income Tax Act of July 4, 1864

On July 4, 1864, an eventful session of Congress adjourned, but not before it imposed an income tax in addition to the one passed on June 30. This emergency levy was inspired by Secretary Chase's fear that despite the large anticipated revenues from the June 30 revenue law the Treasury would lack the income needed to meet all demands, especially those arising from a joint resolution passed on June 21, 1862, and amended on February 24, 1864. This promised to pay a premium of two dollars to every citizen, noncommissioned officer, or soldier for each accepted recruit he could attract to the regular army, and payment of the first month's pay in advance to any soldier who enlisted for three years or during the time of the war.³⁰ The House Ways and Means Committee, through Justin S. Morrill, therefore proposed a joint resolution imposing a special income tax of 5 per cent on all incomes over \$600 for the year ending December 31, 1863, to be collected on or before October 1, 1864. Since the Act of July 1, 1862,

²⁹ Ashley, *Modern Tariff History*, 180ff.; Mitchell, *A History of the Greenbacks*, 269ff.; Stanwood, *American Tariff Controversies*, 2:128ff.; Taussig, *Tariff History*, 164-70.

³⁰ 12 *U.S. Stat. at Large*, 620.

levied a 3 per cent tax on income over \$600 up to \$10,000, and a 5 per cent tax on income over \$10,000, the Committee's resolution had the effect of raising the total rate to 8 per cent for income received in 1863 on incomes over \$600 and under \$10,000, and to 10 per cent on incomes over \$10,000.³¹

After Morrill explained that the emergency tax was expected to raise \$20 million to pay bounties for the enlistment of some 200,000 men authorized by the enrollment act, a short but animated debate took place. James Brooks, Democratic Congressman and editor and owner of the fiercely anti-Lincoln and antiabolitionist newspaper the *New York Express*, objected violently to Morrill's statement that "as a whole, and taking it alone, there is no tax more equal than an income tax . . . and it is in all cases to be paid by those who are able to pay it and who have most at stake in sustaining the credit of the country." Brooks denounced it as an exclusive burden on industry, enterprise, and labor and as failing to touch the farming class because their political support was desired in the coming presidential election. But this and other attacks and proposed amendments failed. John V. S. L. Pruyn, a liberal Democrat from New York, proposed that the tax apply only to incomes over \$1,000 because this bill "as it stands would bear too heavily on men of small incomes." L. W. Ross of Illinois suggested a tax of 10 per cent on all incomes over \$20,000. Both these amendments were voted down by rather narrow margins, as was the amendment to increase the tax on spirits already produced. The bill was then voted on, and, after first being defeated by a vote of 57 to 54, 71 not voting, it was passed by a vote of 53 to 48, with 81 not voting. The Senate then hastily rushed the resolution through so that it became law on July 4, the last day of the session.³² This action was in accord with public opinion. On July 1 the *New York Times* had voiced the demand of the people "to be taxed to a degree which shall fairly correspond with the vast amount of promissory money afloat." Three days later the *Times* had come out for direct as against indirect taxation: "Every man's property, and every man's income, should be, and, we trust, will be taxed."

The Role of Labor

On the same day that this tax on the incomes of the more prosperous classes was passed, Congress had enacted the alien contract im-

³¹ *Cong. Globe*, 38th Cong., 1st Sess., 3527.

³² *Ibid.*, 3529-32; 13 *U.S. Stat. at Large*, 417; Sandburg, *op. cit.*, 2: 141-42, 501, 556.

migration law of 1864. This authorized persons to make contracts in foreign countries to import laborers into the United States and to bind them to work for a term until their passage was paid out of their wages. This extraordinary legalization of contracts similar to the indentured servitude of colonial times compensated the industrial capitalists for their contributions in taxes to the government and for the favors given to the farmer in the Homestead Act of 1862. The immigration law also operated to counteract the stringency in the labor market created by military enlistments and conscription and the higher wage demands by the growing labor organizations. Labor, after having had high hopes for a militant advance in the late eighteen-forties, had suffered a setback from the time of the discovery of gold in California in 1848 to the outbreak of the Civil War. In almost all classes there developed during that period a heightened spirit of capitalistic acquisitiveness. Moreover, the interest of the great masses of American people was largely diverted from the struggle between capital and labor to that between North and South on the issue of slavery and the Union. The first sign of general labor activity during the Civil War occurred in 1863. Throughout the important industrial centers in the East, trades' assemblies were organized to carry on propaganda, collective bargaining, boycotts, strikes, and demonstrations. Organization was necessary as a bulwark against the rapidly rising prices of commodities and the decline in real, as distinguished from money, wages, traceable in part to the inflation of the currency through greenbacks, but in large part to the wartime profits of merchants and manufacturers.³³

Against the threat of a powerful labor movement and of a labor shortage the industrialists secured the safeguard of a large, cheap immigrant supply from Europe. They thus lowered the costs of production, while the high Civil War tariffs protected them against foreign competitive merchandise and enabled them to raise prices to the consumer. The American Emigrant Company was formed after the passage of the 1864 Immigration Act with a capital of \$1 million "to import laborers, especially skilled laborers . . . for the manufacturers, railroad companies, and other employers of labor in America." It was composed of bankers, employers, and politicians, and was endorsed, out of a concern for war labor needs, by such noted public figures as Salmon P. Chase, Secretary of the Navy, Gideon Welles, Henry

³³ Mary R. Beard, *The American Labor Movement* (New York, 1928), 62-79; Fite, *op. cit.*, 190-212; Mitchell, *op. cit.*, 278, 280-351, 380ff.; Norman Ware, *The Industrial Worker 1840-1860* (New York, 1924), 24ff. and *The Labor Movement in the United States, 1860-1895* (New York, 1929), 1-6.

Ward Beecher, and Charles Sumner. A war for the Union and against slavery evidently was compatible with the maintenance and increase of business profits, even though it meant a lowering of the standards of labor, if not a creation of "wage-slaves" out of men who desired to be free laborers, when they could not become independent farmers or entrepreneurs on their own. These words of Lincoln's in his First Annual Message evidently were forgotten: "Labor is prior to and independent of capital. Capital is only the fruit of labor, and could never have existed if labor had not first existed. Labor is the superior of capital, and deserves much the higher consideration."³⁴

Changes in the Treasury Department

While all this portentous legislation was being written into history, a minor revolution took place in the Cabinet. A conflict with the President about an appointment in the Treasury Department led Secretary Chase to send in his resignation on June 29 and he was very much surprised and mortified to have it accepted by Lincoln the next day. The President had become weary of Chase's political wirepulling, his inflexibility in his personal preferences concerning appointments, his self-righteousness and relentless drive for power in all fields, and his unquenchable desire for the presidency. Although Lincoln had been nominated on June 7 by the Republican party for a second term, undoubtedly he resented the efforts of Chase and his friends to displace him from the presidency. The note Chase had intended merely as a means of personal assertion afforded Lincoln an opportunity to remove a political enemy whom he had endured for the abilities he could bring to the financing of the war. In his place Lincoln nominated on July 1 William Pitt Fessenden, Chairman of the Senate Finance Committee. The latter strongly resisted being drafted for so crucially important and difficult a position, and protested that in his state of bad health the job would kill him. Lincoln replied: "Very well, you cannot die better than in trying to save your country." Fessenden, three of whose four sons had gone into the Union army, gave way before this appeal and on July 5 assumed the duties and powers Chase had exercised through three long years of storm and stress.³⁵

The new Secretary of the Treasury had a reputation as the best general debater and practical legislator in the Senate, as a strong champion of sound money, manufactures, fisheries, and shipping, and

³⁴ Richardson, *Messages and Papers of the Presidents*, 6: 57.

³⁵ Francis Fessenden, *William Pitt Fessenden*, 1: 315ff.; J. W. Schuckers, *Salmon Portland Chase*, 487ff.; Carl Sandburg, *Lincoln*, 3: 109-25.

as a foe of slavery and secession. He was respected for his ability, integrity, and courage. As Senator, as it has been pointed out above, he had been an early supporter of the 1861 income tax, and was the originator of the first progressive income tax bill proposed in Congress in 1862. In the debate on the June 30, 1864, income tax he had opposed a 10 per cent tax on income over \$25,000 as harmful to industry and business, but he favored what seemed to other colleagues, such as Morrill and Stevens, a radical 7.5 per cent tax on incomes over \$10,000.

Financial Difficulties in 1864

An extremely grave financial situation faced Fessenden on his assumption of office. The national debt was \$1,740,690,489; the war was costing \$2,250,000 a day. The Treasury's cash balance on July 1 was only \$18,842,000; the customs duties for the fiscal year 1864-65, estimated at \$70 million, were \$21 million below the sum needed to pay the interest on the public debt; \$161,796,000 of certificates of indebtedness needed payment; \$110 million of the seven-twenty bonds of 1861 fell due in August and October. Unpaid requisitions amounted to \$71,814,000; pay to the soldiers was in arrears; an immediate increase in the army had been authorized on July 4 which increased the daily expenses of the war to \$3 million.⁸⁶

This precarious fiscal condition arose from several causes. The expenditures for the year ending June 30, 1864, had exceeded Chase's anticipations by \$116 million. Receipts of \$104 million in excess of the estimated receipts from taxation and miscellaneous sources still did not relieve the necessity of borrowing huge sums. Jay Cooke and the Treasury agencies had sold over \$320 million of the five-twenties, but the subscription books had been closed on January 21. In launching a new loan, Chase had made two errors: he offered bonds running twice the time of the five-twenties, but reduced the rate of interest from 6 to 5 per cent, and instead of keeping Jay Cooke as general agent for the Treasury he attempted to sell the bonds through national banks and other agencies supervised by the Treasury. These were unfortunate changes, especially at a time when an unreceptive state of mind had been created by the unsatisfactory military situation in the spring of 1864 after the battles of the Wilderness, Spottsylvania, and Cold Harbor. Other complicating factors were the unsa-

⁸⁶ *Treasury Report*, 1864, 10-11, 19; Richardson, *Messages and Papers*, 6: 226-27, 247ff.

vory speculation in gold on Wall Street, which forced down the price of greenbacks and helped commodity prices to skyrocket, and the Radical Republicans' attempt to prevent Lincoln's renomination on June 7. The ten-forty loan was as marked a failure as the five-twenty loan had been a success. When Chase resigned, only \$73 million of the new loan had been subscribed.

Chase had attempted to meet his difficulties by issuing \$163 million in a new type of legal tender note which differed from the greenbacks in that it ran for definite terms and bore interest, which he hoped would lead holders to keep the notes as an investment instead of circulating them as money. This stratagem and the attempt to outlaw speculation in gold by an act of Congress on June 17 did not solve the problem. The increase in the premium on gold was so rapid and created such exchange difficulties that business pressure induced Congress to repeal the Gold Act on July 2, only fifteen days after its passage. Chase's delay in asking for heavy taxes from Congress and his reliance mainly on loans to finance the war expenses during the first two years of his financial reign were now exacting their penalty. All of his efforts to obtain funds failed to prevent demands upon the Treasury from mounting more rapidly than they could be met. If he had followed the example of Gladstone when he was confronted by the problem of financing the Crimean War in 1854, Chase would have adopted a bold and resolute policy of defraying the costs of the war with heavy war taxes as far as possible. He would have avoided the necessity of issuing greenbacks, creating a national bank system, and having to rely on ingenious devices for meeting expenses at such critical periods as the spring of 1864.³⁷

July and August, 1864, were months of deep gloom for the Union cause. The Confederates under Jubal A. Early marched down the Shenandoah Valley and appeared in sight of the Capitol at Washington on July 11, but failed to occupy the city and retired next day. The credit of the government fell so that thirty-nine gold dollars could buy a hundred dollars of greenbacks. Dissension within the Republican party arose over Lincoln's pocket veto on July 8 of the Davis-Wade bill for reconstructing the southern state governments along

³⁷ The ratio of loans to taxes in 1861-62 was $8\frac{1}{2}$ to 1; in 1862-63, $5\frac{1}{2}$ to 1; in 1863-64, $3\frac{7}{8}$ to 1; and in 1864-65, 3 to 1. Gladstone in 1845 had asked Parliament to double the income tax already in existence because he felt that to begin the war by a loan would be a confession of financial cowardice and economic weakness unworthy of the character of the country. Cf. Henry C. Adams, *Public Debts* (New York, 1893), 126-42; Dewey, *op. cit.*, 299, 312ff.; F. W. Hirst, *The Political Economy of War* (London, 1916), 143ff.; Larson, *op. cit.*, 160-65; Mitchell, *op. cit.*, 122-31.

Radical Republican lines. Horace Greeley attempted to negotiate a peace between North and South at Niagara. James F. Jaquess and James R. Gilmore also came to grief in their peace efforts at Richmond. A strong movement within the Republican party was also developing to force the withdrawal of Lincoln from the presidential race in favor of a "more vigorous" candidate like Grant. The Democratic party's nomination of General George Brinton McClellan as its presidential candidate seemed a masterly way to win the election through the combined appeal of a noted war leader and a strong peace platform. The political outlook seemed so dark to Lincoln that on August 23 he wrote in a secret memorandum that it seemed "exceedingly probable that this Administration would not be re-elected. Then it will be my duty to so co-operate with the President-elect, as to save the Union between the election and the inauguration; as he will have secured his election on such ground that he cannot possibly save it afterwards."⁸⁸

The Turn of the Tide

A few days before Fessenden took control of the Treasury, a loan on seventeen-year, 6 per cent bonds offered by Chase at 104 or above had been withdrawn for lack of takers. An opportunity to secure \$50 million from the banks of New York, Boston, and Philadelphia was blocked by the sub-Treasury law which prevented the Secretary from drawing upon any but national banks. Vigorous, courageous action was required to salvage the national credit. Fessenden was not physically strong, disliked executive as compared to legislative duties, and feared to incur popular wrath by using the services of Jay Cooke because of widespread criticism of Cooke's profits as Treasury agent. Yet he acted with considerable ability and boldness. Late in July he offered for popular subscription \$200 million of three-year notes, bearing interest at 7.3 per cent in currency, through the national banks; but the loan went slowly, and despite other emergency maneuvers the Treasury ended September with a deficit of \$130 million. The current changed swiftly after the victories of Sherman at Atlanta on September 2 and of Sheridan at Winchester on September 22, and the Republican successes in the Maine and Vermont elections. The opposition to the President weakened, and in the elections Lincoln and Andrew Johnson defeated their Democratic opponents by a popular majority of 400,000 votes and by an electoral majority of 195. William T.

⁸⁸ John G. Nicolay and John Hay, *Abraham Lincoln: A History* (10 v., New York, 1890), 9: 251; Sandburg, *op. cit.*, 3: 107-299.

Sherman began his destructive and effectively demoralizing March to the Sea early in November and arrived triumphantly in Savannah by December 22. The tides of victory were now definitely running in favor of the North.

Consequently, during the October to December quarter, Fessenden was able to raise more than \$207 million through the sale of compound-interest notes and five-twenty, seven-thirty, and ten-forty bonds. Having profited from Jay Cooke's assistance in floating some loans in November, 1864, Fessenden on January 28, 1865, engaged Cooke to head the loan campaign for selling the three-year notes bearing 7.3 per cent interest authorized by the Act of June 30, 1864. At the end of March \$185,000,000 of the seven-thirties had been sold. Fessenden also strengthened the confidence of investors by replacing Chase's 5 per cent bonds with 6 per cent five-twenty and ten-forty bonds, and by substituting the popular 6 per cent compound-interest notes for the troublesome 5 per cent coupon Treasury notes.³⁹

Yet despite these successful loans, and the bracing effect on public opinion of the Union victory at Nashville on December 15, 1864, and the capture of Wilmington, the great importing depot of the South, in January, 1865, the Treasury required increased taxation to meet the colossal expenses required for financing the final military efforts of the war. The public debt on July 1, 1864, was more than \$1,740 million and was constantly mounting. Hence Fessenden recommended in his report of December, 1864, that the internal revenue duties be increased and extended so as to yield \$300 million a year.

Although the income tax had brought into the Treasury only \$2,741,000 in 1863, the yield for 1864 was over \$20 million and promised to be greater. Fessenden therefore championed the progressive income tax, and declared that it could not "be considered oppressive or unjust, inasmuch as the ability to pay increases in much more than arithmetical proportion as the amount of income exceeds the limit of reasonable necessity." He also advocated collecting the income tax from all, without exemption, since the exemption provisions opened the door to innumerable frauds, "and in a young and growing country the vast majority of incomes are small, while all participate alike in the blessings of good government."⁴⁰ His last statement, though somewhat extreme, anticipated the theory of modern economists that the extent of the burden of a tax can be determined only after con-

³⁹ Dewey, *op. cit.*, 314-16; Fessenden, *op. cit.*, 324-78; Larson, *op. cit.*, 160-75; Mitchell, *op. cit.*, 124-26.

⁴⁰ *Treasury Report*, 1864, 14-15.

sidering the benefits the taxpayer receives from the government's expenditure of its funds.⁴¹

The Last War Tax Law

The New York *Times* expressed its approval on December 8 of Fessenden's ideas, and asked Congress to lose no time in giving them "consideration and the early sanction of law." On February 9, 1865, eight days after Congress had adopted and submitted to the states the Thirteenth Amendment abolishing slavery, Justin S. Morrill introduced in the House a bill to amend the Internal Revenue Act of June 30, 1864, so as to increase the revenue and re-enforce the Treasury "at the same time we are adding to our forces in the field." He emphasized the need for heavy taxes in order to maintain the credit of the government and proposed that the "income tax, intrinsically the most just of all taxes," be increased from 7.5 per cent to 10 per cent on all incomes over \$3,000.⁴² A week later the main debate took place on the House Ways and Means Committee's recommendation for a tax of 5 per cent on income from \$600 up to \$3,000, and of 10 per cent on income over \$3,000. Robert Mallory of Kentucky, a lawyer with agrarian sympathies, maintained that a 10 per cent tax was excessively heavy for the family which received a \$3,000 to \$5,000 income in greenbacks and suggested that the tax be 5 per cent on incomes from \$600 to \$5,000, and 10 per cent on incomes over \$5,000. A far more daring proposal was made by Lewis W. Ross, an Illinois Democrat and lawyer. He was an ardent defender of the progressive income tax as the only tax which could not be shifted by the capitalist to the consumer. He moved for a tax of 5 per cent on income over \$1,000, 10 per cent on income over \$5,000, 15 per cent on income over \$15,000, and 20 per cent on income over \$20,000.⁴³

Then James A. Garfield made a remarkable attack on the existing and proposed income taxes "as the very essence of injustice" because they made no discrimination between the sources from which income is derived. They taxed the laborer "with nothing in the world except his hands" at the same rate as the capitalist who merely collects his income from investments. Garfield advocated "taxing the income of labor less than that which arises from unproductive wealth." His

⁴¹ Cf. Hugh Dalton, *Principles of Public Finance* (London, 1934), 189ff.; A. C. Pigou, *A Study in Public Finance* (London, 1928), 19-53; H. A. Silverman, *Taxation: Its Incidence and Effects* (London, 1931), 24-32, 41-65.

⁴² *Cong. Globe*, 38 Cong., 2d Sess., 694-97.

⁴³ *Ibid.*, 836.

speech was in line with the assertion in the *New York Tribune* of January 23, 1862: "We do not think it right to tax an income which is the fruit of present personal exertion as though it were derived from an inheritance or from invested capital." Neither his nor Ross's amendments were accepted. That advanced by Robert Mallory, however, was agreed to by a vote of 65 to 56, on February 16, and became the House's income tax measure.⁴⁴

In the Senate John Sherman, the Chairman of the Finance Committee, on February 27 made an eloquent speech explaining the principles guiding the Committee's revision of the House internal revenue bill. He stressed the need for high taxes to maintain the national credit, but warned against unnecessary increase of the national debt because he saw "in the dim future of our country the same uneasy struggle between capital and labor, between the rich and the poor, between fund-holders and property-holders, that has marked the history of Great Britain for the last fifty years." To prevent that conflict, he suggested changes in the income tax proposed by the House, especially since it was "the only tax on accumulated property, the only tax on money in State and Government securities." The next day the Senate, with practically no debate, gave its approval to the House's income tax with a few minor amendments suggested by the Senate Finance Committee. On March 3, 1865, after the Senate and House had compromised their differences, the internal revenue measure, including the highest income tax of the Civil War, became law.⁴⁵

This Act, in its final form, levied a tax of 5 per cent on income from \$600 to \$5,000, and of 10 per cent on income over \$5,000. To prevent evasion by those receiving large incomes, the assistant assessor was empowered to increase any taxpayer's estimate of his income, even if made under oath, when it seemed an understatement. The taxpayer, if dissatisfied, was permitted to appeal his case to the assessor, and from him to the Commissioner of Internal Revenue. For willful neglect or refusal to make a return, the taxpayer was penalized 25 per cent of the tax; for a false or fraudulent return, the tax was to be doubled.

Final War Changes

On March 3 other important bills became law: the authorization for a \$600 million loan; the Act creating the Freedmen's Bureau for

⁴⁴ *Ibid.*, 837. Boutwell sponsored a sales tax which was passed by the House by a vote of 58 to 56, but was eliminated in the Senate.

⁴⁵ *Ibid.*, 1138-39, 1293; Act of March 3, 1865, 13 *U.S. Stat. at Large*, 479-81.

the control of the emancipated slaves, Negro refugees, and abandoned or confiscated lands in the South; and the Act imposing a 10 per cent tax on state bank note circulation, as a means of favoring the national bank notes. But equally important was the resignation of Fessenden as Secretary of the Treasury. He had been elected United States Senator from Maine on January 5, 1865, and had sent in a letter of resignation on February 6 which was to take effect March 3. Lincoln regretted losing him, but had to consent because of Fessenden's ill health and his strong desire to be back in the Senate. His successor was Hugh McCulloch, a Maine-born Indianian who was recognized for his success as president of the Bank of the State of Indiana and his services as the first Comptroller of the Treasury in organizing the national banking system. He had had close contact with Jay Cooke and had been highly recommended to Lincoln by Chase and Fessenden. Jay Cooke continued as the Treasury's general agent. By the end of July Cooke and his agents had sold \$530 million of seven-thirties, and for once the Treasury was able to meet promptly all requisitions upon it.⁴⁶

On March 4 Lincoln delivered his Second Inaugural Address with its expression of hope for a speedy peace, but determination to continue the war until union and complete emancipation were achieved. His hopes were soon realized. Although Lee had supplanted Jefferson Davis as commander-in-chief of the Confederate armies on January 19, and the Confederate Congress authorized the desperate measure of the enlistment of slaves in the Confederate army with the promise of freedom after service, the Union armies won one success after another until Lee was forced to evacuate Richmond and Petersburg on April 2 and finally to surrender to Grant at Appomattox on April 9. The war was practically over, although the last Confederate surrender did not occur until May 4.

⁴⁶ Fessenden, *op. cit.*, 365ff.; Larson, *op. cit.*, 139, 166ff.; Hugh McCulloch, *Men and Measures of Half a Century* (New York, 1889), 190-209; Sandburg, *op. cit.*, 4: 107ff.; Mitchell, *op. cit.*, 126-31.



Financing the Confederate Cause

WHILE the North under Lincoln was fighting to preserve the Union, the eleven Confederate States of America under Jefferson Davis were waging what they considered their War for Southern Independence. The leaders of the Confederacy firmly believed they could win freedom from the domination of the North through military superiority, internal conflict within the North, control of the cotton, rice, tobacco, and naval stores needed by the North, and perhaps the aid of Great Britain and France. All these considerations had some basis in fact and might have resulted in the victory of the South and the division of the Union. But factors which the statesmen of the Confederacy did not foresee or did not think sufficiently weighty to turn the scales of victory upset their aspirations for an independent South. We cannot go into the tangled web of military, naval, and diplomatic history. The phase of Confederate history with which this chapter will deal is one usually slighted in accounts of the Lost Cause, but extremely important as an explanation for the failure of the South to win the war: the relation of the taxes, especially the income tax, to the problem of financing the South's tremendous war expenditures.

Economically, the South was at a disadvantage in comparison with the North because the Confederate wealth consisted chiefly of land and slaves, and its mining, manufacturing, and transportation facilities were little developed and inadequate for war needs. Although the total assessed property valuation of the eleven seceded states in 1860 was more than \$4 billion, the total banking capital was only \$61 million and the total currency only \$51 million. The South, moreover, had an aversion to direct taxation in both the economic and legal sense of the term and had resented paying annually to the federal government a sum estimated at \$50 million, only \$10 million of which were reputed to have been returned through federal expenditures. The one

form of federal taxation to which they were accustomed was the tariff on imports, and yet they were very zealous that the rates should be purely for revenue and not for protection to northern industries.¹

Six weeks after Lincoln's election as President, South Carolina seceded from the Union and was soon followed by six states from the Deep South. In February, 1861, delegates from these states met at Montgomery, Alabama, adopted a provisional Constitution, and established a provisional government with Jefferson Davis as President and Alexander H. Stephens as Vice-President. Later, the four states of the Upper South joined the Confederacy. A permanent Constitution and government were established that fall. The Confederate army with a brilliant staff of officers was organized and speedily won victories. Confederate diplomats began their negotiations for the recognition of the Confederate States as an independent nation and for a formal alliance with Great Britain and France.

Confederate Fiscal Policy

These activities, however, were not sufficient. A sound financial policy was also needed. Jefferson Davis had appointed as his Secretary of the Treasury Christopher Gustavus Memminger. He was an able, public-spirited lawyer from Charleston, a German by birth, who had been brought up in the family of Governor Thomas Bennett of South Carolina and had acquired a reputation as a champion of popular education and a legal expert on matters of banking and commerce. He had exhibited no special qualifications for the position of organizer and director of the Confederate finances and owed his appointment to the recommendation of Robert Barnwell, the favorite son of South Carolina. Although Memminger was better fitted for his post, in the opinion of some authorities, than Salmon P. Chase, Lincoln's Secretary of the Treasury, his achievements proved far less impressive and provoked much severe criticism and little praise. Nevertheless, it is doubtful whether any other southern statesman, except perhaps Judah P. Benjamin, known best for his work as Confederate Secretary of State, could have managed the Confederate finances in any very different or more successful manner.²

¹ Arthur C. Cole, *The Irrepressible Conflict*, 63, 262-303; James D. Richardson, Ed., *Messages and Papers of the Confederacy* (2 v., Nashville, 1906), 1:361; James L. Sellers, "The Economic Incidence of the Civil War in the South," *Mississippi Valley Historical Review* (September, 1927), 14:179-91.

² Henry D. Capers, *Life and Times of C. G. Memminger* (Richmond, 1893); Burton J. Hendrick, *Statesmen of the Lost Cause* (Boston, 1939), 3-11, 188-232; John C. Schwab, *The Confederate States of America* (New York, 1901), 1ff.

The fatal mistake of Memminger and the rest of the Davis administration was to depend upon loans as much as possible and upon taxes as little as possible for the Confederate revenue, especially during the first two years of the war. On February 28, 1861, the Confederate Congress issued \$15 million in bonds to secure for the government's use a large part of the available specie held by southern banks. A cotton export duty of one eighth of one cent a pound was also levied. The specie obtained was sent abroad for the purchase of military supplies. But Congress allowed some months to elapse before doing anything further about raising a tax revenue. Memminger, on May 10, 1861, proposed a direct tax of \$15 million, to be levied and collected by means of the established state tax machinery. He hoped to raise over \$13 million by October 1, but others thought such a direct tax too cumbersome and argued that the customs duties would suffice. Congress wanted to avoid a policy of taxation and was content to pledge the faith of the Confederacy to raise a sufficient revenue to meet the principal and interest of the loans it had authorized.³

The 1861 Direct War Tax

Three days after the first battle of Bull Run, Memminger urged Congress to raise \$25 million by taxing real estate, slaves, and personal property, including merchandise, bank and other corporate stock, and money at interest, at a uniform rate of fifty-four cents on each one hundred dollars. Their total assessed value he calculated at more than \$4,600 million, nearly half representing slaves, and nearly two fifths real estate. In response to this request Congress imposed a direct war tax of $\frac{1}{2}$ of 1 per cent on all property, except Confederate bonds and money on hand, through the Act of August 19, 1861.⁴ The collection of the tax was to be made by May 1, 1862, and the states were allowed, through an unfortunate provision, to anticipate the amount of taxes assessed upon their citizens by paying the sum minus a 10 per cent rebate into the Confederate Treasury at any time before April 1, 1862. The consequence was that delays in the assessment and collection of the tax prevented any revenue from the tax being received during the first fiscal year of the Confederacy. During 1862, however, \$16 $\frac{1}{2}$ million revenue was received, and more than \$4 million during the first nine months of 1863.

Less than one tenth of the \$20 million collected was actually a tax,

³ Schwab, *op. cit.*, 284-312.

⁴ James M. Matthews, Ed., *Stat. at Large of Provisional Government of the Confederate States of America* (Richmond, 1864), 177.

i. e., raised by forced contribution. All the states except South Carolina and Texas changed the tax into a loan in order to avoid putting a burden upon the people and to escape testing by heavy taxation at the outset of the war the popular devotion to the Confederate cause. Hence, the Provisional Congress actually passed no tax act apart from the misnamed war tax, and the Permanent Congress allowed a full year, during which it authorized numerous issues of bonds and notes, to elapse before it passed the first real tax act of the war. This "too late and too little policy" of taxation was to have disastrous results. The easy way out of financial difficulties through the issuing of paper money was adopted. Over \$30 million of Treasury notes were in active circulation by the end of 1861, and about \$450 million by December, 1862.

This situation impelled the Confederate Secretary of the Treasury to urge additional war taxes in March, 1862, and even more strongly in January, 1863. He pointed out that a substantial revenue from taxation was needed as a basis for loans in spite of popular opposition, and commented on the inadequacy of the form of war tax, with its delay and uncertainty in collection by the States. In his June 10, 1863, report Memminger proposed a tax on property and on the gross amount of incomes of every kind above a minimum to be set by Congress. He estimated that a tax of 1 per cent on property would yield about \$36 million and that a 10 per cent income tax would yield \$28 million. He also recommended that the income tax should be payable not only in money but in kind.⁵

The Comprehensive Tax Law of 1863

These suggestions were received with popular approval. Newspapers asserted that a strong popular demand for heavy taxation existed because of the widespread desire to contract the excessive currency and to reduce prices. Congress thereupon enacted a strict tax measure on April 24, 1863.⁶ This avoided the objectionable features of the former war tax and levied a great variety of taxes upon property, earnings, and occupations, to be assessed July 1 and collected on October 1, 1863, with certain exceptions. A property tax of 8 per cent was imposed on naval stores and agricultural products as well as on all kinds of money and currency on hand and on deposit. A 1 per cent

⁵ Capers, *op. cit.*, 436, 448-50; Schwab, *op. cit.*, 165; Seligman, *The Income Tax*, 482ff.

⁶ J. M. Matthews, Ed., *Public Laws of the Confederate States of America* (Richmond, 1862-64), 1st Cong., 3d Sess., 115; Schwab, *op. cit.*, 291ff.

tax was put on all credits on which interest had not been paid and which represented capital not employed in any business. A series of license taxes was placed on a large variety of occupations. They varied in rate from \$50 to \$500 and were supplemented in some cases by a percentage on sales or a tax on production.

A tax on earnings was payable every January 1. The rate was 1 per cent on salaries of \$1,500 and less; on salaries above that amount, the same, and 2 per cent of the excess. Salaries of less than \$1,000 as well as those in the military and naval service were exempt. Net income from sources other than salaries was taxed at a progressive rate: incomes of from \$500 to \$1,500, at 5 per cent; those from \$1,500 to \$3,000, at 5 per cent on \$1,500 and 10 per cent on the excess; those from \$3,000 to \$5,000, 10 per cent; those from \$5,000 to \$10,000, 12.5 per cent; and those of \$10,000 and above, 15 per cent. Incomes under \$500 were exempt. Net income was determined by certain deductions from the gross revenue from rents, manufacturing, mining, and other business enterprises, from the sale of merchandise, and from other occupations.

A tax in kind of one tenth of the agricultural produce during the year 1863 was also provided. This was to be delivered to the postquarter masters by the farmers not later than March 1, 1864. They were to distribute the food products directly to the army and the cotton to agents of the Treasury Department. The money proceeds of the other taxes were to go to the regular tax collectors. In addition to the personal income tax, all joint stock companies and corporations were required to "reserve one tenth of the annual earnings, set apart for dividends and reserve funds." Where this, however, amounted to more than 10 per cent and less than 20 per cent upon the capital stock paid in, the tax rate was 12.5 per cent; where the profits were more than 20 per cent the rate was 16 $\frac{2}{3}$ per cent. It was provided that the dividends so paid to the stockholder should not be considered a part of his income, when his return for the income tax proper was to be made out. A separate 10 per cent tax was also levied on the profits during 1863 from the sale of provisions and other food products, iron, shoes, blankets, and cotton cloth. This tax was aimed at the wholesale, not the retail, trade.

The Act was to be enforced till the end of 1865, except that the 10 per cent tax on profits and the 8 per cent tax on naval stores and agricultural products were levied only during 1863. Exemptions were granted to the property and income of charitable, religious, and educational institutions. The tax collection was delayed until the end of 1863; by October, 1864, over \$100 million in currency, or \$5 million in specie, had been raised. Some objection was raised to the constitutionality of the Con-

federate tax of April 24, 1863, on the ground that it did not apportion direct taxes as provided by the Constitution, but President Davis argued that these taxes need not be apportioned until the Confederate census was taken.

Discontent and Tax Revision in 1864

The main objection to the tax was centered on that part which taxed farm produce in kind. The farmers resented this type of tax because others could pay their income tax in Confederate money, which had now begun seriously to depreciate and could therefore be used as a means of lightening the tax burden. Numerous meetings of protest were held at various places, especially in North Carolina. The tax was denounced in the strongest terms as unjust, tyrannical, unconstitutional, anti-Republican, and oppressive. The farmers asserted that they were in favor of a just and equitable system of taxation, with an equal burden on all classes, and were willing to pay any reasonable tax in money, but not in produce.⁷

Heeding this discontent, the Commissioner of Taxes in his November, 1863, report advocated a great increase in the income tax rates: a tax of 25 per cent on incomes over \$5,000, 50 per cent on all over \$10,000, and 50 per cent on the profits of all joint stock companies and corporations over and above a given 25 per cent paid to their stockholders. He concluded with the statement: "While three fourths, perhaps, of the men of the Confederacy have dedicated their lives or fortunes, in many instances both, to their country's cause, the remaining fraction have no moral right to amass fortunes at their expense." In his report Secretary Memminger also laid stress on the necessity of raising more revenue.⁸ Congress responded to the popular agitation by making certain concessions to the farmers in acts passed on December 28, 1863, and January 30, 1864.⁹ Nevertheless, it re-enacted the tax in kind on February 17, 1864, in its general tax law, though with modifications in the stringency of its provisions.¹⁰ Liberal exemptions were provided, especially for soldiers' families and small farmers.

The general tax law of February 17, 1864, was passed in response to Secretary Memminger's request on December 7, 1863, for taxes that would raise \$100 million. The Act levied new taxes on property and made a sharp increase in the income tax proper. This tax was now in-

⁷ Schwab, *op. cit.*, 293-98.

⁸ *Report of the Commissioner of Taxes* (Richmond, 1863), 2; Capers, *op. cit.*, 466

⁹ *Public Laws of the Confederate States*, 1st Cong., 4th Sess., 171, 177.

¹⁰ *Ibid.*, 208.

creased by 10 per cent, thereby raising the maximum rate to 25 per cent. An additional 10 per cent tax was also imposed upon the profits from any business, and a 25 per cent tax upon the profits of any concern in excess of 25 per cent. The usual exemptions were allowed, particularly in the case of soldiers' families. The taxes were to be collected on June 1, 1864, or as soon after as practicable. On paper these taxes were extremely burdensome, but were added to on June 10 and 14, 1864, by a horizontal increase in rates of one fifth to apply to those levied in 1864—the proceeds to go first to meeting an increase in the soldiers' pay—and by an additional 30 per cent tax on sales made between February 17 and July 1, 1864. One concession to the taxpayers was the repeal of the 5 per cent tax on corporate stocks and the provision that corporations should be treated as individuals. Another was that the 5 per cent tax upon specie levied on February 17, 1864, could be paid in Treasury notes.

The imposition of these extremely high rates indicated the distress of the Confederate government. The currency had been inflated through the issue and circulation of at least \$700 million of Treasury notes by the fall of 1863. Gold dollars had risen in value until, in March, 1864, one gold dollar was worth twenty-three Confederate dollars. The Funding Act of February 17, 1864, had forcibly reduced the volume of Treasury notes by compelling holders of notes in amounts above \$500, under penalty of a heavy tax, to exchange their notes for twenty-year 4 per cent Confederate bonds. Notes for \$500 and less were to be exchangeable for new notes at the rate of \$300 in old for \$200 in new notes after July 1, 1864. The penalty at first for holding such old notes beyond the legal time limit was $33\frac{1}{3}$ per cent of the value of the note; on June 14, 1864, it was raised to 100 per cent. This law, and some military successes, improved the value of the Confederate dollar so that by June it was exchangeable for gold at the rate of 17 to 1. Nevertheless, Memminger so despaired of improving the Confederate revenue that he resigned his post as Secretary of the Treasury on June 14, 1864, two weeks before the retirement of his Union rival, Salmon P. Chase. Memminger was succeeded by George A. Trenholm, a member of the important firm of Fraser, Trenholm, and Company of Charleston, South Carolina, and reputed to be one of the best financiers in the South.¹¹

The new Secretary renewed the recommendations of Memminger and proposed increases in the cotton export duty and in the import

¹¹ Capers, *op. cit.*, 365-69; Schwab, *op. cit.*, 165-73, 300ff.

duties as well as in the taxes on property and earnings.¹² The tide of victory by November and December, 1864, was flowing definitely in the direction of the Union cause. But Congress, after debating the dilemma of further note issues versus heavy taxation, chose the latter and enacted on March 11, 1865, a tax measure which imposed extreme rates upon the objects covered by previous tax laws.¹³ The taxes on incomes and salaries were continued at the previous rates, but profits from sales during 1865 were taxed 10 per cent in addition to the tax upon profits as income. Profits in excess of 25 per cent were taxed 25 per cent. The tax in kind was continued and could not be set off against the money tax on agricultural property. These and the other drastic provisions were supplemented by an act on March 18, 1865, levying a 25 per cent tax, payable in kind on April 1, 1865, upon all coin, bullion, and foreign exchange, provided the specie loan of the same date failed.

The Collapse of the Confederacy

But these final revenue measures came too late. By December, 1864, the will to fight of most of the southerners had gone. Desertion from the Confederate army between December, 1864, and April, 1865, was so serious that the Confederate Congress on March 13, 1865, enacted a law authorizing the employment in military services of as many as 300,000 slaves. Robert E. Lee also favored a plan for the gradual emancipation of the Negro. The war which had begun to extend slavery into the trans-Mississippi West ended with the Confederate leaders willing to give up slavery if they could preserve southern independence. Last-minute efforts to rally the southern forces failed to halt the steady advances the Union armies had been making from September, 1864, on under Grant, Sherman, and Sheridan. Lee surrendered to Grant at Appomattox on April 9, 1865, and the long-drawn-out agony of civil war soon came to an end.¹⁴

Fiscal Causes

The causes of the collapse of the Confederacy are numerous, but the mistakes in public finance were more momentous and deserve more

¹² *Treasury Reports*, November 7, December 15, 1864; January 9, 1865; Schwab, *op. cit.*, 301.

¹³ Charles W. Ramsdell, Ed., *Laws and Joint Resolutions of the Last Session of the Confederate Congress* (Durham, N.C., 1941), 101-07.

¹⁴ Charles H. Wesley, *The Collapse of the Confederacy* (Washington, D.C., 1937), 134.

attention than usually granted them. In the first place, the Confederate Congress erred in allowing the state governments to collect the direct war tax of August, 1861. Secondly, no general tax act was passed until April, 1863, a fatal delay, since meanwhile the almost exclusive reliance on loans and the issuance of Treasury notes had depreciated the Confederate credit. Thirdly, the Confederate embargo on cotton in 1861 cut off a supply of money and credit in Europe which possibly would have turned the scales of war in favor of the Confederacy.

At the first Cabinet meeting called by Jefferson Davis, Judah P. Benjamin, then Attorney-General, proposed that the government should purchase at least 100,000 bales of cotton and ship them at once to England. With the proceeds he suggested the immediate purchase of at least 150,000 stands of arms, a corresponding amount of guns and munitions, and the establishment of a credit fund. The rest of the Cabinet ridiculed the proposal because they did not believe a prolonged war would ensue and because the Confederate statesmen believed that by not exporting cotton either that year or the next the South could force Great Britain and France to recognize the Confederacy as an independent power, and perhaps even become its allies. This failure to foresee the future weakened the financial structure of the Confederacy at the very time that it needed strengthening and enabled the North to create a blockade which became increasingly effective from 1862 and especially 1863 on. By selling their cotton to the Confederate government, the planters who had little cash capital could have obtained Treasury notes which would have been backed by the specie obtained in Europe.

Another grave error was the Erlanger loan of 1863. The noted banking firm of Erlanger and Company misled the Confederate Secretary of the Treasury and his European agents into believing that they would successfully float a \$15 million Confederate cotton loan in return for a handsome commission. Actually the French bankers so manipulated the market and the Confederate agents that the Confederate Treasury obtained only about \$2,500,000 from a bond issue for which it had pledged payment to the extent of \$15 million in capital and 7 per cent in interest, while the bankers gained about \$2,700,000 for themselves. Here again Memminger and his associates proved their inability to safeguard the Confederate Treasury from losses and drains.¹⁵

Other factors contributing to the downfall of the Confederacy arose

¹⁵ Hendrick, *op. cit.*, 194-232; Frank L. Owsley, *King Cotton Diplomacy* (Chicago, 1931), 416ff.; Schwab, *op. cit.*, 301ff.; Samuel B. Thompson, *Confederate Purchasing Operations Abroad* (Chapel Hill, 1935), 48-75.

from the unsound financial policy followed by the Davis administration. From the failure to tax promptly and heavily came an inflated currency with a corresponding rise in prices. This resulted in stimulating business in the second year of the war and in wild speculation from then on. While some became rich by investing their Treasury notes in commodities and selling these at an advance, the salaried and wage-earning classes suffered severely. Their wages and salaries responded slowly and imperfectly to the currency inflation, and whatever nominal rises they gained were far outstripped by the increases in the price of commodities. Administrative inefficiency and corruption also demoralized the masses, who saw speculators, blockade runners, contractors, and certain high government circles living extravagantly and gaily on what seemed to be ill-gotten gains. The conscription laws of 1862, through their liberal exemptions for the wealthy slaveowner, had made the poor whites and nonslaveholders, who constituted three fourths of the Confederate army, feel that this was "a rich man's war and a poor man's fight." This feeling of class hatred was intensified by rumors that rich exempts at home were "grinding the faces of the poor with their extortions and their speculations." Some, if not all, of this economic disorganization could have been avoided by a wiser and more courageous revenue system.¹⁶

The economic conditions following southern defeat reveal among other things the full extent of Confederate financial mismanagement. The South had lost by April, 1865, nearly a sixth of the wealth it had in 1860, the equivalent of over half a billion gold dollars, not counting the loss of property. The emancipation of the slaves accounted for a loss of over \$1,500 million. The personal property that remained by 1865 was only one fourth of that of 1860. The decrease in the amount of actual property due to war consumption, destruction, and decay resulted in a decreased productivity, absolute at first and relative to the nation later on, which handicapped southern agricultural and industrial development. Moreover, although the Confederate public debt was repudiated by the federal government and the investment in the debt by native southerners as well as foreigners was thereby completely lost, the defeated southerners had to assume their proportionate share of the federal war debt. This, when increased by the pensions to veterans of the Union army, totaled fully \$1 billion. The per capita costs of the war eventually fell three times as heavily upon the conquered southerners as upon the victorious North. If one sympathizes with the Con-

¹⁶ Cole, *op. cit.*, 293-407; Randall, *Civil War and Reconstruction*, 665-88; Schwab, *op. cit.*, 165-85, 229-66; Wesley, *op. cit.*, 74ff.

federate cause, then he will regard part of this as due to the fiscal blunders of the Confederate statesmen. If one does not sympathize with the cause, one may rejoice at the failure of secession and yet realize how more skilled financial statesmanship might have succeeded in its objectives.¹⁷

¹⁷ James L. Sellers, "An Interpretation of Civil War Finance," *American Historical Review* (January, 1925), 30: 282-97, and "The Economic Incidence of the Civil War in the South," *Mississippi Valley Historical Review* (September, 1927), 14: 179-91.



Tax Conflict in the Reconstruction Era

THE conflict between North and South which formally ended in April and May, 1865, with the surrender of Lee and the other Confederate generals actually continued from that time until the spring of 1877. The significance of the Civil War can be understood only in the light of the consequences of the northern victory. Those consequences have been appraised from many different points of view. To champions of the antebellum southern planting aristocracy, the period between 1865 and 1877 was an even more tragic era than that of the war. To realistic students of power politics the so-called Reconstruction period has primary importance when seen as the Second American Revolution—the displacement of the southern aristocracy by northern capitalists supported by free farmers as the dominant class in the national political and economic system.¹

The financial history of the United States after the Civil War has to be placed against a background of intense struggle within Congress—between the more conservative Republicans and Democrats, and the Radical Republicans desiring a drastic reconstruction of the South which would ensure them the political support of the southern Negro, and the dominance of northern capitalism and the Republican party. The war had cost the North and South about \$5 billion. The expenditure for three years of reconstruction was estimated at \$3 billion more. From an economic standpoint, the property destroyed in the struggle, the pensions paid to surviving soldiers or relatives of the deceased, and the losses resulting from the diversion of capital and energy from peacetime pursuits were also part of the price paid to preserve the Union. The loss in human capital cannot be realized from the arithmetical statement that some 600,000 soldiers lost their

¹ Cf. Howard K. Beale, "On Rewriting Reconstruction History," *American Historical Review* (July, 1940), 45: 307-27.

lives. In any case, the cost of the conflict in money terms alone far outbalanced the money value of the slaves.²

The War Debt and Demands for Tax Reduction

Although the demands on the national Treasury began to decline once peace was declared, there was an enormous public debt of over \$2,300 million on March 31, 1865, besides the money required to pay interest on the debt and to provide a sinking fund to pay the principal when it fell due. Moreover, the Treasury still had to meet many extraordinary demands arising from the war and the problems of reconstruction. But a conflict speedily arose between different social groups as to the need for and desirability of reducing or abolishing the war taxes, especially the income tax. The *New York Times* had complained on August 13 that the "sting of taxation is wastefulness" and the next day urged Congress to settle such great questions as the reduction of the federal income tax and the proportion which direct should bear to indirect taxation. The *Nation* shortly afterward commented on the lack of an immediate demand for the repeal of the income tax, but stated its opposition to an extended continuation of the income tax.³ Merchants and importers wanted the war-fostered protective tariff abolished and the federal income tax retained. In their opinion, "No tax is collected so economically as this, and with so little injury to the taxpayer."⁴ On the other hand, bankers joined the manufacturers, with their newly gained tariff privileges, in exerting pressure against the retention of the income tax. One line of argument which their spokesmen later came to rely on greatly was first expounded in America by Goldwin Smith, the Anglo-American historian, early in 1866. Following John Stuart Mill, he singled out among the evils of the income tax the "socialistic tendency" in "a tax imposed expressly on the rich, and capable of indefinite expansion and class graduation." This trend was checked—fortunately, in his eyes—by the absence of any sharp class division in the United States and by the political control exercised in England by the income tax payers.⁵

When Secretary McCulloch reported to Congress in December, 1865, he estimated that at the close of the fiscal year ending June, 1866, the national debt would amount to about \$3 billion and the

² Beard, *Rise of American Civilization*, 2: 98ff.; Edward Channing, *A History of the United States*, 6: 446.

³ *Nation* (September 7, 1865), 1: 297-98.

⁴ *Merchants' Magazine* (November, 1866), 45: 373.

⁵ *Bankers' Magazine* (May, 1866), 20: 871.

Treasury would have a deficiency of over \$112 million. By April, 1866, it became evident that McCulloch had underestimated the receipts and overestimated the expenditures. The House Ways and Means Committee thereupon introduced a bill to lower some of the internal taxes so as to cut down the federal income \$75 million and relieve the taxpayers to that extent.⁶

Justin S. Morrill, as spokesman for the Committee, urged the necessity of reducing the burdens of taxpayers and lowering the cost of living as far as possible. Although he did not advocate the abolition of the income tax, he proposed that the weight of the income tax be lessened by removing the graduated feature of the Act of June 30, 1864, and by making the income tax after 1866 a uniform tax of 5 per cent on income over \$1,000. His main argument against the graduated income tax was that "in a republican form of government the true theory is to make no distinctions as to persons in the rates of taxation. Recognizing no class for special favors, we ought not to create a class for special burdens."⁷ This went counter to the majority sentiment in the House and the opinion expressed by President Andrew Johnson that "the taxes should be so distributed as not to fall unduly on the poor, but rather on the accumulated wealth of the country."⁸

The House majority felt that the poorer classes bore many small but burdensome taxes which ought to be reduced or removed before the more wealthy classes received relief. Frederick A. Pike of Maine vigorously attacked Morrill's position and proposed to amend the Committee's income tax measure by a tax of 5 per cent on income over \$1,000 up to \$5,000, and of 10 per cent on income over \$5,000. This suggestion was soon exceeded by that of Lewis W. Ross of Illinois, criticizing Pike for not going far enough and moving for a tax of 5 per cent on income over \$1,000, 10 per cent on income over \$5,000, 15 per cent on income over \$20,000, 20 per cent on income over \$40,000, and 25 per cent on income over \$60,000. Morrill objected violently to this proposal and said that in this country we "should not tolerate anything else than entire equality in our taxation." The principle of progressive taxation, he asserted, "can only be defended on the same ground the highwayman defends his acts."⁹ But he received little support from the rest of the House. Several other Congressmen made suggestions, but the principal amendment approved by

⁶ *Treasury Report* (1865), 20-22; *Cong. Globe*, 39th Cong., 1st Sess., 2435.

⁷ *Cong. Globe*, 2437.

⁸ Richardson, *Messengers and Papers of the Presidents*, 6: 366.

⁹ *Cong. Globe*, 39th Cong., 1st Sess., 2783.

the House was Pike's.¹⁰ An interesting proposal which was lost came from Sydenham E. Ancona of Pennsylvania. It would have limited the tax on all incomes derived from labor and fixed salaries to 3 per cent. Another amendment which failed, proposed by John A. Nicholson of Delaware, would have exempted the income of persons deriving their income from dividends and interest when their annual income from all sources was below \$1,000.¹¹

The Tax Revision of July, 1866

When the House measure was presented to the Senate by the Senate Finance Committee, it recommended that because of lack of time to deal with the many changes proposed by the House of Representatives it was better for Congress at that session to let the income tax stand as it was, except for one minor amendment. The Senate and the House concurred in this. The most important of the minor changes was that the tax was made to apply to the "income of every business, trade, or profession carried on in the United States by persons residing without the United States, not citizens thereof." The previous taxes had reached only citizens and persons residing in the United States. Another modification was the application of the 10 per cent rate on incomes above \$5,000 to salaries of officers of the federal government, which had been previously exempt.¹² The scale of the salaries taxed was also altered so as to conform to that of the income tax proper, and was made 5 per cent on the excess over \$600 and 10 per cent on that over \$5,000. Finally, the income tax was now declared payable every year "until and including the year 1870 and no longer."

The Victory of the Radical Republicans

After Congress adjourned, a vigorous struggle took place between President Johnson and the Radical Republicans over the issue of the reconstruction of the South. The Radical Republicans won a decisive victory in the Congressional elections of the fall of 1866, obtaining more than a two-thirds majority in both houses. The tariff, taxes, government finance, and the exploitation of western lands were factors which the big business supporters of the Republican party kept clearly in mind. They feared losing their control at Washington through a

¹⁰ *Ibid.*, 2786.

¹¹ *Ibid.*

¹² *Ibid.*, 3321ff., 3607-11, 3650, 3785; Act of July 13, 1866, 14 *U.S. Stat. at Large*, 138ff.

new union of southern planters and western farmers against their favors to large corporations, excessive grants of land to railroads, high tariff rates, and contraction of the currency. By skillful use of an appeal to such noneconomic issues as the preservation of the Union and the necessity for protecting the Negro against enslavement, the Republican party was able to win the votes of the nonindustrial sections of the population. The economic interests of the industrialists and their allies determined their support.¹³

In November, 1866, Edward A. Rollins, the Commissioner of Internal Revenue, reported to Congress on the administration of the income tax and for the first time gave the number of taxpayers and the amount of revenue in each class of the progressive tax. He then recommended that the amount of exemption be raised from \$600 to \$1,000 because the internal tax on commodities, the increase of custom duties, and the depreciation of the currency had brought an almost universal advance in prices.¹⁴ On February 13, 1867, Justin S. Morrill presented the House Ways and Means Committee's bill on internal revenue. He again stressed the necessity of lowering taxes and proposed a flat tax of 5 per cent on income over \$1,000. He estimated this would reduce the revenue of the government by more than \$36 million. The bill also eliminated the progressive taxation principle, at a time when the public debt was about \$2,250 million.

Several Representatives voiced strong opposition to the plan put forward by Morrill. Jehu Baker of Illinois proposed a tax of 5 per cent on income over \$1,000 and of 10 per cent on income over \$6,000 on the ground that such a graduated scale fitted in with the ability-to-pay principle better than the uniform or proportional tax of Morrill's. Ralph Hill of Indiana suggested a progressive tax of 3 per cent on income over \$1,000, of 5 per cent on income over \$5,000, and of 10 per cent on \$10,000. But none of these amendments received the approval of the House. James A. Garfield, who had been a vigorous champion of the income tax in 1865, completely reversed himself by attacking bitterly the progressive income tax as unethical, unsocial, and unconstitutional because it discriminated between rich and poor. He evidently expressed a trend of conservative feeling which had rapidly developed after the war, and which was to lead him to the presidency in 1880.¹⁵

¹³ Howard K. Beale, "The Tariff and Reconstruction," *American Historical Review* (January, 1930), 35: 276-94.

¹⁴ *Treasury Report* (1866), 47, 64.

¹⁵ *Cong. Globe*, 39th Cong., 2d Sess., 1216-20, 1482-83.

The Senate also experienced a transformation in mood, and in less than three days accepted the House measure, with its abandonment of the progressive income tax. The one amendment of importance by the Senate Finance Committee was that the rent of a homestead, whether occupied by a man in his own right or in the right of his wife, was to be excepted from the amount of taxable income. The lack of debate and the speed with which the Senate disposed of the entire internal revenue bill would be incomprehensible unless one realized that on March 2, 1867, the day on which the new internal revenue bill became law, several other bills of revolutionary importance were enacted.¹⁶

Income Tax Reduction of March, 1867

The income tax of March 2, 1867, remained in force until 1870. It imposed a tax of 5 per cent on all income over \$1,000. It redefined the concept of taxable income so as to include the profits realized from the sale of real estate purchased within the year or two years previous, as well as the amount of all premiums on gold and coupons from whatever source. Deductions were allowed for all losses actually sustained during the year, but no allowance was to be made for any estimated depreciation of values and losses within the year on sales of real estate purchased two years previous. The farmer was now required to report only the income realized from the sales of livestock and not that from the increased value of livestock, whether sold or unsold. The administration of the law was changed in some respects. The penalty for refusing to make an income tax return was raised from 25 per cent to 50 per cent of the tax due, but the penalty for failure to pay the tax when due was lowered from 10 per cent to 5 per cent of the tax due.¹⁷

Failure of Tariff Reform in 1867

With the reduction in the income tax and other internal taxes, a reduction of import duties should have taken place since the increases in the tariff rates had been put on in order to counterbalance the weight of the internal taxes on the domestic producers. The great rise in prices and in money wages during the Civil War, however, had created a demand for import duties even higher than those of the 1864 tariff,

¹⁶ *Ibid.*, 1844, 1846, 1913-17, 1949ff., 1968, 1979, 1997; Act of March 2, 1867, 14 *U.S. Stat. at Large*, 478.

¹⁷ *Ibid.*, 478-80. The date for assessment was changed from May 1 to March 1, and the last day for payment was shifted from June 30 to April 30.

and in 1866 Justin S. Morrill had guided through the House a bill framed to meet this demand of the manufacturers. But the growing opposition to the protective tariff among the farmers and consumers led the Senate to amend the protectionist House bill by making reductions suggested by David A. Wells, Special Commissioner of the Revenue. He had proposed that the duties on such raw materials as scrap iron, coal, lumber, hemp, and flax be reduced and that the duties on most manufactured articles should either be maintained or slightly lowered. Unfortunately, although a majority of the House was in favor of Wells's measure, the two-thirds majority required to suspend the rules and bring it before the House could not be obtained when a vote was taken on the question on February 28, 1867, just four days before final adjournment. Hence the bill was dropped, and the cause of tariff reform received a great setback. Had the tariff reform bill of 1867 been passed, the protectionist forces might not have become entrenched, high tariff protection might not have become a permanent system, and a beginning would have been made in the direction of tariff reforms and reductions. But not only was no breach made in the protective tariff wall; two acts were soon passed which actually strengthened it. The first was the Woolens Act of March 2, 1867. The second was the Copper Act of 1869.¹⁸ Not until the Tariff Act of 1883 was passed was there a general tariff reform bill which had as good a chance of being passed as that of 1867.

Meanwhile the fierce clash between Andrew Johnson and the Radical Republicans over southern reconstruction had been growing in intensity. On December 4, 1865, the Radical Republicans had captured control of Congress and had refused to admit the southern Congressmen until its Joint Committee on Reconstruction had decided the terms of admission. This meant that Congress disputed the right of the President to put through his own milder plan of reconstruction. It also meant that the exclusion of the southern Congressmen gave the Republicans the opportunity to preserve and extend measures calculated to further the interests of the industrialists and financiers. On December 18 the Thirteenth Amendment formally abolishing slavery went into operation. On Washington's birthday, February 22, 1866, Johnson committed the blunder of indicating the profound breach between Congress and himself in a manner which

¹⁸ Ashley, *Modern Tariff History*, 182-87; Stanwood, *American Tariff Controversies*, 2: 150-58; Taussig, *Tariff History*, 171-78. For a good comparative study of the tariff at this time see L. C. A. Knowles, *Economic Development in the Nineteenth Century* (London, 1932), 3-32, 239-336.

enabled the Radical Republicans to vilify him. Congress then passed, on April 9, a civil rights bill which conferred upon all persons born in the United States the same civil rights and obligations that white citizens had. To make sure that this Act would not be nullified in the future, Congress passed on June 13, 1866, the Fourteenth Amendment, which practically included the civil rights bill and presented the Congressional policy of reconstruction. Ratification was completed on July 28, 1868.

Significance of the Fourteenth Amendment

This Amendment has become famous not only for its guaranty of citizenship, national and state, to all persons born or naturalized in the United States, but also for its interdiction of any state law abridging the privileges or immunities of citizens of the United States or depriving any person of life, liberty, or property without due process of law. Nor could a state deny to any person within its jurisdiction the equal protection of its laws. These clauses of Section I later became potent instruments for defending the privileges and activities of great corporations.¹⁹ Section II reduced the Congressional representation of those states which denied the right to vote at any election for national or state officials to any adult male citizen. This was intended to ensure the right of the Negro in the South to vote so that his vote would help maintain the Republican party in power and prevent the southern whites opposed to emancipation from rising to power and gaining increased representation in Congress. The Radical Republicans were in deadly fear of the Democratic party returning to power in national affairs and undoing the work in behalf of the Negro and the northern capitalists which the Republicans had been able to put through during the Civil War owing to the absence of the southern Democrats and the disappearance of the Democratic majority which otherwise would have prevailed. Section III of the amendment disfranchised from holding national or state office those participants in the Confederate War who had previously held such an office and sworn

¹⁹ For new light on the significance of the Fourteenth Amendment see Louis B. Boudin, "Truth and Fiction about the Fourteenth Amendment," *New York University Law Quarterly Review*, 16: 19-82; Howard Jay Graham, "The 'Conspiracy Theory' of the Fourteenth Amendment," *Yale Law Journal*, 47: 371-403; 48: 171-94; A. C. McLaughlin, "The Court, the Corporation, and Conkling," *American Historical Review*, 46: 45-63. For the text and a brief but pointed and up-to-date exposition of the Fourteenth Amendment, see Edward S. Corwin, *The Constitution and What It Means Today* (Princeton, 1937), 143-56.

to uphold the Constitution. This was designed to deprive the South of the leadership the planter aristocracy had formerly provided. If these clauses had not been nullified in effect by the North after the early eighteen-seventies, they would have had far-reaching tax consequences.

From the point of view of one interested in public finance, Section IV of the Amendment has implications as fascinating to explore as the much more famous sections. It affirmed that the "validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned." This was an extraordinary statement to be put in as an amendment to the Constitution at that late date, but can be explained in the light of the extraordinary and seemingly very dangerous increase in the public debt during the Civil War. The gross public debt had grown from \$28,700,000 in 1857 to \$2,750 million in 1866. The corresponding per capita debt was \$1.01 in 1857 and \$77.69 in 1866. The public debt had been multiplied seventy-eight fold within nine years, the most amazing increase in the public debt in the history of the nation up to that time and since.²⁰

The other provision in Section IV declared that "neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void." This precluded the federal government and the southern states ever from paying the huge Confederate and southern state debt and the interest on it incurred in waging the War for Southern Independence. The result was that the great majority of southerners, as well as foreign Confederate sympathizers, who had invested their liquid capital in Confederate bonds lost that capital and were handicapped in their efforts to make a new start once peace was declared.²¹ Moreover, this constitutional provision prevented any compensation to the southern slave-owners for the millions they had invested in their slaves, and may rightly be regarded as a capital conscription by a revolutionary government.

²⁰ *Treasury Report*, 1939, 450-51; Henry C. Adams, *Public Debts* (New York, 1893), 5, 13ff., 44ff.; Dewey, *Financial History*, 308-12, 332, 341, 552.

²¹ Bessie C. Randolph, "Foreign Bondholders and the Repudiated Debts of the Southern States," *American Journal of International Law* (1931), 25:63-82; Paul Studenski, "Repudiation of Public Debts," *Encyclopedia of the Social Sciences*, 13:321-24; John C. Schwab, *Confederate States of America*, 71-83, 284-312.

On March 2, 1867, the day on which the first reduction in the income tax was enacted, Congress passed two acts directed against President Johnson and the conservative South. The Tenure of Office Act limited the power of the President in the removal of Cabinet officers by making it subject to the consent of the Senate. The Reconstruction Act put the ten unreconstructed Confederate states under military rule, provided for the organization of state government under federal supervision, and denied the Confederate states representation in Congress until they ratified the Fourteenth Amendment. A year later President Johnson was impeached by the House of Representatives on the charge of removing Edwin M. Stanton, the Secretary of War, contrary to the Tenure of Office Act. The Senate, however, acquitted Johnson by a narrow margin. Although the Radical Republicans had failed to sweep away all obstacles to their plan for the reconstruction of the South, they succeeded in electing in November, 1868, a presidential candidate who was responsive to their wishes: Ulysses S. Grant. Grant owed his plurality of 370,000 votes over his Democratic opponent, Horatio Seymour, to several factors: his popular appeal as a military hero, the control of the South by the Radical Republicans, Negro suffrage, and effective party organization. The Democrats erred in the nomination of a candidate known for his opposition to the Union cause, in their too strong denunciation of the Republican plan for southern reconstruction, and in their internal conflicts on financial and other matters. The financial supporters of both the Democratic and Republican parties contributed generously to the campaign chests, but the Republicans seemed to have outdone the Democratic bondholders and capitalists, who were led by Samuel J. Tilden. Henry Cooke, the younger brother of Jay Cooke, and William E. Chandler, the Secretary of the National Republican Committee, induced many bankers, manufacturers, and corporations to finance the Republicans very generously. They were thus able to purchase Democratic newspapers and bribe Washington correspondents to present their political propaganda. An effective argument offered by the Republicans to bondholders was that once the "rebocracy" were in power the national debt would be repudiated. As one banker put it, capitalists and holders of government securities felt safe so long as the dominant party professed readiness to uphold the national credit and refrained from taxing bonds which had been up to that time tax exempt.²²

²² Charles H. Coleman, *The Election of 1868* (New York, 1933), *passim*; William B. Hesseltine, *Ulysses S. Grant* (New York, 1935), 112-31.

The Grant Administration

The abolishment of the income tax occurred during the first administration of Grant. To understand that event properly one must understand clearly the general character of the Grant administration and period. Grant was a folk hero, the great military figure of the North, distinguished by his aggressiveness, persistence, and masterly strategy. To sophisticated observers like Henry Adams, Grant seemed the man of action, sprung from the soil to power, distrustful of himself and others, shy, jealous, sometimes vindictive, dull in outward appearance, with conflict the keenest stimulant. He appeared archaic in his un-intellectuality, his brute power—a defiance of the law of evolution. He wanted to be President of all the people. He lacked, however, the vision and knowledge of the statesman on most of the important foreign and domestic issues. He was also a poor judge of candidates for civil office. His military virtues, decisiveness and obstinacy, were political vices. His loyalty to friends made him the dupe of unscrupulous and corrupt politicians. His admiration for the successful businessman, which sprang from seven years of bitter failure and hardship in private life before the outbreak of the Civil War, led him to become the ally of the most reactionary economic interests of his day, an opponent of radical social reform except on the Negro question, and a champion of imperialism, miscalled Manifest Destiny. The result was a tragic era of political corruption, of triumphant spoilsmen, of growing discontent among the masses on economic and social matters. Grant was a prime example of Bertrand Russell's remark about the harm that some good men (in the conventional sense) do: they never suspect their friends of shady actions and are never suspected by the public of using their reputations for virtue to screen villains.²³

The Campaign Against the Income and Inheritance Taxes

As the Civil War faded into memory, business interests gradually gathered strength to oppose the income and inheritance taxes which had received such strong support from the people when the Union was at stake. When there seemed to be a possibility that these taxes might be retained after the time set for them to expire in 1870, various newspapers began to discuss the matter. The New York

²³ Hesselstine, *op. cit.*, *passim*; Allan Nevins, *Hamilton Fish: The Inner History of the Grant Administration* (New York, 1936), 105ff.; Sidney Ratner, "Review of Hesselstine's Grant," *Political Science Quarterly* (June, 1937), 52:307-09.

Tribune expressed determined opposition to the tax on February 5, 1869, and said: "The Income Tax is the most odious, vexatious, inquisitorial, and unequal of all our taxes." It "is a tax on honesty, and just the reverse of Protective. It tends to tax the quality out of existence." On December 10, 1869, it declared: "We do not believe there is a tax levied by the Government so onerous upon so large a class a people as the Income Tax." On June 1, 1870, it said: "If members of Congress do not know that the most offensive tax upon the list is that levied upon Incomes, they may easily learn that fact by inquiry of their constituents." The *Commercial and Financial Chronicle*, on April 16, 1870, criticized the income tax as collected as unjust and oppressive but wrote that if Congress should amend the law so as to make it operate more justly, the most serious objection to the tax would be removed.²⁴ The *New York Times* at first upheld and then opposed the tax. On November 19, 1869, the *Times* stated: "The Income Tax was never popular with persons having large incomes," but "In our opinion a tax on incomes more nearly approximates to a just tax than any other yet devised." On April 9, 1870, however, it asserted that the income tax had recently become exceedingly unpopular because of unwise administration. Yet on June 4 the *Times* asked for the "continuance of the tax, in a modified form, as one of the most equitable, and withal least burdensome, forms of revenue." This stand the *Times* finally reversed on January 19, 1871, when it declared: "The income tax has been unpopular from the moment of its enactment," and "Let Congress redeem the session from utter barrenness by averting the vexation and unpopularity which will inevitably arise from the continued infliction of the impost."

The *Nation* criticized the opposition to the income tax as largely political, and said on November 25, 1869: "Not that political feeling is opposed to the tax, but that it is rapidly becoming an object of determined hostility to a large number of politicians. . . . We hear no complaint of it from anybody, except from the advocates of some other mode of raising the same amount of money. . . . In fact, we do not know where to look either for any real sign of special popular hostility to it, or for any special reason for popular hostility to it."²⁵ The explanation for the political attacks on the income tax was to be found in the pressure politics of different banking and manufacturing groups. They organized an "Anti-Income Tax Association" in New York City and in Philadelphia. They sent representatives to present

²⁴ Smith, *op. cit.*, 78-79.

²⁵ The *Nation*, 9: 452 (November 25, 1869).

their cause before Congressional committees and not only opposed the renewal of the income tax law but demanded that it be immediately abolished. They engaged in a systematic propaganda campaign and circulated prepared petitions and editorials for the press.²⁶

Ironically enough, these attacks upon the income tax were aided by the improvement in the government credit through the vigorous efforts of Secretary McCulloch under Johnson and Secretary George S. Boutwell under Grant to reduce the public debt and to improve the status of the currency. The total gross debt was reduced from \$2,755 million in 1866 to \$2,430 million in 1870, and the per capita debt was lowered from \$77 in 1866 to \$63 in 1870.²⁷ Moreover, David A. Wells, the Special Commissioner of Revenue, recommended in 1868 that the income tax be made more stringent by allowing exemptions only for incomes not over \$1,500 or \$2,000 and by not permitting any deductions for rent. The next year Wells recommended that the income tax be retained, but with the rate lowered from 5 per cent to 3 per cent, to remove an incentive to tax evasion. Two hundred dollars was to be the limit allowed for house rent. He also pointed out that since only 250,000 persons out of a total population of 39,500,000 paid the tax, the great majority of the people were interested in having the tax maintained.²⁸ They were supported in this position by Francis A. Walker, son of the economist Amasa Walker and chief of the Bureau of Statistics at Washington. In an article on "What to Do with the Surplus" in the *Atlantic Monthly* for January, 1870, Francis Walker defended the income tax law and argued that a highly graduated tax operated for greater justice. Moreover, Columbus Delano, the Commissioner of Internal Revenue, stated in his 1869 report that "so long as a large internal revenue is required by the financial necessities of the government, a portion of that revenue should be collected from incomes."²⁹ Early in 1870 the House Ways and Means Committee introduced a tariff bill in response to pressure from Republicans and Democrats, especially in the West, for reduction of the excessively high tariff rates. Actually the reductions made were almost without exception on purely revenue articles, except for the duty on pig iron, and a significant increase of duties was made on such

²⁶ Elmer Ellis, "Public Opinion and the Income Tax," *op. cit.*, 225-42.

²⁷ George S. Boutwell, *Reminiscences of Sixty Years in Public Affairs*, 2: 125-236; Hugh McCulloch, *Men and Measures of Half a Century* (New York, 1889), 181-257.

²⁸ *Report of the Special Commissioner of Revenue* (1867), 38ff.; *ibid.* (1869), LXIX. The *New York Times* for December 14, 1869, questioned the wisdom of reducing the income tax from 5 to 3 per cent and asked what alternative imposts there were.

²⁹ *Treasury Report* (1869), 14.

important protected articles as steel rails, marble, and nickel.³⁰ To satisfy the pressure for reduction in taxes, which the proposed tariff bill pretended to give in part, the Ways and Means Committee also introduced, on May 16, a bill to reduce some and entirely remove others of the internal taxes. They hoped to repeal over \$33 million of taxes. They proposed to maintain the income tax at the 5 per cent rate, but to increase the exemption to \$1,500 and thus to lower the revenue and spare the taxpayer about \$5,750,000.³¹

Some members of the House felt that the internal revenues could be reduced even more than the committee had estimated, and that in addition to the other proposed reductions the entire income tax could be dropped. The strongest enemies of the tax were Dennis McCarthy of New York, Benjamin F. Butler of Massachusetts, and William D. Kelley of Pennsylvania. McCarthy asserted that the revenues could be reduced by \$70 million to \$75 million without depreciating the government credit, and that eliminating the income tax would reduce the revenue about \$35 million more than the Committee's original estimate. He called the income tax a war tax which should be allowed to die since it was "unequal, perjury-provoking and crime-encouraging, because it is at war with the right of a person to keep private and regulate his business affairs and financial matters." Kelley, known as "Pig-iron Kelley" because of his devotion to the iron industry of Pennsylvania in all tariff controversies, wanted to retain a high protective tariff and therefore strenuously urged the repeal of the income tax. He thought that the government might safely lose \$100 million in revenue and criticized the income tax as inquisitorial. Benjamin F. Butler was a politician with a reputation for ingenuity, nerve, and audacity, a careerist who played the role of "the Man of the People and the Man Who Knows How." He denounced the income tax as "the most irritating, provocative of opposition, and imperfect of all taxes" because "it mistakes earnings for income. It treats as income the products of honest labor, whether mental or physical. . . .The difficulty is, we do not tax incomes at all—only the consciences of those who are supposed to have incomes."³²

But the majority in the House favored retaining the tax. Austin Blair of Michigan asserted that the Treasury could not stand the loss of revenue from the income tax, and that "every dollar which we take off this income tax, which applies to the rich men of the country, must

³⁰ Stanwood, *op. cit.*, 2: 172ff.; Taussig, *op. cit.*, 178ff.

³¹ *Cong. Globe*, 41st Cong., 2d Sess., 3495ff.

³² *Ibid.*, 3993-95.

be laid upon the poorer men of the country." Washington Townsend of Pennsylvania said: "The clamor in favor of the abolition of the income tax is a local and a manufactured cry. It does not come from the masses of the people. It originated in the great cities, among the men of gigantic capital, among the railroad monopolists, brokers and dealers in stocks, wholesale importers, mostly foreigners, and men of colossal fortunes and extraordinary incomes. It was started by papers in their interest and is mostly confined to those places and persons. It has not spread to the country, and the country papers and country people do not demand the abolition of the tax."³³ In the vigorous and extended debate in the House the same arguments were used with but minor variations. Loughridge of Iowa explained the opposition of the New Yorkers on the ground that New York residents had paid about one third of the entire tax, but contended that the tax burden was entirely just because at least one third of the entire wealth of the country was to be found in New York. He quoted with great effect a passage from Amasa Walker's *Political Economy* which strongly supported the income tax. The upshot of the debate was that the House passed a bill to retain the tax, but lowered the rate to 3 per cent and increased the amount of exemption to \$2,000.³⁴

When the Senate considered the House bill a few weeks later, the opposition to the tax manifested itself almost at once. Senator Sumner, who previously had justified a progressive income tax, declared: "Sir, the income tax must go. It must not be continued. It has already lived too long for the good of the country." William A. Buckingham, who had been War Governor of Connecticut, objected to the tax because he felt that, owing to the publicity given the tax returns, people were virtually compelled to pay a tax on more income than they possessed in order to bolster up their credit. Richard Yates of Illinois and James W. Patterson of New Hampshire were among those who denounced the income tax on the grounds that it was "odious," "inquisitorial," and "led to fraud." Roscoe Conkling, the brilliant and magnetic spokesman for the vested interests of New York, and Henry W. Corbett of Oregon also joined in the onslaught against the income tax. But Allen G. Thurman of Ohio presented the most unusual argument: that the income tax was shifted so that the poor man really had to pay it.³⁵

Against the namecalling and glittering generalities of the income

³³ *Ibid.*, 3994, 4023.

³⁴ *Ibid.*, 4038, 4063-64.

³⁵ *Ibid.*, 4709, 4711, 4717, 4757, 4811, 4897, 5086.

tax opponents several very able champions of the income tax spoke.⁸⁶ Senator Sherman of Ohio made the most powerful reply. As chairman of the Senate Finance Committee, his views carried weight. Economically, he preferred the conservative creditor point of view, but he understood the political advisability of giving voice to, and satisfying in part, the radical debtor interests of the Middle West. Later, when Secretary of the Treasury under President Hayes, he won fame by achieving resumption of specie payments.⁸⁷ Oliver P. Morton, formerly the War Governor of Indiana, and Aaron H. Cragin of New Hampshire exposed the rhetorical and flimsy rationalizations conjured up against the income tax.⁸⁸

These speeches, however, did not restrain the Senate from supporting by a vote of 34 to 23 Senator Conkling's motion to strike out the sections in the internal revenue bill referring to income taxes. A very complicated series of parliamentary maneuvers then took place. To replace the revenue lost by the elimination of the income tax, the Senate voted to restore a duty on sugar which the House had removed. Soon some Senators who had voted against the income tax came to realize the need of retaining it and indicated that they might reverse their votes. Three motions to retain some kind of income tax were made, but all were voted down. Senator Thurman of Ohio suggested a tax of 5 per cent on the interest from United States bonds held by persons residing in the United States or citizens residing abroad. Senator Warner of Alabama wanted the tax continued, but only when restricted to the income from capital. Senator Wilson of Massachusetts proposed to retain the regular income tax as provided by the House bill, but to limit it to the years 1871 and 1872 and to the rate of 2½ per cent. A vote of 26 to 22 taken on July 1 seemed to dispose of the income tax provisions with finality. Senator Sherman regretfully made a motion to restore another tax, that on gross receipts, as a needed revenue measure, but his motion was defeated by a tie vote of 25 to 25.⁸⁹

Upon the failure of Sherman's motion the tide against the income tax turned in its favor. Once the gross receipts tax was discarded, cer-

⁸⁶ For an analysis of propaganda techniques see Alfred M. and Elizabeth B. Lee, *The Fine Art of Propaganda* (New York, 1939); L. Susan Stebbing, *Thinking To Some Purpose* (Harmondsworth, England, 1939); Robert H. Thouless, *How To Think Straight* (New York, 1939).

⁸⁷ The best brief study of John Sherman is by Jeannette P. Nichols in *Dictionary of American Biography*, 17: 84-88.

⁸⁸ *Cong. Globe*, 41st Cong., 2d Sess., 4713-15, 4759-60, 5085.

⁸⁹ *Cong. Globe*, 41st Cong., 2d Sess., 4896, 4924ff., 5081ff., 5085-92.

tain Senators, such as Anthony of Rhode Island, Edmunds of Vermont, and Nye of Nevada, were willing to reverse their position and vote for the income tax. The result was that the Senate voted 26 to 25 to reconsider the vote against the continuance of the income tax. Senator Wilson now succeeded in getting his motion to limit the tax to two years at the rate of 2½ per cent approved by a vote of 27 to 21. The foes of the income tax, however, continued their battle by resorting to further invective and to subtle parliamentary devices. Senators Conkling and Sumner were among the leaders of this group. A motion of Conkling's that the tax should not be collected except by special order of Congress was lost by a tie vote of 26 to 26. In this last stand against the champions of big business who desired no restrictions on the rapid accumulation of capital Senator Sherman had an outstanding role. His speech of May 23 is especially noteworthy for its assertion that the income tax "was the most just and equitable tax levied by the United States," and "the only discrimination in our tax laws that will reach wealthy men as against the poorer classes." His speech was enhanced by a keen analysis of the benefits of the British income tax and by felicitous quotations in support of the income tax from the works of the great English economists and two American economists, Amasa Walker and Arthur L. Perry.⁴⁰

The 1870 Reduction in the Income Tax

Although the tax was saved, its productivity was lessened when the House agreed to the Senate amendments which lowered the rates from 5 per cent on incomes over \$1,000 to 2½ per cent on incomes over \$2,000. The tax was also expressly limited to the years 1870 and 1871, "and no longer." The Act, as passed on July 14, 1870, made some changes in the administration of the tax so as to make it less objectionable. The publication of income tax returns, to which there had been little objection from the general public during the Civil War, but to which strong objection from the conservative press developed after the war, was prohibited. No returns were to be required from anyone unless he had an income over \$2,000. No penalties for refusal or neglect to make returns and no increases by officers of anyone's assessments could be made or imposed without due notice to the person

⁴⁰ *Ibid.*, 5095-99, 5232-34. See John Sherman, *Selected Speeches and Reports on Finance and Taxation* (New York, 1879), 284-307, and *Recollections of Forty Years* (2 v., Chicago, 1895), 1:303-08, 331. His citations were from Amasa Walker's *Science of Wealth* (Boston, 1866), 322ff., and Arthur L. Perry's *Elements of Political Economy* (New York, 1865), 444.

charged. A peculiar confusion occurred in the provisions relating to the tax on salaries of United States officers, and to the other taxes collected by "stoppage at the source" on income from interest and dividends. While the income tax proper was assessed at 2½ per cent for 1870 and 1871, the tax on salaries, interest, and dividends was 5 per cent from January 1 to August 1, 1870, 2½ per cent during the year 1871, but nonexistent for the period from August 1 to December 31, 1870.⁴¹

Repeal of the Inheritance Tax

The Act of July 14, 1870, was noteworthy not only for its reduction of the income tax, but for its repeal of the taxes on legacies and successions. These inheritance taxes had received commendation from the Special Revenue Commission in 1865 because they could be made productive of large revenues without checking the development of the country. Although the yield from them was small at first, they brought in over \$2,400,000 for the year 1869. This increase was embarrassing to the champions of the high protective tariff, who were anxious to reduce the internal taxes as much as possible in order to preserve the high tariff rates they had previously won. When on May 16, 1870, Robert C. Schenck of Ohio, as chairman of the House Ways and Means Committee, introduced the Committee's bill to reduce internal taxes, he simply stated that the Committee had repealed the taxes on successions and legacies to save the taxpayers \$2,400,000. There was practically no debate in the House on this question, although there seemed to be no widespread objection to these taxes. In the Senate attention was concentrated on other features of the internal revenue measure. The little discussion given to the subject was in favor of dropping the inheritance tax. The main reasons offered were that if other taxes were repealed these taxes would have to be specially collected, and that it did not seem right to tax the inheritances of direct descendants when the government's revenue needs were not great. And once the tax on direct heirs was repealed, the sum to be collected from collateral heirs was so small as not to be worth the trouble. Even Senator Sherman, the staunchest defender of the income tax, did not present any plea for the retention of the inheritance tax. He said: "Direct devise from a father to a son is so natural a disposition of property that it would not seem to be right to tax it." The conse-

⁴¹ *Cong. Globe*, 41st Cong., 2d Sess., 5089-90; Act of July 14, 1870, 16 *U.S. Stat. at Large*, 257, 259-61; Smith, *op. cit.*, 66-68, 84-86.

quence was that Congress repealed the inheritance taxes, the law becoming effective October 1, 1870. Congress also ruled that any taxes on bequests or devises of any real or personal property made to a literary, educational, or charitable institution, which had not already been paid, were not to be collected.⁴²

An analysis of the distribution throughout the different sections of the United States of the payments on these inheritance taxes reveal certain important facts. From 1864 to 1871, Massachusetts, New York, and Pennsylvania paid about 55 per cent of the legacy taxes (taxes on inheritances of personal property); but in the amount of succession duties (taxes on inheritances of real estate), the order of leadership was New York, Pennsylvania, Ohio, and then Massachusetts. The first three contributed about 46 per cent of the total amount of succession duties, all four about 55 per cent. The incidence of the inheritance taxes was therefore of a distinctly sectional character, but this was due to the concentration of wealth in the Northeast. This fact explains in part the complaints of the *New York Times* on April 30, 1870, that the inheritance taxes were unjust because of differentiation and unequal because property held by corporations was never taxed and no exemption was granted to educational, religious, and charitable institutions.

The general opinion, however, was that the inheritance taxes were just and equitable. As one member of Congress said: "The general idea is that if anything in the world should pay a tax, it is legacies and successions, because they are supposed to be in the nature of a gift to the party receiving them without any consideration moving from him." Confirmation of this point of view was to be found in the authoritative statement in the *Internal Revenue Record* that "this tax is, in principle, one of the best, fairest, and most easily borne that political economists have yet discovered as applicable to modern society." Nevertheless, these justifications for the inheritance taxes failed to prevent their elimination from the federal revenue system at a time when capitalism in America was receiving a new impetus, and when some corrective or restriction on the undue concentration of wealth was needed.⁴³ Moreover, this repeal occurred at a time when the general trend in Europe and throughout the world was toward the adoption or increase of the inheritance tax. The English had had some form of inheritance tax

⁴² *Cong. Globe*, 41st Cong., 2d Sess., 3495, 4073, 4708; Act of July 14, 1870, 16 *U.S. Stat. at Large*, 257, 269.

⁴³ *Ex. Doc. No. 4*, 42d Cong., 3d Sess., 122-23; *Cong. Globe*, 41st Cong., 2d Sess., 4708; 9 *I.R.R.*, 113; Smith, *op. cit.*, 106-07, 298-99; Max West, *The Inheritance Tax*, 91-94.

from 1780 on, the French since 1796, and the Italians from 1862 while the Prussians were to have one in 1873.⁴⁴

Renewed Pressure Against the Income Tax

The campaign against the income tax which had succeeded in 1870 in limiting the continuance of the income tax to 1872 was carried on vigorously after the passage of the Act of July 14, 1870. The Anti-Income Tax Associations in New York and Philadelphia tried to have the income tax law repealed before the time set for it to expire. They succeeded in getting different Congressmen to present bills in the House, but none of these came to a direct vote. In the Senate, on January 25, 1871, John Scott of Pennsylvania, an able lawyer who later became Chief Solicitor to the Pennsylvania Railroad Company, made a powerful effort to have the income tax repealed on the ground that only 94,333 persons in the United States paid their income tax and that \$2,500 a day spent on the salaries of 500 assistant assessors could be saved. Senator Sherman answered these arguments in a speech backed by his authority as a financial expert. He pointed out that the pressure for repeal came from those possessing large property and large income and having the advantage of high social, personal, and delegated influence. He opposed a repeal of the income tax so long as the taxes bearing on the necessities of life were undisturbed. He denied that the income tax law authorized more espionage into a man's private affairs than other tax laws, or that the income tax was more odious and unpopular than any other tax which people had to pay, such as the whisky tax. He dismissed the charge that the tax was unconstitutional or expensive to collect. He exposed the injustice of keeping taxes on articles of daily consumption, like sugar, coffee, tea, and tobacco, and thereby taxing the poor while removing the one tax which reached the rich minority. This plea, and others by Senators Howell of Iowa and Cragin of New Hampshire, did not prevent the Senate the next day from repealing, by a vote of 26 to 25, the income tax law of July 14, 1870.⁴⁵

Meanwhile efforts within the House to have the income tax law repealed cast an interesting light on the complex cross-currents within the Grant administration. On January 1, 1871, Grant had appointed General Alfred Pleasonton Collector of Internal Revenue in New

⁴⁴ W. J. Shultz, *The Taxation of Inheritance*, 18-70; West, *op. cit.*, 22-84.

⁴⁵ *Cong. Globe*, 41st Cong., 3d Sess., 20, 64, 722ff., 747-55, 1037; John Sherman, *Selected Speeches*, 317-36.

York City, to succeed Columbus Delano as Commissioner of Internal Revenue. The appointment was made against the advice of George S. Boutwell, the Secretary of the Treasury, and mainly out of a sense of friendship. Pleasonton took office on January 3 and immediately indicated how compliant he was to the wishes of various big business groups, especially those whose claims were furthered by Samuel Ward of New York, the ablest lobbyist of the day. On January 20 Pleasonton sent a communication to Samuel Hooper, of the House Ways and Means Committee, in which he said that the income tax was "most obnoxious to the genius of our people," was inquisitorial, exposed "the most private pecuniary affairs of our citizens," was not productive of great revenue, and should be unconditionally repealed. This remarkable pronouncement was soon contradicted by Boutwell. In a letter to Hooper, Boutwell advised against the repeal of the income tax at that time as endangering the government's revenue when a deficiency in revenue might have serious consequences owing to the \$2 billion public debt.⁴⁶

Nevertheless, Samuel Hooper moved on February 7 that the House rules be suspended so that a bill for the repeal of the income tax might be passed. His motion was defeated by a vote of 117 to 91. The Senate bill to repeal the tax, when it reached the House, was returned without being considered on the ground that, under the Constitution, revenue measures could not originate in the Senate. The sectional divisions within Congress on this question are of great interest to the student of power politics. In the House vote on Hooper's motion, the representatives of California, Connecticut, Massachusetts, New York, New Jersey, Maryland, Pennsylvania, and Rhode Island, which taken together had contributed about 70 per cent of the total income tax, cast 61 votes against the tax and only 14 for it. On the other hand, the representatives of 14 southern and midwestern states and one New England state, New Hampshire, which together had contributed less than 11 per cent of the tax, cast 69 votes for the tax and only 5 against it.⁴⁷

Grant's Peculiar Role

Behind this attempt to force through the repeal of the income tax lies an extraordinary and little-known story involving President Grant.

⁴⁶ Boutwell, *Reminiscences of Sixty Years*, 2: 131-33; *House Misc. Doc. No. 51*, 51 Cong., 3d Sess., 1ff.; *House Misc. Doc. No. 70*, *ibid.*, 2ff.; Gustavus Myers, *The Ending of Hereditary American Fortunes* (New York, 1939), 99ff.

⁴⁷ *Cong. Globe*, 41st Cong., 3d Sess., 791, 1851; J. A. Hill, "The Civil War Income Tax," *Quarterly Journal of Economics* (July, 1894), 8: 442-43.

Grant, after appointing Pleasonton, authorized him to urge upon Congress the repeal of the income tax, while he himself urged it upon several members of both houses. He evidently did this without consulting the Secretary of the Treasury, who opposed and helped to defeat the repeal Grant had desired. Moreover, Boutwell concealed from the Cabinet the exact extent of the government's revenues, probably because he did not want to give any support to the opponents of the income tax. Proof of his tactics is to be found in a reply he made on April 11, 1871, to a question by Hamilton Fish, the Secretary of State, about the state of Treasury finances. Boutwell said that his monthly statement "will probably show enough to lead to a repeal of the income tax, if there were time for Congress to act, but there is not."⁴⁸

Boutwell's seemingly peculiar behavior in concealing the operations of the Treasury Department undoubtedly was in part due to his experience with those speculators who, on September 24, 1869, had almost succeeded in cornering the gold market on Wall Street with the aid of various influential individuals connected in one way or another with President Grant. But the primary explanation for Boutwell's actions seems to be his desire for the retention of the income tax. "He warmly denounces the repeal of the income tax," Hamilton Fish noted in June, 1870, "but wholly on political grounds; that the substitution or continuance of the other taxes which affect a larger number of persons will be unpopular. (The question of equity or right did not constitute any part of his reasoning; whether it did of his judgment was not apparent from what he said.) He thought it would be used against the Republican Party on the stump. Belknap concurred in this opinion."⁴⁹ On the other hand, Grant's action against the income tax seems to be explained by his wish to strengthen his hold on the support of the great moneyed interests in the presidential election of 1872. He was most likely also influenced by Hamilton Fish's hostility to the retention of the federal income tax in peacetime. The latter wished to have the tax declared unconstitutional and even asked a friend to have some test cases started in the courts, a rather unusual procedure for a Cabinet officer to engage in.⁵⁰ This may be justified, according to one's view of public policy, on the same grounds used to justify Grant's "packing" of the Supreme Court with judges predisposed to reverse the decision

⁴⁸ Nevins, *Hamilton Fish*, 590.

⁴⁹ *Ibid.*, 600.

⁵⁰ Fish to J. C. Hamilton, June 23 and October 1, 1870, Hamilton Fish Papers, Library of Congress.

handed down on February 7, 1870, against the constitutionality of the greenbacks.⁵¹

Strategic Retreat on the Protective Tariff

The next year, 1872, was an election year, with Grant running against Horace Greeley, the candidate of the Liberal Republicans and of the Democratic party. In order to counteract the danger of a popular revolt against the Republican party, the Grant administration came out in favor of civil service reform, downward revision of the tariff, and a modification of the radical Republican policy of militant southern reconstruction. A general Amnesty Act was passed on May 22 to conciliate disfranchised southerners. On May 1 the import duties on tea and coffee were removed so as to create a campaign slogan about the "free breakfast table." On June 6 a Tariff Act was passed which was a masterpiece of protectionist strategy. It made a 10 per cent reduction in the duties on the great protective industries: the manufactures of cotton, wool, iron, steel, metals in general, paper, glass, and leather. The duties on salt and coal were lowered; certain raw materials like hides and paper stock, as well as a number of minor articles used by manufacturers, were put on the free list. These changes in the tariff were deliberately made by the champions of high protection—John L. Hayes, the Washington lobbyist for the wool manufacturers, James G. Blaine, Pig-iron Kelley, Henry L. Dawes, and John Sherman—in order to stave off the powerful tariff reform movement which had been developing among the western farmers, eastern merchants and importers, and consumers in general. This action succeeded in preventing a possibly more drastic tariff reduction and in satisfying the free traders who thought the 10 per cent reduction a movement in the right direction. But the protectionists believed, and, as events proved, rightly, that their strategic retreat really was a victory, because protection for the great industries was maintained almost intact, while the purely revenue, nonprotective duties, like those on tea and coffee, were eliminated as a means of reducing an embarrassing surplus.⁵²

Repeal of the Income Tax

The surplus revenue in each of the fiscal years 1870-71 and 1871-72 amounted to about \$100 million, after payments had been made for all

⁵¹ Sidney Ratner, "Was the Supreme Court Packed by President Grant?" *Political Science Quarterly* (September, 1935), 50: 343-58.

⁵² Ashley, *op. cit.*, 187-88; Stanwood, *op. cit.*, 2: 176-84; Taussig, *op. cit.*, 179-90.

the appropriations and all the interests on the public debt. One means of disposing of this surplus was the purchase of government bonds in the open market; this was cheaper for the government than redeeming them at par on account of the low premium on bonds and the high premium on gold. The Grant administration also curtailed the surplus revenue by the abolition of the income tax.

The business groups which had previously tried to bring about the repeal of the income tax brought increased pressure upon the Grant administration as the presidential election of 1872 approached. In the spring of 1871 they were so determined to frustrate any further extension of the income tax law that they were prepared to bring a test case against the tax in the courts on the ground of its unconstitutionality. A year later they exerted all their energies to prevent any challenge to the expiration of the income tax in 1872 provided for by the Act of July 14, 1870. A wealthy New Yorker, John C. Hamilton, wrote to the Secretary of State on May 31, 1872: "I wish the income tax could yet be repealed. Our Union League has denounced it unanimously. They contribute very largely at elections, and when we are to pay a city tax of 2.75 per cent, it is unfortunate that this income tax is now to be called for. But I suppose . . . it is too late."⁵³

This plea was not in vain. Senator Sherman worked hard to save the income tax and have it made a permanent part of the taxation system. He pointed out on March 15, 1872, that the lapsing of the income tax would leave a system of national taxes which rested the whole burden of taxation on consumption without one cent of tax on property or income, and which was, therefore, intrinsically unjust. As a liberal conservative, he argued:

While the expenses of the National Government are largely caused by the protection of property, it is but right to require property to contribute to their payment. . . . Everyone must see that the consumption of the rich does not bear the same relation to the consumption of the poor as the income of the one does to the wages of the other. As wealth accumulates, this injustice in the fundamental basis of our system will be felt and forced upon the attention of Congress. Then an income tax, carefully adjusted with proper discriminations between income derived from property and income from personal services, and freed from the espionage of our present law, will become a part of our system, just as such a law . . . was the basis of the revolution of the tax system of Great Britain.⁵⁴

⁵³ Nevins, *Hamilton Fish*, 598ff., 606.

⁵⁴ John Sherman, *Selected Speeches*, 348-49.

But neither this speech nor an even more elaborate and much more impassioned one by John M. Rice of Kentucky, in the House the next day, stimulated Congress to enact a new income tax law or extend the old one. The patriotic emotions evoked by the war to preserve the union had now given way to a concern for private gain, and to a zeal for the rapid acquisition of wealth which manifested itself most clearly in the unscrupulous business activities of certain ambitious entrepreneurs and speculators, and in the sympathetic furthering of their designs by various members of Congress. A month after the elections in November, 1872, Congress began exposing the gifts or bribes given to various members of Congress by the Credit Mobilier, a construction company organized by the principal stockholders of the Union Pacific Railroad to build the road. The reputations of such prominent individuals as the outgoing Vice-President, Schuyler Colfax, the incoming Vice-President, Senator Henry Wilson, Senator Patterson of New Hampshire, and eight Congressmen, among whom was James A. Garfield, a future President of the United States, were damaged. Another Congressional inquiry revealed that nearly \$1 million had been expended, and \$565,000 paid directly to lobbyists, in order to bring about the passage in 1872 of an act granting to the Pacific Mail Steamship Company an additional mail subsidy of \$500,000 a year for ten years.⁵⁵

The Growth of Large Fortunes

The repeal of the income tax in 1872, together with the repeal of the inheritance taxes in 1871, should be viewed in relation to the new economic picture. The Civil War had accelerated the accumulation of capital and had tended to centralize in the industrial, urban Northeast, where, moreover, it was concentrated in the hands of a relatively small group. The needs of the national government for carrying on the Civil War and the inflation of the currency by over \$400 million in greenbacks gave active businessmen an opportunity to reap high profits from rising prices, while keeping wages down in relation to the increased costs of living. A general boom market developed in stocks by the fall of 1862, and by the end of 1863 stock operators were reported to have realized profits of a quarter of a billion. Speculation in commodity goods, metals, and especially gold, developed at a rapid pace. Manufacturers multiplied their output in woolens, ready-made

⁵⁵ Gustavus Myers, *The Ending of Hereditary American Fortunes*, 104-105; Nevins, *op. cit.*, 611ff.

clothing, armaments, railroad and other iron and steel products, sugar refining, and petroleum refining. Contractors cheated the government on shoddy goods and obsolete equipment, while charging unjustifiably high prices. Cornelius Vanderbilt did not feel ashamed of charging the United States double the regular price for procuring a fleet of ships in 1862 for a military expedition to New Orleans. Railroad consolidations became the order of the day. Transcontinental railroad building was inaugurated from 1862 on, with the extremely generous aid, in money and land, of the federal government.

The result was that more large fortunes were created than at any other comparable period in the national history up to that time. By 1863 several hundred men in New York City were reported to be worth \$1 million, and some were known to be worth \$20 million whereas twenty years before there had not been five men in the whole United States worth as much as \$5 million and not twenty worth over \$1 million. A. T. Stewart, who owned the largest dry goods store in the country, and had a fortune of nearly \$50 million, reported to the government in 1863 an income of \$1,843,000. This corresponded in purchasing power to probably more than \$4 million in 1929 and represented a larger share of the whole national income than would \$25,000,000 in 1929. Other wealthy New Yorkers listed for that year were William B. Astor, who reported an income of \$854,000; Cornelius Vanderbilt, \$680,000; Moses Taylor, \$573,000; Le Grand Lockwood, \$512,000. Seventy-nine taxpayers in New York City reported incomes of \$100,000 or more, as did sixteen in Boston. H. P. McKean of Philadelphia was said to have reported an income of \$537,000; Nathaniel Thayer, \$365,150. In order to obtain the purchasing power of these incomes in 1929 dollars, these figures should be multiplied by at least two; and to indicate their ratio to the national income, by at least twelve.

For the 1864 income tax returns William B. Astor reported \$1,300,000; Cornelius Vanderbilt, \$576,000; Moses Taylor, \$573,000; and Simon W. Arnold of Philadelphia, \$616,000. Very wealthy men were to be found in other sections of the country. The *New York Herald* in an editorial on January 21, 1865, referred to the "codfish" aristocracy of New England, to whom \$10,000 a year was a comfortable income, and compared them to the "gold" aristocracy of the West, whose incomes ran into hundreds of thousands, and to the "petroleum" aristocracy of Pennsylvania, and the "shoddy" aristocracy of the Great Lakes and the Mississippi Valley, who estimated their incomes in the millions. New England had many incomes over \$100,000: the estate of Colonel

Colt of Hartford reported \$225,000 in 1864; the Ames family of Easton, Massachusetts, more than half a million. The unreported incomes from banks and railway securities were notoriously large in New England, according to Dr. Rufus S. Tucker. Small, comfortable fortunes also developed by the thousands in the northern and Border states. After the conclusion of peace, evasion of the income tax was not considered very unpatriotic, and publicity of income tax returns seems to have had little effect on the evaders. Hence only a small number of incomes over \$500,000 is known. For 1865 Edward S. Jaffery of New York reported \$682,000. For 1868 William B. Astor reported \$1,079,000, but this did not include all of his gains from the sale of real estate or his income from bank and railway securities; the *New York Times* alleged that his reputed income included about \$600,000 of nonreportable dividends. His reported income was equal to about \$1,700,000 in 1929 purchasing power, and corresponded to a \$13 million or more share of the 1929 national income.⁵⁶

Losses of the Working and Farming Classes

Meanwhile American workingmen suffered seriously from the depreciation of the currency and the great rise in prices. One fifth or one sixth of their real incomes was confiscated by the changes induced through the paper currency. While real as well as money profits were unusually large during the Civil War, real wages were low. Even though money wages continued to rise, after prices had begun to fall, the wages had not caught up with the prices by the end of the war. Hence the profits of employers at the close of 1865, though not as great as in 1863 and 1864, were still higher than before the suspension of specie payments in December, 1861. Moreover, the profits increased in direct proportion to the complexity of the business organization, and the number of such consolidated enterprises grew with amazing rapidity during the Civil War. This increase was due in part to the peculiar effect of certain internal taxes. The tax on the sale of most industrial products, placed finally at 6 per cent ad valorem, bore heavily on manufacturers since most products represented more than one process of manufacture. Concentration in manufacturing came to prevail because the more nearly complete and comprehensive the plant, the less the

⁵⁶ A. C. Cole, *The Irrepressible Conflict*, 344-58; E. D. Fite, *Social and Industrial Conditions in the North During the Civil War*, 166ff.; Sandburg, *op. cit.*, 2: 608-24; Rufus S. Tucker, "The Distribution of Income Among Income Taxpayers in the United States, 1863-1935," *Quarterly Journal of Economics* (August, 1938), 52: 547, 563ff.

tax. This meant that the manufacturer with small capital was at a disadvantage against the man with large capital who, by enlarging his plants, could undersell his small competitor.⁵⁷

During the Civil War the farmers in the North seemed to prosper. They increased their acreage, harvested good crops, and received good prices for them, especially between 1860 and 1863. Despite the reduced number of men on the farm, production was increased through the installation of agricultural machinery, the use of new farming methods, and the employment of women, children, and immigrants as farmhands. Wesley C. Mitchell's analysis of farm income reveals, however, that the northern farmers were among those whose products rose in price less than the majority of other articles. On the whole, although inflation favored the farmers at the expense of laborers, landlords, and bankers, these gains were more than offset by the price disturbances. Many of the farmers also came to resent the tariff and tax legislation sponsored by eastern Congressmen as partial to the capitalists. Nearly all the farmers considered the land grants to the railroads a means of making the whole Northwest and the whole West but little more than a province of New York, and bitterly criticized the contractors and profiteers as making money at the expense of the rest of the nation.⁵⁸

The Civil War generated in the North a feeling of prosperity based upon the increase in prices caused by the inflated currency. Although actually the prosperity was experienced mainly by the industrial and mercantile capitalists, rather than by the workingman, the landlord, or the lending capitalists, the extravagant expenditures and ostentatious display by the "shoddy" aristocracy created an impression of a great increase in the general consumption of wealth. Professor Mitchell's careful judgment on economic conditions then prevalent is that the inflation which enabled a small circle to indulge in the conspicuous consumption of wealth caused the great majority of people to suffer from a restricted consumption of goods and services. The laboring man was forced to practice economies in food, clothing, and other articles. The families of many owners of land and lenders of capital had to introduce retrenchments in their living expenses. In short, the wartime fortunes resulted in a very large measure from the mere transfer of wealth from a wide circle of persons to a relatively small number of industrial and mercantile capitalists.⁵⁹

After the return of peace, the working classes benefited from the

⁵⁷ Fite, *op. cit.*, 165ff.; Mitchell, *op. cit.*, 343-51, 382-85.

⁵⁸ Cole, *op. cit.*, 354-60; Fite, *op. cit.*, 1-23; Mitchell, *op. cit.*, 386-88.

⁵⁹ Mitchell, *op. cit.*, 394-402.

general upward trend of wages which had begun during the war. By 1869 the level of wages was higher than that of retail prices, and by 1872 all occupations had higher wage rates than those of 1865. This was due to the almost unparalleled fall in prices from Appomattox until July, 1865, and then, after a resurgence of prices for half a year, to the strong downward general trend of prices until the autumn of 1871. A lively speculative movement in 1871 and 1872 checked this fall and created for the businessman an overexpansion prosperity which led to the crisis in 1873. During the period 1865-72 the unprecedented development of trade and industry absorbed a million men from the disbanded army and an annual average of 326,000 immigrants. The railway mileage of the United States was literally doubled. That expansion of the transportation system opened up a new fertile domain both for farmers and for industry. European capitalists invested by 1869 almost a billion and a half dollars in American securities, chiefly federal government and railroad bonds. The farming classes experienced a boom in the sale of their products, especially in the European market, until a decline began in 1870. Nevertheless their prosperity was more fictitious than real owing to deflation in the currency of about a quarter of a billion dollars between 1865 and 1870, excessive railroad rates on the shipment of their produce, the relatively higher prices of manufactured goods, and overexpansion in farming.⁶⁰

Relation of Taxes and Public Debt to Development of American Capitalism

The attack of the business classes on the income tax and the inheritance tax during this period between 1865 and 1872 must therefore be seen as an effort to increase their profits by shifting the burden of taxes to the shoulders of the laboring and the farming classes at a time when these classes were beginning to recoup some of the losses they had suffered during the Civil War. At the same time the industrialists increased their margin of profit by eliminating competition from European manufacturers through the high protective tariff.

Here then is one of the consequences of the Civil War which made Charles A. Beard call it the Second American Revolution. If the southern members of Congress had not withdrawn from Washington after the election of Lincoln in 1860, but had tried through arbitration

⁶⁰ Wesley C. Mitchell, *Gold, Prices, and Wages Under the Greenback Standard* (Berkeley, 1908), 13ff., 26, 41, 102ff., 121; Alexander D. Noyes, *Forty Years of American Finance* (New York, 1909), 1-5; George F. Warren and Frank A. Pearson, *Gold and Prices* (New York, 1935), 35, 317.

and diplomacy to settle the issues between the North and the South, they and the northern Democrats would have had a majority in Congress and would have been able to prevent the high protective tariff from being established. If the southern states, after the Civil War, had been able to obtain representation, even in reduced numbers, they probably would have been able to support the western Republicans from the agricultural, debtor section of the country in their efforts against the tariff system and in favor of the income and inheritance taxes. But the men who obtained control of the federal government in the crisis of the Civil War consisted either of spokesmen for the northern industrialists and bankers, or of men whose concern with the interests of the free soil farmers and with the preservation of the Union made them willing to make concessions to the capitalists in return for their support.

Hence the income and inheritance taxes were resorted to as temporary instruments for raising the extraordinary revenues required to prosecute the war against the South. The American capitalists, like the English capitalists after the Napoleonic Wars, were so narrowly concerned with the immediate quest for large profits that they were willing to abolish taxes which had played a vital role in the final victory of the war. The English had repealed in 1816 William Pitt's Napoleonic War Income Tax because it seemed unusually inquisitorial and a handicap to business enterprise and initiative, to be tolerated only in a struggle for national existence. Similarly the American capitalists abolished the inheritance tax in 1871 and allowed the income tax to expire in 1872. But, whereas the English revived the income tax in 1842 and increased it thereafter, the American public had to wait until 1894 before another federal income tax law was enacted and not until 1913 did the income tax become a permanent part of our federal revenue system.⁶¹

An important point which has not received due attention is that the repeal of the income and inheritance taxes occurred at a time in our national history when, despite the large reductions in the amount of the federal debt achieved by McCulloch and Boutwell, the net public debt was over \$1,800 million. This debt had been accumulated in the process of preserving the Union in the name of all the people. But the cost of paying off the debt and paying the interest on the debt was thrust upon the farming and working classes by northern industrialists and financiers when they secured through Congress the maintenance of the

⁶¹ Beard, *Rise of American Civilization*, 2: 52-121; Arthur Hope-Jones, *Income Tax in the Napoleonic Wars* (Cambridge, England, 1939), 111-25.

protective tariff and the abolition of the income and inheritance taxes. Hence the public debt became one of the most powerful instruments in America for the enrichment of the rentier class, the lending capitalists. It is true that the public debt was reduced when depressions, like that of 1873-79, or wars, like the Spanish-American in 1898, did not interfere, and that by 1913 the net public debt was about one half of the 1872 debt. But for over forty years the main burden of the public debt was carried by the farmers, workers, and merchants of the country. This handling of the national debt and federal taxes did nothing to obstruct the rapid accumulation of capital by the great American industrialists and financiers.⁶²

Place of the Income Tax in Federal Revenue System

The full implications of the repeal of the income tax can be obtained, however, only when the foregoing analysis is correlated with an analysis of the role of the income tax in the federal revenue system. In 1863, the first year of the operation of the income tax law, the amount collected was rather small, about \$2,750,000, but it increased very rapidly. The figures for 1864 are, in round numbers, \$20 million; for 1865, \$61 million; and for 1866, \$73,500,000. After that year there was a gradual decline. The revenue in 1867 was \$66 million; in 1868, \$41 million; in 1869, \$35 million; in 1870, \$38 million; in 1871, \$19 million; and in 1872, \$14 million. The great increase for the first four years of the income tax collection was probably due to the increase in the rates, to the improvement in the methods of administration, and to the inflation of the currency. The decrease after 1866 was due to the changes in the laws lowering the rates and increasing the amount of exemption and to the improved methods of evading the tax invented and used by citizens whose patriotism was not too strong during the war and ebbed sharply with the return of peace. Each year there seemed to be more evasions and frauds. But the decline in the revenue was also, and perhaps mainly, due to the contraction of the currency instituted by McCulloch with the consequent fall in prices, lower money incomes, and hence smaller tax returns.

⁶² *Treasury Report* (1939), 450; Robert A. Love, *Federal Financing* (New York, 1931), 118-28; A. C. Pigou, *A Study in Public Finance*, 19-41, 286-308; Seligman, *Essays in Taxation*, 717-49; William Withers, *The Retirement of National Debts* (New York, 1932), 208-325; cf. R. R. Doane, *The Measurement of American Wealth*, 10ff., 91; National Bureau of Economic Research, *Studies in Income and Wealth* (3 v., New York, 1939), 3:4-146.

These figures by themselves do not reveal the importance of the revenue from the income tax in the national system. That revenue was calculated to be about 7 per cent of the total internal revenue in 1863; 17 per cent in 1864; 28 per cent in 1865; 23 per cent in 1866; 24 per cent in 1867; 21 per cent in 1868; 21 per cent in 1869; 20 per cent in 1870; 13 per cent in 1871; and 10 per cent in 1872. The income tax therefore brought in on an average about 20 per cent of the total internal revenue during and after a national crisis of the greatest magnitude, and must be judged a decidedly successful fiscal instrument. It functioned best in 1865-67, but performed valuable service before and after that period. At a time when every resource of the federal government was being desperately exploited, the income tax was of crucial assistance. Moreover, it did not have regrettable economic consequences, such as the half-a-million-dollar increase in the public debt caused by the use of the greenbacks, or the burden on the taxpayer of the future created by the excessive use of loans. And this burden would not have been so great after 1872 if the payment to the bondholders had come from those best able to pay taxes instead of from those least able.⁶³

The income tax would have produced even more revenue for the government if Congress had not delayed in having an income tax levied and collected; it allowed two precious years to go by before, in 1863, the first collections were made. Moreover, an entirely new administrative mechanism had to be created, and that resulted in a delay which otherwise would not have occurred. Other errors and defects were a limited application of the stoppage-at-source tax principle to a few classes of corporations instead of to all corporations, and to the income from corporate securities without a corresponding deduction from the salaries of corporate employees; mistake in principle in regard to certain provisions; too high exemptions, especially after the amendment of 1870; inadequate administrative methods, personnel, and tenure of office. There was a failure to distinguish, in the beginning, between gross and net income, or to create a difference in rates between incomes from labor and incomes from invested capital. The taxation of profits from sales of capital assets was not consistently treated. The Act of June 30, 1864, imposed a tax on net profits from sales of real estate purchased within the year for which income was estimated; that of March 2, 1867, extended the period to two years

⁶³ *Ex. Doc. No. 4*, 46th Cong., 2d Sess., 167-71; Kossuth K. Kennan, *Income Taxation* (Milwaukee, 1910), 252-56; Seligman, *The Income Tax*, 471-80; Smith, *op. cit.*, 91-97; Mitchell, *A History of the Greenbacks*, 419-20.

previous to the year for which income was estimated. But attempts to apply this principle to personal property were unsuccessful.

A study of the portion of the income tax paid by the different states of the Union throws light on the concentration of wealth and income already existing at that time. The available statistics show that from 1864 to 1872 New York contributed about one third of the entire tax, its percentage varying in successive years from about 28 per cent to 39 per cent. Next in order were Pennsylvania, with 11½ per cent to 17½ per cent; Massachusetts, with 10 per cent to 14 per cent; Ohio, with 4 per cent to 8 per cent; Illinois, with 2 per cent to 7 per cent; California and New Jersey, each with 2 per cent to 5 per cent; and Maryland, with 2 per cent to 3 per cent. The lowest percentages came from the states which had seceded and from the poorer and less industrially developed states of the Middle West and Far West.⁶⁴ Here is a striking demonstration that the industrial, mercantile, and financial wealth and income of the country were confined to the Northeast, with a slight diffusion in a few of the more industrially developed states of the Middle and Far West.

The number of persons who paid the income tax, according to available statistics, varied from 460,170 in 1866 to 266,135 in 1867 and remained at about that level until the increase in exemptions to \$2,000 caused the number of taxpayers to drop to 74,775 in 1871 and 72,949 in 1872. Since the population of the United States at this period increased from about 35,700,000 in 1866 to 40,800,000 in 1872, the ratio of the income tax payers to the total population was a little over 1 per cent in 1866, about two thirds of 1 per cent from 1867 to 1870, and less than one fifth of 1 per cent in 1871 and 1872. These figures indicated that the great mass of the people were not interested in having the income tax repealed, but that a small high-income group objected so strenuously and so skillfully manipulated their propaganda campaign in the press and their pressure on members of Congress and the Grant administration that they succeeded in having the income tax repealed in response to an alleged public demand.⁶⁵

From a long-time social point of view, it is unfortunate that the partial check which the income and inheritance taxes were offering and would have offered to too great sectional and class differentiation in wealth and income was removed in 1871-72. Although the immediate

⁶⁴ *Ex. Doc. No. 4*, 46th Cong., 2d Sess., 115; Smith, *op. cit.*, 93ff., 294ff. Cf. Carl Snyder's provocative discussion in *Capitalism the Creator*, 21.

⁶⁵ *Ex. Doc. No. 4*, 42d Cong., 3d Sess., vi; *Treasury Report* (1867), 259; Kennan, *op. cit.*, 254ff.; Smith, *op. cit.*, 94, 296.

short-run benefits to the capitalists were great, the political and social consequences were to their disadvantage. From that time on the resentment and antagonism of the sections and classes who felt themselves exploited against the capitalists increased in intensity. Moreover, the good or plausible reasons given by the capitalists for desiring the repeal of the income tax were in the main rationalizations. Other taxes were just as inquisitorial, e. g., the tariff, and led to far more fraud, as the whisky and tobacco tax scandals in the Grant administration demonstrated. The main reason for the opposition to the income tax was that it succeeded in reaching so many of the industrial and financial capitalists who had previously escaped both federal and state taxation through fraud and evasion. Hence they were impelled to eliminate by law a burden they could not avoid by methods outside the law.⁶⁶

⁶⁶ Seligman, *op. cit.*, 473-80; Smith, *op. cit.*, 94ff., 212-17.



The Populist Revolt, the Tariff, and the Income Tax

THE history of the movement for the restoration of the federal income and inheritance taxes between 1873 and 1894 is bound up with the history of the efforts of the farmers, workers, and small businessmen to adjust themselves to changing economic conditions. The rise of industrial monopoly and the beginnings of financial capitalism after the Civil War accentuated the difficulties of the common man. His struggle to maintain and if possible to improve his standard of living was carried on in both the economic and political spheres. The very success of the industrialists and financiers in using political means for achieving their economic ends had led to analogous reactions and counterthrusts by the groups they were dominating. For a variety of reasons, the fortunes of these protesting groups were checkered. The Democratic party was in an unfavorable position because of its strong dependence on and its championing of the South. There was a divergence of economic interests and policies among the workers, farmers, and small businessmen. Those successes that were achieved were the result of adaptation to the new conditions following the Civil War, and programs and tactics were formulated which brought together into a united front the groups which singly had been fighting against the rule of big business with only moderate success.

The Panic of 1873 as Stimulus to Reform

In September, 1873, four months after the panic in Austria, news of the failure of the noted banking firm of Jay Cooke began a panic in New York which spread throughout the United States, helped to bring

on a crisis in Germany, and resulted in one of the most severe business depressions the United States has had. The principal cause seemed to be the unusually rapid railway building of the preceding years; the consequence was that many railways went into bankruptcy and their financial backers lost heavily. A forced deflation of debt and prices took place. The money wages of labor fell until they reached their lowest point in July, 1879, although the purchasing power of what wages the workers did receive steadily increased owing to the still lower drop in wholesale and retail prices. Farmers suffered a severe drop in the prices they could receive for their products. Many lost their farms through mortgage foreclosures.¹

In 1873 and 1874 new parties were established by farmers and workers to fight the evils that the Republican party was not willing to meet and the Democratic party was not strong enough to tackle, even if it had been sufficiently representative of the submerged classes. These third parties were variously called in different states the Independent, Anti-Monopoly, Greenback-Labor, Reform, or Farmers' party. The farmers had discovered the need of organization after the Civil War and by 1872 and 1873 had begun to support the National Grange of the Patrons of Husbandry, founded in 1867, and had begun to use it effectively against the exploitation of the railroads. The workers had come to discover the benefits of labor organization through the effects of large-scale business enterprises, the widespread application of machinery, and the introduction of the division of labor principle. The creation of a national market by railroad building, and the emergence of national employers' associations during the Civil War, gave birth to the national trade-union. The high prices of the Civil War also had spurred workers to protect themselves against the severe losses in real wages created through inflation and speculation. Yet the war produced no durable general organization of labor. In 1866 the National Labor Union, led by W. H. Sylvis, had rallied trade-unionists and social reformers into supporting a program of trade-unionism, the eight-hour day, and independent political action. But it and the National Labor Reform party, formed in 1872, were not successful. The Knights of Labor, organized in 1869 at Philadelphia by Uriah S. Stephens, became the important labor organization at this period. It grew steadily until 1877, and after a severe drop in membership, caused by the failure of the railroad strikes of 1877, increased in

¹ Wesley C. Mitchell, *Business Cycles* (Berkeley, 1913), 44ff., and *Gold, Prices, and Wages*, 103; Allan Nevins, *Emergence of Modern America* (New York, 1927), 154-77, 290-305.

numbers and power until 1886 under the leadership of Terence V. Powderly.²

In the agrarian-labor program, tax revision was only one among many proposed reforms. Currency reform attracted far more attention. In the dramatic election of 1876 the Greenback party, with Peter Cooper as its presidential candidate, called for the immediate, unconditional repeal of the Specie Resumption Act of 1875 and condemned the policy of contraction of the greenbacks, but made no pronouncement on the tariff or on federal income and inheritance taxes. The Greenback party polled only 80,000 votes. The interest of the general public was still centered in the struggle between the Republican and Democratic parties, especially as the 1876 election contest proved to be so close and the outcome was open to question and to political manipulation. The technical victory of the Republicans meant that their capitalistic policies in the main would be continued.³

The administration of Rutherford B. Hayes was marked by the resumption of specie payment for greenbacks in January, 1879, and by skillful refunding of the public debt at lower rates of interest under the able direction of Hayes's Secretary of the Treasury, John Sherman. This stabilization of the currency pleased the bankers but displeased the farmers and workers who thought inflation would restore prosperity. The latter group succeeded in having enacted, in 1878, over Hayes's veto, the Bland-Allison Silver Law. This measure, authorizing the Treasury to buy \$2 to \$4 million worth of silver bullion monthly, and to coin them into silver dollars, was a compromise on the demand for unlimited coinage of silver dollars. The further retirement of greenbacks was also stopped by Congress, and the amount left outstanding was then and thereafter \$346 million. But concessions to the radical group of farmers were later counterbalanced by the use of federal and state troops against the workers in the suppression of the railroad strikes of 1877.⁴

Renewed Conflict Over the Income Tax

During this period the Republican party found that after the panic of 1873 imports and the customs revenue greatly declined. Hence

² Solon J. Buck, *The Agrarian Crusade* (New Haven, 1920), 1-76; Norman J. Ware, *Labor Movement in the United States 1860-1895* (New York, 1929), 1ff., 350-70.

³ Allan Nevins, *Abram S. Hewitt* (New York, 1935), 267-399, has the best account of the 1876 election.

⁴ Alexander D. Noyes, *Forty Years of American Finance*, 1-72.

Congress in 1875 repealed the 10 per cent reduction in the tariff which had been made in 1872 as a concession to the tariff reformers. Yet while Congress was unjustifiably increasing the burden on the consumer, the majority groups in Congress refused to consider the fourteen different income tax bills introduced into Congress between 1873 and 1879 by Congressmen from the Middle West and South. In fact, as soon as these bills were discussed, pressure by the opponents of the income tax was exerted within and outside Congress. Petitions were presented from large cities bearing the names of prominent business leaders. One signed by Cyrus Field, Peter Cooper, and others was circulated throughout the country and presented to Congress on several occasions.⁵

Support for a federal income tax was forthcoming, but took some time to develop. The movement for a federal inheritance tax, however, did not get actively under way for several decades. The Greenback-Labor party, the product of a union between the Labor-Reform and Greenback parties, declared on February 22, 1878, that a graduated income tax should be levied for the support of the government and the payment of its debts. In the same year the Connecticut Greenbackers advocated an income tax, "graduating upwards, but leaving untouched all incomes under \$1,000." A large number of petitions appeared in Congress from Grange members and others in the South and West, asking for the adoption of the income tax. Their pleas did not receive the two-thirds majority required to suspend the rules of the House in order to force through the income tax bill against the will of the House leaders, but large votes on a sectional basis were cast in the House in favor of these measures. Few expected, however, that these bills could be carried through the Senate, where the conservative opposition was stronger.⁶

In opposition to the agrarian-labor position on the income tax, the *Nation* in the spring of 1878 published a fierce criticism of the Grangers' "communistic" attacks upon wealth. Edwin L. Godkin attributed the introduction of the income tax bills to the silver agitators. "The present silver agitation has produced among the farmers and laborers of the country hostile feelings towards bankers, merchants and all that class of persons who do the business of exchange, and this had more than anything else caused the attempt to revive the income-tax." Americans

⁵ Taussig, *Tariff History*, 190-91; *House Journal*, 45 Cong., 2d Sess., 551, 602, 1589; *Bankers' Magazine* (May, 1878), 32: 849; *St. Louis Republican*, April 15, 1878; Elmer Ellis, "Public Opinion and the Income Tax," *M.V.H.R.*, 27: 225-42.

⁶ Fred E. Haynes, *Third Party Movement Since the Civil War* (Iowa City, 1916), 122-23, 129; *Cong. Record*, 46th Cong., 3d Sess., Index, 307-08; *House Journal*, 45 Cong., 2d Sess., 939.

were being poisoned "with the dregs of European Communism."⁷ Other conservative writers, less honest and public spirited than Godkin, used the red herring device to confuse the issues and arouse prejudice. But some viewed the tax controversy more dispassionately. George Marsland, in the *Bankers' Magazine* for March, 1878, and Henry C. Kingsley, in the *New Englander* for July, 1878, presented arguments in favor of the income tax in moderate terms stressing a just sharing by different sections and classes of the burdens of taxation. The conservative St. Louis *Globe-Democrat* stated, on February 9, 1878: "We fail to discover in the proposed legislation any evidence of the communism which is so great a bugbear to the Eastern press. An income tax, when fairly adjusted and properly scaled, is one of the least objectionable methods of raising internal revenue. . . . The capitalists and wealthy creditors of the country are able to bear their share of the public expense."⁸ A more radical position was taken by Felix Adler, the founder of the Ethical Culture movement, in an address given in February, 1880, in which he championed an income tax which would be graduated up to 100 per cent on all income above that needed to supply all the comforts and "true refinements of life."⁹

In sharp contrast to these defenses of the income tax was the line of attack adopted by David A. Wells, who had been a champion of the income tax in 1870 and was a strong advocate of tariff reform. In an article entitled "The Communism of a Discriminating Income Tax" in the *North American Review* of March, 1880, which became a classic source for popular newspaper denunciation of the tax, Wells vigorously and pungently attacked the graduation feature of the income tax as "unmasked confiscation" and "flagrant spoliation." He considered that any exemption of income made a graduated tax and asserted that an exemption of \$2,000 would exempt "more than nine tenths of the entire property" and "more than ninety-nine hundredths of the property owners." He categorically declared: "Any government, whatever name it may assume, is a despotism, and commits acts of flagrant spoliation, if it grants exemptions or exacts a greater or less rate of tax from one man than another man on account of his owning . . . more or less of the same class of property which is subject to the tax." Despite his being a severe critic of the protective tariff, he advocated the payment of taxes out of consumption, through the addition of the taxes to the

⁷ *Nation* (March 7, May 2, 1878), 26: 162-63, 287.

⁸ George Marsland, "Congress and the Income Tax," *Bankers' Magazine* (March, 1878), 32: 678-84; Henry C. Kingsley, "Shall Incomes be Taxed?" *New Englander* (July, 1878), 37: 543-52.

⁹ St. Louis *Missouri Republican*, February 12, 1880; Ellis, *op. cit.*, 234.

price of goods sold. He disapproved of taxes not passed on to the consumer as an invasion of the rights of property.¹⁰ The disapproval of progressive income taxation to which he gave voice was in accord with the teachings of most of the early and middle nineteenth-century economists, but indicated a lack of flexibility and growth on Wells's part which even then was making him fall behind the newer developments both in economic theory and social reform.¹¹

Business Fluctuations and Tariff Changes

In the summer of 1879 harvest failures in Europe and a favorable season at home enabled American farmers to export unprecedented quantities of breadstuffs at high prices. In three years prosperity spread from the farmers and the grain-carrying railroads to merchants, manufacturers, and producers of raw materials until good times reached their peak in 1882. A recession in business activity then began which reached the stage of an acute crisis in May, 1884. With the return of prosperity in 1880, advocacy of federal income and inheritance taxes declined, but tariff revision sentiment gained strength. The resumption of specie payments in 1879 and the revival of prosperity caused a great increase in imports and in the customs revenue. From 1880 to 1890 the surplus revenue in the Treasury was, on the average, a hundred million annually. This situation compelled a revision of the protective tariff, as the Republicans feared they might lose power unless they made some concessions to the growing popular feeling in favor of a reduction of the high protective duties and of the federal revenue. Hence in 1882 a Tariff Commission was appointed to report on "the establishment of a judicious tariff, or the revision of an existing tariff, upon a scale of justice to all interests." A majority of the Commission appointed by Garfield's successor, President Chester A. Arthur, were advocates of high protection, and their president was John L. Hayes, the secretary of the Wool Manufacturers' Association. Nevertheless they admitted in their report that "a substantial reduction of tariff duties was demanded, not by a mere indiscriminate clamour, but by the best conservative opinion of the country, including that which has in former times been most strenuous for the preservation of our national industrial defenses." They recommended an average reduction of from 20 to 25 per cent, to be applied to commodities of general necessary consumption, like

¹⁰ D. A. Wells, *North American Review* (March, 1880), 130: 236-46.

¹¹ Josiah Stamp, *Fundamental Principles of Taxation* (London, 1929), 38-39.

sugar and molasses, and to raw materials, rather than to luxuries or to manufactured goods.

The Senate tacked a tariff bill based in the main on the recommendations of the Tariff Commission on to a House bill for the reduction of internal taxes, but the protectionists in the House managed through adroit parliamentary maneuvers to check the reduction of duties. They abolished such internal taxes as those on bank checks, matches, savings-bank deposits, patent medicines, perfumeries, the capital and deposits of banks. The only important internal taxes retained were those on spirituous and malt liquors, tobacco, and national banks. Then the protectionists were able to secure modifications of the tariff bill along lines of high and even increased protection. Some reductions were made in the duties on raw wool, cheap cotton goods, pig iron, steel rails, copper, marble, nickel, and barley. But in general the duties were raised on protected articles, importations of which had continued in large volume, especially on iron ore, certain manufactures of steel, and the better classes of woolen and cotton goods. The Act of March 3, 1883, retained practically unchanged the high level of tariff duties established during and after the Civil War. None of the changes in the rates of the customs duties was large enough to create a perceptible difference in the conditions under which either American commerce or industry was conducted. The next year William R. Morrison of Illinois proposed an average all-round tariff reduction of 20 per cent, with the rates of duty of the Morrill tariff of 1861 as the maximum. His measure was defeated, however, by a combined vote of Republicans and protectionist Democrats.¹²

Meanwhile some slight activity in favor of the income tax had been going on during these five years. From 1880 to 1884 three bills were introduced into Congress by representatives hailing from three different southern states, though none was enacted into law. Joseph Pulitzer initiated a journalistic propagandea campaign and made an aggressive demand for the income and inheritance taxes a part of his ten-plank editorial platform in the New York *World* from the time he took it over in 1883. In the election of 1884 the Republican party took no clear-cut position in favor of a reduction of the tariff and made no mention of the income and inheritance taxes. Its presidential candidate was a staunch conservative, James G. Blaine, Secretary of State under Gar-

¹² Ashley, *Modern Tariff History*, 192-96; Dewey, *Financial History*, 415-23; Mitchell, *Business Cycles*, 45ff.; Stanwood, *American Tariff Controversies*, 2: 192-222; Taussig, *op. cit.*, 230-52.

field. The Democrats nominated as their presidential candidate Grover Cleveland, the courageous and honest Governor of New York. They criticized the Republicans for the unnecessary high rates of the tariff, but they, too, made no mention of restoring the income and inheritance taxes. Two minor parties did pay attention to this subject. The Anti-Monopoly party nominated as its candidate that demagogue Benjamin F. Butler of Massachusetts, and demanded the control of the giant monopolies in transportation, money, and the transmission of news. It also requested a graduated income tax and a tariff radically reformed in the interest of labor, instead of capital, through as light as possible duties upon necessities. About the same time the National Party of Greenbackers also nominated Butler as its candidate and called for a graduated income tax and a wise revision of the tariff laws through the raising of revenue from luxuries rather than necessities.¹³

The campaign of 1884 was one of the most bitter and most closely contested in American history, with charges and countercharges of public or private immorality hurled against the candidates of the two major parties. The result, however, was that Cleveland won the election by 219 electoral votes to Blaine's 182 and by a popular plurality of 23,000 votes out of a total vote of more than ten million. New York State, with its decisive 36 electoral votes, was carried by Cleveland by the extremely narrow margin of 1,149 votes out of nearly 1,200,000. Butler received only 175,000 votes in the entire country, only one half of what General James B. Weaver, the Greenback candidate in 1880, had received. This was undoubtedly due to Butler's reputation for duplicity and untrustworthiness, as well as the strong popular appeal of Cleveland.¹⁴

The Depression of 1884 and Social Changes

The depression which had begun in May, 1884, was remarkably brief, probably because a year of moderate liquidation had preceded the crisis. Although 1885 was an extremely dull business year, recovery was so prompt that financial journals declared 1886 the best business year since 1880. Rapid railway building was the outstanding feature of the revival. The return of prosperity and the sale of large blocks of railway securities abroad led to enormous importations of merchandise which yielded the federal government a surplus revenue

¹³ Edward Stanwood, *A History of the Presidency*, 419-49; Don C. Seitz, *Joseph Pulitzer* (New York, 1924), 141ff.

¹⁴ Allan Nevins, *Grover Cleveland* (New York, 1932), 145-88.

exceeding one hundred million in each of the fiscal years 1887 to 1890. The Independent-Treasury system, by locking up these excess funds in the government vaults, caused a constriction in the money market despite the government's purchases of government bonds at high premiums, prepayment of interest on the public debt, and large deposits in national banks. The Democrats proposed to solve the problem through a reduction of the tariff, and the Republicans through an extension of protectionist principles and an increase of pensions for Civil War veterans.¹⁵

During Cleveland's administration, the first Democratic one since the Civil War, several notable developments affected the balance of social forces within the country and hence the outstanding tax problems. During the depression of 1884 the Knights of Labor had increased in membership by leaps and bounds, largely because of their success in using the strike and the boycott to fight wage reductions. A strong movement for an eight-hour day developed. Then the tragic Haymarket Affair of May 4, 1886, gave the capitalistic press the means to break the power and prestige of the Knights of Labor by identifying them with reckless violence and bomb outrages. This defeat for the Knights of Labor was a misfortune of the first order for the labor movement as a whole. The American Federation of Labor, under the leadership of Samuel Gompers, then became the dominant labor organization, but its craft-unionism represented a strategic retreat from the struggle for the advancement of all groups of labor.

Before the Knights of Labor went into eclipse in 1889 as a distinctive labor union, it was stimulated by the attacks upon it to take part in the political campaigns of 1886-87. At their General Assembly meeting in 1884 they had voted into their constitution an article reading "that all lands now held for speculative purposes be taxed to their full value." In 1885 proposals had been made in Texas and at the national General Assembly for amalgamation and political action with the Grangers and Anti-Monopoly societies. At the special session of the General Assembly in Cleveland, May 25-June 3, 1886, a list of ten political demands was made. Among them was the demand for a graduated income tax. Others related to the land question, the abolition of the property qualification for voting, and the need for a lobby at Washington. Platform declarations were succeeded by action. In the 1886 elections labor candidates for various local and state offices on labor tickets were elected. Henry George made a remarkable showing in New York City as candidate for mayor on a single-tax plat-

¹⁵ Mitchell, *op. cit.*, 46; Noyes, *op. cit.*, 73-126.

form, supported by the Knights of Labor, trade-unionists, socialists, and liberals. He received 68,000 votes against 90,000 cast for Abram S. Hewitt, the Democratic candidate, and 60,000 for Theodore Roosevelt, the Republican candidate. Two labor candidates running on the Democratic ticket were elected to Congress from Ohio and Indiana.

These political successes inspired a movement for a farmer-labor party. In September, 1886, a convention was held at Indianapolis with representatives from the Knights of Labor, the Farmers' Alliance, the Farmers' and Laborers' Co-operative Union, the Wheel, the Grange, the Greenbackers, the Corn Planters, and Anti-Monopolists. On February 2, 1887, a second convention at Cincinnati formed the National Union Labor party which absorbed what was left of the Greenback Labor party. By the fall of 1887, however, the political labor movement went into a decline despite an agreement with the Farmers' Alliance, approved at the 1887 General Assembly, that both farmer and wage earner were suffering from "unjust laws enacted in the interests of chartered corporations," and that a dual lobby at Washington should be maintained to protect their common interests. Differences developed among the single-tax followers of Henry George, the United Labor party, and the Union Labor party. Two national labor conventions were held in 1888. The United-Labor party nominated Robert H. Cowdry for president while the Union party nominated A. J. Streeter, president of the Northern Farmers' Alliance.¹⁶ Neither was a labor party in the true sense of the term.

Cleveland's Social Outlook and First Administration

Grover Cleveland was a liberal and not a radical. Hence, he did not support these movements, but tried earnestly to carry out his own conception of good government. This view was concerned in the main with what was good for the small businessman and farmer: economy in government expenditures, reduction of the tariff, and support of civil service. Under the Republican regime pensions had been granted liberally and without critical scrutiny to a great many veterans of the Union army. In 1862 the government had established a system of disability pensions which compensated every soldier or sailor who could trace some bodily ailment directly to his wartime service, and had

¹⁶ John R. Commons, et al., *History of Labour in the United States* (4 v., New York, 1918-36), 2: 269-470; Norman J. Ware, *Labor Movement in the United States*, 350-70.

made provision for widows, orphans, and other dependents. The total number of pensioners had risen to 238,000 in 1873, but had begun a slow decline until after the passage of the Arrears of Pensions Act of January 25, 1879. This allowed arrears to be collected for the period from the date of injury in all claims filed before July 1, 1880. The number of pensioners immediately began to rise until in 1885 there were 325,000. Although Cleveland signed far more special pension bills than he vetoed, the vigor and number of his vetoes temporarily stopped the flood of unscrupulous and fraudulent claims and saved the Treasury from what Cleveland considered an unwarranted drain on its surplus funds. On February 11, 1887, Cleveland vetoed the Dependent Pension bill passed by Congress, which would have granted a government stipend to every disabled veteran of at least three months' honorable service who was dependent upon his own exertions for support, and would have pensioned the dependent parents of soldiers who had died in the service. This veto was an assertion of laissez-faire, strict economy principles as well as a thrust at sinecure seekers. Five days later he vetoed a bill granting \$10,000 for seed-grain to be given to certain counties in Texas which had suffered from a drought. Cleveland, contrary to prevalent present-day views, felt that the power and duty of the federal government did not extend to the relief of individual suffering which, in his opinion, was in no manner properly related to the public service or benefit. He felt, as President Herbert Hoover did in 1930, that "though the people support the Government the Government should not support the people."¹⁷

On March 2, 1889, Cleveland vetoed a bill providing for repaying to the states, territories, and the District of Columbia the money collected under the direct tax levied by Congress in 1861. This would have relieved the Treasury of at least \$15 million, or, if the percentage allowed for collecting the tax were included, of over \$17 million. Cleveland objected to the harmful effects to state financial policy which such a gift would create and asserted that the people's money could be used in better ways. He also urged a reduction in taxes—tariff duties, by implication—as the best way of dealing with the surplus revenue problem. Yet he was not opposed to spending government money on matters connected with the commercial prosperity of the country, such as the building of a new navy. William C. Whitney,

¹⁷ Nevins, *Cleveland*, 322-32; Richardson, *Messages and Papers of the Presidents*, 8: 549-58.

his Secretary of the Navy, was allowed to reorganize his department on an efficient and technically modern basis. This type of government investment Cleveland clearly approved of.¹⁸

Tariff Reform as an Issue

On the question of tariff reform Cleveland did not take an aggressive stand until the spring of 1886. He feared injuring established American industries and creating a schism in the Democratic party. Nevertheless his Secretary of the Treasury, Daniel Manning, in his annual report of 1885, called for revision of the tariff. Meanwhile a strong tariff reform movement was exerting pressure on the Cleveland administration. Importers and merchants like Isidor and Oscar Straus, political liberals like Carl Schurz, Jacob D. Cox, Hugh McCulloch, Montgomery Blair, and Lyman Trumbull, publicists like Edwin Godkin, George W. Curtis, Henry Watterson and James Russell Lowell, and economists like David A. Wells, William Graham Sumner, A. L. Perry, and General Francis A. Walker, as well as the western farmers, made their influence felt in Congressional elections and through propaganda. Free-trade clubs had been flourishing in New York and Boston since 1880. A National Tariff Reform League was formed at Chicago in November, 1885, with David A. Wells as president. The consequence of this activity was the attempt by William R. Morrison, the Democratic Chairman of the House Ways and Means Committee, to have the tariff revised downward in the spring of 1886. This effort was defeated on June 17 by a vote of 157 to 140 through a coalition of 122 Republicans and 35 Democrats headed by Samuel J. Randall, the formidable protectionist Democrat from Pennsylvania. The tariff issue was carried over into the Congressional campaign of 1886, but the results of the election were indecisive on this point. The Democratic majority in the House was reduced considerably through the lavish spending of industrial organizations, particularly the iron and steel interests, but the Republican majority in the Senate was also severely cut. Cleveland's plea for tariff reduction in his December, 1886, Message inspired Morrison to a renewed thrust at opening the tariff issue, but his motion was voted down in the House by 154 to 149, a narrower margin of defeat than in the vote of the previous spring.¹⁹

Cleveland was a fighting statesman. He was now positively alarmed

¹⁸ Nevins, *op. cit.*, 217-23; Richardson, *op. cit.*, 8: 837-43.

¹⁹ Nevins, *op. cit.*, 280-98.

by the large surpluses the excessive revenue from tariffs was piling up in the Treasury. After careful consultation with trusted advisers during the summer of 1887, he drew up his annual message to Congress. This broke all precedents by its being devoted exclusively to an attack on the high protective tariff "as a vicious, unequitable, and illogical source of unnecessary taxation" which "ought to be at once revised and amended." Without subscribing to free trade, he urged the reduction of the surplus revenue through a general reduction of tariff duties and the removal of the duties on raw materials. He criticized the tax laid upon the consumer for the benefit of the manufacturer as aiding the rise of industrial trusts and their extortion of high prices. His final words became celebrated: "It is a condition which confronts us, not a theory. . . . The simple and plain duty which we owe to the people is to reduce taxation to the necessary expenses of an economical operation of the Government." This, he affirmed, could be done with safety to industry and labor and with benefit to all the people "by cheapening their means of subsistence and increasing the measure of their comforts." The impact of this message on Democratic Congressmen was so powerful that it galvanized them into immediate action and committed the Democratic party from that time onward to a policy of opposition to the existing protective system. All the Democrats in the House except four voted for the strong reform bill introduced in the spring of 1888 by Roger Q. Mills, the free-trade chairman of the Ways and Means Committee.²⁰ Since the Republicans controlled the Senate, there was no chance that the Mills bill would be enacted that year.

The Presidential Election of 1888

Nevertheless Cleveland had succeeded in making tariff reform an issue for all the American people to consider seriously. It was the primary issue in the presidential campaign during the fall of 1888. Cleveland's renomination as the Democratic presidential candidate was an endorsement of his vigorous tariff position, as well as his emphasis on economy in governmental expenditures. The Republicans, who nominated Benjamin Harrison, a grandson of William Henry Harrison, with a solid reputation as a soldier, lawyer, and Senator, denounced the Cleveland administration for its position on foreign affairs and the tariff. The Union Labor party at its convention in Cincinnati criticized the evils of capitalism with special reference to land mo-

²⁰ Nevins, *op. cit.*, 367-98; Richardson, *op. cit.*, 8: 580-91.

nopoly, bank control of credit and money, the exploitation of labor, and the existence of trusts. Its platform also declared that: "A graduated income tax is the most equitable system of taxation, placing the burden of government on those who can best afford to pay, instead of laying it on the farmers and producers, and exempting millionaire bondholders and corporations." On the debt question they demanded the immediate application of all the money in the Treasury to the payment of the bonded debt and condemned the further issue of interest-bearing bonds, either by the national government or by states, territories, or municipalities. The United Labor party at its convention advocated the Henry George plan of tax reform by taxing "the increasing values which the growth of society adds to land." It also urged government ownership and control of the railroads and telegraphs.

The outcome of the election was decided by the superior organization, unity, and tactics of the Republicans. The Republican National Committee knew how "to fry the fat" out of the business beneficiaries of the party. Pressure organizations like the American Iron and Steel Organization, the Protective Tariff League, supported by the "One Thousand Defenders of American Industries," the Home Markets League in New England, and the Industrial League in Pennsylvania, operated with efficiency and dispatch in spreading propaganda and in using their funds where most needed. The Democratic organizations which attempted to compete with these high-pressure groups were the American Free Trade League, the Massachusetts Tariff Reform League, the New York Reform Club, the American Tariff Reform League, and the Iroquois Club. Cleveland, nevertheless, might have won the election if it had not been for certain unforeseen events. The Republicans were able to win New York State through the hostility of its manufacturers to Cleveland's tariff views, the opposition of many prohibitionists and mugwumps to David B. Hill, the Democratic candidate for governor, and the double-crossing engaged in by many shifting and calculating Democratic machine men. They thought that by electing Hill Governor and defeating Cleveland for the presidency, they would ensure Cleveland's political retirement and Hill's rise to the presidency in 1892. The Republicans resorted also to bribery to win Indiana and New York to their side. In the popular vote Cleveland had a plurality of about 100,000 over Harrison; Harrison had 233 electoral votes to Cleveland's 168. The Union Labor and United Labor parties together polled only 150,000 votes.²¹

²¹ Nevins, *op. cit.*, 398-402, 414-42; Stanwood, *History of the Presidency*, 1: 457-85.

The Harrison administration, once in power, proceeded to enact a program calculated to benefit big business while making some concessions to the small businessman and farmer. On June 27, 1890, the Disability and Dependent Pension Act for Civil War veterans incapable of manual labor and dependent widows and children became law. A few days later the Sherman Antitrust Act was passed, making illegal contracts and combinations in restraint of interstate and foreign commerce. On July 14 the Sherman Silver Purchase Act became operative and superseded the Bland-Allison Act of 1878. This new measure was another and greater compromise with the strong demand for free silver from the farmers and miners of the Far West. The six new states admitted into the Union in 1889-90—North and South Dakota, Washington, Idaho, Montana, and Wyoming—were responsible for this concession from the conservative East. The Act authorized the Secretary of the Treasury to purchase 4,500,000 ounces of silver bullion each month and to issue in payment thereof Treasury notes of full legal tender. This provided for the purchase of all the American output in silver, but did not admit unlimited coinage of silver dollars and asserted that the government would maintain a parity between gold and silver.²²

The McKinley Tariff

These measures for the small businessman, farmer, miner, and Civil War veteran were counterbalanced by the McKinley Tariff Act of October 1, 1890. The advocacy of lower duties by Cleveland led the Republicans not only to champion the existing tariff system, but to urge its further extension by an increase of duties generally. The Republicans in the Senate during the fall of 1888 had presented in opposition to the Mills bill the Allison bill, which on the whole increased the protective rates in the tariff although it provided some reductions and readjustments designed to win farm votes in the discontented Northwest. This bill passed the Senate but failed to get past the House. With a majority in both houses of Congress after the newly elected Congress met in December, 1889, the Republicans, under the leadership of William McKinley in the House and Nelson W. Aldrich in the Senate, felt free to make the most drastic extension of the protective system.

The McKinley tariff increased the average rate imposed on dutiable imports from 44 per cent to 48 per cent. It attempted to extend

²² Noyes, *op. cit.*, 127ff.

protection to certain agricultural products in order to allay the dissatisfaction of the farmers who were turning toward the Democratic and Populist parties. It placed sugar, duties on which had brought in over \$55 million in 1889, on the free list and granted a bounty of two cents a pound for fourteen years on the production of sugar within the United States. The law also introduced the principle of commercial reciprocity, initiated at the suggestion of James G. Blaine, Harrison's Secretary of State, and put into widespread operation decades later by Secretary Cordell Hull. Finally, the Act was an incentive to industrial monopoly and a nullification of the possible good effects which might have flowed from a real enforcement of the Sherman Antitrust Law.

The political and economic consequences of this Republican legislation were far different from what the Republican leaders had anticipated. In the November elections of that year the Republicans suffered a disastrous defeat. In the new Congress they secured only one quarter of the Representatives; their opponents, Democrats and Populists, outnumbered them three to one. Yet during their brief reign of power the Republicans brought about an imperilment of the gold standard and a reduction in the surplus from \$111 million in 1888 to \$26 million in 1891 and \$9 million in 1892. The excessive rates of the McKinley tariff, the increase in expenditures on pensions from \$98 million in 1889 to \$157 million in 1893, the millions spent on purchasing silver bullion, the appropriations for an expanded program of river and harbor improvements and for the construction of a steel navy, and the return to the northern states of the direct tax collected during the Civil War, all these contributed to a dangerous reduction in the Treasury surplus and to some of the conditions making for the panic of 1893.²³

The Background of Social and Economic Discontent

The presidential campaign of 1892 brought to a head all the dissatisfaction which had been brewing among farmers, workers, small businessmen, and importers against the policies of the Republican party. The farmer resented the low prices he had been receiving for his produce since 1884, the high interest rates he had to pay on loans, the excessive freight rates charged by the railroads, the excessively high

²³ Noyes, *op. cit.*, 127-81; Stanwood, *American Tariff Controversies*, 2: 243-95; Taussig, *op. cit.*, 251-83.

prices he had to pay for manufactured goods from the East, the inelasticity of the currency, the control by the grain elevators of the market, and the overgenerous land grants to the railroads by the government. The worker was angered by the way federal and state troops were used to break strikes during the summer of 1892 at the Homestead Plant of the Carnegie Iron and Steel Company, at the mines of the Tennessee Coal, Iron, and Railroad Company, at the Coeur d'Alene silver mine in Idaho, and at the Buffalo railroad switches. The small businessman and the importer feared that the McKinley tariff would increase prices and the cost of living and would encourage the growth of monopolistic corporations which had gained such impetus since the organization of the Standard Oil Trust by John D. Rockefeller in 1879.

Certain figures in the intellectual scene also were seeking to undermine the dominance of the industrialist and financier in this period. Henry George in his *Progress and Poverty*, published in 1879, began a movement against the selfish monopolization of land as the primary cause of poverty and advocated as the solution the appropriation of all rent by taxation and the abolition of all taxation except that upon land values. His program was a weapon for fighting against the unearned increment in rental values obtained by real estate speculators in the rapidly growing, highly congested cities of the East and in the rich frontier regions of the West.

But George was a champion of Jeffersonian democracy in an age in which the agrarian basis of such a society was becoming circumscribed by the expansion of industrialism. Although he clearly indicated one important cause of the exploitation of the common people, he did not realize sufficiently that in the new order of industrial and financial capitalism arising in his day other sources of power and privilege existed which had to be challenged as much as land monopoly. His analysis and solution were inadequate for capturing the centers of control in the economic system dominated by Rockefeller, Morgan, and Carnegie. Yet George himself was sure that "with the abolition of the land monopoly, socialism must die out" and that "the mixture of socialism with the single tax confuses the issue and delays our progress."²⁴ After 1886 the path which the labor and farmer rebels took diverged more and more from his. Nevertheless his ideas acted as a ferment and aided the growth of the Populist party and the Progress-

²⁴ *George to John Paul, November 7, 1893, Henry George Papers, New York Public Library.*

sive Movement associated with Robert La Follette, Theodore Roosevelt, and Woodrow Wilson.²⁵

Instead of looking backward to the dream of the Physiocrats and Jefferson about an agrarian democracy, Edward Bellamy looked forward to the development of industrial capitalism into a national socialistic commonwealth. Out of the frustrations of a middle-class intellectual in a highly competitive, profit-seeking, wasteful economy, Bellamy projected a Utopian romance entitled ironically *Looking Backward 2000-1887*, which was published in 1888. This novel portrayed a society in which the state owned all the resources and agencies of production and distribution, and created complete political, economic, and social equality for all through the full social utilization of science, invention, and the machine system. This non-Marxian vision of social salvation, achieved without any class struggle or violence, through the diffusion of enlightenment and good will, soon evoked intense and widespread enthusiasm and interest. Nearly 400,000 copies of the book were sold within ten years in the United States alone. The rising Populist movement among the farmers and workers was stimulated in many ways by the Bellamy Nationalist principles, and in many ways, too, aided in their dispersion. The *Farmers' Alliance*, an important farm newspaper, for example, offered in 1889 a copy of *Looking Backward* and a year's subscription to the paper for a dollar and a quarter. The book alone could be obtained in paper covers for fifty cents. Bellamy's ideas, however, were not sufficiently linked to specific social mechanisms and definitely articulated groups for translation into action on the scale he envisaged. But different elements of his thought became effective through the medium of the Populist party's platform in 1892 and through the activities of the more radical elements in the labor movement.²⁶

²⁵ On the general cultural background of post-Civil War America, the classic work still is Vernon L. Parrington, *The Beginnings of Critical Realism in America* (New York, 1930). Other useful studies are Ralph H. Gabriel, *The Course of American Democratic Thought* (New York, 1940); Fred E. Haynes, *Social Politics in the United States* (Boston, 1924); and Edward R. Lewis, *A History of American Political Thought* (New York, 1937). On Henry George and his influence, see Charles Abrams, *Revolution in Land* (New York, 1939); Carl R. Bye, *Developments and Issues in the Theory of Rent* (New York, 1940); J. R. Commons, *History of Labour*, 2: 446-61; George R. Geiger, *The Philosophy of Henry George* (New York, 1933); Henry George, *Complete Works* (10 v., New York, 1871-97); and Arthur N. Young, *The Single Tax Movement in the United States* (Princeton, 1916).

²⁶ Cf. Gabriel, *op. cit.*, 210-12; John D. Hicks, *The Populist Revolt* (Minneapolis, 1931), 131-32; Arthur M. Schlesinger, *The Rise of the City 1878-1898* (New York, 1933), 262, 426; Norman J. Ware, *Labor in Modern Industrial Society* (Boston, 1935), 208, 265.

Another rebel, Henry Demarest Lloyd, published in 1894 his *Wealth against Commonwealth*, a scathing indictment of the emerging monopoly capitalism as exemplified by the methods of the Standard Oil Company. But he had begun ten years earlier his exposé articles on the oil monopoly, corruption in the Land Grant Office, the abuses of the railroads, and the injustice done to the Haymarket martyrs. He started as a muckraking reformist of capitalism and ended as an advocate of government ownership in all fields in which private sovereignty had become through monopoly a despotism over the public. His writings, though often exaggerated and inaccurate, became an arsenal of facts and arguments for reformers and radicals and were influential in molding the programs of the diverse farmer-labor groups.²⁷

Realistic novelists also contributed to the currents making for social change through taxation and other means. Mark Twain's *The Gilded Age* and *A Connecticut Yankee in King Arthur's Court* were satires pointed with wit and humor against social injustices and weaknesses. William Dean Howells, in *A Hazard of New Fortunes* (1889) and *A Traveller from Altruria* (1894), indicted competitive capitalism and pictured the benefits of a socialistic community along the lines of Edward Bellamy's earlier Utopia. Hjalmar H. Boyesen portrayed in a realistic manner in *The Mammon of Unrighteousness* (1891) and in two later and slighter novels the distorting and dehumanizing effects of the ruthless struggle for wealth and power in the American business world. Many other less-well-known writers expressed their resentment at the evils of an expanding capitalistic system with its accompanying contractions for the common man by depicting societies in which their wish fulfillments could be realized. Still other novelists depicted the bitterness resulting from the plight of the farmer caught in the grip of an evolving, evermore complex national and world economic system, in which the banker, the manufacturer, the railway and grain elevator companies, and the grain market speculators had the upper hand. E. W. Howe's *The Story of a Country Town* (1884), Harold Frederic's *Seth's Brother's Wife* (1887), Joseph Kirkland's *Zury: The Meanest Man in Spring County* (1887), and Hamlin Garland's *Main-Travelled Roads* (1891) were most powerful pioneering studies of the harshness and drabness of a rural life burdened with

²⁷ Cf. John Chamberlain, *Farewell to Reform* (2d ed., New York, 1933), 48-55; Caro Lloyd, *Henry Demarest Lloyd* (2 v., New York, 1912); and Allan Nevins, *John D. Rockefeller* (2 v., New York, 1940), 2: 53ff., 331ff.

toil and deprived of the advantages and joys the American farmer and his family felt they were entitled to.²⁸

The Populist Revolt

The mighty Populist revolt sprang from these many sources: the discontent of the farmers, workers, and small businessmen, reinforced and patterned by discussions such as arose from the writings of George and Bellamy, the realistic novelists, and the publicists. A struggle developed against the dominance of the industrialists, merchants, and financiers over the farmer and worker. Attacks were made on corporate privilege and on the inequalities of the taxation system. This revolt was based in the main on the activities of the farmers. Although the Granger movement had collapsed in the middle eighteen-seventies, some of the Grangers had survived, and in the eighteen-eighties new farmers' clubs arose spontaneously and became organized into alliances. The most important of these were the Southern and Northwestern Alliances.

In December, 1889, the Southern Alliance and the Knights of Labor, although the latter had become extremely weak as a labor union, united at St. Louis in a plan of co-operation between "the millions who till the soil" and "the millions who consume the product of their labor." Their platform demanded "equal rights to all, and special privileges to none," and asserted that taxation, national or state, should not be used to build up one interest or class at the expense of another. At the same time and place the Northern Alliance declared that it favored a graduated income tax and "such a revision and reduction of the tariff that the taxes may rest as lightly as possible upon productive labor and that its burdens may be upon the luxuries." Unfortunately, the Southern and Northwestern Alliances were not able to unite sufficiently on economic and political issues to create a national organization.²⁹

During the elections of 1890 the Alliance men won control of the Democratic machine in some of the southern states while scoring victories in the West through state parties. They obtained command of five state legislatures and elected three governors, forty-four Representatives, and two Senators. The campaign put on by the farmers was like a religious crusade. Mrs. Mary E. Lease won votes through

²⁸ Cf. Parrington, *op. cit.*, 86-101, 168-88, 241-300; Schlesinger, *op. cit.*, 247-70; A. B. Forbes, "The Literary Quest for Utopia, 1880-1900," *Social Forces*, 6: 179-89.

²⁹ Solon J. Buck, *The Agrarian Crusade* (New Haven, 1920), 99-124; John D. Hicks, *The Populist Revolt*, 97, 124, 428-29.

her fiery eloquence and her advice to Kansas farmers that they should "raise less corn and more HELL!" In December, 1890, the Supreme Council of the Southern Alliance met at Ocala, Florida. Although no immediate action was taken on the demand of the Kansas delegation for a third party, the Council agreed that among other pressing reforms the existing high tariff should be removed from the necessities of life and a just and equitable system of graduated taxes on income be imposed.³⁰ The Alliance men, imbued with third-party hopes, held a convention with representatives from the Knights of Labor at Cincinnati in May, 1891, to form a new political party. In the platform adopted by the convention was a plea for a graduated income tax as well as for financial reform and government control of the means of transportation and communication. At St. Louis a great agrarian and labor convention was held in February, 1892, to work out plans for the final formation of the People's party, or Populist party as it was usually called, and to unite labor with the farmer on a common stand. The convention enthusiastically supported the ringing denunciation of the evils of American capitalism by Ignatius Donnelly, the noted Populist orator, and voted its approval of a program for economic reform, including a graduated income tax.³¹

The great event to which these various conventions served as a prelude was the first national convention of the People's party in Omaha. On July 4, 1892, this assembly enthusiastically adopted a platform which stressed reforms centered on land, transportation, and finance. Farmers and workers were called upon to unite, and demands were made for government ownership of railroads and the telegraph and telephone systems, a safe and flexible currency, with the sub-Treasury system of loans, and the free and unlimited coinage of silver and gold at the ratio of 16 to 1. In addition there were planks calling for a graduated income tax, honesty and economy in governmental expenditures, and postal saving banks. No mention, however, was made of a federal inheritance tax. Resolutions were also passed requesting the adoption of the secret ballot system, the initiative and referendum, and the direct election of United States Senators. But the emotional context of the source from which these proposals for reform came was conveyed in all its intensity in the bitterly severe arraignment of American society made in the preamble to the party platform by Ignatius Donnelly. The nation was pictured as brought to the verge of moral, political, and material ruin through political

³⁰ Hicks, *op. cit.*, 153-85, 205-10, 430-31.

³¹ Hicks, *op. cit.*, 223-29, 435-39.

corruption, the prostration of business, the impoverishment of labor, and the reduction of the free farmer to the status of tenant on land concentrated in the hands of a few capitalists. "The fruits of the toil of millions are boldly stolen to build up colossal fortunes for a few, unprecedented in the history of mankind; and the possessors of these, in turn, despise the republic and endanger liberty." Both the Republican and the Democratic parties were criticized for having permitted "the existing dreadful conditions to develop without serious effort to prevent or restrain them" and for not presenting any substantial reform or issue except that of the tariff.³²

Conflicting Issues and Interests in the 1892 Election

The Populist party nominated for President General James B. Weaver, of Iowa, a leader who had been the Greenback presidential candidate in 1888 and who had a reputation for ability, integrity, and oratory, although handicapped in the eyes of some by his record as an old-time agitator with whom defeat was a habit. The farmers and their supporters in the Knights of Labor entered the 1892 campaign determined to save the independence and security of the farmer and the worker from the despotism of corporate capitalism. In the same campaign the Socialist Labor party, despite its extremely small membership, almost entirely among immigrant workers in the East, presented a candidate and a platform which among more sweeping economic reforms favored a progressive income tax and a tax on inheritances, with exemptions for the smaller income.³³

Benjamin Harrison recaptured the presidential nomination of the Republican party against strong opposition by the machine bosses within the party and many of its leading figures. Whitelaw Reid, the owner of the conservative New York *Tribune*, was made the vice-presidential candidate. The party platform defended the McKinley tariff, evaded the free silver demands by advocating the use of both gold and silver so that a parity between them could be maintained, and indulged in other rhetorical assertions designed to create an impression of the party as champion of the cause of the farmer, the laborer, and the Negro. The Democratic party presented as its presidential candidate Grover Cleveland in the face of strong opposition from the New York machine politicians. He had the backing of those

³² Buck, *op. cit.*, 142-44; Hicks, *op. cit.*, 230-32, 439-44.

³³ Hicks, *op. cit.*, 232-37; Stanwood, *A History of the Presidency*, 1: 513-15; Ware, *Labor Movement in the United States 1860-1895*, 367-70.

concerned about administrative honesty, tariff reform, and a conservative financial policy. Many eastern bankers, members of Wall Street associated with William C. Whitney, rich merchants like Isidor and Oscar Straus, and railroad magnates like Henry Villard, who were fearful of the threat to the gold standard and the other proposals of the Populist party and were dissatisfied with or pessimistic about the Republican party, turned to Cleveland as their defender, and used their influence in his behalf. The vice-presidential nomination was given to Adlai E. Stevenson of Illinois, as a concession to the Democrats desiring free silver and patronage. The Democratic platform was notable chiefly for its denunciation of "Republican protection as a fraud, a robbery of the great majority of the American people for the benefit of a few" and of the McKinley tariff "as the culminating atrocity of class legislation." The rest of the platform was an appeal to the small businessman, the farmer, and worker, and to those sympathetic to white supremacy in the South against the policies of the Republicans. The plank on the silver issue equaled that of the Republican party in its equivocation and tried to please all factions by supporting the use of both gold and silver on terms ensuring their parity.⁸⁴

The conclusion of the hard-fought campaign of 1892 was the election of Grover Cleveland to the presidency for a second term. Cleveland won 277 electoral votes to Harrison's 145 and Weaver's 22. The significant thing about this election, however, was not the defeat of the Republican party, discredited with the majority of Americans by its excessive favoritism to big business and by the lack of popular appeal of its candidate, but the remarkable successes scored by the Populists. Through fusion with the Democrats in the West, Weaver carried Colorado, Idaho, Nevada, Kansas, and North Dakota, and polled over a million votes, about 9 per cent of the total. The Populist vote undoubtedly would have been even greater if the discontented farmers of the South had not been hindered in their support of the Populist party by their fear that white supremacy would be lost once the Democratic monopoly were broken. The Populists also were unfortunate in not being able to attract a large support from the prosperous farmers and the industrial workers of the Northeast, either because they disapproved of the radicalism of the Populists' platform or were drawn to support a mild liberal like Grover Cleveland.⁸⁵

⁸⁴ Nevins, *Cleveland*, 480-98; Stanwood, *op. cit.*, 1:486-505.

⁸⁵ Hicks, *op. cit.*, 238-73; Nevins, *op. cit.*, 498-509; Stanwood, *op. cit.*, 1:516-18.



Pressure Politics on Tax Issues

THE problem of achieving the reforms in taxation and other matters desired by the liberal Democrats and by the Populists was rendered extremely difficult by the downswing in the business cycle known as the panic and depression of 1893. The conditions which had inspired a revolt against the rule of monopoly capitalism as embodied in the Republican party became acute and led to increased efforts to create a more favorable situation for the farmer and the industrial worker. Paradoxically, this in turn led to a reaction and counterthrust by diverse conservative groups against reforms in general. The second administration of Grover Cleveland is notable for the opportunities which were open to groups desiring social change but which were not brought to fruition.

Cleveland and the Panic of 1893

When Cleveland took office on March 4, 1893, heavy failures among important business firms had already begun, and by May one of the most violent panics in the country's history had broken out. Republicans like Thomas B. Reed, Speaker of the House, attributed it to the fear of tariff reductions aroused by the sweeping Democratic victories in the autumn of 1892. In reply, the Democratic spokesmen gave as the cause of the panic the legislation and extravagance of the Harrison administration. But impartial investigators now point to various factors throughout the world which contributed to bringing the crisis into being. France had undergone a mild depression beginning in 1889. England had suffered a severe crisis in the autumn of 1890 from the suspension of the famous banking house of Baring Brothers. This crisis had spread to Germany and had ushered in a depression which lasted in the three leading European countries until the

close of 1894. Meanwhile farmers and businessmen in the United States had benefited from the poor harvests in Europe in 1891, but from 1892 on uneasiness was caused among businessmen by the decreasing gold reserves in the Treasury. This had resulted from the decrease in revenue yielded by the McKinley tariff, the large silver purchases authorized by the Sherman Silver Purchase Act of 1890, and the excessively generous appropriations of the Republicans. The consequence was that foreigners not only stopped buying American securities, but also tried to unload their holdings upon the New York market. An outflow of gold from America to Europe began which, in terms of net gold exports from February, 1891, to June, 1893, amounted to about \$155 million.

This loss of gold threatened a suspension of gold redemptions by the Treasury and hence a depreciation in the gold value of the dollar. Although no law specified the amount to be held in reserve, business sentiment, based upon *auri sacra fames*, Treasury practice, and certain incidental clauses of monetary statutes, had come to consider \$100 million in gold the minimum balance consistent with safety. The Treasury reserve fell from \$150 million in February, 1891, to \$110 million in July, 1892, and after rising to \$121 million by December 31, 1892, would have fallen far below the \$100 million mark during the spring of 1893 if it were not for aid from the New York banks. But on April 15, 1893, John G. Carlisle, Cleveland's Secretary of the Treasury, publicly was forced to admit that the gold reserve in the Treasury had fallen below the \$100 million mark. To reassure the business world that the United States was not going off the gold standard, Cleveland announced on April 24 that he and the Cabinet were determined to preserve the parity between gold and silver. On June 30 he issued a call for a special session of Congress beginning August 7. A short time before this the British government had closed the mints in India to the free coinage of silver and had caused a decline in the price of silver bullion. This made the eastern financial circles in the United States have even greater fears concerning the possible pressure on the Treasury from the silver mine interests of the West. Finally, the economic disorganization of the country was intensified by the various failures and weaknesses caused by the overexpansion of railroad construction, of manufacturing establishments, of such new corporate creations as the trusts, and by rash speculation in farm lands and town lots. To cap the climax, the farmer, who had suffered from farm prices hitting a new low after the panic, was plagued by partial crop failures in 1893.

On August 7, 1893, a dramatic battle over the repeal of the Sherman Silver Purchase Act began in Congress, and ended on October 30 in a victory for Cleveland and the supporters of the gold standard. This freed the Treasury from the drain involved in the constant purchase of silver, yet the other factors making for depletion of the gold reserve and the lack of improvement in commerce and industry exhausted the Treasury's immediate revenues. The panic had run its course by the end of October, but a deep depression followed throughout the rest of 1893 and 1894. In fact it lasted, despite a temporary revival of business in the summer of 1895, until the end of 1897.¹

Democratic Pledge of Tariff Reform

Against this background of prostrated trade, shaken credit, depressed agriculture, and labor on the verge of open revolt, the Democrats had to meet their 1892 campaign pledge of tariff reform. The Democratic party had been carried into power in the Congressional elections of 1890 and the presidential election of 1892 by those opposed to the essential inequality and injustice of the McKinley tariff, with its fostering of increased prices and its aid to the dangerous power of the trusts. Moreover, the McKinley tariff had proved its inability to meet the expenses of the government under the prevailing trade conditions. The excess of federal revenue over expenditures declined from \$85 million in 1890 to \$26 million in 1891, and to a little under \$10 million in 1892. But the revenue deficit became continuous in every quarter from September, 1892, on, with the result that the \$2 million surplus of June 30, 1893, was offset in June, 1894, by a deficit of \$61 million. Hence revision of the tariff downward would have been required to increase the revenue even by a Republican administration.²

The political situation was complicated by the fact that although the Democrats had a majority in the House of Representatives, with 218 members as against 127 Republicans and 11 Populists and Independents, the Democratic control of the Senate was insecure because there were only 44 Democrats as against 38 Republicans and 3 Populists. Furthermore, the sharp struggle over the silver issue within the

¹ James A. Barnes, *John G. Carlisle* (New York, 1931), 216-86; Dewey, *Financial History*, 434-62; W. Jett Lauck, *The Causes of the Panic of 1893* (New York, 1907); W. C. Mitchell, *Business Cycles*, 51-63; Noyes, *Forty Years of American Finance*, 153ff.; Nevins, *Grover Cleveland*, 510-48.

² *Treasury Report* (1893), LXIX.

ranks of both parties had weakened party discipline, especially among the Democrats. The debtor classes of the West and South and their representatives in Congress felt aggrieved at Cleveland and the eastern Democrats and Republicans for their defense of the gold standard, which seemed to be dictated by Wall Street. The great masses desired a cheaper dollar than the gold dollar, whose purchasing power, nearly double that of 1873, had correspondingly increased the burden on the debtor. Moreover, many Populists felt that silver reform would not only prevent a collapse in commodity prices but would also pave the way to other and greater reforms, such as the government ownership of railroads.

Cleveland, on the other hand, was inspired by an intense conviction that upon the preservation of the gold standard the economic welfare of the nation hung. The savage force with which Cleveland pushed through the repeal of the silver purchase measure despite the vehement opposition of William Jennings Bryan in the House and William V. Allen in the Senate created among the radical Democrats and the Populists an antagonism toward conservative finance, and toward a government which seemed to the Populists to be its representative. Yet Cleveland could not count on the conservatives in the Democratic and Republican parties who had supported his gold standard policy to back him on tariff reform. Most of the Republicans were, in tariff matters at least, like the Bourbons, who never forgot anything and never learned anything. A small but powerful minority group among the Democrats, especially in the Senate, even had protectionist sympathies and were willing to indulge in logrolling with the Republicans.³

At the special session of Congress, called by Cleveland for the special purpose of repealing the 1890 silver purchase measure, Charles F. Crisp, the Speaker of the House, appointed William L. Wilson of West Virginia as chairman of the very important Ways and Means Committee. While the struggle over the silver issue raged, this committee, selected on August 23, 1893, worked on the problems involved in writing a revenue bill which would free commerce from the onerous

³ Cf. Robert Giffen, *The Case Against Bimetallism* (4th ed., London, 1896); J. L. Laughlin, *History of Bimetallism in the United States* (4th ed., New York, 1897); John Maynard Keynes, *A Treatise on Money* (New York, 1930), 2: 289-301; Alfred Marshall, *Money, Credit, and Commerce* (London, 1923), 60-67; George F. Warren and Frank A. Pearson, *Gold and Prices* (New York, 1935), 246-96; Knut Wicksell, *Lectures on Political Economy* (London, 1935), 2: 36-44, 122-32, 215-28; H. P. Neisser et al., "Gold and the Monetary Problem," *American Economic Review* (Proc. v. 30, no. 5, February, 1941), 1-37.

duties of the McKinley Tariff and which would at the same time provide additional revenue for the Treasury. An income tax seemed to be one of the means of solving the Committee's difficulty.

The Income Tax Issue

The agitation for an income tax had been steadily growing since the late eighteen-eighties, especially within the Populist movement. Even the Ohio State Democratic Convention had approved a graduated income tax in the summer of 1891. Despite the harsh epithets hurled against the income tax by the conservative eastern newspapers, especially the New York *Tribune* and *Sun*, the Ways and Means Subcommittee on Internal Revenue investigated the possibilities and desirability of the income tax in a series of hearings and discussions from October, 1893, through January, 1894. Its chairman was a southerner of marked ability, Benton McMillin of Tennessee. An earnest advocate of the income tax, who had introduced bills for an income tax from 1879 on, he was now encouraged in his efforts by the enthusiasm for the proposal which his country-wide correspondence on the measure revealed.⁴

McMillin was supported in his views by eight of the eleven Democratic members of the Ways and Means Committee and was ably aided by William Jennings Bryan. Bryan had been re-elected to Congress in 1892 through the aid of the Populists, favored many of their principles, and had been urged to lead the income tax movement by C. H. Jones, editor of the St. Louis *Republic*. The latter wrote on May 8, 1893, a letter which reveals the motives and arguments behind western feeling on the subject at that time:⁵

I want to suggest to you that by far the most effective weapon for use against the Plutocratic policy is the graded income tax or an income tax of 5 per cent or 10 per cent on all incomes in excess of \$10,000 per annum. There is nothing which those Eastern Plutocrats dread so much as that, and it is a weapon which the Democrats should have used long ago to stop the piling up of pensions. At the present juncture I am quite sure there is nothing which could be so effectually used to put a cog in the wheels of the Plutocratic program. . . .

⁴ *Cong. Record*, 53d Cong., 1st Sess., 554; *Public Opinion* (July 25, 1891), 11: 372-73; (June 3, 1893), 15: 220; (June 17, 1893), 15: 265-66; D. A. S. Alexander, *History and Procedure of the House of Representatives* (Boston, 1916), 126; *New York World*, November 18, 1893.

⁵ Jones to Bryan, May 8, 1893, Bryan Papers, Library of Congress, cited by Barnes, *Carlisle*, 325. Cf. Hicks, *The Populist Revolt*, 262, 328; *New York World*, November 22, 24; December 5, 1893.

The income tax is one that ought to be levied at the next session of Congress. Some way of increasing the revenues must be found, especially if we are to redeem our pledges of tariff reform, and an income tax on abnormal incomes is far preferable to replacing the duty on sugar or even to an increase of the internal revenue tax on whiskey, though the latter may have to be resorted to also.

I suggest that you equip yourself for taking the lead in urging a tax on incomes. I do not believe there is any way in which a member of the House could impress himself on legislation and on the country more effectively than by fighting such a measure through. I think you could do it, and if you will undertake it I will be in Washington to back you up.

This may have inspired Bryan, during the fall of 1893, to work out a plan for a graduated income tax with an exemption limit of \$3,000 or \$4,000. He regarded this tax as preferable to an increase of the tax on tobacco and beer since it did not increase the burdens of the poor. But Bryan was not alone in his views. Support for the income tax also came from southern and western Congressmen, among whom the most ardent was Uriel S. Hall of Missouri.⁶ Similar economic and sectional cleavages existed in the House Ways and Means Committee itself. Early in November, 1893, eight of the Democratic members were in favor of the income tax; they were from the West and South. Three Democrats were opposed: William L. Wilson, the chairman, whose opposition was caused mainly by his fear that it would impede and perhaps defeat the passage of the tariff bill; Bourke Cockran, a noted Tammany orator; and Moses T. Stevens, a banker from Massachusetts. The six Republicans were unanimously against the measure. But by the end of November pressure or advice from Secretary Carlisle, from Isidor Straus, the New York importer, and from David A. Wells had persuaded a majority to favor the compromise measure of a tax on the net income of corporations and, perhaps, on successions and legacies.⁷

On December 4, 1893, Congress met for its second session and heard the reading of Cleveland's annual message. In it he called for tariff reform, particularly for reductions in the duties on the necessities of life and on raw materials. He also urged the strictest economy in governmental expenditures and concluded with the hope that the revenue would be increased through the reduced tariff rates and "a few additional internal-revenue taxes, including a small tax upon incomes de-

⁶ Paxton Hibben, *The Peerless Leader: William Jennings Bryan* (New York, 1929), 156; Thomas G. Shearman, *A Just and Practicable Income Tax* (Washington, 1893); *New York World*, November 10, 11, 13, 17, 18, 22; December 2, 4, 8, 1893.

⁷ *New York World*, November 22, 25, 26, 30; December 1, 2, 7, 1893.

rived from certain corporate investments." This reference to a small tax on incomes from corporate investments took Congress by surprise, but seems to have been prompted by a suggestion made by Secretary Carlisle at the end of November. On December 20 Carlisle presented his report to Congress and recommended the imposition of new taxes on legacies, successions, and incomes "derived from investments in stocks and bonds of corporations and joint stock companies" as one means of "most conveniently and justly" raising the fifty million dollars of additional revenue needed by the government. He defended this tax on income from corporations against the charge that it was inquisitorial, liable to evasion, unjust, and a tax on ability, and argued that it was only fair for the government to tax corporations to which it gave special privileges. To the taxation of individual incomes neither Cleveland nor Carlisle expressed any opposition in public. Though Cleveland was besieged by those who wished him to defeat this income tax, he did not use his influence in the matter one way or the other. He and Carlisle seemed to have regarded the tax on personal incomes as just, but politically inexpedient at that time since it would antagonize the financial interests to whom they looked for support of the gold standard.⁸

The Struggle in the House

The wishes of Cleveland and Carlisle, however, were not to be realized. The support for a tax on individual incomes grew steadily in strength. Bills for an income tax were introduced into the House by John L. Bretz of Indiana on December 19, and by John Davis of Kansas the next day. On December 19 William L. Wilson presented to the House a report advising the adoption of a tariff bill which made sweeping reductions in the duties on manufactured goods and put raw materials on the free list. After this, McMillin and Bryan recommended to the Ways and Means Committee the imposition of a tax on individual incomes of \$4,000 and over. The committee agreed on January 2 by a vote of 7 to 4 to impose a tax of 2 per cent on all net incomes of corporations and on individual incomes over \$4,000. Subsequently they agreed that the internal revenue bill would be offered as a separate measure at first but might later be offered as an amendment to the Wilson tariff bill.⁹

⁸ Richardson, *Messages and Papers of the Presidents*, 9:458-60; *Treasury Report* (1893), LXXXIII; Barnes, *Carlisle*, 204, 215, 234; Letter to Author by Barnes, January 4, 1932; *New York World*, December 5, 6, 21, 1893.

⁹ The full, detailed story of the conflict between the Democratic committee mem-

On January 8, 1894, William L. Wilson opened debate in the House on the Wilson tariff bill. The measure he proposed placed important raw materials on the free list, but made moderate reductions in the duties on manufactures. The Republicans criticized the bill as revolutionizing the economic system in the direction of free trade. On the other hand, the extreme free-trade journals attacked it as not going far enough, and as being a cowardly surrender to protection. After a week's debate various amendments were proposed. One important amendment provided that the section making wool free of duty was to take effect immediately on the passage of the Act. Others stipulated that the payment of sugar bounties should cease and that the tariff duties on sugar, raw or refined, should be abolished. These amendments were supported by those friendly to the income tax because they regarded the sugar duties as a burden on the great masses and expected to replace the revenue thereby lost with an income tax.¹⁰

The struggle between the proponents and opponents of the income tax now grew more keen. On January 24 Benton McMillin succeeded in getting the Ways and Means Committee to agree that the income tax and other internal revenue proposals be presented to the House in an internal revenue bill which was to be independent of the Wilson tariff bill. But the Democrats from the Northeast, Bourke Cockran and Moses T. Stevens, had made every effort possible to prevent consideration of the measure, and McMillin had had to resort to some amazing stratagems to circumvent them. The favorable vote by the Committee had been made possible by William L. Wilson and by two Democrats from the South and West who abandoned their opposition to the income tax. But the conservative Democrats did not give up hope of blocking this radical measure. The New York and New Jersey Democratic Congressmen held conferences that afternoon at which they agreed to fight any motion to have the income tax tacked on to the Wilson tariff bill as an amendment. The culmination of the day's strife between these warring groups occurred in the House at the end of the day when McMillin rose to report his internal revenue bill with the income tax provisions. Cockran immediately moved for adjournment in order to prevent the measure from being presented, but McMillin secured recognition from the Speaker and the defeat of Cock-

bers from the West and South and those from the Northeast is given in the *New York World*, December 7, 11, 22, 28, 29, 1893; January 2, 3, 6, 13, 1894. The motions by Bretz and Davis are listed as House bills nos. 4861, 4898, *Cong. Record*, 53d Cong., 2d Sess., 425, 461.

¹⁰ For a detailed account and analysis of the 1894 Tariff Act see Stanwood, *American Tariff Controversies*, 2: 296-359; Taussig, *Tariff History*, 284-320.

ran's motion by running down the aisle waving his bill and shouting that he had a Committee report.¹¹

The next day was even more tense and charged with action. Bourke Cockran, with the aid of General Daniel F. Sickles, a wealthy, picturesque, and highly conservative Civil War veteran, led the pro-capitalistic New York delegation's fight against all the efforts of the zealous advocates of the income tax who now proposed to offer McMillin's income tax bill as an amendment to the Wilson tariff bill. Richard Croker, the notorious Tammany boss, used his influence to spur on the New York Congressmen against the income tax, but failed to win over any other Democratic group in the House. Late that same day a Democratic Congressional caucus, called together through a petition by William Jennings Bryan, had a heated debate on whether the internal revenue bill sponsored by McMillin should be added by the Democrats to the Wilson tariff bill. Wilson, acting perhaps at the instigation of Cleveland, strongly opposed this proposal as imperiling the passage of the tariff bill. The caucus, despite additional and more vehement protests by Cockran, voted by a considerable majority in favor of the motion. Bryan then secured an agreement from the caucus to have the tariff debate extended another three days to permit free discussion of the internal revenue bill.¹² A major victory had at last crowned the efforts of McMillin, Bryan, and the other income tax champions. Within the next two days the House Committee on Rules recommended, and the House agreed to, the measures proposed by the caucus.¹³

On January 29 Benton McMillin, whose courage and perseverance had made possible the consideration of the income tax by the Fifty-third Congress, moved that the Wilson tariff bill be amended by an income tax provision levying a 2 per cent tax on all incomes above \$4,000, to be payable by individuals and corporations alike. He then opened debate on the measure by an eloquent defense and justification of the income tax. He blamed the Republican party for encouraging the concentration of wealth through unjust taxation, levied upon the needs of the people rather than on the accumulated wealth of the country. He argued passage of an income tax would lessen the antipathy

¹¹ Barnes, *Carlisle*, 324; Letter to the Author from Barnes, February 25, 1932; *New York World*, January 25, 1894; *Cong. Record*, 53d Cong., 2d Sess., 1352. McMillin's bill was listed as House bill no. 5442.

¹² William Jennings and Mary Baird Bryan, *The Memoirs of William Jennings Bryan* (Philadelphia, 1925), 463-64; Champ Clark, *My Quarter Century of American Politics* (New York, 1920), 2: 37-43, 305; *New York World*, January 26, 1894.

¹³ *New York World*, January 27, 28, 1894.

between different social classes and would render the revenue system more elastic by enabling Congress to stabilize the tariff and change the internal revenue taxes according to the government's needs.¹⁴

Against McMillin's fervent plea for the income tax a number of Democrats from New York and New Jersey and Republicans from the Northeast spoke with great heat and vehemence, if not much light and logic. They maintained that the income tax could be justified only as a war measure, that it discriminated against business enterprise, encouraged fraud, perjury, and lying, and that it was sectionally biased in favor of the South and against the North. They attempted to damn the income tax by calling it a Populistic and Socialistic Labor measure and its advocate a "specter of free trade" extending his hand to the "specters of anarchy and communism." In addition to these name-calling devices, the opponents of the income tax, especially the Republicans, asserted that the income tax would have a bad effect on real estate and stocks, would hamper business by taxing savings, and would be an unfair burden on the rich since they already paid their share of the taxes in other forms. The income tax was also charged with being "rank class legislation" because it exempted incomes under \$4,000. On the other hand, a Republican Congressman declared that the rich would not bear the burden of the income tax because they would be able to shift it onto the shoulders of the poor. An ominous prediction made by Franklin Bartlett, a New York Democrat and lawyer, was that the Supreme Court would declare the income tax unconstitutional despite previous decisions upholding the Civil War income taxes.¹⁵

These attacks on the income tax inspired equally vigorous, but more enlightening, counterattacks by champions of the income tax. These came in the main from the South and West, but a few were repre-

¹⁴ *Cong. Record*, 53d Cong., 2d Sess., 1594; *Appendix*, 411-21; *New York Tribune and World*, January 30, 1894. The adoption of McMillin's amendment resulted in the discarding of the previous bills on the income tax submitted by John L. Bretz, on December 19, 1893; John Davis, on December 20, 1893; Tom L. Johnson, on January 3, 1894; the Ways and Means Committee, on January 24, 1894; and John Davis, on January 25, 1894.

¹⁵ The speakers from New York were George W. Ray, Charles Daniels, James W. Covert, Franklin Bartlett, William J. Coombs, William Ryan, and Joseph C. Hendricks; those from New Jersey were John T. Dunn and Jacob A. Geissenhainer; from Massachusetts, William Everett and Joseph H. Walker; from Maine, Thomas B. Reed; from Pennsylvania, William A. Stone; from Ohio, Charles H. Grosvenor; from South Dakota, William V. Lucas. For reports of their speeches, see *Cong. Record*, 53d Cong., 2d Sess., 28: 1600-06, 1642-63, 1730-34; *Appendix*, 187, 207-09, 265, 277, 395-98, 878; *New York Tribune and World*, January 30, 31; February 1, 1894. See also the *Biographical Directory of the American Congress, 1774-1927*, and *The Dictionary of American Biography*, under the proper headings, for information about the personal and official life of the public figures connected with the 1894 income tax.

sentative of the Northeast. Able speakers, like John C. Tarsney and Uriel S. Hall of Missouri and John Sharp Williams of Mississippi, argued with great effectiveness against the assertions that the income tax was a class or sectional legislative measure, that it was inquisitorial, unconstitutional, contrary to the Democratic platform, or that it was a Populistic vagary and demagogic proposal. An income tax, they maintained, secured a contribution from those with wealth which was proportional to the protection and benefits the government extended to them, whether the wealth was concentrated in one section or diffused throughout the country. Williams and Hall pointed out that an income tax, unlike the high protective tariff, taxed the surplus rather than the necessities of citizens and had been used with great success in other countries and by various state governments within the United States. The point was also made that an income tax was a means of encouraging economy in government and of checking the huge fortunes which the American people had come to regard as a threat to democracy. James P. Pigott of Connecticut suggested that incomes over \$1,000 should be taxed; Clifton R. Breckenridge of Arkansas asked that a tax be levied on inheritances rather than incomes.¹⁶

The Great Debate Between Bryan and Cockran

This extended controversy reached its climax in a passage at arms between Bourke Cockran and William Jennings Bryan in the late afternoon of January 30. Cockran was famous as an orator, and as the spearhead of the Tammany opposition to Cleveland's renomination in 1892. He vigorously supported all efforts to revise the tariff downward, but was the outstanding leader of the opposition to the income tax. This seeming paradox may be explained by the fact that Tammany was responsive to the wishes of the wealthy New York merchants and importers who favored low tariffs at the same time that they objected to the imposition of federal taxes on the profits they would secure through such tariffs. Cockran gave a superb restatement of all the plausible and telling arguments against the federal income tax, and denied the necessity of an income tax as a revenue measure. His most original and effective point was that democracy could not continue if those who controlled the government were relieved from taxation, because then the basis for the right to control the government was removed. He prophesied that the men who wanted to offer the

¹⁶ *Cong. Record*, 26:1605-18, 1646-55, 1663-74, 1727-37; Appendix, 187, 212-13, 271-72, 277, 329-40, 405-06, 437-39, 500-03, 601-05; *New York Tribune and World*, January 30, 31; February 1, 1894.

income tax as a sop to the discontented would be swept away by the rising tide of socialism.¹⁷

After the applause and congratulations extended to Cockran had ended, William Jennings Bryan, then only thirty-four years old, attempted a reply to the Tammany Goliath. "Clad in the armour of a righteous cause," as Bryan put it, and supported by extended and careful study of the income tax question, he proved that he had been able to outmatch in rhetoric and logic the best efforts of the strongest foe of the income tax in the House. He refuted Cockran's argument that the income tax exemption threatened the participation of the poor in the government with the statement: "If taxation is a badge of free men, let me assure my friend that the poor people of this country are covered all over with the insignia of free men. . . ." The Nebraskan denied that the rich welcomed the income tax as a means of securing greater power. After lashing those who considered expediency better than equity in the adjustment of taxes, he singled out for attack Ward McAllister, leader of the "400," who had threatened to leave the United States if an income tax were levied. Bryan said:

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 per cent deep. . . . If "some of our best people" prefer to leave the country rather than pay a tax of 2 per cent, God pity the worst . . . we can better afford to lose them and their fortunes than risk the contaminating influence of their presence . . . if we are to lose some of our "best people" by the imposition of an income tax, let them depart, and as they leave without regret the land of their birth, let them go with the poet's curse ringing in their ears. . . .¹⁸

The response from the audience was so enthusiastic as to indicate another great oratorical triumph for the Boy Orator of the Platte. The next day, after a number of far less influential speeches were made, a few minor amendments to the income tax provisions were proposed. Lafe Pence of Colorado proposed a graduated income tax, with rates ranging from 1 per cent on incomes of \$2,500 to 5 per cent on incomes above \$100,000; this amendment was defeated by a vote of 112 to 66. Another amendment for a graduated income tax, advanced by Joseph C. Sibley of Pennsylvania, with rates from 2 per cent on incomes over \$10,000 to 10 per cent on incomes over \$200,000, was also voted

¹⁷ *Cong. Record*, 53d Cong., 2d Sess., v. 26, Appendix, 462-67; *New York Tribune and World*, January 31, 1894.

¹⁸ *Cong. Record*, *op. cit.*, 1655-58; *New York Tribune and World*, January 31, 1894.

down. Then the vote was taken on the adoption of the income tax bill as an amendment to the tariff bill, and the motion was passed 175 to 56.¹⁹

Sectional and Class Cleavages in the House

McMillin, Bryan, Hall, and the other advocates of the income tax had overcome the first great obstacle to its adoption in the open House. The final vote on the tariff bill, with which the income tax was now so closely knit, still had to be taken, however. On February 1 the galleries of the House were packed with a large and distinguished audience. Thomas B. Reed, "the mentor of the Republicans and the tormentor of the Democrats," made a masterly attack upon the Wilson tariff bill and a classic defense of the high protective tariff. In reply to the Republicans' most able debater and floor leader, Charles F. Crisp, Speaker of the House and leader of the Democrats, made a clear and forceful counterattack on the Republican position and a skillful defense of the Democratic tariff bill. Finally, William L. Wilson, the Chairman of the Ways and Means Committee, small and slight of build, concluded the debate with a speech which surpassed even Reed's in eloquence and power. Although neither Reed nor Crisp had made any reference to the income tax, Wilson gave it due attention. He explained that he had not originally concurred in the policy of attaching an income tax to the tariff bill, owing to some doubts concerning its expediency at that time, but that when the Committee decided otherwise he threw in his fortunes earnestly and loyally with them because he had never been hostile to the idea of an income tax. He repudiated the charge of class legislation by declaring that the income tax was simply an honest first effort to balance the weight of taxation so that it would not be carried exclusively by the poor consumers of the country who had hitherto borne it all. He also denied that the income tax was a sectional measure aimed at New England and New York by representatives of the South and West, and cited as proof the books written in favor of the income tax by such great New England economists as W. G. Sumner, Amasa and Francis A. Walker, and Arthur L. Perry. At the conclusion of his speech the Democrats expressed their enthusiasm by wild cheers, and Bryan, John Sharp Williams, and others carried Wilson on their shoulders down the aisle.²⁰

When the House had subsided into comparative tranquillity, the

¹⁹ *Cong. Record*, 26: 1739; *New York World*, February 1, 1894.

²⁰ *Cong. Record*, *op. cit.*, 26: 1781-92; Appendix, 204; *New York Tribune and World*, February 2, 1894; *Alexander, op. cit.*, 84, 311-12; *Clark, op. cit.*, 1: 353-54.

internal revenue amendment was formally passed that same day, February 1, by a vote of 182 to 48, with 122 not voting. All except 10 of the Republicans refrained from voting, most likely on account of the income tax provision. The Wilson tariff bill was then voted on as a whole and was passed by a vote of 204 to 140, with 8 not voting. An analysis of the income tax and internal revenue amendments and of the Wilson tariff bill reveals marked sectional and economic cleavages in the House. This is shown to a certain degree in the party alignment on the final vote on the entire tariff bill. One hundred and ninety-six Democrats and 8 Populists voted for it; 122 Republicans, 17 Democrats, and 1 Populist voted against it. A sectional classification of the tariff votes shows a union of the agricultural South and Middle West against the industrial Northeast and some of the states of the extreme Far West. The vote on the internal revenue amendment, however, lays bare most clearly the economic cleavages in the House owing to the injection of the income tax issue. Although no roll call was taken in the vote on the income tax provision, the difference between that vote and the one on the internal revenue amendment was so slight that an analysis of the internal revenue vote may be safely used for conclusions concerning the sectional differences on the income tax question. Such an investigation demonstrates a clear-cut opposition between the agrarian America represented by the Congressmen of the South and West and the industrial America represented by the northeastern Congressmen. Since the vote on the internal revenue amendment was cast almost exclusively by Democrats, a break or split within the Democratic party reflected the definitely opposed economic interests of the different sections of the country.²¹

The Senate Conflict

The step taken by the House toward tariff reform and the correction of inequalities in wealth through the Wilson tariff bill with its income tax amendment was an advance in the direction of the ideals of political and economic democracy. But the response to public opinion on these matters given by the House was not reflected in the action of the Senate and the Supreme Court, as events soon showed. The Senate was farther removed from direct public pressure than the House and generally more responsive to and conservative about large property interests. At that time the Senate was closely divided: there were 44 Democrats, 38 Republicans, and 3 Populists. Two Populists, Allen and Kyle, were

²¹ *Cong. Record*, *op. cit.*, 26: 1795-96; *New York Tribune and World*, February 2, 1894.

considered favorable to the bill; one, Peffer, was against it. High tariff lobbyists had been working for months on Democratic Senators regarded as doubtful. Senator Hill of New York was opposed to any bill containing an income tax. Senators Blanchard and Caffery of Louisiana were against the free sugar provisions of the Wilson tariff; the Senators from West Virginia, Maryland, and Alabama were against any bill admitting coal and iron ore without duty. Others in opposition were Senators Gorman of Maryland, Murphy of New York, Smith of New Jersey, and Brice of Ohio. The situation was further complicated by the intense personal enmity many Senators had against Cleveland for his policies on free silver, civil service, Hawaiian annexation, and judicial appointments.

Conservative Victory on the Tariff

On February 2, 1894, the Wilson tariff bill was referred to the Senate Committee on Finance, and was turned over by its Chairman, Senator Voorhees, to Senators Vest of Missouri, Jones of Arkansas, both tariff experts, and to Isham G. Harris of Tennessee, the Democratic floor leader. After vehement protest at a Democratic caucus meeting by Democratic Senators desiring protection on sugar, coal, iron ore, and other commodities, Senators Vest, Jones, and Mills attempted to meet the objections by placing moderate duties on these articles in a bill presented to the Senate on March 20. But the protectionist Democratic Senators were sharply dissatisfied with these slight concessions and demanded drastic amendments. Realizing that they were in a strategic position to bargain for everything they wanted put through, they entered into an alliance designed to obtain for each his special demands by all agreeing to support one another. Senator Gorman told Andrew Carnegie: "I can afford to fight the President and beat him, but I can't afford to fight him and be beaten."²²

Among the powerful interests which exerted pressure on the insurgent Democrats for changes in the tariff bill favorable to themselves was the Sugar Trust. The House had admitted raw and refined sugar free of duty. While the Louisiana Senators and the Cleveland administration, for revenue reasons, secured a duty on raw sugar of 40 per cent ad valorem, the lobbyists for the American Sugar Company, which controlled four fifths of the sugar refining industry, persuaded certain

²² Andrew Carnegie, *Autobiography of Andrew Carnegie* (Boston, 1920), 147-48, and "My Experiences with, and Views upon, the Tariff," *Century* (December, 1908), 77: 186-205; Matthew Josephson, *The Politicos 1865-1896* (New York, 1938), 541-55; Allan Nevins, *Grover Cleveland*, 563-88, and *Abram S. Hewitt*, 559-60.

Senators to impose a duty on refined sugar to protect their interests. Henry O. Havemeyer and his agents, besides using what influence they had with William C. Whitney and Daniel Lamont, the Secretary of War, evidently enabled Senators like McPherson and Quay to make large profits through speculation in sugar stocks. The result was a duty of one eighth of a cent on refined sugar and an extra one tenth of a cent on refined sugar coming from Continental countries like Germany which gave an export bounty and whose competition was severe. The Whisky Trust also profited through an increased duty of twenty cents per gallon on whisky because it could add the additional tax to the sales price before the Act went into effect.

The reason Senator Gorman and the other insurgent Democrats felt certain that they could afford "to fight the President and beat him" was that they had the support of the Republicans, especially Nelson W. Aldrich of Rhode Island. This master of parliamentary strategy and proud champion of the vested interests evidently suggested many of the tactics and amendments to the House tariff bill adopted by them. Senator Jones of Arkansas, who had undertaken to discover what would satisfy them and make possible passage of some kind of reform bill, was forced to accede to their demands. He worked out some 408 new amendments, to which he secured the reluctant consent of Carlisle and Cleveland, with Cleveland hoping that free coal and iron ore would be restored by the Conference Committee of the House and Senate later. The Democratic Senators then gave their approval at a caucus held early in May as the only way to get a compromise measure which might be a very slight improvement on the McKinley tariff. The result was that after an extended debate the Senate passed on July 3 by a vote of 39 to 34 a tariff bill with 634 amendments, which was far removed from the Wilson tariff bill and was renamed the Wilson-Gorman tariff bill. The House, at the suggestion of William L. Wilson, agreed to a conference, but violently disapproved of the Senate revisions. On July 19 Wilson reported to the House his inability to secure an agreement with the Senate and then read a letter from President Cleveland in which Cleveland insisted upon the principle of free raw materials, though conceding a tariff on sugar, and criticized the Senate's abandonment of Democratic principles as "party perfidy and party dishonor."

Although the House applauded this arraignment of the insurgent Democrats in the Senate, the reaction in the Senate was disastrous for any plan for mitigation of the harm done to the original Wilson tariff bill. Not only the obstructionists like Gorman, but administration sup-

porters like Senators Jones, Harris, and Vest considered Cleveland's letter an assault upon their personal and political integrity. Gorman, who had directed Cleveland's presidential campaigns in 1884 and 1892, delivered one of the most vitriolic attacks ever made by a responsible Senator on a President of his own party. He asserted that all the changes introduced into the Wilson tariff bill in the Senate by Jones and Vest had been accepted by Cleveland and Carlisle as necessary under the circumstances and as not violating Democratic principles. He obtained corroboration on these points from other Senators and then charged Cleveland with violating the spirit of the Constitution through executive encroachments on the powers of Congress. The consequence was that the Senate assumed an intransigent position on its revision of the tariff bill and forced the House to yield unconditionally on August 13. Cleveland was confronted by a dilemma: if he vetoed the bill, the McKinley tariff would persist; if he signed the bill, he would be contradicting the scathing criticism he had given in his letter of July 2. He escaped either fatal choice by allowing the bill to become law on August 27 without his signature.²³

Yet, bad as the Wilson-Gorman Tariff Act was from the point of view of the tariff reformer and the consumer, a few gains can be noted. One was the removal of the duty on wool, another was a series of minor reductions in duties which at least were below those of the McKinley Act, even though above the rates in the Tariff Act of 1883. The really substantial advance over all other tariff acts since 1872 was the inclusion of the income tax provisions. How this radical measure survived the tortuous and keen attacks of the Senate conservatives during the long-drawn-out and bitter debate on the Wilson-Gorman tariff bill forms an interesting episode in the history of American pressure politics which deserves further exploration.

The Issues in the Income Tax Debate

When Senator Daniel W. Voorhees, the Chairman of the Senate Finance Committee, introduced into the Senate on April 2, 1894, the Wilson tariff bill with a few minor amendments, he delivered an impassioned address justifying a reform in the tariff and defending the income tax provisions. These would, he declared, further democracy and counteract the excessive concentration of wealth and exercise of

²³ Barnes, *Carlisle*, 322-43; Nevins, *Letters of Grover Cleveland* (Boston, 1933), 342-43, 354-57; Nathaniel W. Stephenson, *Nelson W. Aldrich* (New York, 1930), 108ff.

power by a plutocracy which had been granted favors by the government but had not been contributing to its support according to their means.²⁴ Against this and other vindications of the income tax by Democratic and Populist Senators the chief opponent was David Bennett Hill. He had been governor of New York from 1885 to 1891, United States Senator since 1892, and was the chief political power in the New York Democratic machine. He was aptly characterized by Henry George several months later: ²⁵

David B. Hill does not represent the Democratic principle. He is the representative of the Democrat machine, if those non-partisan organizations for systematic public plunder which usurping the Democratic name stifle the Democratic principle and bring Democracy into contempt. . . . As Governor Mr. Hill stood against every attempt to simplify taxation, to expose corruption, to purify the ballot. As a Senator Mr. Hill signalized himself by a similar persistent opposition not merely to any radical reform of the McKinley Act, but in reality to any reform of it at all. Under the guise of opposition to the income tax—a tax which whatever its shortcomings is vastly preferable to a tariff tax, as an attempt to tax men on what they have rather than on what they need—he did the last service for the sugar trust and other allied rings in preventing the repeal bills passed by the House from coming to a vote, and he stands to-day and by his latest utterances as much a protectionist as Gorman or McKinley, as fully and even more openly committed to the policy of taxing the poor for the relief and benefit of the rich.

Hill denounced with great vigor and pungency the income tax as unnecessary from the point of view of revenue once the Senate amendments were made, as ill timed at a period when business confidence needed encouragement, and as contrary to the Democratic party's traditions. He brought up the old charges of its being inquisitorial, unjust, an incitement to sectional and class legislation, and a violation of states' rights. He denied that the British income tax was a precedent or was expedient for the United States, and attempted to impugn the validity of the income tax by indicting its originators as European professors, socialists, communists, and anarchists, and their American emulators, the Populists. He also used Cockran's argument that the \$4,000 exemption clause was a blow at democracy because it deprived the poor

²⁴ *Cong. Record*, 53d Cong., 2d Sess., 26: 3397-98. Voorhees had been a brilliant orator, but at this time he suffered from ill health and lacked the fire and effectiveness in presentation he formerly possessed. Cf. *New York Tribune and World*, April 3, 1894.

²⁵ Henry George to A. P. Potter, November 2, 1894, Henry George Papers, New York Public Library.

of feeling a responsibility for the conduct of the government. He was fearful of the dangers of multiple taxation and felt that it was a revival of an odious war tax in a time of profound peace as well as a dangerous extension of the powers of the federal government.²⁶

Most of the other speeches made against the income tax rang the changes upon the notes first struck with such firmness and intensity in the speeches of Hill. A few addresses, however, deserve mention. Justin S. Morrill, who had played so important a part in Civil War tariff and income tax legislation, had supported in that crisis an income tax as a war necessity, but thirty years later he objected to the income tax on the ground that it failed to discriminate between different kinds of income, taxed corporation dividends, and was sectional in character. John Sherman, who had defended most valiantly the income tax against those desiring its abolition in 1870-72, preserved his consistency of principle by affirming the justice of the income tax, but safeguarded the conservative position by denying that the income tax was needed for revenue by the federal government or was demanded by the people. He objected strenuously to the high exemption as "a low and mean form of socialism." "In a republic like ours, where all men are equal," he asserted, "this attempt to array the rich against the poor or the poor against the rich is socialism, communism, devilism." He argued that the income tax ought to be levied by the states and that a federal tax was an invasion of the rights of the states. He also objected to the flat 2 per cent tax on inheritance as an element of income over \$4,000 included in the income tax provisions on the ground that the inheritance tax was a matter for state action.²⁷ George Frisbie Hoar, although more liberal and independent than the majority of the Republicans, joined in the attack on the income tax by raising the cry of sectionalism and federal interference with states' rights and by criticizing the tax on income from real estate as a direct tax on real estate and therefore unconstitutional.²⁸

Senator Orville H. Platt, one of the central powers among the conservative Republicans, although he protested that he was in favor of an income tax if it were necessary as a revenue measure and were justly and fairly constructed, came out with the inarticulate major premise behind all the conservative onslaughts against the income tax: "I wish to state that the rights of property are just as sacred as the rights of life

²⁶ *Cong. Record*, 3557-68 (April 9, 1894); 6611-24 (June 21); 6764-70 (June 23); 6932-34 (June 28); H. J. Carman, "David Bennett Hill," *Dictionary American Biography*, 9: 28-29; *New York Tribune and World*, April 10; June 22, 24, 29, 1894.

²⁷ *Cong. Record*, 6694-96.

²⁸ *Ibid.*, 6638-39.

and liberty, and that no country which has not a just regard for the right of private property can go on progressively as a republic.”²⁹ Senator James Smith of New Jersey shared in the feelings expressed by Platt and declared at the culmination of a tirade against the income tax: “Even the misrule of the Republican party is to be preferred to the communism of the Populists and Socialists.” Evidently on this subject as well as on the Wilson tariff bill in general Smith was an insurgent among the Democrats and an ally of the Republicans on account of his extensive business interests.³⁰ Smith later achieved fame as the Democratic boss who helped Wilson become governor of New Jersey in 1910.

The defenders of the income tax faced a difficult task in trying to refute and expose the rhetorical devices used to dodge the fundamental issues and to evade the facts supporting the liberal position. Hill and the other spokesmen for the big business interests had created smoke-screens by raising spurious issues and had also drawn a red herring of communism across the trail to confuse and divert the Senate from a sober appraisal of the validity of the income tax. Many of the propaganda techniques now used by high-pressure reactionary organizations were then experimented with by those fighting the income tax, consciously or unconsciously. But the appeal to hysteria, chauvinism, and narrow or obstinate possessive sentiments failed to succeed, in part because of the very able justification of the income tax given by the best Populist and Democratic speakers on the subject. Senator William V. Allen, regarded by many as “the intellectual giant of Populism,” gave the most eloquent defense. It equaled in fire and surpassed in ability Bryan’s speech in the House. Allen demonstrated that property rights were not supreme, that the government had the power to aid the masses when they were in distress, and that the tax was not unconstitutional, unjust, sectional, encouraging to perjurers, or more inquisitorial than state property taxes. His strongest point was that the study of census statistics indicated that 91 per cent of the 12 million families of the country owned no more than 29 per cent of the national wealth and that 9 per cent of the families owned about 71 per cent of that wealth. He attributed this concentration of wealth in the hands of a few to the favoritism shown that minority group by the national govern-

²⁹ *Ibid.*, 6701-06; Claude G. Bowers, *Beveridge and the Progressive Era* (Boston, 1932), 138-39 has a penetrating sketch of Platt.

³⁰ *Cong. Record*, 3778-85; *Biographical Directory of the American Congress*, 1538; Champ Clark, *op. cit.*, 1: 336.

ment and its failure to keep "the opportunities of life open to every American citizen equally with every other American citizen."³¹

Next to Allen in power and force as a debater was James H. Kyle, a Populist of South Dakota. He gave an illuminating analysis of the growth in the concentration of wealth and suggested as a partial remedy a tax on incomes over \$1,000 and a graduated tax on all incomes above \$5,000.³² William A. Peffer of Kansas, although far inferior in personality and attainments to both Allen and Kyle, made a number of good points in behalf of a graduated income tax. He pointed out that the rich man benefited most from the protection and services of the government and therefore, in return for those benefits, should bear the heaviest part of the taxes. He proposed a graduated income tax rising from 1 per cent on incomes over \$2,000 to 5 per cent on those over \$100,000. He also espoused the argument that persons ought to pay for the support of the government in proportion to their means, both because the ability-to-pay criterion was just and because it would help to counteract the menace to Republican institutions created by centralization of wealth.³³ Among the Democrats who championed the income tax, Patrick Walsh of Georgia made the most incisive comments. He cut through the rationalizations of the standpatters and exalters of the *status quo* by showing how the discontent and distress among the working classes in the various sections of the country were evidence of the need for remedial legislation. The income tax, in his opinion, offered the rich the opportunity to assume a fairer proportion of the expenses of the government, and he suggested that instead of their declaring the income tax socialistic in character they would do well to co-operate cordially in its passage and to put a stop to the conditions which gave rise to socialistic ideas. He, too, advocated a graduated income tax.³⁴

Various amendments were offered. Out of different motives Senators Peffer and Hill attempted in vain to have the exemption lowered from \$4,000 to \$1,000. Hill also tried to get rents from real estate and state bonds exempted. The most important amendments to pass were those limiting the operation of the tax to January 1, 1900, ex-

³¹ *Cong. Record*, 6706-16 (June 22, 1894); Hicks, *Populist Revolt*, 282-83. Allen's economic authority was George K. Holmes, "The Concentration of Wealth," *Political Science Quarterly* (December, 1893), 8: 589-600. Holmes was gravely concerned about economic inequality and suggested progressive taxes on income, gifts, and inheritances to keep the concentration of wealth from going too far.

³² *Cong. Record*, 6684-90 (June 22, 1894); *Dictionary of American Biography*, 10: 515-16.

³³ *Cong. Record*, 3676, Appendix, 650-67 (April 11, 1894); 26: 6633-35 (June 21).

³⁴ *Cong. Record*, 5381-82.

empting the salaries of judges and the President, and deducting from the taxable income of corporations the amounts payable for interest on bonds. Hill made a desperate effort on June 28 to have the income tax sections stricken from the tariff bill, but his motion was defeated by a vote of 40 to 24 through a combination of southern and western Senators against the unanimous stand of the Senators from the Northeast. On July 3 the entire tariff bill, with the income tax as an integral part, was passed by a vote of 39 to 34, through a union of Senators from the South and Middle West against those from the Northeast and the Far West. The story of the battle between the House and the Senate on the latter's amendments to the Wilson tariff bill has already been told. The income tax provisions, however, were not a matter of dispute, and when the conflict ended by Cleveland allowing the Wilson-Gorman bill to become law on August 28 without his signature, the income tax also became a part of the law of the land.³⁵

Public Opinion and Pressure Groups

The role of public opinion on the income tax casts an interesting light on the intellectual scene of the Gilded Age. Newspapers like the *New York Tribune*, *Times*, and *Sun*, the *Brooklyn Eagle*, the *Washington Evening Star*, the *Philadelphia Public Ledger*, the *Cleveland Plain Dealer*, the *Milwaukee Journal*, and the *Des Moines Iowa State Register* voiced a full-throated denunciation of the income tax as socialistic, communistic, a tax on thrift and industry, and an incitement to perjury and fraud. But sturdy defenders of the income tax were to be found among a large number of newspapers in the South and West, as well as a few in the East. The *New York World*, *Chicago Times*, *St. Louis Republic*, *Missouri Times* (Kansas City), and the *Ohio State Journal* championed the tax as a means of correcting the great inequalities in wealth and of putting the burdens on those best able to pay it. The *Springfield Republican*, while opposed to the tax, was fair enough to admit that the arguments for it were sound and reasonable and deserved serious consideration in the East.³⁶

During the time when the matter was before Congress, magazines had published articles debating the desirability and validity of the income tax while Congress was discussing and eventually deciding the matter. In December, 1893, George F. Holmes of the Census Office

³⁵ *Cong. Record*, 6631, 6827, 6934, 7136, 8666. Cf. William Hill, "Comparison of the Votes on the McKinley and Wilson Bills," *Journal of Political Economy* (March, 1894), 2: 290-92.

³⁶ *Public Opinion* (June, 1893), 15: 220, 265-66; (January, 1894), 16: 354.

published in the *Political Science Quarterly* an essay on the concentration of wealth in the United States which attracted wide attention and was of great aid to the Populists in Congress both for its statistics and for its suggestion that progressive taxes on income, gifts, and inheritances should be used to keep the concentration from going too far. The next month William L. Wilson, author of the House tariff bill, had an article in the *North American Review* advocating a corporation tax as preferable to a tax on individual incomes. At the same time David A. Wells, the economist, attacked the practicability of the income tax in the *Forum* while Congressman Uriel S. Hall defended it. In March, 1894, Wells returned to the subject and denounced the income tax vehemently as socially undesirable. Nevertheless, he concluded regretfully that "a system of class legislation, full of the spirit of communism, seems to find favor with the American people." Senator Hill used this article and Wells's authority as an economist in his polemic against the tax in the Senate. After the Act was passed, an article signed "Plain Speaker" appeared in the *North American Review* which prophesied that those with incomes over \$4,000 would be forced to bear progressively higher taxes and their welfare would be sacrificed by the envious masses to an extent equal to that of "the wildest Socialist dream."³⁷

Among the pressures within and outside Congress against the federal income tax the *New York World* singled out the Sugar Trust, for its effort to defeat the income tax in the Senate, through Hill and other insurgent Senators, as a means of ensuring the introduction and passage of the duties on sugar which the Sugar Trust desired. Various Chambers of Commerce, especially in the Northeast, exerted what pressure they could on Congressmen and Senators. Their protests were strikingly similar to the manifestoes issued early in the nineteenth century by the corporation of the City of London and the resolutions adopted by the anti-income tax leagues several decades later in London, Manchester, and Birmingham.³⁸

³⁷ U. S. Hall, "The Income Tax: Reasons in its Favor," *Forum* (January, 1894), 17: 14-18; George F. Holmes, "The Concentration of Wealth," *Political Science Quarterly* (December, 1893), 8: 589-600; F. C. Howe, "Federal Revenues and the Income Tax," *Annals of the American Academy of Political and Social Science* (January, 1894), 4: 557-81; "Plain Speaker," *North American Review* (May, 1895), 160: 605; David A. Wells, "The Teaching of Our Recent Economic Experiences," *Forum* (January, 1894), 16: 527-43, and "An Income Tax: Is It Desirable?" *ibid.*, (March, 1894), 17: 1-13; William L. Wilson, "An Income Tax on Corporations," *North American Review* (January, 1894), 158: 1-7.

³⁸ *New York World*, January 26, February 28, March 14, 19, 21, April 23, May 4, June 17, 1894; *Cong. Record*, 6612, 6623; Stephenson, *Aldrich*, 109-21; Seligman, *The Income Tax*, 106-78.

The 1894 Income Tax Law

The character of the income tax law enacted on August 28, 1894, since it was based almost completely on the Civil War legislation with only a few important exceptions, requires only a brief statement and analysis of its main provisions.³⁹ The tax was to start on January 1, 1895, and continue until January 1, 1900. It was a 2 per cent tax on all "gains, profits, and income" over \$4,000 "derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, employment, or vocation." The tax applied to the entire income of all citizens of the United States, resident or nonresident, to all persons residing within the United States, and to the income of persons residing abroad which was derived from property or business within the United States. Income was defined to include interest on all securities except such federal bonds as were exempted by the law of their issuance from all federal taxation. Profits realized from the sale of real estate were declared income when the real estate had been purchased within two years previous.

All personal property acquired by gift or inheritance was also classed as income. Individuals were not required to include in their income tax returns income on which the tax had already been paid by other parties. This provision affected officials of the federal government and owners of corporate stock, since the federal government was to withhold the tax from the salaries of its officials and the stock companies were required to pay the tax in the first instance. The salaries of state, county, and municipal officers were exempted from the tax.

Besides the tax on individuals the Act imposed a tax of 2 per cent on the net profits or income above operating and business expenses of corporations, companies, and associations doing business for profit in the United States, but not of partnerships. The corporate income tax was not extended to states, counties, or municipalities, to charitable, religious, or educational associations, to fraternal beneficiary orders, building or loan associations, mutual insurance companies, or to savings banks or societies under certain conditions.

Various criticisms of the Act were and have been given from different points of view. Among the important and weighty points made against the act was the charge that no distinction was made between precarious

³⁹ Act of Aug. 28, 1894, Sections 27-37; 28 *U.S. Stat. at Large*, 509. For the text of the law and a commentary on practically every provision see Roger Foster and Everett V. Abbot, *A Treatise on the Federal Income Tax* (Boston, 1895), and John M. Gould and George F. Tucker, *The Federal Income Tax Explained* (Boston, 1895).

or earned incomes and permanent or unearned incomes. Another objection of some weight was that the \$4,000 exemption limited severely the number of individual taxpayers and reduced a potentially rich source of revenue. Here the reaction of the working and middle classes against the abuses in the exercise of economic and political power of the capitalists prevented a more reasonable exemption limit. A third point was that the incorporation of an inheritance tax into the income tax law was unwise because it did not differentiate between regular and periodic income and an irregular increase in capital or windfall by providing different rates. A fourth defect was the failure to introduce the principle of stoppage at the source except for deductions by corporations of the tax from dividends and by the federal government of the tax from the salaries of public officials. This would have been a powerful check against evasion and undervaluation which the system of self-assessments at that time would have rendered highly probable. Another grave weakness in the Act was the carelessness with which it was drawn and the lack of co-ordination between certain provisions. These lapses and inconsistencies would have seriously interfered with the enforcement and efficient operation of the law, until corrected either by Congress or the Commissioner of Internal Revenue. These defects would have created considerable dissatisfaction among those affected by its provisions. Yet the general public felt more optimistic about the income tax in even so imperfect a form and thought that, whatever its shortcomings might be, it was a step in the direction of correcting the existing inequalities in wealth and income and could be used as the basis for more scientific and efficacious tax measures in the future.⁴⁰

⁴⁰ Cf. Charles F. Dunbar, "The New Income Tax," *Quarterly Journal of Economics* (October, 1894), 9: 26-46; F. C. Howe, *Taxation and Taxes*, 231-41; A. C. Miller, "National Finance and the Income Tax," *Journal of Political Economy* (June, 1895), 3: 255-88; Seligman, *The Income Tax*, 508-30; George Tunell, "The Legislative History of the Second Income-Tax Law," *Journal of Political Economy* (June, 1895), 3: 311-37.



The Judicial Veto of the Federal Income Tax

THE great power wielded by the Supreme Court of the United States over our political life has long troubled those interested in social progress. When in 1935-36 the Supreme Court vetoed various New Deal measures and in 1937 President Roosevelt attempted to enlarge the Court with additional liberal judges, even the mythical man in the street became conscious of the judiciary as a force affecting his and the national welfare. Yet this judicial control over the acts of Congress had been an important factor in national affairs only in the last half of the one hundred and fifty years that the federal government had been operating under the Constitution set up in 1789.

The Court vs. Congress

Throughout the first generation living under the Constitution the important questions of national governmental power were decided in Congress and the Cabinet. In 1803 the Court asserted its right and power to nullify an act of Congress on the ground of unconstitutionality, but the law set aside in *Marbury v. Madison*¹ was a minor provision of the 1789 Judiciary Act which still remains on the statute books, though slightly changed in phraseology. The Court first dealt with problems of national power in a fundamental manner in the great case of *McCulloch v. Maryland*,² decided in 1819. The principles of interpretation expounded by Marshall were so elastic and the balance of social forces such that not till 1857 did the Court exercise the power to veto acts of Congress. But the opinion by Roger B. Taney³ in de-

¹ 1 Cr. 137.

² 4 Wheat. 316.

³ *Scott v. Sanford*, 19 How. 393.

fense of the southern planter aristocracy's property rights in slaves was overruled by an act of Congress during the Civil War. Although the Court reasserted and extended its review of national legislation during and after this struggle, the Court did not seriously interfere with Congress's activity on most economic questions until the eighteen-nineties. This was in large part due to the fact that the Republican party dominated both the Court and Congress; the Court, however, was generally more conservative than Congress. In 1870 the Court declared the greenbacks unconstitutional, but President Grant and Congress "packed" the Court with judges who succeeded, during the next year, in having the ultraconservative decision overruled.⁴

The next series of occasions when the Court came into conflict with Congress on the economics of social welfare occurred in 1895. The decisions handed down in the Sugar Trust case, the Debs case, and the income tax cases were among the most momentous in Supreme Court history. They revealed the power of the Court as a protector of big business interests against the efforts of small businessmen, farmers, and workers to defend their rights and further their welfare.⁵ In the Sugar Trust case⁶ the Court held that the Sherman Antitrust Act did not apply to a combination which was admitted to have nearly complete control of the manufacture of refined sugar on the ground that manufacture was not commerce and therefore no violation. This decision pleased not only the powers in the Republican party, but also Richard Olney, Cleveland's Attorney-General. He had been a noted Boston lawyer, counsel for the Chicago, Burlington and Quincy Railroad and for the Whisky Trust. Shortly after taking office, he backed an attempt to have the Sherman Antitrust Act repealed. Failing in that, he insisted on a narrow interpretation of the statute and saw to it that, with the exception of the Knight case,⁷ no antitrust cases were initiated during his two years as Attorney-General.

Richard Olney was not only a champion of big business and monopoly as against small business and laissez faire, but a zealous opponent of labor and the trade-unions. He took vigorous action against

⁴ *Hepburn v. Griswold*, 8 Wall. 603; *Knox v. Lee*, 12 Wall. 457. Cf. Sidney Ratner, "Was the Supreme Court Packed by President Grant?" *Political Science Quarterly* (September, 1935), 50: 343-58.

⁵ Cf. Edward S. Corwin, *Constitutional Revolution, Ltd.* (Claremont, 1941), 10, and *The Twilight of the Supreme Court* (New Haven, 1934), 52-101; Max Lerner, "The Supreme Court and American Capitalism," *Yale Law Journal* (March, 1933), 42: 668-701.

⁶ *U.S. v. E. C. Knight Co.*, 156 U.S. 1.

⁷ Homer Cummings and Carl McFarland, *Federal Justice* (New York, 1937), 317-23.

the march of Coxey's army to Washington. It was Olney who took the initiative in breaking the Pullman strike in Chicago. He also had used some of the most sweeping injunctions issued against labor up to that time in order to break all the activities of the American Railway Union. Eugene V. Debs and other labor leaders were arrested and convicted of contempt charges. The Debs case⁸ was carried to the Supreme Court and was argued by Olney about two weeks after he had presented his first argument on the constitutionality of the income tax in March, 1895.⁹

The Propertied Classes vs. the Income Tax

Against this background the income tax cases of 1895 can be better understood. On August 28, 1894, the income tax sections of the Wilson-Gorman tariff took effect. The attack upon the income tax began on December 22, 1894, with a bill filed in the Supreme Court of the District of Columbia to restrain the Commissioner of Internal Revenue from collecting the tax imposed by the law on John G. Moore. The case was argued ably and elaborately by two leaders of the Washington bar, Samuel Shellabarger and Jeremiah M. Wilson, and ex-Senator George F. Edmunds, the noted framer of important Republican legislation and, until his retirement in 1891, one of the great constitutional authorities of the United States Senate. The counsel for Moore, it is important to point out, at this time felt obligated to concede that the law did not impose a direct tax and based their attack solely on the charge that the law violated the uniformity clause of the Constitution. Their argument was not sufficiently persuasive, however, and the case was dismissed on January 23, 1895.¹⁰ It is typical of the inconsistencies to be met in many political careers that Senator Edmunds, the main author of the so-called Sherman Antitrust Act of 1890, which he maintained was directed at the "unnatural and unequal distribution of wealth and power," should have been one of the leading legal opponents of a measure designed to correct in part the inequalities he on other occasions deplored.¹¹

⁸ *In re Debs* 158 U.S. 564.

⁹ Barnard, *op. cit.*, 280-358; Nevins, *op. cit.*, 611-28; Henry James, *Richard Olney* (Boston, 1923), 36-69; Cummings and McFarland, *op. cit.*, 432-43.

¹⁰ *Moore v. Miller*, 5 App. D.C. 413, 417. See Edward B. Whitney, "The Income Tax and the Constitution," *Harvard Law Review* (February, 1907), 20: 280-96, an important article by the Assistant Attorney-General of the United States who played a leading role in the 1895 income tax cases.

¹¹ William A. Robinson, "George Franklin Edmunds," *Dictionary American Biography*, 6: 24-27.

While the Moore case was being argued in Washington, D.C., two other suits were started almost simultaneously in the Federal Circuit Court for the Southern District of New York: *Hyde v. Continental Trust Company* on January 11, 1895, and *Pollock v. Farmers' Loan and Trust Company* on January 19, 1895. Although a federal statute passed in 1867 prohibited the issue of any injunction against the collection of taxes, the opponents of the income tax used the device of having a stockholder of each corporation bring suit to restrain the corporation from voluntarily paying the tax. When the lower court dismissed the suits and refused to issue the injunctions, appeals were immediately taken to the United States Supreme Court. At the same time the Moore case was appealed. The Supreme Court agreed on January 28, 1895, to accept all three cases, despite important reasons for refusing them. There were strong objections to the procedure in the Moore case. There was, moreover, no ground for equitable intervention in the Pollock and Hyde cases since the tax could have been paid under protest and then recovered from the collector if the Act were finally declared unconstitutional.¹²

The First Legal Conflict

The first hearing before the Supreme Court on the income tax cases took place on March 7, 8, 11, 12, and 13, 1895. Some of the most distinguished lawyers in the country appeared before the Court as counsel for one side or the other. Challenging the constitutionality of the tax were William D. Guthrie, Clarence A. Seward, ex-Senator George F. Edmunds, and Joseph H. Choate, all noted as corporation lawyers. Choate was noted particularly for his extremely dexterous defense of the Standard Oil Company during the New York legislative investigation. In defense of the tax were Attorney-General Olney, Assistant Attorney-General Whitney, and James C. Carter, the latter considered by many the leader of the American bar.

The chief issue upon which the constitutionality of the income tax depended was whether a tax on income derived from property was a "direct" tax, in the sense understood by the Fathers of the Constitution. The counsel for the government and James C. Carter concentrated their efforts on showing that for a hundred years all the Supreme Court decisions involving a definition of the term had agreed in defining

¹² Edward S. Corwin, *Court Over Constitution* (Princeton, 1938), 177-81; Felix Frankfurter and Adrian S. Fisher, "The Business of the Supreme Court at the October Terms, 1935 and 1936," *Harvard Law Review* (February, 1938), 51: 577, 628-29.

direct taxes as capitation or poll taxes and taxes on real estate.¹³ The first such case was that of *Hylton v. United States*,¹⁴ decided in 1796, which involved a tax laid upon pleasure carriages. This the taxpayer had insisted was void because it was direct and was not apportioned according to population. But the four justices hearing the case agreed with Alexander Hamilton, counsel for the government, that this tax was not a direct tax and that the direct taxes contemplated by the Constitution were land and capitation taxes and possibly a general tax on all personal property or on all property, real and personal.¹⁵

The Court's dictum on direct taxes in this case was the basis on which all similar succeeding cases were decided by the Supreme Court until 1895. These involved the validity of taxes upon the income of an insurance company,¹⁶ upon the circulation of state bank notes,¹⁷ upon the succession of real estate,¹⁸ and upon general incomes.¹⁹ Since the opposing counsel could not deny that the precedents,²⁰ the usual bulwark of conservatism, supported the constitutionality of the income tax, they, especially Seward and Choate, took the line that the precedents were contrary to the weight of evidence concerning the intent of the Fathers of the Constitution. Seward and Choate maintained that the distinction between direct and indirect taxation was well understood by the framers of the Constitution, although the historical records contradicted this. Choate advanced the ingenious but unfounded theory that the purpose of the direct tax clause was to prevent the imposition of an unjust tax upon a small group of wealthy states by a combination of the poorer states. He then argued with great confidence that since the Constitutional Convention of 1787 had considered a tax on land a direct tax, they must also have considered a tax on income from land a direct tax. He even maintained that a tax upon the income from personal property could not be distinguished in principle from a tax on rents and was therefore a direct tax and unconstitutional.

The numerous precedents from 1796 to 1881 delimiting a direct tax

¹³ *Pollock v. Farmers' Loan and Trust Company*, 157 U.S. 429, 469-82 (Whitney), 499-513 (Olney), 513-32 (Carter).

¹⁴ 3 Dall. 171 (1796).

¹⁵ Cf. Corwin, *op. cit.*, 201-05.

¹⁶ *Pacific Insurance Company v. Soule*, 7 Wall. 433 (1869).

¹⁷ *Veazie Bank v. Fenno*, 8 Wall. 533 (1870).

¹⁸ *Scholey v. Rew*, 23 Wall. 331 (1874).

¹⁹ *Springer v. United States*, 102 U.S. 586-603 (1881). In 1871 Justice Strong, as a member of the United States Circuit Court for the Eastern District of Pennsylvania, upheld the constitutionality of the income tax imposed by the Act of June 30, 1864. *Clark v. Sichel*, 14 Internal Revenue Record 6.

²⁰ 157 U.S. 442-52 (Guthrie), 452-69 (Seward), 482-99 (Edmunds), 532-53 (Choate).

to a poll tax or a tax on land he dismissed as never having decided the question as to a direct tax upon the income of real and personal property. These decisions and the principle of *stare decisis*, he attempted to prove, should be disregarded as perpetuating a century of error. These arguments on the direct tax issue proved to have the most weight with the Court. Choate, Guthrie, and Edmunds, however, devoted a major part of their time and energy to attacking the income tax on the ground that if it were not a direct tax it still was unconstitutional, because it violated the rule that all duties, imposts, and excises shall be uniform throughout the United States. The exemptions granted in the income tax law to those with incomes under \$4,000, to mutual savings banks, and to mutual insurance companies were alleged to go counter to the fundamental American principle of equality of rights, duties and burdens. This contention the counsel for the government was able to refute by presenting impressive evidence showing that the term "uniformity" in the Constitution was intended to mean only geographical uniformity and that Congress had the right to make exemptions and discriminations between different economic classes on grounds of public policy. Carter, Olney, and Whitney also exposed the fallacy underlying the claim that a tax on rentals was a tax on the land rented and therefore a direct tax. None of them devoted much attention to the questions involving taxes on income from personal property and municipal bonds because they assumed the Court was predisposed in the government's favor.²¹

In addition to these legal and historical arguments the counsel on both sides made powerful emotional appeals to the Court on the social issues involved and on the desirability or undesirability of a judicial veto on the 1894 income tax law. When William D. Guthrie opened the campaign against the income tax, he predicted that "class legislation and attempts of the majority to spoliolate private property would ultimately wreck the American republic." He appealed to the Court to act as "the bulwark of the people against their own unadvised actions, their own uninstructed will. It [the Court] saves them not merely from their enemies, it saves them from themselves."²² Similarly George F. Edmunds concluded his ingenious proof that the income tax was a direct tax with a glorification of "the grand mission of this court of last

²¹ Illuminating and detailed analysis of the legal, historical, and economic arguments of the counsel and Court in the income tax cases are to be found in Boudin, *Government by Judiciary*, 2: 206-61; Corwin, *op. cit.*, 177-209; and Seligman, *Income Tax*, 531-89.

²² *Opening Argument by W. D. Guthrie* (Washington, D.C., March 7 and 8, 1895), 47-49; 157 U.S. 442-52; *New York Times*, March 8-9, 1895.

resort, independent and supreme, to bring the Congress back to a true sense of the limitations of its powers." ²³

Against these pleas to the Supreme Court to curb American democracy Richard Olney advanced the argument that Congress had to be allowed the discretion of determining the nature of the taxation system and of public policy. Although a champion of big business, he denounced the rich for calling "upon the judicial department of the government to supplant the political in the exercise of the taxing power" and to "overlook and overstep the bounds which separate the judicial from the legislative power." ²⁴ The last and most powerful defender of the income tax was James C. Carter. To the image of class war conjured up by his opponents, and to their predictions that inevitably oppressive increases in the tax would endanger the institution of private property, he opposed the argument that the best way to preserve private property was to relieve the great mass of people from the excessive burdens of taxation. On the pivotal question of judicial review he said: ²⁵

The powers of this Court are limited as well as those of Congress, and those limits are already transgressed when it finds itself even considering whether this or that view of a question of political economy, or of the wisdom of taxation, is a sound one.

. . . Nothing could be more unwise and dangerous—nothing more foreign to the spirit of the Constitution—than an attempt to baffle and defeat a popular determination by a judgment in a lawsuit. When the opposing forces of sixty millions of people have become arrayed in hostile political ranks upon a question which all men feel is not a question of law, but of

²³ 157 U.S. 499; *New York Times*, March 12, 1895. Edmunds's definition of direct taxes, given in 157 U.S. 491, was criticized as being easily punctured in almost every successive clause by a tyro in economic science. Seligman, *Income Tax*, 538n.

²⁴ *Oral Argument of the Hon. Richard Olney, Attorney General* (n.p., n.d.), 20, 157 U.S. 499-513; *New York Times*, March 13, 1895. Clarence A. Seward eulogized Olney's argument as "the work of a mastermind and the composition of a trained, accomplished and most able argument . . . of the highest order." Seward to Olney, March 18, 1895, Olney Papers, Library of Congress. But Olney had not had much time to prepare his argument owing to the other cases pressing upon his time, especially the Debs case, in which he confessed he was much more interested than in the income tax case. He relied very heavily upon the assistance of his secretary, A. M. Straw, and upon William H. Pope. Olney to A. M. Straw, February 24, 1895; Olney to Tweed, March 15, 1895; Olney to Peck, April 12, 1895—Olney Papers.

²⁵ *Argument of Mr. James C. Carter, for the Appellees* (New York, 1895), 48-49; 157 U.S. 513-32; *New York Times*, March 13, 1895. For more light on Carter see Joseph H. Choate, *American Addresses* (Boston, 1912), 271-93; J. C. Gray, *The Nature and Sources of the Law* (2d ed., New York, 1921), 233-39, 283-92; G. A. Miller in *Great American Lawyers*, Ed. by W. D. Lewis (8 v. Philadelphia, 1907-09), 8: 1-41. Carter expressed himself as being in favor of the income tax as early as January, 1894. See *New York World*, January 24, 1894.

legislation, the only path of safety is to accept the voice of the majority as final. . . .

Unfortunately for Congress and the American people, Carter and Olney's exhortations on judicial self-restraint and reliance on democratic process were counterbalanced by the remarkable plea of Joseph H. Choate for the invalidation of the income tax. Though less distinguished as a legal authority or thinker than Carter, he was noted for his oratorical powers and was aided by a brilliant brief written by Charles F. Southmayd, a retired partner of his with a strong sense of property rights.²⁶ Choate began his address by denouncing the income tax law as "defended here upon principles as communistic, socialistic—what shall I call them—populistic as ever have been addressed to any political assembly in the world." He played upon the Court's apprehension that the "communistic march" of increasingly high tax rates and exemptions might go on indefinitely. "I have thought," he said, "that one of the fundamental objects of all civilized governments was the preservation of the rights of private property . . . that it was the very keystone of the arch upon which all civilized government rests, and that this once abandoned, everything was at stake and in danger." After using this rationalization of the middle class's will-to-power as the basis for a wide variety of historical and legal arguments against the validity of the income tax, Choate ended his speech with an appeal to the Court's *amour-propre*, sense of power, and class interest:²⁷

I do not believe that any member of the Court ever has sat or ever will sit to hear and decide a case the consequences of which will be so far-reaching as this. . . . If it be true . . . that the passions of the people are aroused on this subject, if it be true that sixty million citizens may be incensed by this decision, it is the more vital to the future welfare of this country that this Court again, here and now, resolutely and courageously declare, as Marshall did, that it has the power to set aside an act of Congress in violation of the Constitution, and that it will not hesitate to exercise that power, no matter what the threatened consequences may be.

The Court's First Verdict

Almost a month elapsed before the Court handed down a decision which indicated the varied responses of the different judges to the

²⁶ Edward S. Martin, *Life of Joseph Hodges Choate* (New York, 1920), 2: 2-17; Allan Nevins, *John D. Rockefeller* (New York, 1940), 2: 118, 120, 147-49, 155, 145, 574.

²⁷ *Closing Argument by Mr. Choate on Behalf of Complainants, in support of the Contention that the Income Tax Law of 1894 is Unconstitutional* (n.p., n.d.), 2, 4, 6, 7, 82. *New York Times*, March 13-14, 1895; 157 U.S. 532-53.

personalities and to the emotionally colored symbols of the proponents and opponents of the income tax. The opinions delivered on April 8, 1895, demonstrate the truth of Charles Beard's dictum: "Each act of constitutional interpretation is the act of an individual personality, at a given moment or hour in time, and the so-called collective act of interpretation by the Court is merely a temporary coherence of enough individual justices to constitute a majority for the decision. For another active interpretation, at another date, and even on the same law . . . there may be and often is a dissolution and re-coherence of judicial forces."²⁸

A century of precedent, the weight of legal and historical authority, logic, and social welfare were in favor of the income tax, but these did not prove to be the determining factors in the Court's decision. The opinion Chief Justice Fuller handed down declared that the tax on rents or income from real estate was a direct tax and must be apportioned among the states according to population. Since such apportionment of the tax was not provided for in the Act, the tax on rents was unconstitutional. The tax on income from interest on municipal bonds was nullified on the ground of infringement by the federal government on the power of the state and its instrumentalities to borrow money. The Court expressed no opinion, owing to an equal division among the eight judges hearing the cases, on the three other questions argued at the bar: 1. Whether the provisions of the Act declared unconstitutional invalidated all the income tax provisions. 2. Whether the tax on income from personal property was a direct tax and hence unconstitutional. 3. Whether any part of the tax, if not considered a direct tax, would be invalid as offending against the rule of uniformity.²⁹

Chief Justice Fuller's opinion reproduced many of the errors in historical facts and logic contained in the oral arguments and the briefs of Choate and Seward, and to a lesser extent in those of Guthrie and Edmunds. The Chief Justice did not take over any of the arguments advanced against the income tax as violating the rule of uniformity, but he did accept almost all of Choate's historical and legal arguments about the tax on income from land being a direct tax. Fuller also agreed with Choate that the question as to a direct tax upon the income of

²⁸ Charles A. Beard, "The Act of Constitutional Interpretation," *National Lawyers Guild Quarterly* (December, 1937), 1:9, 11.

²⁹ *Pollock v. Farmers' Loan and Trust Company*, 157 U.S. 429. The cases of *Hyde v. Continental Trust Company* and *Moore v. Miller* were argued with the Pollock case. The Hyde case was decided upon the Pollock opinion and in the same way. The Moore case was left undecided at this time, at the rehearing in 158 U.S. 601, and was ultimately dismissed at the request of the appellant in 163 U.S. 696.

real and personal property had never been decided in any of the cases where a definition of direct and indirect taxes had been given. The most difficult of these cases for the Chief Justice to surmount was the Springer case, in which the Supreme Court had upheld the constitutionality of the 1864 income tax as an excise or duty against the contention that the tax was direct and, not being apportioned, invalid.³⁰ He succeeded in eliminating this case as a precedent for sustaining the tax involved in the 1895 cases by declaring that the Court in 1881, contrary to its own affirmation, had not ruled on the general validity of the income tax. He cited the record of the case as disclosing the fact that although Springer's real estate had been sold to pay the income tax he had refused to give the government, his income was not derived from real estate, but from his earnings as a lawyer and from interest on United States bonds. The Chief Justice then observed³¹ that the Springer case "would have been more significant as a precedent if the distinction [between the two kinds of income] had been brought out in the report and commented on in arriving at judgment, for a tax on professional receipts might be treated as an excise or duty, and therefore indirect, when a tax on the income of personalty might be held to be direct." He and the rest of the majority of the Court then proceeded to hold that³² "an annual tax upon the annual value or annual user of real estate appears to us the same in substance as an annual tax on the real estate, which would be paid out of the rent or income"; and that therefore the 1894 income tax, being unapportioned, was void in so far as it applied to income from real estate. This conclusion was arrived at by following Choate's use of the fallacy of the undistributed middle, in his contention that since a tax on land was a direct tax a tax on income from land was also a direct tax. Moreover, the Act of 1894 did not tax rentals as such, but *net income*. The 1894 income tax, therefore, so far as it reached the land, was both legally and economically an indirect tax.³³

Six of the judges made at that time the crucial judgment that a tax on rents was unconstitutional. Once this point was granted, it served as an entering wedge for overthrowing the constitutionality of the entire income tax measure. This overthrow of precedent, even on one point, can perhaps best be explained in the light of the conclusion to Justice Field's remarkable concurring opinion:³⁴

³⁰ 102 U.S. 586 (1881).

³¹ 157 U.S. 579.

³² *Ibid.*, 581.

³³ Cf. Corwin, *op. cit.*, 186-87.

³⁴ 157 U.S. 607.

If the provisions of the Constitution can be set aside by an act of Congress, where is the course of usurpation to end? The present assault upon capital is but the beginning. It will be but the stepping stone to others, larger and more sweeping, till our political contests will become a war of the poor against the rich; a war constantly growing in intensity and bitterness.

Justice Field, the oldest member of the Court at that time and one of the strongest champions of unfettered capitalism,³⁵ went, however, beyond his other colleagues in holding that all the income tax provisions in the 1894 law should be declared void. His vitriolic outburst against the 1894 income tax was in striking contrast to the approval he had given in 1881 to the income tax acts passed during the Civil War.³⁶ Did increasing age strengthen his conservatism and make him repent the liberalism and concern he had shown for the national welfare on this question when younger? Or did he draw a distinction between taxes on income levied in time of war and those levied in time of peace? During the year 1894-95 he had begun to suffer from impairment of memory. Shortly after the first hearing on the income tax cases he told a group "that he remembered almost every case argued but had no remembrance whatever of the Springer case—that it could not have attracted attention and that he was prepared to reconsider it."³⁷

In his reconsideration of the subject he sought the advice and counsel of David A. Wells, the economist most strongly opposed to the income tax. Some paragraphs of Field's opinion were almost word-for-word reproductions of statements written to him in a letter by Wells.³⁸ Justice Field's lapse of memory, sensitivity to the images and arguments of Choate and his associates concerning the imminent populistic danger to capitalism, and Wells's authoritative re-enforcement of Field's prejudices may explain his disregard in 1895 for the precedent he had helped to establish not only in the 1881 case but also in earlier cases involving the meaning of the term "direct tax" decided in 1869, 1871, and 1875.³⁹ His inconsistency has been strangely overlooked,

³⁵ See Louis B. Boudin, "Truth and Fiction about the Fourteenth Amendment," *New York University Law Quarterly Review* (November, 1938), 16: 19-82 on Justice Field's originality in using the Fourteenth Amendment as a bulwark for the liberty of action of the corporations.

³⁶ *Springer v. U.S.*, 102 U.S. 586.

³⁷ Edward B. Whitney to Richard Olney, *circa* March 17, 1895; Olney to J. C. Carter, March 18, 1895, Olney Papers.

³⁸ Carl B. Swisher, *Stephen J. Field* (Washington, D.C., 1930), 396-412; David A. Wells, *Theory and Practice of Taxation* (New York, 1900), 545-55.

³⁹ *Pacific Ins. Co. v. Soule*, 7 Wall. 433; *Veazie Bank v. Fenno*, 8 Wall. 533; *Scholey v. Rew*, 23 Wall. 331; and *Brainard v. Hubbard*, 12 Wall. 1.

yet it is a noteworthy example of a pendulum-swing in thought and emotion and was an important factor in ultimately rendering unconstitutional a statute which otherwise might have been upheld. This contradiction in position also indicates how much stronger Field's concern for property rights was than his respect for precedent, the popular will, or the right of Congress to exercise its discretion on matters of public policy.⁴⁰

In sharp contrast to Justice Field's assertion "that the whole law of 1894 should be declared void and without any binding force," Justice Edward D. White, appointed by Cleveland to the Supreme Court on February 19, 1894, and elevated by Taft to the Chief Justiceship in 1910, took the position that the entire income tax law, except that involving a tax on income from municipal bonds, should be upheld. He delivered a brilliant and forcible refutation of Chief Justice Fuller's and Justice Field's opinions. Although he had been a strong champion of the sugar planting interests of Louisiana in the United States Senate and was not a radical by any stretch of the imagination, he was closer to public feeling and to the sentiments of the common people on this question than most of the other judges on the bench. He declared⁴¹ that the Court's opinion and decree in the income tax cases "virtually annuls its previous decisions in regard to the powers of Congress on the subject of taxation, and is therefore fraught with danger to the Court, to each and every citizen, and to the republic. . . . If the permanency of its [the Court's] conclusions is to depend upon the personal opinions of those who from time to time may make up its membership, it will inevitably become a theatre of political strife and its action will be without coherence or consistency." Justice White's views were concurred in by Justice John M. Harlan in a brief but emphatic statement.⁴²

All eight judges hearing the cases, however, united in the first Court

⁴⁰ Some elements in the background of Field's decision worth mentioning were his intimate relations with the powerful railroad interests of California and various banking groups in New York. These friendships probably made him identify the income tax with the free silver threat of the Populists to the gold standard, which he considered the basis of capitalism. See Sidney Ratner, "Was the Supreme Court Packed by President Grant?" *Political Science Quarterly* (September, 1935), 50: 343-58, for Field's conservative position on the Greenback issue in 1870.

⁴¹ 157 U.S. 608, 650-51; H. L. McBain, "Edward Douglass White," *Dictionary of American Biography*; Nevins, *Cleveland*, 547, 569-72, 670; Warren, *The Supreme Court*, 3: 441-43.

⁴² 157 U.S. 652-53. Cf. R. T. McCracken, "Justice Harlan," *University of Pennsylvania Law Review* (February, 1912), 60: 297-310.

decision that a federal income tax upon the income derived by private persons or corporations from municipal bonds was a tax on the power of the state to borrow money and was therefore unconstitutional. This concern of the Court for the rentier class and for state and local rights was to lead to the creation of a "tax-exempt aristocracy" and was to furnish a loophole for tax dodgers, whereby the federal government was to be deprived of a large portion of its legitimate revenue. By 1933 some \$30 billion was invested in state and municipal securities, and the situation had become so serious that Cordell Hull, then a Senator, proposed a constitutional amendment against tax exemption of so-called government instrumentalities. In March, 1941, the Treasury, impelled by the need for revenue, began a test action intended ultimately to prove in the Courts that the federal government has the right under the Constitution to tax the income from state and municipal securities. The fruits of this 1895 Act of judicial legislation, despite the unanimity of the Court at that time, have been definitely contrary to the welfare of all but a small minority of the people.⁴³

The uncertain status of the income tax law of 1894 after this decision was considered very unsatisfactory both by the champions of the income tax who wanted it vindicated in all respects and by their opponents who desired its complete annulment. Accordingly, a rehearing of the case was requested on April 15, 1895, by Joseph H. Choate and his associates, and was granted by the Court. The rehearing took place on May 6, 7, and 8, 1895. William D. Guthrie and Joseph H. Choate spoke for the contestants of the income tax while Attorney-General Olney and Assistant Attorney-General Whitney represented the United States government. James C. Carter did not appear for the Continental Trust Company because they were not anxious to have his great abilities used in defending the income tax and in winning a victory they did not desire. Olney evidently was limited by the funds at his disposal and hence was unable to retain Carter as a government counsel. This was a disaster for the government because Carter's interest in the income tax cases and his legal abilities were far greater than those of Richard Olney.⁴⁴

⁴³ Maggs, *op. cit.*, 1: Book Five, 514-42; Louis B. Boudin, "Taxation of Governmental Instrumentalities," *Georgetown Law Journal* (November, 1933; January, 1934), 22: 1-40, 254-92; Randolph E. Paul and Jacob Mertens, *The Law of Federal Income Taxation* (6 v., Chicago, 1934), 1: 68-101, and *1939 Cumulative Supplement* (Chicago, 1939), 56-59; *New York Herald Tribune*, March 15, 1941.

⁴⁴ Carter to Olney, April 27 and 30, 1895, Olney Papers.

The Second Legal Battle

The rehearing was before the full Court of nine justices. This time Justice Howell E. Jackson, who had been absent from the first hearing owing to ill health, was present. His keen sense of duty made him summon the little strength he had left in order to help settle finally this crucial problem. His illness had been so serious as to make the Chief Justice, President Cleveland, and Attorney-General Olney attempt very delicately in January, 1895, to provide for Justice Jackson's retirement, but he evidently insisted on remaining on the bench, although he took no part in the Court's activities until the income tax cases were scheduled for rehearing.⁴⁵

William D. Guthrie opened the reargument of the cases by criticizing the rule of precedent and *stare decisis* as closing the door on reason and on truth. He repeated with slight modifications the themes he had first presented about the income tax being a direct tax and about the injustice of the various exemptions granted in the Income Tax Act.⁴⁶ Assistant Attorney-General Whitney presented an able analysis of the distortions of his opponents on direct tax and uniformity questions. The Attorney-General centered his argument upon a justification of the tax on rents or income from land. He felt that if he could not "get the rents back into the law, perhaps it [the entire income tax law] had better go by the board." His argument, as he told James C. Carter, was "really a criticism upon the Chief Justice's opinion." Olney concluded with a strong assertion that the income tax was not populist, communistic, Jacobean, or anarchistic. He deplored the serious impairment of the government's taxing power which would result from the income tax being declared unconstitutional. He pointed out that in time of crisis or of war the income tax was a necessity for the preservation of the Union and for the prevention of popular discontent over the possessors of accumulated wealth shirking and escap-

⁴⁵ This episode in Supreme Court history has never previously been published. The evidence is to be found in the correspondence between Chief Justice Fuller and Olney, January 30, February 23, 1895, and between Olney and Senator Isham G. Harris, February 13, 1895, Olney Papers, Library of Congress. The consequence of Jackson's firm refusal to retire from the Court was that he left his home near Nashville, Tennessee, where he had been resting, to sit in on the income tax cases. The strain of the work and trip evidently took its toll and he steadily lost strength from that time on until his death on August 8, 1895. *New York Times*, August 9, 1895; 159 U.S. 701-08; Appendix 1, *In memoriam Howell Edmunds Jackson*.

⁴⁶ *Opening Argument by Mr. W. D. Guthrie, on Behalf of the Appellants* (Washington, May 6, 1895), 6, 69-70.

ing their due share of the public burdens under cover of constitutional provisions.⁴⁷

The final argument at the rehearing was given by Joseph H. Choate. He used all his powers of invective, flattery, impassioned eloquence, and dialectic to convince the Court that the entire income tax law should be declared unconstitutional. He developed his argument by stressing the points already won at the previous hearing, the unconstitutionality of the tax on interest from municipal bonds and on rents or incomes from land. He dismissed Whitney's elaborate historical argument that the income tax was not a direct tax in the constitutional sense as illusory and as following "a will-o'-the-wisp all the time." Choate then went on to argue that personal property was entitled to the same protection as real property and that a tax upon personal property and a tax upon the income directly received from personal property were direct taxes. He admitted that there were no previous court decisions to substantiate his claim, but maintained that the rule of *stare decisis* should not prevent the Court from accepting his interpretation of the Constitution as the right and sound one. He contended that the exemption granted to mutual insurance companies and to those having incomes under \$4,000 violated the provision concerning uniformity of taxation in the Constitution. He also pleaded that the whole Income Tax Act was void because the first ruling of the Supreme Court in the income tax cases exempted real estate owners and bondholders and left the rest of the income tax burden as a tax upon labor rather than capital. His conclusion pictured Congress increasing in the future "the exemption from \$4,000 to \$10,000 or to \$40,000, and increasing the tax from two per cent to ten per cent, or to twenty per cent, and so establishing a new theory of constitutional government, namely, that in the future, as rapidly as we can attain that position, we may run this Government, not on the product of the imposts, as was originally intended, but on the incomes of real and

⁴⁷ *Argument of Edward B. Whitney, Assistant Attorney-General on Behalf of the U.S., upon the Uniformity Question; Oral Argument of Hon. Richard Olney, Attorney-General; Olney to A. M. Straw, May 9, 1895; Olney to Carter, May 11, 1895, Olney Papers; James, Richard Olney, 73-76. Olney's argument was very largely based on the work of William H. Pope. Pope Memoranda, on rents, constitutional rule on direct taxation, May, 1895. Olney Papers. George S. Boutwell wrote to Olney on May 14, 1895, that Olney's argument "ought to lead to a reversal of the opinion rendered in April" and that he was "altogether incapable of foreseeing the process by which your argument can be answered." Olney Papers. Boutwell had even suggested to Whitney that the government make a special effort to reply to the Choate-Southmayd brief as far back as March, 1895. Whitney to Olney, April 1, 1895, Olney Papers.*

personal estates, thereby thrusting substantially the whole burden upon the property of the land."⁴⁸

The Second Decision: Judicial Revolution

Twelve days later, after feverish speculation and conjecture as to the final outcome of the Court's deliberations, Chief Justice Fuller handed down a decision⁴⁹ reaffirming the unconstitutionality of a tax on rents or income from real estate unless apportioned as a direct tax. The majority of the Court then extended the line of reasoning used to prove that a tax on rents was a tax on land and concluded that a tax on income from personal property was a tax on personal property and therefore a direct tax. Unless levied under the method of apportionment, the tax was invalid. The whole Court agreed, however, that a tax on the income from professions, trades, employments, or vocations was valid and that such taxes had been sustained as excises in the past. But the majority of five, who had ruled against a tax on income from real and personal property, held that since the crucial income tax sections of the Tariff Act were invalid, all the sections should be held invalid.

The Mystery of the Vacillating Judge

Justice Jackson, whose vote nearly everybody had expected would be decisive at the rehearing, cast his vote for the income tax on all points.⁵⁰ The favorable vote of Justice Jackson was expected to have made the decision a 5 to 4 vindication of the income tax except for the tax on rents and income from municipal bonds. To everybody's astonishment, a judge who six weeks before had upheld the validity

⁴⁸ *Closing Argument by Mr. Choate* (Washington, D.C., May 7 and 8, 1895), 3-10, 31, 34, 47-48, 71ff., 84. This argument of Choate's and the earlier one he delivered in April were so important in influencing the Court that it is worth quoting his own words on his role and fee in the case: "A good many people," said he, "have stated that my fee was as high as \$250,000, but nothing could be further from the truth although that amount would not have been excessive. The parties directly interested in the case, who could be called on for a certain amount, were a few insurance companies, with the expectation, however, that a number of banks, and other financial interests, would contribute to some extent, but not one of them did so, and all that I received for my services for preparing the case and making the two arguments before the Supreme Court of the United States was \$34,000." Theron G. Strong, *Joseph H. Choate* (New York, 1917), 232.

⁴⁹ 158 U.S. 601, 617-37.

⁵⁰ 158 U.S., 696-706. Whitney, "The Income Tax," *Harvard Law Review*, 20: 286, asserts that Justice Jackson upheld the constitutionality of the tax on income from municipal bonds, but had no chance to discuss the question at the rehearing.

of the income tax on the three points left undecided on April 8 reversed his stand. He thereby rendered every section of the 1894 income tax law unconstitutional on all points. Who that judge was, only the judges within the secret chambers of the Supreme Court at the time the vote was taken knew positively. But they did not choose to dispel the mystery. The published Court reports gave no explicit statement of the lineup of the judges in the April 8 decision which would have enabled the public to discover which judge had then been led after the reargument of the cases to a different opinion on May 20. People, however, could not be restrained from jumping to conclusions. Rumor immediately fastened on Justice Shiras as the vacillating judge. On May 21 such influential newspapers as the *New York Times*, the *Tribune*, and the *World* declared with complete assurance that it was Justice Shiras who had changed his position and brought about the annulment of the income tax law. Constant repetition of this gossip over a long period of time led many writers to accept the charge against Justice Shiras as an unquestioned historic fact.⁵¹

A rigorous analysis of the evidence, however, proves that Justice Shiras was unjustly accused of an act he never committed.⁵² The disproof of this historical fiction revives the mystery about the true identity of the vacillating judge. Which of the eight other judges on the bench in the spring of 1895 has been protected from public criticism by the studied silence of the Court despite the totally unjustified attacks on Justice Shiras's name? An intensive examination of the nine

⁵¹ See Boudin, *Government by Judiciary*, 2: 249; James, *Richard Olney*, 75; Drew Pearson and Robert S. Allen, *The Nine Old Men* (New York, 1937), 320; Warren, *The Supreme Court*, 3: 422.

⁵² Denials of Justice Shiras's alleged shift of opinion were made by John Dalzell on March 2, 1897, in Congress, *Cong. Record*, 54 Cong., 2d Sess., 29: 2563 *et seq.*; by Frank Warren Hackett in a letter, "The Income Tax Cases—A Correction" *Yale Law Journal* (June, 1915), 24: 661-62; by the Hon. (later Chief Justice) Charles Evans Hughes in his volume of lectures, *The Supreme Court of the United States* (New York, 1928), 54. Dalzell and Hackett were close personal friends of Justice Shiras. Hughes based his statement about the charge against Justice Shiras being "without foundation" on the oral tradition of the Court which he had received as an Associate Justice of the Court between May, 1910, and June, 1916. Further corroboratory evidence is the statement by Dr. George Shiras, 3d, a son of Justice Shiras and a distinguished naturalist and lawyer, that he had received the impression from conversations with his father after the latter had retired from the Court in 1903 that his father had not changed his position in the Pollock case. Justice Shiras had "expressed the hope that before Chief Justice Fuller retired he would make public the record of the vote in Chambers but in this he [Justice Shiras] was disappointed. Later on he expressed the same wish regarding Chief Justice White, but was again disappointed." Letter from George Shiras, 3d, to the author, dated January 21, 1932. For some interesting sidelights on Justice Shiras, see George Shiras, 3d, "Anecdotes of Justice Shiras," *Daily Mining Journal*, Marquette, Michigan, August 1, 1934.

opinions written on these cases reveals that only Justice Brewer or Justice Gray could have undergone the dramatic reversal of opinion resulting in the second decision. Although the evidence as to which of these two judges was the one who wavered is difficult to unravel, Professor Edward S. Corwin has been able to demonstrate that Justice Gray was the man. The causes for Justice Gray's reversal of position were undoubtedly complex. He had been a radical in politics when young, an original Free Soiler when it required great independence and courage. During his service on the United States Supreme Court from 1881 to 1902 he won a reputation as one of the strongest champions of the powers of the national government. These facts and his great respect for precedent undoubtedly influenced him to uphold the constitutionality of the 1894 income tax law on most points at the first hearing. Evidently the arguments of Choate and his associates, as well as perhaps a growing conservatism, influenced him to change his opinion at the second hearing. In any case, Professor Corwin has convincing proof that the tradition of the Court is that Justice Gray was the judge who changed his mind.⁵³

Justice Gray had the right to reverse his position after the reargument of the income tax cases on the basis of his honest convictions concerning the validity of the attack against the Income Tax Act. He is open to criticism, however, because he did not make known to the general public either the fact or the reasons for his change of opinion. He was clearly under obligation to the American people to present the considerations influencing his decision on a matter so vitally affecting the national welfare.⁵⁴

⁵³ Edward S. Corwin, *Court over Constitution*, 201; Letters from Professor Corwin to the author, March 24, 1936, and February 14, 1938. An interesting confirmation is to be found in a letter from Clement Hugh Hill, a noted lawyer, to Richard Olney, dated June 8, 1895: "It is amusing to see Gray taking the side of the capitalists, but I suppose he thinks nothing is to be gained at his age in being a Radical any longer. Parker used to say that he decided early in life that radicalism was the best card, and had convinced himself that it was the right side too. I remember his telling me years ago that he would rather be governed by the lower half of society than by the upper half, and his skin-deep radicalism always appeared awkwardly on a man of his insolent overbearing temper." Olney Papers. Against this harsh judgment of Justice Gray see George F. Hoar, "Memoir of Horace Gray," *Proceedings Massachusetts Historical Society* (2 ser., January, 1904), 18: 155-87; Samuel Williston, "Horace Gray," in *Great American Lawyers*, 8: 137-88, Ed. by W. D. Lewis (8 v., Philadelphia, 1907-09).

⁵⁴ Justice Gray apparently never informed even members of his family about his role in these cases. Mr. Roland Gray, the nephew of Justice Gray, informed my friend, Mr. Harold Davis, in a letter dated January 24, 1938, that, although he had been Justice Gray's secretary in 1898-99, he had never heard any suggestion about Justice Gray's having changed his vote.

The Minority's Dissent

The strongest indictment of the decision handed down by Chief Justice Fuller on May 20 before the large and distinguished audience in the courtroom was given by the four dissenting judges. As soon as the Chief Justice had concluded his invalidation of the 1894 Income Tax Act, Justice Harlan began reading his dissenting opinion and proceeded to demolish the arguments adopted by the Chief Justice from Choate and made into the law of the land. The intensity with which Harlan spoke, the strong feeling he displayed and directed at the Chief Justice, and at Justices Field and Gray, and the disrespect he showed for the opinion of "a bare majority" of the Court shocked conservative lawyers who felt they had never listened to such revolutionary statements from the bench or from the most rampant Populist. Harlan declared ⁵⁵ that the Supreme Court by its ruling against the income tax

practically decides that, without an amendment of the Constitution—two-thirds of both Houses of Congress and three-fourths of the States concurring—such property and incomes can never be made to contribute to the support of the national government. . . . The practical effect of the decision today is to give certain kinds of property a position of favoritism and advantage inconsistent with the fundamental principles of our social organization, and to invest them with power and influence that may be perilous to that portion of the American people upon whom rests the larger part of the burdens of the government, and who ought not to be subjected to the dominion of aggregated wealth any more than the property of the country should be at the mercy of the lawless.

Justice Jackson, though not fully recovered from his long illness and in fact destined to die within a few months, then read a short but pointed dissenting opinion. In his conclusion he said with great earnestness: ⁵⁶

The practical operation of the decision is not only to disregard the great principles of equality in taxation, but the further principle that in the imposition of taxes for the benefit of the government the burdens thereof should be imposed upon those having most *ability* to bear them. . . . Considered in all its bearings, this decision is, in my judgment, the most disastrous blow ever struck at the constitutional power of Congress.

⁵⁵ 158 U.S. 638, 672, 685; *New York Times, Tribune, and World*, May 21, 1895.

⁵⁶ 158 U.S. 705-06.

Justice Brown joined the dissenters with the strong statement of his views:⁵⁷

It is never a light thing to set aside the deliberate will of the legislature, and in my opinion it should never be done, except upon the clearest proof of its conflict with the fundamental law. . . . Even the spectre of socialism is conjured up to frighten Congress from laying taxes upon the people in proportion to their ability to pay them. . . . While I have no doubt that Congress will find means of surmounting the present crisis, my fear is that in some moment of national peril this decision will rise up to frustrate its will and paralyze its arm. I hope it may not prove the first step toward the submergence of the liberties of the people in a sordid despotism of wealth.

The last dissent was made by Justice White, who expressed himself in opposition to the Court's judgment with the same intense earnestness which had characterized his manner in delivering his celebrated dissent of April 8. He declared that the majority opinion

takes invested wealth and reads it into the Constitution as a favorite and protected class of property. . . .

and that any attempt to apportion taxation by population and not by wealth could not be called into being

without the red spectre of revolution's shaking the foundations of the Union; without making the Constitution the engine of the most outrageous oppression and inequality the world has ever known.⁵⁸

The Public Reaction to the Decisions

The reaction of the press to the Court's decision against the income tax varied with its political and economic affiliations. The *New York World* declared: "The overthrow of the income tax is the triumph of

⁵⁷ 158 U.S. 695. Cf. Boudin, *Government by Judiciary*, 2: 249-52. If the Sixteenth Amendment had not been adopted in 1913 in order to overrule the income tax decisions, the United States might not have been able to raise sufficient revenue to win the first World War and Justice Brown's fears might have been definitely realized. Justice Brown reversed his April 8 opinion on the unconstitutionality of the tax on income from real estate on May 20. Cf. Corwin, *op. cit.*, 186, 195.

⁵⁸ 158 U.S. 712, 713-14. The second quotation in the text comes from the report in the *New York Times*, May 21, 1895, which stated Justice White did not confine himself to his manuscript and "that if he had not had time to elaborate his reasons on paper, that elaboration was present in his mind and expressed in his words." The corresponding statement in 158 U.S. 713-14 is: "If a tax on invested personal property were imposed by the rule of population, and there were no other means of preventing its enforcement, the red spectre of revolution would shake our institutions to their foundation."

selfishness over patriotism. Great and rich corporations, by hiring the ablest lawyers in the land and fighting against a petty tax upon superfluity as other men have fought for their liberties and their lives, have secured the exemption of wealth from paying its just share toward the support of the government that protects it." The *St. Louis Post Dispatch* asserted: "Today's decision shows that the corporations and plutocrats are as securely entrenched in the Supreme Court as in the lower courts which they take such pains to control." Such western and southern newspapers as the *Augusta (Georgia) Chronicle*, the *Detroit Free Press*, and the *Louisville Courier-Journal* published stringent criticism of the majority opinion. On the other hand, the conservative newspapers in both the Northeast and Middle West gave full voice to their feelings of triumph. The *New York Tribune* exclaimed: "The great compromises which made the Union possible still stand unshaken to prevent its overthrow by communist revolution. The fury of ignorant class hatred, which has sufficed to overthrow absolute power in many other lands . . . has dashed itself in vain against the Constitution of the United States, fortified by the institutions which a free people have established for the defence of their rights." The sentiments of the *New York Sun* were similar: "The wave of socialistic revolution has gone far, but it breaks at the foot of the ultimate bulwark set up for the protection of our liberties. Five to four the Court stands like a rock." Other members of the chorus of property rights defenders were the *New York Times*, the *Brooklyn Daily Eagle*, the *Philadelphia Inquirer*, the *Cincinnati Enquirer*, the *New York Journal of Commerce*, the *Cleveland Plain Dealer*, the *St. Louis Globe-Democrat*, and the *Chicago Daily Inter-Ocean*. But the *Springfield Republican* very wisely said: "They make a great mistake who think to find in the decision of the Supreme Court the final word against the so-called socialistic tendencies of the moment. The people, whether for good or ill, will speak that word."⁵⁹

In addition to the newspaper comment, a stream of articles rapidly appeared and continued to flow until the Court's decision was overruled through the ratification of the income tax amendment years later. As defenders of the Supreme Court Edwin L. Godkin, the editor of the *Nation*, ex-Senator George F. Edmunds, William Howard Taft, then a United States Circuit Judge, and others wrote sincere vindications of the Court's integrity and wisdom in nullifying the 1894 Income Tax Act. Godkin clearly saw that the "history of tax-

⁵⁹ *Literary Digest* (New York, June 1, 1895), 11:126; *Public Opinion* (May 23, 30, 1895), 18:563, 594-96.

ation from the earliest ages has been the history of the attempts of one class to make other classes pay the expenses, or an undue share of the expenses, of the Government." But he refused to admit that the propertied classes should submit to the burden of an income tax, and sneered at Justice Harlan as an "agitator" expounding "the Marx gospel from the bench."⁶⁰

The critics of the income tax decisions outnumbered and outweighed the defenders. The editor of the *American Law Review* wrote that "some of the judges of that court seem to have no adequate idea of the dividing line between judicial and legislative power, and seem to be incapable of restraining themselves to the mere office of a judge." George S. Boutwell, Grant's Secretary of the Treasury, joined in the criticism of the decisions as contrary to the Constitution and the precedents. The *Harvard Law Review* carried a devastating refutation of the decisions by Francis R. Jones, a well-known legal authority of the time, who predicted that the decisions might very well be overruled by a future Court. Edward B. Whitney, the Assistant Attorney-General, denied in the *Forum* the Court's authority to remove "a balance between the poor and the rich" by passing judgment on the necessity of an income tax. Professor Seligman, considered the greatest tax authority in America, stressed the Court's errors in economics and constitutional interpretation. Governor John P. Altgeld of Illinois castigated the Court for acting as the agent of concentrated wealth. Governor Sylvester Pennoyer of Oregon outdid all the others by attacking the power of the Supreme Court to declare acts of Congress unconstitutional. He urged Congress to impeach the nullifying judges for their usurpation of legislative power, to remove them from office, and to instruct the President to enforce the collection of the income tax.⁶¹

⁶⁰ George F. Edmunds, "Salutary Results of the Income-Tax Decision," *Forum* (July, 1895), 19: 513-20; L. Allen, "The Income Tax Decision," *North American Review* (1895), 160: 84ff.; E. L. Godkin, "The Income Tax Decision," *Journal of Political Economy* (1895), 3: 509, and *Nation* (April 11, May 23, 1895), 60: 272, 394; William Howard Taft, "Criticisms of the Federal Judiciary," *American Law Review* (September-October, 1895), 29: 641-74. See Warren, *op. cit.*, 3: 425 n.1 for further citations.

⁶¹ John P. Altgeld, *Live Questions* (Chicago, 1899), 464-66; "The Income Tax Decision," *American Law Review* (May-June, 1895), 29: 424-28; George S. Boutwell, "The Income Tax," *North American Review* (May, 1895), 160: 589-601; Francis R. Jones, "Pollock v. Farmers' Loan and Trust Co.," *Harvard Law Review* (October, 1895), 9: 198-211; Sylvester Pennoyer, "The Income Tax Decision," *American Law Review* (July-August, 1895), 29: 550-89; E. R. A. Seligman, "Is the Income Tax Constitutional and Just?" *Forum* (June, 1895), 19: 48-56; E. B. Whitney, "Political Dangers of the Income-Tax Decision," *Forum* (July, 1895), 19: 521-31.

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Taxes for the War with Spain

THE attempt of the Supreme Court to prevent Congress from enforcing the will of the great majority of the people on matters they deemed of vital importance to the furtherance of democracy stimulated the resentment of the working, farming, and small business classes. Since, under the accepted conventions of the American Constitution, Congress and the President were not entitled to override the Supreme Court's income tax decisions by passing another law or by disregarding the decisions, recourse had to be taken by the advocates of the income tax to a constitutional amendment. This meant political action at the 1896 presidential conventions, in Congress, and in forty-eight state legislatures. The task was difficult; over a thousand constitutional amendments had been introduced in Congress during the first hundred years of the Constitution's history, and only fifteen had been adopted, three of these under the emotional stress of the Civil War.

Sectional and Social Conflict in the 1896 Election

But the impact of the depression, the failure of the Cleveland administration to help the people in any constructive manner other than attempts at civil service and tariff reform, and the Supreme Court's frustration of the small business people in its Sugar Trust decision, of labor in its Debs decision, and of the common people, the working, farming, and small business classes in its income tax decisions provided the stimuli for a crusade for social justice and economic well-being of which William Jennings Bryan became the leader.

The Republican platform ignored the income tax and defended the protective tariff, sound money, a vigorous foreign policy, compulsory arbitration of labor disputes in interstate commerce, and generous pen-

sions for Civil War veterans. The Democrats, at their convention in Chicago, deserted Cleveland and went over almost completely to the Populist positions. Governor Altgeld of Illinois laid out the program of the convention, dictated its platform, and impressed his personality on all the major policies. His slogan was: "No Compromise" against the Gold Democrats' plea: "Do Not Split the Party" through too radical measures. The Democratic platform demanded the coinage of gold and silver at the ratio of 16 to 1, tariffs for revenue only, and enlargement of the powers of the Interstate Commerce Commission. The platform denounced government by injunction and asserted that "it is the duty of Congress to use all the constitutional power which remains after that [income tax] decision, or which may come from its reversal by the Court as it may hereafter be constituted, so that the burdens of the taxation may be equally and impartially laid, to the end that wealth may bear its due proportion of the expenses of the government."

The Socialist Labor party protested against "the perversion of democracy to the ends of plutocracy" and urged various sweeping economic changes, among which was the call for a progressive income tax and tax on inheritances. But neither the Socialist Labor party nor the Prohibition and National parties won many votes. The 1896 election campaign was waged between William McKinley as the candidate of the Republican party and William Jennings Bryan as candidate of the Democratic, Populist, and Silver parties. McKinley received the support of most of the Gold Democrats, despite the fact that they officially had as their own presidential candidate John M. Palmer of Illinois.

This election marked a political revolution in political issues and in the lines drawn among various social groups. The Populists had captured the Democratic party. A comparison of the two platforms reveals a striking similarity in the demands and in the language used. The Populists also urged "a graduated income tax, to the end that aggregated wealth shall bear its just proportion of taxation" and regarded "the recent decision of the Supreme Court relative to the income tax law as a misinterpretation of the Constitution, and an invasion of the rightful powers of Congress over the subject of taxation."

Bryan waged one of the most remarkable campaigns in history, almost singlehanded. He traveled more than 13,000 miles through two thirds of the states in the Union and made more than 400 speeches during the campaign. His Silver Democratic and Populist supporters were almost fanatical in their enthusiasm and felt that they were waging a crusade against the inequity of wealth and for the welfare of

all the common people. But Bryan's superb eloquence and indefatigable energy, despite wide-spread support, was not sufficient to overcome the smoothrunning machine created by Mark Hanna, McKinley's campaign manager and one of the great President-makers in American history. Hanna felt keenly the danger of a social revolution which Bryan's election might precipitate, and was determined to prevent it by bringing about the election of McKinley through the use of every high-pressure political means and propaganda technique available.

Realizing that "money is the sinews of war," Hanna systematically built up the largest campaign fund ever obtained in America until that time. Against the \$600,000 of the Democrats, he marshaled from \$3,500,000 to \$7 million--the estimates vary, but the higher figures are probably accurate. This huge sum was obtained from those who felt most threatened by the revolt against the privileged classes, financiers on Wall Street, monopoly industrialists, the big insurance companies, and the great railroad magnates. The Standard Oil Company, through John D. Archbold and William Rockefeller, contributed \$250,000, as did J. P. Morgan; \$400,000 came from the great Chicago meat-packing companies. The banks of the country were assessed one fourth of 1 per cent of their capital to ensure McKinley's election, and this assessment, although a capital levy, was paid for the most part without protest by men who had vilified the income tax as communism. This money was used to launch a hurricane of pamphlets, speeches, blue and gold emblems, and placards. McKinley was advertised as "The Advance Agent of Prosperity" while Bryan was pictured as an unrestrained Pcpulist, an anarchist, a blasphemer, and the anti-Christ.

In addition to the persuasive appeals to the hopes of the business classes for the restoration of prosperity and to the fears and prejudices of many against seemingly dangerous innovations in economics and government, the supporters of McKinley used other effective devices for exerting pressure on those who otherwise would have supported Bryan. Manufacturers were given large orders to be executed only in the event of McKinley's election. This fact was conveyed to workers in the factories. Many employers of labor told their workmen the week before the election that they need not return to work if Bryan were successful. Insurance companies hinted to western debtors that five-year mortgage extensions would be given provided McKinley's election occurred. The banks exerted influence on their customers. Conservative clergymen also raised their voices against the character and

ideas of Bryan. Finally, since victory did not seem assured as election day drew near, the Republican party machine resorted to importing floaters into doubtful districts, especially in Indiana and Ohio, so as to ensure election even at the cost of resorting to outright bribery and corruption.

McKinley defeated Bryan by a popular vote of 7,098,000 to 6,380,000 and an electoral vote of 271 to 176. Given McKinley's tremendous financial advantage, Bryan's feat in winning twenty-two states against McKinley's twenty-three was a remarkable achievement. If Bryan could have won the five states west of the Mississippi and the four states south of Mason and Dixon's Line, he would have won the election without needing a single electoral vote in the region east of the Mississippi and north of the Ohio. Bryan's vote was larger than that received by Cleveland in 1892 and Wilson in 1912. But the big business interests behind the Republican party had been able to win over to their side through their stress on the dangers of unsound currency the small businessmen, the prosperous farmers in the East, and many of the urban industrial workers who were scared by the prospect of unemployment. They defeated the debt-ridden farmers of the West, the discontented workers convinced of exploitation, the silver miners and owners, and the members of the middle class who were in rebellion against what they considered the malpractices of high finance and the large corporations.¹

Although it is customary for many historians to regard the victory of McKinley as saving the United States from dire experiments by the radical agrarian and labor groups in the country behind Bryan, one may, without being a bimettallist, point out that Bryan's defeat carried with it the defeat not only of bimettallism, but also of a whole series of proposed reforms which are now regarded as being very moderate modifications of capitalism, acceptable to even the mildest liberal. The adoption of the income and inheritance taxes, the abolition of government by injunction, the elimination or sharp reduction of the protective tariff, the strict control of railroads and large corporations attempting or exercising monopoly control, and the direct election of Senators, to mention only the most prominent of the Democratic

¹ Harry Barnard, *Eagle Forgotten*, 359-73; Thomas Beer, *Hanna* (New York, 1929), 131-66; Herbert Croly, *Marcus Alonzo Hanna* (New York, 1912), 164-227; Paxton Hibben, *William Jennings Bryan*, 162-201; Hicks, *The Populist Revolt*, 340-79; William Diamond, "Urban and Rural Voting in 1896," *American Historical Review* (January, 1941), 46: 281-305; Nevins, *Cleveland*, 677-712; Edgar E. Robinson, *The Presidential Vote 1896-1932* (Stanford, 1934), 4-7, 46-53; Stanwood, *A History of the Presidency*, 1: 519-69.

and Populist proposals, would have directly benefited the great majority of the people. In fact, the Populist contribution to the furtherance of American democracy has now been definitely established. But some twenty years had to pass before the seemingly radical ideas of Bryan and the Populists were adopted and made part of our governmental machinery.²

*The Distribution of Wealth and Income
in the Eighteen-Nineties*

Bryan's defeat was regrettable from the point of view of those interested in checking the great concentration of wealth which had been making spectacular strides since the outbreak of the Civil War. The national wealth in 1860 had been over \$16 billion; by 1890 it had grown to \$65 billion; by 1900 it was to be \$88½ billion. Meanwhile the population had jumped from 31½ million in 1860 to 63 million in 1890 and was on its way to 76 million in 1900. The per capita wealth was estimated at \$514 in 1860 and at \$1,036 in 1890; by 1900 it was to be \$1,165. But, although the total wealth within the United States had increased almost fivefold between 1860 and 1896, many feared that the distribution of the wealth had not been equal to or in proportion to the native ability of the American people. American democracy was endangered in the eyes of most of the farmers, workers, and small businessmen by the growth of big business and the accumulation of great fortunes by a relatively small number of individuals.

The fears concerning the rise of a plutocracy in the United States to which the Populists and their predecessors had given voice were not unfounded. In November, 1889, Thomas G. Shearman, a prominent lawyer and tax reformer, published in the *Forum* an essay on "The Owners of the United States" which attracted wide attention. He asserted that 70 per cent of the national wealth was concentrated in a minority of either 182 thousand or 235 thousand families. He maintained that contrary to the British trend toward a wider diffusion of wealth among the masses, the drift in the United States was toward a greater and greater concentration of wealth. Although federal taxation had increased sixfold since 1860, his belief was that the whole weight of this increase had been borne by the relatively poorer classes;

² Hicks, *The Populist Revolt*, 404-23; Benton Harris Wilcox, *A Reconsideration of the Character and Economic Basis of Northwestern Radicalism* (Ph.D. Thesis, University of Wisconsin, 1933), 64-69.

that the wealthier classes had so adjusted the indirect taxation that it took from the rich only 3 to 10 per cent of their annual savings while taking from the poor 75 to 90 per cent. Shearman was opposed to all schemes for arbitrary limitations of individual wealth, whether by a graduated income tax, a heavy succession tax, or otherwise. He predicted that by 1920 the United States would be substantially owned by less than 50,000 persons, constituting less than one in 500 of the adult male population, if the then prevailing methods of taxation were continued.³

In June, 1892, the *New York Tribune* published in its monthly supplement a list of 4,047 millionaires in the United States. This was in response to popular interest in the subject. On the basis of this list and of census data, George K. Holmes of the Census Bureau presented a modest but scientific estimate of "The Concentration of Wealth" in the *Political Science Quarterly* for December, 1893, which became a widely used arsenal of facts in the popular and Congressional battle over the desirability of an income tax. Holmes concluded after elaborate calculations that about 91 per cent of the families in the United States owned only 29 per cent of the national wealth, that 8.97 per cent of the families owned about 51 per cent of that wealth, and that .03 per cent of the families, the millionaires, owned 20 per cent of the national wealth. In short, 9 per cent of the families possessed 71 per cent of the wealth. To prevent the concentration of wealth from going too far, he suggested progressive taxes on income, gifts, and inheritances.⁴

Three years later Charles B. Spahr, an economist sympathetic to the Populists' aims, issued a volume on *The Present Distribution of Wealth in the United States*, which was the most ambitious statistical estimate of the problem thus far attempted. He gave a vivid survey of the growth of the wealthy classes in the United States and showed through acute analysis how the sectional and class inequalities in wealth and income had developed. His calculations indicated that 1 per cent of the families in the United States held 51 per cent of the national wealth, that 11 per cent of the families owned 35 per cent of the wealth, and that the remaining 88 per cent of the families owned only 14 per cent of the wealth. As to the distribution of income in the

³ Thomas G. Shearman, "The Owners of the United States," *Forum* (November, 1889), 262-73.

⁴ G. K. Holmes, "The Concentration of Wealth," *Political Science Quarterly* (December, 1893), 8: 589-600. Holmes also published, with J. S. Lord, *Farms and Homes: Proprietorship and Indebtedness in the United States at the Eleventh Census, 1890* (Washington, 1896), a valuable and elaborate pioneer study.

United States in 1890, Spahr presented figures which indicated that the wealthiest 200,000 families, those with yearly incomes of \$5,000 and over, received three tenths of the national income, that the 1,300,000 families receiving between \$1,200 and \$5,000 family income a year received one fifth of the national income, and that the 11,000,000 families having incomes under \$1,200 received one half of the national income. He concluded that more than five sixths of the income of the wealthiest class was received by the 125,000 richest families, while less than one half of the income of the working classes was received by the poorest 6,500,000 families. This meant that the poorest family group had an average income of \$354, the next poorest, \$556, the well-to-do classes, \$2,223, the moderately wealthy classes, \$6,911, and the wealthiest class, \$20,733.

Since Spahr believed that the distribution of wealth became more or less equitable precisely as the national conscience was directed to or from the laws controlling that distribution, he took considerable pains to expose the injustice of indirect taxes. In his opinion the available statistics proved that the wealthy class paid less than one tenth of the indirect taxes, the well-to-do classes less than one fourth, and the relatively poor, those with incomes under \$1,200, more than two thirds. When the local taxes were joined to the national, he estimated that the wealthiest class was taxed less than 1 per cent on its property while the mass of the people were taxed more than 4 per cent on theirs. Hence he urged reform in taxation based on the ability-to-pay principle. He specifically advocated a proportional income tax, exempting subsistence incomes and taxing permanent incomes from property more than life annuities or labor incomes. He proposed a constitutional amendment as the best means of correcting the injustice of the Supreme Court's income tax decisions.

Although the methods and statistical conclusions of Shearman, Holmes, and Spahr are open to severe criticism from a rigorously logical point of view, their general appraisal of the trends in the distribution of American wealth and income since the Civil War seems tenable.⁵ In their own day their views concerning both the facts and

⁵ Cf. C. L. Merwin, Jr., "American Studies of the Distribution of Wealth and Income by Size," in *The Conference on Research in National Income and Wealth, Studies in Income and Wealth* (3 v., New York, 1939), 4-84; and G. P. Watkins, "The Growth of Large Fortunes," *Publications of the American Economic Association*, 3d series, 8, no. 4 (1907), 735-904. An interesting study on a neglected theme is F. S. Kinder, "The Effects of Recent Changes in Monetary Standards upon the Distribution of Wealth," *Economic Studies* (American Economic Association, December, 1899), 4: 409-99. Rufus S. Tucker, "The Distribution of Income," *Quarterly Journal of Economics* (August, 1938), 52: 561, asserts that if the income tax return sub-

the undesirability of the concentration of wealth were accepted by the general public. Even champions of the great capitalists did not deny that the rich were getting richer and that the poor did not get their relative share of the increased aggregate wealth. What they offered in defense of the great fortunes being built up was that this great wealth in the main was being used productively and that since the national wealth was not stationary the poor were becoming steadily better off than they ever had been before.⁶ Some, J. Laurence Laughlin and W. H. Mallock, for example, also maintained that the law of the survival of the fittest carried over from biology to economics and that those who won the great fortunes were the most competent to direct industry and trade and to promote civilization.⁷

Increases in the Protective Tariff

In any case, at a time when the world trend was toward counteracting the concentration of wealth through the use of the income and inheritance taxes, the United States through the election of McKinley guaranteed the possessors of the great fortunes here the opportunity to increase their wealth with every possible government aid, such as the tariff, and with no or very light federal restrictions.⁸ McKinley, as soon as he was elected, planned to give the businessmen of the country the security they desired. He appointed as his Secretary of the Treasury Lyman Judson Gage, president of the First National Bank of Chicago, a former president of the American Bankers' Association, and a strong supporter of the gold standard. Before being appointed,

mitted in 1895 were a fair sample, "income over \$4,000 was more concentrated in 1894 than in any year since 1917, with the possible exception of 1925-29."

⁶ Carroll D. Wright, "Are the Rich Growing Richer and the Poor Poorer?" *Atlantic Monthly* (September, 1897), and *Public Opinion* (September 16, 1897), 23: 365.

⁷ Alfred Bornemann, *J. Laurence Laughlin* (Washington, D.C., 1940), 1-7, 39-46; W. H. Mallock, *Aristocracy and Evolution* (New York, 1898), 284-378. Cf. Sidney Ratner, "Evolution and the Rise of the Scientific Spirit in America," *Philosophy of Science* (January, 1936), 3: 104-22.

⁸ Great Britain decided in 1874 to permanently retain the income tax. In 1894 England introduced three great tax reforms: an extension of the inheritance tax, introduction of the progressive principle in estate taxation, and increase of the minimum of subsistence exemption in the income tax. Note that these reforms took place precisely at the time the United States Supreme Court nullified the 1894 income tax. South Australia initiated the income tax in 1884, Japan in 1887, New Zealand and the German commonwealths with Prussia in the lead in 1891, the Netherlands in 1893, and Tasmania in 1894. Cf. W. H. Mallock, "Is an Income Tax Socialistic?" *Forum* (August, 1895); E. R. A. Seligman, "Recent Reforms in Taxation," *Yale Review* (February and May, 1895), *Public Opinion* (1895), 18: 250-51 280-81, 601, 635-36; 19: 239-40.

Gage told McKinley that he was not in full sympathy with the high protective tariff and that he feared that McKinley did not have sufficiently strong convictions on the necessity of maintaining the gold standard. McKinley replied, however, that he also believed that it was for our best interests to return gradually to a much less drastic tariff system than the McKinley bill represented, and that he was as firmly convinced as Gage of the desirability of preserving the gold standard.⁹

In his inaugural address on March 4, 1897, McKinley stressed the immediate necessity of maintaining government credit by securing an adequate income through a system of taxation, external or internal, or both. He therefore called for a special session of Congress on March 15, 1897, which would pass a tariff law designed to provide ample revenue not only for the ordinary expenses of the government but also for the prompt payment of liberal pensions and the liquidation of the principal and interest of the public debt. Since the Republicans had won control of Congress in both the 1894 and 1896 elections, McKinley seemed assured of the kind of tariff he desired to meet the deficit of \$186 million he had inherited from the Harrison and Cleveland administrations. As soon as Thomas B. Reed, the Czar of the House, was re-elected Speaker, he appointed Nelson Dingley, Jr., of Maine, as chairman of the Ways and Means Committee. Dingley, a former governor of Maine and an able spokesman for the gold standard and the protective tariff, had been chairman of the same committee since 1895. This committee had prepared during the previous session of Congress a tariff bill which Dingley was able to introduce to the House on March 15. Under the stern rule of Speaker Reed and the pressure of severe party discipline, the House speeded consideration of the bill and passed it on March 31, after only four days of general debate, by a vote of 205 to 122, on almost strict party lines. Dingley's bill was not a tariff-for-revenue-only bill by any means, but his intention was to cut nearly all the duties considerably below the level of those in the 1890 tariff.

In the Senate the Senate Finance Committee amended the Dingley bill in order to impose some purely revenue duties and to reduce its protective duties except for certain articles like low-grade wool and hides. The Republican leaders of the Senate, Nelson W. Aldrich, William B. Allison, Orville H. Platt, and John C. Spooner, felt that in-

⁹ Lyman J. Gage, *Memoirs* (New York, 1937), 87-103; R. C. McGrane, "Lyman Judson Gage," *Dictionary of American Biography*, 7: 85-86; Charles S. Olcott, *The Life of William McKinley* (Boston, 1916), 1: 327-49.

dustrial conditions in the country with very few exceptions did not demand a return to the rates imposed by the McKinley Act. At the same time they wished to aid President McKinley in securing an international bimetallic agreement with France and England. While the Senate debate on the tariff was going on, three American commissioners were negotiating in Paris and London on the subject of the free coinage of silver at a fixed ratio to gold. The success of the mission depended in large measure on a tariff which would be favorable to the products of French industry and art and would not antagonize the British through excessively high rates. The leaders of the Republican party preferred solving the currency question to gaining temporary increases in profits for the industrialists. So long as the currency issue was alive, these profits might be canceled by the free silver forces gaining political control of Congress and taking unilateral action on the question in the United States.

But the conservative Republicans were frustrated in both their plans by the free silver Senators. They held the balance of power in the Senate and used their position to force through amendments which increased the protective duties to the extent of making the general scale of duties in the Senate bill higher than that in the House bill instead of lower, as the Senate Finance Committee had planned originally. When the Senate finally passed the tariff bill on July 7 by a vote of 38 to 28 the bill contained some 872 amendments. About four fifths of these amendments were agreed to by the House, and the Dingley bill became law on July 24, 1897. The Dingley Act in its final form was thoroughly protective in character, but, since the Wilson-Gorman tariff of 1894 had not been a tariff for revenue only or even a low protective tariff, the differences between the two acts were not as momentous as they otherwise might have been. The Dingley tariff, nevertheless, represented an extension of the extreme protection system because it restored the scale of duties lowered by the Wilson-Gorman Act and in many important industries established higher import duties than even the McKinley Act of 1890. The average rate of duties under the Dingley Act rose to heights unparalleled even under the Civil War tariffs. Duties were reimposed on hides and raw wool and were raised on woolens, silks, and linens and on certain iron and steel manufactures. Owing to the dominant world position of the American iron and steel industry, the duties on iron and steel in the 1894 tariff were left practically unchanged. The duty on raw sugar was increased, and the policy of free raw sugar which the Republicans had adopted in 1890 was abandoned in order to ensure an

adequate tariff revenue and to protect the young beet-sugar industry. The Sugar Trust was allowed to retain the protection of one eighth of one cent a pound on refined sugar which the 1894 tariff had granted it, but the spokesmen for the Sugar Trust in the Senate were not able to gain any increase.

While these Senate changes in the direction of more rigid protection were being made, the American negotiators on bimetallism met vigorous criticism from the French for the non-co-operative attitude of Congress. To conciliate the French Ministry, Senator Aldrich and his associates reintroduced the principle of reciprocity which the McKinley tariff had inaugurated. The President was authorized, after securing reciprocal and reasonable concessions, to suspend certain duties and to replace them by lower duties on articles exported by France, such as argol, brandies, champagne, wines, paintings, and statuary. The President was also authorized to make treaties providing for reductions of duty up to 20 per cent on any and every article. But these treaties had to be approved by Congress and could not extend beyond five years. However, these attempts to win over the French did not succeed. The American commissioners attempted to retrieve what they could out of the complicated situation, but their efforts resulted in failure when the government of India definitely refused in October, 1897, to reopen its mints to the coinage of silver. Since all hope of England and France joining with the United States in an international bimetallic agreement hung on the decision of India, the plans of the Republican party leaders on monetary affairs had to be changed. The eventual result was the establishment of the single gold standard by act of Congress on March 14, 1900. Thus the desires of the free silver Senators for high protection had led them to block the one international action which would have been favorable to their currency interests.¹⁰

To the extent that the Dingley tariff was designed to correct the deficit in the Treasury, it was not effective. Since the customs duties were higher, they decreased the volume of imports and brought in less revenue. The deficit continued and the customs revenue during the year after the Dingley tariff's passage was smaller than in either year under the Wilson tariff. Business prosperity had not returned as speedily after the election of McKinley as the Republicans had promised. Uncertainty about the new tariff promised by the Republicans,

¹⁰ Olcott, *William McKinley*, 1: 340-61; Stanwood, *American Tariff Controversies*, 2: 360-94; Stephenson, *Aldrich*, 138-50; Taussig, *Tariff History*, 321-60; Richardson, *Messages and Papers of the Presidents*, 10: 11-21.

floods in the South, the low price of cotton, the threat of railway rate wars, and the war between Greece and Turkey made the first half of 1897 a dull one for business. But in July, in spite of the restricting influence of the Dingley tariff, the long-deferred revival of prosperity began. The reason was that by July it became known that the wheat supply from France, the Danubian provinces, Australia, India, and Argentina would be far below normal and the American wheat harvest would be in great demand to save Europe from a severe shortage. With this extraordinary export of American wheat to Europe at unusually high prices went a revival in general trade, especially in the grain-growing West. With the expansion of domestic trade, the demand for money increased and caused the importation of \$120 million in gold within a year. This inflow of gold into the Treasury made possible the success of the Gold Standard Act in 1900 by providing the gold reserve which had been lacking in 1896. There began a period of prosperity which lasted for some six years despite the European crisis of 1900-01 and the excesses of domestic speculation.

The War with Spain

But this expansion of financial and industrial activity soon met a severe test. Relations between the United States and Spain on the Cuban question had long been strained. During the first Cuban revolt for independence between 1868 and 1878 the United States had gone close to the brink of war over the harsh treatment of the Cubans by the Spaniards. Although peace between Cuba and Spain had been made in 1878 at the strong urging of the American State Department, the conditions for a lasting peace were not present. Spaniards monopolized all the Cuban offices and received favors in taxation and the administration of justice. Spain had tried in 1890 to hurt American trade with Cuba by placing a high tariff on American goods, but had changed its policy in 1891 under the threat of economic retaliation which the reciprocity clause of the McKinley tariff made possible. Owing to this new liberalism on the part of Spain, Cuba's prosperity increased by leaps and bounds. The value of its sugar crop increased \$12 million in one year. In 1894, however, occurred a fatal blow to all this prosperity. The tariff revision embodied in the Wilson-Gorman tariff of 1894 aimed at more revenue for the federal government without injury to the vested interests created by the McKinley tariff. Hence the 1894 tariff restored the duty on raw sugar and retained the differential duty in favor of domestic refined sugar. Reciprocity with Cuba was abolished.

This increase in tariff duties came at the same time that prices for sugar were falling in the world market. A low of less than two cents a pound for sugar was reached for the first time in the history of the sugar industry. At the same time Spain restored the high duties of its colonial system, with consequent higher prices for everything Cubans purchased abroad.

The economic debacle produced in Cuba by the conflicting mercantilistic policies of Spain and the United States gave a tremendous impetus to the Cuban Republican movement. The storm of revolution against Spanish rule in Cuba broke out in February, 1895. The policy of the insurrectionists was one of incessant skirmishes to destroy the sugar plantations and every other source of revenue in order either to exhaust Spain or to force the intervention of the United States. The Spanish method of counterattack resulted in General Weyler's famous "reconcentration" policy. The Cubans were forced to congregate in towns held by Spanish troops. Thousands died owing to lack of food and unsanitary conditions.

Public opinion in the United States was thoroughly aroused by the execution of policies which not only were inhumane for the unfortunate inhabitants of Cuba, but paralyzed the industries of the island and destroyed its commerce. American citizens owned at least \$50 million of property in Cuba, and American commerce with Cuba amounted to \$100 million annually. So long as Cleveland was President, however, the American government had refused to be drawn into war. McKinley was less resolute than Cleveland, but equally desirous of peace. He succeeded in getting Spain to recall General Weyler, to abandon the reconcentration policy, and to promise autonomy to the Cubans. But the grant of autonomy came too late: riots broke out in Havana in January, 1897. The American battleship *Maine* was sent to Havana against Spanish protest. On February 9, 1897, the *New York Journal* published under great headlines a letter written by the Spanish Minister at Washington castigating McKinley as weak, desirous of mass admiration, and eager to be on good terms with both the jingoists and the no-war groups at the same time. This insult to the American national honor was followed by the blowing up of the *Maine* in Havana Harbor on the night of February 15, 1898.

Although Spain attempted to meet nearly every demand of McKinley's, the pressure of public opinion overwhelmed the President and induced him to send a militant message to Congress on April 11, 1898. Passion had triumphed over reason and the calm sense of businessmen. Sensational journalists like Hearst and Pulitzer, and am-

bitious statesmen, naval officers, and writers like Theodore Roosevelt, Henry Cabot Lodge, Captain Mahan, and Albert Shaw had been able to arouse the whirlwind of emotion which impelled McKinley on April 11 and Congress on April 25 to declare war against Spain.

The war was short but glorious in the eyes of most Americans. Within two weeks Commodore Dewey had shattered the enemy's fleet in Manila Bay and had rung the doom of Spanish rule in the Pacific. On July 3 the Spanish fleet under Admiral Cervera was destroyed while attempting to escape from Santiago; Santiago itself fell on July 17. A week later the conquest of Puerto Rico was begun. In August Manila was carried by storm. A temporary peace treaty was signed on August 12 and a permanent one on December 10 at Paris. Spain agreed to relinquish sovereignty over Cuba and to cede to the United States Puerto Rico, the Philippines, and Guam; the United States paid Spain \$20 million for the Philippines. The Senate ratified the treaty on February 6, 1899, after the intercession of William Jennings Bryan had overcome the vehement protests of the anti-imperialists. He induced the needed number of Democratic Senators to vote for the ratification of the treaty on the ground that it was necessary to end the war and that Philippine independence could be secured more easily through action by the United States than through a renewal of negotiations with Spain. Some contend, without proof, that he believed that if the McKinley administration were saddled with the responsibility of converting the American republic into an empire the Democrats would win the presidential election of 1900.¹¹

War Finance: The Populist vs. the Conservative Method

Wars, no matter how short, have to be financed. The war against Spain, which began as a crusade to liberate the Cubans and ended with the United States taking its place in the sun as a world power with overseas dominions, raised the perennial question: On whom should be placed the burden of supporting the government. The issues which had been debated during the struggle over the 1894 income tax measure were again being raised in Congress and before the Supreme Court. Strangely enough, American businessmen in general had strongly opposed action which would lead to war with Spain. The outbreak of war seemed to imperil the whole policy of domestic economic amelio-

¹¹ Leland H. Jenks, *Our Cuban Colony* (New York, 1928), 31ff.; Matthew Josephson, *The President Makers* (New York, 1940), 3-87; Walter Millis, *The Marital Spirit* (Boston, 1931); Julius W. Pratt, *Expansionists of 1898* (Baltimore, 1936).

ration which they placed before all other objects of political action. The financial interests opposed the war because American business prosperity following the panic of 1893 had been checked by the war scare Cleveland had created on the Venezuela issue in December, 1895, and by the free silver menace in 1896. Since a real revival seemed to be under way in 1897, war threatened to endanger the stability of the American currency, to interrupt American trade, and to expose to attack American coasts and commerce. Many conservatives also feared that war would lead to inflation in paper or silver.

The American businessmen had been indifferent or opposed to the program of colonial expansion because they had faith that American industry would win world markets through superior efficiency and quality without the United States acquiring colonies. After war against Spain had begun their attitude changed because they felt that the partition of China in 1898 by Germany, Russia, Great Britain, and France was a threat to the market for surplus products which American businessmen had hoped to build up in China. The acquisition of the Philippines and the Hawaiian Islands offered a means of securing the Far Eastern trade.

On the other hand, the Populists and their sympathizers were among the first to respond to the humanitarian pleas against Spanish tyranny in Cuba and became as concerned about the sufferings of the oppressed Cubans as about the hardships of American farmers and workingmen. They vigorously supported the groups working for a declaration of war, but they were insistent on the war being waged for the purpose of freeing the Cubans. They forced the adoption of the Teller Resolution, which disclaimed any intention of the United States exercising sovereignty, jurisdiction, or control over Cuba and declared it to be the purpose of the United States, after pacifying the island, to leave its government and control to the Cuban people.

Although nearly all the Populists and Democrats were wholeheartedly behind the McKinley administration in the prosecution of the war and many of them volunteered with William Jennings Bryan for military service, they nevertheless differed with the businessmen on how the war was to be financed and who was to pay for it. The Democrats and the Populists had not resigned themselves to defeat on the income tax question merely because the Supreme Court had ruled the 1894 income tax unconstitutional. As early as December 27, 1895, Senator Marion Butler of North Carolina began introducing income tax amendments. In 1896 two more amendments on the same subject were presented, and in 1897 there were six. After that thirty-three

proposals for such an amendment were introduced, until finally success was achieved in Congress in 1909. All these proposals came from southern and western Congressmen and Senators who were Democrats or Populists.¹²

During the debate on the Dingley tariff bill of 1897 and on the tariff bill introduced by the Republicans in December, 1896, the Populists and the Democrats, led by Benton McMillin of Tennessee, made vigorous attacks on the principle of the protective tariff and severely criticized the Supreme Court for nullifying the income tax of 1894. They also strenuously urged the adoption of the income tax amendment to the Constitution as a means of counteracting the concentration of wealth and of putting the burdens of taxation on those best able to bear them. But they believed that so long as a Republican majority dominated Congress, all proposals for such an amendment "will sleep the sleep of death." In the eyes of the Democrats and Populists the Republican party was too much obligated to the corporations for their assistance in the last campaign to take this advance step in behalf of humanity.¹³

Once the war was declared again Spain, the Populists and the Democrats did not allow the war excitement to stampede them into supporting measures contrary to their principles or to divert their minds from the problems at home which were pressing for solution. In March, 1898, Congress had passed a \$50 million appropriation for national defense, to be spent by the President without restriction. On April 25 Nelson Dingley introduced a war revenue measure which he estimated would raise about \$100 million. That same day Congress passed a resolution declaring that a state of war existed between the United States and Spain and had existed since April 21, 1898. Dingley felt that the tariff could not be changed without disturbing industry or creating political difficulties for the Republicans. Since he was not an advocate

¹² M. A. Musmanno, *Proposed Amendments to the Constitution*, 70th Cong., 2d Sess., House Doc. No. 551 (Washington, 1929), 210-15. In 1895, 1898, 1907, and 1912 four amendments were presented which proposed to authorize Congress to levy direct taxes without limitation. Although the constitutionality of the inheritance tax was upheld in *Knockton v. Moore*, 178 U.S. 41 (1900), ten amendments had been introduced into Congress specifically authorizing Congress to levy inheritance taxes. *Ibid.*, 161-64. On December 21, 1895, Uriel S. Hall of Missouri introduced into the Senate a resolution designed to bring about uniformity in taxes, as well as in duties, imports, and excises, as required by Art. 1, Sec. 8, Cl. 1 of the Constitution. McRae of Arkansas presented a similar amendment in 1897. *Ibid.*, 171-72.

¹³ Cf. *Cong. Record*, 55th Cong., 1st Sess., 30: 123-30, 141-47, 182-91, 218-34, 256-58, 1492; *Public Opinion* (1897), 22: 357-59, 421-22, 579, 611-13, 677-79; 23: 72, 358.

of the income tax, he was forced to turn for additional revenue to the existing internal revenue taxes and to supplement them by new taxes of the same sort. But as the revenue from the Dingley tariff and the new proposed internal taxes threatened to be insufficient for the war needs, Dingley suggested that a government bond issue up to \$500 million be authorized. The interest-bearing federal debt amounted at that time to about \$847 million—\$100 million at 5 per cent interest and the remainder at 4 per cent. Dingley's bond proposal meant increasing this federal debt by more than 55 per cent and shifting the major burden of the war costs to the taxpayers of the next ten years or so.

The Republicans endeavored to seek Democratic and Populistic support for the Republican war finance measures by appealing again and again to the need for patriotism, unity, and harmonious action in the face of danger to the United States. As John Dalzell of Pennsylvania put it: "We are brethren, and the cause of all is the sacred cause of each. One cause, one country, one flag, and, marching to the music of the Union, one great heart beat." But the Democrats and the Populists, even before the age of propaganda analysis, told the Republican spellbinders: "You count upon the heat of battle and the enthusiasm of patriotism to fasten fetters upon our people. . . . It is in time of war and under the cloak of patriotism that the most vicious schemes of legislation obtain a foothold upon our statute books and the most infamous conspiracies of public plunder are carried into execution."¹⁴

The Democratic and Populistic Congressmen attacked with great vehemence the internal revenue proposals of Dingley as taxation of the masses for the benefit of the privileged classes. They declared that his bond issue suggestion, instigated by the "goldbug press," would mean that an incubus of debt might be put on the American people for the advantage of the wealthy classes. In the Republican bonded system the rich would receive the great benefits of the interest-bearing bonds as a safe and most desirable investment for their money;

¹⁴ *Cong. Record*, 55th Cong., 2d Sess., 31:4356 (Dalzell), 4371 (James A. Norton, Ohio), 4376 (E. W. Carmack, Tennessee). On the finances of the Spanish-American War see E. N. Dingley, *Nelson Dingley*, 448-67; L. J. Gage, *Memoirs*, 122-51; F. W. Hirst, *The Political Economy of War*, 227-36; A. D. Noyes, *Forty Years of American Finance*, 257-83, and *The Market Place* (Boston, 1938), 142-73; Carl C. Plehn, *Introduction to Public Finance* (5th ed., New York, 1926), 425-34, and "Finances of the United States in the Spanish-American War," *University Chronicle* (October, 1898), 1:419-63.

the poorer classes, after fighting to free the Cubans, would return home to discover that they would be taxed for generations to pay the hundreds of millions of interest on these bonds.

The Democrats and Populists in the House advanced their own solutions to the revenue problem. They proposed repudiation of the Supreme Court's income tax decision as "a legal anomaly, a political anachronism, and an economic blunder," adoption of a tax of 3 per cent on incomes over \$2,000, the issue of \$150 million in greenbacks, and the coinage of \$42 million silver dollars from the seigniorage on the silver bullion in the Treasury, as well as a reduction in the rates of the tariff. These measures, they felt, would eliminate the necessity for the bond issue and would prevent the government from favoring the "bond patriots" and the "money power" as against the "musket patriots" and the common people. But all the eloquence and intensity of the Democrats and Populists, especially those from the West and South, failed to sway their Republican opponents on any of their suggestions. An effort by Joseph W. Bailey of Texas and Benton McMillin of Tennessee to have an income tax amendment added to Dingley's bill was voted down on April 29, 1898, by a vote of 171 to 134. That same day, by a vote of 181 to 131, the House passed Dingley's bill with various modifications introduced by the Republicans.¹⁶

The House war revenue bill then had to run the gauntlet of the Senate. Six Democrats and one Populist formed the majority of the Senate Finance Committee. They revised the bill drastically and recommended the issue of \$150 million of greenbacks, the coinage of \$442 million from the seigniorage on the silver bullion in the Treasury, and a tax on legacies and successions to personal property. They felt that this would bring in the required revenue and put the weight of the war expenditures on those best able to bear it. The five Republicans, headed by Nelson W. Aldrich of Rhode Island, who constituted a minority of the Committee agreed to the desirability of an inheritance tax in the face of the war emergency, but offered as alternative measures the issue of \$100 million in certificates of indebtedness and \$300 million of twenty bonds at 3 per cent.

The Senate then engaged in a powerful debate on all the economic and political implications of the Democratic and Republican plans for financing the war against Spain. The Democrats and Populists, led by William V. Allen of Nebraska, Marion Butler of North Carolina, and Henry M. Teller of Colorado, indicted the Republican party as the agent of the capitalists who had been "peace at any price" men previous

¹⁶ *Cong. Record*, 31: 4457-59.

to the declaration of war and after that had become advocates of loans versus taxes as the means of paying the war expenses. Senator Allen and his associates pointed out that the Republican plan meant saddling the cost of the war upon the common people, making them "the bond slave and the servant of the few," and transforming the American Republic into "an offensive aristocracy." Senator Butler protested against "the divine right of accumulated wealth to escape taxation" by forcing the masses to pay taxes out of all proportion to their ability in a war for humanity which was being turned into an instrument for the benefit of the privileged few, the "monopoly kings." Butler, Allen, and John T. Morgan of Alabama offered income tax amendments to the Senate Finance Committee's bill, but all of these were rejected.¹⁶

The Republicans refused to yield on the income tax question because they did not want to confront the Supreme Court with the necessity for overruling its income tax decision even during the war emergency, as such a reversal of judicial opinion would not only confirm the radicals' criticism of the Supreme Court in 1895-96, but would also open the door to the retention of the income tax in peacetime. The Republicans also resisted the attempt of the Democrats and Populists to impose a general excise tax on corporation franchises of one fourth of 1 per cent on the gross receipts of large corporations. This excise tax would have been a way of getting around the income tax decision in part, and that was one of the reasons for the Republican opposition to the Democrats' stratagem. One of the concessions which the Republicans made to the Democrats and Populists in the Senate was the imposition of a tax of one fourth of 1 per cent on the gross receipts over \$200,000 of companies engaged in sugar refining and oil refining. This tax was in response to the popular indignation at the power and wealth of the Standard Oil Company and the Sugar Trust. A concession which the eastern Republicans were forced to make to their opponents was the inclusion of a provision for the issue of \$42 million in silver certificates by the Treasury.¹⁷

After making these concessions, the Republicans under the leadership of Nelson W. Aldrich were able to win the major fiscal victory in the Senate by securing the passage of an amendment providing for the issue of \$100 million in certificates of indebtedness and \$300 million in 3 per cent ten-twenty bonds. The vote of 45 to 31 on the bond

¹⁶ *Cong. Record*, 31: 4492, 5509-16, 5533; Appendix, 468-83. The vote against Morgan's amendment was 38 to 35 and was on almost strictly sectional lines. *Ib.*, 31: 5516.

¹⁷ *Cong. Record*, 31: 5394, 5396-97, 5456-58.

amendment revealed the same cleavage of economic interest between the capitalistic Northeast and the debtor West and South as had the vote on the income tax. But Aldrich's astute leadership, his acceptance of the inheritance tax without question, and his exploitation of the need for immediate revenue on a basis that would not unduly disturb business evidently were sufficient to outweigh the stringent criticism by the Democrats and Populists of the Republican party's advancement of financial interests through the use of loans rather than heavy taxes. The crisis of war engendered fears for national safety which were greater than those concerning the excessive concentration of wealth and income in the hands of a privileged minority group.¹⁸

The Inheritance Tax Movement

The chief social reform section of the war revenue bill as passed by the Senate on June 4, 1898, was the section imposing an inheritance tax. The House bill prepared by Nelson Dingley had contained a tax on probates of wills and letters of administration, beginning at fifty cents on small estates and varying from one twenty-fifth of 1 per cent to one tenth of 1 per cent on larger estates. The Senate Finance Committee unanimously agreed to strike out this tax and to insert instead a tax on legacies and distributive shares of personal property only, graduated according to degree of relationship and the amount of the estate. The emphasis of the tax was on the transmission of the property and hence it was in effect a modified estate duty rather than an inheritance tax. A general exemption was allowed for estates under \$10,000 and for all property passing to the surviving husband or wife. The rates on bequests to other beneficiaries were progressively higher according to the size of the decedent's estate, rather than that of the individual beneficiary's share, varying from three quarters of 1 per cent on bequests from estates of \$10,000 to \$25,000 to lineal issue, lineal ancestors, and brothers and sisters, to 15 per cent on bequests from estates of over \$1 million to more distant relatives, strangers in blood, and "bodies politic or corporate." This tax was an attempt to revive one section of the 1894 income tax bill and to get around the 1895 income tax decision.

The Democrats in the Senate backed this feature of the War Reve-

¹⁸ *Cong. Record*, 31: 5468-69. The most elaborate analyses from the Populist point of view of the loan versus tax issue at this time in terms of cost to the American people are to be found in the speeches by Senators Allen and Butler, *op. cit.*, 5178-82, and Appendix, 468-89. See also J. C. Ridpath, "The Bond and the Dollar," *Arena*, 1896.

nue Bill wholeheartedly, because it responded to the popular desire to put a curb on the alarming growth of colossally large hereditary fortunes. The inheritance tax movement which had existed before the Civil War in the various states had undergone a resurgence in the late eighteen-eighties and nineties. The New York collateral inheritance tax law of 1885 became the model for many states adopting such taxes in the next few years. In 1892 New York, by imposing an inheritance tax upon direct heirs, gave an impetus to other states. Between 1890 and 1900 eighteen new state taxes, some with progressive rates, went into operation.

American economists showed almost no interest in the social significance of the inheritance tax until the eighteen-eighties and nineties. While European writers were devoting much thought and analysis to the subject, most American authors dismissed the inheritance tax with David Ricardo's statement that such a tax was a burden on capital and therefore something to be avoided. Few writers except such radicals as Orestes Brownson ventured to defend it. Although Henry George published his *Progress and Poverty* in 1879, the first author to attract attention to the inheritance tax question was Charles Bellamy. In 1884 he suggested in his book *The Way Out* that the amount which any individual might receive by bequest or inheritance be limited to a sum "the income of which would provide an ample income." He also suggested the limitation of the total amount of property which might be distributed by will. Four years later, at the time when Edward Bellamy's book *Looking Backward* appeared and created a movement for a national socialistic commonwealth, Augustus Jacobson advocated in his *Higher Ground* a federal estate tax rising from 1.4 per cent on estates under \$25,000 to 10 per cent on estates above \$1 million. The revenue from this was to be devoted to the establishment and maintenance of schools for manual training. That very year Professor Richard T. Ely declared in his widely read *Taxation in American States and Cities* that the inheritance tax was "in accord with the principles of Jeffersonian Democracy, and also with the teachings of some of the best modern thinkers on economic and social topics." He even advocated progressive rates, no doubt owing to the training he had received a short time before at the German universities, where interest in the inheritance tax was at a high peak.

In 1890 Andrew Carnegie startled the general public by advocating, in his essays on the "Gospel of Wealth" in the *North American Review*, the adoption of a progressive federal inheritance tax which would confiscate all of a decedent's estate except a moderate allowance to im-

mediate heirs. Carnegie argued that the accumulation of great wealth can occur only through the appropriation by the individual of values produced by society, and that the return of such wealth to the nation was a just retribution. He felt that no injustice was done to the heirs, since they had not earned any title to the wealth through their own labor. Nor could they object to this proposal as being un-American, since within the American tradition of democracy and equality of opportunity their opportunities were better than those of laborers' sons. Finally, inherited wealth was more often a curse than a boon to rich heirs; and no one need fear that inheritance taxes would check initiative, since captains of industry built up great fortunes not so much for the sake of their posterity as for the pleasure in the struggle for wealth.

Carnegie's one criticism of the inheritance tax laws passed in England and America, which had been bitterly attacked by nearly all the propertied classes as being revolutionary, was that they did not go far enough. His views carried weight with the more progressive elements of the propertied classes just because he had demonstrated his ability as a businessman and could not be dismissed as self-seeking or as compensating for business failure and lack of worldly success.

In 1893 Professor Edwin R. A. Seligman of Columbia University, already known for his progressive tax views, pointed out in the *Political Science Quarterly* that the suggestion of a graduated inheritance tax was in harmony with the growing public sentiment on the question. That same year Dr. Max West, a brilliant young economist, aided the movement by articles in the *Review of Reviews* and in the *Political Science Quarterly* which were widely read and cited. The next year he published the first comprehensive American survey of inheritance taxation in all its aspects. In 1895 Frederick N. Judson advocated *Justice in Taxation as a Remedy for Social Discontent*. He warned that injustice in taxation aroused the most dangerous class spirit and that the capitalists should establish justice and equality in taxation in order to have security of property.¹⁰

These works created a climate of opinion which made many conservatives more receptive to ideas formerly branded as socialistic and Populistic than they had been. Moreover, the war emergency made the more intelligent conservatives, especially in the United States Senate, realize the necessity for making some concession to the radicals.

¹⁰ Cf. Joseph Dorfman, *Thorstein Veblen and His America* (New York, 1934), 18-78; Burton J. Hendrick, *The Life of Andrew Carnegie* (Garden City, N.Y., 1932), 1: 143-49, 330-51; W. J. Shultz, *The Taxation of Inheritance*, 98-113, 152-56; Max West, *The Inheritance Tax*, 94-115. See also *Public Opinion* (1892-93), 14: 279, 494; (1897), 22: 197, 679-80.

They felt that a concession on the inheritance tax was far less of a danger to the wealthy classes than one on the income tax.

The Senate Debate

In the Senate debate on the proposal for a tax on legacies and distributive shares of personal property, Henry Cabot Lodge criticized the provision making the rates of the tax depend upon the whole amount of the decedent's personal estate instead of upon the size of the individual legacies. He and Stephen B. Elkins of West Virginia argued vigorously that the inheritance tax should be left to the state governments for their exclusive revenue use and should not be resorted to by the federal government. Elkins declared that a federal inheritance tax would create a conflict between the federal government and the states which was dangerous and unnecessary for such a minor war as the Spanish-American one. He tried to create a fear that multiple taxation would destroy business and take away the incentive to the accumulation of wealth and to individualism, "the creator of wealth and progressive civilization." But neither Lodge nor Elkins was able to sway the Senate from a federal inheritance tax.²⁰

The War Revenue Act: Its Social and Fiscal Effects

The war revenue bill passed the Senate on June 4, 1898, by a vote of 48 to 28 along almost the same sectional and class lines as the vote on the income tax. A Conference Committee compromised on the major differences between the Senate and the House. The Senate and House then accepted the Conference Report by votes revealing the clash between the Northeast and the South and West, and the President signed the bill on June 13, 1898. An analysis of the war revenue bill reveals the triumph of the sound-money, conservative war finance group on most of the important issues, with just enough compromises with the Democrats and Populists to give the appearance of national unity and to ensure final passage of the measures most desired by the conservative businessmen. The protective tariff was maintained despite the fact that reductions in tariff duties would have increased the government revenue. The major portion of the war expenses was met by loans rather than taxes. The Secretary of the Treasury was authorized to issue up to \$100 million in certificates of indebtedness and up to \$400 million in 3 per cent 10-20 bonds. To free the government of subservience to the

²⁰ *Cong. Record*, 31: 5074-81.

financial interests, especially the bond syndicates, and to attach the people by closer ties of sympathy to the government, special efforts were made to float the bonds through popular subscription. The \$200 million bond issue was oversubscribed until the total subscription amounted to \$1,400 million. The success of the loan was partly due to the self-interest of the national banks, which were anxious to obtain additional bonds so as to increase their national bank-note issue. The Treasury lost about \$5 million which it would have obtained as a premium from competitive bidding. The administration's hope that the middle and working classes would hold on to their bonds and would have their sympathies attached thereby to the government was soon destroyed by the rapid sale of the bonds at a slight profit to a small group of wealthy persons and corporations.

The tax provisions of the War Revenue Act were purposely designed to raise revenue with the maximum expediency on items that would arouse the least opposition from influential sections of the public. Hence the criteria of justice and social welfare were neglected. No income taxes were levied, partly because of the 1895 income tax decision, mainly because the Republicans had no desire to introduce an income tax which might be sustained by the Court under the stress of war emergency and might then persist. Income taxes also would have lessened the war profits and would have taken away the benefits of the bond issue, which put the burden of the war costs on taxpayers who were not bondholders.

Although the Republican supporters of the Spanish-American War were not willing to have the business classes share the major part of the war expenses, they could not disregard public sentiment completely. Hence the Senate taxes on legacies and distributive shares of personal property and on the Oil and Sugar Trusts were accepted by the Republican leaders of the House as unpleasant but necessary concessions to radical demands. The other disagreeable but necessary concession by the Republicans was the agreement for the Treasury to coin at least $1\frac{1}{2}$ million silver dollars from the silver bullion in the Treasury. This was considerably less than the Senate's provision for the coinage of 4 million silver dollars a month, and represented a victory over the extreme silver wing in the Senate.

The other taxes in the War Revenue Act were mainly on things consumed by the common people or on articles or activities which permitted the shifting of the tax from the business or professional classes to the common people. Special taxes were imposed on bankers, brokers, pawn brokers, theaters, circuses and other shows, bowling al-

leys and billiard rooms. The existing tax rate on tobacco, beer, and similar fermented liquors was nearly doubled. Stamp taxes were placed on stocks and bonds, commercial papers, legal documents, checks and drafts, insurance policies, proprietary medicines, toilet articles, chewing gum and wines.²¹

Public opinion on the War Revenue Act varied from enthusiastic praise by Republican and conservative Democratic newspapers like the *New York Tribune* and the *New York Times* to severe criticism by Independent, radical Democratic and Populistic papers like the *Springfield (Massachusetts) Republican* and the *San Francisco Star*. The *Pittsburgh Chronicle-Telegraph* objected to the federal inheritance tax as invading a field "which more properly should be reserved to the states." The attitude of the extreme radical press can be summed up in the statement by the *San Francisco Star*: "The war against privilege is more important than the war against Spain, of which the privileged are taking advantage to increase their own emoluments and other people's burdens."²² Whatever the merits or demerits of the War Revenue Act as an engine of social justice, the measure enabled Lyman J. Gage, the Secretary of the Treasury, to meet the tremendously increased army and navy expenditures. The war, which had been started merely as a war for liberation of the Cubans from Spanish tyranny, ended by securing the nominal independence of Cuba and the acquisition of a colonial empire by the United States.

The cessation of hostilities against Spain did not mean the immediate ending of war expenditures. A Philippine insurrection against American tyranny, led by Aguinaldo, broke out in February, 1899, and lasted for more than two years; and in 1900 the Boxer Rebellion broke out in China. Army and navy expenditures for 1898-1901 were \$842 million, more than three and a half times the sum spent in 1894-97; they covered the costs of the war against Spain, the campaign in China, and the creation of an imperial peace in the Philippines. Moreover, new pensions for the Spanish-American War casualties or their dependents became an added drain upon the Treasury. The federal deficit from June, 1897, to June, 1899, was almost \$130 million, but was covered by the \$200 million bond issue of 1898. Expenditures did taper off, however, after 1899. Federal expenditures fell from \$605 million in 1899 to \$521 million in 1900 and to less than \$500 million in 1902.

²¹ War Revenue Act of June 13, 1898, 30 *U.S. Stat. at Large*, 448-70; *A Report of the Secretary of the Treasury*, 1898, XXIVff., LXXIXff.; and 1899, VII, XXXII. Cf. Horst Mendershausen, *The Economics of War* (N.Y., 1940), 119-44, and A. C. Pigou, *The Political Economy of War* (London, 1940), 72-111.

²² *Public Opinion* (June 23 and July 7, 1898), 24: 773-74 and 25: 5-10.

The series of deficits in the federal Treasury from 1894 to 1900 inclusive was wiped out in 1901 by a Treasury surplus of over \$46 million obtained from the revenue brought in by the customs duties, the liquor excise, and the war excises.²³

²³ Dewey, *Financial History*, 467-68, 472-75.



Theodore Roosevelt and the Progressive Movement

THE presidential campaign of 1900 submitted for popular ratification or rejection the Republican party's policies on taxation, imperialism, the control of trusts, and the rights of labor. William McKinley once more opposed William Jennings Bryan, but McKinley no longer had to fear the magic of Bryan's eloquence. The free silver issue had lost its hold on the popular mind, owing to new discoveries of gold in Australia, South Africa, and the Klondike, and to the invention of the cyanide process of refining gold. The revival of business ushered in by the profitable harvest of 1897 had brought the restoration of prosperity throughout the country, with only a slight setback just before the outbreak of war against Spain. The war had acted as a stimulus to business by providing the opportunity for large profits in supplying government contracts and by raising hopes of new foreign markets through the colonial acquisitions of the United States. Because only one half as many workers were idle in 1899-1900 as in 1896-98, and because general economic conditions had improved greatly, Bryan was not able to win as many votes from the farmers, workers, and the lower middle class as he had in 1896. Bryan was also severely handicapped by lack of funds. The Republicans had a campaign fund of \$2,500,000, while the Democrats had less than one fifth of that amount. Though Bryan's program aimed to curb the expansion of big business at home and abroad, and to further the interests of the laborers and the farmers in most respects, McKinley, with the assistance of Theodore Roosevelt's popular appeal, won the election

by a popular vote of over 7,200,000 to Bryan's 6,800,000 and by an electoral vote of 292 to Bryan's 155.¹

Roosevelt's Start as President

The rejoicings of the Republicans over what seemed a clear mandate to govern the country in the interests of business expansion were broken shortly after McKinley's second inauguration by his assassination by an anarchist in September, 1901. Theodore Roosevelt, the picturesque Rough Rider whom the Republican bosses had made Vice-President to prevent his becoming a really radical reform governor of New York State, became President of the United States. On taking the presidential oath of office, Roosevelt declared that his intention was to continue the policy of McKinley for the peace, prosperity, and honor of the country. Henry Adams had characterized McKinley, without malice, as a very able political strategist who "undertook to pool interests in a general trust into which every interest should be taken, more or less at its own valuation, and whose mass should, under his management, create efficiency." Theodore Roosevelt, although he was later to create a new public role for himself as a reformer of capitalism with seemingly radical tendencies, in the first year or so of his accession to the presidency followed very cautiously the orbit marked out by Mark Hanna and the other Republican elder statesmen.²

The Gold Standard and the Public Debt

On March 14, 1900, the Gold Standard Law had been enacted. This established the gold dollar as the standard unit of value, required that all other forms of money be maintained at parity with gold, and set up a Treasury gold reserve of \$150 million. The Secretary of the Treasury was authorized to refund a large portion of the public debt, including the 1898 bond issue, into 2 per cent, thirty-year gold bonds upon a 2¼ per cent income basis, the premium to be paid in cash. National banks depositing the new 2 per cent United States bonds were to be taxed only one half of 1 per cent annually on circulation, whereas the tax on circulation secured by any other bond issue remained at 1 per cent. The act also stimulated national bank-note expansion by

¹ T. A. Bailey, "Presidential Election of 1900. Was It a Mandate on Imperialism?" *Mississippi Valley Historical Review* (June, 1937), 24: 34-52; Herbert Croly, *Hanna*, 302-41; Hibben, *Bryan*, 224-33; Olcott, *McKinley*, 2: 262-94.

² Henry Adams, *Education* (Boston, 1918), 373; Josephson, *The President Makers*, 111ff.; Olcott, *McKinley*, 2: 295-375.

raising the ratio of bank-note issue to bond deposits from 90 to 100 per cent, so long as the market price of the bonds was at or above par.

The general policy of the federal government after the Civil War had been to pay its interest-bearing debts as soon as possible in order to avoid unnecessary burdens upon the taxpayers. The Treasury Department, by using a flexible redemption clause in its bond issues, had been able to apply its surplus revenues to paying off its bonds at par instead of buying them in the market at a premium. But the Gold Standard Act made it impossible to retire nearly \$550 million of the public debt for three years, except by purchase in the open market. The government paid a bonus of nearly \$50 million on the old bonds, of which it recovered less than \$2 million as premium on the new ones. The loss to the government and to the federal taxpayers was enormous. The surplus in the Treasury from 1900 to 1907 might have been used to extinguish over \$200 million of the interest-bearing debt and save the public from paying the large interest charges that accumulated. The justification for this type of operation was that if the government's interest-bearing debt had been paid there would have been a shortage of bonds to be held as security for national bank notes. Nevertheless, the economic consequences of the 1898 war loans were such as had been predicted by the Populistic and Democratic critics in 1898. The burdens of the war were put on the shoulders of those least able to bear them: the workers, the farmers, and the small businessmen. The big profits from the war went in the main to the industrialists, bankers, and merchants. Lyman J. Gage, the Secretary of the Treasury, in arranging for this type of bond refunding, counteracted in large part the good work he had done in 1898 by floating only a \$200 million bond issue instead of a possible \$400 million, at the low interest rate of 3 per cent. Perhaps the ties he had established as president of the First National Bank of Chicago and as president of the American Bankers' Association influenced his actions in favoring the banks through such a long-term bond conversion.³

The Attack on the Federal Inheritance Tax

While the war against Spain was being carried on, the special taxes imposed by the War Revenue Act of June 13, 1898, had been borne without much complaint by the great mass of the people. But after victory had been won, various wealthy individuals and corporations at-

³ A. Barton Hepburn, *A History of Currency in the United States* (New York, 1924), 371-86; F. W. Hirst, *Political Economy of War*, 228ff.; R. C. McGrane, "L. J. Gage," *Dictionary of American Biography*, 7: 85-86.

tempted to escape from bearing their share of the burdens of the war taxation and turned for relief to the courts, as they had done with overwhelming success in 1895 in fighting the income tax. A powerful effort was made to have the inheritance tax declared unconstitutional. The United States Supreme Court had upheld the constitutionality of state inheritance taxes in two notable cases: *U.S. v. Perkins* (1896) and *Magoon v. Illinois Trust and Savings Bank* (1898).⁴ The Court laid down the principles that a state inheritance tax was not a tax on property but on the right of succession to property, and that the right to inherit property was not a natural right but a privilege conferred by the state. Moreover, in 1874 the Supreme Court had upheld the constitutionality of the federal Civil War inheritance taxes in the noted *Scholey v. Rew* decision on the ground that an inheritance tax was not a direct tax but an excise tax or duty, authorized by Article 1, Section 8, of the Constitution.⁵ Nevertheless the heirs to certain large estates hoped to persuade the Supreme Court that a federal inheritance tax was unconstitutional. They argued that the income tax decisions of 1895 logically required the inheritance tax to be viewed as a direct tax, as violating the uniformity clause of the Constitution, and as being repugnant to fundamental principles of equality and justice on account of the progressive rate feature of the War Revenue Act.

The Court's Checkered Course

The Supreme Court might have responded to this appeal as it had in the income tax cases. But by May 14, 1900, the day on which the Court handed down the celebrated *Knowlton v. Moore* decision,⁶ the national situation had changed. There was no longer the danger that a radical Democratic or Populistic administration might rule the country. The patriotic emotions evoked by the Spanish-American War called for some sharing of the war cost by the propertied classes, if public indignation was not to be inflamed against the wealthy. Yet the Court had no desire to impose what would now be considered the very moderate progressive tax rates on legacies and distributive shares of personal property set by the War Revenue Act of 1898. At that time the conservatives considered these taxes a radical encroachment on private property rights. Hence the Supreme Court was confronted by a dilemma. If it nullified the federal inheritance tax, it would incur the

⁴ 163 U.S. 628; 170 U.S. 283.

⁵ 23 Wall. 331.

⁶ 178 U.S. 41.

wrath of the common people; if it upheld the constitutionality of the act, it would put a larger part of the tax burden on the wealthy than a majority of the Court desired.

The majority escaped between the horns of this dilemma through a remarkable exercise in dialectical ingenuity and judicial legislation which has escaped the attention and appreciation of the general public and of most of the legal profession. Justice White, strangely enough one of the dissenters in the income tax decisions, wrote and delivered this masterpiece of compromise between public duty and private profit. Justice White upheld the right of Congress to tax inheritances concurrently with the state legislatures. He denied that the income tax decisions overruled the *Scholey v. Rew* decision on the question of whether the inheritance tax was a duty or an excise. He denied that the progressive rates in the inheritance tax violated the uniformity clause of the Constitution or were repugnant to fundamental principles of equality and justice. He maintained that:

The grave consequences which it is asserted must arise in the future if the right to levy a progressive tax be recognized involves in its ultimate aspect the mere assertion that free and representative government is a failure, and that the grossest abuses of power are foreshadowed unless the courts usurp a purely legislative function. If a case should ever arise, where an arbitrary and confiscatory exaction is imposed bearing the guise of a progressive or any other form of tax, it will be time enough to consider whether the judicial power can afford a remedy by applying inherent fundamental principles for the protection of the individual even though there be no express authority in the Constitution to do so.

But this protestation of judicial virtue unfortunately was not completely justified by the main section of the decision. Justice White and the rest of the Court majority deliberately interpreted the War Revenue Act contrary to Congress' intent. They desired that a tax be placed on legacies and distributive shares of personal property at a progressive rate, with the amount of the rate determined by the volume of the whole personal estate of the decedent. Instead the Court majority construed the statute so that the tax was to be levied on the legacies or distributive shares of personal property with a progressive rate on each, separately determined by the size of each of these legacies or distributive shares. Justice White disregarded completely the attempt of the Solicitor-General to show by quotations from the Senate debates what was the intention of the Senate—where the measure had originated—concerning the basis for measuring the amount of the tax. Consequently Justice White was able, through extended historical and textual analy-

ses, to prove that the Act necessarily required the type of tax he and the other members of the majority wanted.⁷

Although Justice White was able to convince Chief Justice Fuller and Justices Brown, Gray, and Shiras of the validity of his proof, three other judges on the Court dissented. Two of them felt, as Bertrand Russell has put it, that the chief virtue of elaborate proofs is to instill a skepticism concerning the validity of all proofs. Justice Brewer refused to admit that a progressive tax could be validly imposed, although he concurred with the rest of Justice White's opinion. Justice Harlan, who had stood shoulder to shoulder with Justice White in notable dissents against the income tax decisions, here took issue with his colleague. He argued that an inheritance tax was constitutional, but asserted that it was to be imposed with reference to the whole amount of the personal property out of which legacies and distributive shares arose. He maintained that the Act could not "be otherwise interpreted without defeating the intent of Congress." But, unfortunately from the liberal point of view, Justice Harlan was able to persuade only Justice McKenna to concur in this dissent.⁸

The economic consequence of Justice White's interpretation of the War Revenue Act was that the Treasury lost millions of dollars which otherwise might have been realized, and that the centralization of wealth was not counteracted to the extent that Congress had desired. Public reaction to this usurpation by the Court of the legislative function varied according to the economic beliefs of the different social groups throughout the country. The New York *Evening Post* conservatively declared that the decision would probably make the federal government's future policy one of appropriating or confiscating an increasingly large part of the property left by wealthy decedents for the expenses of the government. The middle-of-the-road, liberal magazine *Outlook* praised the decision for vindicating the constitutionality of a federal inheritance tax and of the principle of progressive taxation. Its editors felt that the Court's alteration of the inheritance tax basis from the size of the estate to the size of the legacy was in accord with principles of justice, although they expressed a desire to have the "one per cent of our people who own half of the wealth" pay their proper share of the federal taxes. Democratic and Populistic Republican newspapers like the *Kansas City Star*, *Chicago Inter-Ocean*, and *Seattle*

⁷ 178 U.S. 43-110.

⁸ 178 U.S. 110-111. The composition of the Court had changed since the income tax decisions. The places of Justices Jackson and Field had been taken by Rufus Wheeler Peckham on December 9, 1895, and Joseph McKenna on January 21, 1898. Peckham took no part in the *Knowlton v. Moore* decision.

Post-Intelligencer rejoiced over the decision as enabling retributive justice to be visited on wealthy tax evaders and as indicating that the inheritance tax could be retained as part of the permanent revenue system of the country. None of these, however, realized or stressed the economic import for the masses of the Court's distortion of Congress's intent on the tax basis.⁹

A number of important cases disputing the constitutionality of other sections of the War Revenue Act of 1898 also tested the Court's liberalism. The Court probably was influenced by the patriotic emotion aroused by the Spanish-American War and upheld the validity of taxes on sales of exchange made at boards of trade, despite the fact that the amount of the tax was measured by the amount of the sale. Taxes on tobacco were held to be excises. The tax imposed upon the annual gross receipts of sugar refining companies over \$250,000 was upheld as a special excise tax, and furnished a precedent for evading in part the income tax decisions. The Court took an extremely generous attitude toward the imposition of a federal inheritance tax on United States bonds even when they contained tax-exempt provisions. It also sanctioned a state tax on legacies consisting of United States bonds.¹⁰

Reduction of the Spanish-American War Taxes

While the Supreme Court was attempting to vindicate its reputation for patriotism and was upholding in considerable measure the War Revenue Act with such novel features as a federal inheritance tax, some Congressmen and Senators were working hard to reduce the war taxes and to repeal them as quickly as possible. A month after McKinley was re-elected to the presidency Sereno E. Payne, a New York Congressman, introduced a bill to reduce the war taxes by some \$40 million. Neither he nor any of the other Republicans in Congress at that time dared to eliminate the inheritance tax, but he did suggest and carry through a tax exemption for bequests given for charitable, religious, literary, or educational purposes.

The Democrats in the House attacked the Republicans for not making a reduction of \$70 million in the war revenue taxes and for not

⁹ *Chatauqua* (July, 1900), 31: 327; *Outlook* (May 26, 1900), 65: 197-98; *Public Opinion* (May 31, 1900), 28: 677.

¹⁰ *Nicol v. Ames*, 173 U.S. 509 (1899); *Patton v. Brady*, 184 U.S. 608 (1901); *Spreckles Sugar Refining Co. v. McClain*, 192 U.S. 397 (1903); *Murdock v. Ward*, 178 U.S. 139 (1900); *Plumber v. Coler*, 178 U.S. 115 (1900). The Court upheld a federal inheritance tax on bequests to states and municipalities in *Snyder v. Bettman*, 190 U.S. 249 (1903). Cf. *Harvard Law Review* (June, 1902), 15: 864-65; and (May, 1934), 47: 1209-89, for interesting editorial notes on inheritance tax issues.

eliminating taxes on mass consumption articles or increasing the taxes on wealth. Oscar F. Underwood of Alabama, later noted as the author of the 1913 tariff, made a vigorous attack on the Supreme Court for its perversion of the clear intention of Congress as to the rate basis of the 1898 inheritance tax. He proposed that the tax exemption granted to legacies by the Court's decision be reduced from \$10,000 to \$5,000, but his amendment was defeated by a vote of 83 to 45. On the other hand, the Republicans' proposal to exempt from the inheritance tax the estates of all decedents who had died before June 18, 1898, was passed by a large majority.¹¹

The Democrats urged the adoption of a special excise tax of one twentieth of 1 per cent on the gross annual receipts over \$500,000 of all manufacturing corporations. Democrats also suggested an income tax so framed as to evade the income tax decisions of the Supreme Court. The Democrats pleaded that only by making the wealthy classes bear their share of federal taxes could the discontent against "lawless and predatory wealth" that found its vent in communism and socialism be lessened. The two motions were voted down, however, and immediately afterward the House voted to pass Payne's war tax reduction bill.¹² The Senate Finance Committee took issue with the House bill on so many points that it submitted a war revenue reduction bill of its own to the Senate. The Senate concurred in nearly all the committee's suggestions. No important modifications of the inheritance tax were made. The one dramatic proposal was the amendment offered by John T. Morgan of Alabama, reviving the 1894 tax of 2 per cent on incomes over \$4,000, with the provision that the Secretary of the Treasury apportion this tax among the states so as to evade the ruling of the Supreme Court. This amendment also had a provision for the repeal of the War Revenue Act. The Senate rejected this proposal by a vote of 38 to 21, and then passed Senator Aldrich's drastic modification of the House war tax reduction bill.¹³ The differences between the Senate and the House were ironed out by the Conference Committee, and their bill became law on March 2, 1901.

This War Revenue Reduction Act retained the legacy taxes (except for the exemption noted above), the excise taxes on the oil and sugar refining companies, and the special annual duties on bankers and brokers. Various stamp taxes were either repealed or modified. The

¹¹ *Cong. Record*, 56th Cong., 2d Sess., 34: 87, 245-48 (Payne), 225-37 (Underwood).

¹² *Op. cit.*, 34: 337-40, 346-47.

¹³ *Op. cit.*, 34: 2002-05.

taxes on fermented liquors and tobacco, which had brought in a major share of the war revenue, were somewhat lowered.¹⁴ Theodore Roosevelt, although he had been conscious of the need for tax reform when he was governor of New York, did not dare tackle the tariff question or make any comment on the inheritance and income taxes when he became President. His first presidential message to Congress in December, 1901, had been written after consultation with President A. J. Cassatt of the Pennsylvania Railroad, Senators Nelson Aldrich, Mark Hanna, and Elihu Root, and two representatives of the House of Morgan, George W. Perkins and Robert Bacon. Roosevelt made no statement at this time which went counter to the primary interests of big business, although he intended to pursue cautiously but steadily the course which he believed to be morally right.¹⁵

Repeal of the 1898 War Taxes

Roosevelt's Secretary of the Treasury, Lyman J. Gage, informed Congress that in his opinion the surplus in the Treasury justified reducing the federal revenue to the extent of \$50 million. As a first step in that direction he recommended the repeal of all the war taxes. He considered them vexatious, in some instances oppressive, and, separately considered, yielding only a small revenue.¹⁶ This suggestion was immediately taken up in Congress by Sereno E. Payne, chairman of the House Ways and Means Committee. He introduced on January 31, 1902, a bill to repeal all the Spanish-American War revenue taxes. The highly organized Republican machine used its large majority in the House to push through this bill with the minimum debate. The Democrats, especially Oscar Underwood of Alabama and James D. Richardson of Tennessee, protested vehemently against the steam-roller tactics of the Republicans. The time for debate was limited and the special rule required that the House members vote either for or against the bill as a whole without any opportunity to exercise independent judgment on different items. Underwood and Richardson championed retention of the taxes on inheritance and corporations because they reached citizens and classes of property that were not taxed by the federal government in any other way, or that did not pay their

¹⁴ War Revenue Reduction Act of March 2, 1901, 31 *U.S. Stat. at Large*, 938-50. Cf. *World Almanac*, 1902, 91-95.

¹⁵ Henry F. Pringle, *Theodore Roosevelt* (New York, 1931), 244-46; Richardson, *Messages and Papers of the Presidents*, 10:417-56. Cf. Richard Baker, *Theodore Roosevelt and the Tariff*, a forthcoming detailed study.

¹⁶ *Report of the Secretary of the Treasury* (1901), 73.

fair share of the burdens of government. John Dalzell of Pennsylvania and Joseph Cannon of Illinois maintained that the Republican party was pledged to a repeal of all the war taxes once peace was established, and that any party or administration which collected more than enough revenue to carry on the government was derelict in its duty and ought to, and would, lose power. These plausible arguments obscured the fact that the total government revenue could have been reduced by the adoption of a very low tariff, without sacrificing the inheritance tax or failing to use an income tax. In any case, the sentiment and the pressure for reduction of federal revenue to offset the accumulating Treasury surplus was so great that the House passed Payne's bill by a vote of 288 to 0. The Democrats and Populists who disapproved of the bill felt that its passage was a lesser evil than the retention of all the war revenue taxes and therefore either voted for the bill or refrained from voting.¹⁷

The Senate disposed of this momentous issue in almost as short a time as the House. On March 20 Senator Aldrich introduced the House bill, with certain amendments proposed by himself and other members of the Senate Finance Committee. After a brief debate on comparatively minor questions, the Senate passed the bill the next day without even a record of the individual votes. After the differences between the House and the Senate on various details were settled by the Conference Committee, the bill to repeal the war revenue taxes became law on April 12, 1902.¹⁸

The pleas for patriotic unity and sacrifice which the Republicans had made in the spring of 1898, and the professions for distributing the weight of taxation according to the ability of the taxpayer, were forgotten or repudiated once victory had been won and the American colonial empire established. Cuba had been freed from Spanish tyranny through the sacrifices of the common people of the United States, but the propertied classes refused to maintain the taxes on inheritances and on corporations which would have helped both to counteract the trend toward concentration of wealth, and would have made those who benefited most from the war contribute substantially to the upkeep of the federal government. As in the aftermath of the Civil War, the desire for individual profit outweighed concern for social welfare on the part of the powerful business classes.

¹⁷ *Cong. Record*, 57th Cong., 1st Sess., 35: 1198-1249, 1829-37. The political composition of the House was 198 Republicans, 153 Democrats, 4 Populists.

¹⁸ *Op. cit.*, 35: 3044, 3113-25, 4060. Act to Repeal War Revenue Taxes . . . April 12, 1902, 32 *U.S. Stat. at Large*, 96. The Senate consisted of 56 Republicans, 29 Democrats, 1 Populist, 1 Independent, 1 Fusionist.

In 1900 the national wealth was estimated at \$88½ billion, the national income at over \$16 billion, and the interest-bearing public debt was over \$1 billion. By June, 1902, this debt had been reduced almost \$100 million, and by June, 1907, another \$38 million had been retired. But deficits in 1908 and 1909, as well as increased governmental expenditures for the War and Navy Departments, the Department of Agriculture, the construction of the Panama Canal and other government services, prevented the debt from being reduced more drastically before 1909 and caused its increase from 1909 onward. The Secretary of the Treasury refunded the public debt or issued bonds at as low a rate of interest as possible, so that nearly three fourths of the total interest-bearing debt in 1916 bore interest at the low rate of 2 per cent. But since the major part of the federal revenue came from consumption taxes (tariff duties or excises on liquor and tobacco), these taxes entailed the transfer of wealth and income from the farming, laboring, and small business classes to the big industrialists, the bankers, and the rentier class in general.¹⁹

Theodore Roosevelt throughout his first term as President carefully sidestepped most issues weighted with dynamite, such as tariff reform and the adoption of income and inheritance taxes. Instead, he centered his attention on a vigorous foreign policy and on certain domestic reforms which created a reputation for himself as a champion of the common man against "the malefactors of great wealth." In February of 1902 Roosevelt had his Attorney-General begin his trust-busting campaign by announcing a suit against the Northern Securities Company. This disturbed big business very much. In the fall of 1902 Roosevelt also urged government control of trusts and even tariff revision. But the elder statesmen of the Republican party—Senators Aldrich, Allison, Hanna, Lodge, and Spooner—brought pressure to bear on Roosevelt at a secret conference at Roosevelt's home in Oyster Bay on September 16, 1902. At this meeting it is alleged an agreement was reached that Roosevelt should have his way in all things outside of economics and finance, and that the elder statesmen should dictate a policy on the reserved subjects. In any case, Roosevelt refrained from that time on until after the 1904 election from pressing his plans for big business control or from making suggestions concerning tariff reform.

Roosevelt achieved some domestic progress and won a great deal

¹⁹ Dewey, *Financial History of the United States*, 494-98; National Industrial Conference Board, *Studies in Enterprise and Social Problems*, 66, 79; *Report of the Secretary of the Treasury* (1939), 450.

of public acclaim by settling the anthracite coal strike in October, 1902, winning support for the Newlands Reclamation Act in June, 1902, getting a department of Commerce and Labor established, and aiding the passage of the Elkins Act as a means of regulating the railroads. But the events in Roosevelt's first administration of which he was proudest were his intervention in the dispute between Venezuela on the one hand and Germany and Great Britain on the other, the American success in the dispute over the boundary line between Alaska and Canada, and his instigation of the Panama revolution against Colombia, with the consequent Panama Canal Treaty. These adventures in foreign affairs involved the use of the Big Stick, and, in the case of Panama, revealed a moral callousness and reliance on *Machtpolitik* which were contrary to the principles Roosevelt professed in domestic affairs.

Roosevelt's Election in 1904

Despite Roosevelt's spirited foreign policy and his carefulness in avoiding tariff and currency controversy, many of the key figures in the Republican party and big business were strongly opposed to the nomination of Roosevelt as the Republican presidential candidate in 1904. The death of Mark Hanna in February, 1904, however, removed the one man who might have succeeded in capturing the Republican nomination from Roosevelt. Since the opposing Democratic candidate, Judge Alton B. Parker, was conservative and colorless, Roosevelt was able to win the election by a two-million plurality. No sharp conflict occurred between the Republican and Democratic candidates except on the issue of big business financial support for Roosevelt. Later investigation revealed that \$150,000 contributions had been made by J. P. Morgan and the Metropolitan, Mutual, and the New York Life Insurance Companies; \$100,000 contributions by John D. Rockefeller, Henry H. Rogers, jointly, and by E. H. Harriman, and Chauncey M. Depew; \$50,000 contributions by C. S. Mellon, Jacob H. Schiff, Percy Rockefeller, Henry C. Frick, James H. Hyde. Other large contributions came from prominent bankers, industrialists, and corporations.

The Democratic party, with its presidential candidate a supporter of the gold standard and friendly to business interests, was able to obtain financial support from eastern bankers and merchants, but apparently without the widespread support that Wall Street gave Roosevelt in the hope of winning him to its side. The largest known contributions

were \$450,000 from Thomas F. Ryan and \$250,000 from August Belmont, two New York financiers.²⁰

The Progressive Movement

Roosevelt's remarkable victory in the election indicated his popularity with the masses, but the common man was thus expressing his disapproval of the new conservatism of the Democratic party. Parker polled nearly a million and a half votes less than Bryan had in 1900, and the vote for Eugene V. Debs and the Socialist party increased from nearly 90,000 in 1900 to 400,000 in 1904. Progressives like La Follette and Cummins won in the Middle West. The discontent of the farming, working, and small business groups, which had been brewing from the end of the Spanish-American War, was now finding articulate expression and effective political pressure. The defeat of the Populist revolt in 1896 had inspired various financiers and industrialists to emulate John D. Rockefeller's successful creation of the Standard Oil Trust which cut down the cost of production and increased the margin of profit through the elimination of competition. The process of industrial consolidation which the Panic of 1893 had interrupted gained new strength in 1898, and proved so profitable that in 1904 there were 318 greater or lesser industrial trusts representing mergers of nearly 5,300 distinct plants and a capitalization of over \$7 billion. Those attracting the most public attention were the Standard Oil Company, United States Steel Corporation, the American Sugar Refining Company, the Amalgamated Copper Company, the American Smelting and Refining Company, the Consolidated Tobacco Company, and the International Mercantile Company. Other important consolidations occurred in the communication and transportation industries.

The profits of these gigantic industrial and commercial enterprises incited the envy and discontent of the small businessman, the farmer, and the industrial worker. The small businessman feared that he would be crushed out of business or reduced to a subsistence level by the large corporations. The farmer felt that he was being forced to pay higher prices for the manufacturers' goods he bought in a domestic market controlled by big business while he sold his commodities in a market of world-wide competition. The industrial worker considered the increases in the cost of living unjustified. He struggled against low wages, kept down by the use of child labor, the influx of unorganized

²⁰ Ferdinand Lundberg, *America's Sixty Families* (New York, 1937), 66-86; Matthew Josephson, *The President Makers*, 111-68; Pringle, *Theodore Roosevelt*, 237-358; Hibben, *Bryan*, 237-58.

immigrant labor, and the opposition of corporations to the spread of unionism.

The cost of living rose nearly one fourth between 1898 and 1907. The wages of unionized workers increased on the average of only 14 per cent; nonunion wages even less. In terms of 1914 dollars, purchasing power of average wages in manufactures fell from \$603 in 1899 to \$582 in 1904. Although labor benefited from the improvement in employment between 1901 and 1907, the majority of wage earners failed to earn an income adequate to maintain a minimum satisfactory standard of living as defined by the sociologist. In 1904 Robert Hunter, a millionaire socialist, was able to assert in his widely read and much-debated volume on *Poverty* that not less than ten million persons in the United States, almost one seventh of its total population, lived in poverty.²¹

The workers, farmers, small businessmen, and professional men suffered frustration in their attempts to lead a rich and independent life in a society which professed democracy, but which in actuality was dominated politically and economically by an oligarchy, the captains of industry and finance, and their political henchmen, machine-party bosses. Dissatisfaction led to a rebellion against the vested interests and to an attempt at governmental and economic reorganization, which took on the character of a crusade for social justice. Shortly before the outbreak of the Spanish-American War, Carroll D. Wright, United States Commissioner of Labor, asserted in a speech on labor's rights that "labor troubles are not produced through ignorance, but through intelligence, and the intelligence which leads the working man into labor disturbances is one which leads to a higher intelligence that will ultimately prevent these conflicts."²² A few months later a Populist newspaper declared: "Let the corporations continue to rob the people. Nothing will advance government ownership more rapidly."²³

The intelligent farmers of the Middle West had supported John P. Altgeld and Hazen S. Pingree as reform governors of Illinois and Michigan in the late eighteen-nineties. Robert La Follette won the governorship of Wisconsin in 1900, Albert B. Cummins that of Iowa in 1901, William R. Stubbs, a millionaire contractor reformer, that of Kansas in 1908, Coe Crawford that of South Dakota in 1906, and John Johnson that of Minnesota in 1904. Progressive Republicans

²¹ J. R. Commons, *History of Labor*, 3: 51-59; Harold U. Faulkner, *The Quest for Social Justice, 1898-1940* (New York, 1931), 1-51.

²² *Public Opinion* (February 17, 1898), 24: 208.

²³ *Ibid.* (July 7, 1898), 25: 10.

united with the Democrats in electing governors of North Dakota and Rhode Island. In 1904 Missouri elected as its governor Joseph W. Folk, noted as a reform district-attorney in St. Louis. In Oregon, after 1891, William S. U'Ren guided the Progressive forces in securing needed reforms and a socially conscious government. Other governors who emulated these pioneers in government responsive to the needs of the common people were Charles Evans Hughes in New York, Hiram Johnson in California, Woodrow Wilson in New Jersey, and Robert P. Bass in New Hampshire.

Simultaneous and in certain cases prior to these victories in state reform were the battles against municipal corruption and misrule. Samuel M. Jones in Toledo, Tom L. Johnson in Cleveland, Joseph W. Folk in St. Louis, Ben Lindsey in Denver, Hovey C. Clarke in Minneapolis, Mark Fagan in Jersey City, Emil Seidel in Milwaukee, and Seth Low in New York fought against political graft, misappropriation of public funds, betrayal of the people's interest for the benefit of public utility companies, evasion of taxation by the rich, and other evils. As instruments for securing and preserving these local and state reforms many cities and states adopted the initiative and referendum, the recall, direct primaries, municipal home rule, and the commissioner or city-manager form of government.²⁴

After this movement for municipal and state government reform had got under way, various magazines began what Theodore Roosevelt later called "muckraking," but what others defended as the exposure of evils and corruption for the purpose of promoting righteousness and social justice. Henry George, Edward Bellamy, and Henry Demarest Lloyd with the aid of such novelists as William Dean Howells, H. H. Boyesen, and Hamlin Garland in the eighteen-eighties and nineties had done much to make the general public desirous of correcting various social ills. Reform movements were also aided by the rise in the eighteen-nineties of such popular magazines as *Munsey's*, *McClure's*, *Cosmopolitan*, *Everybody's*, and *Pearson's*. Less popular than these periodicals, but influential with the more serious and educated progressive reader, were the radical *Arena* and the middle-of-the-road liberal *Outlook*, the *Review of Reviews*, the *Yale Review*, and the *North-American Review*.

Although the American Economic Association had been established in 1885 by economists like Henry C. Adams and Richard T. Ely who

²⁴ B. P. DeWitt, *Progressive Movement* (New York, 1915), *passim*; Faulkner, *op. cit.*, 81-100. Cf. B. H. Wilcox, *Northwestern Radicalism*, 70-110, a very penetrating analysis of the economic basis of the Progressive movement.

felt strongly the need for social control of the economic order, the majority of American economists continued to teach traditional laissez-faire economics such as was presented in J. Laurence Laughlin's conservative edition of John Stuart Mill's *Principles of Political Economy*. Edward L. Godkin of the *Nation*, David A. Wells, William Graham Sumner of Yale, and Simon Newcomb vigorously attacked the younger men as intellectual rebels and unsound social reformers. Peace was reached between the conservative and liberal economists by 1892 but at the cost of dropping the "radical" platform of 1885. The conflict between these two groups and the social pressures to which they responded prevented all but a few of the economists from influencing public opinion in any decisive manner against the social abuses of the day. John Bates Clark, regarded by many as the greatest constructive general theorist in economics that America had produced up to then, developed a highly original system of marginal utility economics, which strongly defended competitive as against monopoly capitalism. He sought to demonstrate that the distribution of the income of society was controlled by a natural law of marginal productivity and was in the main honest and just. Sumner at Yale and F. W. Taussig at Harvard attacked the protective tariff and the monopolies they fostered, but did not make any extended critique of the existing inequalities in income and wealth. Richard T. Ely and John R. Commons wrote sympathetic studies of labor problems and labor history, and gave their services as economists to La Follette in his efforts to restore democracy. Henry C. Adams and Edwin R. A. Seligman, with R. T. Ely, introduced a broadly social point of view into the theory of taxation, and were among the advocates of taxation and government expenditure as instruments of social welfare. Simon Patten at the University of Pennsylvania, carrying on the tradition of Henry Carey, justified the protective tariff and a nationally planned economy as a means of avoiding the scarcity and inefficiency resulting from uncontrolled individualism. But Patten presented no specific program or pattern for national autarchy.

The economist who went most deeply to the roots of social discontent was Thorstein Veblen. His work reflects his Scandinavian and midwestern agrarian background. Having a wide knowledge of cultural anthropology, psychology, and philosophy as well as of institutional and theoretical economics, Veblen drew upon this arsenal for analytical tools and weapons of attack upon the structure and functioning of American society. In his *Theory of the Leisure Class*, published in 1899, and his *Theory of Business Enterprise*, published in 1904, as well as in numerous essays and later volumes, Veblen used

the technique of the detached, completely objective student of comparative institutions to reveal the unwarranted preconceptions and rationalizations embodied in the economic thought and practice of his day. He stressed the conflict between the desire of the businessman for profit and the desire of the craftsman and engineer for production; the dependence of profits and income in general upon the state of the industrial arts and sciences; and the analogy between the captain of industry and the financial magnate on the one hand, and the pirate chieftain and the robber baron on the other. Business cycles, with their increasingly intense crises, in Veblen's opinion were due to the inadequacies of the price system, based on the quest for profits as the primary human goal. Veblen never engaged in active politics and did not formulate any program for reorganizing the economic order until after the first World War. In 1921 he suggested in his *Engineers and the Price System* that the engineers and the managerial class in general could control production and distribution so as to increase social welfare.

In philosophy and psychology such figures as William James, Charles Sanders Peirce, Josiah Royce, John Dewey, and George Santayana broke new paths. Since most of the professional economists, philosophers, psychologists, and sociologists either dared not or could not reach more than a limited audience on the crucial social issues at the beginning of the twentieth century, the job of arousing the farmers, workers, and professional and small-business groups to action against the malpractices of high finance and big business fell upon the shoulders of labor leaders like Eugene V. Debs, lawyers like Brandeis and La Follette, and journalists like Lincoln Steffens and Ida Tarbell. Late in 1902, in *McClure's Magazine*, Lincoln Steffens began exposing the widespread corruption in the leading cities of the United States. Shortly after Ida Tarbell launched her sensational *History of the Standard Oil Company* in the same periodical. At the same time James H. Bridge wrote *The Inside History of the Carnegie Steel Company*. Their success in reaching a wide public and obtaining an enthusiastic response led others to exploit systematically the public interest in the hitherto concealed activities of the economic and political rulers of America.²⁵

This literature of exposure, which flourished until about 1913, helped to stimulate and bring to a head the people's fears that a plutocracy might supplant the democracy they cherished as a not unattainable ideal. Scores of articles appeared each year during this period on

²⁵ Louis Filler, *Crusaders for American Liberalism* (New York, 1939); C. C. Regier, *The Era of the Muckrakers* (Chapel Hill, 1932), Dorfman, *Veblen*.

the dangers or responsibilities of great wealth, the number and power of millionaires, the menace of riches, the evils of extravagance (conspicuous consumption and waste), the need for eliminating or curbing the power of the trusts, the justice or tyranny of income and inheritance taxes, the need for downward revision of the tariff, and the conflicts between capital and labor.²⁶ The *New York World*, which since May 17, 1883, had been an ardent champion of income and inheritance taxes, in its effort to satisfy public curiosity and interest published in its *Almanac* for 1902 a list of over 2,000 American millionaires. A new impetus was given to economic, historical, and statistical studies of the growth of large fortunes and the distribution of wealth.²⁷

Meanwhile the labor movement had grown in various ways. The total membership of the American trade-unions increased from 500,000 in 1898 to 2,000,000 in 1905 and was to reach 3,000,000 by 1917. The opposition offered to labor by the National Association of Manufacturers and by the state and national courts in general, notably in the *Danbury Hatters'*, *Lochner v. New York*, and the *Buck's Stove and Range* decisions, created intense resentment among workers and helped to swell the Socialist vote.²⁸

The Liberalism of Theodore Roosevelt

Theodore Roosevelt was gifted with a sensitivity to the currents of public opinion which was unusual for a member of the upper classes. As early as February, 1905, he felt that the growth of the Socialist party was "far more ominous than any populist or similar movements of the past." By March, 1906, he was complaining to Taft of the "dull purblind folly of the very rich men, their greed and arrogance, and the way in which they unduly prospered by the help of the ablest law-

²⁶ See the *Readers' Guide to Periodical Literature* (Minneapolis, 1905-) for an extended list of articles on these subjects from 1900 to 1909. *Public Opinion* to June, 1906, and *Literary Digest* from July, 1906, offer valuable summaries of the most discussed essays and books on these topics.

²⁷ Basil A. Bouroff, *The Impending Crisis* (Chicago, 1900); Donald E. Bridgman, *Economic Causes of Large Fortunes* (St. Paul, 1909); Willford I. King, *Wealth and Income of the People of the United States* (New York, 1915); Gustavus Myers, *History of the Great American Fortunes* (Chicago, 1909); Frank H. Streightoff, *Distribution of Incomes in the United States* (New York, 1912); Joseph H. Underwood, *The Distribution of Ownership* (New York, 1907). For other technical studies see C. L. Merwin, "American Studies of the Distribution of Wealth and Income by Size," *op. cit.*, 78-84.

²⁸ J. R. Commons, *History of Labor*, 3: 293ff., 660-700, 4: 13ff.; Faulkner, *op. cit.*, 51-80; Leo Wolman, *Ebb and Flow in Trade Unionism* (New York, 1936), 15-20.

yers" as responsible for popular irritation and revolutionary feeling which the muckrakers helped to build up.²⁹ Since Roosevelt was fundamentally concerned with preserving the capitalistic system against socialistic onslaughts, he felt that his task was to bring about such reforms as would raise the standard of living for the masses and prevent gross abuses of power by the privileged classes. By following this policy, he would prevent revolution, preserve the spirit of free business enterprise, and win glory and power for himself and others who cherished aristocratic ideals of public service and nonpecuniary pursuits. His strategy was to play off one extreme group against another and to build up an enthusiastic following among the great middle class.³⁰

During the first year of the second administration Roosevelt devoted most of his energies and thoughts to playing a role in world diplomacy. The pressure of domestic discontent prevented him, however, from obtaining escape from the issues which the muckraking movement had brought to the fore of popular consciousness. Realizing the need for action on these questions, he took a vigorous stand in 1905 and 1906 on the conservation of natural resources, the need for meat inspection and pure food laws, enforcement of the antitrust acts, and greater government control of railroad rates. By June, 1906, he had secured most of his demands, although the conservatives in the Senate led by Nelson W. Aldrich forced him to accept many drastic modifications which were bitterly resented by Progressives like Beveridge and La Follette. Roosevelt, though checked on certain fronts, was satisfied with the gains he had made in protecting the American people from the most gross of the various abuses practiced by big business, and enjoyed the admiration he received from the masses for his thundering attacks on the malefactors of great wealth. Yet he evaded acting on such important matters as tariff revision and child labor, because they contained too much dynamite or would excite too much conservative opposition.

Roosevelt on the Inheritance Tax

The middle-of-the-road position Roosevelt took at this period of potentially acute social conflict and the manner in which he advocated exceedingly radical measures in order to head off violent changes in

²⁹ Josephson, *The President Makers*, 210; Pringle, *Roosevelt*, 367-68.

³⁰ An interesting comparison between Theodore Roosevelt and Tiberius Gracchus was made by Charles S. Dana in the *North American Review*, March, 1905; *Public Opinion* (March 25, 1905), 38: 454. Stress was laid on the opposition of the U.S. trust magnates and the great Roman landholders, especially through their Senates, to needed reforms in their respective areas.

the structure of American economy can perhaps best be seen in his celebrated speech of April 14, 1906. In that speech he first attacked the stringent critics of big business as muckrakers, concerned only with the filth in American society. After pleasing the conservatives in this manner by singling out the vices of the radicals, he turned around and championed "the adoption of some such scheme as that of the progressive tax on all fortunes, beyond a certain amount either given in life or devised or bequeathed upon death to any individual—a tax so framed as to put it out of the power of the owner of one of these enormous fortunes to hand on more than a certain amount to any one individual; the tax, of course, to be imposed by the National and not the State Government. Such taxation should, of course, be aimed merely at the inheritance or transmission in their entirety of those fortunes swollen beyond all healthy limits."³¹ The sensation and consternation he created among Republican statesmen and businessmen on this question were equaled only by their dismay over his assertion of the need of government supervision over corporations engaged in interstate business.

Few presidential speeches have excited as much public discussion as this one. The section of Roosevelt's speech which aroused the most widespread interest was his proposed "Cure for the Disease of Wealth." The conservative press denounced Roosevelt as the "Great Leveler" and inciter of class war. The *Philadelphia Record* declared that Roosevelt gave "more encouragement to state socialism and centralization of government than all that frothy demagogues have accomplished in a quarter of a century of agitation of the muddy waters of discontent." The *New York Globe and Commercial* and the *Brooklyn Eagle* invoked the specters of class antagonism, the destruction of the Constitution, and the loss of business confidence.

Less reactionary than these newspapers, but safely conservative, were the *Boston Transcript* and the *New York Times*. Great fortunes, they maintained, helped to raise the standard of living by lowering the rate of interest or by making possible great benefactions. On the other hand, the liberal and radical press were enthusiastic over Roosevelt's proposal. The *Baltimore News* and the *New York World* suggested the adoption of graduated income and inheritance taxes as just and needed measures. Pulitzer also urged sharp reductions in tariff duties and vigorous antitrust action. Among the other supporters of the

³¹ Theodore Roosevelt, *Works* (20 v., New York, 1926), 16: 415, 421. See Champ Clark, *My Quarter Century of American Politics*, 1: 440, for an amusing account of the speech.

President were the Springfield *Republican* and the Philadelphia *Press* and *North American*.³²

Roosevelt's success in his social welfare legislation and in his trust-busting activity continued through the remainder of 1906 and into the spring of 1907. He was especially pleased by the suits instituted against the Standard Oil Company of New Jersey, the American Tobacco Company, and the American Sugar Refining Company. In his presidential message of December 3, 1906, he suggested that Congress pass a heavily progressive inheritance tax. He also discussed the social desirability of a graduated income tax, but considered the difficulty of amending the Constitution so great that only real necessity could justify resort to such a measure. The alternative was the enactment of a law circumventing the income tax decisions of 1895, an "intricate and troublesome" procedure.³³ In June, 1907, Roosevelt told the people: "most great civilized countries have an income tax and an inheritance tax. In my judgment both should be part of our system of federal taxation."³⁴ Press opinion of these suggestions varied from enthusiastic approval by liberal and radical papers, such as the *Raleigh News and Observer*, to denunciation of such a radical, "if not actually revolutionary," proposal by the *New York Commercial*.³⁵

The Panic of 1907

The thrusts of Roosevelt in the direction of social reform along lines parallel to those of Lloyd George in England and Clemenceau in France were met by the counterthrusts of the economic rulers of America. The United States had enjoyed a high degree of prosperity since 1898, almost uninterruptedly. After the re-election of McKinley in 1900 the stock market had suffered from a speculative mania which culminated in the May 9, 1901, panic. Business, however, soon recovered, despite severe droughts and a great steel strike. The assassination of McKinley did not retard the advances that continued until the fall of 1902. From November, 1902, until December, 1903, a pronounced and prolonged decline of security prices took place, which was called by the public "the rich man's panic," although not a panic in a technical economic sense of the term. The consequence was a mild industrial depression lasting until August, 1904, after which a vigorous revival of business occurred. Throughout 1905 and 1906 business pros-

³² *Public Opinion* (April 28, 1906), 40: 521-22; Sullivan, *Our Times*, 3: 94-97.

³³ Theodore Roosevelt, *Presidential Addresses* (8 v., New York, 1910), 5: 934-39.

³⁴ *Ibid.*, 6: 1319.

³⁵ *Literary Digest* (December 15, 1906), 33: 888-92; (June 22, 1907), 34: 981-82.

perity seemed even more widespread and intense than in 1899 or 1901. But this expansion of business overtaxed the resources of the money market. A recession of business activity began in the spring of 1907, but did not develop into an acute stage until October.

On October 18, 1907, a panic began on the New York Stock Exchange over the extremely sharp drop in the stock prices of the United Copper Company, a leading rival of the Amalgamated Copper Company controlled by Henry H. Rogers and William Rockefeller, the adventurous speculators of the Standard Oil Trust. Immediately the banks and trust companies dominated by C. W. Morse and F. Augustus Heinze, especially the Knickerbocker Trust, the Trust Company of America, and Mercantile National, became adversely affected. Rumors about their insolvency, spontaneous or inspired, led to the failure of the Knickerbocker Trust Company on October 23, and to a panic run on nearly all the banks and trust companies in New York City. Roosevelt was blamed for undermining public confidence in big business through initiating some forty six antitrust suits and thereby creating a Rooseveltian Reign of Terror on Wall Street, especially against the Standard Oil interests. Actually the American panic was due to a variety of complex causes, among them an international crisis in Egypt, Japan, Hamburg, Chile, Holland, and Denmark, caused by excessive world-wide speculation and strain on the money market, and the all too successful raid by the Copper Trust on its rival's stocks and credit resources.

The panic was so severe as to threaten the solvency of even the strongest New York banks. The danger was met by Secretary of the Treasury George B. Cortelyou's depositing \$35 million of the Treasury's surplus funds with the House of Morgan, by the formation of money pools for lending on the stock exchange, by the issue of clearing-house loan certificates, by the offer of new government securities for sale as a basis for an increase in national bank-note issues, and by the importation of over \$100 million of gold from Europe in November and December. The panic was well under control by the end of the year; industry and trade then passed into a deep depression which lasted until the autumn of 1909.

The panic of 1907 had been precipitated by one group of financial speculators—Henry H. Rogers, William Rockefeller, and their associates in the Copper Trust—as a means of gaining dominance in the copper industry through the ruthless liquidation of the United Copper Company. Once the panic was on, the House of Morgan served as the

rallying point against the collapse of the American credit and banking system. John P. Morgan, George F. Baker, his ally and president of the First National Bank, James Stillman, head of the powerful National City Bank, which was closely linked with the Standard Oil interests, and the other leading financiers and industrialists joined together under the compulsion of a common danger. They used their own and the government's financial resources not only to halt the panic but also to increase their fortunes through forcing reorganizations and consolidations which gave them the centralized control they desired in certain fields. The banks and companies controlled by F. A. Heinze and C. W. Morse were either allowed to go bankrupt or were saved on condition that the Heinze-Morse directorate resign. This meant the triumph of the Copper Trust.

An even more spectacular victory for industrial consolidation was the acquisition by the United States Steel Corporation of the Tennessee Coal and Iron Company in November, 1907, despite the antitrust law. Elbert H. Gary and Henry C. Frick obtained President Roosevelt's permission for the transaction on the ground that otherwise an important firm would fail and the panic would be intensified. This excuse was not strictly accurate as relief for the threatened firm could have been given in other ways. But Roosevelt was predisposed to favor the House of Morgan. On August 22, 1907, he had asked his Attorney-General not to file the suits against the International Harvester Company, which had a practical monopoly in the manufacture of farm machines, because George W. Perkins, the Morgan partner responsible for organizing the company, had pleaded in its behalf as a "reasonable" corporation and because Roosevelt already anticipated the impending panic. Hence, under the stress of the panic situation, he allowed another suspension of the Antitrust Act when it seemed to be required to curb the panic and to win the good favor of the House of Morgan. Throughout the rest of his administration Roosevelt called a truce in his war against the trusts as a means of restoring business confidence and prosperity. In the spring of 1908 Roosevelt stopped proceedings against the New York, New Haven, and Hartford Railroad, a Morgan-controlled enterprise, despite the exposure of the directorate's scandalous and fraudulent activities. Roosevelt's discrimination between the good and the bad trusts, and his temporary change of heart concerning the virtues of trustbusting, may have fostered a slight resumption of the trend toward monopoly capitalism which had been partially counteracted for a few years. The importance of this episode lies in the

sanction for consolidation of economic power which the key figures in finance and industry were able to obtain from even a president anxious to introduce income and inheritance taxes as controls on dangerously large fortunes.³⁶

³⁶ Lewis Corey, *The House of Morgan* (New York, 1936), 338-48; Ferdinand Lundberg, *America's Sixty Families* (New York, 1937), 90-97; W. C. Mitchell, *Business Cycles*, 64-82, 591-99; A. D. Noyes, *Forty Years of American Finance*, 284-380; Pringle, *Roosevelt*, 432-45.



Republican Insurgency on Taxation

THEODORE ROOSEVELT had been forced by the panic of 1907 to beat a retreat from his trustbusting activities. Once the worst of the storm was over, however, he resumed his role as reformer, either because of a sincere desire to remedy various social ills, or because he had to compensate for the humiliation and inadequacy he had felt when confronted by the economic forces behind the panic of 1907. In his messages to Congress in December, 1907, Roosevelt had asked Congress to enact various social reforms, but in his message of January 31, 1908, he made the most radical proposals of his presidential career. He recommended the passage of a direct income and inheritance tax, the introduction by the government of workmen's compensation for its employees, the curbing of labor injunction abuses, and government valuation of railroad property and regulation of rates. Moreover, to the horror of many conservative newspapers Roosevelt criticized stock market manipulations, insurance, banking, and railroad scandals and evasion or defiance of national laws by unscrupulous businessmen aided by corporation lawyers. His desire for "the moral regeneration of the business world" made the *New York Globe* "fear the consequences of arousing a spirit of class hate, of stimulating the latent envy that the improvident feel toward the thrifty" and inspired the *New York Times* to impute delusions of persecution to the President. On the other hand, the general public, especially the workers and farmers, seemed to approve highly of his unmerciful castigation of the predatory interests.¹

Although Roosevelt had the satisfaction of giving release to his and the public's anger at the malefactors of great wealth, the conservative Republican machine's opposition permitted only a few of his sugges-

¹ Roosevelt, *Presidential Addresses*, 7:1597-1638; *Literary Digest* (February 8, 1908), 36:175-76.

tions to be adopted by Congress. Since Roosevelt was not a candidate for re-election, his Big Stick, as one editor put it, was no longer loaded with patronage; and with patronage—the gift of offices or privileges—out of it, that weapon was only a stuffed club.² Hence, his main accomplishments during his last year as President were securing the nomination of the man he desired as his successor, the denouncing of the courts for decisions against labor and in favor of the Railroad and the Standard Oil Trusts, rounding out his conservation program, and winning respect from Japan and the rest of the world for the American battle fleet he had sent around the globe.³

Taft vs. Bryan

The man whom Roosevelt made the Republican candidate for the presidency was William Howard Taft. He had won Roosevelt's affection and respect as Governor of the Philippines and Secretary of the War Department. Taft was not a radical in any way, and as a judge in Ohio had displayed a strong antilabor bias in the eighteen-eighties and nineties. But under Roosevelt's influence Taft seemed to be a vigorous exponent of the Square Deal and to view public questions in the light of Roosevelt's basic principles. Taft was nominated in June on a platform which was liberal in its rhetoric, but avoided any drastic reforms. Revision of the tariff and greater government control of trusts were promised, but nothing was said concerning antilabor injunctions or income taxes.

William Jennings Bryan, many of whose policies Roosevelt had taken for his own, recaptured the Democratic nomination without any difficulty against the opposition of eastern conservatives. The Democratic platform sounded the note of revolt by the middle and working classes against the rule of predatory wealth. Straightforward demands were made for the immediate revision of the tariff, the adoption of an income tax, the direct election of senators, the abolition of trusts, and the restricted use of the labor injunction. The minority party which scored the highest vote in the election was the Socialist party, with Eugene V. Debs as its presidential candidate. Its program was directed toward the replacement of capitalism by socialism and included among its specific demands the adoption of graduated income and inheritance taxes. The widespread unemployment at the time and the series of judicial decisions directed against labor made these proposals unusually pointed.

² *Memphis Commercial Appeal, Literary Digest* (May 9, 1908), 36: 665.

³ *Pringle, Roosevelt*, 476-94.

Taft's victory over Bryan was won by an electoral vote of 321 to 162 and by a popular plurality of 1,269,000 votes. But a critical analysis of the election returns showed that Taft's lead over Bryan was less than half that achieved by Roosevelt in 1904 and that Bryan had won nearly a million and a half votes more than Alton B. Parker. Moreover, a rising tide of protest in the Middle West was indicated by Bryan's capture of three states—Colorado, Nebraska, Nevada—which had voted for Roosevelt in 1904 and the new state of Oklahoma. But Bryan also had heavy support in all the other sections of the country, urban as well as rural. This was due to the distrust shown by the farmers, workers, and small businessmen toward Taft in the role of a foe of privilege, monopoly, and antilabor measures. Although the American Federation of Labor refrained from formally endorsing the Democratic party and Bryan's candidacy, Gompers and other labor leaders threw their support to the Democratic party. This explained why the Socialist vote, despite Eugene Debs's vigorous campaign, increased only from 409,000 in 1904 to 424,000 in 1908. The vote for Bryan, Debs, and the other minority parties indicated an increasing dissatisfaction on the part of the common people with the policies sponsored by the die-hard conservatives. Taft's presidency was to be tested by his ability to convince the general public that he was a true disciple of Roosevelt and not an ally of Nelson W. Aldrich and Uncle Joe Cannon.⁴

The Tariff Reform Issue and the Income Tax

The tariff issue very speedily revealed the factors responsible for the tragic failure of Taft to satisfy Roosevelt's hopes for a successful continuance and fulfillment of his program. Agitation for downward revision of the tariff had gone on consistently from the passage of the Dingley Tariff on July 24, 1897, to the spring of 1909. But the return of prosperity to the country in the fall of 1897, the national interest in the Cuban situation, the prosecution and the outcome of the Spanish-American War, and the remarkable increase in American exports to Europe between 1897 and 1904—the so-called "American Invasion of Europe"—were used by the champions of high protection as justifications for not "tinkering with the tariff." McKinley, although his name was associated with one of the highest tariffs in American history, had become concerned in his last years with the trend toward excessively

⁴ Hibben, *Bryan*, 276-88; Commons, *History of Labor*, 4: 150-58, 282-83; Henry F. Pringle, *Life and Times of William Howard Taft* (New York, 1939), 1: 311-78; E. E. Robinson, *The Presidential Vote*, 13ff., 31-34, 50-53; *New York Tribune Almanac* for 1910, 183-88, 198-220; *World Almanac*, 1909, 153-67, 436-42, 617.

high protection and had advocated in a speech at Buffalo on September 5, 1901, downward revision of the tariff through reciprocity agreements with other nations. But he was assassinated the next day. Roosevelt, despite his sympathies with the tariff reform, lacked the mastery of economics to appreciate fully the significance of the tariff as a factor in promoting the growth of the trusts and the large fortunes against which he declaimed. He also felt it unwise to fight the Aldrich-Cannon machine on that issue since they might then block completely the other measures he wanted to have passed.

The success Aldrich and his group had had in blocking the reciprocity treaties initiated by McKinley and in heading Roosevelt off from "dangerous thoughts and actions" on the tariff question did not prevent an insurgent movement in the Republican party from developing within the Middle West. The program of Governor Cummins of Iowa for trust regulation, railroad control, and revision of those tariff schedules offering "shelter to monopoly," popularly called the "Iowa Idea," had spread after 1901 from Iowa to Wisconsin, the Mississippi Valley, and even New England. By 1906 such sturdy Republicans as Senator Beveridge and Taft, then Secretary of War, felt impelled by public sentiment to advocate tariff revision. The panic of 1907, which had arisen out of excessive stock manipulation and had resulted in the extension of industrial consolidations, had one effect which high finance and big business had not anticipated: such widespread unemployment at a time of excessively high living costs that a tremendous pressure from the public developed for sweeping revision of the tariff as a means of lowering the cost of living.

Hence the Republican platform of 1908 declared "unequivocally for the revision of the tariff by a special session of Congress immediately following the inauguration of the next President." The word "downward" was purposely omitted by those desiring to increase the tariff after the election on the ground given in the platform that the "true principle of protection" was best maintained by "the imposition of such duties as will equal the difference between the cost of production at home and abroad, together with a reasonable profit to American industries."⁵ Taft, however, from the time of his acceptance speech to the end of his campaign made definitely clear his support of downward revision of the tariff.

Taft also declared himself in favor of an income tax. In a speech at Columbus, Ohio, on August 20, 1907, he had declared that a graduated

⁵ Kenneth W. Hechler, *Insurgency* (New York, 1940), 92ff.; Olcott, *McKinley*, 2: 295ff.; Pringle, *Taft*, 1: 418ff.

income tax had a tendency to reduce the motive for the accumulation of enormous wealth and would be of great financial assistance to the government in times of great national need. Although he objected to such a tax in ordinary times as inquisitorial and provocative of perjury, and recognized the Supreme Court's invalidation of the income tax in 1895, he asserted that "it is not free from doubt how the Supreme Court, with changed membership, would view a new income tax law" under conditions of great national need.⁶ In January, 1908, he predicted in an address that the country would some day resort to the income tax as a revenue measure. Finally, when he formally accepted the Republican presidential nomination on July 28, 1908, he said that, contrary to the Democratic platform, he thought that an amendment to the Constitution for an income tax was not necessary. "I believe that an income tax, when the protective system of customs and the internal revenue tax shall not furnish income enough for governmental needs, can and should be devised which, under the decisions of the Supreme Court, will conform to the Constitution."⁷

These declarations of Taft for the income tax seemed to have been inspired in part by sincere feelings on the subject, but mainly with a view to "stealing Bryan's thunder." Bryan attempted in a speech at Des Moines on August 21, 1908, to prove that Taft and his supporters were obligated to support the adoption of an income tax amendment since it seemed improbable that Congress could circumvent the Supreme Court's objections to an income tax.⁸ Once the election was won, Taft made no reference to the income tax either in his inaugural address or in his brief message to the special session of Congress he sent on March 16, 1909. In his inaugural address he expressed his determination to continue and to make enduring the reforms begun by Roosevelt, especially those directed "to the suppression of the lawlessness and abuses of power of the great combinations of capital" invested in railroads and interstate business enterprises. He stressed the revision of the tariff as a matter of the most pressing importance and then suggested if new taxes were needed, "a graduated inheritance tax as correct in principle and as certain and easy of collection."⁹ He evidently considered this more practical and safe than an income tax, despite his former professions.

⁶ Cincinnati *Times Star*, August 21, 1907; *Cong. Record*, 61st Cong., 1st Sess., 44: 487. This important speech seems not to have been noticed by any previous writer.

⁷ *New York Times*, July 29, 1908.

⁸ *New International Yearbook*, 1908, 588.

⁹ *Cong. Record*, 44: 2-5.

The 1909 Congressional Tax Battle

On March 17, 1909, Sereno Payne, Chairman of the House Ways and Means Committee, introduced his tariff bill to the House. Based on extended hearings since December, 1908, it was frankly protectionist, yet made significant, although not revolutionary, reductions, which to its friends, but not to the Democrats, indicated the desire to bring about some real revision. The bill gave increased protection to mercerized fabrics, women's gloves, hosiery, plate glass, and fruits competing with California's. New duties were imposed on tea and crude cocoa, solely to provide revenue. On the other hand the bill put on the free list wood pulp, hides, petroleum and its products, iron ore, and raw flax. The duties on lumber, iron and steel, and a few manufactured products were cut in half. Reciprocal free trade between the United States and the Philippine Islands was provided, with a limitation, however, on the admission of duty-free Philippine sugar and tobacco. An important change in tariff policy was the introduction of the provision for minimum and maximum rates of duty. The former, which were the stipulated rates of the tariff schedules, were to apply to imports coming from all countries not discriminating in their tariffs in any way against the products of the United States. The maximum rates, fixed as a rule 20 per cent higher than the minimum rates, or 20 per cent, ad valorem in the case of articles on the free list, were to apply against all countries practicing such discrimination. One consequence of this provision was that all existing reciprocity conventions, except that with Cuba, were to be ended.¹⁰

Despite active debate and a strong effort by interested Congressmen to retain duties placed on the proposed extension of the free list or to win reductions on wood pulp, print paper, and lumber, no great changes were made in the original bill. The most important changes were: putting coffee and tea on the free list in compliance with Taft's expressed wish, reducing the duty on cocoa, making petroleum and its products duty free despite the pressure of Standard Oil interests, and reducing the duty on lumber by one half. More drastic downward revision was not secured, partly because certain southern Democrats desiring protection for southern products were willing to compromise with

¹⁰ For detailed analysis of the 1909 Tariff Act and its background, see Ashley, *Modern Tariff History*, 224-51; Hechler, *op. cit.*, 11-145; Claude G. Bowers, *Beveridge in the Progressive Era* (Boston, 1932), 298-366; Pringle, *Taft*, 418-69; Sullivan, *Our Times*, 4: 348-72; F. W. Taussig, *Free Trade, the Tariff and Reciprocity*, 48-94, 134-79, and *Tariff History*, 361-408; Stephenson, *Nelson W. Aldrich*, 341-61, 477-83.

the representatives of other interests, and partly because Taft lacked the detailed knowledge and the willingness to use patronage as a club to force through the revisions needed.

A radical break with Republican peacetime tax policy was the introduction of a federal inheritance tax by Payne, who had played a leading role in having the Spanish-American War inheritance tax repealed in 1902. Evidently the threatened deficit of \$100 million for the fiscal year of 1909 forced even those who had been most ardent in opposing a peacetime resort to the inheritance tax to abandon their prejudices, at least under the pressure of the 1907 panic's fiscal effects and Taft's inaugural recommendation. Payne's measure was modeled on the New York State inheritance tax law and provided for duties ranging from 1 per cent to 5 per cent according to the size of the bequest and the relation of the heir to the decedents. He estimated that the new tax would bring in \$20 million more revenue and affirmed that it was a fair tax, easy to pay and to collect, and did not interfere unduly with the thirty-three states using inheritance taxes for their own needs. He dismissed the alternative proposal for a tax on net earnings of corporations because his committee felt that the 1907 panic had put many of the corporations into a pretty precarious position. He failed to mention, however, that several such proposals had been submitted to the Ways and Means Committee by George W. Wickersham, the Attorney-General, on behalf of Taft. Nor did Payne show any enthusiasm for an income tax, which he maintained was unconstitutional and a stimulus to "perjury and fraud unlimited."¹¹

Democratic Attacks on the Payne Bill

The mildness of the Republican tariff revision and tax reform measures led many of the Democrats to a strong attack on their opponents' position. From the date of the Supreme Court's nullification of the 1894 income tax down to 1909, a long line of southern and western Congressmen and Senators had introduced income tax bills and constitutional amendments. They were defeated by the strong control of the conservative Republicans in both the Senate and the House. In 1909 a split within the Republican party between the Insurgents and the Standpatters weakened the power of Aldrich in the Senate and Uncle Joe Cannon in the House and enabled the champions of the income tax in both parties to achieve some success. Cannon's dictatorial powers as

¹¹ *Cong. Record*, 44: 139-42, 194-97; 4003, 4717. Taft's position was revealed *op. cit.*

Speaker of the House, however, were modified only to a small degree in March, 1909, owing to his success in intrigue and manipulation, but were overthrown completely the following year, through the skillful leadership of George Norris and his associates.

Hence the speeches in favor of an income tax by Cordell Hull of Tennessee, Ollie M. James of Kentucky, Frederick C. Stevens of Minnesota, and other Progressive Democrats and Republicans were valuable as expressions of public sentiment on the question and as a means of converting the more liberal members of the House to future action on the matter. Undoubtedly the most powerful speech in favor of the immediate adoption of an income tax act was that delivered by Cordell Hull on March 29. He approved of the inheritance tax principle, but preferred an income tax because it infringed less on the revenue sources of states and because the taxation of incomes was "the fairest, the most equitable system of taxation that has yet been devised." He therefore proposed that Congress re-enact the 1894 income tax law except for the tax on state and municipal bonds, in spite of the 1895 income tax decisions. He felt that an income tax amendment to the Constitution was impractical because a minority of 3 per cent of the people could prevent its adoption, and that imposing an income tax by the rule of apportionment was so unjust as to be unfeasible. Congress's imperative duty consequently was "to invoke every remedy at its command for the restoration" of its lost taxing power and to secure a review by the Supreme Court of the questions erroneously decided. His peroration ended with an appeal to tax wealth not poverty, and to end the "infamous system of class legislation" imposing the major burden of federal taxation on the American people through the protective tariff while "virtually exempting the Carnegies, the Vanderbilts, the Morgans, and the Rockefellers, with their aggregated billions of hoarded wealth."¹²

Cordell Hull, destined to be Secretary of State under Franklin D. Roosevelt in one of the most critical periods of world history, was then at the beginning of his long and distinguished career as Congressman and Senator. He was later to become famous as the author of the federal income tax system of 1913, the revised Income Tax Act of 1916, and the first Federal Estate Tax Act, passed also in 1916. In 1909 he was thirty-eight years of age and was beginning a second term as a Representative from Tennessee after having served two terms in the lower house of the state legislature in the eighteen-nineties, having

¹² *Cong. Record*, 44: 532-36. Other able speeches were delivered by A. Mitchell Palmer, later known as Wilson's Attorney-General, James H. Covington of Maryland, Charles L. Bartlett of Georgia, and William E. Tou Velle of Ohio.

fought in the Spanish-American War as a volunteer infantry captain, and having acted as judge of the fifth judicial circuit of Tennessee. Although he came from a family of moderately wealthy farmers and lumber people, he became thoroughly rooted in the Jeffersonian tradition and carried on the struggle for social justice as embodied in the Democratic program of William Jennings Bryan and Woodrow Wilson. He knew intimately Benton McMillin, who also came from Tennessee and had been primarily responsible for the 1894 income tax law. It was Hull's aim to make the tariff for revenue and income tax objectives of his party operate as instruments for increasing the national welfare, as he saw it.¹³

But all of Hull's ability and that of the other income tax champions in the House could not overcome the ironclad rule of Speaker Cannon. They were offered no opportunity to propose an income tax amendment to the Payne bill. Hence, on April 9, 1909, the Republican machine was able to have the Payne bill passed by a vote of 217 to 161 despite the omission of an income tax provision and the disapproval of the Insurgent Republicans and the Democrats concerning many of the tariff schedules. Champ Clark failed to influence the Insurgents to vote with the Democrats against the bill because his resolution to send the bill back to the Ways and Means Committee was framed on the lines of the Democratic platform of 1908. Since the Insurgents wanted a downward revision of the tariff, but along protectionist lines, they felt impelled to show their loyalty to the protectionist system by voting against the Democrats. The Insurgents were also influenced by their feeling that the Payne bill was more moderate than the extreme protectionism Senator Aldrich and his allies were advocating, and by their intense concentration on reform of the House rules.¹⁴

Although the *New York Times* criticized the Payne bill as worse than the McKinley bill and as adding new extortions to those practiced under the Dingley Act, President Taft felt that the Payne bill came as near to complying with the Republican promises as he could hope for and was a genuine effort in the right direction. If the unjustified in-

¹³ No adequate biography of Hull has been written as yet. See the sketches in *Biographical Directory of the American Congress, 1776-1927*, 1128; *Who's Who in America*; by Anon., *The New Dealers* (New York, 1934), 286-95; Hamilton Basso, "Judge Hull of Tennessee," *New Republic* (May 27, 1940), 102: 720-23; Walter Davenport, "Hull of the Hills," *Colliers* (May 4, 1940), 13ff. Hull's efforts in behalf of an income tax had begun in 1907. In 1909 income tax bills had been introduced in the House by Hull, Adam M. Byrd of Mississippi, and Morris Sheppard of Texas. Resolutions had been made by Ollie M. James of Kentucky, and Frederick C. Stevens. None of these measures ever came to a vote; all died in committee.

¹⁴ *Cong. Record*, 44: 1301; Hechler, *op. cit.*, 98-99.

crease in the duties on hosiery and gloves which Congressman Littauer, a New York manufacturer, had secured from Speaker Cannon in return for aid in getting him re-elected as Speaker in March, had been omitted, Taft would have felt glad to sign it. Robert La Follette, who had been elected to the United States Senate in January, 1905, urged Taft to send a message to Congress criticizing the Payne bill as a violation of the party pledges, but Taft refused because he disapproved of executive interference with Congressional legislation and evidently hoped that through the threat of a veto he would be able to force Aldrich to live up to the Republican campaign promises.¹⁵

Senate Tax Conservatism: The Aldrich Bill

While the House was debating the Payne bill, the Republican members of the Senate Finance Committee, headed by Nelson W. Aldrich, were conducting hearings and drafting their own tariff bill. On April 12 Senator Aldrich introduced a substitute measure, known as the Aldrich bill, which made far fewer concessions to the revisionist sentiment than the Payne bill had. Although the excessively high glove and hosiery duties imposed by the House had been cut, these reductions were more than counterbalanced by the replacement of iron ore, raw flax, and coal on the dutiable list, by the doubling of the duty on print paper, and by the increases in the duties on iron and steel goods, lead products, lumber, fruits, and silks. Numerous advances in the rates on cotton and wool were also made through disingenuous methods. The inheritance tax provision in the House bill was carefully deleted, despite Taft's sponsorship of it, because it threatened to encroach on the great fortunes for which Aldrich was the spokesman, especially those in eastern states where state inheritance tax laws already existed. Aldrich maintained that the rates contained in his bill were lower than those in the Payne bill or in the Dingley Act.¹⁶

Aldrich, a millionaire in his own right, allied to the Rockefeller family by marriage, had been the undisputed leader and dictator of the Senate since the eighteen-nineties. His philosophy was distinctly Hamiltonian and was based on a hierarchical conception of society, with a strong faith in the downward percolation of good fortune from the upper classes through all the others. His power over the other Republican Senators was due to his ability to raise campaign contributions

¹⁵ *Literary Digest* (April 17, 1909), 38: 635-36; Pringle, *Taft*, 2: 428ff.; *New York Times*, April 2, 1909.

¹⁶ *New York Times*, March 18, 24; April 12, 13, 1909.

from the powerful industrial, railroad, and banking interests in return for legislation favorable to them. His success in securing the kind of tariff bills he had desired in 1890, 1894, and 1897, as well as his influence in other financial and business legislation, led him to believe that he could force through the kind of high protective tariff he desired even though it went against the desires of the President, general public sentiment, and the will of a picked minority opposition.¹⁷

The Senate at this time consisted of fifty-nine Republicans and thirty-three Democrats. At least seventeen and probably twenty-three of these Senators were millionaires; all but two were Republicans. The list of reputed millionaire Senators, with their states and political affiliation (D—Democrat, R—Republican), was as follows: Nelson W. Aldrich (R.), R.I.; Jonathan Bourne, Jr. (R.), Ore.; Frank B. Brandegee (R.), Conn.; Morgan G. Bulkeley (R.), Conn.; Winthrop M. Crane (R.), Mass.; Chauncey M. Depew (R.), N.Y.; Henry A. Du Pont (R.), Del.; Stephen B. Elkins (R.), W. Va.; Simon Guggenheim (R.), Col.; Eugene Hale (R.), Me.; John Kean (R.), N.J.; Henry Cabot Lodge (R.), Mass.; Francis G. Newlands (D.), Nev.; George T. Oliver (R.), Penn.; George C. Perkins (R.), Cal.; Isidor Rayner (D.), Md.; Nathan B. Scott (R.), W. Va.; Harry A. Richardson (R.), Del.; Elihu Root (R.), N.Y.; Reed Smoot (R.), Utah; Isaac Stephenson (R.), Wis.; Francis E. Warren (R.), Wy.; and George P. Wetmore (R.), R.I. Nearly all these Senators were staunch conservatives although a few voted for liberal legislation on various occasions. Nearly three fourths of them came from the industrial Northeast; many of them held key positions on the most powerful Senate committees. The Senate Finances Committee, which had charge of all tariff and tax bills, had Aldrich as its chairman and Lodge and Smoot as two of its most active members.¹⁸

Many of the other Senators, though not millionaires, were regarded by radicals as the active or passive agents of the "moneyed interests." In this group were included Joseph W. Bailey (D.), Tex.; Shelby M. Cullom (R.), Ill.; William P. Fry (R.), Me.; Thomas S. Martin (D.), Va.; Knute Nelson (R.), Minn.; and William J. Stone (D.),

¹⁷ D. G. Phillips, "The Treason of the Senate," *Cosmopolitan Magazine* (April, 1906), 40: 628-38; Stephenson, *Aldrich*, 341-61.

¹⁸ N.Y. *World Almanac*, 1902, 135-46; *Tribune Almanac*, 1910, 72-74; Harvey O'Connor, *The Guggenheims* (New York, 1937), 246-47; Lundberg, *op. cit.*, 97-105. The millionaire Congressmen were John Gill, Jr. (D.), Maryland, Nicholas Longworth (R.), Ohio. According to Henry Cabot Lodge, *Correspondence of Theodore Roosevelt and Henry Cabot Lodge* (New York, 1925), 2: 334, the hard work on the Aldrich bill was done by Aldrich, Smoot, Lodge, and Boies Penrose, Pennsylvania.

Mo.¹⁹ But the control of Aldrich over the Senate was threatened and weakened in 1909 by the fact that three of his associates—William B. Allison of Iowa, Orville H. Platt of Connecticut, and John C. Spooner of Wisconsin, as well as Joseph B. Foraker of Ohio—had left the Senate through death and voluntary retirement, and by the emergence of a powerful Insurgent Republican opposition.

The Republican Insurgents

Robert M. La Follette, after an extraordinarily brilliant and successful career as a Progressive Governor of Wisconsin, had entered the Senate in January, 1906, with the determination to battle against special privilege in behalf of the common people throughout the nation as he had done in Wisconsin. To him, as to John Dewey and Justice Brandeis, democracy was and is "a way of personal life controlled not merely by faith in human nature in general but by faith . . . in the capacity of the intelligence of the common man to respond with common sense to the free play of facts and ideas which are secured by effective guarantees of free inquiry, free assembly, and free communication."²⁰ But all of La Follette's genius for getting down to the grass roots of problems, and presenting incisive analyses and solutions in clear and telling fashion, and all his courage in facing the sternest opposition were not sufficient to overcome the conservatives' stranglehold on legislation until he was joined in 1909 by a group of sturdy supporters. Such new and progressive Senators from the Middle West as Joseph L. Bristow of Kansas, Albert C. Cummins, former Governor of Iowa, with William F. Borah of Idaho, Jonathan Bourne of Oregon, and Joseph M. Dixon of Montana, and such established but newly converted Senators as Jonathan P. Dolliver of Iowa, Moses E. Clapp of Minnesota, and Albert J. Beveridge of Indiana furnished La Follette the shock troops he needed for the assault upon the entrenched position of the big business interests. The Insurgents were not able to win all or many of the drastic modifications in the Aldrich bill they desired, but with the assistance of the Democrats they were able to expose the invalidity and injustice of whole sections of the bill and to secure certain victories on important points.²¹

¹⁹ D. G. Phillips, *op. cit.*, 40: 487-502, 628-38; 41: 3-12, 123-32, 267-76, 368-77, 525-35, 627-36; 42: 77-84. These articles present important facts on pressure politics which have not been fully exploited by historians.

²⁰ John Dewey, "Creative Democracy—The Task Before Us," in S. Ratner, Ed., *The Philosopher of the Common Man*, 224.

²¹ Bowers, *op. cit.*, 313-32; Hechler, *op. cit.*, 83-91; Robert M. La Follette, *Autobiography* (Madison, Wisconsin, 1918), 370-475.

The Insurgents divided the tariff schedule among themselves so that each could become a master of the duties on such important commodities as cotton, metal, sugar, and oil. They felt that they were working in harmony with Taft's desire to have the tariff revised downward. None of them were classical free traders, but all were interested in cutting down the cost of living, especially for their farming constituencies. They wished to combat the growth of big business as fostered by the protective tariff and to readjust the burden of taxation so that it fell more on those best able to pay. The Insurgents felt that protection was necessary to develop American resources and to protect American wages against cutthroat competition from abroad, but argued that excessive profits on manufactured goods should be cut through reduced tariff duties. They also maintained that oil, coal, lumber, iron, lead, and lead ore should be put on the free list so as to preserve American natural resources. Finally they objected to the lowering of the tariff on raw materials which aided the trusts in securing larger profits, but at the expense of the American producer of those materials.

The position of Aldrich was completely opposed to that of the Insurgents. He brazenly denied that the Republicans had ever promised to revise the tariff downward and dismissed the claims of the consumers with the remark: "Is there any class except the very limited one that consumes but does not produce? And why are they entitled to any greater consideration?" The consequence of the conflict in economic theory and interest between the Insurgents from the agrarian Middle West and the standpat Republicans from the industrial Northeast was one of the most dramatic and intense parliamentary debates staged in American history. The struggle which began on April 22 continued until July 8, when the Senate passed the tariff bill by vote of 45 to 34. But ten Insurgent Republicans defied Aldrich's attempt to force them to uphold his bill by the threat of reading the Insurgents out of the Republican party.²² The Insurgents had not been able to effect any important changes in the tariff schedules, but their great achievement was "a clean-cut, straightaway undeviating fight for principle," which won public admiration and led to the upsurge of the Progressive Movement in 1912. They had clarified the issues between the Progressive and Standpat Republicans beyond any possibility of popular confusion or obfuscation.²³

²² These rebels from the Middle West were Beveridge of Indiana, Bristow of Kansas, Brown and Burkett of Nebraska, Clapp and Nelson of Minnesota, Crawford of South Dakota, Cummins and Dolliver of Iowa, and La Follette of Wisconsin. *Cong. Record*, 44: 4316. See Horace M. Kallen, *The Decline and Rise of the Consumer* (New York, 1936), for a penetrating critique of the exaltation of the producer per se.

²³ La Follette, *op. cit.*, 446-47.

Taft's Failure

The tariff bill with 847 Senate amendments went to a Conference Committee packed with high protectionists handpicked by Aldrich and Cannon, much to Taft's disappointment. Taft had refrained from any serious effort to influence the course of the tariff legislation during the long debates in Congress because of his belief that the President had no legal right to initiate legislation or intervene in Congressional legislative disputes. He also trusted unduly pledges of support from Aldrich and Cannon for the tariff revision he desired. When events revealed the insincerity of their pledges, Taft failed to force Congressional conformity to his wishes through his control of patronage. He encouraged the Insurgents early in the spring to fight for downward revision of the tariff, but by June he had become alienated from them owing to their unequivocating radicalism and highly charged personalities. Hence he was dependent upon either the threat of a veto or the pressure of his will upon the Conference Committee. He came to spurn the use of the veto because he believed that it would greatly injure the Republican party and prevent him from effecting future reforms by throwing him out with the Senate and House leaders. He also valued the provisions in the bill containing the corporation tax and tariff reductions for the Philippines.

The consequence was that Taft battled with the high protectionists on the Conference Committee between July 12 and 30 in an effort to have them disgorge part of their loot. He was particularly anxious to secure free iron ore, coal, oil, wool, and hides and lower duties on lumber, newsprint paper, gloves, and hosiery. He was successful in getting the committee to put hides on the free list despite the intense opposition of Senators from the grazing states. He browbeat Cannon and Aldrich into granting reductions in the rates on gloves, hosiery, and lumber by threatening to reconvene Congress immediately unless his minimum demands were met. This ultimatum effectively squelched Cannon's high-pressure and dictatorial tactics and efforts in behalf of the vested interests, especially those of Lucius N. Littauer, a New York glove manufacturer and Congressman, to whom Cannon was indebted for his re-election as Speaker and retention of his tyrannical power over the House that spring. Taft also had the satisfaction of having the Conference Committee reduce considerably the duties on coal, iron ore, pig iron, scrap iron and steel, steel ingots and rails, tin plate, leather, and shoes. Adherence to his free raw materials and cost of production principles would have required, however, that these items be

put on the free list, but the pressure from the domestic producers was too strong to be overcome completely.

When the Conference Report on the tariff bill was presented to the House by Sereno E. Payne, the Insurgents and the Democrats launched a fiery attack upon it, but the Cannon machine succeeded in getting the Conference Report approved on July 31 by the narrow vote of 195 to 183. In the Senate an even more scathing denunciation of the Payne-Aldrich tariff bill was made by the key Insurgents and Democrats. The culmination of the Democratic criticism was Bailey's prediction that this bill was the last license which would be granted to its beneficiaries "to rob and plunder industrious consumers." The high point of the Insurgent assault was Dolliver's assertion that the Insurgents did not propose "to become a party to a petty swindle of the American people." Aldrich attempted to vindicate his tariff creation as beneficial to American industry without being conducive to monopoly. He made a final plea for the support of all the Republicans, but, although the Senate approved the Conference Report on August 5 by a vote of 47 to 31, seven out of the ten Insurgent Republicans stood firm in their opposition.²⁴

The Payne-Aldrich Act

The tariff bill signed by Taft that same day made no essential change in the tariff system of the United States. The extremely high rate structure and intolerant attitude toward foreign trade embodied in the McKinley and Dingley Tariff Acts were preserved by the Payne-Aldrich Act. The abolition on the duty on hides was the one change of considerable importance. It was estimated that the 1909 law reduced rates in 584 instances affecting 20 per cent of the imports. On the other hand, rates were increased in 300 instances. La Follette maintained that the increases applied to over \$10 million of the annual imports and the decreases to only \$45,000. Champ Clark, the Democratic leader in the House, asserted that the average tariff increase over the 1897 Act was 1.7 per cent. These estimates were hotly challenged by the Standpat Republicans. Taft went so far as to say in a speech at Winona, Minnesota, on September 17, 1909, that: "On the whole, however, I am bound to say that I think the Payne bill is the best bill that the Republican party ever passed." This and other ill-advised

²⁴ *Cong. Record*, 44: 4755, 4928, 4946-49. Brown and Burkett of Nebraska and Crawford of South Dakota deserted the Insurgents and voted for the bill, in part because of Taft's persuasion, in part because of some of the Conference improvements secured by Taft.

statements by high protectionists created a sharp public reaction against the Republican party and led to a growth in the strength of the Insurgents and Democrats.

Although the Payne-Aldrich Act achieved no important downward revision, it was less aggressively protectionist than previous Republican tariffs and indicated a defensive attitude on the part of the protectionists. Congress abandoned the principle of reciprocity and adopted the maximum and minimum principle as a means of retaliating against countries discriminating against goods coming from the United States. But Taft was able by April 1, 1910, to declare that there was no undue discrimination against the United States and that the minimum rates, those set down in the tariff act, were to be universally applied. A group of experts, organized by Taft into a Tariff Board, was used to collect data on the cost of production at home and abroad in an effort to provide a scientific basis for carrying out the maximum and minimum clause. This board was another halfway concession to the Insurgents, who had desired a strong and independent Tariff Commission as an objective counteragent to and check on protectionist propaganda.²⁵

The Democratic-Insurgent Struggle for an Income Tax

The failure of the Insurgents to break through the protectionist tariff walls to any considerable degree was due to the fact that many of the Democrats, in some cases more than half, voted for protective tariffs on iron ore, lumber, and other southern products and thereby prevented defeat of the Aldrich machine on some, if not all, the items attacked by the Insurgents. The latter were able to compensate in part for their frustration on the tariff by the large measure of success they had in forcing through their income tax proposals. This success arose out of the co-operation of the Democrats, the pressure of public opinion, and the partial backing given by Taft. The first Senator to introduce an income tax measure as an amendment to the Aldrich bill was Joseph W. Bailey, the leading orator and constitutional authority on the Democratic side. Intellectually keen, physically impressive through his height and powerful build, gifted with a melodious voice, Bailey was unusually fitted to be one of the leading sponsors of the income tax at a time when the legislative cross-currents threatened to shipwreck any inexpertly guided proposal. He had begun his long Congressional career in 1891 as a fellow Representative of William Jennings Bryan,

²⁵ Hechler, *op. cit.*, 132-45; Pringle, *op. cit.*, 1: 436-58; Taussig, *op. cit.*, 377-408; U.S. Tariff Commission, *Dictionary of Tariff Information* (Washington, 1924), 756, 772-76.

had risen to be Democratic minority leader in the House by 1897, and had been one of the most influential Democratic Senators since 1901.

On the other hand, Bailey, though regarded as a liberal by many, had suffered from attacks launched by radicals, especially in 1906, who accused him of being an agent of the Standard Oil interests and a lieutenant of Nelson W. Aldrich on matters affecting corporate interests. As early as 1900 he had given his legal and political assistance to a Standard Oil subsidiary, the Waters-Pierce Company of Missouri, so that it could be readmitted to operations in Texas despite an anti-monopoly law. In return for this service Bailey was able to borrow \$3,300 from Henry Clay Pierce, the president of the Waters-Pierce Company in 1900 and \$1,700 more in 1901 on what Bailey understood to be Pierce's personal account, but which actually came from company funds. Moreover, Bailey had acted as an attorney for John H. Kirby, a Texas multimillionaire, lumber and oil king, and chief backer of the Texas Democratic machine, and was charged with securing huge Indian territory coal, timber, and oil grabs for Kirby and various private interests. Although ostensibly a supporter of the pure food bill of 1906, Bailey was said to have sabotaged it on the states' rights issue used so often by conservatives anxious to thwart federal control of business. Finally, Bailey had openly defied Bryan not only in 1896 but also in 1908 both for his populistic proposals and for his championship of free raw materials as a cardinal point in the Democratic tariff position. Bailey was the leading Democrat in the Senate to demand protection in the tariff on such southern products as wood pulp, print paper, lumber, and iron ore, but justified himself on the grounds that the manufacturer should not be given free raw materials without a corresponding reduction in the duties on manufactured products.²⁶

Despite his conservatism on many economic issues, Bailey had been an ardent champion of the income tax since 1897. When Cordell Hull became convinced of the impossibility of getting the House to adopt an income tax, in the spring of 1909, he persuaded Bailey to fight for the income tax in the Senate. Hull even presented Bailey with a valuable array of material on the operation of the income tax in all parts of the world, especially brought up to date for his convenience.²⁷ Bailey

²⁶ Sam Hanna Acheson, *Joe Bailey* (New York, 1932), 1-275, offers a sympathetic exposition and defense of Bailey's life down through 1909. D. G. Phillips, *op. cit.*, 41: 267-76, is an acid attack on Bailey's reputation; Allan Nevins, *Rockefeller*, 2: 507, 531, 568, 572-73, clears Bailey's reputation in part, but indicates that he was indiscreet and his actions, whatever his intentions, were beneficial to the Standard Oil Company.

²⁷ Roy G. and Gladys C. Blakey, *The Federal Income Tax* (New York, 1940), 29.

gladly undertook the task because it was in accord with his personal interests, the policy of the Democratic party, and widespread public sentiment. He was also influenced by the virulent attacks made upon him as an agent of the Standard Oil Trust, which had received wide public attention in 1906 during his campaign for re-election and in the fall of 1908. Perhaps these inspired him to vindicate his honor as a public servant by championing a measure directed against the colossal fortunes for which he was supposed to be a spokesman. Whatever his motives were—compensation for a guilt complex or a sincere desire for the social welfare—Bailey announced on April 1, 1909, that he would offer a general income tax amendment to the tariff bill and fulfilled his promise on April 15 with a proposal for a tax of 3 per cent on incomes over \$5,000; income from state, county, and municipal securities, however, was exempted because of the unanimous decision of the Supreme Court on that point in the income tax decisions of 1895. In all other respects his measure was the same as the 1894 law and was a direct challenge to the Supreme Court to reconsider the question. Bailey denied that his proposal came simply from a desire to tax prosperous people and asserted that the tax was recommended by its justice and its ability to raise at least \$60 million against the expected deficit of \$100 million.²⁸

On April 19 six of the Insurgent Republicans met at the home of Albert B. Cummins, who had been discussing and planning a graduated income tax for some time. They were inspired by Bailey's action to work out the details of Cummins's more radical proposal. Two days later Cummins introduced an income tax amendment to the Aldrich bill, which proposed a graduated tax on all incomes over \$5,000, with rates ranging from 2 per cent on incomes over \$5,000 to 6 per cent on incomes over \$100,000. Cummins, who had won a reputation as being the most militantly progressive state governor next to La Follette, had popularized the Iowa Idea of trust regulation, railroad control, and downward revision of tariff schedules favorable to the monopolies. Although not a great orator, he was a persuasive speaker and a very able debater owing to his mastery of logic and all the facts involved in the problems he discussed. Tall, handsome, endowed with courage, energy, intellectual power, and a capacity for handling men, he was amply qualified to act as the Insurgent spearhead for the income tax against the determined and shrewd opposition of Aldrich and his followers. Cummins explained that his measure differed from Bailey's in that his was based on the principle of progressive taxation and taxed

²⁸ *Cong. Record*, 44: 1351.

only individual incomes; and he was opposed to a direct tax on corporations as burdening stockholders, especially the small ones, as against the bondholders. Unlike Bailey, he justified the income tax as supplementing the revenue from a properly proportioned protective tariff instead of paving the way for a Democratic low tariff or tariff for revenue only. This speech was so effective that twenty-one Republicans signified their adherence to his proposal.²⁹

A week later Bailey delivered a powerful and eloquent address in defense of his income tax measure before a packed audience. His presentation of the arguments for his proposal—constitutional, fiscal, and social—was so pointed and so masterfully presented that, according to Cordell Hull, it stimulated the income tax movement throughout the country.³⁰ His culminating argument was that since the chief expense of the government was incurred in the protection of property and the maintenance of order for the benefit of the rich, Congress had the right to have the Supreme Court reconsider its 1895 decision “in behalf of justice to all the people and not to help the greedy rich escape the law’s just tribute.” Remarkable as Bailey’s speech was, it was equaled on May 3–4 by William E. Borah, then at the outset of his long and tumultuous career as Senator. Two years before he had attracted national attention by his powerful prosecution of Big Bill Heyward and other I.W.W. leaders for the alleged murder of ex-Governor Steunenberg of Idaho, who had broken the Coeur d’Alene strike of 1899 with great brutality. Years later he was to win praise from isolationists and bitter criticism from supporters of Woodrow Wilson for his position on the League of Nations and the World Court. Not as radical economically as La Follette or the other Insurgents, Borah was nevertheless critical of the Standpat Republicans and took a position of independent progressivism within the orbit of the Republican party. On the tariff issues he voted three quarters of the time with the Aldrich group because of strong pressure from the Idaho mining, lumber, and livestock interests and little co-operation from the eastern Republicans for exchange reductions. Nevertheless, on the income tax question Borah became, next to Bailey and Cummins, the outstanding Senatorial exponent of its merits. On May 3–4 Borah poured forth a flood of learning and cogent analysis to prove the economic necessity, social justice, and constitutionality

²⁹ *Cong. Record*, 44: 1420–28; Beveridge, *op. cit.*, 330–31; Hechler, *op. cit.*, 86–87, 146ff.

³⁰ *Cong. Record*, 44: 1533–42, 1558–66; Blakey, *op. cit.*, 30. Secretary Hull’s memorandum, as cited by Blakey, errs in attributing to Bailey’s April 15 speech the qualities and effects of his April 26–27 speech. See *Literary Digest* (April 24, 1909), 38: 677–79 for public opinion favorable to the income tax.

of the income tax. His ability, dignity, and power as an advocate won high and widespread praise, even from conservative Republicans like Elihu Root who had tried to refute Borah's contention that "the vast accumulated wealth of the country" was relieved of the great burden of taxation.³¹

A valiant effort to refute the persuasive arguments advanced by Bailey, Borah, and Cummins was made by George Sutherland two weeks later. Sutherland was an extremely conservative Senator from Utah, and a very able corporation lawyer. He was an ardent defender of the Republican party machine and of big business, and was to demonstrate on the Supreme Court between 1922 and 1937 the extreme limits to which he would go in trying to make his Hamiltonian philosophy prevail against the progressive tendencies of his day.³² He criticized the federal income tax bills as creating multiple taxation and then launched into an extended and slashing attack on their constitutionality. He used all the legal and historical rationalizations presented in 1895 in the income tax cases by Choate and Chief Justice Fuller to justify the Court's decision against the income tax. But he was unwilling to admit that the principle of *stare decisis*, which the Court had disregarded then, should be challenged in 1909; in fact, he asserted that the 1895 decision was proper and should be left undisturbed by Congress.³³ Chauncey Depew, a millionaire Senator from New York and chairman of the New York Central board of directors, supplemented Sutherland's speech by stating that unless "as in wartimes, there is an absolute necessity for an income tax, it is the most direct possible attack upon the protective system."³⁴

On May 18 the Insurgent Republicans and Democrats held a meeting at which they agreed on a compromise between the bills of Bailey and Cummins, although Bailey did not give up his right to present his own measure independently. Cummins was authorized to write the joint measure, which was to have a 2 or 3 per cent tax on corporation and individual incomes over \$5,000. This compromise was designed to prevent Aldrich from killing the income tax by securing an adverse

³¹ *Cong. Record*, 44: 1680-87, 1693-1702; Claudius O. Johnson, *Borah of Idaho* (New York, 1936), 73-134. A biography by a warm but not uncritical admirer. See *Literary Digest* (May 15, 1909), 38: 830-34, on the Borah-Root debate.

³² No adequate study of Sutherland has appeared as yet, but see the references to him in Alfred Lief, *Brandeis* (New York, 1936); Drew Pearson and Robert S. Allen, *The Nine Old Men* (Garden City, 1937), 198-206; Pringle, *Taft*, 2: 1050-58.

³³ *Cong. Record*, 44: 2080-96.

³⁴ *Ibid.*, 2103. For a devastating attack upon Depew as the "tool" of the Vanderbilt-Morgan-Rockefeller-Harrison interests, see D. G. Phillips, *op. cit.* (March, 1906), 40: 487-502.

vote from the conservative Republicans and Democrats on Cummins's graduated income tax proposal. Some time after this meeting Borah and Cummins called at the White House and informed Taft that they had "secured the assent of nineteen Republicans in addition to all of the Democrats to the proposition to pass a regular income tax exactly in the teeth of the decision of the Supreme Court in order to bring it up before the Supreme Court." Meanwhile Bailey pressed Aldrich for a Senate vote on his income tax amendment to the tariff bill despite Cummins's desire to have such a vote postponed until the tariff rates were definitely established. But on May 27 Aldrich very skillfully persuaded the Senate to postpone, by a vote of 50 to 33, consideration of the amendment until June 10. When the question came up again on June 11 Bailey presented his measure and Cummins offered the measure embodying the compromises he and Bailey had agreed upon. But this proposal for a 2 per cent tax on all net income of individuals and corporations over \$5,000 did not come to a vote because Aldrich won a second postponement by the Senate until June 18.³⁶

Conservative Strategy vs. Income Tax

The reason that Aldrich secured these successive postponements of a Senate vote on the income tax was his intense fear that such a vote from May 24 on would result in a victory for the Insurgents and the Democrats. On May 24 Aldrich, Winthrop M. Crane, and Henry Cabot Lodge, all three millionaire Senators, went to the White House and appealed to Taft to save them from defeat on the income tax issue. Aldrich had previously refused to accept Taft's proposal for a federal inheritance tax on the ground that it would be oppressive in view of the state inheritance taxes. Nor had he been agreeable to Taft's suggestion for a tax on the net income of corporations, as he feared such attacks would give an undesirable (from his point of view) degree of publicity to the business of all the corporations. Now Aldrich was forced to swallow his pride and admit that the corporation tax offered the only escape from the immediate enactment of an income tax law. He also knew that Taft had come to feel, contrary to the position he had taken while a presidential candidate in his July 28, 1908, speech, that an income tax amendment to the Constitution was necessary in order to spare the Supreme Court the painful dilemma of reversing its 1895 position or incurring unpopularity through a judicial veto of the

³⁶ *Cong. Record*, 44: 2443-57, 3135-38; *New York Times*, May 19, 1909; Pringle, *Taft*, 1: 434.

proposed income tax measure. Hence Aldrich consented to support the constitutional amendment as a means of pleasing Taft and of defeating the impending danger of an income tax law being passed that year. Aldrich, however, wanted a two-year limit to be placed on the corporation tax law, but Taft insisted upon the removal of this limitation as necessary to his winning over the support of the Insurgents. The next day Aldrich capitulated to Taft on this point. Taft at once asked his Attorney-General, George W. Wickersham, to draft a bill based on the outline submitted by Aldrich. This draft was later introduced into the Senate by Aldrich despite the habitual jealousy of the Senate Finance Committee concerning its legislative prerogatives as against the Executive.³⁶

Taft's Message vs. 1909 Income Tax Act

On June 16 Taft sent a message to Congress stressing the dangers to popular confidence in the Supreme Court which would arise if Congress were to enact a general income tax in the hope that the Court would reverse itself. He suggested the adoption of a joint resolution by two thirds of both Houses proposing to the states a federal income tax amendment to the Constitution. He also proposed a 2 per cent excise tax on the net incomes of all corporations except national banks, savings banks, and building and loan associations. This was to be a substitute for or an addition to the inheritance tax which had been passed by the House as part of the tariff bill.³⁷

The impact of Taft's message on the Insurgents and Democrats was like that of a stunning body blow delivered without warning. The radical Insurgents held a hurried meeting in Borah's rooms and decided to stand firm despite their dismay at the split in their ranks and the danger to the immediate enactment of an income tax. Borah and Bristow drafted a statement which was also signed by Cummins, La Follette, and Clapp and which asserted their determination to secure the adoption of the Bailey-Cummins amendment to the tariff bill. But their slender ranks had been thinned through underground work by Taft and Aldrich on Jonathan Bourne of Oregon, Norris Brown of Nebraska, Carter of Montana, and Curtis of Kansas. Taft had invited these Senators to the White House and had won them over by explaining how impossible it was to get the income tax amendment to the tariff

³⁶ Pringle, *op. cit.*, 1:433-36.

³⁷ William Howard Taft, *Presidential Addresses and State Papers* (New York, 1910), 166-69.

bill through Congress and how desirable it was to substitute the tax on corporation income. The message to Congress was designed to put behind these deserters of the Insurgent income tax plan the influence of the President and general public opinion.³⁸

The Democrats, led by Bailey, also held a conference and resolved to hold their position on the general income tax and to support their Insurgent allies. The reaction of the press to Taft's bombshell varied from warm approval by a few Republican newspapers to outright condemnation by such ultraconservative Republican papers as the *New York Commercial and Financial Chronicle* and the *Sun*. The Democratic and Independent press was either highly skeptical or actively hostile,³⁹ although on different grounds. The business interests of the country sent "an avalanche of corporation objectors" to Washington and deluged their Senators and Congressmen with denunciations of the corporation tax as discouraging private initiative, killing the profit motive, retarding business recovery from the 1907 panic, and sanctioning governmental prying into private business affairs. These businessmen did not realize that their political representatives and champions were outnumbered by the representatives of the hitherto politically ineffective masses and that the choice was between a general income tax or a corporation tax measure, and not between the corporation tax and no tax.⁴⁰

The Corporation Tax: Origin and Uses

On June 18 Bailey and Cummins resumed their fight for Senate approval of their income tax measure, but consented to Aldrich's request for postponement of a vote until after the completion of the tariff schedule. Aldrich announced that the Senate Finance Committee would then present a corporation tax amendment to the tariff bill. Elihu Root and Attorney-General Wickersham, with the aid of the committee and the Cabinet, drafted the measure, and on June 29 Aldrich had Bailey's amendment laid before the Senate, while Bailey was absent, so that he could put through the corporation tax as he desired. Henry Cabot Lodge first introduced an irrelevant tariff amendment to Bailey's measure; Aldrich then moved to amend Lodge's amendment by the substitution of a special excise tax of 2 per cent on the net incomes over \$5,000 of corporations. This complicated procedure put Bailey's in-

³⁸ Hechler, *op. cit.*, 149-51.

³⁹ *Literary Digest* (June 26, July 3, July 10, 1909), 38: 1085-86; 39: 1-2, 35.

⁴⁰ *Jacsup, Root*, 2: 230-31; *Stephenson, Aldrich*, 354-55.

come tax into the background and practically forestalled any amendment of Aldrich's proposal.⁴¹

The strategy and motivation behind the conservative Republicans' espousal of the corporation tax was laid bare with brutal frankness by Aldrich a short while before he had made his motion. He said during a Senate interchange: "I shall vote for a corporation tax as a means to defeat the income tax. . . . I am willing to accept a proposition of this kind for the purpose of avoiding what, to my mind, is a great evil and the imposition of a tax in time of peace when there is no emergency, a tax which is sure in the end to destroy the protective system."⁴² Other Republicans were less frank, and, like Frank P. Flint of California, justified the tax on other grounds. But these rationalizations were speedily punctured by Cummins and Borah. On June 29-30 Cummins laid down a steady barrage of arguments against the corporation tax and in favor of the income tax. He stressed the need for supplementary income created by the high protective tariff system and pointed out the injustice of taxing stockholders irrespective of the size of their income instead of levying a tax on all those with incomes over \$5,000. While defending the constitutionality of the income tax, he impugned that of the corporation tax on the ground that it discriminated between different classes of persons in a business since the tax left individuals and copartnerships untouched. He also charged the sponsors of the corporation tax and the income tax amendment to the Constitution with using them as "instruments to defeat the income tax provision" proposed by Bailey and himself.⁴³

Borah carried through the attack on the corporation tax begun by Cummins to its logical conclusion. On July 30 and July 1 he denounced the corporation tax as imposing another heavy burden on those already bearing an unjust and undue proportion of the burdens of government and cited noted Republican leaders as admitting in 1898 the transfer of the tax from the great corporations to the consumers. Then he uttered another powerful plea for the adoption of the Bailey-Cummins income tax measure despite the 1895 decisions. Like Cummins, he felt

⁴¹ *Cong. Record*, 44: 3484-88, 3935.

⁴² *Ibid.*, 3929. Taft was disturbed by this admission, as he felt it was "an effort on the part of the Rhode Islander to throw the odium of the (corporation) tax on the President." Archie Butt, *Taft and Roosevelt* (Garden City, 1930), 1: 133.

⁴³ *Cong. Record*, 44: 3954-85. Cummins expressed approval of the inheritance tax proposals of Senators Lincoln Dickson of Indiana and Robert L. Owen of Oklahoma on June 29. *Ibid.*, 3940-54. Cummins stated that his and Bailey's income tax measure included an inheritance tax.

that the proposers of the constitutional amendment were insincere in their advocacy and would fight for its defeat in the state legislatures. If successful in twelve states, the accumulated wealth of this country would have won its greatest victory in the history of representative government. His conclusion was a rebuttal of the epithets posing as arguments used against the income tax: socialism, class legislation, and an indictment of the great and powerful, the wealthy classes, for committing the "crimes of the century" and displaying contempt for law, disregard for the Constitution, and disrespect for our government. He urged the immediate adoption of an income tax law "not as an assault upon wealth, but as an assault upon the vicious principle of exemption of wealth."⁴⁴

It was fitting that the man who made the most effective attempt at a reply to Borah and Cummins was Elihu Root, one of the greatest corporation lawyers the United States has ever had. McKinley's Secretary of War and Theodore Roosevelt's Secretary of State, he had won a distinguished reputation as an administrator and statesman, and had been seriously considered, both by Roosevelt and conservatives, as the Republican presidential candidate in 1908. To liberals and radicals Root seemed an exceedingly able and therefore dangerous legal adviser, if not tool, of Wall Street, a legal Calvinist with his distrust of democracy and his faith in economic individualism and the *status quo*.⁴⁵ Yet he had the wisdom and sensitivity to see the need for certain minimum reforms if the vested interests he represented were not to create too much opposition and antagonism, and thus might justly be called a liberal-conservative.

On July 1, not long after Borah had ended his philippic against Aldrich and his corporation tax supporters, Root made an elaborate and, as events were to show, successful plea to the majority of the Senators to support the corporation tax as against the income tax. He invoked the prestige of Taft's active support for the corporation tax and boldly declared: "Gentlemen may say that I am for the corporation tax to beat the income tax. I care not. I am for the corporation tax

⁴⁴ *Ibid.*, 3985-4000.

⁴⁵ Morris R. Cohen, *Law and the Social Order*, 12-18, is a brilliant critique of Root's social philosophy. Jessup, *Root*, offers the best scholarly and sympathetic portrait of Root. Taft maintained that he and Root were the most progressive members of Roosevelt's last Cabinet "and the two who usually aided and abetted President Roosevelt in what were called his radical policies." Butt, *op. cit.*, 1: 128. This judgment, however, cannot be taken as establishing either Taft or Root as a thoroughgoing liberal.

because I think it is better policy, better patriotism, higher wisdom than the general income tax at this time and under these circumstances." He then proceeded to play on the fears of conservatives that the passage of an income tax law would force the Court to reverse itself or to yield, and in either case to lose its honor. To liberals he appealed on the ground that Bailey and Cummins failed to discriminate between earned and unearned incomes and therefore were harsh on the laboring classes. The \$5,000 exemption he considered an act of class and sectional discrimination of the western and southern poorer classes against eastern capitalists. He asserted that the general income tax as a whole threatened to be a substitute for the protective tariff system, whereas the corporation tax was a mild and temporary supplement; moreover, the corporation tax not only exempted the workers and landowners, and taxed "possessors of the stored-up wealth of the country" invested in corporations, but also provided through its publicity features the factual basis for a sound revision of the tariff.⁴⁶

The next day Cummins attempted to counteract the rhetorical effectiveness of Root's invocation of conservative and liberal sentiments against different features of the income tax. Cummins denied that any harm would come to the United States if a new income tax case were to go before the Court. He explained that the income tax was based on taxing wealth where it could be found and not on any sectional bias. His and Bailey's failure to discriminate between earned and unearned incomes and to use the principle of progressive taxation was due to the objection voiced by various Senators that such provisions were socialistic. Finally, Cummins hammered home the point that the corporation tax advocated and in large measure drafted by Root hit earned income by taxing enterprising stockholders and by exempting conservative bondholders, such as Morgan and Harriman, as well as holding companies.⁴⁷ Such exemptions meant that many opportunities existed for the ingenious wealthy to avoid the tax Root asserted was directed especially at them. But the logic and appeals to social welfare by Cummins, Borah, Bailey, and other proponents of the income tax failed to prevail against the subtle arguments and tactics of Aldrich and Root. That same day the Senate, by a vote of 59 to 11, agreed to substitute Aldrich's corporation tax amendment to the tariff bill for the income tax. On July 7 Bailey made a final effort to get his general income tax measure accepted, but was defeated by a vote of 47 to 28. The follow-

⁴⁶ *Cong. Record*, 44: 4002-07.

⁴⁷ *Ibid.*, 4036-41.

ing day the Senate passed the Aldrich tariff bill, with the corporation excise tax, by a vote of 45 to 34.⁴⁸

When the House received the tariff bill with 847 Senate amendments, it was extremely resentful of the arrogance of the Senate in practically writing a new bill and in supplanting the House inheritance tax with Aldrich's corporation tax. Sereno F. Payne, the main author of the House tariff bill, although bitterly opposed to the Senate revisions, persuaded the House on July 9 to give full powers to the Conference Committee of the Senate and House to mediate the differences between the two houses. But before he did so Charles F. Townsend, a Republican from Michigan, and three Democrats, Charles A. Bartlett of Georgia, Champ Clark of Missouri, and John J. Fitzgerald of New York, expressed the protest of the Democrats and the Insurgent Republicans against the corporation tax as an undesirable substitute for a general income tax. The Senate tax, they maintained, was deliberately designed to defeat the movement for an income tax.⁴⁹ Three weeks later Payne, in presenting the Conference Report, frankly admitted: "I have no use for an income tax, and what use I have for a corporation tax is the fact that you can sometimes get rid of an unconstitutional income tax appended to a bill." He boasted of helping to reduce the corporation tax from 2 to 1 per cent, and justified the Conference's elimination of the tax on the dividends of holding companies which Senator Clapp had forced Aldrich to accept temporarily.⁵⁰ This indiscreet confession was explained away, so far as he was able, by Nicholas Longworth, Theodore Roosevelt's son-in-law, a millionaire Congressman from Ohio, who had acted as Taft's personal agent in transmitting the presidential tax proposals to the House Ways and Means Committee. Longworth pretended that: "Far from being a legislative trick, designed to meet a particular condition in the Senate, or designed to beat any particular measure, this corporation tax is a well-considered plan, designed to go upon the statute books on account of the merit it has in it."⁵¹

This flimsy rationalization was exposed by Oscar W. Underwood of Alabama as the Republican subterfuge for defeating the Bailey-Cummins income tax. The corporation tax was objectionable because of

⁴⁸ *Ibid.*, 4066, 4228, 4316.

⁴⁹ *Ibid.*, 4364-84. The House vote on Payne's resolution was 178 to 152.

⁵⁰ *Ibid.*, 4690 (July 31, 1909).

⁵¹ *Ibid.*, 4717. See the *New York World Almanac*, 1902, 143, for the inclusion of Mrs. Nicholas Longworth in its list of American millionaires. On Longworth's connection with Taft, see *Cong. Record*, 4002.

its exemption of those who invested their money in bonds or in real estate. But his eloquence on this and the tariff changes failed to prevent the House from ratifying the Conference Report by a vote of 195 to 183.⁵² When this report reached the Senate, the Insurgents and Democrats centered their attack upon the tariff schedules since Aldrich's resolution to submit an income tax amendment to the Constitution to the states had been debated and disposed of on July 5. Hence, although the Insurgents and Democrats regarded the corporation tax as unsatisfactory because it did not go far enough, and the Conservative Republicans would have eliminated it during the Conference if they had dared defy Taft and risk open warfare in the Senate, neither group secured its removal. When the Senate approved the Payne-Aldrich tariff bill on August 5 by a vote of 47 to 31, the corporation tax passed its last serious barrier.⁵³

The Importance of the 1909 Corporation Tax

The significance of the enactment of the corporation excise tax section of the Payne-Aldrich Tariff Act is that it offered an escape for the conservative Republican leaders in Congress from the popular pressure for the immediate enactment of an income tax law. Taft, unlike Aldrich and the Old Guard Senators, could say: ⁵⁴

I prefer an income tax, but the truth is I am afraid of the discussion which will follow and the criticism which will ensue if there is another serious division in the Supreme Court on the subject of the income tax. Nothing has ever injured the prestige of the Supreme Court more than that last de-

⁵² *Ibid.*, 4725, 4755. Since there were 170 Democrats and 219 Republicans in the House, the negative vote of 183 indicated 13 Insurgent Republican votes on the side of the Democrats.

⁵³ *Ibid.*, 4949. Taft exerted considerable pressure on the ultraconservative members of the Conference Committee to keep them from double-crossing the Insurgents by removing the corporation tax after the Bailey-Cummins income tax measure had been defeated through the offer of the corporation tax. Hechler, *op. cit.*, 152-53. Roosevelt told Lodge in a letter on July 26, 1909. "I believe we should have a Federal Inheritance Tax, aimed only at the very large fortunes, which cannot be adequately reached by State Inheritance taxes, if they are sufficiently high and the graduation sufficiently marked. Offhand, it would seem to me that a tax on the net receipts on corporations would be the best way out of the Income Tax business." Henry Cabot Lodge, *Correspondence of Theodore Roosevelt and Henry Cabot Lodge* (New York, 1925), 2: 341-42. This indicated a temporary reversal on Roosevelt's part to a halfway position between conservatism and liberalism on tax issues.

⁵⁴ Butt, *op. cit.*, 1: 134. Yet two years later Taft told a journalist that he did not favor levying a general income tax "except in an emergency like war," although he believed in the principle of the tax. F. E. Leupp, "President Taft's Own View," *Outlook* (December 2, 1911), 99: 816.

cision, and I think that many of the most violent advocates of the income tax will be glad of the substitution [of the corporation tax] in their hearts for the same reason. I am going to push the Constitutional Amendment, which will admit an income tax without question, but I am afraid of it without such an amendment.

But to the Insurgents and the Democrats the corporation tax seemed a mess of pottage compared to the income tax law from whose passage they felt cheated. On the other hand, the extreme conservatives in Congress felt chagrined at having to retreat from their defiant stand against all peacetime taxation of the high income groups. Their hope was for a speedy repeal of the corporation tax and a defeat for the proposed constitutional amendment.

Prior to 1909 corporate profits had been entirely free of federal taxation except during the Civil War period. The 1894 Income Tax Act contained provisions applicable to corporations, but these were rendered inoperative by the Supreme Court's decision in 1895. The Spanish-American War stimulated suggestions for a tax on the gross earnings of corporations, but this was defeated and a substitute tax of one fourth of 1 per cent on the gross receipts over \$250,000 of all persons, firms, corporations, and companies engaged in the business of refining petroleum or sugar had been passed. When its constitutionality was questioned on the basis of the 1895 income tax decisions, the Supreme Court upheld the tax as a special excise tax, not coming within the scope of the 1895 decision.⁵⁵ The 1909 Corporation Tax Law was drawn with special reference to bringing it within the protective coloration of that decision. The Act ⁵⁶ provided that every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares, and every insurance company should be subject to pay annually a special excise tax with respect to carrying on or doing business. This tax was to be 1 per cent of the entire net income over \$5,000 received from all sources, exclusive of amounts received as dividends from other corporations subject to the tax. Exemption was granted to such nonprofit organizations as labor and agricultural organizations, fraternal beneficiary societies, domestic building and loan associations organized exclusively for the benefit of their members, and religious, charitable, and educational organizations, "no part of the net income of which inures to the benefit of any private stockholder or individual."

Net income was to be ascertained by deducting from the gross in-

⁵⁵ *Spreckles Sugar Refining Co. v. McClain*, 192 U.S. 397.

⁵⁶ Act of August 5, 1909, 36 U.S. Stat. at Large, 112.

come all the ordinary and necessary operating expenses, all losses actually sustained within the year and not compensated by insurance or otherwise, interest actually paid within the year on bonded or other indebtedness to an amount "not exceeding the paid-up capital stock . . . outstanding at the close of the year," taxes of the United States or of every state, territory, or foreign country, and dividends from stock of corporations subject to the tax. The net income of foreign corporations doing business in the United States was to be determined by deducting from the gross income received from business transacted and capital invested in the United States all the expenses incurred in the United States which were deductible for domestic corporations.

Each taxable corporation was required to file a return by March 1 of each year and to give information concerning the status on the preceding December 31 of: the total amount of paid-up capital stock outstanding; the amount of bonded debt; the gross income; the total amount of all ordinary and necessary expenses; the total amount of all losses, the amount allowed for depreciation, the sums, in the case of insurance companies, other than dividends paid within the year on policy and annuity contracts; the interest paid on debt and, in the case of banks, the interest paid on deposits; taxes, with the amount paid to foreign governments shown separately; and the net income, calculated through the authorized deductions. Corporations were to be notified of the amount of tax due on or before June 1.⁵⁷

Business Pressure vs. Corporation Tax

Mild as the corporation tax of 1909 was, large and powerful groups of businessmen objected violently both to the imposition of the tax on corporate profits and to the publicity features of the Act. Taft's Secretary of the Treasury, Franklin MacVeagh, informed Taft about

⁵⁷ The penalty for making false or fraudulent returns was fixed at 100 per cent of the tax; for refusal or neglect to make a return, at 50 per cent of the tax due; for failure to pay the tax on time, at 5 per cent of the amount of the tax unpaid and interest at the rate of 1 per cent a month from the time the tax was due. If a company refused or neglected to make a return or made a false return, it was liable to a penalty of not less than \$1,000 and not more than \$10,000. The returns were to be filed in the office of the Commissioner of Internal Revenue and were to constitute public records and be open to inspection as such. This provision was amended in 1910 to read: "open to inspection only upon the order of the President" under rules prescribed by the Treasury and approved by the President. The Commissioner of Internal Revenue was given the power to require delinquent corporations to file returns and to examine their books and papers for the purpose of ascertaining the correctness of the returns or of making a return where none had been made; he also had the right to require the attendance of any officer or employee and to invoke the aid of any court.

wide discontent, especially from small corporations concerning the publicity on their income and the sources from which it was derived. MacVeagh said that if he were involved he would do all he could "to evade the law."⁵⁸ But Taft stood firm on that issue for a time, although he allowed some restrictions on the public inspection of the tax returns to be enacted in 1910. The amazing statement made by MacVeagh as a responsible government official was surpassed by the campaign of invective against the tax released by businessmen. "Writhing under the sting of the corporation tax law which has been saddled upon the corporations of this country by the Washington administration," the businessmen started a campaign against the measure and attacked it at every point where a foothold could be obtained. They made demands on the President and Congress that the law be repealed and started suits in every section of the country attacking the constitutionality of the tax. A conference was held at Chicago in January, 1910, as "the first gun for a national movement which has in view the uniting of all" interested in securing these objectives.⁵⁹

The Court Upholds Congress

These statements were not idle threats. Fifteen different suits by insurance companies, public service corporations, real estate companies, and diverse commercial firms from states in the Northeast and North Central regions reached the United States Supreme Court early in 1910. All these corporation tax cases, the most noted of which was *Flint v. Stone Tracy Company*, were argued together on March 17 and 18, 1910, and, since the Court could not arrive at a decision, the cases were then reargued on January 17, 18, 19, 1911. A large and brilliant group of lawyers, among whom were such noted attorneys as William D. Guthrie, Frederic J. Stimson, and Frederic R. Coudert, presented every possible constitutional objection against the tax while two successive Solicitors-General, L. W. Bowers and Frederick W. Lehmann, made equally valiant defenses. On March 13, 1911, Justice Day handed down a unanimous decision by the Court that the corporation tax of 1909 was not a direct tax, but "an excise upon the particular privilege of doing business in a corporate capacity." As an excise, the corporation tax was properly measured by the entire income of the

⁵⁸ Butt, *op. cit.*, 1: 262-63.

⁵⁹ *Proceedings of Conference of Industrial and Commercial Organizations and Representatives of Corporations* held under the auspices of the Illinois Manufacturers' Association to secure the repeal of the Corporation Tax Law and to secure a decision as to its constitutionality (Chicago, January 14, 1910), 3.

parties subject to it, notwithstanding the fact that a part of this income might be derived from nontaxable property, such as municipal bonds and other property not directly or actively used in the corporate business.⁶⁰

Almost sixteen years before the Supreme Court had nullified the 1894 income tax law. The difference between the Court's position in 1895 and in 1911 Justice Day explained on the ground that the difference between the 1894 and 1909 Acts "is not merely nominal, but rests upon substantial differences between the mere ownership of property and the actual doing of business in a certain way." The tax on income from property he considered to have an "element of absolute and unavoidable demand" which makes it a tax on property merely because of its ownership. This element, however, he felt was lacking in taxes on privilege, because if no business was done in the manner prescribed in the statute no tax was payable.⁶¹ But astute critics of judicial rationalizations like Thomas Reed Powell pointed out the dialectical legerdemain by which a few words in a statute turned a tax on income into a tax on something else merely measured by income; they believed in it, nevertheless, "as the gentleman believed in baptism, because he had seen it done."⁶²

The importance of the Court's decision in *Flint v. Stone Tracy Company* lies in the fact that the Court in 1911 *willed* or *chose* to follow and use the precedents which would sustain the corporation tax instead of *willing*, as the Court in 1895 did, to disregard the available precedents and to use those categories which would invalidate a tax to which powerful business interests were opposed. The explanation for the Court's *volte-face* is to be found in two factors: the change of personnel within the Court between 1895 and 1911 and the change in public sentiment and the balance of political power. The entire country had become more sensitive and responsive to measures for advancing the social welfare, and the more intelligent conservatives, such as Taft and Root, realized the need for moderate social reforms to head off discontent which otherwise might have turned to radical and even revolutionary measures.

Although ultraconservatives on Wall Street and their press spokesmen regretted the liberalism of the Court,⁶³ Taft and his followers

⁶⁰ *Flint v. Stone Tracy Co.*, 220 U.S. 107.

⁶¹ *Ibid.*, 150, 152.

⁶² Robert M. Haig, Ed., *The Federal Income Tax* (New York, 1921), 54.

⁶³ *Literary Digest* (February 19, 1910; March 2, 5, 1911), 40: 333; 42: 559. See *Readers' Guide to Periodical Literature*, 2: 2194-95; 3: 619, for the numerous articles on the taxation of corporations which appeared between 1909 and 1913.

were pleased. The corporation tax, despite an inadequate staff in the Bureau of Internal Revenue and the need for creating a new tax apparatus, proved to be productive as a revenue measure. The revenue it yielded increased from almost \$21 million in 1909 to \$35 million in 1912. Its total yield for the four years, 1909-12 and the two months of January and February, 1913, of its operation was almost \$129 million.⁶⁴

⁶⁴ U.S. Treasury, *Statistics of Income* (1920), 29; *Report of the Commissioner of Internal Revenue* (1914), 19. See C. J. Hynning, *Taxation of Corporate Enterprise*, T.N.E.C. Monograph No. 9, 76th Cong., 3d Sess. (Washington, 1941), 21 ff., 149.

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The Struggle Over the Income Tax Amendment

THE strength of the movement for the immediate enactment of an income tax law in the spring of 1909 had led Taft and Aldrich to propose both a corporation tax and an income tax amendment to the Constitution; these could extricate the conservative Republicans from the dilemma of accepting defeat or acquiescing in the Bailey-Cummins income tax proposal. Resolutions for income tax amendments to the Constitution had been introduced into the Senate that session on March 25, 1909, by Thomas P. Gore, a Democrat from Oklahoma, and on April 28 and June 11 by Norris Brown, a halfway Insurgent from Nebraska. But the Senate Finance Committee buried these suggestions, as they had all previous ones since 1895. Taft's double-barreled message to Congress on June 16 provided the Republicans who were committed to an income tax by pressure from their constituents with "a greased plank for them to slide on." By supporting the corporation tax and the constitutional amendment, they could pose in the 1910 election campaigns as spokesmen for the common people and at the same time, by not voting the Bailey-Cummins measure, they could avoid losing the backing of Aldrich and the conservative national Republican machine.¹

When Taft's message was read in the Senate, Thomas P. Gore seized the opportunity to ask that the Senate Finance Committee report on or before June 18 a constitutional amendment in accordance with Taft's recommendation. But this motion was speedily tabled. On June 17

¹ *Cong. Record*, 44: 263, 1568-70, 3138; *New York Tribune*, June 10, 1909. U.S. Department of Justice, *Taxation of Government Bondholders and Employees* (Washington, 1939), 134-90, offers the most detailed history of the proposal and ratification of the Sixteenth Amendment so far published. I am indebted to it for some valuable leads and citations.

Norris Brown attempted to force the issue by introducing another resolution for a constitutional amendment, which read:

The Congress shall have power to lay and collect direct taxes on incomes without apportionment among the several States according to population.

Senator Anselm J. McLaurin of Mississippi suggested that instead of an addition to, a subtraction from the Constitution was what was needed. He wanted Brown to change his amendment so as to strike out the phrases "and direct taxes" and "or other direct" (tax) from the Constitution.² The difference between these proposals was that Brown's accepted the Court's ruling in the income tax cases of 1895 that a tax on income from invested capital constituted a direct tax, and merely abolished the rule of apportionment formerly laid down for that type of direct tax. Since the income tax would have remained a direct tax in the eyes of the Court, the source of all income would have continued to be open to constitutional challenge and the source of the income would still have been considered by the Court the object of the tax. The justification for the income tax given in 1895, that income is taxable irrespective of the source from which it is derived, would not have been written into the Constitution by Brown's amendment.³

Brown's resolution was referred to the Senate Finance Committee after Brown rejected McLaurin's suggestion. The Committee amended the resolution offered by Brown by striking out the word "direct" preceding the word "taxes," and by adding the words "from whatever source derived" after the word "incomes." These crucially important and liberal changes were introduced by Senator Aldrich at the suggestion and the insistence of Senator Knute Nelson of Minnesota, a member of the Senate Judiciary Committee.⁴ Nelson, although a conservative and Standpat Republican with a long record of service in behalf of the vested interests, especially the railroads, seems to have become responsive to the progressive upsurge in Minnesota which had put into the governorship an outstanding Democratic liberal, John Johnson.⁵ Hence Nelson had taken a firm stand against the excessive

² These phrases occurred in Art. I, Sec. 2, Cl. 3 and Art. I, Sec. 9, Cl. 2. These stated: "Representatives and direct taxes shall be apportioned among the several States" and "No capitation or other direct tax shall be laid . . ."

³ *Cong. Record*, 44:3345-47, 3377.

⁴ Harry Hubbard, "From Whatever Source Derived," *Journal of American Bar Association* (December, 1920), 6:202-03.

⁵ La Follette, *Autobiography*, 386, 447-52; Phillips, "Treason of the Senate," *op. cit.* (October, 1906), 41:634-35.

increases in the Aldrich tariff bill and was to be one of the seven Republicans who dared to defy Aldrich by voting against his bill both on July 8 and August 5, 1909. Nelson had also supported the Bailey and Cummins income tax amendments to the tariff bill. Perhaps he was induced by his colleague, Moses F. Clapp, to aid the liberal cause by using his influence with Aldrich. But why Aldrich should have acceded to this request is difficult to explain except on the supposition that he thought at this time that granting Nelson's demand might swing some of the Insurgents to support the tariff bill. Aldrich also might have been motivated by the expectation that the constitutional amendment would be defeated in the state legislatures anyway and may have therefore felt that these alterations would be of no consequence in the long run.⁶

Aldrich's Proposal for a Constitutional Amendment

On June 28, one day before he introduced his corporation tax measure as a substitute for Bailey's income tax proposal, Aldrich reported to the Senate the Finance Committee's resolution:

Article XVI. The Congress shall have power to lay and collect taxes on incomes, from whatever sources derived, without apportionment among the several States and without regard to any census or enumeration.

Aldrich expressed the hope that the Senate would approve of this constitutional amendment without debate before discussing the Bailey-Cummins income tax measure. But this maneuver was forestalled by Senator Tillman of South Carolina, and Aldrich's resolution was ordered to be printed and to lie on the table.⁷ The next day Bailey and Cummins renewed their fight for Senate approval of the income tax amendment to the tariff bill. Concentration on the tariff schedules then intervened until June 29. On that day Norris Brown suggested that the Senate consider the Finance Committee's constitutional amendment, but Bailey objected. Later that day, during Bailey's absence, Aldrich put through in an underhand fashion his corporation tax measure as a substitute for Bailey's income tax provision. Then Cummins and Borah made their magnificent pleas for the enactment of the Bailey-Cummins income tax proposal as against Aldrich's constitutional amendment and corporation tax. The two felt that the constitutional amendment sponsored by Aldrich was simply one of the instruments

⁶ Stephenson, *Aldrich*, 353-61, is silent on most of the important secret history of the Sixteenth Amendment, yet offers some useful clues.

⁷ *Cong. Record*, 44: 3900.

devised by the conservatives to defeat not only the Bailey-Cummins measure, but all future income tax bills. They were sure that the proposers of the constitutional amendment would fight against its ratification in the state legislatures. If the enemies of the income tax won twelve states against the amendment, they would not only have killed the amendment, but, by distorting the meaning of the defeat, would have prevented Congress from considering the passage of any income tax law out of fear of judicial veto.⁸

Unfortunately, from the progressive point of view, Elihu Root's ingenious and persuasive attack on the constitutionality of the Bailey-Cummins income tax provision, and his defense of the corporation tax on July 1, furnished the rationalizations needed by wavering Senators to disregard Cummins's and Bailey's rebuttals and to desert the radical income tax position of the Insurgents and Democrats. On July 2 the Senate approved of Aldrich's corporation tax amendment to the tariff bill as a substitute for the income tax provision. The following day Norris Brown again asked for unanimous consent for an immediate vote on the Finance Committee's constitutional amendment. Aldrich had no objection to this request, provided there was no discussion or the discussion was limited. But McLaurin objected on the ground that a constitutional amendment, even if ratified, would defer the enactment of an income tax law. He also suggested his "direct tax" alteration in the Constitution as preferable to the Committee's resolution.⁹

Congressional Approval

Hence the debate and final action on Aldrich's constitutional amendment took place on July 5. Bailey said he would vote for the amendment "with reluctance, because I do not think it necessary and I know the submission of it [to the state legislatures] is fraught with extreme danger." To lessen this danger he proposed unsuccessfully that the amendment be submitted to state conventions especially chosen for passing on the subject, rather than to the state legislatures which he feared might be too easily manipulated by the opponents of the income tax. Bailey also suggested that Congress be given the distinct and specific authority to graduate an income tax, as a precautionary measure against possible judicial invalidation of a progressive income tax law. When he saw that this proposal would be voted down on partisan grounds, he withdrew it in order not to warrant such an action by the

⁸ *Ibid.*, 3974, 3998-99.

⁹ *Ibid.*, 4067.

Supreme Court. McLaurin made an attempt to circumvent the income tax decisions through his "direct tax" amendment. Although this amendment would have affected solely the rule of apportionment, the Senate rejected it and chose Aldrich's amendment, which was a definite grant of substantive power to Congress. The final vote on the resolution of Aldrich was 77 to 0.¹⁰

On July 12, 1909, the House entered into an intense four-hour debate on the Senate resolution. Sereno E. Payne frankly stated his and the administration's utter opposition to the general policy of an income tax. Nevertheless, they desired the passage of the constitutional amendment on the ground that "if this Nation should ever be under the stress of a great war," they did not wish "this Nation to be left, without any opportunity to avail itself of every resource to provide an income adequate to the carrying on of that war." A few ultraconservative Republicans, like McCall of Massachusetts and Hill of Connecticut, objected that the amendment would enable the small states to plunder the large states and would be used to create a vast centralized government at Washington interested in regulating the citizen's behavior rather than in cutting public expenditures.

The Democrats in the House, led by Champ Clark and Cordell Hull, took the position that the Bailey-Cummins income tax measure was constitutional and should have been enacted as part of the tariff bill. Although they distrusted the sincerity of the constitutional amendment's sponsors, they would vote for its passage by Congress. They warned of a bitter fight in the state legislatures against ratification of the amendment and emphasized the need for ratification in order that the government might correct the maldistribution of wealth. Hull insisted that the wiser course would have been for Congress to enact an income tax law and only in the event of an adverse Court decision to resort to a constitutional amendment. His conclusion was that "Republican tariff humbuggery and fraud" would endure until "we can secure the imposition of an income tax and thereby destroy it." At the end of the debate the House voted 318 to 14 in favor of the Senate resolution for a constitutional amendment.¹¹

¹⁰ *Ibid.*, 4108-21. Bailey's first amendment was rejected by a vote of 46 to 30 with six not voting. Out of the twenty-two millionaire Senators voting, two favored the measure, fourteen voted against it, and six abstained from committing themselves. In the final vote on the resolution six of the fifteen Senators not voting were millionaires. They were Brandegee, Bulkeley, Elkins, Hale, Lodge, and Richardson.

¹¹ *Ibid.*, 4390-440. The fourteen negative votes were cast by die-hard Republicans; fifty-five Republicans refrained from voting. The Insurgent Republicans in the House took no part in this debate although they voted for the resolution.

The intention of Congress in passing the Sixteenth Amendment, as revealed by the debates, was to confer upon itself the power to reach incomes "from whatever source derived." This included incomes from state and municipal securities as well as incomes from fortunes consisting of invested capital.¹² When the new amendment to the Constitution was proposed to the state legislatures for ratification a fierce battle began. The newspaper press seemed on the whole to be favorable to the amendment although the *New York Times* and *Tribune*, the *Boston Transcript*, the *Buffalo News*, the *Rochester Post-Express*, and the *San Francisco Chronicle* tried to prove that the amendment was unnecessary, harmful, and demagogic, as well as destructive of states' rights. On the other hand, the *New York World* and the *American*, the *Philadelphia Record*, *Springfield Republican*, *Indianapolis News*, and *Chicago Record-Herald* were staunch champions of the amendment. Amazingly enough, the *Wall Street Journal* declared: "The change from indirect to direct taxation is a mark of economic progress."¹³

The Groups For and Against Ratification

The first prominent attack upon the proposed Sixteenth Amendment came, interestingly enough, from Justice Brewer, one of the two surviving members of the Court majority which had nullified the 1894 income tax law and thereby created the seeming necessity of a constitutional amendment. As far back as June 8, 1898, he had ventured outside the traditional nonpolitical orbit of the judiciary in order to make a public defense of the 1895 income tax decisions and to attack the movement for a constitutional amendment which would override the Court's decree.¹⁴ His desire to have a judicial elite, with views like his own, act as the rulers of the nation, his fear of democracy and legislative majorities, led him to criticize publicly the progressivism of Theodore Roosevelt. In a speech delivered on July 21, 1909, he attacked as demagogues and revolutionaries those seeking ratification of the Sixteenth Amendment. He declared: "If once you give the power to the nation to tax all the incomes you give them the power to tax the states, not out of their existence, but out of their vitality."¹⁵

¹² See Department of Justice, *Taxation of Government Bondholders*, 146-62, for detailed proof of this.

¹³ *Literary Digest* (1909-12), 39: 35, 117, 150, 188; 40: 88, 472; 44: 516, 629.

¹⁴ Justice David Josiah Brewer, *The Income Tax Cases and Some Comments Thereon*. This was an address at the University of Iowa Law School.

¹⁵ *New York Times*, July 22, 1909. This speech was delivered before the Agents'

Justice Brewer's injudicious and impolitic remarks aroused widespread criticism by progressives, but did not appreciably deter the ratification movement. The Alabama legislature, in fact, ratified the amendment on August 10, 1909.¹⁶ A few days earlier John D. Rockefeller joined the ranks of the stern opponents of the amendment. "When a man has accumulated a sum of money within the law, that is to say, in the legally correct way, the people no longer have any right to share in the earnings resulting from the accumulation." This was in sharp contrast to a statement by the millionaire Socialist, Robert Hunter, author of a path-breaking study on *Poverty*, that concentration on the income tax amendment obscures the fact that the "vital question before the people is the abolition of all incomes which are not the product of honest, useful and productive labor."¹⁷

After these incidents no great public debate occurred until Governor Hughes of New York (later Chief Justice of the United States Supreme Court) sent on January 5, 1910, to the New York Legislature a special message on the income tax amendment. He pointed out that he favored an amendment conferring on Congress "the power to lay and collect an income tax," but stated that the power to tax incomes should not include the power to tax incomes derived from state and municipal bonds. He asserted:

To place the borrowing capacity of the State and of its governmental agencies at the mercy of the Federal taxing power would be an impairment of the essential rights of the State which, as its officers, we are bound to defend.

He maintained that the proposal that the federal government have the power to lay and collect taxes on incomes "from whatever source derived" would, if ratified, "be in effect a grant . . . of the power" to tax "not only incomes from ordinary real or personal property, but also incomes derived from State and municipal securities."¹⁸

Association of the Northwestern Mutual Life Insurance Company in Milwaukee. See L. A. Lardner, *Constitutional Doctrines of Justice Brewer*, 203-25, on Brewer's philosophy of judicial imperialism.

¹⁶ See the *New York Times* and the *World*, July 23, 1909, for criticism of Brewer by Senator Norris Brown and others. For complete record of the ratification, see U.S. Library of Congress Legislative Reference Service, *Data on Ratification of the Constitution and Amendments by States* (71st Cong., 3d Sess., Senate Doc. 240), 10.

¹⁷ *Literary Digest* (August 7 and 14, 1909), 39:188. See Nevins, *Rockefeller*, 2:463-554, on Rockefeller's charities, relation to public opinion, and attitude to "tainted wealth."

¹⁸ *Special Message from the Governor, New York Senate, No. 3* (1910), 5.

Hughes's message attracted attention throughout the country and became a rallying point for conservative opposition to ratification. The governors of South and North Dakota and Connecticut expressed their agreement with Hughes's opposition to the amendment. A long line of conservative newspapers gave their approval and support to Hughes's plea for rejection of the Sixteenth Amendment. On April 11, 1910, six noted corporation lawyers, two of whom, Joseph H. Choate and William D. Guthrie, had persuaded the Court to nullify the 1894 income tax law, reinforced Hughes's state paper with further arguments. Against this effort to defeat the Sixteenth Amendment on the ground of its infringement of local and state powers two different defense groups and procedures developed. Senators Borah, Bailey, and Root, and Professor Edwin R. A. Seligman took the position that the Sixteenth Amendment, contrary to Governor Hughes, was not intended to and did not grant the federal government the power to tax income from state and municipal securities. Professor Seligman, wealthy in his own right, was recognized for his early study and defense of the income tax. He further contended that even if Hughes's legal interpretation were correct, the economic consequences of federal taxation of state and municipal securities feared by Hughes would not follow. Seligman also argued that the changing needs of American political and social life justified a development in constitutional interpretation which would sanction such taxation as part of a general income tax.

The progressive Republican and Democratic press in the main accepted Hughes's interpretation of the Sixteenth Amendment, but disputed his view that interest from state and municipal bonds should not be taxed. The governors of Florida, Missouri, and Ohio as well as the ranking members of the House Ways and Means Committee, Underwood of Alabama, Bartlett of Georgia, Walter Smith of Iowa, Sulzer of New York, and Sherley of Kentucky, expressed in press interviews their view that Congress should be granted the powers Hughes wished to deny it. J. Hampden Dougherty, a well-known and able lawyer, published on April 26, 1910, an elaborate justification of the Sixteenth Amendment against the strictures of Hughes and Choate. Senator Norris Brown of Nebraska, the chief proponent of the constitutional amendment in the Senate, stated that in his opinion the Sixteenth Amendment had the single purpose of conferring on Congress the power to tax incomes directly without regard to apportionment, and was not intended to extend to state and municipal securities. He was willing, however, to assume the contrary view for the sake of de-

bate, and on this assumption insisted that the Sixteenth Amendment should be ratified because it would result in all incomes being treated alike.

The temporary defeat of ratification in New York in April and May, 1910, resulted from the pressure of the moneyed classes upon the legislature, reinforced by the prestige of Hughes, Choate, and other opponents of the amendment. Fears were aroused that the amendment might be doomed to failure. Eight states, however, had already ratified the amendment that spring,¹⁹ and the election in the fall of 1910 reversed the stand of several legislatures. In New York State the Democratic party, with John A. Dix as its gubernatorial candidate, and ratification of the amendment as part of its platform, swept into control of both houses of the legislature and the governorship. Governor Dix urged the legislature to ratify the amendment and give Congress the power to tax interest from state and municipal bonds and the salaries of state and municipal officers. Mayor Gaynor of New York City and others pleaded against such action. Dix's argument that tax exemption of such incomes was contrary to the American doctrine of equal rights to all and special privileges to none, and that it was a perversion of the principle of state sovereignty, induced the New York State Legislature to ratify the amendment by July, 1911. That same year twenty other states ratified the amendment. All except Maine, North Carolina, and Tennessee were western states.²⁰ In nearly all the states the ratification took place by either a unanimous vote, or with only one or two votes against the proposal.

During the year 1912 few of the state legislatures were in session, but four states—Arizona, Louisiana, Minnesota, and South Dakota—gave their approval to the amendment. Since the Insurgent Republicans and Democrats won sweeping victories in both the national and state elections, changes occurred in states where income tax opponents had been strong. During the first two months of 1913 eight more states, five of which were eastern, ratified the amendment.²¹ This made a total of forty-two states, six more than the necessary three fourths required by Article V of the Constitution. On February 25, 1913, Secre-

¹⁹ The states were Georgia, Illinois, Kentucky, Maryland, Mississippi, Oklahoma, South Carolina, and Texas.

²⁰ Arkansas, California, Colorado, Idaho, Indiana, Iowa, Kansas, Michigan, Missouri, Montana, Nebraska, Nevada, North Carolina, North Dakota, Ohio, Oregon, Tennessee, Washington, and Wisconsin.

²¹ Delaware, Massachusetts, New Hampshire, New Jersey, New Mexico, Vermont, West Virginia, and Wyoming.

tary of State Knox certified that the Sixteenth Amendment had become a part of the Constitution.

For eighteen years the common people of the United States had been frustrated by the Supreme Court's action in the income tax cases and by the conservative Republicans and Democrats opposed to social welfare as a criterion of tax policy. They were sufficiently strong to secure complete rejection of the Sixteenth Amendment by Connecticut, Florida, Rhode Island, Virginia, and Utah. They also had succeeded temporarily in 1910 or 1911 in securing rejections by Arkansas, Massachusetts, New Hampshire, New Jersey, and New York, but their influence was counteracted and their action countermanded by the progressive Republicans and Democrats. The failure of Rhode Island to ratify the Sixteenth Amendment is a very strong indication that Senator Aldrich had sponsored the Senate resolution only as a means to defeat the enactment of the Bailey-Cummins income tax proposal of 1909. In sharp contrast to Senator Root, who despite his conservatism, loyally championed the amendment before his state legislature, Senator Aldrich made no effort to secure the ratification of the amendment in the state where he was the undisputed party leader and boss. Fortunately by 1912 the national influence and power he once had exerted in behalf of the big business interests had declined, and he was not able to stem the tide of liberalism.²²

Changes in Distribution of Wealth and Income, 1895-1913

The full significance of the eighteen-year delay in the imposition of an income tax is revealed by an analysis of the changes in the distribution of wealth and income between 1895 and 1913. According to Dr. W. I. King's study on the subject, the 1.6 per cent of the richest families in the United States received 10.8 per cent of the national income in 1890 and 19 per cent in 1910. On the other hand, the 88 per cent of the people who had received 65 per cent of the income in 1890 received only 62 per cent by 1910. These figures, although based on imperfect data and hence not definitive, indicate very clearly that a marked concentration of income in the hands of the very rich had occurred since 1890. The poor had lost relatively little of their share of

²² For detailed references and documentation, see Edward S. Corwin, "The Power of Congress to Tax Income from State and Municipal Bonds," in D. B. Maggs, Ed., *Selected Essays*, 1: Book 5, 514-34; Kennan, *Income Taxation*, 287-306; Earle H. Ketcham, *The Sixteenth Amendment* (Urbana, Illinois, 1926), 7-10; Seligman, *Income Tax*, 590-673; Department of Justice, *Taxation of Government Bondholders*, 163-90; *Readers' Guide to Periodical Literature* (1909-13), 2: 1113-14; 3: 1299.

the national income; the middle class, however, had been the principal sufferer.²³

This increased concentration of wealth was due to a variety of factors, but the Supreme Court's 1895 decisions and the Republican Old Guard's obstructive action on the income tax undoubtedly had contributed to the accelerated growth of large fortunes during this period. The ratification of the Sixteenth Amendment resulted in a change in the federal tax structure that had profound repercussions on the trend toward inequality of wealth and income. "In 1913 . . . taxes on commodities in the country or at its ports yielded 94.6 per cent of all federal tax revenues. In 1930, taxes on personal and corporation incomes yielded 66.5 per cent of all federal revenues. Taxes on commodities provided only 29.5 per cent. . . ." ²⁴ Since commodity taxes fall heavily on the lower income groups as a rule, and since the incidence of the federal income tax thus far has been on the higher income groups, it becomes evident that the federal tax system prior to 1913

²³ Willford Isbell King, *The Wealth and Income of the People of the United States* (New York, 1915), 230-35. King also estimated the money income of different fractions of the population in the United States in 1910 as follows:

Class of Population	Percentage of Total Income Received by Class	Average Income Per Capita in Dollars
Poorest, 65%	38.6	197
Lower middle class, 65-80%	14.2	314
Upper middle class, 80-98%	26.8	494
Richest, 2%	20.4	3,386
All classes	100.0	332

Merwin, *Studies in Income and Wealth*, 3:26-27, 35-37, points out the limitations of King's 1915 study, but indicates that it was relatively satisfactory and has not been superseded as yet for the period covered.

²⁴ M. Slade Kendrick, *Taxation Issues* (New York, 1933), 25; Edgerton, *op. cit.*, 338-42. The following table from Twentieth Century Fund, *Facing the Tax Problem* (New York, 1937), 45, is a valuable supplement to the above estimate:

RELATIVE IMPORTANCE OF FEDERAL TAXES

1913, 1936

Tax	Percentage of Total Federal Tax Revenue	
	1913	1936
Customs duties	48	10
Taxes on incomes and profits	5	36
Estate tax and gift tax	—	10
Automotive taxes	—	8
Tobacco taxes	12	13
Liquor taxes	35	13
Other taxes	—	10
	100	100

avored the high income groups out of all proportion to the immense benefits they derived from the protection and aid given to their interests by the federal government. This exemption from large federal taxes for this favored minority group enabled them to increase their capital at a higher rate than they have been able to do since 1913. The tax system in the United States after 1913 has not permitted as much transfer of wealth from, and concentration of the tax burden on, the poorer classes as the national system prior to 1913.²⁵

Taft's Presidential Record

The movement for the adoption for the Sixteenth Amendment was an integral part of the Progressive Movement which culminated in the cleavage of the Republican party and the victory of the Democrats in 1912. Taft during his one-term presidency achieved as many social reforms as Roosevelt had in his two terms. But Taft lacked Roosevelt's gift for "rhetorical radicalism" and for playing the role of the strong man who held both the extreme right and left under control. Moreover, public opinion and action had moved forward along the line of social reform so that merely following Roosevelt's earlier positions was not sufficient to keep one abreast of the advance guard. Both Roosevelt and Taft were fundamentally economic conservatives, but whereas Taft's speeches were generally in line with his moderate reform legislative policy, Roosevelt's talk was far more progressive than the specific policies he adopted in practice.²⁶

Taft's biographers and admirers have stressed such achievements as his extension of the civil service, his selection of competent federal judges, his active support and recommendation of the corporation tax, the Sixteenth Amendment, the postal savings system, the Customs Court, and the Bureau of Mines. These friends have also pointed out Taft's role in laying the basis for the federal budget system through the creation of the Commission on Efficiency and Economy. Although Taft is not remembered as a trustbuster, his antitrust record of twenty-two bills in equity and forty-five indictments under the Sherman Law exceeded that of Roosevelt, who had in comparison only eighteen bills in equity, twenty-five indictments, and one forfeiture proceeding to his credit. The suits against the Standard Oil and Tobacco Trusts were carried through to successful legal conclusions against powerful pres-

²⁵ Gerhard Colm and Helen Tarasov, *Who Pays the Taxes?* T.N.E.C. Monograph 3, 76th Cong., 3d Sess., 1-7; Clark, *Conditions of Economic Progress*, 423-33.

²⁶ Cf. La Follette, *Autobiography*, 478-85.

sure and opposition from Wall Street. Taft even had a suit brought against the United States Steel Corporation for acquiring the Tennessee Coal and Iron Company, notwithstanding Roosevelt's grant of permission during the panic of 1907. Taft also lent considerable support to the conservation movement although with less crusading ardor and vigilance than Roosevelt.²⁷

Nevertheless Taft failed to win public credit for the various liberal reforms he instituted and he aroused the hostility of the anticonservative public by acts of indiscretion and maladroit conservatism. His first great error from the purely political angle, committed at the outset of his administration, had been his espousal of Aldrich and Cannon at a time when progressive groups throughout the country, especially the Insurgent Republicans from the Middle West, were in revolt against their reactionary leadership. Roosevelt, like Taft, had co-operated and compromised with Aldrich and Cannon in order to put through at least part of the legislation he desired, but Roosevelt, unlike Taft, never praised in public the men who in the public's eyes were the spearhead of big business opposition to all social reform. Taft's second major error was his rashness in defending the Payne-Aldrich tariff by saying at Winona, Minnesota, that "this is the best tariff bill that the Republican party has ever passed, and therefore the best tariff bill that has been passed at all." This statement completely alienated the Insurgent Republicans, with whose downward tariff revision principles Taft had been and was in considerable sympathy, but with whom he did not know how to co-operate.²⁸ When, in March, 1910, the Insurgents in the House were led by George Norris to victory over the dictatorship of Joseph G. Cannon, Taft suffered an additional loss in prestige. Although out of sympathy with Cannonism, he had not aided the Insurgents in their fight and had seemed to support the arbitrary power and reactionary policies of Cannon.²⁹

An even more grievous blunder on Taft's part was his removal, in January, 1910, of Gifford Pinchot, Chief of the Forest Service, for supporting Louis R. Glavis, an investigator, in his public charge that the Secretary of the Interior, Richard Achilles Ballinger, was favoring the Morgan-Guggenheim syndicate and the other groups behind the largely illegal Cunningham land options on supposedly very valuable coal lands in Alaska. Eventually Ballinger, incompetent and vindictive rather than designedly criminal, resigned and the Cunning-

²⁷ Pringle, *Taft*, 1: 515-37; 2: 603-25, 654-77; Sullivan, *Our Times*, 4: 397-414.

²⁸ Pringle, *op. cit.*, 1: 402-17, 442-69.

²⁹ *Ibid.*, 2: 557-58, 612-13; Hechler, *Insurgency*, 65-82.

ham claims were canceled, but by that time Roosevelt, the Insurgents, and the general public had lost faith in Taft as a progressive.³⁰

Tariff Issue in 1910-11

Taft also incurred criticism for sponsoring a railroad bill, drafted by Attorney-General Wickersham, which originally repealed the Antitrust Act in its application to railroads and legalized all watered railroad capitalization. The Insurgents in the Senate and the House succeeded in wiping out most of the objectionable provisions of this Mann-Elkins Act, but felt no gratitude for Taft.³¹ The tariff issue came to the fore again in 1910 and 1911 when Taft attempted, according to the Insurgents, "to foist upon the country a sham reciprocity measure" with Canada.³² He was inspired to take this action as a means of restoring the personal and party prestige which had been damaged by the Cannon and Ballinger episodes and of conciliating the press which had hounded him because the Payne-Aldrich Act had not provided duty-free newsprint. Taft also hoped the reciprocity agreement would enable the Republican party to win the Congressional elections in the fall of 1910 and prevent the movement for drastic tariff reform which the Insurgents and Democrats were urging. Domestic business interests in Canada and Insurgent opposition in Congress prevented the Reciprocity Agreement from being passed by Congress until July 22, 1911. It never went into effect, however, except on the free importation of print paper and wood pulp, because the Liberal administration of Sir Wilfrid Laurier was defeated in Canada in the general elections of September 21, 1911, through the influence of certain manufacturing interests, fearful of American competition and appealing to Canadian fears of American annexation. Not until 1936 was a reciprocity treaty between the two countries negotiated, and the opposing interests harmonized.³³

The larger issues on tariff revision which Taft's reciprocity proposal raised were seized upon both by the Insurgent Republicans and Democrats. The Democrats and Insurgents in the House passed in May, 1911, a farmers' free list bill introduced by Oscar Underwood which admitted duty free about one hundred articles which the farmer bought but did not sell. They also passed a wool bill with drastic downward

³⁰ Alpheus T. Mason, *Bureaucracy Convicts Itself* (New York, 1941) is the most scholarly and best balanced study of the Ballinger-Pinchot controversy.

³¹ Hechler, *op. cit.*, 163-77.

³² La Follette, *op. cit.*, 477.

³³ L. Ethan Ellis, *Reciprocity 1911* (New Haven, 1939), 187-96.

revisions. The Senate failed to pass either measure because the Senate Democrats were afraid to jeopardize reciprocity by supporting any amendments which might cause Taft to veto the reciprocity agreement. After the passage of the agreement, however, the Democrats and Insurgents formed a coalition and succeeded in passing a bill sharply reducing the rates on wool and woollens and a farmers' free list bill. But the Democrats then broke with the Insurgent Republicans and secured the co-operation of the Old Guard Republicans in pushing through a bill which reduced almost by half the average duty on cotton goods and made other reductions in the chemical, iron, and steel schedules. Taft promptly vetoed all three bills on the ground that the revisions they contained were not based on scientific investigation and were not properly framed. His action was motivated by a desire to defend the great manufacturing interests of the country from the slightest danger of too strong foreign competition, but exposed him to severe criticism from the Insurgents and Democrats. They pointed out the inconsistency between, on the one hand, Taft's previous admissions concerning the defects in the Payne-Aldrich Act, and his championship of drastic tariff changes on American agricultural products in his reciprocity agreement, and on the other hand, his unwillingness to rectify the 1909 tariff mistakes and to expose American manufacturers to foreign competition.³⁴

Taft and the Money Powers

Another important matter of great concern to progressives of all parties was the stability of the banking system and the power of the great financiers over the American economic system. Although Taft had launched a campaign against many trusts dominated by bankers, his view was in favor of the bankers as the men best fitted to manage the credit-money mechanism under moderate government supervision and control.³⁵ Hence he did little to aid the investigation of the "money trust" by the House Committee on Banking and Currency.³⁶

³⁴ Hechler, *op. cit.*, 186-93; Pringle, *op. cit.*, 2: 599-602.

³⁵ Pringle, *Taft*, 2: 716-22. Only in December, 1912, did Taft become convinced that the government might very properly be given a greater voice in the control of the new banking system.

³⁶ Committee to Investigate Concentration of Control of Money and Credit, *Report* (62nd Cong., 3d Sess., House Rep., No. 1593), 15-16. Taft also declined to follow a recommendation by his Attorney-General that the National City Bank of New York should be forbidden to operate the National City Company as its subsidiary for making investments and transacting other profitable business not within the express corporate powers of a national bank. Taft was influenced by Secretary of the Treasury MacVeagh

The Committee, headed by Representative Arsene P. Pujo of Louisiana and guided by its brilliant counsel, Samuel Untermyer of New York, uncovered during 1912-13 a mass of data which demonstrated how the existing concentration of money and credit had been built up through the activities of four powerful groups.³⁷ The first and inner group consisted of J. P. Morgan and Company, and George F. Baker and James Stillman in their individual capacities and in their joint administration and control of the First National Bank, the National City Bank, the National Bank of Commerce, the Chase National Bank, the Guaranty Trust Company, and the Bankers Trust Company. Closely allied with this primary group were the powerful international banking houses of Lee, Higginson and Company and Kidder, Peabody and Company in Boston, and Kuhn, Loeb and Company in New York City. The fourth group consisted of the First National Bank, the Illinois Trust and Savings Bank, and the Continental and Commercial National Bank of Chicago. Radiating from these principal groups and closely affiliated with them were smaller but important banking houses.³⁸ The firm members or directors of the House of Morgan, the First National Bank, the National City Bank, and the Bankers and Guaranty Trust Companies alone held 341 directorships in 112 corporations having aggregate resources or capitalization of \$22,245 million.³⁹

On the basis of their inquiry the Pujo Committee reached the conclusion that "If, therefore, by a 'money trust' is meant—

An established and well-defined identity and community of interest between a few leaders of finance which has been created and is held together through stock holdings, interlocking directorates, and other forms of domination over banks, trust companies, railroads, public-service and industrial corporations, and which resulted in a vast and growing concentration of control of money and credit in the hands of a comparatively few men—

your committee . . . has no hesitation in asserting as the result of its investigation up to this time that the condition thus described exists in this country today."⁴⁰ Conservatives attacked the conclusions of the

and Secretary of State Knox into permitting a speculative device which helped to bring on the panic of 1929. Pringle, *Taft*, 2: 676-77.

³⁷ Committee on Banking and Currency, *Money Trust Investigation* (3 v., Washington, 1913).

³⁸ Committee, *Report*, 131-32.

³⁹ Committee to Investigate Concentration of Control of Money and Credit, *Report* (62nd Cong., 3d Sess., House Rep., No. 1593), 89-90.

⁴⁰ *Ibid.*, 130.

Committee as going beyond the evidence and giving unjustified alarm to the country about the power of the bankers, but liberals and radicals like Louis D. Brandeis maintained that the "power and pelf" of the chief bankers were not overstated and that even more drastic remedies had to be invoked than the Committee had proposed.⁴¹

Roosevelt's New Nationalism and Break with Taft

The Insurgent Republican discontent with Taft gradually led to the formation of an organized movement by the Progressives to capture control of the Republican party. Theodore Roosevelt had returned in June, 1910, from his world tour and speedily became involved in the conflict between the Insurgents and the Standpat Republicans. He toured the Middle West late in the summer of 1910 and promulgated the New Nationalism. Inspired by Herbert Croly's *The Promise of American Life*, Roosevelt stressed the need for advanced social legislation, attacked reactionary decisions of the Supreme Court, and advocated changing the rules of the economic game so as to bring about greater equality of opportunity and reward. These speeches seemed revolutionary to Taft and the conservative public, but encouraged those discontented with conservative rule.⁴² On January 21, 1911, Robert La Follette succeeded in getting the National Progressive Republican League organized as a means of securing progressive legislation and winning the 1912 presidential nomination. His plans and hopes for the presidency were dashed, however, by Roosevelt's throwing "his hat in the ring" on February 22, 1912. Events then moved swiftly. Roosevelt was motivated by the feeling that Taft had not lived up to the progressive program he had instituted and by anger at the suit brought against the United States Steel Corporation as an indirect attack upon his own honesty or intelligence, and by the desire to recapture the prestige and power he had formerly exercised. The consequence was a virulent debate between Taft and Roosevelt and a fierce struggle for delegates to the National Republican Convention, but the Taft forces, through their control of the party machinery, secured a majority. Despite the dramatic showmanship of Roosevelt and the fervor of his followers, the balloting on June 22 resulted in Taft winning the presidential nomination by a vote of 561 to 107 for Roosevelt, and 41 for La Follette,⁴³ with 344 not voting.

⁴¹ Louis D. Brandeis, *Other People's Money* (New York, 1914).

⁴² Pringle, *Roosevelt*, 540-44, and *Taft*, 2: 559-72.

⁴³ Pringle, *Taft*, 756-809; Sullivan, *Our Times*, 455-532.

Taft's was a Pyrrhic victory. That evening the followers of Roosevelt laid the basis for the National Progressive party, popularly known as the Bull Moose party. On July 2 Woodrow Wilson was nominated by the Democrats at Baltimore, through the influence of William Jennings Bryan, after a struggle against Champ Clark and Judson Harmon rivaling in bitterness and intensity the conflict between Taft and Roosevelt in June.⁴⁴ The Progressives with wild enthusiasm nominated Theodore Roosevelt for the presidency on August 7 at their Chicago convention. Meanwhile the Socialist party presented Eugene V. Debs as its presidential candidate, and the Socialist Labor party nominated Arthur E. Reimer.⁴⁵

Clashing Issues and Personalities in the 1912 Election

The campaign which followed, with its sharply contrasting personalities, divergent platforms, and highly charged mass emotion, was one of the most dramatic in American history. Taft regarded both Wilson and Roosevelt as dangerous radicals, although he considered Roosevelt the more menacing of the two and announced that Wilson's election was preferable to that of Roosevelt. The appeal to the electorate made by Taft was mainly on his presidential record in enforcing the antitrust laws, working for a reasonable protective tariff, and maintaining in general a mildly liberal businessman's government. His emphasis and that of his party was on a safe and sane conservatism and a repudiation of the seemingly extreme proposals of such "political emotionalists or neurotics" as Roosevelt.⁴⁶ But neither his record nor his campaign was able to counteract the vigor, pungency, and attractiveness of his two chief opponents. Moreover, Taft was handicapped by lack of funds, as many industrialists and financiers believed that it was vital to crush Roosevelt and that it was wiser to back Wilson than Taft as the man to save the country from socialism. The Republican National Committee had less than a million dollars to spend on its 1912 campaign in contrast to the usual \$2 and \$3 million fund.⁴⁷

On the other hand, certain traditional supporters of the Republican party who had been alienated by the vigorous antitrust program of Taft turned to Theodore Roosevelt and the Progressive party. Chief

⁴⁴ Ray Stannard Baker, *Woodrow Wilson: Life and Letters* (8 v., Garden City, 1927-39), 3: 322-63.

⁴⁵ *New International Yearbook*, 1912, 570-71.

⁴⁶ Pringle, *Taft*, 2: 766, 815-42.

⁴⁷ *Ibid.*, 2: 828-32.

among these big business backers were George W. Perkins and Frank Munsey. Perkins had been a partner of J. P. Morgan, a power in the New York Life Insurance Company, and the organizer of the International Harvester Company, against which an antitrust suit had been brought in April, 1912. Munsey had been a muckraking publisher and was a powerful stock market operator as well as the biggest stockholder in United States Steel between 1907 and 1911. They both admired Roosevelt greatly and influenced him to bolt the Republican party by promising him financial support. They also persuaded him to delete an antitrust plank that otherwise would have been adopted at the Progressive convention and to substitute a plank for government regulation of the trusts.⁴⁸

Roosevelt when President had not achieved more concrete acts of progressive legislation than Taft, although he had helped to create currents of public opinion and to establish precedents on the basis of which more far-reaching reforms could be built. Nor had he taken a more radical stand than Taft on the income tax, the Payne-Aldrich Tariff Act, the Reciprocity Agreement with Canada, or the antitrust issue until he became a candidate for the presidency.⁴⁹ Nevertheless, after Roosevelt presented his vision of the New Nationalism at Osawatimie, Kansas, on August 31, 1910, he gradually, if somewhat erratically, advanced to a position which on most issues seemed far in advance of Taft's and could become the rallying point for the Insurgent Republicans. Fearful of a government dominated either by a plutocracy or the socialistic masses, Roosevelt attempted to forge a program which would preserve American capitalism by removing the abuses through measures designed to safeguard and advance the welfare of the small businessman and worker. This guiding principle led him to advocate a protective tariff aimed at giving labor an adequate standard of living, and constructive regulation of the trusts, on the one hand, and to champion direct participation of all voters in the processes of government, the recall of judicial decisions, income and inheritance taxes, and a wide and detailed program of social legislation, on the other. His basic assumption was that although his 1912 campaign fund of \$676,000 came mainly from financiers and industrialists like Perkins, Munsey, and Thomas W. Lawson, and although his trust-regulation stand seemed to his opponents like a sellout to the United States Steel Cor-

⁴⁸ Bowers, *Beveridge*, 419-32.

⁴⁹ La Follette, *op. cit.*, 618-44, 671-756, offer a devastating critique of Roosevelt's progressivism, which is substantiated in the main by other authorities. See Lodge, *Correspondence*, 2: 7, 129, 225-27, 335, 340-42, 346; Pringle, *Taft*, 2: 756-95.

poration and International Harvester Trust, he could force big business to behave and reform once he was elected.⁵⁰

Although it is impossible to dogmatize on what Roosevelt would have accomplished had he been elected in 1912, he probably soon would have been engaged in a struggle for dominance with Perkins and his other financial supporters on the extent to which his rhetorical radicalism was to be translated into action. Such a conflict between the political rulers and the economic masters has resulted in our own day in the more or less complete victory of the political bureaucracy which resorts to state capitalism. Brooks Adams in his brilliant and comparatively neglected *Theory of Social Revolutions*⁵¹ gave the most comprehensive analysis of the threatening collapse of capitalistic government in America formulated at the time and defended with great persuasiveness Roosevelt's efforts to establish a new social equilibrium based on the curbing of the capitalists and the courts. But, as the aspirations of the common people developed, new and radical positions would have had to be taken, and new leaders probably would have been needed to supplant Roosevelt.⁵²

Wilson's Strategy and Success

The third major candidate, Woodrow Wilson, had been a conservative Democrat who had risen from a southern clerical middle-class background to the presidency of Princeton University through his abilities as a brilliant lecturer and able, but not radical, writer on American history and politics. After he resigned from the presidency in protest against the interference of the Princeton trustees, and turned to a political career, he underwent a metamorphosis. The penetration he had shown concerning political mechanisms in his doctoral thesis, *Congressional Government*, he extended and applied in his career as governor of New Jersey between 1911 and March, 1913. He created a na-

⁵⁰ Walter F. McCaleb, *Theodore Roosevelt* (New York, 1931), 303-304; Pringle, *Roosevelt*, 556-70. Harold L. Ickes has said that while Perkins was working loyally to elect Roosevelt in 1912, he was not overlooking any opportunity to build himself up as the Warwick who had restored Roosevelt to the White House. Once the election was over, Perkins appointed himself receiver of the Progressive party. "The House of Morgan has always known how to 'liquidate' ailing business concerns for its own profit. George W. Perkins had a substantial 'investment' in the Progressive party, and a man of his record and background was not the sort to fail to do everything in his power to realize what he could on that 'investment.'" H. L. Ickes, "Who Killed the Progressive Party?" *American Historical Review* (January, 1941), 46: 308.

⁵¹ New York, 1913.

⁵² See John Dewey, *Characters and Events* (2 v., New York, 1929), 1: 87-94 for evaluation of Roosevelt's liberal and reactionary tendencies.

tional reputation for himself as a bold and skillful progressive by pressing through the legislature advanced social legislation in defiance of the political bosses who had helped to put him into power. These acts and his espousal of the initiative and referendum won the popular esteem. Backed by the influence of Bryan and the prenomination campaign fund of \$208,500 secured by Cleveland H. Dodge of the National City Bank and other friends, Wilson gained the Democratic presidential nomination.⁵³

In his campaign Wilson appealed in the rhetoric of Jeffersonian democracy to those suffering from the dominance of big business and high finance in both the economic and political spheres. Louis D. Brandeis and others supplied the factual and theoretical ammunition. The New Freedom Wilson preached was a recapture of power and prestige by the small businessmen, farmers, and laborers through a regulated competition which he felt would prevent monopoly. He also urged a tariff for revenue which would lower the cost of living and eliminate the parasitic industries as well as break down the artificially protected, inefficient monopolies. His position on the tariff was the main difference between him and both Roosevelt and Taft. Wilson and Taft had similar antitrust positions although Wilson formulated his views with an insight into the desire of the common man for the equality of opportunity, economic independence, and determination of national policies which Taft could not even approach. At the same time, Wilson, by saying that he was not opposed to honest big business, based on efficiency rather than monopoly control or power, met Roosevelt's accusation that he was trying to restore an outmoded laissez-faire economy, and assured the more moderate big businessmen of a reasonable attitude on his part toward their problems. Wilson attracted the support of small businessmen and farmers who feared Roosevelt's program of acceptance and control of monopolies as paving the way for big business control of the government.⁵⁴ Although Wilson was determined to receive no campaign contributions for which favors would later be exacted, and obtained almost one third of the \$1,110,000 campaign fund from contributors giving less than \$100 each, he was ob-

⁵³ James Kerney, *The Political Education of Woodrow Wilson* (New York, 1926), 3-282, is a valuable corrective to Ray Stannard Baker, *Wilson*, v. 1-3. According to Lundberg, *America's Sixty Families*, 109, C. H. Dodge contributed to this prenomination fund \$51,000; Cyrus H. McCormick, head of the International Harvest Co., and Jacob H. Schiff together gave \$34,000; Henry Morgenthau, New York realty operator, \$20,000; William F. McCombs, Wilson's campaign manager, an agent on occasion of Thomas F. Ryan, \$11,000; Charles R. Crane, \$10,000; and Samuel Untermyer, \$7,000.

⁵⁴ Baker, *Wilson*, 3: 364-403; Woodrow Wilson, *The New Freedom* (Garden City, 1913), *passim*.

ligated to various wealthy Princeton friends and more or less liberal big businessmen for the greater part of his fund. Some of them expected through their support to prevent Wilson from embarking on too radical a course.⁵⁵

Far more radical than either Roosevelt or Wilson were Eugene V. Debs, the Socialist party's presidential candidate, and Arthur E. Reimer, the candidate of the Socialist Labor party, with their program for the replacement of capitalism by a new socialistic order. The membership of the Socialist party had grown rapidly after 1908 and had more than doubled between 1910 and 1912, owing to the progressive trend throughout the country, the increased cost of living, and the discontent aroused by the recession of 1910, the depression of 1911, and the bitter labor battles at the Lawrence textile mills and the anthracite coal mines in 1912.⁵⁶

The outcome of this almost melodramatic contest for the presidency was 6,296,547 popular votes for Wilson, 4,118,571 votes for Roosevelt, and 3,486,720 votes for Taft. Moreover, Wilson obtained 435 electoral votes, Roosevelt, 88, and Taft, 8. The Socialist vote of 899,164 was more than double that received in 1908 and was larger than that recorded for any except the presidential election of 1920. Although Wilson obtained fewer votes than Bryan had in any of his three presidential campaigns, and although the combined popular votes of all his opponents exceeded his by almost 2,500,000, his victory was a decisive one

⁵⁵ Baker, *op. cit.*, 3: 398-400. Lundberg, *op. cit.*, 109-20, 493-95, stresses the contributions made by C. H. Dodge, Cyrus McCormick, *et al.* to the prenomination campaign fund, George W. Harvey's role as a friend of J. P. Morgan, Thomas F. Ryan, and William C. Whitney in booming Wilson for the presidency on Wall Street, Perkins's contribution to the presidential campaign fund, and Wilson's meeting with James Stillman and William Rockefeller at the home of Frank A. Vanderlip, president of the National City Bank, before the Baltimore convention. Lundberg also emphasizes the Wall Street connections of William F. McCoombs, Wilson's campaign manager, and William G. McAdoo, who became Wilson's Secretary of the Treasury. On the other hand, according to Herbert L. Satterlee, *J. Pierpont Morgan* (New York, 1939), 554, 568, J. P. Morgan himself made no contribution to any of the candidates in 1912 and was not in favor of Wilson's election despite George Harvey's enthusiasm for Wilson. Morgan, however, told Harvey after the election that "When you see Mr. Wilson, tell him for me that if there should ever come a time when he thinks any influence or resources that I have can be used for the country, they are wholly at his disposal." *Ibid.*, 569. Edward M. Sait, *American Parties and Elections* (New York, 1939), 649-50 states that 33.3 per cent of the Democratic campaign fund of 1912 consisted of gifts of \$5,000 or more as compared with 44.8 per cent of the Republican fund. The Democrats received only two gifts of \$25,000 or more as compared with four such gifts for the Republicans. No Democratic gifts of \$50,000 or more and two Republican gifts of that size were received.

⁵⁶ Commons, *History of Labor*, 4: 282-85, 266-73, 335; 3: 59-60; *New International Yearbook 1912*, 571, 587-88.

and represented the predominant progressive sentiment throughout the country. Undoubtedly the split in the Republican party was a major factor in his success. The Republican party, for the first time in its history, came out third in a national election, but it could have overcome defeat only by offering as advanced a platform and candidate as its rivals. The election also assured Wilson a Democratic Congress, with a House majority of 147 and a Senate majority of six. The Democrats elected 21 of the 35 governors elected that year. The Standpat Republicans and the conservative economic groups they represented were now definitely ousted from the seats of power they had occupied, with some limitations under Theodore Roosevelt, since the election of 1896.⁵⁷

⁵⁷ Baker, *Wilson*, 3:410-11; *New International Yearbook*, 1912, 576-77, 768; Robinson, *Presidential Vote*, 14-17, 31-34. George Edwin Mowry, *Theodore Roosevelt and the Progressive Movement* (Ph.D. Thesis, University of Wisconsin, 1938) offers the best analysis of the factors behind the Progressive movement and Roosevelt's failure to win the 1912 election.



Wilsonian Liberalism and Tax Reform

THE first administration of Woodrow Wilson represented the height of welfare capitalism in the United States prior to the New Deal of Franklin D. Roosevelt. Although the various reforms inaugurated by Wilson and his supporters seemed to radicals like Debs minor variations upon the capitalistic theme, they seemed to the mass of farmers, small businessmen, and workers to be major advances in the social welfare of the nation. The first onslaught against special privileges for the vested interests was made against the high protective tariff and in behalf of the income tax. In 1912, as in 1911, the Democrats in Congress had passed various "pop-gun" tariff bills designed to make breaches in the high protective tariff wall, which had been vetoed by Taft. The Democrats in the House also passed a bill placing sugar on the free list, and attempted to make up the resulting loss of more than \$50 million in revenue through an income tax disguised as an excise bill. Since the Sixteenth Amendment had not yet been ratified and the Supreme Court had upheld in 1911 the Corporation Tax Act of 1909, Cordell Hull had hit upon the stratagem of levying a special excise of 1 per cent "upon doing business by copartnerships or individuals." All incomes of \$5,000 and less were exempted, as were incomes affected by the corporation tax, which was still in operation. Owing to various changes made by the Senate in both the free sugar bill and the excise bill, which the Conference Committee was unable to harmonize with the demands of the House, neither bill was enacted, despite widespread popular support for the measures.¹

¹ *Literary Digest* (March 16, 30, 1912), 44: 516, 629-30; *New International Year-book*, 1912, 700-04.

Wilson's Call for Tariff Revision

In his inaugural address of March 4, 1913, Wilson dedicated the Democratic party to creating equality of opportunity for the American people through a reconstruction of the tariff, the banking and currency system, the industrial order, agriculture, and the natural resources.² He soon issued a call for an extraordinary session of Congress for April 7, to revise the tariff and to consider other related problems. By delivering his message in person the next day he dramatized the legislative leadership he was assuming and gave an impetus to the reforms he desired. As the House Ways and Means Committee had begun work on writing a new tariff bill in December, 1912, under the leadership of Oscar W. Underwood, the latter was able to report to the House on April 22 a bill which embodied the most sweeping downward revisions of the tariff in half a century. Although strong opposition to these changes was manifested by the wool and sugar producers as well as by the cotton manufacturers, papermakers, California fruit raisers, Minnesota millers, and Texas cattle men, Wilson was able with the support of Underwood, Cordell Hull, Carter Glass, and other strong Democratic leaders to get the Underwood tariff bill passed by the House on May 8 by a vote of 281 to 139.³

Notwithstanding the fact that the Democrats in the Senate numbered 51 to the Republicans' 45, the traditional independence and conservatism of the Senate and extremely strong pressure by lobbyists for the various threatened vested interests resulted in a stormy and extended battle of four months over the tariff bill. After it was received from the House, it was revised even further downward by the Senate Finance Committee headed by Furnifold McLendel Simmons of North Carolina. Simmons was an archconservative, a ruthless foe of the Populists and the Negro, and a supporter of the high schedules in the Payne-Aldrich Tariff Act, but he fought steadily and skillfully for the tariff changes demanded by Wilson in return for Wilson's sanctioning his election as chairman of the Finance Committee. Wilson aided his Senatorial champions through an unprecedented public attack on the tariff lobbyists in Washington. The consequence of his unflagging leadership and the sturdy support of most of the Democrats and of two Progres-

² Ray Stannard Baker and William E. Dodd, *Public Papers of Woodrow Wilson* (6 v., New York, 1926), 3: 1-6.

³ Baker, *Woodrow Wilson*, 4: 93-113; *Literary Digest* (April 19, 26; May 3, 24, 1913), 46: 874-76, 931-33, 996-97, 1161-62; Oscar W. Underwood, *Drifting Sands of Party Politics* (New York, 1928), 171-84. The Democrats in the House were 290; the Republicans, 127; the Progressives, 18. *World Almanac*, 1914, 517.

sive Republicans, La Follette and Poindexter, was that the Senate passed the Underwood-Simmons tariff bill on September 9 by a vote of 44 to 37. After the differences between the House and Senate were ironed out in Conference, the bill became law on October 3.⁴

The Underwood-Simmons Tariff Act

The distinctive features of the new tariff act grew out of a concern for the rights and interests of the American consuming public which the Republican party had never shown, as well as out of a desire to secure sufficient revenue for the government without putting unnecessary burdens on the common people. The Act was not by any means a free trade measure. It was to end the special privileges to the giant industries and to lower the cost of living for the masses. At the same time, it granted a moderate protection to "legitimate" domestic industries through what was called "a competitive tariff." The average ad valorem rate of the Payne-Aldrich Tariff Act had been 40.12 per cent; that of the Underwood-Simmons Act was estimated to be between 27 and 29 per cent. Luxuries were taxed at higher rates than necessities, and the specific and compound duties favored by protectionists were replaced by ad valorem duties. The free list was greatly extended and included raw wool, which had borne a rate of about 44 per cent, iron ore, pig and scrap iron, steel rails, agricultural implements, coal, lumber, wood pulp, many agricultural products, including live cattle, meat, eggs, milk, cream, wheat and flour, and numerous manufactures, especially leather boots and shoes, gunpowder, and print paper. The rates on woolens, cottons, silks, and iron manufactures were reduced substantially. The duty on raw sugar was lowered from one and two thirds cents a pound to one and one quarter cents a pound; after May 1, 1916, all sugar was to be admitted free; actually this duty was retained until 1922 owing to political changes in 1916. The provisions for the maximum and minimum duties established in 1909 were dropped entirely. The regulations governing customs administration were made more effective against fraud than they had been under the Republican administrations.⁵

Shortly before the special session of Congress opened John Pierpont Morgan, the symbol and key figure of American finance capitalism, died.

⁴ Baker, *Wilson*, 4: 100-04, 113-30; *Literary Digest* (June 7, September 20, 1913), 46: 1257-58; 47: 453-54; *New York Herald-Tribune*, May 1, 1940, obituary of F. M. Simmons.

⁵ Taussig, *Tariff History*, 409-46; H. P. Willis, "The Tariff of 1913," *Journal of Political Economy* (January-March, 1914), 22: 1-42, 105-31, 218-38.

His passing evoked tributes from his admirers as the greatest financier in America or in the world. Joseph H. Choate described him as "the greatest power for good in America." Elihu Root asserted that Morgan had been the most commanding and controlling figure in the country and that he "acquired a great fortune by making the prosperity of many and by taking his fair and just share of that prosperity." On the other hand, liberals like Brandeis and La Follette and the Socialists in general regarded the elder Morgan as the leader of the speculative "banker barons" forming the Money and Credit Trust, responsible not only for excessive charges for banking services and losses to the public through security manipulations but also for the suppression of competition and industrial liberty through the formation of trusts. Whatever the final verdict on Morgan's career might be, many contemporary writers felt that Wilson's administration indicated a trend which would counteract the great centralization in industry, commerce, and finance which the elder Morgan had done so much to promote.⁶

Like most men of great wealth, Morgan feared all political measures which might threaten his power. According to Lord Northcliffe, Morgan regarded Lloyd George, then at the height of his career as a social reformer in England, as a great danger to the United States. Morgan believed that American legislation constantly followed closely upon that enacted in England and cited in proof the freeing of the slaves, the income tax, death duties, the Employers' Liability Act (then pending), and the introduction of the parcel post. He regarded English conservatism as radicalism, and English radicalism as socialism, and remarked to Northcliffe: "Should Lloyd George's Socialistic legislation make progress in your country, we shall follow you."⁷

Revival of the Income Tax

Although Morgan's fears concerning English and American socialism were not realized, his prophecy of American progressive legislation was speedily verified. The ratification of the Sixteenth Amendment on February 25, 1913, enabled the Democrats to incorporate an income tax in the Underwood-Simmons tariff bill without fear of judicial veto. Conservative newspapers like the New York *Herald* and *Journal of Commerce* and the St. Louis *Globe-Democrat* attempted to head off the enactment of an income tax through denunciation of the tax as "wrong in principle and un-American in spirit." Their language and

⁶ Louis D. Brandeis, *Other People's Money*, 16, 30-35; La Follette, *Autobiography*, 762-97; *Literary Digest* (April 12, 1913), 46: 811-13.

⁷ *Literary Digest* (April 12, 1913), 46: 867-68.

tactics were similar to the British conservative press's criticism of Lloyd George's radical 1909 tax program as "Plundering the Middle Class," "General Attack on Capital and Industry," and "Triumph of Socialism."⁸ But the sweeping victory of the Democrats and the Progressive party in 1912 empowered the new majority in Congress to disregard the die-hards. Cordell Hull drafted the income tax sections of the Underwood tariff bill, which was intended both to fulfill Democratic campaign pledges and to make good the \$100 million revenue loss expected to follow the tariff reductions. His work was then reviewed by a subcommittee of the House Ways and Means Committee consisting of Underwood, Hull, Andrew J. Peters of Massachusetts, and A. Mitchell Palmer of Pennsylvania. They made few changes in Hull's original draft, but John Nance Garner, later Vice-President of the United States, fought hard to introduce the principle of graduation. Despite strong opposition by Underwood, Hull, and other committee members who wanted to ensure judicial approval of the tax and to reduce the chances of its repeal, Garner, with the aid of Dorsey W. Shackelford of Missouri, won his point. Conservative groups throughout the country failed in their effort to force the Committee to discard a progressive tax.⁹

Cleavages within the House

Woodrow Wilson displayed a keen interest in the income tax provisions of the tariff bill and wrote Underwood on April 16, 1913, about his desire to exempt "all persons receiving less than \$3,000 a year income from the necessity of making income returns at all, in order to burden as small a number of persons (as possible) with the obligations involved in the administration of what will at best be an unpopular law."¹⁰ The House Ways and Means Committee conferred with the Senate Finance Committee, agreeing on the measure to be submitted

⁸ *Ibid.* (May 29, 1909; February 15, 1913), 38:917-18; 46:326.

⁹ Blakey, *Federal Income Tax*, 74-77; Marquis James, *Mr. Garner of Texas* (Indianapolis, 1939), 66-68; *Literary Digest* (February 15, April 19, 1913), 46:326, 877.

¹⁰ Baker, *Woodrow Wilson*, 4:111-12. On the influence of Edward M. House upon Wilson's domestic reforms and foreign policy, especially as formulated in House's novel, *Philip Dru: Administrator* (1912), see Arthur D. Howden Smith, *Mr. House of Texas* (New York, 1940) and Jennings C. Wise, *Woodrow Wilson: Disciple of Revolution* (New York, 1938), a somewhat sensationalistic and distorted interpretation. Smith's book, a sober and balanced study, points out (pp. 49-50) the amazing extent to which the reforms advocated in *Philip Dru* were carried out by Wilson. They included tariff reform, a graduated income tax, a banking law destroying the credit trust and creating a flexible currency based largely on commercial assets, government sharing of corporation net earnings, old age pension and laborers' insurance laws, grant-

to the House. On April 23 Underwood, after making a notable exposition and defense of the tariff bill he was proposing, announced to the House that the tariff reductions would be counterbalanced by levying a tax on the great untaxed wealth of America.¹¹ However, he left the responsibility for explaining and justifying the Committee's income tax proposal to Cordell Hull. The latter three days later made a masterly address in which he surveyed the long struggle of the Democratic party against judicial and conservative political obstruction of its efforts to get an income tax adopted. He exalted the ability-to-pay criterion in taxation, and urged that the adoption of the income tax as a permanent part of the federal tax system would be a means of securing justice in taxation, flexibility and stability of revenue, and economy in expenditures. The measure he advocated imposed a tax of 1 per cent on net incomes over \$4,000 to be applied alike to all individuals and corporations. A graduated additional tax was to be imposed upon the total annual net income of every individual derived from all sources, including corporation dividends, exceeding \$20,000. The rates were to be: 1 per cent on that part of an individual's income which was over \$20,000, 2 per cent on the amount above \$50,000, and 3 per cent on the amount over \$100,000.

Hull defined the meaning of the net income of a taxable individual as not embracing "capital or principal, but only such gains or profits as may be realized from rent, interest, salaries, trade, commerce, or sales of any kind of property . . . or profits . . . derived from any other source." The Treasury Department was relied upon to clarify the distinction between taxable income and capital. Hull evidently intended to exempt capital gains from taxation, but was not absolutely clear on this point.¹² He pointed out that inheritances, contrary to the 1894 procedure, were not considered as taxable income because a federal inheritance tax, he felt, should contain rather highly graduated rates and be enacted separately. Tax exemption was granted to the salaries of state and local officials and to interest upon state and local bonds in

ing labor the right to be represented on the boards of corporations, with a percentage of earnings above their wages and a corresponding obligation to submit all grievances to arbitration. Many of these ideas were in the air, but House made his own synthesis.

¹¹ *Cong. Record*, 63d Cong., 1st Sess., 50: 332. On April 24 Andrew J. Peters explained the chief provisions in the Underwood bill, including the income tax. *Ibid.*, 396-99. A graduated income tax bill was also introduced by Adolph J. Sabath of Chicago, on April 7, but died in the Ways and Means Committee. *Ibid.*, 87.

¹² For a microscopic citation of Congressional discussion on important income tax provisions in the 1913 Act, see J. S. Seidman, *Legislative History of Federal Income Tax Laws* (New York, 1938), 983-1007. It is extremely useful for following the intricate details of tax legislation from 1913 to the present.

order to avoid controversy on a constitutional question which might have been raised despite the clear grant of power given to Congress by the Sixteenth Amendment. For similar reasons exemption was also given to the salaries of the President and the federal judges then in office.¹³

An exemption of \$4,000, Hull explained, was given to every individual taxpayer because people with incomes below \$4,000 pay the principal part not only of the federal tariff taxes but of the state and local taxes, and such an exemption reduced the number of the deductions which otherwise would have to be provided. The new tax was to be collected through an unusually broad application of the English principle of stoppage or deduction at the source in order that the government might obtain a greater yield of revenue, and at less cost than in the past, and eliminate or reduce tax evasion by holders of intangible property. A tax of 1 per cent was imposed on the net income of corporations, but without the exemption allowed to individuals. Hull concluded his speech with a prediction that the new income tax bill would equal in its satisfactory operation and excel in its justice, flexibility, and productiveness any tax law on the statute books.

Press comment on the Hull-Garner income tax proposal was vigorous. Conservative Republican and Democratic papers like the *New York Sun*, *Tribune*, and *Journal of Commerce*, and the *Brooklyn Eagle* protested against the introduction of an odious tax reserved only for great national emergencies like war and complained that "this is not taxation for revenue, but taxation of the few for the benefit of the many." On the other hand, progressive Republican and Democratic papers like the *New York World*, *Globe*, and *Commercial* and the *Providence Journal* defended the tax as designed to make taxation more equal between the poor and the rich and to counteract the excessive levies on the poor.¹⁴ The discussion in the House on May 6 and 7, when Hull's measure was up for amendment, unlike debates in previous years, involved no dispute concerning the desirability of an income tax or even the principle of progressive taxation. The climate of public and Congressional opinion had changed remarkably since 1894 and 1909.

¹³ Cf. U.S. Department of Justice, *Taxation of Government Bondholders and Employees*, 191-93.

¹⁴ *Literary Digest* (April 19, May 24, 1913), 46: 877-78, 1163-64. Strong press criticism was directed against the \$4,000 exemption, the seemingly light tax on income from corporation bonds, taxation of the incomes of insurance companies, the administrative features, especially the collection at the source of income, and the "obscure and contradictory" language of the bill. Hull made an equally strong reply to these charges, which won the approval of such liberal papers as the *Springfield (Massachusetts) Republican*.

Several amendments were advanced which increased markedly the rates in the progressive scale, but none was passed.¹⁵

In line with this effort to counteract the excessive concentration of wealth was the defense of the \$4,000 exemption against conservative attacks. Fred A. Britten, a Chicago Republican, vainly tried to raise the exemption to \$6,000 for married men with an additional \$500 exemption for each child supported.¹⁶ On the other hand, Frederick H. Gillett, a Massachusetts Republican lawyer, attempted to check "the disease of extravagance" by lowering the exemption limit and imposing a tax of one half of 1 per cent on incomes over \$1,000 up to \$4,000; his suggestion, however, was severely criticized and rejected.¹⁷ As William H. Murray, a Democratic farmer of Kansas, put it, the advocates of the \$1,000 exemption "forget the principle upon which this tax is founded, and that is that every man who is making no more than a living should not be taxed upon living earnings, but should be taxed upon the surplus that he makes over and above that amount necessary for good living."¹⁸ The majority of Congressmen also realized how unpopular a low exemption would be and were influenced by considerations of political expediency as well as of justice.

William M. Calder, a Brooklyn Republican and builder, was bold enough to propose a tax on the incomes of city, state, and county officials under the authority extended by the Sixteenth Amendment, yet could not convince Hull that the possible legal conflict was worth the comparatively small amount of revenue involved at that time.¹⁹ George S. Graham, a Philadelphia Republican lawyer, tried to get a tax on the President and federal judges accepted and J. Hampton Moore, another Philadelphia Republican, a tax on state obligations. But each failed because the Democrats wished to steer clear of judicial controversy and state resentment of federal encroachment on their fiscal powers.²⁰ Con-

¹⁵ Ira C. Copley of Illinois, a corporation director, lawyer, and one of the nineteen Progressives in the House, proposed a graduated surtax on incomes over \$10,000 which rose from 1 per cent on incomes between \$10,000 and \$15,000 to 68 per cent on incomes over \$1 million. *Cong. Record*, 50: 1245-47. Melville C. Kelly, a Pennsylvania Progressive, suggested a 9 per cent tax on incomes over \$100,000; Victor Murdock, the noted Insurgent from Kansas, a 6 per cent surtax on incomes over \$100,000; J. A. Falconer, a Washington Progressive, a 5 per cent tax on income over \$100,000. *Ibid.*, 1250, 1252, 1257.

¹⁶ *Ibid.*, 1254.

¹⁷ *Ibid.*, 1247-51.

¹⁸ *Ibid.*

¹⁹ *Ibid.*, 1261-62. By 1938 this problem and that involving the taxation of government bondholders had become so acute that the President and the Treasury Department took special action to break down the immunity rule which had grown up under the Sixteenth Amendment.

²⁰ *Ibid.*, 1263.

siderable debate took place on the tax imposed on the life insurance companies, especially the mutuals, which brought great pressure to bear on Congress through their policyholders in order to secure the same exemption that fraternal associations enjoyed. Hull got the House to reject the extreme demands made by insurance spokesmen, but compromised on certain points where the companies were able to justify their complaints. He allowed the mutual fire and marine insurance companies to receive special concessions because of the hazards of their business.²¹ The problem of capital gains and losses, particularly as involved in the sale of real estate and securities, came up for only slight discussion and was disposed of by Hull's assurance that the bill would apply only to purchases and sales made within the same year.²²

On May 7, 1913, the House completed its consideration of the first income tax which was to go into effect since the expiration of the Civil War income taxes in 1872. No roll-call vote was taken, unfortunately, on this section of the tariff bill or on its most important provisions. The sectional and economic class divisions, however, which had prevailed in the past between the high and low income groups, the Northeast and the South and West, the conservative Republicans and the Democrats, with their Populist or Progressive supporters on occasion, evidently continued to operate. The one difference between 1894 and 1913 was that the Progressives of 1913 considered the Democratic income tax measure not radical enough and desired to see much higher progressive rates established. After the House passed the entire Underwood tariff bill on May 8, the Senate Finance Committee officially received the bill, on the revision of which it had been working throughout the House debates. A subcommittee headed by John Sharp Williams of Mississippi, a veteran champion of the income tax since 1894, made various important changes in the House's income tax measure. The amount of personal exemption was reduced from \$4,000 to \$3,000, but an additional \$1,000 exemption was granted to the married taxpayer, with another \$500 for each minor child and \$1,000 as the total exemption for children. This was regarded by some newspapers as a tax on bachelors, but was defended on the ground of the importance of the family as the unit in American society. Readjustments were also made in the taxation of corporation profits and returns on indebtedness and in the granting of exemptions to mutual life and marine insurance companies. The Committee vetoed a proposal to put the tobacco and other

²¹ *Ibid.*, 506-12, 1239, 1240-41, 1257-59, 1263-64, 1304-05, 1307, 1310-11, 1369; *Literary Digest*, 46: 1163-64.

²² *Cong. Record*, 50: 513, 1257.

trusts out of business through a tax graduated according to the degree of monopoly exercised by corporations in different lines of production, a plan submitted by Gilbert M. Hitchcock, a Nebraska Democrat and newspaper publisher.²³

Cross-Currents in the Senate

The narrow Democratic majority of six votes in the Senate led Wilson to fear that the anti-income tax as well as the antitariff reduction pressure groups might frustrate his plans through their influence on wavering or deviating Democratic Senators. Hence he not only launched his famous onslaught against the tariff lobbyists, but used his personal influence with individual Senators and secured meetings of the Democratic Senate caucus from June 20 to July 7. "Red-hot" discussions were held on tariff schedules in June and on the income tax section after July 1. Intense conflicts occurred over the Senate Finance Committee's recommendations on deductions for children, exemption of insurance dividends, taxation of undivided corporation profits, and the Hitchcock tobacco trust tax. The Committee, however, won out, and on July 7 the caucus declared the tariff bill "to be a party measure" and urged "its undivided support as the duty of Democratic senators." On July 11 F. M. Simmons formally laid the revised tariff bill before the Senate, and on July 21 the Democratic caucus designated John Sharp Williams and William Hughes, a strong Wilson supporter from New Jersey, as defenders of the income tax section in the Senate debates.²⁴

Although Senate debate on the tariff bill began on July 14, no extended discussion of the income tax section took place until August 26.²⁵

²³ *Literary Digest* (July 5, 1913), 47: 5-6; *New York Times*, June 4-6, 25; July 1, 1913. Hitchcock's general antimonopoly measure was offered in the Senate on June 17, 1913. *Cong. Record*, 50: 2020. Although Attorney-General James C. McReynolds suggested this plan to Hitchcock, Wilson disapproved of it.

²⁴ Baker, *Wilson*, 4: 113-24; Blakey, *op. cit.*, 85-87; *New York Times*, June 21-July 8, 22, 1913. Hitchcock refused to be bound by the caucus decisions and said he would offer his amendment to the Senate later. Six Senators—Hollis, Hughes, O'Gorman, Pomerene, Reed, Vardaman—voted against the caucus ruling that all the Democrats should support the bill as drafted by the caucus and not vote for any Republican amendments. See Senate Finance Committee, *Tariff Handbook*, 63d Cong., 1st Sess., Senate Report 80 (2nd Print), 26-27, 390-403, for the difference between the House and Senate income tax measures.

²⁵ Elihu Root on July 18 proposed that the tax be assessed on incomes accruing from the time of the passage of the new tariff act rather than on income received from March 1 to December 31, 1913, on the ground that income once received became principal and could not be taxed without apportionment. On August 26, 1913, Williams inserted into the record refutations of Root's position by Cordell Hull, Thurlow M. Gordon, an assistant to the Attorney-General, and Senator John K. Shields of Tennessee. *Cong. Record*, 50: 2467, 3766-70.

On that day Simmons decided to break through the Senate impasse on some one hundred tariff schedules by taking up and disposing of the income tax section before attempting to get final action on the other matters.²⁶ The chief point of controversy in the discussion on the income tax turned out to be the question whether the surtaxes imposed on the higher incomes by the Committee bill should be increased and the exemption limit lowered. Borah, Joseph L. Bristow, La Follette, and Miles Poindexter of Washington offered amendments which ranged from imposing the surtax on \$10,000 to increasing the rate to 5 or 10 per cent on incomes over \$100,000, and to 20 per cent on incomes over \$1 million. These Midwestern Progressives felt that the Committee's surtax of 1 per cent on income over \$20,000, of 2 per cent on income over \$50,000, and of 3 per cent on income over \$100,000 did not sufficiently assess the men with large incomes and great fortunes. Since those with small incomes paid a higher percentage of their income in taxes than the favored few in the high income group, these Senators felt that increasing the surtaxes on the larger incomes, usually in their eyes acquired by special privileges, was simply an act of justice based on the ability-to-pay principle.²⁷

Mild as these proposed surtaxes were to appear in later years, they aroused fierce opposition by conservative Republicans and mildly liberal Democrats. John Sharp Williams, a traditional Jeffersonian Democrat and a strong opponent of radical Bryan Democrats in his later days, attacked these proposals as designed not to raise revenue but to punish and to take from those who had large incomes so as to produce equality of income throughout the country. "No honest man can make war upon great fortunes per se. The Democratic Party never has done it; and when the Democratic Party begins to do it, it will cease to be the Democratic party and become the socialistic party of the United States; or, better expressed, the communistic party, or quasi communistic party, of the United States."²⁸ Equally, if not more, vehement than Williams was Henry Cabot Lodge, a millionaire as well as a Republican stalwart, who denounced high surtaxes as "confiscation of property under the guise of taxation" and as converting the income tax "from the imposition of a tax to the pillage of a class."²⁹ He and the other conservatives in the Senate approved of the suggestion of Porter J. McCumber,

²⁶ *Ibid.*, 3766.

²⁷ *Ibid.*, 3771-73, 3805-06, 3835-36, 3818-21, 3830-34.

²⁸ *Ibid.*, 3821; C. S. Sydnor, "J. S. Williams," *Dictionary of American Biography*, 20: 277-79. Williams was a plantation owner, an able lawyer, and spokesman for the conservative Democrats.

²⁹ *Cong. Record*, 50: 3840.

the Republican high protectionist from North Dakota, that the exemption be lowered from \$3,000 to \$1,000 and that a tax of one tenth of 1 per cent be imposed on incomes between \$1,000 and \$5,000.³⁰

The surtax amendments offered by the Progressives were all voted down, yet the oratory of Williams and Lodge could not prevent the growth of an incipient revolt by the more radical Democrats against the iron rule of the Democratic leaders. The threat of a bolt from the caucus agreement by twenty-five to twenty-seven Democrats in favor of higher surtaxes inspired the majority leaders to call a caucus on September 5 at which a compromise was reached. This raised the surtaxes to a maximum of 6 per cent of incomes over \$500,000 and met with Wilson's approval. The more radical Democrats, led by Reed of Missouri, tried to increase the highest rate up to 10 per cent, but were unsuccessful.³¹ Four days later Bristow, La Follette, and Poindexter once more introduced high surtax amendments to the income tax section, but, despite their disclaimer of pillaging any class and La Follette's eloquent plea on the need to destroy the menace to democracy from swollen fortunes, their measures were defeated.³² The reason for this was that the radical Democrats had been sufficiently satisfied by the caucus compromise measure, which the Senate had passed on September 6,³³ to vote with their party and against the Progressives.

This partial victory and party loyalty explained also the defeat of such proposals as that of George W. Norris, which imposed an inheritance tax ranging from 1 per cent on bequests of \$50,000 to 75 per cent on bequests over \$50 million.³⁴ During the extended Senate debate numerous technical questions, of special interest to the tax expert, arose and were discussed, often at great length and with considerable intensity. Among these problems were the nature of taxable income, the desirability of taxing unearned income more heavily than personally earned income, the exemption limit for minor children, surtax evasion through the use of corporate devices, the equitable taxation of insurance companies, and the basis for appointment of the new collectors and inspec-

³⁰ *Ibid.*, 3834-35.

³¹ *New York Times*, August 29; September 6, 1913. Senators Vardaman of Mississippi, Ashurst of Arizona, and Thompson of Kansas were among the other leading radicals in the Democratic caucus. Vardaman on August 28 voted for La Follette's surtax amendment and thereby precipitated the revolt movement among the radical Democrats.

³² *Cong. Record*, 50:4611-13.

³³ *Ibid.*, 4379.

³⁴ *Ibid.*, 4422-27, 4468; Alfred Lief, *Democracy's Norris* (New York, 1939), 144-45. A similar proposal was made by Wesley L. Jones of Washington. *Cong. Record*, 50:4460-68, 4469-70.

tors.³⁵ On September 9, late in the afternoon, the struggle over the income tax ended when the Senate, without voting separately on the income tax section, gave its approval to the Underwood-Simmons tariff bill. As Wilson said, a fight for the people and for free business had at last been won. For the second time in American history the Senate had passed a tariff bill with rates substantially lower than those recommended by the House. But equally important were the first income tax provisions to be enacted since 1870,³⁶ and the first surtaxes ever enacted by Congress.

For almost three weeks the Conference Committee worked over the differences between the Senate and the House on the income tax and the tariff. Between September 22 and 27 the Committee agreed to the Senate increases in the surtaxes on large incomes, lowering of the exemption to \$3,000 for bachelors, and other changes in the original House income tax section.³⁷ The Committee resisted pressure by bankers and others to exempt alien holders of American securities from the tax.³⁸ On October 3, 1913, Wilson signed the statute which he and his supporters felt represented a victory for those desiring greater social justice.

The 1913 Income Tax Law

The 1913 income tax law, technically Section II of the Underwood-Simmons Tariff Act,³⁹ imposed a "normal" tax of 1 per cent on the taxable net income of every citizen of the United States, whether residing at home or abroad, and every resident of the United States, including the Philippine Islands and Puerto Rico.⁴⁰ An exemption of \$3,000 was given to each taxpayer, with an additional \$1,000 for a married person living with wife or husband. Although this additional exemption for married persons was an innovation in federal income tax legislation, no special exemption for minor children as such was allowed de-

³⁵ Cf. Blakey, *op. cit.*, 89-94. Coe I. Crawford of South Dakota never pressed to a vote his suggestion for exemption of personally earned income up to \$20,000. *Cong. Record*, 50: 3815.

³⁶ *New York Times*, September 10, 1913.

³⁷ *New York Times*, September 23, 26-27, 1913. Hull was not a member of the Committee, but was consulted by them as an authority.

³⁸ *Ibid.*, September 18, 25, 1913. See 63d Cong., 1st Sess., *House Report 86*, 26, for the Committee's conclusions.

³⁹ Act of October 3, 1913, 38 *U.S. Stat. at Large*, 114.

⁴⁰ The administration of the law and the collection of the taxes imposed in Puerto Rico and the Philippines were to be by the internal revenue officers of those governments, and the revenues collected were to accrue to those governments. The 1909 Corporation Tax Act did not extend beyond the United States.

spite Senate pressure. These exemptions applied to all taxable incomes, irrespective of their size. Exemption was also granted the salaries of the President of the United States and of the federal judges then in office, and the interest upon the obligations of the United States and its possessions. The salaries of all officers and employees of the state governments and their political subdivisions, and the interest upon state and local bonds and other obligations, were similarly excluded from taxation. Constitutional and political considerations influenced the determination of these latter tax-immunity allowances.

Besides the normal tax an additional tax or surtax with progressive rates was levied on the amount of an individual's net income exceeding \$20,000. The rates of the additional tax were as follows:

Rate (per cent)	Amount of Income
1	\$ 20,000—\$ 50,000
2	50,000— 75,000
3	75,000— 100,000
4	100,000— 250,000
5	250,000— 500,000
6	500,000—

The maximum rate of the income tax as a whole, therefore, was 7 per cent. This was somewhat lower than the English maximum of 1s.8d. on the pound then prevailing. Nevertheless the American graduated surtax represented a victory for the advocates of the principle of progressive taxation.⁴¹ Although the Civil War income taxes had much higher rates, which began at much lower income levels, than the 1913 tax, the 1913 law was the first peacetime measure to embody a principle previously condemned as extremely radical, if not socialistic.

Taxable income was defined to include "gains, profits, and income derived from salaries, wages, or compensation for personal services . . . or from professions, vocations, businesses, trade, commerce, or sales or dealings in property, whether real or personal . . . also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent." Proceeds of life insurance policies were not included as income.⁴²

⁴¹ See Hugh Dalton, *The Inequality of Incomes* (London, 1929), 106-49, for a discussion of the trend in economic theory to an acceptance and application of this principle.

⁴² In computing their taxable net income, individuals were allowed to deduct from their gross income: 1. necessary business expenses, but not personal, living, or family

The 1913 law, through the exemptions and deductions granted and through its specific provisions on taxable income, gave to that concept the quite clear-cut meaning of receipts of money or its equivalent arising out of business and actually realized after the deduction of all necessary costs of acquisition. Stress was laid on income as a regular and periodic return. Unlike the 1894 law, gifts and inheritances were not included as taxable income.⁴³

In addition to the tax on personal incomes, the 1913 statute provided for a 1 per cent tax on the net income of corporations, joint stock companies or associations, and insurance companies, but not partnerships. No exemption such as the \$5,000 exemption in the 1909 Act was given. The corporate net income definition and the exemptions to certain non-profit organizations were substantially the same as those of the 1909 law. No "additional" tax or surtax comparable to that on individuals was imposed upon the corporations. Corporations were allowed to deduct from their gross incomes all ordinary and necessary business expenses; all losses actually sustained and not compensated by insurance, including a reasonable allowance for depreciation. Insurance companies could subtract the net addition they were required by law to make within the year to their reserve funds and to the sums other than dividends they paid within the year on policy and annuity contracts. Corporations could also deduct interest on their indebtedness to an amount not exceeding "one-half of the sum of its interest-bearing indebtedness and its paid-up capital stock outstanding at the close of the year";⁴⁴ and all taxes paid to the United States or any state or foreign government.

expenses; 2. interest paid on personal indebtedness within the year; 3. federal, state, and local taxes, except those assessed against local benefits; 4. losses sustained actually during the year in trade or from fires, storms, or shipwreck, and not compensated for by insurance or otherwise; 5. bad debts actually charged off as worthless; 6. a reasonable allowance for exhaustion, wear and tear of property used in business, not exceeding in the case of mines 5 per cent of the gross value of the output; 7. dividends upon the stock or from the net earnings of any corporation taxable upon its net income; and 8. the amount of income on which the tax was paid at the source of the income. The deduction of the dividends was allowed only in the computation of the normal tax.

⁴³ Cf. William W. Hewett, *The Definition of Income* (Philadelphia, 1925), 46-49; Seligman, *Income Tax*, 675-704; Henry C. Simons, *Personal Income Taxation* (Chicago, 1931), 41-58.

⁴⁴ Insurance companies were given special consideration. Life insurance companies were allowed to exclude as income "such portion of any actual premium received from any individual policyholder as shall have been paid back or credited" to the policyholder within the year. Mutual fire and marine insurance companies were permitted to deduct refunds of premium deposits to policyholders. Foreign corporations were taxed on the net income they derived from business transacted and capital invested within the United States. Persons carrying on business in partnership were liable for the income tax only in their individual capacity, and each partner was taxed on his share of the profits, whether distributed or not.

The Corporation Tax Act of 1909 was extended to February 28, 1913. On March 1, 1914, the tax on both corporate and personal income went into effect. In order to secure the maximum revenue and to prevent evasion by the dishonest taxpayer, the personal assessment method of the Civil War and 1894 income tax laws was abandoned, and the principle of collection or stoppage at the source of income, used so successfully in England, was applied wherever possible. The normal tax on individuals was to be deducted and paid to the tax collector by any person or corporation making payments of more than \$3,000 in interest, rent, salary, or any other form of fixed annual income to individuals. In the case of interest, mortgages, or deeds of trust of domestic corporations, and the interest and dividends of foreign corporations, the tax was to be deducted on all sums even if the income amounted to less than \$3,000. Certain exceptions were made to avoid double taxation.

Every person with an income of \$3,000 or over was required to make on or before March 1, 1914, a return under oath of his gross income from all sources and the total deductions legally authorized. Corporations had to file their returns on the same date or within sixty days after the close of the fiscal year. Penalties were provided for individuals and corporations refusing or neglecting to make returns or filing false returns. The income tax returns of corporations were made public records but were open to inspection only upon the order of the President under the rules prescribed by the Secretary of the Treasury. The officials of states imposing general income taxes were granted access to the federal corporation returns. The Commissioner of Internal Revenue's power to regulate the collection of the tax gained importance from the vague or contradictory nature of many parts of the 1913 law.⁴⁵

The administration system set up for the 1909 corporation tax permitted the new corporation tax to be administered with a minimum degree of difficulty. The personal income tax, however, required a new organization and gave rise to many intricate and difficult problems, especially those arising from the provisions on the deduction of the tax at the source. Hence the revenue yield for the first ten months' operation of the personal income tax was only \$28 million instead of the estimated \$70 million, but the receipts for each succeeding year, as the administration improved, were larger and more promising. The corporate income tax yielded more in the beginning than the personal tax, but failed to increase in yield proportionately.⁴⁶

⁴⁵ See Henry C. Black, *A Treatise on the Law of Income Taxation* (2d ed., Kansas City, 1916), on all phases of the act and its operation.

⁴⁶ U.S. Treasury, *Statistics of Income 1920*, 30.

The Court and the Income Tax Amendment

Just as the constitutionality of the Civil War and 1894 income tax laws and of the corporation tax of 1909 had been questioned by wealthy groups anxious to avoid taxation to which they were unaccustomed, so the validity of the 1913 income tax law was challenged. Two cases were brought before the Supreme Court in 1916: *Brushaber v. Union Pacific Railroad Co.* and *Stanton v. Baltic Mining Co.*⁴⁷ Brushaber and Stanton as stockholders in these two companies brought suits to prevent their corporations from complying with the 1913 income tax law and from paying the tax, on the ground that the Act was invalid. The stratagem invoked here and the probable collusion between the parties involved were strikingly parallel to the methods resorted to in the noted 1895 income tax cases. This time, however, despite the numerous and ingenious arguments presented by the able counsel of the plaintiffs, the Court upheld the validity of the 1913 act. Chief Justice White, one of the great dissenters in the 1895 cases, very appropriately delivered the opinion for a unanimous Court in these two cases. The Chief Justice affirmed the constitutionality not only of the normal tax on incomes of \$3,000 or over and the so-called discriminatory tax on certain corporations, but also of the allegedly arbitrary, confiscatory, economically unsound and socially unjust progressively graduated surtax on incomes over \$20,000. He denied that because taxpayers believed a tax "to be wanting in wisdom and to operate injustice, from that fact in the nature of things there arises a want of due process of law and a resulting authority in the judiciary to exceed its powers and correct what is assumed to be mistaken or unwise exertions by the legislative authority of its lawful powers, even although there be no semblance of warrant in the Constitution for so doing."⁴⁸

Nevertheless, while the Chief Justice refused to abuse the power of judicial review in behalf of the propertied classes and sustained the authority of Congress as far as it had chosen to go at that time, the reasons he gave for his decisions became the basis for later judicial restrictions on the taxing power of Congress. Although the Sixteenth Amendment was a clear grant of power to Congress to tax any and all income, and the phrase "from whatever source derived" was intended to include income from state and municipal securities and the salaries of officials formerly exempted, the Chief Justice interpreted the amendment not in the "sense most obvious to the common understand-

⁴⁷ 240 U.S. 1; 240 U.S. 103.

⁴⁸ 240 U.S. 26.

ing at the time of its adoption,"⁴⁹ but in the sense he desired to see prevail. Motivated most likely by his desire to protect from taxation state and municipal bonds and the salaries of federal judges, he amended the Sixteenth Amendment, with the approval of the majority of the Court, so that it conferred no new power of taxation on Congress, but merely restored to Congress the power it had had prior to 1895 to tax income from real and personal property, without apportioning the tax among the states according to population.⁵⁰ By so doing, the Chief Justice and the Court majority asserted their superiority not only to Congress, but to the legal sovereign of the United States, the state and national legislatures needed to amend the Constitution. The Court, instead of being the guardian of the Constitution, assumed or usurped the role of its master.⁵¹

Wilson's Liberalism in Action

Once Wilson saw that his tariff reform and income tax plans were on the way to being achieved, he took action to secure the changes in the banking and currency system which would free the small businessman from the tyranny of the credit and money trust and provide the elasticity of credit and currency, adequacy of banking reserves, and safeguards against speculation which had been demanded by the radical third parties since the Civil War. The plea he made to Congress on June 23, 1913, set off a long and intense legislative and public debate between conservatives and radicals on the proper mechanism which ended in large measure when the Federal Reserve Act became law on December 23, 1913. Although the Act did not break the power of the bankers as the Populists of the eighteen-nineties would have desired, it did make possible an adequate and elastic national currency and placed supreme control of the country's banking and credit resources in the hands of a Federal Reserve Board, appointed by the President with the consent of the Senate, instead of a central bank dominated completely by bankers. The Federal Reserve System, despite the criticism of certain radicals that it was merely a façade for and an instrument of Wall Street banks, especially during Republican administrations, was a valuable first step to the democracy in finance still being striven for.⁵²

⁴⁹ Justice Holmes, dissenting, *Eisner v. Macomber*, 252 U.S. 219-20.

⁵⁰ 240 U.S. 17-18; 240 U.S. 112-13.

⁵¹ Cf. A. V. Dicey, *Law of the Constitution* (8 ed., London, 1920), 144-45, 170-71.

⁵² Baker, *Wilson*, 4: 131-202. J. Laurence Laughlin, *The Federal Reserve Act* (New York, 1933), 3-208; Paul M. Warburg, *The Federal Reserve System* (2 v., New

The guiding principle behind Wilson's legislative program was the restoration, if not the creation, of a competitive capitalism so regulated as to prevent the rise of monopolies and to ensure the dominance of self-reliant small businessmen and farmers. At the same time the welfare of the working classes was to be safeguarded and advanced through appropriate social legislation. Given the complexity of the economic system, Wilson and his supporters had to resort to a variety of instruments for achieving their goal. The Federal Reserve System was intended to strike at Wall Street's excessive control of the credit system. The tariff reductions embodied in the Underwood Act were aimed at enabling foreign competition to curb the growth and power of American corporations with monopoly or near-monopoly control and thereby reducing the cost of living. The income tax with its progressive rates put part of the federal tax burden on those best able to bear it and to that extent retarded the growth of the great fortunes already established or in the process of being established. The antitrust legislation Wilson and Brandeis envisaged would have prevented the formation of these gigantic fortunes by reintroducing and reinvigorating domestic competition in areas dangerously dominated by big business.

On January 20, 1914, a month after the passage of the Federal Reserve Act, Wilson appeared before Congress and appealed for legislation which would strike at the roots of monopoly by prohibiting interlocking directorates, ending banker domination of the railroads, clarifying the Sherman Antitrust Act, creating a Federal Trade Commission, and legally punishing the individuals responsible for breaking the antitrust laws. After prolonged debate and pressure from various affected interests, the Federal Trade Commission Act was passed on September 26, 1914, and the Clayton Act on October 15, 1914. The Rayburn bill giving the Interstate Commerce Commission power to pass on the issue of railroad stocks and bonds was the capstone of Wilson's project, but failed to get past the Senate owing to the powerful opposition which the bankers were able to create and the impact of the first World War on the investment market. This measure was the first war casualty of Wilson's domestic reform program.

Under the Wilson administration the Federal Trade Commission proved to be an effective and intelligent investigating and regulating agency. The Clayton Act turned out to be less effective in the long run as an antitrust weapon than its friends had hoped it would be, owing to various loopholes in certain key provisions, the inventiveness

York, 1930), presents the bankers' and Republican party's contributions; Lundberg, *op. cit.*, 121-23, the radical point of view.

of big businessmen, conservative judicial interpretation, and the inaction of succeeding administrations. Nevertheless, the Act, especially through its provisions exempting labor and agricultural organizations from the antitrust regulations and restricting the use of injunctions in labor disputes, seemed to be the Magna Carta of labor and small business and might have been the basis for a long-time reconstruction of business and labor conditions if war and the reaction which followed had not intervened.⁵³

Despite the keen opposition of big business to these social reforms and the disturbances created by the first World War, Wilson persisted in his course of action and made the minimum number of concessions he thought necessary. He signed La Follette's Seamen's Act on March, 1915, won Brandeis a place on the Supreme Court in the face of the most vitriolic attack, supported the Farm Loan Act of July, 1916, and settled a nation-wide railroad dispute over the eight-hour day by getting Congress to pass the Adamson Act that September. He took great care to safeguard certain national oil reserves against private exploitation. At the same time he helped to enact the first federal child labor law. Although it was declared unconstitutional by the Supreme Court in 1918, the act was a landmark in social legislation and indicated the extent to which the liberalism of Wilson and his public was an advance over that of Theodore Roosevelt.⁵⁴

⁵³ Baker, *Wilson*, 4: 353-75; Commons, *History of Labor*, 4: 164-66, 535-36; Frank A. Fetter, *The Masquerade of Monopoly* (New York, 1931), 311-15, 381-94.

⁵⁴ Baker, *Wilson*, 4: 375-93; 5: 77ff.; 6: 98-117; Commons, *op. cit.*, 3: 694-95.

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America Prepares for War

THE struggle for power, prestige, and profits among the ruling groups in Europe which culminated in war in 1914 drew the United States into its vortex by 1917. During the period of two years and seven months in which the United States abstained from military intervention in the war, the Wilson administration had to grapple with the crucial questions of neutrality, preparedness, and new sources of revenue for the gigantic expenditures entailed by the crisis. On August 4, 1914, after Germany had declared war on Russia and France and had invaded Belgium, Wilson issued a neutrality proclamation. Two weeks later he issued a public appeal for impartiality in thought as well as in action. On August 10 he approved the recommendation by his Secretary of State, William Jennings Bryan, to J. P. Morgan and Company that loans by American bankers to any foreign nation at war were inconsistent with the true spirit of neutrality.

American Loans to the Allies

This policy of the administration was privately reversed in October by Bryan and Robert Lansing, acting Secretary during the former's absence. A distinction was drawn, with Wilson's aid, between loans to belligerents calling for bond issue and credits and arrangements for meeting debts incurred in the ordinary course of trade. The way was cleared for the floating of Allied treasury obligations and a small German loan among the banks of the United States, but the government did not officially announce the change in its ruling and its approval of the extension of credits to belligerents while maintaining its official ban on loans to belligerents until March 31, 1915.¹ Meanwhile the German submarine campaign in the spring of 1915 which culminated in the sinking of the *Lusitania* on May 7 caused Wilson to take so

¹ Charles C. Tansill, *America Goes to War* (Boston, 1938), 70-89.

strong a stand against Germany that Bryan felt forced to resign in protest from the cabinet on June 8. He considered Wilson's foreign policy pro-British and anti-German. Soon afterward the Allies seemed to have reached the limit of their short term credits and appealed through American bankers for officially sanctioned American loans. William G. McAdoo, Secretary of the Treasury and Wilson's son-in-law, wrote to Wilson that American prosperity was dependent on continued and enlarged foreign trade and that, to preserve it, the United States had to assist its customers to buy. Otherwise the results would be disastrous. Similar advice by Robert Lansing, Bryan's successor as Secretary of State, Colonel House, and others persuaded Wilson to give indirect and discreetly concealed approval on August 26, 1915, to the funding of the American credits to the Allies into publicly sold bonds. The consequence was that by April, 1917, the Allied Powers through the buying and liquidating of American securities owned by their nationals had borrowed over \$2½ billion in the United States as against a mere \$7½ million by Germany. These huge loans to the Allies were granted on liberal terms and were widely subscribed to by private citizens, banks, business firms, and institutions, especially those concerned with financing or producing for the Allies.² These financial stakes in the victory of the Allies became one factor in the American government's decision to go to war against the Central Powers in April, 1917.

Impact of the War on Revenue

The first effect of the war on the American economy was a demoralization of trade. The attendant abrupt and sharp decreases in the returns from the tariff and other taxes created a crisis in federal finance. In order to meet this loss in revenue, Wilson urged Congress on September 4, 1914, to raise an additional \$100 million through internal taxes. Congress responded by passing the War Revenue Tax Act of October 22, 1914. It was in large part a renewal of the Spanish-American War Revenue Act and provided for excises on fermented liquors, wines, toilet articles, and chewing gum. The law also imposed special taxes on bankers, brokers, tobacco dealers and manufacturers, and owners of amusement places, and it reintroduced stamp taxes on legal documents and telegraph and telephone messages. The act was to expire on December 31, 1915.³ The Wilson administration made no attempt to increase the income tax because the 1913 income tax law had been oper-

² Cleona Lewis, *America's Stake in International Investments* (Washington, 1938), 351-60; Tansill, *op. cit.*, 90-113.

³ 38 *U.S. Stat. at Large*, 745.

ating for only a short time and the Treasury needed revenue which would be available in a short time. Congress received some criticism, especially from conservative Republican newspapers, for striking "the American people in the pocket-nerve" through a war tax which they maintained was due to the unjustified reductions in the tariff the previous year and to the passage of the River and Harbor and other "pork-barrel" appropriations of Congress, but strong defenses of the war tax as a moderate tax necessitated by the war were made by McAdoo and the Democratic papers.⁴ They also pointed out that the European War and the diplomatic and military difficulties with Mexico as well as the new parcel post system of the Post Office Department were responsible for increased expenditures.

During 1915 a marked and decisive recovery from the industrial depression of the preceding year occurred, stimulated in large measure by the great volume of orders from abroad for war munitions and supplies. This prosperity, however, was based on a war situation which did not permit an enjoyment of profits without corresponding and offsetting burdens and perils. The German submarine attacks on American shipping that spring, the high-handed British blockade methods, the Civil War in Mexico, and the raids by Villa on American soil in the spring of 1916 led to the development of the movement for preparedness against possible foreign foes. A contest ensued between peace pressure groups like the Women's Peace Party, League to Enforce Peace, Labor's National Peace Council, and the Friends of Peace and military preparedness pressure groups like the American Legion, American Defense Society, National Security League, and Navy League. Wilson had been predisposed to hope for a speedy conclusion to the European War and had taken an antimilitaristic position during 1914. Events in 1915, despite his approval of House's peace mission to Europe early in the year, led him to change his position. On March 3 Wilson signed the naval appropriations bill carrying \$45 million for the increase of the navy. Wilson took the first great step in the new direction on July 21, after his challenging *Lusitania* notes to Germany, when he asked Lindley M. Garrison, his Secretary of War, and Josephus Daniels, his Secretary of the Navy, to draw up programs for the development and equipment of the army and navy. Wilson followed this initial move by active leadership of Congress and the Cabinet on the detailed preparedness program.⁵

⁴ *Literary Digest* (September 19; November 7, 1914), 49: 491-93, 874-75.

⁵ Baker, *Wilson*, 5: 276-321; 6: 1-22; Frederick L. Paxson, *Pre-War Years 1913-1916* (Boston, 1936), 274-94.

Wilson's Preparedness Program

On December 7 the President appeared before Congress and delivered a forceful appeal for adequate preparedness. As early as August, 1915, he had told William F. Dodd that if a single European power dominated the whole of Europe, "we are bound to intervene. Pacifist that I am, world peace is vital."⁶ But this private conviction Wilson was not yet ready to translate into public action or avowal. In his speech to Congress he denied any desire for aggressive war by the American democracy, but affirmed the American people's determination to protect themselves against possible assault through increases in the army and the navy. He recommended a five-year naval building program with \$100 million allotted each year to new ships so that the American navy would have parity with the greatest fleet on the seas. He also asked for the passage of a bill, which had been defeated in the Senate in the previous session, and which authorized the purchase or construction of merchant ships to be owned and directed by the government.

To meet these new demands on the Treasury, Wilson suggested the continuance of the emergency War Revenue Tax of 1914 after December 31, 1915 and such changes in the income tax as lowering the personal exemptions and the minimum amount of income upon which the surtax could be put. He also proposed the retention of the duty on sugar and the imposition, after May 1, 1916, of new excise taxes on gasoline and naphtha, automobiles and internal combustion engines, bank checks, and pig iron and fabricated iron and steel. He opposed the raising of the needed funds by bond issues as unfair to future generations. "Borrowing money is short-sighted finance . . . we should pay as we go." "The industry of this generation should pay the bills of this generation." In this view of the desirability of taxes as against loans he was supported by the majority of newspapers. The Republicans criticized his specific tax proposals as a burden on production and industry and a proof that tariff reductions were unwise.⁷

Although Congress on December 17, 1915, passed a resolution to extend the 1914 War Revenue Tax Act, strong opposition to the President's preparedness program existed in Congress and was voiced by such powerful figures as Claude Kitchin of North Carolina, Democratic House leader and Chairman of the House Ways and Means Commit-

⁶ *New York Times*, July 1, 1916.

⁷ Baker and Dodd, *Public Papers of Wilson*, 3: 406-28, especially 421-22; *Literary Digest* (December 18, 1915), 51: 1411-14.

tee, and James Clarke, president pro tempore of the Senate. Even those favorable to Wilson's defense plan were not, in the main, enthusiastic about his tax proposals, although Wall Street generally approved. Western and southern Congressmen objected to the taxes on gasoline and automobile engines as a burden on the farmer. They regarded the stamp taxes on bank checks as vexatious. The champions of taxes on munitions of war regarded the tax on pig iron and steel as a feeble substitute for a direct tax on munitions profits.⁸ Secretary of the Treasury McAdoo in his news releases and in his annual report for 1915 aided those Congressmen desiring income tax increases by his recommendations for increasing the rate of taxation on individual and corporate incomes and for lowering the existing exemption limits for both the normal tax and the surtax.⁹

Raising Revenue for Defense

The upshot of various conferences between McAdoo and the Democratic leaders in Congress was an informal agreement on January 23, 1916, to abandon the stamp and special taxes suggested by Wilson, to increase the surtaxes sharply, to lower the income tax exemptions, and to retain the duties on sugar. An impetus to putting the heaviest burdens of the national defense program upon the higher income level groups was given the next day by the Supreme Court decision upholding the constitutionality of the 1913 income tax law. Cordell Hull, upon whose shoulders the main responsibility for framing the new tax bill had already begun to be placed, declared that the decision would enable Congress to more than double the revenue from the income tax.¹⁰ But the apathy in Congress and the dissension in the Democratic party on the armament and tax issues impelled Wilson to carry the issue of preparedness to the people directly in a speaking tour in the Northeast and Middle West between January 27 and February 4. He aroused great enthusiasm for his position and, in spite of a threatened Congressional revolt against his German submarine and Mexican policies, he succeeded in pushing through Congress the legislation he desired. On June 3 the National Defense Act, increasing and reorganizing the regular army and the national guard, became law. On August 29 the largest naval appropriation bill in American history up to that time, carrying about \$270 million, and the army appropriation bill, carrying \$314 million, were enacted. On September 7 Wilson had the

⁸ *New York Times*, December 8, 17, 18, 1915.

⁹ *Treasury Report*, 1915, 51; *New York Times*, November 26, December 9, 1915.

¹⁰ *New York Times*, January 24, 25, 1916.

satisfaction of signing the Shipping Act. This Act, which had been defeated by the shipping interests in 1914-15, created a government-controlled corporation with a capital of \$50 million to lease, buy, build, and operate a fleet of merchant ships. When Congress adjourned on September 8, the appropriations it had made exceeded those of any preceding Congress. For current appropriations and future expenses the total was over \$1,800,000,000. This was \$750 million more than the total of the preceding fiscal year.¹¹

To meet these huge appropriations, the House Ways and Means Committee under the leadership of Hull gradually evolved by May 21 and June, 1916, an omnibus bill which included proposals by Hull on income and inheritance taxes, by Champ Clark on a munitions tax, and by Wilson for a nonpartisan Tariff Commission.¹² Conservative papers and business interests tried to influence the tax program by warning of the perils to industrial development of a supertax on the very rich and of the socialistic tendencies of the too highly progressive income taxes.¹³ On the other hand, liberals like John Dewey and Frederic C. Howe supported the efforts of the Association for an Equitable Federal Income Tax and demanded that \$300 million be raised through highly progressive income tax rates, with incomes above \$1 million taxed a third to a fifth. Labor leaders like Samuel Gompers warned against letting the burden of taxation for preparedness fall upon the poor and urged increases in the income tax which would fall most heavily upon those best able to pay.¹⁴

House Action in the Democratic Tax Program

On July 5, 1916, Claude Kitchin, Chairman of the House Ways and Means Committee, introduced to the House the Committee's bill to raise the \$200 million additional revenue for the fiscal year necessitated by the defense appropriations. The next day he opened the debate by jestingly asserting that the bill was an absolutely nonpartisan bill, and then tried to persuade the Republicans that his remark was to be taken seriously by citing Republican precedents for almost all the tax provisions he advocated. The military operations in Mexico against Villa were to be financed by the issue of \$125 million in bonds.

¹¹ Baker, *Wilson*, 6: 24-40, 154-76; Paxson, *op. cit.*, 294-307; *New International Yearbook*, 1916, 710-11.

¹² Baker, *Wilson*, 6: 107-08; *New York Times*, February 14; May 22, 30; June 26, 1916.

¹³ *New York Times*, January 30; March 1, 1916.

¹⁴ *Ibid.*, January 5, 26; March 5, 6, 1916.

The extraordinary expenditures for the army and navy were to come through increasing the existing income tax rates, levying an estate tax, imposing a tax upon the manufacture of war munitions, and retaining certain of the special taxes provided for in the 1914 War Revenue Act.¹⁵

In order to place the extra tax burden on those deriving the most benefit and protection from the government, the bill increased the normal tax on corporate and individual incomes from 1 to 2 per cent and raised the surtax rates on incomes over \$40,000 so that the maximum rate on incomes over \$500,000 became 10 per cent instead of 6 per cent. Although no federal inheritance or estate tax had been allowed by the conservatives since the Spanish-American War, the Democrats dared to propose a federal estate tax ranging from 1 per cent on net estates not over \$50,000 to 5 per cent on those over \$450,000. An exemption of \$50,000 and deductions for all valid claims and administrative expenses from the gross value of the estate were granted and were made the basis for determining the value of the net or taxable estate. Kitchin maintained that the federal estate tax would not affect adversely the forty-two states which imposed inheritance taxes because the state taxes were mild and the federal tax was purposely made light. To satisfy those who regarded the munitions manufacturers as war-mongers and profiteers, a tax was levied on munitions manufacturers making a net profit of 10 per cent and over. The rates varied from 1 to 8 per cent of the gross receipts, depending upon the size of the receipts and the nature of the article manufactured. Gunpowder and other explosives were taxed most heavily, projectiles and firearms somewhat less, and copper least.

Since the income, estate, and munitions taxes raised most but not all of the estimated needed revenue, resort had to be made to the special taxes imposed by the 1914 Emergency Revenue Act on beer and wine, and on tobacco manufacturers, bankers, brokers, and owners of amusement places. The unpopular stamp taxes, however, were to be repealed immediately upon the passage of the new bill. Finally, Kitchin recommended the creation of a nonpartisan Tariff Commission, the granting of a protective tariff to the dyestuffs industry for a five-year period owing to the war emergency, and provisions directed against the dumping of foreign goods in American markets. He concluded with an appeal to all the parties to put patriotism above partisanship, to perfect the bill and then pass it. But the Republicans refused to

¹⁵ *Cong. Record*, 64th Cong., 1st Sess., 53:10470, appendix, 1937-50. See *House Report 922*, 64th Cong., 1st Sess., for a compact and incisive analysis of the bill.

respond to this plea as the presidential campaign had got under way in June with the nominations of Charles Evans Hughes and Wilson as the Republican and Democratic candidates respectively. The Republican Congressmen, led by Joseph W. Fordney of Michigan and Nicholas Longworth of Ohio, launched a series of attacks on the Underwood Tariff, the enormous defense appropriations, the Tariff Commission, and the general record of the Wilson administration. Longworth, the millionaire son-in-law of Theodore Roosevelt, criticized the surtaxes on high incomes and the exemption of \$3,000 and \$4,000 as class legislation pure and simple and as putting the burden of the income tax on less than one half of 1 per cent of all the American people. He urged the reduction of the exemption to \$1,000 or \$1,500 as a means of increasing the revenue and promoting social justice.¹⁶

A counterattack was made by the Democrats, with Cordell Hull and Champ Clark as the main defenders of the revenue bill and the Democratic administration. Hull refuted the indictments of the Underwood Tariff and the preparedness appropriation. The difference between the Democrats and the Conservative Republicans on tax issues he summed up by saying: "An irrepressible conflict has been raging for a thousand years between the strong and the weak, and the former always trying to heap the chief tax burdens upon the latter. That conflict still continues."¹⁷ Hull then gave an admirable justification of the federal income and estate taxes in terms of the distribution of wealth and income, the allocation of the tax burden, and the revenue needs of the federal government.¹⁸

The Democratic speakers after Hull could add little to his comprehensive analysis, and soon the House turned to the consideration of the numerous amendments to the revenue bill suggested by Congressmen. Among the few which stand out for their social and economic importance were the proposals by Robert Crosser, an Ohio Democrat, for increasing the surtaxes to a maximum of 12 per cent on incomes of \$500,000 and over, and by Joseph W. Fordney for striking out the federal estate tax.¹⁹ A powerful effort was also made by Representatives from the copper-producing states of Arizona, Montana, and Michigan to have the special tax on copper either abolished or limited to copper used in the making of munitions. They were defeated through statements made by Hull and others on the "abnormal, peculiar, and colos-

¹⁶ *Cong. Record*, 53: 10528-29.

¹⁷ *Ibid.*, 10652.

¹⁸ *Ibid.*, 10655-57.

¹⁹ *Ibid.*, 10765-66, 10761.

sal profits" made in the entire copper industry because of the war demands.²⁰ The House did adopt, however, an amendment suggested by Nicholas Longworth and proposed by Claude Kitchin which limited the tax on personal income derived from stock dividends to the amount of their cash value.²¹ This provision attracted national attention four years later when the Supreme Court declared that the taxation of stock dividends as income was unconstitutional unless apportioned as a direct tax.²²

On July 10, by a vote of 238 to 142, the House passed the unprecedented peace tax bill it had debated for four days with such vigor. The Democratic majority was bolstered by the votes of thirty-nine Republicans and one Independent, all but two of whom came from the North Central and Far West states.²³ The verdict of the newspapers varied. The *New York Times* damned the House bill, especially the high income rates and exemptions, as "class legislation."²⁴ The *Springfield Republican* and the *New York Evening Post* expressed little sympathy for the complainers against the increased tax burden because most of them had been "clamoring for armament without end" and were now learning that "militarism comes high."²⁵ Groups adversely affected by the new taxes, such as the munitions manufacturers, copper mine owners and refiners, investment bankers and theater owners, protested.²⁶ On the other hand, the Association for an Equitable Federal Income Tax defended the new tax measure as reducing the inequality of sacrifices created by the hitherto prevalent indirect tax system.²⁷

Senate Conflict on Tax Burdens

The fate of the House revenue measure, however, was to be determined by what action the Senate took on the various disputed questions. The Senate Finance Committee, headed by Simmons of North Caro-

²⁰ *Ibid.*, 10740-49, 10759-61. The copper spokesmen were Carl Hayden of Arizona, John M. Evans of Montana, and Joseph W. Fordney and W. Frank James of Michigan.

²¹ *Ibid.*, 10727.

²² *Eisner v. Macomber*, 252 U.S. 189 (1920).

²³ *Cong. Record*, 53:10768; *New York Times*, July 11, 1916. The House had 232 Democrats, 199 Republicans, 7 Progressives, 1 Socialist, and 1 Independent; *The World Almanac*, 1916, 499.

²⁴ *New York Times*, July 3 and 24, 1916.

²⁵ *Literary Digest* (July 15, 1916), 53:119.

²⁶ *New York Times*, July 3, 8, 10, 1916.

²⁷ *Ibid.*, July 17, 1916. To equalize the sacrifices of the different economic classes they advocated increasing the tax rates to 20 per cent on net incomes over \$500,000 and to 33½ per cent on those over \$1 million, with corresponding increases on the lower incomes over \$50,000, especially on those derived from investments. They felt that such surtax advances would make unnecessary the tax on war munitions profits.

lina, devoted a month ²⁸ to revision of the bill and then spent a week presenting and defending its report before the Democratic Senate caucus. The Committee won the support of the caucus on nearly all its major recommendations despite strong criticism from certain radical senators who desired higher surtaxes on the large incomes ²⁹ than the Committee proposed and equally firm demands by conservative and election-conscious Senators that the increased direct taxes be abandoned and bonds be issued in their place.³⁰ On one important point the Committee yielded to pressure from Senators from copper and cotton states and reduced the tax on materials entering into the composition of munitions from 10 per cent to 5 per cent.³¹

Two days after the Democratic Senate caucus had ended its rather heated meetings Simmons formally presented to the Senate the Finance Committee's report on, and revision of, the House tax bill.³² On August 22, a week later, he opened the Senate debate by explaining the need for additional revenue as due to the extraordinary expenses arising from the military and naval preparedness program and the difficulties with Mexico. To raise this money, the Democratic majority of the Finance Committee proposed to increase up to 13 per cent the surtax rates on the larger incomes; to raise the tax rates on the millionaire estates; to levy a new tax on corporation capital, surplus, and undistributed profits; to increase the taxes on profits from munitions and the materials used in their production, calculated on a net-profits instead of a gross-receipts basis; and to retain most of the documentary stamp taxes provided by the Emergency War Revenue Act of October 22, 1914, which the House had voted to repeal. Simmons attempted no elaborate justification of most of these taxes, but simply said they were taxes on wealth or the abnormal profits from war orders.³³

Owing to their desire to win the impending presidential election, the Republicans launched a fierce attack on the Democratic party's tariff, appropriations, and direct taxes record and program. The Democrats defended the Wilson administration and counterattacked with

²⁸ *Ibid.*, July 8, 38; August 5-8, 1916.

²⁹ Senators Key Pittman of Nevada, Henry L. Myers of Montana, and James A. Reed of Missouri. Reed wanted the surtaxes varied to 28 per cent instead of the Committee's 13 per cent. *Ibid.*, August 12, 1916.

³⁰ Senators James H. Lewis of Illinois, Oscar W. Underwood of Alabama, William E. Chilton of West Virginia, Thomas W. Hardwick of Georgia, and James E. Martine of New Jersey. *Ibid.*, August 14, 1916.

³¹ *Ibid.*, August 14, 1916. For the final caucus action of August 15, see *ibid.*, August 15, 1916.

³² *Senate Report* 793, 64th Cong., 1st Sess.

³³ *Ibid.*, Pt. 1; *Cong. Record*, 53: 12953-57.

great effectiveness and skill.³⁴ After four days of rhetorical fireworks the Senate settled down to the legislation before it. John Sharp Williams, the able and affable chairman of the income and estate tax subcommittee, presented and explained changes and increases recommended by the Finance Committee in the income and estate taxes. He gained the approval of the Senate on a majority of the points, but encountered stubborn resistance on a few key questions. Oscar W. Underwood, the coauthor of the 1913 Tariff Act, created a dramatic scene when he revolted against what he considered unjustified committee and caucus domination and sought to have the income tax exemptions reduced from \$4,000 to \$3,000 for married men and from \$3,000 to \$2,000 for unmarried men.³⁵

A series of sharp clashes occurred over the attempts by midwestern liberals to secure publicity on the income tax assessments of individuals.³⁶ Another keen debate arose over the tax of 5 per cent on the net profits of corporations selling or manufacturing materials entering into the manufacture of munitions, although only a few conservative Republicans protested against the tax of 10 per cent on the net profits of the munitions manufacturers. Senators from the western mining states, such as Henry F. Ashurst of Arizona and Henry L. Myers of Montana, and Senators from the cotton-growing South, such as Ellison D. Smith of South Carolina and Underwood of Alabama, argued against the tax on materials used in munitions manufacture as unfair to their sections unless extended to all raw materials enjoying war prosperity and as unnecessary in view of the possible increases in income and inheritance taxes. Since William J. Stone of Missouri, who had drafted the munitions tax section, asserted that the tax under fire would be expensive to collect and would not yield much revenue, the opponents of the tax were able to secure its elimination from the bill.³⁷

Among the important questions which were speedily and quite peaceably settled were the increases in the income and estate tax rates, the tax on corporate capital stock, the tax exemption extended to federal judges, state employees, and the tax on dividends received by holding companies. Conservative Republicans like Boies Penrose, the "Boss" of Pennsylvania, and George T. Oliver, a Pittsburgh millionaire manufacturer, expressed disapproval of the federal income and inheritance taxes in times of peace as Democratic weapons against the protective

³⁴ *New York Times*, August 23-26, 1916.

³⁵ *Ibid.*, August 27, 1916; *Cong. Record*, 53: 13266-73.

³⁶ *Cong. Record*, 53: 13290-92, 13852-59.

³⁷ *Ibid.*, 13492-13500, 13511.

tariff, the capitalist class, and the industrial Northeast,³⁸ but could muster little support for their position when the votes were taken.³⁹ Oscar W. Underwood made a gallant but unsuccessful assault on the special protective tariff for the dyestuffs industry as contrary to the Democratic party's principles and the welfare of the people,⁴⁰ and as not necessary for meeting the war situation. He also arraigned severely the creation of a Tariff Commission at that time as paving the way to the adoption of a protective tariff, but he did not succeed in stopping that measure.⁴¹

On September 6 the Senate passed by a vote of 42 to 16 the general revenue bill it had been deliberating on and revising for almost two months. Five Progressive Republicans from the Middle West—Moses E. Clapp of Minnesota, Albert B. Cummins and William S. Kenyon of Iowa, La Follette of Wisconsin, and George W. Norris of Nebraska—joined the Democrats in supporting the bill because it embodied, in the main, the tax principles they had long championed.⁴² The Conference Committee appointed by the House and Senators to settle their differences, after informal consultations carried on during the previous week, was able after three days and two nights of hard labor to present a report acceptable, on the whole, to both the House and the Senate. The Senate, however, won the major number of victories. Out of 273 of its amendments, all but 34 were retained, and of the 34 only four or five were considered of great importance. Though both chambers protested against certain of the decisions reached by the Conference Committee, the Senate and the House passed the bill in its final form on September 7. The next day it was signed by the President and became law.⁴³

The Progressive Character of the 1916 Revenue Act

The Emergency Revenue Act of 1916, when enacted, did not get into the focus of public attention owing to the threatened railroad strike which Wilson averted by getting Congress to pass the Adamson Act of September 3.⁴⁴ Conservative papers like the *New York Times* criticized the Revenue Act as directed against the Northeast, the well to do,

³⁸ *Ibid.*, 13060-65, 13295-97.

³⁹ *Ibid.*, 13261, 13298, 13333, 13414.

⁴⁰ *Ibid.*, 13751-59, 13768. The vote was 43 to 7 against him.

⁴¹ *Ibid.*, 13864-68.

⁴² *Cong. Record*, 53: 13873; *New York Times*, September 6, 1916.

⁴³ *Cong. Record*, 53: 14016-32, 14103-20, 14158. *New York Times*, September 1, 7, 8, 1916.

⁴⁴ Paxson, *Pre-War Years*, 353-56.

and the superrich. On the other hand, the New York *Evening Post* and other liberal papers generally praised the act as constituting "another advance toward the historic goal of the party now in power—the substitution of direct taxation for the protective tariff."⁴⁵ Progressive economists shared the enthusiasm of Professor Roy G. Blakey when he declared the new Act would take high rank in legislative history because of its radical departures from previous policies "in order to carry out new and far-reaching national policies on a scale that is unprecedented and that was little dreamed of until two years ago." The abandonment of the tariff as a source of additional revenue and the trend toward equalitarianism led him to assert: "More and more is privileged protectionism to be undermined front and rear; more and more is great wealth, especially easily gotten war-made wealth, to be made to disgorge and to share its gains by lifting the burdens of government and of government subsidies from the shoulders of the great consuming masses."⁴⁶

The basis for this high praise is evident after even a brief study of the 1916 Revenue Act,⁴⁷ as it finally emerged on the statute books. More than one half of the estimated needed \$205 million was to be obtained through additions to the income tax. The normal tax was increased from 1 per cent to 2 per cent on net incomes above \$4,000 for married persons and \$3,000 for single persons. The surtax on incomes over \$20,000 was raised on a graduated scale from a maximum of 6 per cent on incomes over \$500,000 to a maximum of 13 per cent on incomes over \$2 million. This made the maximum rate of the income tax, as a whole, 15 per cent. The exemptions granted in the 1913 law to the salaries of the President, federal judges, and state and local employees and to federal, state, and local obligations were retained. The tax on the net income of corporations also rose from 1 per cent to 2 per cent. With these higher rates on the higher incomes went various important technical changes in the provisions on deductions, partnerships, stock dividends, capital gains and losses, the depletion of mines and oil wells, and other matters.⁴⁸

⁴⁵ *Literary Digest* (September 16, 1916), 53: 657; *New York Times*, September 9, 1916.

⁴⁶ Roy G. Blakey, "The New Revenue Act," *American Economic Review* (December, 1916), 6: 837, 850.

⁴⁷ Act of September 8, 1916, 39 *U.S. Stat. at Large*, 756.

⁴⁸ Deductions for losses were extended to include those incurred in transactions not connected with the taxpayer's business or trade, to an amount not exceeding the profits arising from the transactions. Partnerships were allowed the same deductions as individuals. Capital gains from sale of property acquired before March 1, 1913, were to be determined by the fair market price or value of the property on March 1, 1913,

On a few points experts made criticisms. They pointed out the continued failure of Congress to lighten the taxes on earned as against unearned (or funded) incomes, as was common in England and most other countries. Congress, on the other hand, favored the farmer and homeowner by exempting farm produce and house rent when consumed by the producer and owner respectively. Businessmen complained of the inconvenience and financial costs of the stoppage-at-the-source method of collection and wanted an information-at-the-source procedure used as a substitute. Some objected strongly to the double taxation of holding companies. Aliens in the United States and non-resident American citizens also felt unjustly exposed to double taxation.⁴⁹

The First Permanent Federal Inheritance Tax

In addition to the highest income tax rates on large incomes until then levied by Congress, the 1916 "Preparedness" Revenue Act contained the first inheritance tax (in the broad sense of the term) to become a permanent part of the federal revenue system. The Civil and Spanish-American War inheritance taxes had both been repealed within a few years after the close of the emergencies which had called them into being, and the inheritance tax provision in the 1909 tariff bill, although backed by Taft and the House of Representatives, had been killed by the conservatives in the Senate. By 1916 the number of states having inheritance tax laws of one sort or another had grown from twenty-six in 1902 to forty-two; thirty imposed taxes on both direct and collateral heirs while twelve others imposed taxes exclusively on the collateral heirs. But the keen opposition the states had previously shown to a federal inheritance or estate tax was now weak-

as the basis. The 1913 limitation on the depletion allowance for coal mines and oil wells to 5 per cent of the gross value of the year's output was supplanted by a reasonable allowance for depletion which the Secretary of the Treasury was to prescribe. Stock dividends were made taxable to the amount of their cash value, and individuals with net incomes less than \$20,000 were taxed on their corporation dividends, whether in cash or in stock. Nonresident aliens, in contrast to the 1913 law, were made subject to the tax on dividends from the stock, and on interest from the securities, of American companies. The list of tax-exempt corporations (mainly nonprofit) was increased to include many not mentioned specifically, although implied, in the 1913 act. The scope of the income tax was broadened to include gains from unlawful as well as lawful business. See Blakey, *op. cit.*, 837ff., and Robert H. Montgomery, *Income Tax Procedure 1917* (New York, 1917), *passim*, for more details.

⁴⁹ Blakey, *op. cit.*, 837-43; Montgomery, *op. cit.*, 340-57. The latter also objected to the \$3,000 exemption, the taxation of corporate income, and the failure to adopt the English three-year average of profits and losses as the basis for determining the tax on net profits.

ened by the preparedness needs of the federal government, and the sponsorship of the measure by the Democratic party, the traditional guardian of states' rights. Moreover, the states received comparatively little revenue from their inheritance taxes owing to the skill shown by various millionaires in state tax avoidance and evasion.⁵⁰

An important factor behind the enactment of the federal estate tax in 1916 was the pressure of public opinion as manifested in the discontent of the common people concerning the high cost of living, the power of big business, and the increase in the concentration of wealth. The reform movement which had led to the election of Wilson in 1912 and the ratification of the Income Tax Amendment in 1913 also stimulated the inheritance tax movement. In 1915 the Industrial Relations Commission issued its much-debated reports on the causes of unrest among industrial workers in the United States. Basil M. Manly, its research director, declared in his report one prime cause was the unjust distribution of wealth and income which enabled forty-four families to possess aggregate incomes totaling at least \$55 million a year while adult male workers in factories and mines earned from less than \$10 to \$20 a week. He condemned existing laws controlling the inheritance of property as a chief source of the industrial feudalism created by fortunes of the Rockefellers, Morgans, Vanderbilts, and Astors. To promote economic equality and to check the growth of a hereditary aristocracy menacing to democracy, he urged an inheritance tax which would limit the inheritances from any estate to \$1 million.⁵¹ Although the Manly Report was endorsed warmly by the Chairman and the three labor members of the Commission, the five nonlabor Commission members subscribed to a much less radical report written by Professor John R. Commons. The Commons Report, however, came out for a federal inheritance tax on all estates, graded from 1 per cent on the amount over \$25,000 to 15 per cent on that over \$1 million. Higher rates were to be imposed on collateral inheritances.⁵²

These recommendations for a federal inheritance tax gained wide publicity and strong support from labor unions, small businessmen, and

⁵⁰ Shultz, *Taxation of Inheritance*, 108-30, 150-56. In fact, the adoption of the federal estate tax in 1916 encouraged states either to enact inheritance taxes of their own or to increase their rates and to improve their enforcement.

⁵¹ The fund thus accumulated was to be used to extend education, to develop various social services, and to aid such public work as road building, irrigation, and reforestation. U.S. Commission on Industrial Relations, *Final Report and Testimony* (10 v., Senate Doc. 415, 64th Cong., 1st Sess., Washington, D.C., 1916), 1: 30-35. On the concentration of wealth and influence through corporations and foundations, see *ibid.*, 1: 80-86.

⁵² *Ibid.*, 1: 221.

farmers, although the *New York Sun* called the Manly Report a plan of "plain outright robbery"; the *New York Times*, "a frank project of confiscation."⁵³ These proposals came at a time when such surveys of the cost of living as John A. Ryan's *A Living Wage*, such economic studies as Richard T. Ely's *Property and Contract in Their Relations to the Distribution of Wealth*, Willford I. King's *Wealth and Income of the People of the United States*, and Scott Nearing's *Income* had helped to make the liberal middle-class public eager to use income and inheritance taxation as instruments of social reform.⁵⁴ Then Professor E. R. A. Seligman extended his income tax work by writing a notable essay in the *New Republic* of March 25, 1916, on the wisdom of a national inheritance tax as a revenue and social measure. This encouraged Cordell Hull and his Democratic colleagues to draft the federal estate tax and make it part of the 1916 Revenue Act.⁵⁵

The federal estate tax of 1916 imposed a tax upon the transfer of the net estate of every person dying after the passage of the Act, whether a resident or nonresident of the United States. The tax was purposely laid, not upon the property, but upon its transfer from the decedent to others in order to avoid legal challenge or nullification as a direct tax. The tax applied to the entire net estate, not to any particular and separate legacies or distributive shares. Thus it was not an individual inheritance tax. No differentiation was made because of the value of the separate interests or the relationship of the beneficiary to the decedent. The taxable net estate was determined by deducting from the value of the gross estate funeral and administrative expenses, debts, losses, and a \$50,000 exemption for resident decedents of the United States. Nonresident decedents were not allowed the \$50,000 exemp-

⁵³ *New International Yearbook*, 1915, 323-26; *Literary Digest* (September 4, 1915), 51:460-62. See also Myers, *Ending of Hereditary American Fortunes*, 237-62.

⁵⁴ Commons, *History of Labor*, 3:62-63; Dalton, *Inequality of Income*, 142-55; Merwin, "American Studies of Wealth and Income," *op. cit.*, 78-84. Dalton points out how few professional American economists published theoretical works on inheritance as a factor in the distribution of wealth. He singles out Ely's great work (1914) and the discussions in F. F. Taussig's *Principles of Economics* (1911) and Irving Fisher's *Elementary Principles of Economics* (1912) for special mention. Credit should also be given to the work done by E. R. A. Seligman, Max West, M. L. Lorenz, W. M. Persons, G. P. Watkins, and A. A. Young. The reason for comparative neglect of the subject in American universities deserves study. Cf. Thorstein Veblen, *The Higher Learning in America* (New York, 1919).

⁵⁵ Seligman, "National Inheritance Tax," *New Republic* (March 25, 1916), 6:212-14. For other periodical articles, 1910-18, see *Readers' Guide*, 3:1317, 4:1029. Vice-President Marshall created a stir in 1913 through his advocacy of the inheritance tax. *Literary Digest* (May 3, 1913), 46:995-96. Note that in 1907 Professor C. J. Bullock called a federal inheritance tax "a fiscal crime" and the National Tax Association went on record as absolutely opposed to it. Shultz, *op. cit.*, 155-56.

tion, but were granted the other deductions on property situated in the United States in proportion to the value which that part bore to the value of the entire gross estate, wherever situated.

The rates levied on taxable net estates ranged from 1 per cent on the first \$50,000 to 10 per cent on the amount over \$5 million.⁵⁶ The tax was due one year after the decedent's death. A discount of 5 per cent on the tax was granted for prior payment, a 6 per cent penalty was imposed for unavoidable delays in payment, a 10 per cent penalty for avoidable delays. To prevent tax evasion and avoidance, the value of the net estate was determined by including in the gross estate all transfers or trusts made by the decedent "in contemplation of or intended to take effect in possession or enjoyment at or after his death," except bona fide sales. Gifts made within the two years prior to death were presumed to have been made in contemplation of death. The recipient of such a transfer or trust was made liable to the amount of the tax due.⁵⁷

The guiding principles behind the federal estate tax were productivity of revenue in the face of a fiscal emergency, ease and simplicity of collection, and placement of the preparedness tax burden on the wealthy rather than the poor. From the standpoint of the heir against that of the community, an inheritance tax on, and graded to, the shares of the individual beneficiary was preferable to the estate duty, but the difficulties of administration and loss in revenue entailed impelled Congress at that time to choose the latter. Although the 1916 federal tax was superior to most of the state inheritance tax statutes in simplicity of statement and ease of application one serious defect marred it. The burden of the tax was not apportioned among the various beneficiaries according to their respective shares, but fell solely upon the residuary legatees, often the decedent's wife or family, unless the will directed otherwise. On the other hand, the federal estate tax, although modest in its rate compared to the first World War and New Deal

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Rate (per cent)	Amount of Net Estate
1	Under \$50,000
2	\$50,000-\$150,000
3	\$150,000-\$250,000
4	\$250,000-\$450,000
5	\$450,000-\$1,000,000
6	\$1,000,000-\$2,000,000
7	\$2,000,000-\$3,000,000
8	\$3,000,000-\$4,000,000
9	\$4,000,000-\$5,000,000
10	\$5,000,000, all over

⁵⁷ Cf. Shultz, *op. cit.*, 156-58.

rates, did act as an influence, along with the income tax, toward partially decreasing the then existing inequality in the distribution of wealth.⁵⁸

The Munitions Tax: An Innovation

A completely new addition to the federal revenue system was the munitions manufacturer's tax. Like the first federal income and inheritance taxes, it owed its creation to the fiscal exigencies of war, popular resentment against war profiteering, and the example set by other countries. Unlike these other taxes, however, the new tax was explicitly limited to the duration of the first World War and the year after its close. The munitions taxes in neutral Denmark and Sweden and in belligerent Canada, France, Germany, Great Britain, and Italy served as models and inspired the hope that the American tax would yield \$71 million, or a third of the estimated needed \$205 million. The tax of 12½ per cent was imposed on the net profits of all partnerships, corporations, and associations manufacturing gunpowder, explosives cartridges, projectiles, firearms, electric motorboats, submarines, or any of their parts. The deductions allowed for raw materials, running expenses, interest on debts, taxes, business losses, and amortization were liberal and were skillfully used by the manufacturers to decrease their taxes and to increase their profits.⁵⁹

The munitions tax was severely criticized by Professor Charles J. Bullock of Harvard University as due to a mistaken public sentiment that the munitions industry was wicked and had been coining unjustified profits out of war. He maintained that the industry was necessary to American defense and that its development should not be halted by unwise restrictions in profits. The issues involved were complex. The United States was less ready for possible participation in the war than any other country involved. Before 1914 only six government arsenals and two large private ordnance works were competent to manufacture heavy artillery. Although Allied orders led to some expansion in this direction, even in 1917 only a score of firms turned out artillery amuni-

⁵⁸ *Ibid.*, 159-60, 213-20. See Dalton, *op. cit.*, 239ff., and Allyn A. Young, *Economic Problems New and Old* (Boston, 1927), on the meaning of economic inequality. The 1916 Revenue Act, however, did not affect the concentration of wealth and income maintained through the use of corporations and foundations. See U.S. Commission on Industrial Relations, *Report*, 1: 80-86.

⁵⁹ Cf. Montgomery, *op. cit.*, 389-406; Robert M. Haig, "The Taxation of Excess Profits in Great Britain," *American Economic Review* (December, 1920, v. 10, No. 4, Supplement), 3-8; J. C. Stamp, "Taxation of Excess Profits Abroad," *Economic Journal* (March, 1917), 27: 26-37.

tion, big guns, rifles, machine guns, and other important ordnance supplies. In 1912 the American Powder Trust had been ordered to dissolve. Yet, despite the division of plants and business in dynamite and black sporting and blasting powders, the du Pont Company controlled the production of military and sporting smokeless powders. The outcome was that the economies of mass production and plant expansion made possible through profits from Allied orders enabled the American government, once it entered the war, to obtain its smokeless powder at less than prewar prices. On the other hand, the pressing need for new revenue, popular resentment at the tremendous munitions profits, and fear of warmongering by the munitions interests inspired the punitive munitions tax. Government monopoly of arms production, the solution to the problem of securing adequate defense without strengthening prowar interests, was not seriously considered then by many other than the pacifists and socialists.⁶⁰

Although the bulk of the extra revenue was designed to come from the income, estates, and munitions taxes, Congress also relied on excise taxes. A special capital-stock tax on all corporations having a capital stock represented by shares was imposed at the rate of fifty cents on each \$1,000 fair value of capital stock. An exemption of \$99,000 was allowed each corporation, and the reserves of insurance companies were excluded. Munitions manufacturers were not liable to both this tax and the munitions tax. They were subject to the one which yielded the greater revenue to the government. The taxes imposed by the 1914 and 1915 Revenue Acts on documents, cosmetics, toilet articles, and telegraph and telephone messages were repealed. The only consumption taxes increased were those on wines.

A protective tariff for the dyestuffs industry was created for a five-year period as a war-defense measure. At the end of this period the rates were to be taken off in five equal annual installments, if the domestic production was at least 60 per cent of the domestic consumption.

⁶⁰ See C. J. Bullock, "War Finance," *Proc. National Tax Assoc.* 1917, 146ff., 155; John M. Clark, *The Costs of the World War to the American People* (New Haven, 1931), 262-71; and E. Kehr, "Munitions Industry," *Encyclopedia of Social Sciences*, 6: 128-34 for facts and considerations against the munitions tax. *Per contra*, see Philip Noel-Baker, *The Private Manufacture of Armaments* (London, 1936), a masterly study of the subject and of the factors relating to the first and second World Wars; and Nye Committee, *Report on Government Manufacture of Munitions*, Senate Report No. 944, Pt. 7, 74th Cong., 2d Sess. David Lloyd George, *War Memoirs* (Boston, 1933), 2: 117-19, points out the influence of the copper and oil interests on American diplomacy and states that by March, 1915, the "Allies had secured control of 95 per cent of the exportable copper of the United States, and the powerful influence of the Copper Trust was no longer a menace to good relations between us and the States."

Otherwise the special duties were not to be levied. This was intended to prevent unjustified protection for the industry. Printing paper was put on the free list, if valued at five cents or less per pound, because the rise in the price of paper had made much of the imported paper dutiable at the 1913 basing point of two and a half cents. The dumping of foreign goods in the United States with the intent of injuring or destroying domestic industries was prohibited and a double duty was imposed upon goods imported under any agreement that the importer or any other person should use these goods exclusively.

The impact of the first World War upon the American economy was reflected not only in the new and higher taxes levied by the 1916 revenue bill but in the provisions empowering the President to take reprisal and retaliatory measures against belligerent powers discriminating against Americans. British interference with American commerce with neutral countries from the outbreak of the war became heightened on July 18, 1916, with the publication of a blacklist against certain American individuals and firms. The resentment of Wilson and the pressure of adversely affected business groups led Congress, in the Shipping Board Act of September 7, 1916, to give the President the authority to refuse clearance to any vessel declining to ship the freight of any American citizen because of his connection with a blacklist. In the Revenue Act the President was empowered to deny clearance papers to any ship unfairly discriminating against the commerce of United States citizens, and to refuse facilities in American ports to the merchant marine of any nation which employed discriminating practices against American commerce. These powers, however, were never fully used because Wilson, on the advice of Secretary Redfield of the Commerce Department, feared that they might lead to British retaliatory measures which could paralyze American industries dependent on rubber, wool, jute, tin, and other essential raw materials.⁶¹

An important administrative creation of the Revenue Act was the Tariff Commission, which has functioned since then. Unlike the Tariff Board of 1911 which President Taft set up under very vague statutory authority, it was specifically established by Congress, with six Commissioners, not more than three of any one party, extensive powers of investigation, and a considerable appropriation. Some of its sponsors hoped the Commission would "take the tariff out of politics"; others

⁶¹ *New York Times*, August 11, 30, 1916; Tansill, *America Goes to War*, 535-47. It is the irony of history that on July 17, 1941, President Franklin D. Roosevelt followed British World War I precedents and issued a blacklist of Latin-American firms and individuals believed to be acting in the interest of Germany or Italy. *New York Times*, July 18, 1941.

that it would aid Congress in establishing tariff rates on a more rational basis. Although the Utopian expectations of some were not realized, subsequent events proved the Commission to be of considerable value when not frustrated by strongly reactionary pressure groups.⁶²

⁶² Taussig, *Tariff History*, 481-87, 521-26.



America Goes to War

THE background of Congressional discussion and actions concerning the seemingly gigantic tax levies of the 1916 Revenue Act and other important measures was the presidential election to be held that November. The Republicans at their Chicago convention in June refused the Progressive party's proposal to select Theodore Roosevelt as their joint candidate and nominated Charles Evans Hughes, then an Associate Justice of the Supreme Court, as the Republican choice. The Progressives insisted on formally proclaiming Roosevelt their nominee, but he soon rejected the honor because he felt Wilson and his foreign policy should be defeated at all costs, even if it meant the sacrifice of the Progressive party. Hence he became a vigorous public supporter of Hughes until the Progressive party split into supporters of either Wilson or Hughes.¹ Meanwhile the Democrats at St. Louis renominated Wilson with great enthusiasm and confidence on a platform he had almost completely drafted. The Socialists put forward a very moderate candidate, Allen L. Benson, with a program critical of both capitalism and the violent revolutionary action associated with Bill Haywood and the I.W.W., while the Prohibitionists nominated J. Frank Hanly, former Governor of Indiana, on a broad platform of social justice, antimilitarism, and political reform.

Causes of Wilson's Re-election

Although Hughes had a creditable record as a progressive governor of New York and as an able, mildly liberal judge, he failed to win the American public through his presidential campaign speeches. His strategy consisted in criticizing Wilson for his nonmilitant conduct of

¹ Bowers, *Beveridge and the Progressive Era*, 485-93; H. L. Ickes, "Who Killed the Progressive Party?" *American Historical Review* (January, 1941), 46: 306-37; Henry L. Stoddard, *As I Knew Them* (New York, 1927), 426-59.

foreign affairs, his yielding to labor on the Adamson Act, his responsibility for the 1913 tariff, and in trying to use both the pro-Ally and the anti-British votes at the same time. Wilson was re-elected, however, owing to Hughes's failure to offer constructive policies, factional politics in California, and Wilson's success in dramatizing the issues of Americanism, the maintenance of an honorable peace, and his contributions to the welfare of workers, farmers, and small businessmen. The final count showed that Wilson's victory occurred through the narrowest margin of electoral votes since the Hayes-Tilden campaign of 1876—277 to Hughes's 254—yet Wilson's popular vote of 9,127,695 to Hughes's 8,533,507 represented a plurality of almost 600,000 and was a gain of nearly 3 million over the vote Wilson had received in 1912. Hughes carried nearly all the eastern states, in large part because of the powerful backing he received from the financial and industrial powers, but Wilson broke all precedents by winning Ohio, New Hampshire, California (by a margin of 3,773 votes), and an almost solid South and West. He also enabled the Democratic party to retain control of both houses of Congress for the following two years.²

In view of the financial gains made by financiers and industrialists from American participation in the war a few months after this election, it is interesting to note that a very large majority of them favored Hughes and many contributed handsomely to the Republican campaign fund of \$2,500,000. Pierre S. du Pont gave the largest individual contribution, \$92,500; several, including John D. Rockefeller, Sr., Jr., and J. P. Morgan, \$15,000 to \$25,000, and large numbers from \$1,000 to \$10,000. On the other hand, the Democrats received \$79,000 from Cleveland H. Dodge, the copper and munitions magnate and Wilson's close friend, \$50,000 from Edward L. Doheney, owner of the Mexican Petroleum Company, and smaller but substantial contributions from liberal businessmen. But the major share of the Democratic fund of \$1,585,000 came from the small contributions of 170,000 middle-class citizens.³ Wilson's support came in general from the ranks of the workers, farmers, professional men, and small businessmen convinced of his sympathy with and efforts for their objectives. Radicals and pacifists, fearful of Hughes as an agent of capitalistic imperialism, turned to Wilson and caused the Socialist vote to drop to 589,446, almost one half of the 1916 Socialist record vote.⁴

² Baker, *Wilson*, 6: 231-301; Paxson, *Pre-War Years*, 325-64; Robinson, *Presidential Vote*, 17-19, 46.

³ Lundberg, *America's Sixty Families*, 128-33; *New International Yearbook*, 1916, 746.

⁴ Cf. Commons, *History of Labor*, 4: 286.

The First Excess-Profits Tax: March 3, 1917

A month after the re-election of Wilson, Congress met to consider the fateful domestic and foreign problems before the country. Although the President in his message to Congress on December 5 concentrated his attention on the railroad problem, William G. McAdoo, the Secretary of the Treasury, pointed out that the enormous sums estimated at that time by the army and navy as required for the preparedness in 1917 and 1918 rendered the existing revenue legislation, including the Act of September 6, 1916, inadequate. He warned that unless it was supplemented, an estimated deficit of \$185 million would result by June 30, 1918.⁵

In response to this plea, Congress, after several months of fiery debate on this and other matters, passed a revenue measure signed by Wilson on March 3, 1917, which never went into effect because events very speedily necessitated its replacement, but which is important as a pathbreaker in American finance during the first World War. The Act⁶ imposed for the first time in federal tax history an excess profits tax of 8 per cent on the net income of corporations and partnerships above \$5,000 and 8 per cent of their actual invested capital.⁷ Fifteen countries, led by Scandinavia and Great Britain, had adopted one form or another of this tax during 1915 and 1916, and by 1919 the number was to swell to twenty-seven. Thus world-wide experiment with a new type of taxation was based on the principle that there was a limit to the necessity or legitimacy of gains from business enterprise, especially in wartime. The American munitions manufacturers' tax of September 8, 1916, had been inspired by the British Munitions Levy of July 2, 1915, and had been the first suggestion in American federal finance of a tax on excess profits as differentiated from normal profits, but had been limited to a single group of industries. Similarly, the British and Canadian Excess Profits Tax Statutes acted as an inspiration to Congress.⁸

⁵ *Treasury Report* (1916), 31, 49.

⁶ Act of March 3, 1917, 39 *U.S. Stat. at Large*, 1000.

⁷ Actual capital invested was defined as meaning: "(1) actual cash paid in, (2) the actual cash value, at the time of payment, of accounts other than cash paid in, and (3) paid in or earned surplus and undivided profits used or employed in the business"; but as not including "money or other property borrowed by the corporation or partnership."

⁸ Harcourt L. Caverly, *The Differential Taxation of Profits* (Ph.D. Thesis, University of Michigan, 1929), 1-19. Caverly, like Josiah Stamp, drew a distinction between "war" profits as gains due to war and excess profits as abnormal profits made

Claude Kitchin, the Democratic floor leader in the House and Chairman of the Ways and Means Committee, seems to have been the driving force behind the excess-profits tax. He was misrepresented by the *New York Times* and other conservative, prowar eastern papers as a narrow-minded, bigoted southerner who was anxious to put all the tax burden created by the preparedness appropriations on the states north of the Mason and Dixon line. This, they said, would appease insurgent southern Democrats opposed to Wilson's foreign policy and at the same time meet the fiscal needs of the administration. Actually, he was free of sectional malice and was highly patriotic but was determined to protect "the great silent masses" by levying the needed taxes on those best able to pay, especially those making large profits out of the European War.⁹ He justified his proposal by citing the European precedents and showed that the 8 per cent tax on excess profits was slight in comparison with the rates for Germany, France, Russia, and Great Britain, which ranged from 30 to 60 per cent.¹⁰ The reason that Kitchin and other champions of the excess-profits tax chose the Canadian plan of basing the "excess-profits credit" or "normal deduction" on the invested capital rather than the British prewar profits plan was that the former could serve as the basis of a permanent tax, while the latter could not.¹¹

Kitchin succeeded in making the Revenue Act of March 3, 1917, increase the 1916 estate tax rates by 50 per cent so that they ran from a minimum of 1½ per cent to a maximum of 15 per cent. No change was made in the brackets to which they were to apply. The Act also provided for the sale of \$222 million of Panama Canal lands and the issuance of \$100 million in bonds to cover the Mexican border patrol, the purchase of the Danish West Indies, the construction of a government armor-plate plant, and other matters. The amount of 3 per cent Treasury certificates of indebtedness was increased from \$200 million to \$300 million to tide over the Treasury until the current year's income tax returns, payable in June, would be available. The receipts from the excess-profits tax and one third of those from the estate tax, together with \$175 million collected from the taxes levied by the 1916 Revenue Act, were to be set aside as a special preparedness fund.

On February 1, 1917, by a vote of 211 to 196, the House passed

during the war. The latter, he said, could be computed on a prewar average profit base or on the normal return of the invested capital.

⁹ Arnett, *Claude Kitchin*, 108-14, 241.

¹⁰ *Cong. Record*, 64th Cong. 2d Sess., 54: 2271.

¹¹ Thomas S. Adams, "Should the Excess Profits Tax be Repealed?" *Quarterly Journal of Economics* (May, 1921), 35: 364.

the bill despite stern Republican resistance led by Joseph W. Fordney of Michigan, who attempted in vain to have the excess-profits tax eliminated from the bill.¹² Passage through the Senate was delayed for a month by dissension within the Finance Committee and the Democratic Senate Caucus on the advisability of a bond issue as against the House tax bill, and by forcible objections delivered against the excess profits by spokesmen for the munitions manufacturers, the mutual life insurance companies, and the business interests. La Follette was the outstanding radical who fought the excess profits too, but he did so because of the difficulties involved in measuring invested capital and because he advocated as a substitute higher income and estate taxes, publicity on income tax returns, and taxation of corporate dividends held by the individual recipients.¹³ In addition to these obstacles to the passage of the revenue bill, there was the turmoil created by the resumption of the German submarine campaign on February 1, Wilson's proposal for "armed neutrality," and the fight against his prowar policies by La Follette, Norris, and ten other "peace-at-any-price" Senators. The upshot was that the Democrats in the Senate decided to break through the legislative log-jam by passing on February 28 the new revenue measure in precisely the form it had come from the House.¹⁴ But swift-moving events soon rendered the Revenue Act of March 3, 1917, ineffective.

America's Entrance into the War

From the outbreak of the first World War in August, 1914, Wilson had struggled to keep the United States out of the European maelstrom, because he believed both sides had similar imperialistic objectives in view and because he hoped to bring the war to an end through negotiation. He wanted the United States to be the one great neutral power in a position to propose and enforce terms which would guarantee world peace. Hence he had sent Colonel House on peace missions to Europe early in 1915 and 1916, and had thwarted attempts by Robert Lansing, Page, House, and others to break off relations with Germany. In December, 1916, he appealed to all the belligerent powers to state their war aims and terms of peace, and on January 22, 1917, after receiving

¹² *Cong. Record*, 54: 2440, 2442. The party division in the House was: 227 Democrats, 199 Republicans, and 10 minor party representatives.

¹³ *Ibid.*, 4495.

¹⁴ *Ibid.*, 4523. Cf. Blakey, *Federal Income Tax*, 122-29.

discouraging replies from the two contending groups, he made his noteworthy address to the people of the world on the essential conditions for permanent world peace: a "peace without victory," between equals, and the creation of a League of Nations.¹⁵

But his hopes and those of the masses stirred by his eloquence and vision were speedily dashed to earth when the German government formally announced on January 3 that beginning February 1 it would wage unrestricted submarine warfare upon all commerce within certain specific zones about Great Britain, France, and Italy. This decision had been made by the German Supreme Command, Hindenberg and Ludendorff. Ludendorff was the real military dictator of Germany from August, 1916 to October, 1918. He was convinced that an economically unfavorable peace for Germany, which would involve the imposition of overwhelming taxes upon the people, would be so keen a disappointment to the demobilized soldiers that they would be impelled to revolution. A victorious peace, with annexation of territory and huge indemnities from the opposing countries, was essential to the continuation in power, political and economic, of the ruling class in Germany, with which he identified himself. Because of the superior numbers of the Allies and the long-time effects of the British blockade the military situation at the end of 1916 did not promise victory for the Germans, despite spectacular victories in Rumania and extremely effective defense operations on all fronts. Victory might have been gained through the negotiation of a separate peace with Russia, but that opportunity was bungled and lost. As a result, the German military and naval command turned to ruthless submarine warfare as the sole means by which Germany could destroy so many British ships as to compel England within six months to sue for peace through lack of food and raw materials. Ludendorff and his supporters discounted the danger of American intervention: American industry was already serving the Entente and thus America was already economically at war with Germany. The addition of the American fleet to the British and French was a matter of indifference since Germany was not waging naval battles. The active participation of the American army in Europe was dismissed because the German administration declared the submarines would prevent a single American soldier from landing. Moreover, it was assumed that the war would be won by the time an American army could be mobilized and trained for European service.¹⁶

¹⁵ Baker, *Wilson*, 5: 1-76, 276ff.; 6: 177ff., 302-446; 6: 127-32.

¹⁶ Arthur Rosenberg, *The Birth of the German Republic* (London, 1931), 114-49.

The German imperial government rejected peace by mutual consent in 1916 because it would lead to democracy within Germany and it gambled on the submarine campaign as an indispensable means of securing the victorious peace needed to give the governing upper classes the security they craved for their privileges. The consequence was fatal to the German government. Wilson had favored England and France in his interpretations of international law and in allowing them first credits, then loans. He had dealt harshly with Germany's violations of American neutrality rights up to May, 1916, but had become extremely irritated by the end of 1916 with Great Britain's high-handed rejection of America's maritime grievances and blacklisting of American firms. He felt on February 1 and 2 that it would be a tragedy to become involved in a war that it was humanly possible to avoid, and he did not wish to see either side win. Nevertheless he became convinced through Cabinet and Senate advice that he should sever diplomatic relations with Germany on the submarine issue, and did so on February 3. A near Cabinet revolt against Wilson's forbearance with Germany on February 23, and the disclosure two days later of the Zimmermann note asking Mexico to attack the United States in case of war, led him to ask Congress on February 26 for authority to put armed guards on American merchantmen. When the Senate filibuster against his plan prevented its adoption, he assumed the authority on March 12 and thereby took a step leading directly to war.¹⁷

Three days later came news of the Russian Revolution, which removed the one obstacle to declaring a war against Germany a war for democracy. By March 18 five American merchant vessels had been sunk, and by March 21 Wilson had become persuaded by his Cabinet and Colonel House that a declaration of war was inevitable and that Congress should be convened for that purpose. Although Wilson agonized over that decision, and vividly pictured the evils arising out of war, he felt impelled on April 2 to ask Congress to declare war on Germany in order to maintain American neutrality rights, to avenge and prevent the loss of American lives, and to make the world safe for democracy. The power of his speech won the Senate to an approval of the war resolution on April 4 by a vote of 82 to 6 despite La Follette's magnificent rebuttal. The House followed on April 6 with a vote of 373 to 50.

¹⁷ Baker, *Wilson*, 6: 447-85.

War Finance Policy of Wilson and McAdoo

Space does not permit our going into all the factors behind Wilson's and Congress's decision.^{18, 19, 20} In his long-drawn, lonely meditation on whether to go or not to go into war, Wilson clearly saw the dangers. He told intimate friends:

Every reform we have won will be lost if we go into this war. We have been making a fight on special privilege. We have got new tariff and currency and trust legislation. We don't know yet how they will work. They are not thoroughly set. War means autocracy. The people we have unhorsed will inevitably come into the control of the country for we shall be dependent upon the steel, oil and financial magnates. They will run the nation.

Industry would be so demoralized, profiteering run rampant, robbery would become the order of the hour and prices would soar so high that even after peace should be restored, it would require a generation to restore normal conditions.²¹

He rejected early in 1917 the conservative Republicans' proposal for a coalition Cabinet: "It is the *Junkerthum* trying to creep in under cover of the patriotic feeling of the moment."²²

This concern for preserving the principles of the New Freedom was reflected in Wilson's war finance policy. In his war message of April 2 he asked for the extension of the most liberal financial credits to the governments at war with Germany and "the granting of adequate credits to the [National] Government, sustained . . . so far as they can equitably be sustained by the present generation, by well-conceived taxation." He asserted that it would be most unwise to base the credits which were then necessary entirely on money borrowed. Otherwise he feared that very serious hardships and evils "would be likely to arise out of the inflation which would be produced by vast loans."²³ These views were in accord with those of William G. McAdoo, the resourceful and energetic Secretary of the Treasury. The latter had the primary responsibility for financing the war which he, along with other pro-Ally Cabinet members, had urged his father-in-law to enter.²⁴ McAdoo

¹⁸ *Ibid.*, 6: 486-517; Tansill, *America Goes to War*, 631-59.

¹⁹ Thomas A. Bailey, *A Diplomatic History of the American People* (New York, 1940), 644-45.

²⁰ Charles A. Beard, *The Devil Theory of War* (New York, 1936), *passim*.

²¹ Baker, *Wilson*, 6: 506, n. 2; Remarks to Josephus Daniels, W. C. Adamson.

²² *Ibid.*, 6: 462. Letter to House, February 12, 1917.

²³ *Public Papers of Woodrow Wilson*, 5: 9-10.

²⁴ Baker, *Wilson*, 6: 471.

studied Civil War finance and decided to avoid Chase's errors. He at first thought that half the cost of the war should come from taxes, but soon concluded that "taxation on such a scale would be excessive, and destructive to some extent of the capitalized energy which keeps the wheels [of industry] turning."²⁵ His final decision was that the proper ratio of taxes to loans was 1 to 3. This was in sharp contrast to the opinion of J. P. Morgan that not more than 20 per cent of the total expenditure for the war should be obtained by taxation. Morgan wrote:

It is exceedingly important that investors of all sizes should not be discouraged, as they easily may be, by a scale of taxation which is felt by them to bear unjustly upon the investing class of the country.²⁶

War Loans before War Taxes

Yet the first measure McAdoo secured from Congress was an act on April 24, 1917, authorizing an issue of \$5 billion of bonds, "the greatest single bond issue in the history of the world," and \$2 billion of Treasury certificates of indebtedness. He estimated at that time in his first "war budget" that the total government expenditures for the next fiscal year would amount to about \$8½ billion. Congress and the country were startled by his estimates, but responded to his request when it was backed by Wilson. He was authorized to extend loans to England, France, and the other governments at war with Germany to the extent of \$3 billion. They appeared on the verge of financial collapse, and the credits given to them to purchase needed military supplies in the United States were regarded as substitutes for American soldiers.²⁷ The American Ambassador to England a month previous had cabled the State Department that "France and England must have a large enough credit in the United States to prevent the collapse of world trade and of the whole European finance. If we should go to war with Germany, the greatest help we could give the Allies would be such a credit."²⁸ Later investigations were to reveal that the danger of imminent British financial insolvency was great but had been exaggerated by the British in order to prevent British equities being used as collateral for new loans, and that Wilson and McAdoo had been misled as to the extent,

²⁵ William G. McAdoo, *Crowded Years* (Boston, 1931), 384.

²⁶ *Ibid.*, 383.

²⁷ *Ibid.*, 375-77; Baker, *Wilson*, 7: 13; Alexander D. Noyes, *The War Period of American Finance* (New York, 1926), 172.

²⁸ *Nyc Report*, Senate Report No. 944, Pt. 5, 74th Cong., 2d Sess., 72.

if not the necessity, of financing Allied purchases and assuming Allied debts.²⁹

On May 14, 1917, McAdoo offered for public subscription the First Liberty Loan, a bond issue of \$2 billion, bearing interest at 3½ per cent, maturing in thirty years and redeemable after fifteen. The bonds were exempt from all taxation both as to principal and interest, except estate and inheritance taxes, and could be converted into bonds of any subsequent war issue which might bear a higher rate of interest. McAdoo used the tax-exemption and conversion features in order to facilitate the sale of the bonds, and then to ensure the success of the first great bond issue. He also hoped that the low rate of interest would help to limit the cost of the war to the American people, would exceed the loss in revenue arising from the tax exemption, and would win popular support for the Treasury. A direct appeal was made to the people through Liberty Loan Committees supervised by the Federal Revenue Banks, and the great bond-selling campaign resulted in more than 4 million subscriptions amounting to over \$3 billion, an oversubscription of nearly 52 per cent more than the amount offered.

In three months the increased demands occasioned by the war and the financial needs of the Allied Powers led Congress on September 24, 1917, to authorize a bond issue of over \$7½ billion, \$4 billion of which the Secretary of the Treasury was allowed to extend in credits to these powers. The Treasury offered on October 1 a Second Liberty Loan of \$3 billion. The rate of interest was raised to 4 per cent because the tax exemption was limited by making the bonds subject to income surtaxes, excess-profits, and war-profits taxes as well as to estate and inheritance taxes. McAdoo justified this change in the tax-exemption feature to the public on the ground that the change cut off from the very rich a means of escaping from their proper share of the tax burden. The appeal to and capitalization of patriotism, by the dramatic and high-pressure publicity methods McAdoo invoked, made the second campaign an even greater success than the first: an oversubscription of 54 per cent of the amount offered by more than twice the number of subscribers to the First Loan. The Treasury accepted 50 per cent of the oversubscription and thereby made the total issue over \$3,800 million.³⁰

The Treasury anticipated the yield of war loans and war taxes by

²⁹ *Ibid.*, 69-77; *Ibid.*, Pt. 6, 121-69. Cf. Charles A. and Mary R. Beard, *America in Midpassage* (New York, 1939), 407-20.

³⁰ Love, *Federal Financing*, 146-66; McAdoo, *op. cit.*, 378-91, 403-09; *Treasury Report 1917*, 5-13.

using negotiable short-term certificates of indebtedness. They were usually issued with a maturity of one to three months, at an interest rate of 2 to 4½ per cent, and were retired at intervals by the issue of long-term funded loans. The certificates, since they could be used for payments on loans and taxes, were quickly sold to the Federal Reserve Banks and their member banks, which in turn sold them to their customers. The Treasury issued \$50 million of these debt certificates on March 31, 1917, in anticipation of the internal revenue taxes payable that June, \$868 million in advance of the First Liberty Loan, and nearly \$2¼ billion before the Second. Even larger amounts were issued later as the war expenses mounted. The use of these certificates enabled the Treasury to absorb a large part of each bond issue and tax collection in advance of its date, and thereby meet the government's fiscal requirements with great ease, reasonable economy, and no evident laxity or extravagance.³¹

Pressure for War Taxes

While the Liberty Loans and Treasury certificates were meeting the pressing and unprecedented war needs of the national government, Congress earnestly sought new revenue legislation which would prove adequate to the crisis.³² Such noted economists as Professors O. M. W. Sprague of Harvard, Irving Fisher of Yale, and F. Dana Durand of Minnesota urged Congress to finance the war, enormously costly though it was, mainly, if not entirely, from the proceeds of taxes collected during its progress. Their argument was that government reliance on loans would lead to an inflation of credit, a general and rapid rise in prices, an increase in the money costs of the war, a reduction in the real income of the masses, extraordinary profits for a few, and consequent social discontent. To avert these evils and the danger of revolutionary class antagonism, they advocated that the conscription of men should logically and equitably be accompanied by something in the nature of the conscription of current income above that of the prewar

³¹ Jacob H. Hollander, *War Borrowing* (New York, 1919), 25-41, 203ff. The defect of the method, according to Hollander, was the creation of a huge volume of additional bank credit in the form of government deposits without a corresponding contraction or deflation incident to the liquidation or funding of the certificate issues. This contributed to inflation and rising prices. Hollander proposed a program of installment loans as a substitute.

³² See Blakey, *Federal Income Tax*, 130-55, and Paxson, *op. cit.*, 143-55, for the detailed legislative history. For tracing the currents of pressure politics, the *New York Times Index* is invaluable.

income and that portion of it not needed for absolutely necessary consumption. They favored high progressive income taxes, practically confiscatory of incomes above \$100,000. Similar views were given wide currency through the American Committee on War Finance, headed by Amos Pinchot, in its "pay-as-you-go" war campaign. This program was criticized by Professors E. R. A. Seligman and R. M. Haig of Columbia, C. J. Bullock of Harvard, and others as being too extreme, but they agreed that a long-time policy of increasingly heavy taxation, coupled judiciously with loans, was desirable.³³ A large number of distinguished economists in sympathy with the heavy taxation program sent a memorial to Congress setting forth its advantages as against the bad effects of relying too strongly upon bond issues.³⁴

Claude Kitchin, the Democratic leader of the House, had fought America's entrance into the war and Wilson's conscription or selective draft program.³⁵ Yet he worked hard and skillfully in getting the Republicans and Democrats on the Ways and Means Committee, despite sharp differences in social outlook, to agree unanimously on a far-reaching war tax bill which would yield the \$1,800 million demanded by McAdoo early that spring. On May 9 and 10 Kitchin presented to the House with his usual wit and charm a bill based on the principle of paying one half of the anticipated war expenditures from a wide variety of taxes. Though different features of the compromise measure received keen criticism from radicals and conservatives, and various attempts at drastic amendment were made, the House passed on May 23, by a vote of 329 to 76, the hastily drafted and hitherto unparalleled tax bill with few important changes.³⁶

Under the pressure of war the Democrats and Republicans on the Senate Finance Committee joined together to revise the House revenue

³³ C. J. Bullock, "Financing the War," *Quarterly Journal of Economics* (May, 1917), 31: 357-79; *Literary Digest* (April 28, 1917), 54: 1230; E. R. A. Seligman, *Essays in Taxation*, 714-47; Seligman, E. D. Durand, et al., *Financial Mobilization for War* (Chicago, 1917); O. M. W. Sprague, "Loans and Taxes in War Finance," *American Economic Review* (March, 1917, v. 7, No. 1, Supplement), 199-223. See J. Maurice Clark et al., *Readings in the Economics of War* (Chicago, 1918), 380-409 and *Reader's Guide to Periodical Literature* (1915-18), 4: 1912-13 for selections and further references. Cf. Paxson, *America at War*, 11-12, 145-46.

³⁴ *Cong. Record*, 65th Cong., 1st Sess., 55: 2045.

³⁵ Arnett, *Kitchin*, 193-248.

³⁶ The House had 209 Democrats, 212 Republicans, and 8 minority party representatives. *World Almanac*, 1918, 763. All the negative votes were cast by Republicans. *New York Times*, May 24, 1917. For criticisms of the House bill see E. R. A. Seligman, C. C. Plehn, and T. S. Adams, *Financial Mobilization for War*, 9-12, 95-97, 110-25; for a defense, see Arnett, *op. cit.*, 249-66.

bill carefully and conscientiously. The conservative majority, influenced by the business interests and by certain tax experts, reduced the revenue yield of the bill one third by drastic cuts and changes. But new and staggering demands by McAdoo and the passage of a wartime liquor prohibition law during the summer led the Committee to alter their measure so that it would bring in a \$2 billion revenue. On August 10 F. M. Simmons, the chairman of the Committee, opened the Senate debate on the greatly revised tax bill. Five days later he presented the majority justification of the bill. Robert La Follette gave the sharply dissenting report of the radical Committee minority.³⁷ La Follette, Borah, Hiram Johnson, and other champions of paying the war costs mainly, if not wholly, out of high taxes on those with large incomes and great wealth succeeded through their vigor and persistence in getting the Senate to adopt some important increases and modifications in the taxes under consideration. Their most radical proposals were voted down, however, as too extreme. Unfortunately La Follette's anti-war position exposed him to unjustified attacks as a "sinister enemy of democracy" and prevented most of his suggestions on taxes from being adopted.³⁸

On September 10 the Senate ended its highly charged debate by approving the much-changed revenue bill 69 to 4.³⁹ But the battle in the House and Senate between different sections and classes on who was to pay for the war to preserve democracy was continued with equal, if not greater, intensity inside the Conference Committee. Kitchin and the other House conferees resented many of the Senate changes as favoring the big business interests, and they fought with remarkable tenacity for certain principles and features of the House Revenue Bill. The consequence was that the Conference Committee spent three weeks going over every point of difference between the House and the Senate, reaching compromises, and recasting important sections. The bill's revenue yield was increased to \$2½ billion. On October 3, 1917, the first actual war tax measure became law. Although Simmons boasted that the conference agreement was a distinct Senate victory, the House succeeded in winning out on some of the most significant issues and felt it had scored a major triumph.⁴⁰

³⁷ *Senate Report*, 103, 65th Cong., 1st Sess.

³⁸ *Literary Digest* (October 6, 20, 1917), 55: 15, 11.

³⁹ *Cong. Record*, 55: 6886. The four dissenters were Borah, Asle J. Gronna of North Dakota, La Follette, and Norris. All were from the Middle West, and all but Borah had voted against America's entrance into the war. The Senate had 51 Democrats, 42 Republicans, and 1 Republican-Progressive.

⁴⁰ *New York Times*, October 3, 1917.

The 1917 War Revenue Act

The War Revenue Act of October 3, 1917,⁴¹ superimposed all the new taxes upon the existing revenue system, repealed the excess-profits tax of March 3, 1917, and lowered the tax on munitions manufacturers to 10 per cent. This last tax was to expire after January 1, 1918. The mainstay of the law were the new income and excess-profits taxes. The remainder of the Act provided for a great variety of imposts, the most important of which were the higher rates of the long-established internal taxes on alcoholic liquors and tobacco. An analysis of the distribution of the tax burden imposed by the War Act reveals that the new taxes on wealth amounted to about 74 per cent of the whole sum to be raised, the taxes on luxurious or harmful consumption to about 13 per cent, and the taxes on exchange and general expenditure to a little less than 13 per cent.⁴² This record almost equaled that of Great Britain, where an even larger percentage of the war taxes was derived from wealth and luxurious or harmful consumption. The contrast with the tax distribution of the Civil and Spanish-American wars was proof of the progress in fiscal justice and democracy made by the pre-World War I generation.

Shortly after Congress declared war on Germany the *Boston News Bureau* said that "War is a hothouse of income taxation."⁴³ The truth of this remark was shown by the great increases over the 1916 income tax rates. The War Income Tax imposed a war "normal" tax of 2 per cent on the incomes of individuals and of 4 per cent on the incomes of corporations. These taxes were supplementary to the 2 per cent "normal" tax on individuals and corporations provided for by the 1916 Act and brought the total rates to 4 per cent for individuals and 6 per cent for corporations. In the case of the supplementary "normal" tax, the exemption was reduced from \$3,000 to \$1,000 for unmarried persons and from \$4,000 to \$2,000 for married persons. The head of a family was allowed an additional exemption of \$200 for each dependent.

To counterbalance the reduction in exemption, sharp increases were

⁴¹ 40 *U.S. Stat. at Large*, 300. For extended analyses of the act see R. G. Blakey, "The War Revenue Act of 1917," *American Economic Review* (December, 1917), 7: 791-815; Edwin R. A. Seligman, *Essays in Taxation* (9th ed., New York, 1923), 679-714; F. W. Taussig, "The War Tax of 1917," *Quarterly Journal of Economics* (November, 1917), 32: 1-37. American Economic Association, "Report of the Committee on War Finance," *American Economic Review* (March, 1919, Supplement 2 of v. 9).

⁴² Seligman, *op. cit.*, 691-92.

⁴³ *Literary Digest* (May 12, 1917), 54: 1398.

made in the rates on the higher incomes. The 1916 law had levied a surtax ranging from 1 per cent on personal incomes over \$20,000 to 13 per cent on those over \$2 million. The new surtax began at 1 per cent upon the amount of the total income over \$5,000 and rose to 50 per cent upon the amount over \$1 million. The result was that the maximum rate became 67 per cent through the accumulation of the 2 per cent old "normal" tax, the 2 per cent supplementary normal tax, the 13 per cent old surtax, and the 50 per cent new surtax. Professor Seligman exclaimed: "This is the highwater mark thus far reached in the history of taxation. Never before, in the annals of civilization, has an attempt been made to take as much as two thirds of a man's income by taxation."⁴⁴ Yet such Congressmen as Rainey of Illinois and Keating of Colorado had urged the conscription of all incomes over \$100,000 and \$150,000 respectively.⁴⁵ Senators Borah, Norris, Johnson, and their sympathizers shared the disappointment of La Follette at the limits imposed by the Senate majority when the latter said that it was not possible "for any government to finance the war on economically sound principles, because wealth would not stand for it, and wealth is always potentially able to control the finances of war."⁴⁶

An important administrative change was the virtual abandonment of the stoppage-at-source method of collection and the substitution of the information-at-source method. Although the tax was henceforth to be collected from the person receiving the income, information was required from corporations, trustees, employers, and all other persons making payment to another person or corporation of any "fixed or determinable gains, profits, and income" of \$800 or more. This change helped the Treasury to achieve the main purposes of the collection-at-source method without the attending discomforts and complications.

The War Excess-Profits Tax

When Congress was debating the advisability of incorporating an excess-profits tax in the Act of March 3, 1917, considerable newspaper discussion of the seemingly revolutionary tax proposal took place. The general public resented the very high rise in the cost of living brought on by the war trade with Europe and shared the sentiment of the *Philadelphia Public Ledger* when it urged the government "to make the war-brides pay up." On the other hand, the *Wall Street Journal*

⁴⁴ Seligman, *op. cit.*, 694.

⁴⁵ *New York Times*, April 28, 1917; *Cong. Record*, 55: 2419.

⁴⁶ *New York Times*, October 3, 1917.

denounced the proposal as striking "at the foundation of industry, by taxing the machinery of production." The New York *Globe* questioned the validity of the excess-profits tax and pointed out that it "embodies the first attempt ever made in a country whose industries are organized under capitalistic leadership to limit profits as a part of its economic system." The *Globe* favored the theory that "to permit a concern unlimited profits was a good thing because leading to greater efficiency in production . . . and . . . the cheaper production of objects of desire."⁴⁷

The public sentiment which had led to the adoption of the first federal excess-profits tax in March, 1917, operated as the stimulus to further Congressional action after the United States entered the war. Claude Kitchin, who had been mainly responsible for the form the first excess-profits tax measure had taken, persuaded the House to adhere to the invested-capital standard set forth in that Act. The one change made was an increase in the rate from 8 to 16 per cent on the profits in excess of \$5,000 plus 8 per cent of the actually invested capital. Intangible assets, such as good will, trademarks, and franchises, were not to be considered as part of the capital, unless specifically paid for in cash or in tangible property. The Senate Finance Committee, however, felt that the difficulties of measuring the amount of actual capital invested and the need for increasing the revenue for the Treasury justified its abandoning the House *excess-profits* tax and adopting instead a *war-profits* tax. The British war-profits tax was taken as the model, in the main. The average profits for the prewar period, 1911-12-13, were taken as the base, and profits in excess of these were considered war profits. Moreover, the flat rate of 16 per cent was replaced by a graduated tax which began with a 12 per cent tax on war profits not over 15 per cent of the prewar profits and rose to 50 per cent on the amount of the war profits in excess of 250 per cent of the prewar profits. Each successive increment of profit was to be subjected to a higher rate of tax, always imposed on the amount by which it exceeded the preceding increment or "bracket."

While the shift to a graduated rate received general approval, the change to a strict war-profits tax aroused vehement opposition from Senators La Follette, Borah, Johnson, and their followers. They feared that companies making great profits before the war, especially those in the tobacco and automobile industries, would escape making their due contribution to the war expenses and urged a return to the House invested-capital standard. The pressure they were able to exert caused

⁴⁷ *Literary Digest* (January 27, 1917), 54: 175-76.

the Senate Finance Committee and the Senate to adopt a compromise measure. This kept the average prewar profits during 1911-13 as the basis for the exemption, but reintroduced the excess-profits principle by stipulating that this exemption should be not "less than 6 per cent nor more than ten per cent than the actual invested capital for the taxable year." Further compromises between the Senate and House methods occurred in the Conference Committee, but Kitchin won a substantial triumph for the excess-profits base through his persistence. Wilson and the Treasury Department favored the Senate viewpoint and tried to bring Kitchin into line, but the latter succeeded in convincing the President.⁴⁸

The war excess-profits tax, as embodied in the October 3, 1917, Act, applied to the income of corporations, partnerships, and individuals. A tax was levied on the difference between the average profits of 1911-12-13 and the profits of the taxable year. Deductions were granted consisting of a fixed sum, \$3,000 for domestic corporations and \$6,000 for partnerships, citizens, and residents, and an amount equal to the percentage of the invested capital represented by the average annual income during the prewar period. This percentage was not to be less than 7 or more than 9 per cent of the invested capital for the taxable year. In cases where a business was not in existence during the prewar period, the deduction was fixed at 8 per cent. In cases where there was no net income or a low net income, compared with that of representative concerns in similar businesses, the Treasury was empowered to grant deductions equal to that of the representative concern.

The key term, "capital," was defined to include: (1) actual cash paid into the trade or business; (2) the actual cash value of tangible property paid in other than cash, for stock or shares at time of such payment; (3) earned surplus and undivided profits. The problem of intangible assets was settled by including as invested capital the actual cash value of patents and copyrights at the time when paid for, even if in stock rather than cash, and the bona fide payments in cash or tangible property for good will, trademarks, and franchises.

The graduated rates of the excess-profits tax were as follows:

20 per cent of the amount of net income in excess of the deduction and not in excess of 15 per cent of the invested capital for the taxable year;

25 per cent of the amount of net income in excess of 15 per cent and not in excess of 20 per cent of such capital;

⁴⁸ Arnett, *op. cit.*, 259-66; Taussig, *op. cit.*, 27-37. Baker, *Wilson*, 7:92, 154, shows Wilson's interest in and concern about a practicable excess-profits tax.

35 per cent of the amount of the net income in excess of 20 per cent and not in excess of 25 per cent of such capital;

45 per cent of the amount of net income in excess of 25 per cent and not in excess of 33 per cent of such capital; and

60 per cent of the amount of net income in excess of 33 per cent of such capital.

In the case of businesses with no invested capital or only a nominal capital a tax of 8 per cent was levied on the net income in excess of a deduction of \$3,000 for domestic corporations and \$6,000 for partnerships or individuals.⁴⁹

An important innovation was the extension of the excess-profits tax to individuals in occupations or professions having an income over \$6,000. This tax of 8 per cent on highly skilled labor incomes of the professional classes in addition to the regular income surtaxes was originated by Kitchin in the Conference Committee and aroused violent criticism as a discriminatory "tax on brains" and unduly favorable to income from property.⁵⁰ The compensation of government officials and employees, federal, state, and local, was exempted from this tax. This seeming favoritism led to a movement to abolish the exemption for this group. Congress specifically removed this exemption by amending the Revenue Act on December 18, 1917.⁵¹

An interesting attempt was made to prevent corporations from deliberately withholding their earnings in order to escape war surtaxes. Congress imposed an additional tax of 10 per cent upon the amount of total net income left undistributed by a corporation six months after the end of its fiscal year. This tax, however, was not applied to surplus "actually invested and employed in the business or retained for employment in the reasonable requirements of the business." This re-

⁴⁹ J. C. Stamp, "The Special Taxation of Business Profits," *Economic Journal* (December, 1919), 29: 412, pointed out "that on this method of taxing by 'slices' the final rates of the scale must be very high before the average rate is at all heavy. For example, the true rate on a 20 per cent profit is 10.75 per cent only, reducing the profit of 17.85 per cent on capital. A 15 per cent dividend would be 14.1, allowing for the tax. If the rate of profit was 100 per cent, the tax would reduce it to 52.3 per cent.

"It is difficult to see how this gradual entry into taxation can constitute at any ordinary point a severe deterrent to personal enterprise beyond that point."

⁵⁰ *Literary Digest* (October 20, 1917), 55: 14. On the validity of this extension, see R. W. Green, "An Excess Income Tax," *Economic Journal* (December, 1920), 30: 542-49; Taussig, *op. cit.*, 35-37. The most comprehensive and up-to-date study on all the problems of the excess-profits tax is Carl Shoup, "The Taxation of Excess Profits," *Political Science Quarterly* (December, 1940, March-June, 1941), 55: 535-55; 56: 84-106, 226-49.

⁵¹ *New York Times*, October 6, 7; December 3, 4, 19, 1917.

striction prevented the tax from standing in the way of conservative management carried out in good faith. If the Secretary of the Treasury found that any portion of the retained surplus was not employed or reasonably required in the business, the tax was to be 15 per cent. The broad character of this permission to retain earnings made it extremely difficult to prove tax liability, and the entire provision was repealed by the Revenue Act of 1918.⁵²

The War Estate Tax

As in the Spanish-American War, Congress turned to the inheritance tax as an additional source of revenue during the emergency created by the first World War. The rates of the 1916 federal estate tax had been increased by one half in the March 3, 1917, Revenue Act. The House under the leadership of Kitchin superimposed upon this latter law a war estate tax which the Senate eliminated despite the opposition of Senator Robert L. Owen of Oklahoma. The Senate opposition was based on an unwillingness to entrench upon the revenue obtained from the source by the states and to penalize the heirs of those dying during the war period, especially those in the army and navy. But the Conference Committee, through the influence of the House conferees, restored the main features of the House tax. In its final form the 1917 war estate tax doubled the 1916 rates and added two new brackets so that the rates varied from 2 per cent on taxable net estates under \$50,000 to 22 per cent on the part of an estate between \$8 million and \$10 million and 25 per cent on any excess over \$10 million. A special clause provided that the war tax rates added to the March, 1917, rates were not to be applied "to the transfer of the net estate of any decedent dying while serving in the military or naval forces of the United States, during the continuance of the war in which the United States is now engaged, or if death results from injuries received or disease contracted in such service, within one year after the termination of such war."⁵³

⁵² The precedents for this undistributed profits tax were the provisions in the 1913-16 revenue acts against the evasion of surtaxes through the use of corporations. The act of June 30, 1864, provided that the gains and profits of corporations should be included in the annual gains, profits, or income of any person entitled to the same, whether divided or otherwise. Senator Andrieus A. Jones of New Mexico was responsible for getting the Senate Finance Committee to recommend a 15 per cent tax, in addition to the regular corporate income tax, on undivided earnings exceeding 20 per cent of the total net income in its report on the October 3, 1917, Revenue Act. This provision became the basis for the tax mentioned above. Blakey, *Federal Income Tax*, 141, 149-52; C. J. Hynning, *Taxation of Corporate Enterprise*, 130-31.

⁵³ Cf. J. Frederick Essary, *Your War Taxes* (New York, 1917), 47-60, 150-51; Shultz, *Taxation of Inheritance*, 156-58. For a careful yet amusing analysis of "The

The taxes on incomes, excess profits, and estates were so drafted as to raise 74 per cent of the estimated \$2½ billion yield of the 1917 War Revenue Act. Congress, except for a small minority, felt that the remainder of the revenue from taxes should come through large increases in the duties on liquor and tobacco, new internal taxes on transportation, communication, insurance, and the sale by the manufacturer, producer, or importer of automobiles, motorcycles, phonographs, moving-picture films, cameras, jewelry, and sporting goods. The documentary stamp duties and the taxes on cosmetics and toilet articles, repealed in 1916, were re-established, and taxes on proprietary medicines were added. Taxes of 10 per cent were levied on admissions to places of amusement and on club dues. Congress expected all these taxes either to be paid by or shifted to the consumer. These internal consumption taxes were not supplemented by any increases in the tariff, because the Senate rejected a provision passed by the House for an additional duty of 10 per cent ad valorem on each and every article imported. Tea, coffee, and cocoa were allowed to remain on the free list, and the low duty on sugar was kept despite strong pressure in the Senate and the opinion of some experts that these taxes would not have imposed any undue burden upon the classes not reached by the income tax.⁵⁴

A bitterly contested section of the revenue measure increased the rates on second-class mail, the periodicals sent by publishers through the mails. Claude Kitchin felt the government's annual \$90 million subsidy to the press was unjustified, especially in wartime. The increases he sought, however, were fought with such great vehemence by the publishing interests that the Senate was induced to modify the rates. The compromise which was enacted advanced in two one-year stages the rate on the space occupied by reading matter in periodicals and in four one-year stages that occupied by advertising matter. Increases were also made in the letter and postcard rates, but no organized opposition made an issue out of this.⁵⁵

Public opinion concerning the 1917 War Revenue Act was favorable, in the main. The *Cleveland Press* stressed the extension of the income tax through the lowering of the exemption limits to five million Americans who, until then, had been taxed only indirectly by the national government. The *New York Times* condemned the excess-profits tax with its invested-capital standard as "a tax to punish profits as profits,

Rising Cost of Inheriting \$10,000,000," see *Literary Digest* (February 17, 1917), 54: 444-46.

⁵⁴ Committee on War Finance, *op. cit.*, 48-62; Tausig, *op. cit.*, 5-14.

⁵⁵ Arnett, *op. cit.*, 256-66, 270-81; Paxson, *op. cit.*, 146-48.

under conditions of either peace or war, rather than to regard war profits as a suitable subject for discriminating taxation in support of war costs." On the other hand, the New York *Evening Mail* expressed its indignation toward Congress for refusing "to take any decent proportion of the war-profits which our corporations are earning."⁵⁶

The attitude of the tax experts varied according to their social sympathies and economic principles. Professor Seligman called the War Revenue Act of 1917 "the most gigantic fiscal enactment in history," and a noteworthy "adoption of democratic principles hitherto unrealized in fiscal history." Professors Bullock and Taussig praised the law as sound in the main. They pointed out that it imposed tax levies heavier than those made by the United States at any corresponding stage of previous emergencies and heavier than those imposed by any other country at a corresponding stage in the first World War. On the other hand, Professors Sprague, Fisher, Roy G. Blakey, and other "conscription of income" advocates stated very powerfully their belief that the government's reliance on \$15 billion through loans as against \$4 billion through taxation for the expenditures of the fiscal year ending in June, 1918, would lead to inflation, cause serious hardship for the common people, prevent full wartime efficiency, encourage waste, increase inequality of wealth and income, and jeopardize American democracy in the effort to "make the world safe for democracy." John Maynard Keynes pointed out that the mainstay of the American Revenue Act, the taxes on income and excess profits, did not begin to approach in severity the corresponding British taxes.⁵⁷

The most hotly debated and vigorously attacked feature of the tax measure was the excess-profits tax. Professor Seligman was very hostile to the invested-capital standard. He declared: "To penalize enterprise and ingenuity in a way that is not accomplished by a tax on either capital or income—this is the unique distinction of the law."⁵⁸ Professor Bullock pronounced the 1917 excess-profits tax a great fiscal success, but maintained that Treasury statistics showed that the tax collected from individual contributors bore no necessary relation to war profits and imposed much heavier rates upon small than upon

⁵⁶ *Literary Digest* (October 13, 1917), 55: 14-16; *New York Times*, October 2, 1917

⁵⁷ C. J. Bullock, "War Finance," *op. cit.*, 146-57; Irving Fisher, "How the Public Should Pay for the War," *Annals American Academy of Political and Social Science* (July, 1918), 78: 112-17; J. M. Keynes, "New Taxation in the United States," *Economic Journal* (December, 1917), 27: 561-65; F. W. Taussig, E. R. A. Seligman, O. N. W. Sprague, R. G. Blakey, "Financing the War," *Annals American Academy of Political and Social Science* (January, 1918), 75: 1-11, 52-82, 83-89, 90-104.

⁵⁸ Seligman, *Essays on Taxation*, 705.

large concerns. He suggested that Congress abandon the established excess-profits tax and substitute a simple tax upon the net income derived from business enterprise.⁵⁹

On the other hand, Professor Thomas S. Adams of Yale, although a severe critic of the invested-capital standard defects, staunchly defended the excess-profits tax. Through the government's assertion of its right to share in the "supernormal" success of every business enterprise, the excess-profits tax measured roughly the value of the facilities, opportunities, and environment provided by the community. In his eyes this tax was the most revolutionary development in public finance since the introduction of income taxation. He attempted to resolve the sharp contrast between the capital and the prewar profits standards by defining capital as normal earnings capitalized and by advocating the creation of some agency charged with the general power and duty of correcting grave inequalities arising from the narrow definition of invested capital in the law.⁶⁰ Professor Adams's views received considerable support from such prominent economists as M. W. Sprague, Irving Fisher, David Friday, and Roy G. Blakey.⁶¹ Josiah Stamp, the great English tax authority, also concluded that formidable as the practical difficulties of the excess-profits tax in the United States and Great Britain were, "They are all capable of being met upon broad practical lines . . . and they can hardly be felt to outweigh the economic soundness of the system when a decision upon the competing alternative remedies for our present troubles is necessary."⁶²

⁵⁹ Committee on War Finance, "Report," *op. cit.*, 15-48. The views expressed in this report were an extension and development of those made in his November, 1917, essay, "War Finance," *op. cit.*, 155-57. Yet he remarked that the excess-profits tax "was the sort of tax that Congress was bound to enact, and could not possibly avoid. . . . The only difficulty is in finding the way of drawing an excess-profits tax that will do the thing that you want to do." *Ibid.*, 155.

⁶⁰ T. S. Adams, "Federal Taxes Upon Income and Excess Profits," *American Economic Review* (March, 1918, v. 8, No. 1, Supplement), 18-35; and "Principles of Excess Profits Taxation," *Annals American Academy of Political and Social Science* (January, 1918), 75: 147-58. Professor Adams took a somewhat different position in June, 1917, *Financial Mobilization for War*, 110-25. He reversed his position almost completely in May, 1921, *Quarterly Journal of Economics*, 35: 363-93.

⁶¹ Cf. David Friday, "The Taxable Income of the United States," *Journal of Political Economy* (December, 1918), 26: 952-69.

⁶² J. C. Stamp, "The Special Taxation of Business Profits," *Economic Journal*, 29: 427.



American War Finance

WHILE Congress and the Treasury Department were raising the revenue needed to finance the war, the United States was being turned into a gigantic war machine. The mobilization of the country's resources proceeded on three fronts: the economic, cultural, and military. The co-ordination of the national economic life into a war economy was effected through various executive agencies, the Council of National Defense, the War Industries Board, the War Trade Board, the War Labor Board, the Munitions Standard Board, the Federal Fuel Administration, the Federal Food Administration, the Federal Railroad Administration, and the United States Shipping Board. Key individuals, among them Bernard Baruch, William G. McAdoo, Julius Rosenwald, Vance C. McCormick, Edward N. Hurley, Herbert Hoover, and Harry A. Garfield, played a leading role in securing the needed raw materials, production and transportation facilities, and commercial credit for capital expansion. They established, as best they could, systems of priorities and price control, rationed consumers' goods, and where necessary facilitated government operation of industry. Government operation of the railroads and government building of a bridge of ships to Europe were perhaps the most spectacular civilian achievements during the war.¹

On the intellectual and emotional front, the national government took effective steps to mobilize sentiment against the enemy, to preserve the friendship of allies and neutrals, and to demoralize the enemy. The Committee on Public Information, under the direction of the journalist George Creel, molded public opinion through a remarkably skillful and effective use of spoken, written, and pictorial propaganda. Wilson himself displayed a matchless skill in arousing enthusi-

¹ Paxson, *America at War*, 19-42, 66-87, 115-36; Mendershausen, *The Economics of War*, 11 ff.

asm at home and abroad for "making the world safe for democracy" through waging a "war to end war." But the government also resorted to the Espionage Act of June, 1917, and the Sedition Act of May, 1918, to suppress and punish those opposed to or obstructing the war efforts. The illiberal enforcement of these acts militated against the fruition of the democratic ideals Wilson cherished.²

On the military front a peacetime army and navy were expanded through enlistment and the selective draft to almost five million men. Although there were fewer than 200,000 American troops in France by December, 1917, a million men were transported there by the mid-summer of 1918, and two million by November, 1918. Their participation in the fighting on the Western Front was an important if not crucial factor in stopping the great German offensive in the spring and summer of 1918, and in leading to the collapse of German army morale in the fall. The efficiency of the American navy in convoying troop ships and merchantmen and in combating submarines also contributed to the German acceptance of the armistice dictated by Foch on November 11, 1918.³

The interpenetration of the military, economic, and cultural factors responsible for the defeat of Germany is most strikingly revealed by the effect upon the contending nations of the two Russian Revolutions of 1917 and Wilson's Fourteen Points. The Russian Revolution of March, 1917, with its overthrow of the Czar's government and the establishment of a middle-class regime under Kerensky, had enabled Wilson on April 2, 1917, to proclaim a war of democracy against autocracy. At the same time he created a wedge between the German people and their government by stressing American friendship for the German people as against their military masters.

The Bolshevik Revolution against the Kerensky government and publication of the Allied secret treaties in November, 1917, forced Lloyd George on January 5, 1918, to make a specific disavowal of Allied imperialistic aims as disclosed in certain of the secret treaties and to give an idealistic statement of Allied war aims. But the masterpiece in the Allied counteroffensive against the Bolsheviks' appeal for world revolution was Wilson's epoch-making Fourteen Points address three days later. In this and subsequent addresses he inspired the Allied peoples in their fight and weakened the resistance of the enemy nations through his program for a just and enduring peace based on the aboli-

² James R. Mock and Cedric Larson, *Words that Won the War* (Princeton, 1939), 3ff.; Paxson, *op. cit.*, 272-94.

³ Paxson, *op. cit.*, 88-114, 182ff.

tion of secret diplomacy, on freedom of the seas, removal of international economic barriers, reduction of armaments, regard for national and colonial rights, and the establishment of a League of Nations.

The impact of Wilson's prophetic vision and the military strength of the American and Allied forces upon the internal weaknesses of the German regime led, between September 27 and November 11, 1918, to the surrender by Ludendorff of his dictatorial powers, the creation of a parliamentary government, the abdication of the Kaiser, the establishment of a middle-class republic, and the acceptance of the armistice terms.⁴

The expenditures required to secure final victory by the United States and the Associated Powers over the Central Powers were so enormous that the record-breaking sums obtained from the First and Second Liberty Loans, Treasury debt certificates, and the Revenue Act of October 3, 1917, had to be supplemented in the spring and fall of 1918. Secretary McAdoo informed Congress on December 3, 1917, that although the estimated receipts for the fiscal year in 1918 would be over \$12½ billion, the estimated disbursements would be over \$18¾ billion. Only \$1½ billion of this latter sum were devoted to the civil establishment; over \$11½ billion were for war purposes. A sum of \$6 billion was set aside for loans to the Allied governments.⁵

Further Recourse to Loans

To prevent an anticipated deficit of \$6 billion by June, 1918, and of \$7½ billion by June, 1919, the Treasury and Congress resorted to new loans and taxes. The Third Liberty Loan was offered to the public between April 6 and May 4, 1918, and provided for the issue of \$3 billion of ten-year nonconvertible gold bonds. The price of Liberty Bonds had fallen below par, partly because of the financial methods employed in the first two issues, and partly because the market rate of interest on loanable funds had increased owing to the war boom in business. To counteract the difficulties in the way of placing the new bonds, a forceful appeal was made to the people's patriotism, and the attractiveness of the bonds was enhanced by several devices. The interest rate was increased from 4 to 4¼ per cent; the bonds were made acceptable in payment of federal estate or inheritance taxes; and the government arranged to enter the market and buy bonds on its own account for the

⁴ Mock and Larson, *op. cit.*, 235ff.; Rosenberg, *Birth of the German Republic*, 232-74; Charles Seymour, *American Diplomacy during the World War* (Baltimore, 1934), 253ff.

⁵ *Treasury Report*, 1917, 54-78.

purpose of stabilizing the price of bonds. The tax-exemption features were the same as in the Second Loan: the bonds, principal and interest, were subject to estate or inheritance taxes, surtaxes, and excess profits and war-profits taxes. The value of these changes was shown by the oversubscription of \$3 billion bond issue. As the Treasury reserved the right to allot additional bonds up to the full amount of any oversubscription, the aggregate amount of subscriptions allotted was over \$4,176 million. The number of subscriptions reached the gigantic total of $18\frac{1}{3}$ millions, or almost one out of every six persons in the country.⁶

Notwithstanding the success of the Third Liberty Loan, the Treasury had to supplement its revenue throughout the summer of 1918 by issuing short-term Treasury debt certificates. On September 28, 1918, the Fourth Liberty Loan was floated to the amount of \$6 billion of $4\frac{1}{4}$ per cent nonconvertible gold bonds, payable in twenty years and redeemable after fifteen. The tax exemption provisions remained the same as those in the Second and Third Loans. In order to improve the market status of the new bonds, a special exemption was granted from surtaxes, excess-profits taxes, and war-profits taxes on the interest of Fourth Liberty Bonds, the principal of which did not exceed \$30,000. Moreover, the purchaser of the new bonds could secure a further exemption from these taxes on the income derived from a maximum aggregate of \$45,000 of the three prior loans. This exemption was limited to two years after the close of the war, as fixed by the proclamation of the President. The new features and the campaign methods used by McAdoo succeeded in raising \$7 billion involving over 21 million subscribers. McAdoo regarded the oversubscription of this largest of all loans ever floated by any government as the greatest financial achievement in all history. The one serious defect was that many persons of wealth took advantage of the exemption privileges to secure a larger tax exemption for their bond holdings than the Treasury had anticipated. The major exceptions to this practice occurred when the unexempted bonds were used to pay federal estate taxes at a gain which was greater than that derived from the exemption feature.⁷

The success with which the Treasury had anticipated in 1917 the yield of war loans and war taxes through the use of short-term Treasury certificates of indebtedness led to the continuation of the policy throughout 1918 and 1919. The Treasury offered six issues of these certificates, amounting to over \$3 billion, in anticipation of the Third Liberty Loan and another six issues, totaling over \$4½ billion, in an-

⁶ Love, *Federal Financing*, 167-75; *Treasury Report*, 1918, 5-13, 159-63.

⁷ Love, *op. cit.*, 176-84; *Treasury Report*, 1918, 13-19, 174-84.

icipation of the Fourth Liberty Loan. The end of armed conflict on November 11, 1918, did not end the expenditure of war funds. In anticipation of income and profit taxes for 1919 some \$1 $\frac{3}{4}$ billion of Treasury certificates were issued by March 15, 1919. The increase of this floating debt at the rate of \$1,400 million a month overloaded the federal debt structure with short-term issues. Carter Glass, McAdoo's successor as Secretary from September 16, 1918, to February, 1920, found it necessary to request for authority to float another large bond issue in order to fund the floating debt and obtain additional needed funds. On April 21, 1919, the Victory Liberty Loan was offered for popular subscription and consisted of \$4 $\frac{1}{2}$ billion of 4 $\frac{3}{4}$ per cent three-to four-year convertible gold notes. The tax-exemption provisions were similar to those of the previous loans, but the notes were made convertible at the option of the holder into 3 $\frac{3}{4}$ per cent notes, which were entirely tax exempt except for estate or inheritance tax. The reason for the variation in the interest rate and degree of tax exemption between these two types of securities was that the Treasury believed each type would appeal to a different group of purchaser. A demand for the highly exempted securities was expected from the owners of newly made war fortunes. Those in the lower income brackets were expected to be attracted by the securities with the higher rate of interest. An additional sales inducement was the provision granting the purchaser of Victory Notes an exemption from surtaxes and excess-profits and war-profits taxes on the interest from old Liberty Bonds equivalent to three times the amount of Victory Notes purchased. The total amount of bonds exempted, however, was not to exceed \$20,000. These ingenious contrivances and a last, strong appeal to the people's patriotism resulted in subscriptions totaling over \$5 $\frac{1}{4}$ billion, by about twelve million subscribers. But only \$4 $\frac{1}{2}$ billion of the bonds were allotted.⁸

In order to tap the savings of those who were too poor to buy Liberty Bonds, the Treasury obtained authority from Congress late in 1917 and 1918 to issue \$4 billion of War Savings Stamps and Certificates. The Certificates were sold from \$4.12 to \$4.23 each, according to the month in which purchased, and five years after the date of issue they had a maturity value of \$5.00. Like the Bonds, they were exempt, both as to interest and principal, from all federal, state, and local taxes, except federal, state, or inheritance taxes, surtaxes, and excess-profits and war-profits taxes. Thrift Stamps costing twenty-five cents each, but bearing no interest, were also sold. They could be accumulated to

⁸ Hollander, *War Borrowing*, 26-27, 44-69; Love, *op. cit.*, 185-92; *Treasury Report*, 1919, 32-60, 235-49, 260.

buy War Savings Stamps. The campaign for the sale of these Certificates and Stamps began in December, 1917. They met, however, with comparatively little success at first, owing to considerable passive and some active opposition by groups of businessmen, especially in the Northeast, who desired not only to carry on "business as usual" but "more business than ever." Through the publicity efforts of the National War-Savings Committee, of numerous state and local committees, and of the Post Office Department, the sales increased in volume until over \$200 million in stamps were sold in the peak month of July, 1918. By the end of 1918 a total sale of over \$970 million had been made. This sum was increased during 1919-20 by the sale of another \$200 million. The Treasury also issued from July, 1919, on Certificates in two additional denominations, one of \$100 and the other of \$1,000 maturity value. To prevent tax avoidance on a large scale, no one was allowed to hold at any one time certificates of any one series to an aggregate amount exceeding \$1,000.⁹

The Last War Tax Effort

While the Third Liberty Loan was being floated, McAdoo became concerned about the appalling way in which the estimates for the coming fiscal year's appropriations were mounting and wrote to Wilson for immediate revenue legislation. After discussions with leading Congressmen and Senators as well as Treasury experts, Wilson appeared before Congress on May 27, 1918, the day the first news of the renewed German offensives on the Western Front had reached Washington. He pleaded with Congress to avoid weakening the economic system by relying too heavily upon loans and urged additional taxes upon war profits, incomes, and luxuries. He stressed the winning of the war as the supreme consideration and advocated a courageous tax policy despite the coming fall election and the pressure of the big business interests. The American people, he felt, were ready and willing to undergo any sacrifice necessary to win the war so long as the burden was distributed justly and they could see the high uses for which their wealth had been used.¹⁰

Although few members of Congress relished spending the summer in Washington on a revenue bill, the House Ways and Means Committee complied with Wilson's request. After extended hearings and

⁹ *Treasury Report*, 1917, 19-20; *ibid.*, 1918, 32-36; *ibid.*, 1919, 60-64; *ibid.*, 1920, 142-47.

¹⁰ Baker, *Wilson*, 8: 128, 154-55, 158, 162, 171-72; McAdoo, *Crowded Years*, 410-11; *Public Papers of Woodrow Wilson*, 5: 216-20.

much debate within the Committee and with the Treasury, the Committee and the Wilson administration finally agreed upon a bill which Claude Kitchin introduced in the House on September 3, 1918. His bill was based upon McAdoo's estimate that the expenditures for the fiscal year 1918-19 would amount to \$24 billion. Kitchin proposed to raise \$8,182 million of this sum by taxes, roughly one third of the total. After a debate in which traditional political and sectional differences on tax issues appeared, the House passed the bill under the pressure for unity created by war by the remarkable vote of 350 to 0 on September 20, 1918.

The hopes of the administration for a new tax law on the statute book before the Fourth Liberty Loan was launched were not realized. The Senate Finance Committee made such a thorough redrafting of the House bill that both the fall election and the armistice occurred before its revision.

Newspapers like the *New York World* and *Evening Mail* declared that every American citizen would cheerfully pay his taxes in order to ensure his happiness, liberty, and opportunity "against assault by unscrupulous autocrats." But conservative papers like the *New York Journal of Commerce* and the *Globe* protested against the bill's "strong flavor of Socialism" and its throwing "practically the whole of the burden on the rich and well-to-do classes." Surely, the *Globe* concluded, "in view of the contents of this tax bill, we shall no more hear the nonsense that this is a 'capitalistic' war, waged for the benefit of men of capital. It is a poor man's war, waged at the expense of capital, and one of its collateral effects will be to diffuse wealth."¹¹ The unpopularity of the unparalleled tax burden advocated by McAdoo and Kitchin with the conservatives of all parties and Wilson's error in appealing for a democratic Congress contributed to the defeat of the Democratic party in the 1918 Congressional elections. The Republicans gained control of both houses of Congress, with a majority of two in the Senate and about forty in the House, for the period beginning March 4, 1919.

Within a week after the November election the first World War came to an end, and the financial pressure upon the Treasury was greatly lessened. McAdoo and the Senate Finance Committee thereupon reduced the estimated government expenditures from \$24 billion to \$18 billion and the amount to be raised by taxes from \$8 billion to \$6 billion for 1919 and \$4 billion for 1920. The irony of the situation lies in the fact that if the armistice had occurred a month

¹¹ *Literary Digest* (September 14, 1918), 58: 14-15.

earlier, the Democrats probably would have won the election, and the history of the following years would have been very different. The new bill which F. M. Simmons reported to the Senate on December 6 received considerable criticism from conservative Republicans and the radical minority headed by La Follette. Nevertheless the Senate passed the bill on December 23 without even a roll call. After the Christmas holiday the Conference Committee spent over a month in a bitter struggle over the numerous and important differences between the House and Senate bills. Compromises were finally made, and the new tax measure became law on February 24, 1919, the day Wilson returned from his first Paris Peace Conference stay.¹²

The Revenue Act of 1918-19

The law, formally known as the Revenue Act of 1918,¹³ was the fourth great revenue measure of the noted series enacted during the Wilson administration. Tremendous as the tax load of the 1917 Revenue Act had been, the 1918 Act increased that load by about 250 per cent, and was called "the greatest measure of taxation in the financial history of the United States and probably in the history of the world."¹⁴ About four fifths of the \$6 billion revenue yield was planned to come from the taxes on incomes, war-excess profits, and estates and the remainder from taxes on luxuries, semiluxuries, imports, and other items. The sources of revenue remained almost the same as those of the October, 1917 Act, but the income and war-excess-profits taxes were drafted so as to raise a larger percentage of the total than previously. Although a few novel features were introduced, the new Act was essentially similar to the prior one. The taxpayer was not required to master a new principle and technique.

Prompt and full payment of the 1917 income tax, despite the high rates, as "an urgent duty and a glorious privilege," had been induced by Treasury and newspaper appeals and Four-Minute Men speeches. As the *New York World* said: When you "give till it hurts," there is always the consolation that such giving "is going to hurt the enemy

¹² Arnett, *Kitchin*, 266-85; Blakey, *Federal Income Tax*, 156-88; McAdoo, *op. cit.*, 410-12. See Baker, *Wilson*, 8: 300, 314, 334, and *Treasury Report*, 1918, 46-53, for additional light on Wilson's and McAdoo's tax views.

¹³ 40 *U.S. Stat. at Large*, 1057. See R. G. and G. C. Blakey, "The Revenue Act of 1918," *American Economic Review* (June, 1919), 9: 213-43; R. M. Haig, "The Revenue Act of 1918," *Political Science Quarterly* (September, 1919), 34: 369-91; T. S. Adams, "Federal Taxation," *Proceedings National Tax Association*, 1919, 300-14, for detailed studies.

¹⁴ "Washington Notes," *Journal Political Economy* (March, 1919), 27: 214.

more than it does you.”¹⁵ This patriotic spirit was not expected by Congress to continue after the armistice at the same height as before, but revenue necessities led Congress to surpass the previous record income tax rates. The personal exemptions remained the same as in the 1917 Act: \$1,000 for a single person or for a married person not living with wife or husband; and \$2,000 for married persons living with wife or husband, or for a person maintaining a home for one or more dependents. An additional exemption of \$200 was granted for each dependent person. The normal tax on the net incomes of all individuals above the exemption limits was fixed at 6 per cent upon the first \$4,000 and at 12 per cent upon the remainder for the year 1918. For subsequent years these normal rates were made 4 and 8 per cent respectively.

In addition to the normal tax, a surtax was imposed on incomes above \$5,000. The surtax rates began at 1 per cent on incomes over \$5,000 and increased by 1 per cent for every \$2,000 increase of income from \$6,000 to \$100,000; after that the increases continued at a smaller rate until a maximum of 65 per cent was reached upon the amount of income accruing to an individual in excess of \$1 million. The total tax, therefore, on portions of income over \$1 million amounted to 77 per cent. This was 10 per cent higher than the 1917 maximum which Professor Seligman had labeled the highest ever reached “in the annals of civilization.” Yet La Follette and his supporters in the Senate had advocated surtax rates rising from 5 per cent on incomes over \$5,000 to 78 per cent on those over \$500,000.¹⁶

Corporations were taxed at the rate of 12 per cent of their net income for 1918 and 10 per cent for each succeeding year. The corporations were granted for the first time an initial exemption of \$2,000. As railroads were then under federal control, their tax was limited to 10 per cent for 1918 and 8 per cent thereafter. Partnerships and “personal service corporations” were not taxed as corporations; instead, their profits were taxed as the income of the individual partners or stockholders. In order to prevent corporations from accumulating their surplus earnings and thereby enabling their stockholders to avoid paying the surtaxes on dividends, the new law made dividends, except for a restricted class of stock dividends, taxable at the rate in force in the year when declared. Moreover, in the case of corporations formed or used for the purpose of such tax evasion, the stockholders or mem-

¹⁵ *Literary Digest* (June 8, 1918), 57: 11.

¹⁶ *New York Times*, December 24, 1918. The vote against this bill was 55 to 6. His supporters were Borah, Gronna, Norris, Nugent, and Vardaman.

bers were made taxable in the same way as partnerships or personal service corporations. This provision, however, proved to be unenforceable.

The Court Intervenes on Taxes

In January, 1918, the Supreme Court had declared unanimously that under the Revenue Act of October, 1913, a true stock dividend was not taxable as income and was to be regarded as capital.¹⁷ In spite of this decision, Congress imposed a tax on stock dividends on the theory that the decision affected cases arising under the 1913 Act, which, unlike the later revenue acts, had not specifically provided for taxing stock dividends as income. But on March 8, 1920, the Supreme Court disappointed Congress and the general public by ruling in the case of *Eisner v. Macomber* that "neither under the Sixteenth Amendment nor otherwise has Congress power to tax without apportionment a true stock dividend made lawfully and in good faith, or the accumulated profits behind it, as income of the stockholder."¹⁸ Four justices out of the nine dissented to the majority opinion handed down by Justice Pitney. Justice Holmes maintained that:

The word "incomes" in the Sixteenth Amendment should be read in "a sense most obvious to the common understanding at the time of its adoption. . . . The known purpose of this Amendment was to get rid of nice questions as to what might be direct taxes, and I cannot doubt that most people not lawyers would suppose when they voted for it that they put a question like the present to rest."¹⁹

Justice Holmes's contention was undoubtedly correct and was in line with the view on direct taxes taken by Justice White in his dissenting opinion in the *Pollock v. Farmers' Loan & Trust Co.* case in 1895. Ironically enough, the vote of White, still Chief Justice in the spring of 1921, was essential to a majority in *Eisner v. Macomber*. Justice Brandeis also dissented, but advanced a different set of considerations. He strongly objected to the decision enabling "the owners of the most successful businesses in America . . . to escape taxation on a large part of what is actually their income."²⁰ The practical effect of the Court's decision was to save the wealthy minority from a large amount of taxation, in the long run, and thereby to strengthen

¹⁷ *Towne v. Eisner*, 245 U.S. 418. Justice Holmes delivered the opinion.

¹⁸ 252 U.S. 189, 219.

¹⁹ *Ibid.*, 219.

²⁰ *Ibid.*, 237.

the movement for the taxation of undistributed corporate surpluses.²¹

Another provision in the 1918 Revenue Act which had judicial repercussions was that imposing a tax upon the salaries of the President and federal judges. This led to the case of *Evans v. Gore*,²² in which a United States district judge sued to recover money paid under protest as an income tax. The Court held in effect that despite the Sixteenth Amendment an earlier constitutional provision forbidding the diminishing of the salaries of federal judges during their continuance in office still continued in force. Income derived by a federal judge as compensation for services could not be taxed without interfering with the independence of the judiciary. This was denied by Justice Holmes in a dissent in which Justice Brandeis concurred. Justice Holmes pointedly remarked that "to require a man to pay the taxes that all other men have to pay cannot possibly be made an instrument to attack his independence as a judge."²³ The self-interest of the judges was the mainspring for the rationalizations contained in the majority opinion.

The sharp rise in the cost of living, the intense public sentiment against war profiteering, and the war-revenue needs which had inspired the 1917 excess-profits tax were largely responsible for the 1918 war excess-profits tax. The enthusiastic response of Congressional radicals like Borah and Kitchin to Wilson's May 27, 1918, plea for heavy taxation of high incomes and excess business profits frightened conservative eastern newspapers. They suggested that the big business goose which laid such golden eggs ought to be kept alive as a revenue producer, but many people regarded this particular bird "as a bird of prey rather than as a necessary barn-yard fowl."²⁴ The 1918 tax represented a compromise between the plans proposed by the House and Senate. The House, under Kitchin's guidance, evolved an alter-

²¹ See Edgerton, "Judicial Control Over Congress," *op. cit.*, 340-41; Magill, *Taxable Income*, 29ff.; T. R. Powell, "Stock Dividends," *Columbia Law Review* (1920), 20: 536-48, for legal and economic analysis and further references. Economists like Irving Fisher and E. R. A. Seligman agreed with and justified the majority opinion. H. C. Simons, *Personal Income Taxation*, 85 ff., 196-203, offers a sharp critique of the Court and its defenders.

²² 253 U.S. 245 (1920).

²³ *Ibid.*, 265. In 1925 the Court held in *Miles v. Graham*, 268 U.S. 501, Justice Brandeis dissenting, that Congress had no power to tax the compensation of a federal judge, even though appointed after the passage of the tax law. This decision was overruled in 1933 by *Williams v. U.S.*, 289 U.S. 553, so far as the Court of Claims was concerned. In May, 1939, the Court in *O'Malley v. Woodrough*, 307 U.S. 277, rejected the hitherto established view that a tax on judicial salaries, even if general and nondiscriminatory, reduced compensation in the constitutional sense. Cf. Edgerton, *op. cit.*, 341-42.

²⁴ *Literary Digest* (June 15, 1918), 57: 14.

native war-profits and excess-profits tax which was computed according to whichever of the two methods yielded the higher amount of tax. The Senate, for reasons of simplicity and constitutionality, unified the war-profits and excess-profits tax methods through the device of superimposing a war-profits tax upon the excess-profits tax rate brackets.

Tax on War and Excess-Profits

The 1918 war-profits and excess-profits tax, as finally enacted, applied solely to corporations and exempted individuals, partnerships, and certain personal-service corporations. The reason given for this was that individuals and partnerships paid heavy surtaxes upon all net income, and that personal-service corporations generally had too little invested capital to be taxed fairly by the excess-profits tax. Another reason was that the exemptions greatly eased the Treasury's administrative problems.²⁵ The tax schedule for 1918 was as follows:

Excess-profits Tax

1. 30 per cent of the amount of the net income in excess of the excess-profits credit and not in excess of 20 per cent of the invested capital;
2. 65 per cent of the amount of the net income in excess of 20 per cent of the invested capital;

War-profits Tax

3. The sum, if any, by which 80 per cent of the amount of the net income in excess of the war-profits credit exceeds the amount of the tax computed under the first and second brackets.

These provisions required the taxpayer to make two calculations, one under the excess-profits and the other under the war-profits method; whichever tax was higher was the one due.

For 1919 and each taxable year thereafter the rates were reduced to 20 per cent for the first bracket and 40 per cent for the second. The war-profits tax was omitted after 1918 except for a provision taxing at the 1918 rate the net income of every corporation deriving more than \$10,000 from any government war contract.²⁶ The excess-profits tax credit consisted of \$3,000 plus 8 per cent of the invested capital for the taxable year. The war-profits credit was \$3,000 and the average

²⁵ *Senate Report 617*, 65th Cong., 3d Sess., 11 ff.

²⁶ In order to protect small concerns earning high profits relative to their invested capital, Congress stipulated that the tax for 1918 should not be more than 30 per cent of the amount of net income in excess of \$3,000 and not in excess of \$20,000, plus 80 per cent of the amount of net income over \$20,000. For 1919 the rates were reduced to 20 and 40 per cent of these amounts respectively.

net income for the prewar period (1911-12-13), plus or minus 10 per cent of the difference between the average invested capital for the prewar period and the invested capital for the taxable year.²⁷

Since the war-profits tax did not operate after 1918 and functioned during 1918 as an alternative to the excess-profits tax, the invested-capital standard of the excess-profits tax was of great importance. Congress corrected the more glaring administrative errors of the 1917 law and incorporated the more important of the bold rulings which the Treasury had evolved in its effort to make the 1917 law reasonable and equitable. Formerly inadmissible assets were admitted into capital where the income from them was included in the profits taxed. Intangible property like patents, copyrights, good will, and franchises were also included in capital. The upshot of Congress's modifications was that invested capital could be defined as the actual cash value of the property received by the corporation or embarked by the stockholders, at one time or another, in the enterprise and subjected to the risks of the business. The measure of invested capital became the actual contribution for stock plus accretions in the way of surplus; and in no case, except that of improper distribution, was the amount of invested capital less than that which the stockholders had originally paid in for the stock.²⁸

Conflict Over the Estate Tax

Despite the desire of social reformers and such egalitarian Congressmen as Kitchin and I. A. Follette, the 1918 federal estate tax represented a reduction rather than an increase in rates. In September, 1918, the House had approved an increase of 50 per cent on nearly all the rates on estates so that they ran from 3 per cent on net estates not over \$50,000 to 40 per cent on estates over \$10 million. But the Senate, especially after the armistice, sought to reduce the rates and to substitute an inheritance tax on the ground that it was fairer and

²⁷ For the full complexities of this tax, see Robert H. Montgomery, *Income Tax Procedure 1919* (New York, 1919), 691ff., and *Excess Profits Tax Procedure 1921* (New York, 1921), *passim*.

²⁸ William Edward Butt, *A Permanent Excess Profit Tax* (Ph.D. Thesis, Yale University, 1931), 144-45. The allowances to corporations of full deduction under the new income tax for interest paid eliminated the necessity of admitting as assets the portion of borrowed money corresponding to the interest which could not be deducted. Full deduction was allowed of the excess-profits and war-profits credits, even though the sum exhausted the amount in the first bracket and carried over into the second. Liberal amortization and depreciation relief provisions were introduced to protect businessmen from the bad effects of the war situation. These, unfortunately, led to great administrative difficulties.

more equitable than the estate tax. The conflict between the House and Senate resulted in a draw: the estate tax was kept, but the 1917 rates on all estates under \$450,000 were halved; a smaller reduction in rates was made for estates between \$450,000 and \$1 million but the 1917 rates were retained on all estates above \$1 million. The scope of the tax was extended in certain directions, and some administrative changes were made.²⁹

In sharp contrast with the federal income and excess-profits taxes, the federal estate tax played a relatively minor role in the government's war financing. This was in part due to the claims of the states to a vested right in death taxes. Forty-two states were levying them at low rates in 1916 while only four states were making a serious effort to collect an income tax. Pressure from representatives of large fortunes in the Senate also seems to have been influential. The American decrease in federal estate tax rates occurred at a time when increases in death duties were being made by England, France, and other European countries. The ruling groups there were inspired by the imminent possibility of a capital levy into raising the death duties as a means of appeasing the widespread popular demand for a tax upon capital. In the United States Harlan E. Read, a successful businessman turned reformer, urged late in 1918, in his book *The Abolition of Inheritance*, that the enormous national debts piled up by the war should be paid for by heavy taxes on unearned wealth. He pleaded for the immediate restriction of inheritances to \$100,000 and for their eventual abolition, with certain exceptions in favor of widows

²⁹ The taxable estate was specifically stated to include: (1) the interest of the surviving spouse existing at the time of the decedent's death as dower, courtesy, or by virtue of a statute creating an estate in lieu of dower or courtesy; (2) property passing under a general power of appointment exercised by the decedent by will or in contemplation of death; and (3) all insurance accruing to the estate, and insurance to the extent of the excess over \$40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life. On the other hand, exemption was granted to bequests by residents or nonresidents to charitable or educational institutions, including art foundations and societies for the prevention of cruelty to animals, no part of the net earnings of which inured to the benefit of any private stockholder or individual. Residents and nonresidents were allowed a deduction equal to the value at the time of the decedent's death of any property, real, personal, or mixed, which could be identified as having been received by the decedent as a share in the estate of any person who died within five years prior to the death of the decedent, or which could be identified as having been acquired by the decedent in exchange for the property so received. The tax burden on the estates of nonresident decedents was increased by the provision that the prorated deductions allowed on the property in the United States could not exceed 10 per cent of the value of that property. But in 1921 nonresident estates were given practical equality with the estates of resident decedents, except for the exemption allowed the latter. Shultz, *The Taxation of Inheritance*, 158-59.

and other dependents, as a means of counteracting economic inequality, improving the social welfare, and meeting the war fiscal needs of the government. But neither his dramatic propaganda nor the cool reasoning of Professor Irving Fisher had any immediate political effect. Fisher suggested that the existing undemocratic distribution of wealth be corrected by adopting the plan of the Italian economist Eugenio Rignano. This made the state co-heir of all bequests so that it would receive one third of the estate on the first descent, two thirds of the remainder of the second, and the residue on the third descent.³⁰

Only slight changes were made in the taxes on transportation, insurance, admissions and dues, and in the stamp taxes. The ratification of the Eighteenth Amendment in January, 1919, reduced the expected revenue from the tax on beverages, formerly the mainstay of the internal revenue system, from an anticipated billion dollars to \$75 million. The most novel, probably the most unpopular, feature of the 1918 Act was the luxury tax, a tax upon luxury commodities. The tax on corporate capital stock was increased from fifty cents to one dollar for every \$1,000 of capital stock, and the exemption minimum reduced from \$99,000 to \$5,000. A tax which attracted wide attention and much popular support was the tax on the employment of child labor. The Supreme Court in June, 1918, had declared unconstitutional in a 5 to 4 decision the 1916 child labor law on the ground that the power of Congress to prohibit interstate commerce was limited in that it could not control the states in their exercise of the police power over local trade and manufacturers.³¹ Thereupon the champions of the child labor law attached a rider to the 1918 Act providing for a tax of 10 per cent on the net profits from the products of a mining or manufacturing establishment in which children were employed under sixteen, in the case of mines, and under fourteen in the other cases. This provision the Supreme Court ruled unconstitutional in an 8 to 1 decision rendered in May, 1922.³²

The verdict of the tax authorities upon the 1918 Revenue Act was, on the whole, favorable. Professor Robert M. Haig pronounced it "a well considered and constructive piece of legislation," based on the

³⁰ Cohen, *Law and the Social Order*, 27-31; Irving Fisher, "Economists in Public Service," *American Economic Review* (March, 1919, v. 9, No. 1, Supplement), 5-21; Shultz, *op. cit.*, 72-97, 194-99; Myers, *Hereditary American Fortunes*, 273-75; Twentieth Century Fund, *Facing the Tax Problem*, 31-32.

³¹ *Hammer v. Dagenhart*, 247 U.S. 251.

³² *Bailey v. Drexel Furniture Co.*, 259 U.S. 20. Cf. Commons, *History of Labor*, 3: 441-42.

“sound and scientific policies” of heavy taxation of war profits and of dependence, so far as administratively practicable, upon direct taxes. Others praised the law as an improvement over the previous revenue measures, but asserted that it left too much to be raised by borrowing. They favored, with Claude Kitchin, a tax levy of \$8 billion to pay for the continuation of the war expenditures and the interest on the war debt. Yet they also pointed out the striking revolution in federal taxation accomplished by the government’s shift since 1913 from reliance on the tariff, liquor, and tobacco taxes to the income, estate, and excess-profits taxes as the chief sources of federal revenue.⁸³

The newspaper reaction to the \$6 billion tax law was better than might have been anticipated. The *New York Journal of Commerce* and the *Baltimore Sun* expressed the feeling of businessmen by saying that they were willing to pay the high taxes, but insisted on strict government economy. The *Sun’s* sentiments were that “war-taxes should cease with the war” and that the tax law was the product of “sectional favoritism and class discrimination.” On the other hand, the *Baltimore American* and the *New York Evening Post* defended the measure as justified by the war expenditures and by its laying the enormous “burden of obligation where it can best be borne.”⁸⁴

⁸³ Blakey, *op. cit.*, 239-43; Haig, *op. cit.*, 384.

⁸⁴ *Literary Digest* (February 22, 1919), 60:14.

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“Normalcy” and Financial Conservatism

WHILE Congress was wrangling about the tax load to be imposed upon the American people by the Revenue Act of 1918 Wilson went to Europe in an effort to secure the just peace which he thought essential to the creation of the new world order. Wilson was hampered by domestic and foreign opposition to the Fourteen Points, especially that pertaining to the League of Nations. He had lost the support of many Republicans by his appeal in October, 1918, for the election of a Democratic majority to Congress and by his failure to include influential Senators and Republicans in his peace delegation. The heads of the victorious European governments disliked and feared Wilson's peace project because it was hostile to the imperialistic program embodied in the secret treaties and would prevent the ruling groups in their countries from achieving the world dominion they desired.¹

The Versailles Treaty: American and European Reactions

The much-discussed and highly dramatic Peace Conference at Paris culminated in the Treaty of Versailles, signed by the German delegates on June 28, 1919, and the separate treaties of peace with Austria, Hungary, Bulgaria, and Turkey, signed later in 1919-20. None of these treaties embodied all or most of Wilson's high hopes and ideals. The treaties were not as harsh as those which the German imperial government would have imposed if they had been victorious, and contained a number of liberal provisions regarding minority rights, the creation of new states for formerly oppressed nationalities, and a League of Nations. But these good features were offset by the vindictive attitude taken toward Germany, the crushing indemnity

¹ Seymour, *American Diplomacy during the World War*, 366-400.

imposed upon it, the division of the German colonies among the Allied Powers, and other punitive measures.

To treat the tangled web of good and evil, praise and blame, which has been woven around the peace treaties and the leading actors in the negotiations is beyond the scope of this study. A few like John Maynard Keynes warned of the dangers to civilization which would flow from the unwise burdens placed on Germany, but their counsel was ignored by European statesmen. Such radicals as Thorstein Veblen bluntly denounced the treaties as screens of diplomatic verbiage behind which the Elder Statesmen of the Great Powers continued their pursuit of political chicane and imperialistic aggrandizement, with the guiding motive of making “the world safe for a democracy of absentee owners” by securing the defeat of Bolshevism in Russia and elsewhere. Veblen therefore prophesied that the Allied Powers would use the German indemnity as the basis for reinstating the reactionary regime in Germany as a bulwark against Bolshevism and would guarantee the secure tenure of absentee ownership in Germany. Although the predictions of both Keynes and Veblen were realized in large part, the one great chance of correcting the defects in the peace treaties and of securing a tolerant attitude toward Germany and Soviet Russia was lost when the Senate failed to ratify the League of Nations and the other provisions of the peace treaties.

If Wilson had not collapsed in his “swing around the country” in the fall of 1919, and if he had been willing to compromise on some of the reservations proposed by his opponents, he would have won the required two thirds of the Senate votes on November 19, 1919, and March 19, 1920. The United States would then have entered the League of Nations and, under progressive administrations, would have acted as a force for world peace and social progress.² But, as Keynes wrote, many people in America and England in 1919 and 1920 were unaware of the possibilities arising from the failure to forge a just international order. “The reaction from the exertions, the fears, and the sufferings of the past five years is at its height. Our power of feeling or caring beyond the immediate questions of our own material well-being is temporarily eclipsed. The greatest events outside our own direct experience and the most dreadful anticipations cannot move us. . . . Never in the lifetime of men now living has the universal element in the soul of man burnt so dimly.”³

² Bailey, *Diplomatic History of the American People*, 648-80; John Maynard Keynes, *The Economic Consequences of the Peace* (New York, 1920), *passim*; Thorstein Veblen, *Essays in our Changing Order* (New York, 1934), 399ff., esp. 462-70.

³ Keynes, *op. cit.*, 297.

The consequence of this state of demoralization in the United States was that in the presidential election of 1920 the amiable but unqualified Republican candidate, Warren G. Harding, defeated James M. Cox, the Democratic candidate, and Eugene V. Debs, the Socialist candidate, by a popular vote of more than 16 million to votes of 9 million and 900,000 respectively. With that victory went the hopes of liberals and progressives for the restoration of Wilson's New Freedom or the inauguration of a more radical economic program, as well as for a continuation of Wilson's high-minded internationalism. The pattern initiated by Harding and continued by Coolidge and Hoover until 1929 was characterized as one of "normalcy," of restoration to the dominant business interests of control over the economic and political orders.⁴ The financiers and industrialists who supplied the campaign funds for the Republicans in 1920, 1924, and 1928 were anxious to be free from the restriction of either reform or wartime controls, regulations and organizations, to have their tax burdens lessened, to have the tariff raised, and to have the government restrain radicalism at home and further big business policies abroad.⁵ At the time that the big business groups recaptured their leading position in the American political economy, the nationalist Right Bloc was ruling France, the fascist dictatorship was coming to power in Italy, and Lenin was beginning a retreat from the efforts of the Bolsheviks to bring about victorious workers' revolutions outside Russia. The antidemocratic groups either retained or gained the upper hand in most of Western Europe except for Czechoslovakia, where a successful social democracy was established, and Great Britain, where the Conservatives retained power, but were threatened by the growth of the Labor party.⁶

*The Drive for Tax Reduction: Sales Taxes vs.
Excess-Profits Taxes*

Against this political background and the great period of prosperity for the business classes between 1922 and 1929 the tax and expenditure policy of the national government must be placed. Even during the last two years of Wilson's final term as President a strong movement for downward revision of the income tax structure had got

⁴ Beard, *The Rise of American Civilization*, 2: 663ff.

⁵ Lundberg, *America's Sixty Families*, 149-88; Schumpeter, *Business Cycles*, 2: 709-10.

⁶ Arthur Rosenberg, *Democracy and Socialism* (New York, 1939), 338-41.

under way. In November, 1919, Carter Glass, as Secretary of the Treasury, warned Congress of the need for stringent government economy and urged reliance on the income tax for raising the needed revenue. But he voiced strenuous objections to the continuance of the excess-profits tax in peacetime. "It encourages wasteful expenditure, puts a premium on overcapitalization and a penalty on brains, energy and enterprise, discourages new ventures, and confirms old ventures and their monopolies. In many instances it acts as a consumption tax, is added to the cost of production upon which profits are figured in determining prices, and has been, and will continue to be, a material factor in the increased cost of living."⁷

The next month Professor Thomas S. Adams of Yale, adviser to the Treasury, told the American Economic Association that there was an imperative need for immediate simplification in the system of internal revenue taxes, especially the heavy and intricate income and profit taxes. He advocated the repeal of the excess-profits tax in order to prevent an administrative log jam, and the imposition of a high tax on the undistributed profits of corporations. This view he amplified in a noted article in the spring of 1921. His proposal, though approved by some of the economists, was criticized by such authorities as Professors Robert M. Haig and David Friday. They felt that the alternatives to the excess-profits tax were undesirable and that improvements in the administration could be designed.⁸

During 1920 businessmen throughout the country launched a crusade against the excess-profits tax and high surtaxes. In the presidential campaign that summer and fall the Republicans pledged their party to a more just and simple system of taxation while the Democrats condemned "the failure of the Republican Congress to respond to the President's demand for the readjustment of the tax laws to peace conditions" and denied the Republican claims of economies. The Republicans as usual urged adoption of the protective tariff in order to preserve the home market for American labor, agriculture, and industry; the Democrats, on the other hand, reaffirmed their party

⁷ *Treasury Report*, 1919, 23-24.

⁸ T. S. Adams, "Should the Excess Profits Tax be Repealed?" *Quarterly Journal Economics* (May, 1921), 35: 363-93; R. M. Haig, T. S. Adams, D. Friday, et al., "Excess Profits Tax," *American Economic Review* (March, 1920, v. 10, No. 1), 1-14, 15-18, 19ff. See also Carl C. Plehn, "War Profits and Excess Profits Taxes," *American Economic Review* (June, 1920), 10: 283-98; and F. R. Fairchild, "Suggestions for Revision of the Federal Taxation of Income and Profits" (December, 1920), *ibid.*, 10: 785-99, a strong attack on, and a defense of, the profit taxes respectively.

doctrines and came out for the policy of basing tariff revisions upon the intelligent research of a nonpartisan commission rather than upon the demands of selfish interests. Although the minor radical parties, the Socialist, Socialist Labor, and the Farmer-Labor parties, proposed drastic changes in the system of private ownership and advocated the use of the tax system as an instrument of social control, their policies did not receive widespread support except among workers and farmers.⁹

Special organizations of businessmen were created to agitate for the sales tax. Among these pressure groups were the Business Men's National Tax Committee, the Tax League of America, the Boston Chamber of Commerce, and the New York Board of Trade.¹⁰ Businessmen and bankers, such as Otto Kahn, Jules S. Bache, and Charles E. Lord, acted as strong champions of a sales tax as a substitute for the excess-profits tax. They waged a war on the war taxes as vexatious, unjust, the cause of high prices, a hindrance to business expansion, and a burden on the consumer, onto whose shoulders they maintained the tax burdens were shifted.¹¹ The advocates of the sales tax generally favored an all-inclusive tax of 1 per cent on the gross turnover of the country, but some favored a tax limited to the sale of goods, wares, and merchandise over a certain annual amount. Still others wanted a tax on retail or final sales for use.

But all these groups preferred a sales tax to the excess-profits tax and asserted that the burden on the public would be lighter, and that the certainty and simplicity of the sales tax would free the businessman from the hardships entailed by the excess-profits tax. Another important consideration was the large revenue the sales tax would yield. Such tax experts as Professors T. S. Adams, F. R. Fairchild, David Friday, and E. R. A. Seligman admitted various weaknesses in the excess-profits law, and some of them favored its repeal. But all agreed that a sales tax under normal conditions would be shifted to the consumers whereas the evidence indicated that there was no general or important shifting of the excess-profits tax burden. Moreover,

⁹ *New International Year Book*, 1920, 706-08; Sullivan, *Our Times*, 6: 109-37.

¹⁰ Other groups were Trades Council of Manufacturers' Club of Philadelphia, the National Association of Real Estate Boards, the National Retail Dry Goods Association, National Association of Retail Clothiers, the National Shoe Retailers Association, the National Garment Retailers Association, National Automobile Club of Commerce, and the National Association of Manufacturers.

¹¹ K. M. Williamson, "The Literature on the Sales Tax," *Quarterly Journal Economics* (August, 1921), 35: 618-33, offers the best brief survey of the groups and arguments for and against various types of sales taxes. See also *Literary Digest* (December 20, 1919), 63: 133; (April 3, 1920), 65: 20-21; (May 15, 1920), 65: 142-47.

their statistical analyses showed that the excess-profits tax was not responsible for the increase in prices after 1915 although the tax greatly stimulated the payment of bonuses to executives and expenditures for building up good will by advertising or other means.¹²

The pressure groups against the sales tax were the American Farm Bureau, the National Grange, the Farmers' Federal Tax League, the American Federation of Labor, and the Railroad Brotherhoods. They were aided by certain business groups hostile to the excess-profits tax, but opposed to the adoption of a sales tax. These included the Tax Committee of the National Industrial Conference Board, the National Association of Credit Men, the United States Chamber of Commerce, and the National Association of Retail Grocers. These groups, for varying reasons, objected to the sales tax as a burden to the consumer, as violating the ability-to-pay criterion, and as administratively difficult.

In the spring and winter of 1920 David F. Houston, Glass's successor as Secretary of the Treasury, urged thorough revision of the internal tax laws, but the Republican Congress refused to take action because its leaders feared Wilson's veto and did not have an adequate substitute for the excess-profits tax.¹³ Although hearings on the profits tax were held during the winter of 1920, Congress devoted most of its attention to the revision of the tariff. War had increased the demand for national preparedness for future conflicts; numerous "war babies" had been born, especially in the chemical and metallurgical industries, and needed protection; the impact of the unprecedented drop in prices in 1920-21 led the farmers to clamor for agricultural tariff protection. The consequence was the passage by Congress of the Fordney Emergency Tariff Bill, which levied high duties on imported agricultural products. This was vetoed by President Wilson on March 3, 1921. After Harding's inauguration, however, Congress met in special session and swiftly passed the revised Emergency Tariff Act of May 27, 1921, which tried to protect agricultural products from foreign competition by imposing high duties upon wheat, corn, meat, wool, and sugar. Although the new duties were stipulated for only a six months' period, they were re-enacted until the final passage of the 1922 Tariff Act. They failed to halt the decline in farm prices,

¹² Williamson, *op. cit.*, 626-33. On the economic issues involved, see David Friday, *Profits, Wages, and Prices* (New York, 1920), 176-206; J. A. Hobson, *Taxation in the New State* (New York, 1920), 12-77; E. R. A. Seligman, *Studies in Public Finance* (New York, 1925), 59-98; J. Stamp, "Taxation Risk-Taking and the Price Level," *Economic Journal* (June, 1928), 38: 204-15.

¹³ *Treasury Report*, 1920, 25-46.

but served to pave the way for the extreme protectionist victory in 1922.¹⁴

Economic Cleavages on the 1921 Revenue Act

After the House of Representatives had passed its "Permanent" Tariff Bill, the House considered and passed in July, 1921, the revenue bill drafted by the Republican leaders. The main basis for the House bill had been the recommendations by Andrew Mellon, Harding's noted Secretary of the Treasury. He had urged: 1. the repeal of the excess-profits tax; 2. the increase of the corporation tax; 3. reduction of the combined normal and surtaxes upon incomes to 40 per cent for 1921 and 33 per cent thereafter; 4. the repeal of minor luxury taxes, known as "nuisance" taxes; 5. the retention of such specific sales taxes and excises as the transportation, tobacco, admissions, and capital-stock taxes; 6. the imposition of new stamp taxes or a license tax on the use of automobiles.

The Senate reacted less favorably to Mellon's proposals than did the House. The Senate Finance Committee postponed the consideration of the tariff bill in order to rewrite the revenue bill. The "progressive and agricultural bloc" of western Republicans united with the Democratic minority in the Senate in refusing to accept either the House or the Senate Finance Committee's handiwork. Intense conflicts occurred over the surtax rates upon individual incomes, the maximum rates of the estates tax, the income tax rates upon corporations, the repeal of the excess-profits tax, and the adoption of a comprehensive sales tax. This group of Insurgents, called by their enemies the "wild asses of the desert," forced the Senate to accept their amendments and won the support of the House on the surtax rates against the opposing recommendations of Harding and Mellon. Owing to the lateness of the special session, the closeness in the balance of political power within Congress, and the assessment needs of the Treasury, the Senate and the President approved the compromise measure finally worked out. It became law on November 23, 1921.¹⁵

Disappointment over the new tax law was widespread. Senator Penrose, Chairman of the Senate Finance Committee, called it "a temporary makeshift." The New York *Herald* described it as "a thoroughly bad job," while the New York *Times* wrote: "Bad and

¹⁴ Tausig, *Tariff History*, 447-53.

¹⁵ Blakey, *Federal Income Tax*, 189-222.

wrong as the law is, it does have the virtue of repealing the excess-profits taxes.” Some exasperated accountant labeled the Act “the crime of 1921.”¹⁶ Daniel C. Roper, former Commissioner of Internal Revenue, asserted the new law was “merely a collection of patches on the old Act,” and Cordell Hull ascribed the failure to achieve a scientific tax revision to the “wrangle between champions of large income tax payers and those of the smaller tax payers, each striving to see which could unload the largest amount of taxes first.”¹⁷

The Revenue Act of 1921,¹⁸ characterized as indicating a revolution in the control of political power,¹⁹ was principally important for its repeal of the excess-profits tax after 1921, its reduction of the surtax rates, its treatment of capital gains and losses, and its provisions on consolidated returns and tax simplification. The rates of the 1918 normal income tax were kept at 4 per cent upon net incomes of \$4,000 or less and 8 per cent on incomes in excess of that amount. But a reduction in the normal tax was effected through the increase in the personal exemption for heads of families from \$2,000 to \$2,500 where the family net income did not exceed \$5,000. The exemption for children under eighteen and other dependents was raised from \$200 to \$400. In this way the tax load of the middle and working classes was lightened.

The bitterest struggle in Congress occurred over Mellon's proposal to have the surtax rates reduced from 65 per cent to 32 per cent for 1921 and 25 per cent thereafter. The arguments advanced by Mellon and his supporters, especially Senator Smoot of Utah, were that the high rates hindered the creation of new capital, diverted capital from productive industry into tax-exempt securities, and limited the freedom of business.²⁰ As an admiring economist put it, “Gladstone himself could perhaps have acted more brilliantly, but hardly more soberly.”²¹

But the Midwestern agrarian bloc and the Democrats did not share this opinion. They succeeded in establishing the maximum surtax rate for 1922 and thereafter at 50 per cent on the net income in excess of \$200,000. The other surtax rates began at 1 per cent upon the amount

¹⁶ *Literary Digest* (December 10, 1921), 71: 8.

¹⁷ Blakey, *op. cit.*, 218.

¹⁸ 42 *U.S. Stat. at Large*, 227.

¹⁹ R. G. Blakey, “The Revenue Act of 1921,” *American Economic Review* (March, 1922), 12: 75-108.

²⁰ Andrew Mellon, *Taxation: The People's Business* (New York, 1924) gives the highlights of his tax principles.

²¹ Schumpeter, *Business Cycles*, 2: 709.

of the net income over \$6,000 and rose by 1 per cent increases upon each successive income bracket of \$2,000 until the rate of 47 per cent on the \$98,000-\$100,000 bracket was reached. Then the brackets became much larger. For 1921 the 1918 rates applied. On the whole, the Progressive Republicans and the Democrats won the major victory.²²

The taxation of capital gains was given special treatment. The Treasury had held that a capital gain should be taxable in its entirety as of the date of sale, although the property might have been held and the actual gain accrued through a number of years. This ruling had prevented many sales and deprived the government of taxes which otherwise might have been obtained. To correct this situation, the 1921 Act provided that capital net gains could be taxed at 12½ per cent instead of at the higher surtax rates applicable to ordinary net incomes in the higher brackets. But the taxpayer who elected to have his capital gains taxed at 12½ per cent was required to pay a total tax in no case less than 12½ per cent of his total net income. This limitation narrowed the benefit of the alternative tax to those having a net income of at least \$30,000 and was due to the action of the Senate conferees in favor of the high income groups. Since no provision was made to limit the amount of capital loss which could be deducted, taxpayers soon took advantage of the provision and used their capital losses to cancel entirely their income. Mellon therefore recommended in 1922 that Congress either limit capital gains and losses by the same percentage or refuse to recognize either capital gains or capital losses for income tax purposes. In 1923 Mellon said that it would be sounder taxation policy generally not to recognize either capital gain or capital loss for income tax purposes and that the government probably lost more revenue by permitting the deduction of capital losses than it realized by including capital gains as income.²³ This proposal was quickly seized upon by the real estate interests and received considerable support from economists

²² Other important provisions were: 1. A stock dividend was not subject to tax. 2. Distributions and liquidation and all other distributions not out of earnings accumulated since February 28, 1913, were to be treated as a partial or full return of cost of stock or shares to the distributee; if the stockholder received more than the cost price of the stock he was taxable upon the excess in the same manner as though the stock had been sold. 3. To prevent tax evasion through gifts of property which had appreciated in value, the basis for determining gain or loss in the case of property acquired by gift after December 31, 1920, was to be the same as if the last preceding owner had sold it. 4. Transfers of property from one corporation to another or to a new corporation upon reorganization was permitted without tax liability under certain conditions. 5. The net losses of a business incurred in one year could be deducted from the taxable net income of the following two years when these losses resulted from the operation of trade or business regularly carried on by the taxpayer.

²³ *Treasury Report*, 1922, 14; *ibid.*, 1923, 9.

hostile to the inclusion of capital gains and losses in the definition of income. But their efforts were not successful.²⁴

The tax on corporate net income was continued at the rate of 10 per cent for the calendar year 1921, but was increased to 12½ per cent for the succeeding years in order to compensate in part for the repeal of the excess-profits tax, effective after 1921. An exemption of \$2,000 was allowed to corporations with a net income of \$25,000 or less. Consolidated returns of affiliated corporations were permitted after 1921, but all future returns had to be upon the same basis. Partnerships were not taxed as corporations; instead, each of the partners was taxed on his individual income. This was to include his distributed share of the net income of the partnership. Personal service corporations were taxed as partnerships for the year 1921, but after that were taxed like other corporations.²⁵

The Repeal of the Excess-Profits Tax

The reason for the mild increase in the corporation tax was that the conservative Republicans desired to lessen the resistance of the farmer-labor bloc in Congress to the repeal of the excess-profits tax. The crusade launched by businessmen against the excess-profits tax after the first World War succeeded in its objective once the Democrats were ousted from the seats of power. The businessmen feared that the excess-profits tax might be an opening wedge for socialism and felt that in any case it was a barrier to the expansion and power they desired. They were aided by the fact that Professor Thomas S. Adams, adviser to the Treasury, late in 1919 had become convinced that the excess-profits tax should be repealed and cast the weight of his great authority in that

²⁴ Robert M. Haig, “Capital Gains and How They Should be Taxed,” *Proceedings Academy Political Science* (May, 1924), 11: 131-42. On the problems involved, see R. Blough and W. W. Hewett, “Capital Gains,” in National Bureau of Economic Research, *Studies in Income and Wealth*, 2: 191-263, and Henry C. Simons, *Personal Income Taxation*, 148-69.

²⁵ If partnerships or individuals in business preferred to be taxed as corporations for 1921 and the succeeding years rather than as individuals, they could be taxed as such, provided that they incorporated prior to March 23, 1922, that the taxable net income for 1921 was not less than 20 per cent of the invested capital, and that the capital stock tax of \$1.00 per \$1,000 of invested capital were also paid.

Owing to the charge that the taxes on life insurance companies were inadequate, the 1921 law taxed them upon their net investment income from interest, dividends, and rent at the rate of 12 per cent. They were relieved, however, from the excess-profits and capital-stock taxes. Other insurance companies were not required to pay any other federal corporation tax for 1922 and thereafter. The tax exemption granted to building and loan associations in 1918 was limited to those whose business was confined to making loans to members.

direction. Other noted experts did not share his opinion. Professor Robert M. Haig had made a brilliant study of the British excess-profits tax and had concluded against the hasty repeal of the American profits tax. He pointed out the need for various reforms, yet stressed the desirability of eliminating monopoly profits through this tax. The American public could thus seize "some of the promised advantages of socialized industry without incurring the risks and disadvantages of socialism."²⁶

Another expert, Professor David Friday, also defended the excess-profits tax on the score of justice and of its beneficial economic and industrial effects. He agreed with J. A. Hobson that the operations of the market resulted in giving many people who furnished economic services incomes which were larger than necessary to induce the services, and that a tax upon this surplus income was the tax which impeded enterprise and business activity least while aiding in the fairer distribution of income and wealth.²⁷ But Professor Adams persuaded Congress and the Treasury that there was danger of an administrative collapse arising from the burdens of the excess-profits tax superimposed upon those of the income tax, and that unless the former were repealed the latter would become also discredited and be repudiated.²⁸ The arguments he gave in all sincerity were utilized by the Old Guard Republicans not only to win by a narrow margin repeal of the excess-profits tax but also to serve as a basis for urging the adoption of a sales tax. Senator Reed of Missouri was the chief opponent of the repeal while Senator Smoot was the indefatigable champion of the sales tax. The social principles dividing the conservatives from the liberals on the tax issues in Congress were epitomized by Senator Moses's plea for Smoot's 3 per cent manufacturers' sales tax on the ground that it would "strike down the vicious principle of graduated taxation which appears in the pending tax bill, and which is but a modern legislative adaptation of the Communistic doctrine of Karl Marx."²⁹

The upshot of the struggle between the conservative Republicans from the industrial Northeast and the progressive Republicans and Democrats from the South and West was that the excess-profits tax rates effective in 1919 and 1920 were retained for 1921 but were to

²⁶ Robert M. Haig, "The Taxation of Excess Profits in Great Britain," *American Economic Review* (December, 1920), v. 10, No. 4, Supplement), 175.

²⁷ David Friday, *Profits, Wages, and Prices*, 176ff.; J. A. Hobson, *Taxation in the Modern State* (New York, 1920), 12-78.

²⁸ Thomas S. Adams, "Should the Excess Profits Tax Be Repealed?" *Quarterly Journal of Economics* (May, 1921), 35: 363-93.

²⁹ *Cong. Record*, 67th Cong., 1st Sess., 61.

be abolished after that date, that all the sales tax proposals of Smoot were rejected, and that the corporation income tax rates were to be increased after 1921. Most authorities agreed that the 1918 excess-profits tax law had serious defects and unfairly discriminated between under-capitalized and overcapitalized corporations and in some cases between corporations and partnerships or individual businesses. The difficulties of determining invested capital especially came under fire, but some experts have argued that these problems were well on the way to being solved, either through a redefinition of the invested-capital standard, or through the adoption of an eight to ten-year base-period standard.³⁰

In view of the complaints against the hardships of the excess profits tax, one should note that the total profits of American business during the years 1916-20 inclusive were estimated at \$47 billion, of which no more than \$9 billion were taken in taxation. Business reserves increased in large enough volume to compensate for the rise in prices. “In the golden years which were to follow there was not much sign of capital shortage.”³¹

The rates of the 1918 federal estate tax were not changed by the Act of 1921 although an intense contest in the Senate resulted in a doubling of the maximum rates on the larger estates by a Senate vote of 44 to 15. The maximum rate of the 1918 law was 25 per cent on the amount of the net estate exceeding \$10 million. The Senate increased the rates to 30 per cent on the amount over \$15 million to 50 per cent on that over \$100 million, but the Conference Committee responded to the pressure of great wealth and eliminated the increases.³²

Because of the depressed condition of the railroads, Congress voted to repeal the 1918 transportation taxes, effective after 1921. Taxes on insurance were also eliminated, but the taxes on telephone, telegraph, cable, and radio messages were retained, as were those on cigars, tobacco, admissions, and dues. Most of the other special excises and stamp taxes were re-enacted although some changes were made. The capital-stock tax of \$1.00 on each \$1,000 of the fair average value of capital stock in excess of \$5,000 was kept despite efforts by the conservatives to have it eliminated. An important administrative innovation was the

³⁰ Butt, *A Permanent Excess Profit Tax*, 368-90, advocates the base-period standard; Caverly, *Taxation of Differential Profits*, 80-111, 130-43, the invested-capital standard.

³¹ J. R. Hicks, U. K. Hicks, and L. Rostas, *The Taxation of War Wealth* (Oxford, 1941), 132. For varying estimates of the effects of the excess-profits tax, see Hynning, *Taxation of Corporate Enterprise*, 121-25, and Nye Committee, *Senate Report 944*, Pt. 2, 74th Cong., 1st Sess., 3-53.

³² *American Economic Review*, 12: 97-98.

creation of the Tax Simplification Board. This was to consist of three members representing the public and appointed by the President and three officers or employees of the Bureau of Internal Revenue. They were to investigate the procedure of the Bureau and make recommendations for simplification. The Board was continued under the 1924 Revenue Act and proved valuable in proposing administrative improvements and needed legislation, yet was unable to halt the increasing complexities in the law because of general economic and political factors beyond its control.³³

The 1922 Tariff and Economic Nationalism

Once the Revenue Act of November 23, 1921, was out of the way, Congress was able to devote itself to the problem of revising the tariff. As early as July 21, 1921, the House had passed the "Permanent" Tariff Bill in response to the combined demand from agricultural and manufacturing pressure groups for protection from European competition. But the Senate Finance Committee, because of its primary interest in the 1921 Revenue Act and its desire to revise thoroughly the House tariff bill, did not report the tariff bill to the Senate until April 11, 1922, and then with over 2,000 amendments. After an extended conflict in the Senate between the Democrats and the Republicans, with the agricultural bloc from the Middle West forcing concessions from the Northeast, the Senate passed the bill on August 19 by an almost strictly partisan vote of 48 to 25. The bill finally became law on September 19, 1922.

The Fordney-McCumber Tariff Act was significant not only because it marked a return to, and an advance on, the high protective tariff standard of the pre-Wilson era, but because it "was the first heavy blow directed against any hope of effectively restoring a world trading system." Even after the first World War had ended and the interwar boom had given way to sharp depression and a period of uncontrolled inflation in many European countries, there appeared to be an adequate market for the expanded agricultural and industrial production of the United States and even such "maturing" economies as India, Canada, Australia, and the Argentine. Japan was the chief example of industrial development. The need was also felt for much capital equipment and manufactured consumers' goods. But the means of payment was lacking to those countries most in need of imports and loans. The United States, by raising its tariff in 1922 and passing in 1924 a drastic Immi-

³³ Blakey, *Federal Income Tax*, 541.

gration Restriction Act, stimulated the agricultural and industrial protection system in most of Europe and the rest of the world.³⁴

The extreme protectionist policy embodied in the 1922 Tariff Act was defended on the ground that it equalized the costs of production in competing foreign countries and the United States. Power was given to the President to raise rates whenever the Tariff Commission found that the rates in the tariff duty did not equalize the production costs. The tariff became known as the “flexible” tariff, but the President was under no legal compulsion to follow the Tariff Commission’s advice. The chief increases in the tariff were made in the duties on coal tar products, dyestuffs, manganese and tungsten ores, and magnesite, such agricultural products as wheat, rye, corn, sugar, wool, lemons, butter and milk, textiles such as woven silk fabrics and woollens, laces, cotton gloves, chinaware, cutlery, and guns. Cotton, coal, hides, boots, shoes, and leather remained on the free list. The increases reflected the pressure of different economic and sectional interests. The general economic, although not the political, effect of the duties on agricultural products from the point of view of both the producer and the consumer was not great except in the case of sugar and wool.³⁵ In view of the war dangers which have ensued since 1922 the protection given to the chemical and other industries necessary for national or hemispheric sufficiency seems to be justified. But some contend that the widespread belief in the necessity for protection contributed to international tension and helped to bring on World War II.

It is rather ironic that the agricultural bloc from the Middle West and South which had fought the conservative Republicans from the industrial Northeast on the excess-profits tax and the high income surtaxes should have joined with their opponents on the tariff issue. The sharp decline in farm prices during the fall of 1920 set in motion a new farmers’ movement which took sound action on agricultural credit, cooperative marketing, and other matters, but seems to have erred in seeking a solution for its income difficulties in the tariff. That economic weapon turned out to be a means for increasing the profits of the industrialists at the expense of the farmer, the merchant, and other social groups. At the same time the farmer-labor groups were trying to limit business profits through high income taxes and antitrust agitation.³⁶ Although Joseph W. Fordney called the 1922 tariff “the Constitution of a uniform and universal prosperity,” the progressive Kansas City

³⁴ J. B. Condliffe, *The Reconstruction of World Trade* (New York, 1940), 182.

³⁵ Taussig, *Tariff History*, 447-88.

³⁶ Cf. Fred E. Haynes, *Social Politics in the United States*, 332-63.

Star was nearer the truth in its verdict that: "For a mess of tariff pottage of dubious value the farmer is practically selling his birthright."³⁷

The Harding Scandals and Coolidge's Rise to Power

The smoothness with which the Harding administration had proceeded to introduce economy in government expenditures, reduction in taxes and the national debt, and encouragement to big business was marred in 1923 by the disclosure of various scandals in high government circles. Harding, like Grant, had a reputation for virtue which prevented the public from suspecting him of knavery, and an incapacity for doubting his friends which prevented him from discovering their rascality until it was too late. Undoubtedly his death on August 2, 1923, was due in large part to the strain created by the knowledge he obtained of the way in which his friends from Ohio and elsewhere betrayed his confidence and sacrificed the public welfare to private greed. Congressional investigations revealed how Albert B. Fall, Secretary of the Interior, received large bribes from Edward F. Doheny and Harry F. Sinclair and gave them in return fraudulent leases to the Elk Hill oil reserve in California and the Teapot oil reserves in Wyoming respectively. Charles R. Forbes, Director of the Veterans' Bureau, was shown to have misused his office and to have enriched himself through graft and corruption. Thomas W. Miller, the alien property custodian, was convicted of a criminal conspiracy to defraud the government. Harry M. Daugherty, the Attorney-General and the person most responsible for Harding's election as President, was proven guilty, although not convicted, of using his office to sell illegally liquor permits and pardons, to persecute liberals and radicals, and to reward and protect his friends and various business interests.³⁸

Calvin Coolidge brought back to the Republican party the respectability which the scandals of the Harding era threatened to destroy. He kept the Harding Cabinet and pledged a continuation of Harding's policies. Coolidge was so impressed and dominated by Andrew Mellon as the chief political representative of concentrated wealth that William Allen White has suggested that the Coolidge administration at its zenith should be called "the reign of Coolidge and Mellon."³⁹ The 1921 Revenue Act had resulted in a reduction of \$1½ billion in ordinary receipts from taxes in 1922 and a further decrease of \$250 million

³⁷ *Literary Digest* (April 22, 1922), 73: 7; *ibid.* (October 7, 1922), 75: 12.

³⁸ Samuel H. Adams, *Incredible Era* (Boston, 1939), 252ff.; M. R. Werner, *Privileged Characters* (New York, 1935), 3ff.

³⁹ William Allen White, *A Puritan in Babylon* (New York, 1938), 251.

in 1923, yet the Treasury had succeeded in reducing the gross public debt by almost \$2 billion during the fiscal years 1921-23. Moreover, a surplus of about \$310 million had remained in the Treasury at the end of 1922 and 1923 over expenditures chargeable against ordinary receipts. This situation and other considerations led Mellon, supported by Coolidge and Professor T. S. Adams, to suggest to Congress a drastic tax reduction and revision program late in 1923.

The Mellon Tax Plan Is Congressional Insurgency

The highly debated Mellon Plan centered on reducing the surtax rates from a maximum of 50 per cent on incomes of \$200,000 and over to 25 per cent on incomes of \$100,000 and over, lowering the normal income taxes from 4 and 8 per cent to 3 and 6 per cent respectively, and decreasing the heavy federal estate tax. These proposals were defended on the grounds that the high surtaxes in peacetime induced men of wealth to divert their capital from productive business to tax-exempt securities, that the federal estate tax, joined to the state taxes, impaired the growth of capital, and that the lower normal taxes would help reduce the high cost of living. To counterbalance these seeming favors to the wealthy classes, Mellon also advocated a 25 per cent reduction on the tax on earned income, a 12½ per cent limit to capital loss deductions, the repeal of various excises and nuisance taxes, and other changes.⁴⁰

A vast propaganda machine was put into action by the Republicans with the aid of numerous financiers and industrialists in order to sell the Mellon Tax Plan to the American public and Congress. But the Democrats and the Insurgent Republicans in the House forced through important modifications in the administration bill. John Nance Garner was the Democratic spearhead, and James A. Freat of Wisconsin the progressive Republican spearhead, for the opposition to the reductions in the surtax rates and the estate tax rates. The radicals, led by C. S. Ramseyer of Iowa, even won increases in the estate tax rates and secured the passage of the gift tax. The conservative-dominated Senate Finance Committee, however, attempted to win the Senate to a repudiation of the House bill and to an acceptance of the Mellon Plan. But Senators Couzens of Michigan, Jones of New Mexico, F. M. Simmons of North Carolina, and Walsh of Massachusetts upset the conservative applicart. They led the Democrats and Insurgent Repub-

⁴⁰ *Treasury Report*, 1923, 3-15. Andrew W. Mellon, *Taxation: The People's Business* (New York, 1924) gave wide currency to Mellon's views in a form adapted to the general public.

licans into securing the adoption of the normal and super income tax rates proposed by Simmons, the House rates on estates and gifts, the graduated tax on corporation incomes reaching a maximum of 40 per cent, and the opening of tax returns to full publicity. Mellon and Coolidge were bitterly opposed to the tax bill as it finally emerged from Congress and debated vetoing the measure. But Coolidge finally signed the bill on June 2, 1924, and issued a "veto statement" of his objections to the way in which Congress had disposed of his and Mellon's proposals.⁴¹

The public verdict on the new revenue law ran the gamut from high praise to scathing criticism. The law was correctly characterized as essentially a Radical Democratic measure. Some newspapers, such as the *Charleston News and Courier*, welcomed it heartily as superior to the original Mellon Plan. A small group of die-hard conservative papers like the *Wall Street Journal* and *New York Journal of Commerce* considered the Act so unscientific and harmful in certain of its provisions that they preferred having the 1921 law left as it was. But the largest section of the press concluded that while the 1924 law was far from perfect, it was good as far as it went in the direction of tax reduction. The *New York World* expressed the sentiments of this group most pointedly and stressed the need for distinguishing between earned and unearned income and removing the stranglehold of tax exemption.⁴²

The Revenue Act of 1924

The Revenue Act of 1924⁴³ continued the trend begun in 1918 and 1921 toward the reduction of income and excise taxes, but did not even approach the pre-World War I level of rates. The Act, paradoxically enough, counterbalanced these decreases by the imposition of a gift tax and increases in the estate tax. From the long-time point of view the law was also important for introducing tax structural changes designed to eliminate tax hindrance of business and to prevent tax avoidance. Some of the rules laid down on the computation of gain or loss in corporate reorganization, the exchange of property, the treatment of

⁴¹ Blakey, *Federal Income Tax*, 223-503; O'Connor, *Mellon's Millions*, 129-373; Shultz, *Taxation of Inheritance*, 161-63. The balance of power in Congress was distributed as follows: in the Senate there were 52 Republicans, 42 Democrats, and 2 Farmer-Labor members; in the House there were 223 Republicans, 208 Democrats, 1 Independent, 1 Farmer-Labor, 1 Socialist, 1 vacancy. *World Almanac*, 1925, 39-42.

⁴² *Literary Digest* (June 7, 1924), 81: 12-14.

⁴³ 43 *U.S. Stat. at Large*, 253.

capital gains and losses, and the creation of trusts remained in force until 1932, others until 1934, and still others until the present.⁴⁴

The provisions affecting the largest number of taxpayers involved numerous important changes. A 25 per cent reduction in the taxes payable in 1924 upon individual incomes received in 1923 was granted taxpayers. The normal income tax rates were reduced from 4 per cent upon the first \$4,000 of net income and 8 per cent on the excess to 2 per cent upon the first \$4,000, 4 per cent upon the next \$4,000, and 6 per cent upon the amount over \$8,000. The 1921 exemption for \$1,000 for single persons was retained, but the exemption of \$2,500 for heads of families was not extended to those whose family net income exceeded \$5,000. The credit of \$400 for each dependent was kept. A most important innovation was the provision granting a 25 per cent reduction on “earned” incomes. The first \$5,000 of any taxpayer’s net income was to be considered to be earned and was allowed the lower rate, but in the case of high incomes a limit of \$10,000 was placed on the amount to be considered earned. This differentiation in favor of labor had been advocated since the time of the Civil War. Despite British and other European precedents, the proposal was enacted only when a conservative administration desired to gain popular support for a tax program more favorable to the upper classes than to the working and middle classes. The impending presidential election in the fall of 1924 was a very influential factor in inducing the conservative Republicans to grant various tax concessions.

Those with large incomes were benefited considerably by the new surtax rates, which began at 1 per cent upon the net income in excess of \$10,000 and rose gradually to a maximum of 40 per cent on the net income in excess of \$500,000. The 1921 rates had begun at 1 per cent on the net income over \$6,000 and had risen to a maximum of 50 per cent upon income over \$200,000. These decreases, however, were considered so minor by their beneficiaries that they inspired Judge Gary to say that from the point of view of business prosperity “the worst thing we have at the present time is our American Congress.”⁴⁵

The 1921 distinctions between ordinary income and capital gain and between ordinary losses and capital losses were re-enacted. The maximum tax of 12½ per cent on capital gains was kept, but was no longer restricted to those with high incomes. Capital losses, however, could

⁴⁴ R. G. Blakey, “Revenue Act of 1924,” *American Economic Review* (September, 1924), 14: 475-504.

⁴⁵ *Literary Digest* (May 10, 1924), 81: 6. La Follette’s reply was that Gary spoke for “the organized plunderbund which fattens off special privileges from the Government.” *Ibid.* (June 7, 1924), 81: 9.

no longer be deducted to an unlimited amount; a ceiling of 12½ per cent was imposed upon such losses resulting from the sale or exchange of assets held over two years. This limitation on losses balanced that on the taxation of gains and was defensible from the revenue point of view. Its defect was that the taxpayers benefited by the generous treatment of gains were not necessarily the same as those adversely affected by the limitation on losses. Nevertheless, this system, except for some changes made in 1932, remained in effect for ten years. In 1934 an entirely new method of dealing with capital gains and losses was introduced.⁴⁶

Although Senator Jones of New Mexico influenced the Senate to accept a graduated tax upon the undistributed earnings of corporations, it was deleted by the Conference Committee. Consequently the 1921 tax of 12½ per cent upon corporate net income and the capital stock tax of \$1.00 for each \$1,000 par value were retained. A gallant effort by Representative Frear of Wisconsin to revive the excess-profits tax had been defeated by a vote of 157 to 74.⁴⁷ The allowance for discovery depletion was cut from 100 per cent of net income to 50 per cent. The 1921 law had failed in its attempt to prevent individual surtax evasion through a 25 per cent tax upon the net income of corporations formed or used for that purpose. To remedy this situation, the 1924 law increased this special surtax to 50 per cent and declared that the fact that any corporation was a mere holding or investment company was prima-facie evidence of intent to escape the surtax. The law also extended the definition of corporate net income to include dividends paid by other corporations and the interest on United States obligations which would be taxable in the hands of an individual owner. These alterations, unfortunately, proved inadequate.

A provision granting a limited publicity to tax returns excited much public debate. All the income tax laws since 1913 had provided for the publication of income tax statistics in such a way as not to reveal the facts regarding individual cases. A long campaign had been waged by La Follette and George W. Norris for full publicity on the income tax returns of corporations and individuals, and in 1924 Norris succeeded in getting the Senate's approval on his proposal. But the conservatives on the Conference Committee, influenced by Secretary Mellon, limited

⁴⁶ Cf. A. H. Kent and G. N. Nelson, "Taxing Capital Gains," *Law and Contemporary Problems* (Spring, 1940), 7: 197-98, 211-13; R. H. Montgomery, *Income Tax Procedure 1926* (New York, 1926), 926-50.

⁴⁷ *Cong. Record*, 68th Cong., 1st Sess., 65: 7527ff.; *American Economic Review*, 14: 491.

the publicity by making the tax returns open to Congressional committees, to state tax officials and the general public only upon order of the President. The old provision allowing stockholders to examine the returns of their corporations was re-enacted. The Commissioner of Internal Revenue was required to publish lists containing the name of each person making an income tax return and the amount of the income tax paid. These lists became valuable sources for a study of the exact details of the distribution of income and gave many a new insight into the structure of economic power. For this reason, as well as for other more definable reasons, many conservatives strongly opposed this publicity.⁴⁸

The 1924 Estate and Gift Taxes

The 1924 estate tax contained the highest rates ever imposed by the federal government upon estates. It was a notable demonstration of the political strength in Congress of the Democrats and Insurgent Republicans. Mellon had advocated a sharp reduction in the estate tax, but Christian S. Ramseyer, a progressive Republican from Iowa, persuaded the House to increase the rates on all portions of estates above the first \$100,000. Despite sharp opposition by Coolidge and Mellon and the Senate's attempt to substitute an inheritance tax proposed by Senator Walsh of Massachusetts, Congress finally enacted the revised estate tax. The tax rate began at 1 per cent upon the net estate not in excess of \$50,000 and rose to a maximum of 40 per cent upon the amount over \$10 million. The maximum rate in both the 1921 and 1918 Acts had been 25 per cent.

Counteracting these rate increases was a provision that credit up to 25 per cent of the federal estate tax would be given for the amount of any estate, inheritance, legacy, or succession taxes actually paid to any state or territory or the District of Columbia on any property included in the gross estate. This provision was intended by its author, James A. Frear, and by Congress to impose uniformity upon state taxation of inheritances. Each state now was given an incentive to adopt rates equivalent to 25 per cent of the federal tax. Moreover, such attempts to attract capital from other states as Florida's adoption of a constitutional amendment prohibiting a state inheritance tax and Nevada's abolition of its inheritance tax were negated for the most part. This was shown by the fact that the New York State Legislature passed in 1925 its

⁴⁸ Cf. Lundberg, *America's Sixty Families*, 23-31.

special estate duty on estates over \$1 million. The rates were so graduated as to equal always one quarter of the federal tax.⁴⁹

To prevent evasion of the estate tax, William R. Green, Chairman of the House Ways and Means Committee, with the ardent support of John N. Garner, had proposed a graduated tax on gifts with a maximum rate of 10 per cent on gifts over \$40,000. Green was an independent Republican from Iowa who was opposed to Mellon's plan for lowering the income surtax and estate tax rates as favoring the rich. He, with Garner and Senator Walsh, advocated the gift tax as a means of preventing large losses in the revenue from the estate and income taxes and as an instrument for the equalization of wealth. As revised by the Senate, the rate schedule of the estate tax was applied to the transfer by residents by gift of any property wherever situated, whether made directly or indirectly, and to the transfer by nonresidents by gift of any property situated within the United States, whether made directly or indirectly. An exemption of \$50,000 was granted to residents of the United States, but not to nonresidents. Both, however, were permitted to deduct gifts not in excess of \$500 to any one person and gifts to the federal, state, or local governments or to strictly charitable, cultural, or religious associations.

Congress carefully provided that the "contemplation of death" clauses of the estate tax should have precedence over the gift tax so that a gift made in contemplation of death was included in the net total of the taxable estate and was taxable under the higher brackets of the estate tax. Gifts were defined not only as voluntary transfers of property, without any consideration or compensation, but also as sales and exchanges for less than the fair consideration in money or money's worth. This latter provision was interpreted by Mellon as applying to bad bargains and was used, along with certain other defects in the drafting of the gift tax, as the basis for demanding the repeal of the gift tax.

The gift tax grew out of the need for preventing the evasion of the estate and income taxes. Like the estate tax, it was based upon the act of transfer rather than on the property itself or the act of receiving. Therefore the rates of the gift tax applied to the sum total of gifts made by an individual in the course of a year and not to the amount of the gifts received by individuals. The reason for this was that the revenue yield to the government would be greater and the administration easier than if the tax had been imposed upon the recipients of the gifts.

⁴⁹ Myers, *Hereditary American Fortunes*, 276-81; Shultz, *Taxation of Inheritance*, 161-62.

The precedents for this tax were not very helpful. During the Civil War gifts of real property were taxed as successions; the 1894 income tax law contained a provision for taxing gifts as income. The treatment of gifts in the laws of 1913 and after was always incidental to the taxation of income and estates.⁵⁰ The constitutionality of the 1924 gift tax was soon challenged. In 1926 the Southern District Court of New York declared the federal gift tax a direct tax and therefore unconstitutional,⁵¹ but in 1929 the United States Supreme Court upheld the constitutionality of the tax as an excise.⁵² The Court, however, ruled the year before that the gift tax could not apply to gifts made before the 1924 revenue bill became law.⁵³ Justice Brandeis objected to this restriction of the gift tax on the grounds that for more than half a century the Court had held that tax laws might be retroactive in their operation.⁵⁴

Numerous excise taxes which had been held over from the first World War were reduced or repealed in order to lessen the burden on business, but the heavy taxes upon tobacco and its products were retained. An important administrative change was the substitution of the Board of Tax Appeals for the Committee on Appeals and Reviews, which had heard and decided disputes on the income and excess-profits taxes referred to it by the Commissioner of Internal Revenue. The new Board was independent of the Treasury Department and had the authority to decide claims by taxpayers against deficiencies in their income, profits, estate, and gift taxes as assessed by the Bureau of Internal Revenue. The Board had no authority over claims for refunds, and its decisions were subject to review by the Circuit Courts of Appeals and the Supreme Court.⁵⁵

⁵⁰ C. Lowell Harriss, “Legislative History of Federal Gift Taxation,” *Taxes* (September, 1940), 18: 431-38; Shultz, *op. cit.*, 162-64; R. H. Montgomery, *Excess Profits, Estate, Gift, Capital Stock Tax Procedure 1926* (New York, 1926), 663-90.

⁵¹ *McNeir v. Anderson*, 10F. 813.

⁵² *Bromley v. McCaughn*, 280 U.S. 124.

⁵³ *Blodgett v. Holden*, 275 U.S. 142; *Untermeyer v. Anderson*, 276 U.S. 440.

⁵⁴ 276 U.S. 447-48.

⁵⁵ Selko, *Federal Financial System*, 276-78.



Coolidge Prosperity and Mellon's Tax Policy

THE presidential election of 1924 was a striking demonstration of the success the champions of big business were able to achieve in an era of prosperity in the face of stringent criticism by spokesmen for the less-favored groups. Calvin Coolidge skillfully arranged to secure an almost uncontested nomination by the Republican party on a platform advocating rigid governmental economy, progressive tax reduction, the maintenance of a high protective tariff, and nonrepudiation of foreign debts. The Democrats, after a historic struggle between the McAdoo and the Alfred E. Smith forces, compromised on John W. Davis, Solicitor-General under Wilson, ambassador to Great Britain, and a noted lawyer. Unfortunately, Davis was an attorney for J. P. Morgan and Company, and the Democratic platform with its attack on Republican corruption, its promises of tariff reduction, equitable distribution of taxes, aid to the farmer and worker, and adherence to the League of Nations and World Court ideals was not sufficiently militant to attract the support of labor and agriculture.

Robert La Follette was chosen by the labor and farm groups dissatisfied with the candidates and platforms of the major parties. These groups joined with the Socialists to form a third party, the Conference for Progressive Political Action, which received the endorsement of the American Federation of Labor and seemed the long-awaited political instrument of the farmer-labor movement. Their program contained a strong attack upon the trusts and monopolies, the right of the courts to nullify legislation, and the support given to imperialism by previous administrations. In addition to demanding public ownership or control of the nation's water power, natural resources, and the rail-

roads and other measures designed to improve the position of the farmers and workers, the Conference platform asked for the retention of high surtaxes on swollen incomes, and the restoration of the taxes on excess profits, stock dividends, and undistributed profits. Moreover, La Follette urged rapidly progressive taxes on large estates and inheritances and the repeal of excessive tariff duties and nuisance taxes on consumption in order to transfer the unjust burden of taxation from the masses to those who profited by the war.

The outcome of the election was a sweeping victory for Coolidge and the Republican party in general. The popular vote was 15,718,000 for Coolidge as against 8,385,000 for Davis and 4,832,000 for La Follette. If one considers the limited organization and funds of the Progressives, La Follette made a remarkable showing. He not only carried Wisconsin, but drew a larger vote than Davis in eleven other states and undermined the great strength of the Republicans in the Middle and Far West. Nevertheless, the party most representative of big business had consolidated its control over the federal government for another four years while the Conference for Progressive Political Action speedily dissolved.¹

The investment in the campaign made by the Republicans was \$5,945,495, by the Democrats \$1,614,762, and by the Progressives \$236,963. Joseph R. Grundy, President of the Pennsylvania Manufacturers' Association, collected \$700,000 for the Republican campaign chest; most of the leading financiers and industrialists gave large contributions.² Yet Coolidge, although "a natural ally of organized capital," considered that the Republican party organization owed more to

¹ Nathan Fine, *Labor and Farmer Parties*, 398-414; Robinson, *Presidential Vote*, 21-24, 32-33, 46; *World Almanac*, 1925, 864-80; White, *A Puritan in Babylon*, 295-309.

² Louise Overacker, *Money in Elections*, 75-79, 183. According to Lundberg, *America's Sixty Families*, 171-72, the Republicans received \$25,000 apiece from William Wrigley, James A. Patten, William H. Woodin, and Frederick H. Prince; \$15,000 apiece from Eldridge R. Johnson, Mortimer L. Schiff, Arthur C. James, and Payne Whitney; \$12,500 from J. B. Duke and William N. Cromwell; \$10,000 from Andrew W. Mellon, John D. Rockefeller, Irene du Pont, Ogden Mills, Charles G. Dawes, Vincent Astor, Frank A. Munsey, Julius Fleischmann, Charles Hayden, J. H. Harding, Julius Forstmann, Frank W. Stearns, and Arthur W. Cutten; and \$5,000 from Dwight W. Morrow, Thomas Cochran, Marshall Field, Richard B. Mellon, Helen C. Frick, Cornelius Vanderbilt, Alfred P. Sloan, Jr., Harvey S. Firestone, William H. Todd, Henry G. Huntington, Archer M. Huntington, and Charles M. Schwab.

The largest contributions to the Democrats were \$55,000 from Thomas F. Ryan, \$25,000 each from Bernard M. Baruch and Jesse H. Jones; \$23,500 from Henry Morgenthau; \$20,000 from Thomas L. Chadbourne; \$10,000 from Norman H. Davis, Francis P. Garvan, and S. D. Camden; and \$5,000 each from John W. Davis, Cleveland H. Dodge, Mrs. Jesse H. Jones, C. R. Crane, Cyrus H. McCormick, John D. Ryan, F. L. Polk, Jesse I. Straus, Percy S. Straus, and Allen Wardwell.

him than he to it. But all his policies were in complete harmony with the economic interests behind the Republican party.³

Business Campaign vs. Gift and Estate Taxes

Once the 1924 election was over, a vigorous campaign was begun to repeal the gift and estate taxes and to lower drastically the surtaxes. That December Coolidge told Congress of the need for taxation "scientifically revised downward." An organization, first known as the American Bankers' League, later as the American Taxpayers' League, was formed to spread propaganda and to bring pressure on Congress. Early in the fall of 1925 the House Ways and Means Committee met in order to hear proposals for tax revision by Mellon, such experts as Professors Seligman and T. S. Adams, and the general public. Numerous Tax Clubs from Iowa, Texas, and other states, composed of newspapermen, bankers, and "political wire pullers," appeared before the Committee, attempted to reach Congressmen, and tried to create a political backfire which would stampede Congress. Two conferences of state and federal representatives on inheritance and estate taxation were also held in February and November, 1925, at the instigation of the President. Although the first conference did not agree with Coolidge's proposal that the federal government retire from the estate tax field, the second was more amenable.

Mellon recommended reduction of the income tax rates to a maximum surtax of 20 per cent, and a normal tax of 5 per cent, the reduction and eventual repeal of the estate tax, and the immediate repeal of the gift tax and the excises on automobiles, admissions, and jewelry. He also advocated restricting the publicity of income tax returns and a constitutional amendment to abolish the tax exemption of government securities. The opposition to the second Mellon Tax Plan in Congress was very weak on most points, except on that of the estate tax. The Democratic party had been left divided and demoralized by the election and lacked vigorous leadership. The progressive wing of the Republican party had also suffered election losses and had been deprived of I. A. Follette's dynamic leadership by his death in 1925. The consequence was that although William R. Green and John N. Garner fought hard for the estate and gift taxes the Republican machine, with the assistance of the Democratic leaders, was able to steamroller the administration revenue bill through Congress with unusual speed. Garner and Senator Simmons made their bargains with the Republi-

³ White, *op. cit.*, 309ff.

cans and then used their influence to keep the Democratic party in line as supporters of the Republican bill.

The outstanding opponents of the measure were Representatives Rainey and Frear and Senator Norris. Others who contributed to the opposition were Cordell Hull and Fiorello La Guardia in the House and Couzens, Borah, King, and Robert La Follette, Jr., in the Senate. Couzens published in January and February, 1926, the full report of his extended investigation into the Bureau of Internal Revenue, and throughout the Senate debate presented facts indicative of fraud and inefficiency in the administration of the Bureau. Tax refunds were revealed which totaled \$1,271 million since 1922. Large corporations and wealthy individuals were involved, among whom were various Mellon corporations. But these revelations failed to have much effect upon Congress or the general public because the dominant business interests were satisfied with Mellon's work as Secretary of the Treasury and the administration was able to make a plausible defense on the ground that most of the charges came from dissatisfied Bureau employees and Couzens's antagonism to Mellon.

Given such a background, it is no surprise that the revenue bill introduced into Congress on December 7, 1925, was passed in the House on December 18 by the overwhelming majority of 390 to 25 and in the Senate on February 12, 1926, by a vote of 58 to 19. The bill became law on February 26, 1926.⁴ Proof that big business was in control was the widespread approval of the new tax law by the press. The Republican newspapers and many conservative Democratic papers praised the law as a sound, businesslike, and intelligent tax measure. Among the few dissenters was the *St. Louis Post-Dispatch*, which characterized the law as "the rich man's tax bill." The *Memphis Commercial Appeal* astutely remarked: "The big boys were satisfied; a sop has been thrown to payers of small incomes, but the payers of big incomes are magnificently protected."⁵

The 1926 Shift in Tax Burdens

The Revenue Act of 1926⁶ was distinguished by the greatly reduced burden on the rich, especially the very rich, through lower surtaxes on the high incomes, much diminished tax rates on large estates, and the repeal of the gift tax. The political support for this considera-

⁴ Blakey, *Federal Income Tax*, 251-75; Myers, *Hereditary American Fortunes*, 281-85; O'Connor, *Mellon's Millions*, 139-61.

⁵ *Literary Digest* (March 6, 1926), 88: 5-7.

⁶ 44 *U.S. Stat. at Large*, 9.

tion for the wealthy was secured through the granting of smaller tax cuts to those in the lower brackets.⁷ An analysis of the Act will reveal that although the 1926 Revenue Act seemed to be in accord with what the majority of the electorate voted for in the 1924 election, not all of them clearly understood how that program would affect them practically.

The normal income tax rates were reduced from the 1924 rates of 2 per cent upon the first \$4,000 of net taxable income, 4 per cent upon the next \$4,000, and 6 per cent upon the amount over \$8,000 to 1½ per cent, 3 per cent, and 5 per cent respectively. The personal exemptions were increased from \$1,000 to \$1,500 for single persons and from \$2,500 to \$3,500 for heads of families or married persons. These increases meant the complete exemption of about one third of \$7,300,000 income tax payers of 1925 and was sharply opposed by Cordell Hull and a few others because the exemption made possible retention of the far heavier burdens of the protective tariff and various war-exercise taxes. The 1924 deduction of \$400 for each dependent was retained. The 25 per cent credit first allowed in 1924 on taxes on earned incomes was not only kept, but the maximum amount of earned net income upon which this credit was permitted was increased from \$10,000 to \$20,000. This provision was in line with progressive economic thought and was at the same time politically useful to the conservatives.

The minor favors given to the middle classes were greatly outweighed by those given the wealthy through changes in the surtax. The 1926 surtax rates on incomes of \$26,000 and less followed the 1924 rates in beginning at 1 per cent upon net incomes over \$10,000 and rising to 7 per cent on those in the \$24,000–\$26,000 bracket. But after that income level a gradually increasing reduction in the surtax rates, as compared with the 1924 rates, occurred. The result was that the maximum surtax rate became 20 per cent upon the net income in excess of \$100,000. This was a sharp drop from the 1924 maximum of 40 per cent on the amount over \$500,000. If the Republicans, however, had had their way, there would have been only slight reductions in the surtax rates on incomes under \$100,000. All attempts by Representative Rainey and Senators Norris, Lenroot, and Howell to increase the 20 per cent maximum were crushingly defeated. The main justification given by Secretary Mellon and Senator Smoot for the low surtax rates was that the excessively high surtaxes diverted capital from

⁷ R. G. Blakey, "Revenue Act of 1926," *American Economic Review* (September, 1926), 16: 401–25.

productive enterprise to tax-exempt securities and gave an incentive for tax avoidance and evasion. These charges were severely criticized by such tax experts as Professor F. M. Patterson and by Norris, Rainey, and other liberals in Congress, but those who had the power to reduce the surtax rates did so despite the cogent arguments to the contrary.⁸

To compensate for the repeal of the 1924 corporation tax of \$1 per \$1,000 of capital, the tax on corporate net income was increased from 12½ per cent to 13 per cent for 1925 and to 13½ per cent for each year thereafter. But life insurance companies, which had not been subject to the capital stock tax, were to continue to pay only 12½ per cent upon their net income. The 1924 tax of 50 per cent on undistributed corporate surpluses was kept, but the tax was modified so as not to apply if all the stockholders included in their income tax returns their distributive shares of the corporation's net income for the taxable year, whether distributed or not. The important definition of affiliated corporations and provision for their consolidated returns option were left unchanged in nearly every respect. The principles laid down in 1924 for computing capital net gains and losses were also retained except for some new provisions designed to clarify some obscure points.

The limited publicity given in 1924 to income tax returns was bitterly opposed by Mellon, Senator Smoot and Representative Ogden L. Mills of New York, later Secretary of the Treasury under Hoover. They maintained that such publicity failed to increase the Treasury revenue and encouraged tax evasion, loss of revenue, and undesirable newspaper gratification of public curiosity. On the other hand, Senators Norris, Couzens, La Follette, and others argued that publicity discouraged evasions, promoted honesty, and increased the revenue. But their efforts were not able to prevent the conservatives from repealing the 1924 publicity provision requiring collectors of internal revenue to make public the amounts of taxes paid by individuals and corporations. In order to placate the publicity champions, the names and addresses of those making income tax returns were still required to be made available for public inspection. This, however, prevented the spotlight from being thrown in the future on the hierarchy of wealth which had come to dominate American society. Even such conservative newspapers as the *New York Times* had taken advantage of the 1925 official releases on the size of the reported incomes of individuals. The resulting public concern about the concentration of wealth,

⁸ Charles O. Hardy, *Tax-Exempt Securities and the Surtax* (New York, 1926), and Tax Policy League, *Tax Exemptions* (New York, 1939) offer valuable discussions of the key problems.

coupled with the disclosures of the Couzens investigation, impelled Mellon and his associates to safeguard their privileged positions by keeping from the public vital facts about the individuals who composed the high income elite.⁹

The Estate Tax Salvaged; Gift Tax Repealed

The campaign to repeal the federal gift and estate taxes which Coolidge and Mellon had favored and abetted and which various wealthy individuals and large corporations had financed succeeded in getting Congress to repeal the gift tax, but not the estate tax. The abolition of the gift tax was a severe setback to those interested in preventing evasion of the estate tax and in securing a more equitable distribution of wealth. But the preservation of the federal estate tax in the face of the determined onslaught of the American Taxpayers' League, the Coolidge-Mellon administration, and the Senate majority headed by Senator Smoot was a major achievement for William R. Green, John N. Garner, and their supporters. Green, although Chairman of the House Ways and Means Committee, defied the administration and, with Garner's aid, outmaneuvered the enemies of the estate tax. Green won the support of Congressmen from states with wealthy constituents by recommending that the maximum rates on estates be reduced from 40 to 20 per cent and that the credit allowed toward state taxes be raised from 25 to 80 per cent of the federal tax.

The conservative Senate majority, despite the vehement protests of Senators Norris, Lenroot, Borah, and Glass, voted to repeal the federal estate tax, even with the modifications introduced by Green. But Green and the House conferees on the Conference Committee forced the Senate to yield on this point in return for certain concessions strongly desired by powerful groups in the Senate. These concessions involved raising the exemption from \$50,000 to \$100,000 and approving the Senate's provision for retroactively refunding all taxes collected under the rates of the 1924 schedule in excess of the 1921 rates. This latter provision was defended by the argument that it was unjust to tax the estates of those who had died between the passage of the 1924 and 1926 revenue laws than the estates of those whose deaths

⁹ Lundberg, *America's 60 Families*, 23-31 gives the highlights and an evaluation from the left point of view; the *New York Times*, Sept. 1-15, 1925, the tax returns Lundberg et al. have utilized. Adolph J. Goldenthal, *Concentration and Composition of Individual Incomes, 1918-1937*, (T.N.E.C. Monograph 4) 9-53, and R. S. Tucker, "Distribution of Income," *Quarterly Journal Economics* (August, 1938) 52: 547-87, present the statistical background with varying interpretations.

occurred before or after that period. But Senator Norris in a powerful speech had exposed the fortunes of at least twenty millionaires whose heirs were being given the benefit of these huge refunds.¹⁰ The *New York World* and the *New Republic* gave currency to these facts and pointed out the sinister manner in which influential Republican and Democratic Senators and Congressmen had united to push through an unprecedented rebate and to keep the names of the chief beneficiaries almost entirely out of the debate. Senators Overman and Simmons of North Carolina were alleged to be especially interested in protecting the Duke estate because part of it was being used to endow Duke University, formerly Trinity College, Simmons's alma mater.¹¹ These disclosures, however, were not circulated by the rest of the press, and the refunds were allowed to go through by Congress and the President.¹²

While bestowing favors upon the masters of economic power, Congress repealed various war "nuisance" taxes on luxury articles and sporting goods, but retained, at reduced rates, the taxes on tobacco, alcohol, passenger automobiles, admissions, and dues. The retention of these consumption taxes was necessary if the cut in surtaxes and estate taxes were to be put through. This was consistent with the protective tariff position of the eastern Republicans.

The Board of Tax Appeals, created by the Revenue Act of 1924, was transformed from a temporary to a permanent organization. Its membership was fixed at sixteen, and the salary was raised from \$7,500 to \$10,000. The members were to be appointed by the President with the advice and consent of the Senate for terms of twelve years, although the new appointees were to begin with terms varying from six to twelve years. The justification for making the Board permanent was that it settled disputes between the Treasury and taxpayers on the validity of taxes before collected arising under the income, profits, estate, and gift tax laws. Another administrative change was the creation of the office of General Counsel for the Bureau of Internal

¹⁰ *Cong. Record*, 69 Cong., 1st Sess., 67: 3669. Some of the larger estates involved were those of Anne Benjamin, \$15½ million; William A. Clark, \$41 million; Mai Rogers Coe, \$16¼ million; James B. Duke, \$75 million; A. D. Huntington, \$22 million; Victor F. Lawson, \$19½ million; Jennie Woolworth, \$60 million. The 1924 campaign contributions of J. B. Duke, Julius Fleischmann, Henry G. and Archer M. Huntington, and those of other millionaires may have been induced by the hope of having their tax burden lifted in this way.

¹¹ *New York World*, March 1, 1926; *New Republic* (March 10, 1926), 46: 55, 71.

¹² C. L. Harris, "Legislative History of Federal Gift Taxation," *Taxes* (September, 1940), 18: 531-38; William R. Green, *Theory and Practice of Modern Taxation* (New York, 1938, 2nd ed.), 206-09, 221-23; Shultz, *Taxation of Inheritance*, 162-64.

Revenue; this post was to supplant that of the Solicitor of Internal Revenue in the Department of Justice and was given a higher salary.

In order to carry on the work begun by the Couzens Committee, to investigate the administration of the Bureau of Internal Revenue, and to make suggestions to Congress for the improvement of the tax laws and their operation, a special Congressional committee was created. The Joint Committee on Internal Revenue Taxation was to consist of five members from the House Ways and Means Committee and five members from the Senate Finance Committee. The Committee, composed of six majority and four minority party members, and assisted by a staff of attorneys, statisticians, and economists, has been of great service to Congress through its special studies and reports on tax problems and systems.¹³

The verdict of a tax authority with liberal sympathies on the 1926 Revenue Act was that on the whole it seemed to be in line with what the majority of the electorate voted for in the 1924 election. But he questioned whether all of them knew just what they voted for as well as what they voted against. He pointed out that the application of the Treasury surpluses to further debt reduction appeared to be wiser than general tax reductions. Debt reduction, he maintained, would strengthen credit and lead ultimately to the greatest tax reduction through reduction in the interest of the national debt, which was the largest single item in the federal budget. Moreover, Mellon had secured more reductions in the taxes on the wealthy than on the masses. This was due in part to his Hamiltonian belief in great wealth concentrated in a few hands as the source of general prosperity. Another factor may have been the fact that he benefited to the extent of \$850,000 a year through the surtax reductions and \$15 million or more in estate tax reductions, if they were in effect at the time of his death.¹⁴

Coolidge-Mellon Policies

Tax issues were not featured during the 1926 Congressional election campaign. Coolidge came in conflict with Congress on the question of aid to the farmers who had been suffering from hard times since 1919 when he vetoed the McNary-Haugen bill in February, 1927. He went against the liberals when he vetoed Senator Norris's Muscle Shoals bill in 1928 and sent marines to Nicaragua in 1926-27. Euro-

¹³ Selko, *Federal Financial System*, 154-55, 276-78.

¹⁴ Blakey, *op. cit.*, 419-25.

pean proposals for cancellation of the World War I debts to the United States he dismissed with the statement: "They hired the money didn't they? Let them pay it!" Although business suffered from a recession in the middle of 1927, it recovered with encouragement from the White House and the Treasury. The boom that gradually developed from December, 1927, to July, 1929, seemed to confirm the wisdom of the Coolidge-Mellon policies in tax and other matters.¹⁵

In the fall of 1927 Secretary Mellon recommended to Congress on the basis of a \$600 million surplus that the tax on corporate income be reduced from 13½ to 12 per cent, that small corporations be permitted to pay the corporation tax as partnerships if they so preferred, that the surtax rate on individual incomes from \$10,000 to \$70,000 be readjusted and reduced, and that the estate tax be repealed.¹⁶ The resulting tax reductions he estimated would amount to \$225 million. Both the United States Chamber of Commerce and the Democrats regarded this as too small and demanded a \$400 million tax cut. Coolidge opposed these suggestions as unwise in the face of increased expenditures. The House Ways and Means Committee, guided by William R. Green, rejected all of Mellon's suggestions except the one on corporate tax reduction and the minor one that tax exemption be granted to income derived from American bankers' acceptances held by foreign central banks of issue.

Much to the disappointment of the Republican House leaders, the House adopted important changes proposed by Garner and other Democrats and passed the amended bill on December 15, 1927, by the sweeping majority vote of 366 to 24. The administration was greatly irritated by the House's independence and feared that the reductions would be excessive. The Senate Finance Committee attempted to undo the work of the House Insurgents on such points as the graduated tax on corporation net income, but failed to repeal the estate tax or to retain the tax on automobiles despite pleas from Mellon. Since the Senate was divided into forty-seven Republicans as against forty-six Democrats and one Farmer-Laborite, the Republicans were not in a position to force through their program, unless they secured the cooperation of the Democrats. The Democrats and progressive Republicans were able to secure the retention of the federal estate tax and the restoration of publicity of income tax returns. The Senate finally passed the bill on May 21, 1928, by a close vote of 34 to 33, with the Demo-

¹⁵ White, *op. cit.*, 323ff.

¹⁶ *Treasury Report*, 1927, 47ff.

crats generally against it. The differences between the Senate and House were resolved through compromises, and the bill became law on May 29, 1928.¹⁷

The 1928 Reductions in Corporation and Excise Taxes

The Revenue Act of 1928¹⁸ was the fourth in the series of post-first World War tax reductions. No radical changes in the 1926 Revenue Act were made except in form. The principal alterations occurred in the corporation tax and the excise taxes on automobiles, admissions, and dues. The normal tax and surtax rates on individual incomes remained the same as in the 1926 law. The normal rate was 1½ per cent on the first \$4,000 of taxable net income, 3 per cent on the next \$4,000, and 5 per cent on the amount over \$8,000. The surtax began at 1 per cent upon net income in excess of \$10,000 and gradually increased to 20 per cent upon net income in excess of \$100,000. The personal exemptions were held to \$1,500 for single persons, \$3,500 for the head of the family or married person, and \$400 for each dependent. But the 25 per cent tax credit on earned incomes was raised from \$20,000 to \$30,000.

The tax on corporate net income was reduced from 13½ per cent to 12 per cent, and the lower rate was made applicable to incomes of 1928 as well as those of succeeding years. To corporations of a net income of \$25,000 or less a credit of \$3,000, in contrast with the \$2,000 credit of 1926, was given. Capital net gains were taxed the same as in 1926, and the option given affiliated corporations on filing consolidated returns was retained. Nor was any change made in the tax on undistributed corporate surpluses.

Against the advice of Mellon, but in response to the pressure from automobile manufacturers, Congress repealed the large revenue-yielding tax of 3 per cent upon the manufacturers' prices of passenger automobiles. Congress also granted large increases in the exemptions from taxes on admissions and dues and reduced drastically the taxes on wines. The amount of tax withheld at the source was increased in the case of certain "tax-free covenant" bonds owned by nonresident aliens, foreign corporations, and unknown holders.

The federal estate tax was kept at the same rates as in the 1926 law notwithstanding what William R. Green characterized as "the most extraordinary, highly financed propaganda for a selfish purpose . . .

¹⁷ Blakey, *Federal Income Tax*, 276-300.

¹⁸ 45 U.S. Stat. at Large, 791.

that has ever been known in the whole history of this country."¹⁹ Mellon and the conservative Republicans in Congress worked for the repeal of the estate tax, but were foiled by the progressive Republicans and Democrats. The nomination of Green to the Court of Claims by Coolidge early in the spring of 1928 was interpreted by many as a stratagem for securing the repeal of the tax at a later period.²⁰ Among the administrative changes were provisions giving the Commissioner of Internal Revenue the authority to close cases by agreement with the taxpayer and requiring that all refunds or credits on income, estate, or gift taxes in excess of \$75,000 be referred to the Joint Committee on Internal Revenue Taxation before being paid to the taxpayers.

The press opinion upon the 1928 tax law was favorable, on the whole. The *New York World* regarded it as "a compromise between the advocates of drastic and of moderate revision." The *New York Times* and the *Sun* praised the reduction of the corporation tax as giving a healthy stimulus to business.²¹ Yet despite the agreement of most Republicans and Democrats on the desirability of tax reduction, a minority group of liberal and radical dissenters persisted in arguing that the wiser policy was to pay off the national debt while the country was prosperous and thereby improve the national credit and reduce the rate of interest necessary to pay on all refunding. But their contentions could not prevail against those who felt that taxes were too heavy, that their reduction would aid business, promote general prosperity, and prevent the accumulation of large surpluses which would tempt Congress into extravagant expenditures. In their eyes it was not just to have the war generation alone carry the burden of the war debt.²²

¹⁹ *Cong. Record*, 70th Cong., 1st Sess., 69: 641; *American Economic Review*, 18: 439.

²⁰ *Ibid.*, 440.

²¹ *Literary Digest* (June 9, 1928), 97: 10.

²² Blakey, *op. cit.*, 444 ff.

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Hoover, the Depression, and Crisis Finance

THE policies of the Coolidge-Mellon administration were soon admitted to the popular verdict in the presidential election of 1928. Coolidge had taken himself out of the presidential race by his cryptic statement on August 3, 1927: "I do not choose to run for President in 1928," and then had been bitterly disappointed by the failure of a deadlock arising in the Republican convention out of which he expected his nomination would come.¹ Herbert Hoover, with his reputation as a great engineer, humanitarian relief and food administrator, and champion of big business, easily captured the Republican nomination. Alfred E. Smith, noted as a liberal governor of New York, a sponsor of social legislation, and an opponent of Prohibition, was the Democratic candidate while Norman Thomas appeared as the Socialist nominee. Both Hoover and Smith received strong financial support from powerful groups of bankers, brokers, industrialists, and merchants. The Republican National Committee received over \$6½ million in contributions to the almost \$4 million received by the Democratic Committee; manufacturers and mining and oil investors contributed more heavily to the Republicans than to the Democrats.²

¹ White, *A Puritan in Babylon*, 352-66, 398-408.

² Overacker, *Money in Elections*, 133, 153-68. The largest Republican contributions were: \$100,000 from the Fisher brothers, automobile body manufacturers; \$50,000 from Julius Rosenwald; \$30,000 from the estate of P. A. B. Widener; \$27,000 apiece from George F. Baker, Jr., and Richard B. Mellon; \$26,000 from J. R. Nutt, Cleveland banker and railroad promoter; and \$25,000 each from Andrew Mellon, John D. Rockefeller, John D. Rockefeller, Jr., C. M. Schwab, Alfred P. Sloan, president of General Motors, Alfred I. du Pont, George Eastman, H. S. Firestone, D. M. Goodrich, Daniel, Harry F., and S. R. Guggenheim, Charles Hayden, copper and sugar magnate, Otto Kahn, Eugene Meyer, Mortimer Schiff, Arthur Whitney, John N. Willys, and George Woodruff. Edwin C. Jameson, a New York lawyer and insurance man, contributed \$172,800 to various anti-Smith groups.

Hoover's Election and His Objectives

No sharp contrast in policy was presented by the platforms of the two major parties. Each promised the continuance of prosperity, protection to legitimate business enterprise, and further tax reductions. While the Republicans eulogized the protective tariff, the Democrats advocated a tariff which would permit effective competition, ensure against monopoly, and at the same time provide a fair revenue. But the difference between these two positions was narrowed by the Democratic qualification that the measure of the tariff rate should be the difference between the cost of production at home and abroad, with adequate safeguard for the wages of the American laborer.

The election was determined by the qualities of, and positions taken by, the candidates. Smith came out in favor of fundamental changes in the prohibition laws and aid to the farmers along the lines of the McNary-Haugen bill. Hoover countered by pledges of higher tariffs for the farmers, the creation of a farm board, and correction of the abuses of Prohibition, but no repeal of the Eighteenth Amendment. Norman Thomas and the other minority radical candidates made spirited indictments of both Hoover and Smith as guardians of the capitalistic system. The election returns gave Hoover what seemed to be a landslide victory: a popular vote of over 21 million to 15 million for Smith and 264,508 for Thomas. Although the preponderant majority of rural, "dry," and Protestant Americans voted against Smith because of his Tammany, "wet," and Catholic associations, and certain business groups feared his liberalism as a danger to their prosperity, the vote he polled was almost as large as that obtained by Coolidge in 1924 and almost twice as great as the vote cast for John W. Davis. On the other hand, the Socialist vote sank to the lowest figure since 1900 on account of Smith's appeal to the liberals.³

The largest contributions to the Democratic National Committee included: \$125,000 from William F. Kenny, New York contractor; \$110,000 each from Herbert H. Lehman, J. J. Raskob, and Thomas F. Ryan; \$75,000 from Jesse H. Jones, Texas banker; \$50,000 each from P. S. du Pont, Harry P. Whitney, Charles W. Clark, copper magnate, and J. Meehan, broker; \$37,590 from Bernard M. Baruch; \$35,000 from Robert S. Clark and William H. Todd; \$27,000 from John D. Ryan of Anaconda Copper and National City Bank director; and \$25,000 apiece from Nicholas Brady, Oliver Cabana, Francis P. Garvan, Peter O. Gerry, Arthur C. James, Edith A. Lehman, George W. Loft, George MacDonald, Nicolas M. Schenck, B. E. Smith, Samuel Untermyer, and William H. Woodin. *Ibid.*, 158-59.

³ Charles A. and Mary R. Beard, *America in Midpassage* (New York, 1939), 32-37; *New International Yearbook*, 1928, 699ff., 779-84; Robinson, *Presidential Vote*, 24-27, 32, 46.

The parallelism of the Hoover administration to that of Coolidge's, the continuity between the two in objectives and spirit, was revealed by the policies Hoover supported and the men he appointed. Andrew Mellon was continued in his post as Secretary of the Treasury. Henry L. Stimson was made Secretary of State. On agricultural matters Hoover was in opposition with the position taken by the agrarian bloc in the Senate in favor of some form of crop control. The Agricultural Marketing Act of June, 1929, which he secured, established a Federal Farm Board with the power to use a large revolving fund for loans to co-operative marketing associations and to set up stabilizing corporations which would store, hold, and market certain commodities so as to raise the price level for the farmer. On the tariff question Hoover stood for limited changes, with special reference to agricultural products. Although Congress got out of hand on this issue, he firmly combated the efforts of Senator Norris for government operation of the Muscle Shoals power plants and vetoed Norris's bill in March, 1931. Yet he circumscribed the complete freedom of businessmen when he signed the Norris-La Guardia anti-injunction bill in March, 1932, perhaps because 1932 was an election year.

In foreign affairs Hoover followed the path of previous Republican administrations. Although he sustained indirectly the despotic Machado regime in Cuba, which was expected to guard American investments, Hoover attempted to win Latin-American good will and to promote American trade by withdrawing American marines from Nicaragua and laying the basis for self government in Haiti. In the Far East he upheld the open-door policy by protesting against, and refusing to recognize the legality of, the Japanese conquest of Manchuria. At the same time he vetoed a bill providing for the contingent independence of the Philippines. While refusing to recognize officially Soviet Russia, he showed his interest in the World Court and the League of Nations, but did not work hard for American entrance into either. Hoover's greatest accomplishment in the way of realizing the conception of most American businessmen on foreign relations was the London Naval Treaty of 1930. Although the treaty achieved only a possible restriction on the increase of naval expenditures among the leading naval powers, and not the reduction desired by peace advocates, it was both an aid to government economy and to a freer flow of international trade. Moreover, Hoover and his supporters displayed courage and ingenuity in overcoming the obstacles placed in the way of ratifying the treaty by powerful American shipping and naval interests.⁴

⁴ Beard, *op. cit.*, 37-52.

The Great Depression of 1929

But the good fortune which the Republican party and the Harding-Coolidge-Hoover administrations had been able to enjoy from 1920 on was rudely shattered in the fall of 1929. American business had suffered a brief contraction between September, 1918, and April, 1919, had experienced a boom during the rest of 1919, undergone a severe depression between February, 1920, and September, 1921, and revived and expanded until the spring of 1923. After a depression of a little more than a year business expanded from the summer of 1924 to the autumn of 1926 and then underwent a distinctly mild contraction from the autumn of 1926 to the end of 1927. This was succeeded by a revival which began in the durable-goods industries, spread to other depressed branches of production, and was accompanied by a bull market on Wall Street.

A contraction which began in the construction industry after February, 1928, affecting production of residential building, the passenger-train car and passenger automobiles, spread rapidly after February, 1929, over the rest of the industrial field, and eventually engulfed the entire economic system.⁵ The activity on the stock market which had steadily increased in volume and velocity since 1922 reached its height on September 3, 1929. After that high point prices broke and recovered in September and October until a vast flood of simultaneous selling orders made October 24, 1929, the doomsday of Wall Street prosperity. Not even the prestige of the House of Morgan and the banking pool they helped to create were able to check the decline in security prices. All they accomplished was a rear-guard action to cover the retreat of American security capitalism and their own investments. By November 13, \$30 billion in capital values had been lost, a sum almost as great as the entire cost to the United States of the war against Germany.

Hoover's efforts to restore prosperity by urging big business to continue as usual and by asking Congress to cut the income tax and to inaugurate a public works campaign may have contributed slightly to a boom market of considerable size and to a revival in the automobile, steel, and heavy construction industries during the early months of 1930. But the stock market collapsed in May, 1930, and the revivals during the first half of 1931 and the summer and autumn of 1932 also proved to be partial and abortive. The Great Depression which

⁵ W. C. Mitchell, and A. F. Burns, "Production during the American Business Cycle of 1927-1933," *National Bureau of Economic Research Bulletin* 61 (November 9, 1936).

ensued became the severest in world history since at least the panic of 1873.⁶

The causal relationship between the depression and the distribution of income in the post World War I period has been extensively debated. The best estimate of the detailed distribution of personal incomes in the United States in 1918 indicates that the most prosperous 1 per cent of the income receivers had nearly 14 per cent of the total income, the most prosperous 5 per cent had nearly 26 per cent of the total, the most prosperous 10 per cent had nearly 35 per cent of the total, and the most prosperous 20 per cent had about 47 per cent of the total income. The top 1 per cent included incomes down to \$8,000; the 5 per cent comprised incomes down to \$3,200; the 10 per cent, incomes down to \$2,300; and the 20 per cent, incomes down to \$1,700.⁷ The best available statistical analysis reveals that although the degree of income concentration was at its lowest during the depression year 1920, it increased during the period of rising income and expanding business activity from 1922 through 1928. Most of this increase occurred during the years 1925-28, and a substantial portion of this was due to the realization of profits from the sale of property, largely in the form of securities. This in turn was related to the increase in dividends and the revaluation of securities in anticipation of an increased volume of business. The role of Wall Street and American security capitalism in fostering speculation by the people on Main Street and in creating an unhealthy inflation in market values needs little comment at this date.⁸ But even at the height of prosperity the number of those who enjoyed an income adequate for maintaining a "decent" standard of living are limited. The study of the Brookings Institution, although subject to qualification, gives the approximate income distribution for 1929 as follows:⁹

Nearly 6 million families, or more than 21 per cent of the total, had incomes less than \$1,000.

⁶ *Ibid.*, 4, 18-20; Frederick L. Allen, *The Lords of Creation* (New York, 1935), 390-401.

⁷ National Bureau of Economic Research, *op. cit.*, 146-47.

⁸ Adolph J. Goldenthal, *Concentration and Composition of Individual Incomes, 1918-1937* (T.N.E.C. Monograph No. 4), 16-21, 47-51. The concentration of income is measured by the shares of the income of all individuals received by the highest 2 per cent and smaller proportions of the nation's income recipients. Subject to certain exceptions, the larger the average income of all income recipients, the greater the degree of income concentration.

⁹ Maurice Leven, Harold G. Moulton and Clark Warburton, *America's Capacity to Consume* (New York, 1934), 55-56. For criticism, see Merwin, "Distribution of Wealth and Income," *op. cit.*, 64-66.

About 12 million families, or more than 42 per cent, had incomes less than \$1,500.

Nearly 20 million families, or 71 per cent, had incomes less than \$2,500.

Only a little over 2 million families, or 8 per cent, had incomes in excess of \$5,000.

About 600,000 families, or 2.3 per cent, had incomes in excess of \$10,000.

One tenth of 1 per cent of the families at the top received practically as much as 42 per cent of the families at the bottom of the scale. During this period a family income of \$2,000, at 1929 prices, was regarded as sufficient to supply only basic necessities. More than 16 million families, or practically 60 per cent of the total number, were below this recognized standard of expenditure.¹⁰

Resort to the Tariff as a Stabilizer

Against this background, Hoover's economic and tax program must be placed. The first action that he took was on the tariff. The Fordney-McCumber Tariff Act of 1922 had restored the high protective tariff standards of 1897 and 1909 without bringing the aid for which American agriculture had clamored. But the 1922 tariff was a factor in stimulating Germany to raise its tariff duties on agricultural imports in 1925 and other European countries to consolidate their tariff rates at high levels. These did not interfere too stringently with international trade so long as the large international investment and credit expansion of the nineteen-twenties prevailed. After the stock market crash of October, 1929, however, world prices fell heavily, international trade was greatly reduced, and international capital movements declined sharply.

The World Economic Conference held at Geneva in 1927 and subsequent conferences had attempted to increase international trade through an attack on tariffs, but were unable to secure the support of governments outside the British and the Oslo group of small North European nations.¹¹ At this juncture in world affairs Hoover called, in April, 1929, a special session of Congress to secure further relief for the farmers and to enact an effective tariff on agricultural products with some limited changes in the schedules affecting industries where there had been a substantial slackening of activity. The tariff bill introduced into the House by Willis C. Hawley of Oregon on May 7, 1929, disregarded Hoover's specific limitations on tariff revision and provided

¹⁰ Leven et al., *op. cit.*, 56, 125-33.

¹¹ Condliffe, *Reconstruction of World Trade, 182-84.*

for very extensive changes in tariff duties, most of them upward. Nevertheless the House, under rigid Republican machine control, passed the bill on May 28 by a vote of 264 to 147. Only twelve Republicans voted against the bill while twenty Democrats from industrial areas were in its favor.¹² The pressure groups dominant in the House were able to secure increases on farm products, Cuban raw sugar, and such manufactures as textiles, clothing, and chemicals.

In the Senate the Insurgent Republicans from the Middle West and Far West joined the Democrats, as they had in 1909, in opposition to the revised bill presented by Smoot of Utah for the Senate Finance Committee. The position taken by the Insurgents was that the tariff measure would hurt the farmers more through the tariff increases on goods the farmers had to buy than it would help them through tariff increases on farm products. The resulting conflict, despite Hoover's pleas for speedy action as a business stabilizer, dragged on until March 24, 1930. On that day the Senate passed the Hawley-Smoot tariff bill by a vote of 53 to 31. Although seven Democrats and eight Insurgent Republicans supported the much-amended bill, twenty-six Democrats and five Insurgent Republicans stood firm in their opposition. The passage of the bill at that date was due in large measure to the activity of Joseph R. Grundy, president of the Pennsylvania Manufacturers' Association, who succeeded William S. Vare as Senator in December, 1929.

Grundy was one of the organizers of the American Tariff League, the spearhead of the business groups behind the protective tariff, a power in Pennsylvania and national Republican politics, and a tariff lobbyist for big business since 1897. Through skillful negotiations he arranged with some of the Insurgents to raise the rates on agricultural products in return for corresponding increases on industrial articles. The Insurgents also succeeded in forcing the adoption of a provision for export debentures, a bounty paid out of the customs to American farmers, and a provision placing the administration of the flexibility power in the hands of Congress instead of the President. The differences between the House and the Senate were numerous, and the Senate was obliged to yield to Hoover's and the House's refusal to accept the two major amendments of the Senate Insurgents. The compromise worked out by the Conference Committee was accepted by the Senate on June 13 by the narrow vote of 44 to 42. Although five Democrats voted for the bill, eleven Republicans, headed by Norris

¹² The composition of the House was 266 Republicans, 165 Democrats, and 1 Farmer-Labor. *World Almanac*, 1930, 46.

and Borah, were against it. The next day the House gave its approval by the majority of 222 to 153.

Hoover was besieged by protests from thirty-three foreign governments, the American Bankers' Association, importers, industries with foreign markets, and over one thousand economists. But he felt obligated to sign the measure on June 17, 1930, in order not to stultify his party in an election year. Like Taft in 1909, Hoover erred in not saying at an early stage in Congress's work that he would veto anything which did not accord with his recommendations.¹³ W. C. Hawley, coauthor of the bill, defended his Tariff Act as "an alert guard protecting our industries and labor against unfair competition, improper trade practices and exclusion from an advantageous participation in our markets, which markets our people have created and maintain."¹⁴ On the other hand, many economists agreed that "the bill was a Republican measure written by partisans, thinking in terms of the slogans of the party . . . a revision of a protectionist law by protectionists for people whom they sought to make more and more protectionist."¹⁵

World Retaliation Against the 1930 Tariff

The rates imposed by the Hawley-Smoot Tariff Act were the highest in American tariff history. The average ad valorem rate for all schedules was 40.08 per cent in contrast with the 33.22 per cent average of the Fordney-McCumber Act. There was a general increase in the duties on agricultural products, including those which were used as raw material in American manufacture. But most of these increases were analyzed by experts as either mere pretense or of minor benefit to the farmer. The increase in the duty on sugar was the most important from the revenue point of view and that of the profit given to domestic beet-sugar producers at the cost of the consumer. The duties on such manufactured goods as cotton, wool, and silk goods, glass, chinaware, and watch movements and those on such metals as aluminum, manganese, and tungsten-bearing ores were also raised. Hides, boots, and shoes were removed from the free list to please both the farmer and the shoe manufacturers. No important changes were made in the powers of the Tariff Commission, but the President was empowered to set up an entirely new body in the hope that its quality would be

¹³ *New International Yearbook*, 1929, 816-21; *ibid.*, 1930, 773-74. E. E. Schattschneider, *Politics, Pressures and the Tariff* (New York, 1935) is an admirable and extended study of the pressure groups behind the 1930 tariff.

¹⁴ *New York Times*, June 1, 1930.

¹⁵ Schattschneider, *op. cit.*, 99.

improved. The Commission could not recommend increases or decreases which would change rates by more than 50 per cent or transfer articles from the dutiable list to the free list, or vice versa. But it was required to make investigations, not only on its own motion and the request of the President, but also on resolution by either house of Congress. The President was also empowered to increase existing tariff rates by an additional 50 per cent ad valorem upon goods coming from countries discriminating against American commerce.¹⁶

Much to the astonishment of the general American public, the Hawley-Smoot tariff stimulated a world-wide tariff retaliatory movement and thereby became a turning point in world history. As a result of the first World War the United States had become the world's greatest creditor nation and had sustained its large export trade through extensive loans to and investments in both industrial and nonindustrial countries. This policy had enabled European countries to maintain unfavorable trade balances with the United States and to make war debt payments until the depression of 1929. When the United States stopped making foreign loans and made its general upward revision of the tariff in 1930, it further restricted imports from abroad and threatened to increase still more the deficient trade balance of Europe with the United States and to render more difficult the transfer of money payments to the United States. Confronted by falling prices, unemployment, gaps in the balance of international payments, and the menace of foreign dumping, many countries resorted to "defensive" tariffs in order to create export balances for debt payments, to check price declines, and to stabilize their national economies. Although Hoover eased the strain in the international debtor-creditor relationship by establishing in 1931 a moratorium on all intergovernmental debts and reparations, England felt forced to go off the gold standard in September, 1931, to adopt emergency tariffs in 1931-32, to establish a tariff of substantial proportions, and to support the imperial preference policy adopted in the Ottawa Agreements of August, 1932. The consequences of this series of events were first seen in the widespread adoption of exchange control, quantitative trade restrictions, and regulated national economic systems. The trend toward autarchy or national self-sufficiency became accentuated after 1932, and the full implications were only to be realized after the spread of fascism. An opportunity to counteract this trend was lost when Hoover vetoed in May, 1932,

¹⁶ Tausig, *Tariff History*, 489-526; *Statistical Abstract of the United States 1939*, 467, 494-96.

a bill passed by Congress calling for an international conference on tariffs.¹⁷

The 1929 Income Tax Reduction

In the sphere of internal taxes during the downswing in the business cycle Hoover and Mellon suggested that Congress relieve the taxpayer by reducing the normal income tax rates on income received for 1929 and payable in 1930 from 1½ per cent, 3 per cent, and 5 per cent to ½ per cent, 2 per cent, and 4 per cent, respectively, and by cutting the tax rate on corporate income from 12 to 11 per cent. The surplus for the previous year had made Mellon anticipate even greater Treasury receipts in 1930-31, and he did not expect any great increase in expenditures.¹⁸ Congress responded to this appeal with alacrity and passed a bill embodying the proposal within a month. The measure became law on December 16, 1929. Only a few, such as Ramseyer of Iowa in the House and Couzens and La Follette in the Senate, protested against the reduction.

Crisis Finance: Hoover's Policies

The revenue policy which Hoover evolved during the rest of his administration was a reflection of his estimate of the depression, its probable length, causes, and cure, and the entire program he gradually worked out to meet the situation. At first he believed that the stock market crash in the fall of 1929 affected speculators mainly and left American business sound. He hoped to arrest the decline of security values and encourage the revival of trade by calling upon industrialists to maintain wage scales and the Federal Reserve Banks to grant low discount rates and create an easy money market.

Kept up by such hopes, the Treasury made no change in its budget policies during 1930. The revenues for the fiscal year ending June, 1930, were not only equal to but slightly above those of previous years, and the surplus proved to be as great as in 1928-29 and larger than had been estimated. Mellon wrote in his November 20, 1930, report that the 1930 federal finance "continued the favorable record of recent years." Although he warned against continuing the tax reduction of

¹⁷ Condliffe, *op. cit.*, 184-89; Alvin H. Hansen, "Report," in Commission of Inquiry into National Policy, *International Economic Relations* (Minneapolis, 1934), 113-27; Joseph M. Jones, Jr., *Tariff Retaliation* (Philadelphia, 1934), 1-33, 211-46.

¹⁸ *Treasury Report*, 1929, 22-26. *New International Yearbook*, 1929.

the previous year, he recommended no increases in the rates and anticipated a deficit of only \$180 million for the fiscal year 1931. The actual deficit on June 30, 1931, amounted to \$903 million. Until that date the Treasury had enjoyed a surplus varying around \$760 million for eleven years. The national debt had been reduced from \$24 $\frac{1}{3}$ billion on June 30, 1920, to \$16 $\frac{1}{2}$ billion on June 30, 1930.

The Treasury did not awaken to the serious danger in which the national finances were until the initial payments of the income tax due on March 15, 1931, came in. But the great decline in receipts resulting from the reduced total individual income aroused the administration to a realistic apprehension of the impending deficit. As Congress, however, had ended one session in March and was not due back in Washington until December, 1931, no legislative action on revenue could be undertaken that year except through the calling of a special session. Yet while the revenue decreased, the Treasury had to meet new demands for funds.¹⁹

As the depression deepened, Hoover broke with the tradition of noninterference with economic processes to which Van Buren, Grant, Hayes, and Cleveland had adhered during the major depressions of 1837, 1873, and 1893. He asked for the co-operation of state and local authorities with the federal government in the energetic yet prudent expansion of public works enterprises. Under the Federal Employment Stabilization Act of 1931, a six-year schedule of federal public works was drawn up with the idea that it might be used as a business stimulus. He helped to counteract the spring 1931 financial crisis in Austria and Germany through the moratorium on intergovernmental obligations he proposed in June, 1931. Hoover attempted to correct the collapse of American securities which followed England's going off the gold standard that September through the formation of a voluntary agency, known as the National Credit Corporation, by means of which the stronger banks were to assist the weaker. When this proved ineffective, he had Congress in January, 1932, provide for the creation of the Reconstruction Finance Corporation, empowered to lend on security to banks, railroads, and farmers.

Hoover also favored legislation passed by Congress enlarging the credit facilities of farmers burdened by debt and for homeowners in danger of losing their shelter. In order to stimulate business enterprise, the Glass-Steagall Act of February, 1932, authorized Federal Reserve Banks to make loans to their member banks without security or on

¹⁹ Dewey, *Financial History of the United States*, 535-37; *Treasury Report*, 1930, 1, 34-38.

formerly ineligible security. Moreover, Hoover advocated revision of laws designed to restore confidence in railroad bonds, to safeguard more adequately bank deposits, and to curtail federal expenditures. All these measures were in accord with an economic philosophy which aimed at preserving the prevailing business enterprise system as unchanged as possible and held that prosperity would return if the government expanded the credit facilities offered to the key entrepreneurs and stimulated their business by increasing the buying power of labor through wages paid on public works.

Proposals for direct federal aid to the unemployed went counter to Hoover's views on direct or indirect government doles and federal unemployment insurance and were either condemned or vetoed. He submitted only under great pressure to signing the Emergency Relief and Construction Act in July, 1932, after the presidential campaign had begun. This Act authorized the Reconstruction Finance Corporation to make loans to states and localities up to \$300 million for relief purposes and, for the construction of public works, loans totaling \$1½ billion. Although he signed a bill on July 21, 1932, reducing the interest upon veterans' loans on their bonus certificates and permitting veterans to borrow on their certificates without waiting for two years, he employed federal troops a week later forcibly to drive from Washington a bonus army of needy veterans who had been trying to induce Congress to enact a law for the immediate payment of the bonus certificates. He defended the severely criticized expulsion as necessary to prevent mob rule and insisted to the end of his term that direct aid for the unemployed was a duty of localities and private charities.²⁰

Sales-Tax vs. Income-Tax Advocates

In line with the rest of Hoover's social views was his effort to run the government on the accounting principles of private business by balancing the budget through increased taxes. As early as May, 1931, Secretary Mellon and Undersecretary Ogden L. Mills stressed the need for introducing greater flexibility into the federal revenue system. When Congress met in December, 1931, Mellon, who resigned as Secretary of the Treasury on February 2, 1932, and became ambassador to England, recommended meeting the large deficit by broadening the income tax base through a reduction of personal exemptions,

²⁰ Beard, *America in Midpassage*, 86-95; Dewey, *op. cit.*, 542-44. Hoover's point of view is presented by William S. Myers and Walter H. Newton, *The Hoover Administration* (New York, 1936), 14 ff.

an increase in the normal rate, a raising of the surtax rates to double of what they had been in the higher brackets, an increase in the estate tax, a series of sales taxes on certain selected items, and an increase in postal rates. The chances for pushing through the administration program were rendered slim by the fact that the Democrats controlled the House and, with the aid of the progressive Republicans, dominated the Senate.²¹

At first it seemed that a bill representing the consensus of opinion of the administration and the Democratic leaders in the House would be passed easily. The bill presented by Charles R. Crisp of Georgia, Chairman of the Ways and Means Committee, to the House on March 10, 1932, provided heavy increases in the income taxes on persons in the lower income groups, partly through the reduction of exempt income, and on those in the higher income brackets through doubling the surtaxes. The corporation tax was raised slightly, the estate tax increased to double on the higher brackets, and a gift tax was reintroduced. But in addition to these taxes and some new miscellaneous taxes, the chief innovation and the tax relied upon for raising the most revenue was a manufacturers' sales tax of 2 per cent. Although the sales tax had been widely advocated by the Hearst press and by various business groups and had the support of Hoover, the tax aroused a storm of protest in the House and was voted down several times by large majorities. La Guardia, then a fiery radical Republican from New York, Robert L. Doughton of North Carolina, C. W. Ramseyer of Iowa, and Philip D. Swing of California led the Insurgent Republicans and Democrats in the attack on the sales tax and in radical increases in the income and estate taxes on the wealthy. The conflict between the "soak-the-rich" and the sales tax advocates was checked only through a dramatic appeal to the House by John N. Garner, then Speaker of the House, to put aside partisan and economic differences. A compromise measure for balancing the budget was worked out, and on April 1 was passed by a vote of 327 to 64.

The Senate Finance Committee had a difficult time revising the House revenue bill because of sharp clashes between advocates of the general sales tax and those favoring higher income taxes. The tariff issue was also a disturbing factor since the House bill had imposed a tariff on coal and oil and thus offered an opening wedge for the protectionists. But under the strong pressure of Ogden L. Mills, Mellon's

²¹ The Senate comprised 36 regular Republicans, 12 Progressives, 47 Democrats, and 1 Farmer-Labor. The House had 219 Democrats, 15 Progressives, and 192 Republicans. Myers and Newton, *op. cit.*, 146.

successor as Secretary of the Treasury from February 13, 1932, on, the Committee presented to the Senate on May 11 a bill which kept the House estate and gift tax rates, but increased the tax rates on individual and corporate incomes and imposed import duties on oil, coal, lumber, copper, and rubber. The Committee bill also imposed sales taxes on certain selected articles, though it abandoned some of the House excises and increased the postal rates on first- and second-class mail. Intense conflicts occurred in the Senate over efforts by Huey Long, the "Share-Our-Wealth" champion, Couzens, and Connally of Texas to have the income tax rates raised to the level of those in effect in 1918 or 1922. Attempts by Tydings of Maryland to secure a tax on 2.75 per cent beer, and by Walsh of Massachusetts, backed by Hoover, to obtain a general sales tax, failed only through the diligent opposition of La Follette and the other liberals. But an "unholy alliance" of twenty-eight Senators from coal, oil, copper, and lumber states, headed by Ashurst of Arizona and Huey Long of Louisiana, put through tariff duties, disguised as import excises, on their state products. After a personal appeal by Hoover before the Senate, on May 31, for action on the problems of expenditures, revenue, and relief, the Senate completed its discussion of the tax bill and passed it that day by a vote of 72 to 11. Since the differences between the Senate and House were mainly in the excise and tariff sections, the Conference Committee speedily reconciled the two measures. The bill became law on June 6, 1932.²²

The 1932 Tax Increase to Balance the Budget

The Revenue Act of 1932²³ attempted to balance the federal budget and to uphold the national credit by providing one of the greatest increases in taxation ever enacted by the federal government in time of peace. The gross public debt, which had been reduced by June 30, 1931, to about \$16¾ billion, had mounted in one year to almost \$19½ billion. This was due to a fall of over \$2 billion in revenue below the normal and emergency expenditures of nearly \$2 billion above normal. Hoover had hoped for reductions in federal expenditures of about \$370 million, and the new tax law was expected to yield \$1,118½ million revenue in addition to the \$1¼ billion expected from existing

²² Donald C. Blaisdell, *Economic Power and Political Pressures* (T.N.E.C. Monograph 26), 114-15; Blakey, *Federal Income Tax*, 301-34; Myers and Newton, *op. cit.*, 142-58, 174-219.

²³ 47 U.S. Stat. at Large, 169. Cf. R. G. and G. C. Blakey, "Revenue Act of 1932," *American Economic Review* (December, 1932), 22: 620-40.

internal revenue taxes.²⁴ Almost one half of the additional revenue was to come from manufacturers' excise taxes on a wide variety of articles, most of which were revivals of wartime taxes, though some were entirely new. Sales taxes were imposed on gasoline, tires, passenger automobiles, electrical energy, lubricating oil, brewers' wort, malt syrup, grape concentrates, toilet preparations, furs, jewelry, and other luxury or sporting articles. Included among these excise taxes were the protective tariff duties on crude oil, gasoline, coal, lumber, and copper. In addition to these consumption taxes, easily shifted to the consumer, Congress resorted to increased taxes on admissions and stock transfers and to new taxes on bank checks, bond transfers, telephone, telegraph, and radio messages.

The normal rates on net incomes of individuals were increased from 1½ per cent on the first \$4,000 above the exemption level, 3 per cent on the next \$4,000, and 5 per cent on the remainder to 4 per cent on the first \$4,000 and 8 per cent on the excess. The personal exemptions for individuals were reduced from \$1,500 for a single person to \$1,000 and from \$3,500 for the head of the family or a married couple to \$2,500. The allowance for dependents was kept at \$400. The 25 per cent credit on earned incomes, which was provided for by the laws of 1924, 1926, and 1928, was eliminated. The 1932 surtax rates began at 1 per cent of the amount of net income in excess of \$6,000 and increased by steps of 1 per cent on each \$2,000 bracket of income until they reached 47 per cent on the \$98,000 to \$100,000 bracket. Then the brackets increased in size, and the maximum rate of 55 per cent was imposed on the net income over \$1 million. These surtax rates were higher than the 1928 rates, which had been graduated from 1 per cent on amounts of net income in excess of \$10,000 to 20 per cent on the amounts over \$100,000. Hence the total maximum rate of the 1932 law was 63 per cent (8 per cent normal and 55 per cent surtax) upon the amount of individual net income over \$1 million as compared with the 25 per cent maximum (5 per cent normal and 20 per cent surtax) in the 1928 law.

The corporation income tax rate was increased slightly from 12 per cent to 13¾ per cent. If affiliated corporations wished to make consolidated returns, they had to pay a tax of 14½ per cent for 1932 and 1933. The 1928 exemption of \$3,000 for corporations with net incomes of \$25,000 or less was omitted in the 1932 law. In order to increase the revenue yield from the income tax, Congress restricted the number of deductions and exemptions which it had previously granted

²⁴ *Treasury Report, 1932, 18-22, 408.*

and strictly revised the provisions dealing with corporation reorganizations, and losses arising from the sale or exchange of securities held two years or less.²⁵

The federal estate tax which Mellon and conservative Republicans had attempted to repeal in 1928 regained its popularity with Congress and even the Hoover administration in the revenue crisis of 1931-32. C. W. Ramseyer of Iowa, veteran champion of the estate and gift taxes, was responsible for the provision adopted by Congress which more than doubled the 1926-28 estate tax rates. His motivation and that of his supporters, notably La Guardia of New York and David Lewis of Maryland, was to raise revenue and prevent the concentration of the national wealth in the hands of a few families. The 1932 Estate Tax lowered the exemption from \$100,000 to \$50,000 as the basis for computing the *additional* tax superimposed by the 1932 law upon the 1926 tax rates. The old exemption of \$100,000 was kept in force for computing the tax due under the basic 1926 rates. The 1932 tax rates progressed from 1 per cent on the first \$10,000 net estate to 45 per cent on the amount over \$10 million. The 80 per cent federal credit for state death duties was allowed and computed only upon the 1926 rates in order to increase the yield of the total 1932 estate tax.²⁶

The federal gift tax which had been triumphantly repealed in 1926 through the high-pressure politics of the propertied classes was now restored through the efforts of C. W. Ramseyer and his sympathizers in Congress. They regarded the gift tax as necessary to prevent wholesale avoidance of the federal estate tax by the rich and as

²⁵ These sales were deductible only for the year in which sustained and only to the extent of the gains derived from these sales. Losses disallowed in one year not in excess of the net income, however, were permitted to be carried over to the following year, but this provision was repealed in 1933. No deductions were to be granted for interest incurred for buying or carrying an annuity or for losses already claimed for estate tax purposes. Salaries of presidents of the United States and federal judges taking office after June 6, 1932, were made subject to the income tax explicitly so as to eliminate exemption established by the Supreme Court in *Miles v. Graham* (268 U.S. 501) for salaries of federal judges appointed after the taxing statute was passed. The validity of this provision was upheld by the Supreme Court on May 24, 1939, in *O'Malley v. Woodrough* (59 Sup. Ct. 858). Nonresident employees of the United States also lost their exemption, and the \$300 exemption for dividends from building and loan associations was dropped.

To prevent paper losses, Congress revised the sections on wash sales so as to extend clearly its provisions to sales and repurchases occurring on the same day. The capital gains provision was extended to include stock purchased in wash sales transactions, and the losses from the sale of such stock were limited to 12½ per cent. The rules for depletion deductions were revised for sulphur, coal, and metal mines. They were no longer permitted discovery depletion, but the shift to the percentage-of-gross basis was in their favor.

²⁶ Montgomery, *op. cit.*, 736ff.; Myers, *Hereditary American Fortunes*, 299-304.

helping to lighten the tax burden of the masses. The rates of the gift tax ranged from three fourths of 1 per cent on net gifts not over \$10,000 to a maximum of 33 $\frac{1}{3}$ per cent on net gifts in excess of \$10 million. These rates were fixed at an average of about 25 per cent less than the estate tax rates in order to encourage immediate gifts and to anticipate estate tax revenue. A deduction of \$50,000 was permitted. The 1932 tax, unlike that of 1924, was imposed only upon gifts made by individuals and not upon gifts made by corporations, trusts, and estates as such. An individual was permitted to make gifts in a year or over a series of years up to a total of \$50,000 before becoming subject to this tax. The first \$5,000 of a gift or gifts to any person in any year (other than future interests in property) was not to be included in the total amount of gifts for that year. Exemption was extended to gifts made for public, religious, charitable, and similar purposes. An important feature of the tax was that each year's gifts were made cumulative so that the tax advanced into the higher brackets as the total amount of gifts increased from year to year. This was designed so that the gift tax would approximately duplicate the amount of the estate tax payable at the donor's death if the donated property had continued as part of the original estate.²⁷

The newspaper verdict on the 1932 Revenue Act ran all the way from the *Atlantic Constitution's* calling it "the most vicious tax bill ever sought to be saddled on the country in time of peace," to the *St. Louis Post Dispatch's* conclusion that the law, despite certain faults, was "just about what it should be." The *Chicago Daily News* and other papers friendly to the sales tax were disappointed by the absence of their pet tax and criticized the high income tax rates as "designed to satisfy those whose chief joy is 'soaking the rich.'" Walter Lippmann warned his public not to assume that the new tax law would actually guarantee a balanced budget; "the more business improves the more nearly the budget will be in balance." The *Camden (New Jersey) Courier-Post* made a plea for an unbalanced budget: "The imposition of drastic taxes to balance the budget only tends to defeat that purpose by forcing a decrease in public earning power—and, hence, public taxpaying power."²⁸ The judgments of economists varied according to their belief or disbelief in the advisability or possibility of balancing the budget and their attitude toward the income and estate taxes as against the sales tax.

²⁷ Harris, *Gift Taxation*, 11; Montgomery, *op. cit.*, 815ff.; Myers, *op. cit.*, 299-301.

²⁸ *Literary Digest* (June 18, 1932), 113: 8-9.



The New Deal in Tax and Expenditure Policy

DURING the summer and fall of 1932 the American people engaged in a referendum on the record and proposals for meeting the crisis advanced by the presidential candidates of the various political parties. The Republican party renominated Hoover and presented a platform which repudiated any responsibility for the depression and held out promises of reform and recovery to all groups along semiliberal business lines. The Democrats nominated Franklin D. Roosevelt, then known chiefly as a liberal governor of New York and friend of Alfred E. Smith. The Democratic platform was far from radical. It castigated the Republicans for their errors and offered a program of drastic governmental economy, a balanced budget through taxes based on the ability-to-pay principle, a sound currency, a competitive tariff, aid to the farmer, worker, and small businessman, and repeal of Prohibition. Outside the tariff, Prohibition, and the independence of the Philippines, the two major parties differed more in rhetoric than in principle. Sharply contrasting programs were presented by the Socialist candidate, Norman Thomas, and the Communist, William Z. Foster.

But the vigor and intellectual daring of Roosevelt, especially on the control of agricultural surpluses, the hardships people associated with the Hoover regime, the oratorical support of liberals, radicals, and such demagogues as Huey Long and Priest Coughlin, and financial support almost equal to that of the Republicans turned the political tides in favor of the Democrats. Although the conservatives and some economists believed that Hoover had induced recovery and that "his administration would, but for the whim of the political calendar, have

come out with flying colors,"¹ the great majority of Americans did not. Roosevelt won a popular vote of almost 23 million to Hoover's 15¾ million and Norman Thomas's 872,840. The dramatic Democratic sweep of forty-two states to Hoover's six indicated a revival of the sentiment which had supported Bryan, Theodore Roosevelt, and the elder La Follette.²

In view of the conflict which developed over the New Deal, an analysis of the financial support behind Roosevelt and Hoover may be illuminating. The Republican National Committee received \$2½ million to the Democrats' \$2½ million. A larger number of bankers, brokers, professional people, publishers, advertisers, and investors in railroads and public utilities contributed to the Democrats than to the Republicans. On the other hand, the Republicans received a larger measure of support from those with interests in manufacturing, mining, and oil as well as the backing of the dominant Wall Street figures. Only a small fraction of retail storeowners favored Roosevelt more than Hoover. Both parties had their strongest financial support in the Northeast.³

Before the election took place in November, 1932, a business revival began during the summer and autumn, but it faded late in the year and reached a new low in the early spring of 1933. Farmowners,

¹ Schumpeter, *Business Cycles*, 2: 984-85, n. 2.

² Beard, *America in Midpassage*, 113-49; *New International Yearbook*, 1932, 817-22; Robinson, *Presidential Vote*, 27-34, 46.

³ The largest gifts to the Democratic party were as follows: \$125,000 from John J. Raskob; \$45,000 each from Bernard Baruch and William H. Woodin; \$35,000 from Vincent Astor; \$25,000 apiece from William Randolph Hearst, and R. W. Morrison of Texas; \$22,500 from M. L. Benedum, Pittsburgh oil and gas operator; \$20,000 from R. A. Josey; \$14,500 from Pierre S. du Pont; \$10,000 each from James M. Curley, mayor of Boston, Robert J. Dunham, and Mrs. W. R. Hearst.

The largest contributions to the Republican party were \$53,500 from the Mellon family; \$50,000 from Elbridge R. Johnson; \$36,500 from the Pratts; \$35,000 from the Rockefellers and Edward Hutton, respectively; \$32,000 from the Guggenheim family; \$30,704 from Ogden L. Mills; \$30,000 from the Brestones; \$28,000 from William Nelson Crownwell; \$25,000 from the Milbank family; \$22,000 from Mr. and Mrs. Herbert Straus, of R. H. Macy Company. Contributions from persons interested in the Standard Oil Company totaled \$71,500, the Chase National Bank, \$61,500; Kuhn Loeb and Company, \$28,500; and J. P. Morgan and Company, \$13,500.

The division of financial support between husbands and wives, brothers, and business associates occurred in 1932 most conspicuously in the cases of the T. L. Chadbourne, E. S. Harkness, and Charles E. F. McCann, du Pont, Guggenheim, Vanderbilt, and Straus families and of the Chase National Bank, J. P. Morgan and Co., and Standard Oil Co. The latter contributed more heavily to the Republicans than to the Democrats, however. Louise Overacker, "Campaign Funds in a Depression Year," *American Political Science Review* (October, 1933), 27: 769-83. These facts challenge Lundberg's thesis that the New Deal represents the light-goods industrialists vs. the capital-goods industrialists. *America's Sixty Families*, 449.

tenants, and sharecroppers suffered from the constriction of credit and markets. Congressional investigations revealed the malpractices of high finance. An increasing number of banks were forced to close and during the last three weeks of the Hoover administration a nation-wide banking crisis developed and led to the suspension of nearly all banking activities throughout the United States. The number of unemployed persons had increased from 4¾ million in 1930 to 14½ million in March, 1933. Hoover had not been able, despite two conferences with Roosevelt, to get the "lame-duck" Congress to balance the budget or to put through a program which would meet the banking and unemployment problems. Roosevelt, therefore, had to meet an unprecedented demand and need for undelayed action when he assumed the presidency on March 4, 1933.⁴

The New Deal Program

Relief, recovery, and reform were the guiding principles of the far-flung, highly varied, sometimes contradictory program known as the New Deal which Roosevelt put into effect with amazing rapidity and assurance. Public confidence was restored by the national banking holiday proclaimed on March 5 and by the action which he inspired Congress to take that spring and the following two years. Most of his recovery measures were based upon the belief that recovery would be promoted by a general rise in prices and would be accelerated by an increase in consumer purchasing power. The heart of the New Deal is to be found in the National Industrial Recovery Act, the Agricultural Adjustment Act, and the Roosevelt fiscal policies. The Emergency Banking Act of March 9, 1933, enabled the closed banks to reopen; the Banking Act of June 16, 1933, introduced important reforms and controls over speculation, holding company and security affiliates, and deposit insurance. Other acts extended the powers of the Reconstruction Finance Corporation, gave aid to homeowners and heavily mortgaged farmers, facilitated railroad consolidation and reorganization, and established the Securities and Exchange Commission as the moral supervisor of Wall Street.

The NIRA of June 16, 1933, was counter to the traditional Democratic ideal of competitive small business and gave legal recognition and official encouragement, equivalent to a compulsion, of a modified form of the German cartel which had been developing out of the activities of the trade associations from the first World War on. Al-

⁴ Beard, *op. cit.*, 150-206.

though big business got control of the various Code authorities and not too much concern was felt for the welfare of labor, the small businessman, and the consumer, the NRA helped recovery by pegging weak spots within industries, stopping spirals in many places, and mending disorganized markets. Invalidation of the NIRA by the Supreme Court on May 27, 1935, occurred when the recovery objectives had been achieved and before the harmful effects of stringent big business control could become too apparent or go too far. The AAA of May 12, 1933, and its substitutes, the Soil Conservation Act of February 29, 1936, and the Agricultural Adjustment Act of February 16, 1938, were instrumentalities for subsidizing agricultural landlords and commercial farmers through taxes on the rest of the community. But only the AAA levied special taxes for this purpose. Whatever the objections to the technique and professed aims of these acts, they did increase the income of farmowners and to that extent aided economic recovery.⁶

To improve the status of labor, Section 7a of the NIRA and the Wagner Labor Relations Act were put on the statute books. Despite inadequate support in the beginning from the National Labor Board and the special NRA Boards, the A.F. of L. gained strength while the C.I.O., under John L. Lewis's leadership, became the spearhead for a radical labor movement.⁶ The problem of relief for the unemployed, which Hoover had insisted should be met by the states and cities, was met under the Roosevelt administration by a series of federal measures. During the early stages of the depression the state and local governments had made large loan expenditures for relief and public works. Their outlays for the construction and maintenance of government plant had averaged over \$3 billion in 1930-31, but their resources had become largely exhausted by 1932.⁷

The Federal Emergency Relief Act of May 12, 1933, made available \$500 million for outright relief grants. One half of the funds, however, was to be granted on the matching basis of one federal dollar for every \$2.00 of state and local funds, but this effort to induce state and local responsibility soon turned out to be a failure. Owing to the American opposition to doles, Congress passed the Unemployment Relief Act in March, 1933, authorizing the President to employ citizens in constructing and maintaining public works connected with the coun-

⁶ *Ibid.*, 207ff.; Schumpeter, *op. cit.*, 2: 983-93.

⁶ Robert R. R. Brooks, *When Labor Organizes* (New Haven, 1937) gives a lively account and valuable analysis.

⁷ Alvin H. Hansen, *Fiscal Policy and Business Cycles* (New York, 1941), 86.

try's natural resources. Under this statute the Civilian Conservation Corps was organized and more than 300,000 young unmarried men from families without adequate income were set to work on afforestation, drainage, erosion control, etc. As the pressure of the unemployment problem increased in the fall of 1933, President Roosevelt created, in November, 1933, the Civil Works Administration and allocated to it funds for work projects which could be easily organized and would be capable of employing 4 million men then out of work. The CWA was officially ended on March 31, 1934, after having spent almost \$1 billion.⁸

As the federal government temporarily accepted direct relief in preference to the work relief, it continued the large contributions begun under the CWA. Congress appropriated on June 19, 1934, almost \$900 million for the Federal Emergency Relief Administration. But on January 4, 1935, Roosevelt abandoned the policy of direct relief and proposed that the states and local communities take care of the feeble and dependent while the federal government provided work for the unemployed men and women on the relief roll. In accordance with this suggestion Congress passed the Work Relief Act of April 8, 1935, with an appropriation of \$4,990 million. Harry Hopkins headed the Works Progress Administration which began an amazingly varied program of activities, many of which were useful and productive, some wasteful and open to criticism. Although widely criticized by conservatives and abused by certain private interests, local politicians, and petty parasites, the WPA during its lifetime was important as an attempt to avoid the relief dole and to preserve the self-respect and skills of the unemployed through socially approved work.⁹

Economics of the Social Security Act

Intimately connected with the work relief program was the Social Security Act of August 14, 1935.¹⁰ This created the framework for a national system of old-age and unemployment insurance, established a national program of old-age assistance, and made various provisions for community health and welfare services in co-operation with the

⁸ Beard, *op. cit.*, 223-26; William Withers, *Financing Economic Security in the United States* (New York, 1939), 28-33. Corrington Gill, *Wasted Manpower* (New York, 1939), 151-76.

⁹ Beard, *op. cit.*, 287-89; Withers, *op. cit.*, 35-39. The Work Relief Act was also a means of reducing federal financial responsibility by forcing the states to take care of some of the unemployables. Gill, *op. cit.*, 177-204.

¹⁰ 49 *U.S. Stat. at Large*, 620.

states. The old-age insurance plan, as revised in 1939,¹¹ furnishes qualified workers monthly pensions when they retire at the age of sixty-five or later. The amounts range from \$10 to \$85 per month, depending upon the average monthly earnings of the insured, the number of working years during which the employee has contributed, and the number of dependents. The plan was made self-supporting by the assessments of so-called taxes against the wages of employees and the payrolls of employers, each assessed at rates which were originally designed to begin at 1 per cent and gradually increase to 3 per cent but were frozen by Congress in 1939 at the 1 per cent level until further legislation. That part of annual wages of individuals over \$3,000 are exempt. The 1939 revision of the Act added supplementary benefits to widows and children dependent upon the insured and made the benefit payment start in 1940 instead of 1942.

The unemployment compensation system set up by the Social Security Act encouraged state unemployment insurance through a co-operative federal state plan. A federal tax is levied upon the payrolls of all employers, with certain exceptions, who have employed eight or more persons during at least twenty weeks of the year. The tax rose from 1 per cent in 1936 to 3 per cent in 1938 and thereafter, and does not apply to that part of annual incomes over \$3,000. Against this tax employers were allowed a credit of 90 per cent for any contributions made by them to any state unemployment insurance fund approved by the Social Security Board which administered the Act. By 1939 unemployment systems had emerged in all the states and the District of Columbia, Alaska, and Hawaii.

The federal government, under the Social Security Act, also assists the states to care for the aged, the blind, and dependent children through grants in aid. The federal contribution for needy children is fixed at one third of the state's expenditures, with a maximum of \$6.00 per month for one child in the home and \$4.00 per month for each additional child. For the needy blind and the aged the federal contribution is equal to one half of the state's expenditures, but is not to exceed \$15 per month for each case. By the spring of 1939 forty states and the District of Columbia were operating approved programs for aid to dependent children and were co-operating with the federal government in giving aid to the blind; and forty-eight states and the District of Columbia had approved old-age pension plans in force. The Social Security Act also provided for federal assistance through

¹¹ 53 *U.S. Stat. at Large*, 1360.

the states for maternal, child health, and general public health services.¹²

While accomplishing a great deal toward establishing some protection against economic insecurity for some 20 million people, the Social Security Act had many imperfections, among which were its exclusion from the insurance benefits of the law of employees in small concerns, domestic servants, and agricultural laborers. One criticism by many economists is that too large a reserve fund was built up for the old-age insurance; by 1980 the fund at the rates fixed in 1935 would be \$47 billion. This huge reserve was originally demanded to assure ample funds for the payment of the old-age benefits. The Treasury was allowed to borrow from the reserve and was given an incentive to maintain the federal debt to the level necessary for making securities available for the investment of the reserve fund.

The payroll taxes supporting the social security program were either paid directly out of employees' wages, or when paid by employers were indirectly passed forward to consumers in higher prices or backward to workers in lower wages. Some economists believe that these taxes operate as business costs. Though sales resistance may hinder some shifting to the ultimate consumer, they argue that the small amount of the tax added to the price on each article tends to promote shifting. Moreover, the imposition of these taxes during periods of unemployment may shift the burden of the taxes to employed workers under the disguise of less pay or part-time employment.

By January, 1940, the amount collected under the social security old-age insurance provisions was more than \$1½ billion, but the amount dispersed was only \$25¼ million. This meant that the reserve accumulated by the government and withdrawn from consumer purchasing power through this one section of the social security program exceeded \$1½ billion. From January, 1936, through November, 1939, payroll tax collections under the unemployment provisions of the Act amounted to \$2,547 million while the sum of \$805 million was dispersed to unemployed beneficiaries and for administration of the Act. This made the unexpended reserves for unemployment insurance reach the enormous sum of \$1,742 million. In January, 1940, the total cash reserves extracted through the regressive payroll taxes were more than \$3¼ billion. In 1939 Congress lessened the menace of the anticipated huge reserve by keeping the contributions for old-age insurance stationary until 1942 and by enlarging the disbursements. The reserve

¹² Cf. Paul H. Douglas, *Social Security in the United States* (New York, 1939).

for old-age insurance was thereby reduced to a sum about one fourth or one fifth of the original \$47 billion fund. Nevertheless, these old-age payroll taxes reduced the buying power of workers with low incomes and tended to hinder recovery.

The socially desirable procedure in peacetime therefore seems to be to reform the old-age payment system by making it a charge on the general Treasury, payable out of taxes levied on those better able to pay, and to reduce the payroll charges for unemployment insurance to a sum which would cover the yearly unemployment benefits in the insured industries. The Treasury, if the Act were amended, would then be compelled to make up any yearly deficiencies which resulted. The release for consumer spending of the excess millions collected in the social security payroll taxes would have in peacetime a desirable effect on the social welfare of the common people.¹³ But wartime conditions have caused the Roosevelt administration to consider increases in these payroll taxes as an anti-inflation weapon.¹⁴

Pump-Priming

One of the most hotly debated features of the New Deal was its public works and "pump-priming" program. Public works as a means of counteracting a depression had been considered in the United States after the first World War by various statesmen, notably Hoover, when Secretary of Commerce, and Senator Wagner of New York. In the early stages of the 1929 depression President Hoover had urged both public authorities and private industry to expand construction work as a recovery measure. The Emergency Relief and Construction Act of July, 1932, had authorized the Reconstruction Finance Corporation to supply \$1,500 million to state and local authorities for public works, but had provided that all projects should be self-liquidating. The result was that by December, 1933, only \$60 million had actually been spent.

The Roosevelt administration, soon after coming into office, put forward a large program of public works expenditure. The National Industrial Recovery Act authorized an appropriation of \$3,300 million for public works and set up the Federal Emergency Administration of Public Works, popularly known as the PWA. The Secretary of the Interior, Harold Ickes, became the Administrator of the PWA.

¹³ H. Dewey Anderson, *Taxation, Recovery, and Defense* (T.N.E.C. Monograph 20), 220-22; Withers, *op. cit.*, 107-38, 164-89.

¹⁴ *New York Times*, October 1, 1941.

Actually only \$711 million were available to the PWA out of the first appropriation because other agencies, such as the CWA, received the rest of the sum appropriated. During 1935 Harry Hopkins, the relief Administrator, gained an ascendancy over Ickes at the White House, and the 1935 Appropriation Act, as originally framed, contained no provision at all for the PWA, which would consequently have lapsed. But Congress passed the Emergency Relief Appropriation Act of April, 1935. This not only made available to the President the sum of \$4,880 million for use until June 30, 1937, but specifically continued the life of the PWA until that date.

By April 30, 1936, the federal government under Roosevelt had spent on its public works program about \$4 billion. Of this amount \$1,291 million were appropriated to the PWA; \$1,567 million was spent on federal construction projects of different departments; \$395 million came from the revolving fund of the PWA, obtained by the sale of state and municipal bonds; and \$723 million was spent by the states and municipalities themselves. The total expenditure was divided among the following forms of construction: 23.8 per cent for public buildings; 15.9 per cent for roads; 9.9 per cent for dams; 8.6 per cent for sewerage systems; 7.8 per cent for bridges; 6.8 per cent for ships, including naval vessels; 5.1 per cent for railroads; 5 per cent for water works; and 3.4 per cent for housing. The remainder was distributed among aids to navigation, power stations, aviation, and other items.¹⁵

The numerous and, in some cases, monumental public works projects of the PWA, the Tennessee Valley Authority, and other federal agencies were based upon a gradually evolving theory of deficit financing. The Hoover administration had incurred a combined deficit of \$5,075 million during its last two fiscal years because both the national income and the federal revenue had declined by one half from 1929 to 1932 while expenditures had remained unchanged. The only fiscal attack it had made on the depression was through what may be called the "capital repair" expenditures by the Reconstruction Finance Corporation. The Democratic party had won the 1932 election in part by its attack on the Hoover budgetary deficits in general and the RFC expenditures in particular. During the first few months Roosevelt attempted to enforce federal economy, and under the Economy Act of March 21, 1933, he consolidated and eliminated many governmental agencies and bureaus and made drastic reductions in veterans' pen-

¹⁵ Editors of *London Economist*, *The New Deal* (New York, 1937), 22-29; Jack F. Isakoff, *The Public Works Administration* (Urbana, Illinois, 1938), 9-23.

sions and federal employees' salaries. The total savings were estimated at nearly a billion dollars.

Although this economy policy was soon reversed, the main emphasis for recovery in 1933 was on monetary policy, the devaluation of the dollar with the object of raising commodity prices to the 1926 level, the NRA, and the AAA. The early public works program had little emphasis on *deficit* spending as the means to recovery, and federal deficits were justified mainly on the humanitarian ground that they were necessary to provide temporary relief for unemployment until recovery could be achieved by other means. The theory behind pump-priming was that if lowering the interest rate through central bank policy and deficit financing would not by itself sufficiently stimulate investment, a stream of new investment could be set in motion through public investment by means of deficits.

In the opinion of some observers the beginning of a conscious policy of pump priming by the Roosevelt administration began after the visit to the United States in June, 1934, by John Maynard Keynes. The views he had stated in his pamphlet on "The Means to Prosperity" (1933) he presented with great force to the administration and economists. Other observers, however, maintain that the administration did not adopt a deficit spending policy as a major means to recovery until the spring of 1938.¹⁶ The assumption in the first few years of the Roosevelt administration was that under the combined stimulus of income creation and low interest rates the federal deficits would probably not be large or long continued. The federal budget would have a "diamond-shaped" pattern molded to that of the business cycle, with deficits in depression and surpluses in boom periods both tapering from the turning points.¹⁷

Balanced Budget vs. Balanced Economy

Roosevelt sought to reconcile his 1932 election promise of balanced budgets with the expansion of those expenditures deemed necessary for recovery and relief by accepting in his first Budget Message of January 3, 1934, the principle of a balanced "regular" budget and setting up an "extraordinary" budget for emergency expenditures. This distinction between ordinary or general and emergency expen-

¹⁶ John H. Williams, "Deficit Spending," *American Economic Review* (February, 1941, v. 30, No. 3, Proc.), 52-53.

¹⁷ *Ibid.*, 55-56; Hansen, *op. cit.*, 261 ff.

ditures he continued throughout the rest of his first administration and the whole of the second. But his double budget was far from being a "current" and "capital" budget, or even an ordinary and a "loan" budget. It was only in his Budget Message for 1940, issued on January 3, 1940, that Roosevelt made the capital budget a central issue.

The justification for this change in government accounting was that self-liquidating public projects and investment in self-sustaining governmental corporations and credit agencies did not increase the direct government debt, but on the contrary increased the national wealth. He suggested that extraordinary expenditures on non-self-liquidating public works and on unemployment relief should be met in part from current revenues over the length of the business cycle.¹⁸ A cyclical budget had been in use in the Scandinavian countries for some time, with notable success in Sweden. American fiscal policy was now supposed to be reoriented toward business fluctuations. On the downswing of the cycle government activity was to be increased in order to moderate and offset the decline in business activities. On the upswing government activities were to taper off to permit private business to have its full measure of success. Budgets were to be unbalanced during the downswing so that public works and other federal activities could maintain economic welfare. Large borrowings were to be resorted to in order not to curtail purchasing power through too heavy tax collections. But, as private business recovered, taxes were to be increased, the federal revenue would grow proportionately with the national income, and emergency expenditures for relief and public works would be reduced so that the excess revenue would be devoted to the payment of the national debt.¹⁹

For the decade preceding the introduction of the cyclical budget policy (1931-40) the federal government's total ordinary expenditures amounted to \$40,515 million and total current revenues to \$41,033 million. The current revenues exceeded the ordinary expenditures except for the fiscal years 1932, 1933, and 1936. On the other hand, for the entire decade current revenues contributed only half a billion dollars to the total extraordinary expenditures of \$27,797 million. Of this amount, \$16,231 million was for unemployment relief, \$7,952 million for public works, and \$3,339 million for loans, stock subscriptions, etc. If one adds an estimated \$2,687 million of WPA constructed

¹⁸ Hansen, *op. cit.*, 213-21.

¹⁹ Anderson, *Taxation, Recovery, and Defense*, 229-34.

urable improvements to the public works, loans and stock subscription items, one gets a total of \$13,978 million for public works and investments. This leaves \$13,544 million for unemployment relief expenditures with no material assets left behind.²⁰

Against this background of economic and social policy and practice the increase in the national debt must be viewed. The gross public debt of almost \$25½ billion outstanding on June 30, 1919, had been reduced by June 30, 1930, to \$16,185 million. After this reduction of \$9,296 million in the national debt the depression caused the debt to rise from the postwar low in 1930 to almost \$19½ billion in 1932, \$22,539 million in 1933, and \$27,053 million in 1934. By then the growth of the debt had more than wiped out all the postwar reduction. Each successive year set a new all-time high. In 1935 the total was \$28,701 million, in 1936 \$33,545 million, and by 1940 \$42,967 million. This was an increase of about 175 per cent over the 1919 debt. The war situation from 1940 onward has, of course, not only immensely increased the national debt, but also changed the perspective in which the whole question was viewed during the conflict over the deficit spending policies of the New Deal.²¹

The economic significance of this large increase in the national debt can be understood properly only when one realizes that the public debt does not have the same characteristics or consequences as private debt. While it may be important for the individual to keep his expenditures within the limits of his income, an increase of expenditures for the state may frequently increase the total national income and improve its fiscal position.²² Yet, the problem of the extent to which taxes should be used as against loans still remains an important one. Although one may reject many of the traditional objections to a large public debt, there is no need to increase it when an upswing in the business cycle makes a higher yield from taxes feasible. Moreover, the type of taxation adopted or maintained determines the extent to which the benefits of the government spending are aided or counteracted by the placement of the burden of the tax.²³ The public debt, however, does raise a problem when a transfer of wealth or income from the country is made possible by large foreign investments in the national debt.

²⁰ Hansen, *op. cit.*, 221-22.

²¹ *Treasury Report* (1940), 742-43.

²² Hansen, *op. cit.*, 135-85, has an admirable study of the growth and role of public debt. Henry H. Villard, *Deficit Spending and the National Income* (New York, 1941), 322ff., gives a valuable detailed statement of the federal, state, and local governments' net income-increasing expenditure from 1930 to 1939, inclusive.

²³ Colm and Tarasov, *Who Pays the Taxes?* 27-33.

The AAA and NIRA Taxes

Heavy taxation was deferred quite wisely under the New Deal taxing policy to the period of recovery and was set in motion actively only in 1935. No general tax revision was undertaken by the first New Deal Congress in the spring of 1933 owing to the pressure of more important measures needed to meet the economic crisis. The AAA Act included taxes on the processing of commodities, such as grinding wheat into flour, taxes on domestic products grown in excess of quotas, and customs duties on certain imported farm commodities. The processing taxes were originally determined by a formula administered by the Secretary of Agriculture, although later the amounts were fixed by statute. The proceeds were paid as bonuses to the producers of specified agricultural products who limited their production in accordance with the regulations of the Department of Agriculture. This was in effect a sales tax imposed upon the urban consumer and was regressive because it affected the low-income groups more drastically than the high-income groups. Taxes regulating the cotton and tobacco industries were levied on growers who produced in excess of the quotas allotted. Cotton was taxed at 50 per cent of the value of all excess above quotas, and tobacco at rates ranging from 25 to 33 $\frac{1}{3}$ per cent. Early in 1936 the Supreme Court nullified these Acts, and the taxes were discontinued. At their peak in 1934 these taxes yielded over half a billion dollars. Their total yield from 1933 to the date of their discontinuance was almost a billion dollars.²⁴

In order to meet the interest and sinking fund charges on the money borrowed to finance the \$3,300 million public works program authorized by the NIRA on June 16, 1933, Congress imposed four temporary taxes as a part of the Act. Although Lewis W. Douglas, the Budget Director, had suggested that Congress enact a general manufacturers' sales tax as well as sharp increases in the taxes on income and corporation dividends, Congress disregarded the sales tax because of the public indignation about the disclosure before the Senate Banking Committee that J. P. Morgan and his partners had paid no income taxes in 1932. In its final form the NIRA levied a tax of 5 per cent on corporation dividends received by individuals. An annual tax of \$1.00 for each \$1,000 of the adjusted declared value placed on corporate capital stock was also imposed. Moreover, an excess-profits tax of 5 per cent was placed on corporate net income in excess of 12 per

²⁴ Anderson, *op. cit.*, 155-57.

cent of the last declared value of the corporation's capital stock. The tax rate on corporations filing consolidated returns was made three fourths of 1 per cent higher than the regular rate applicable to the returns of unaffiliated corporations for 1933 and 1 per cent higher for 1934 and 1935.

To satisfy public opinion on the Morgan disclosures, the amount of deductible losses in income tax returns was limited. The privileges of carrying forward net business losses from one year to the succeeding year and of carrying forward losses from the sale of stocks and bonds held less than two years were repealed. If a partnership had more security losses than profits on securities held for less than two years, the individual partners were not allowed any more to take their pro rata share of the excess loss as a deduction from the individual security profits. The exemption formerly granted unincorporated private bankers from the limitations of gains and losses from the sales of capital assets was removed. The 50 per cent penalty tax upon undistributed corporate surplus was extended to prevent evasion by individuals not only of the surtax but any other internal revenue tax, including the 5 per cent excise tax on dividends. All of these changes were made effective retroactively as of January 1, 1933, so as to affect the 1933 returns. In addition to these provisions, the Act imposed an additional gasoline tax of one half cent per gallon which went into effect on June 17, 1933.²⁵

A new source of revenue was opened when the Prohibition Amendment was repealed on December 5, 1933, through the adoption of the Twenty-first Amendment. Congress thereupon passed on January 11, 1934, a Liquor Taxing Act which raised the tax on distilled liquors from \$1.10 to \$2.00 a gallon and increased substantially the taxes on wine. Previously Congress had obtained revenue by ruling on March 22, 1933, that beer and wine of not more than 3.2 per cent alcohol by weight were nonintoxicating and were subject to certain taxes. On that date the sale of beer was permitted in nineteen states not having state Prohibition laws, and the movement for repeal of the Eighteenth Amendment gained such momentum that by the end of the year success was achieved. Along with the internal excises imposed on liquor in January, 1934, went a customs duty of \$5.00 a gallon on imported spirits, which were also required to pay the domestic excise. This duty had only been \$2.00 a gallon before Prohibition. The consequence of these new liquor taxes was that the federal revenue from liquor taxes rose rapidly from \$8 million in 1932 to almost

²⁵ 48 U.S. Stat. at Large, 195. Cf. Blakey, *Federal Income Tax*, 335-46.

\$375 million in 1934 and \$587,306,000 in 1937, and \$725 million in 1940.²⁶

*The Drive for Increased Revenue and Tax Reform
in 1934*

The Revenue Act of May 10, 1934, was the first attempt to enact on a broad scale some of the New Deal principles in the field of taxation. The primary purpose of the new law was the prevention of tax avoidance and evasion so as to increase the federal revenue and place a due part of the tax burden upon those of great wealth and high income who had succeeded in the past in avoiding income tax payments. The Act²⁷ imposed a flat normal rate of 4 per cent on the first \$4,000 of individual net income. This replaced the 1932 provisions for a normal tax of 4 per cent on the first \$4,000 and of 8 per cent on the remainder. While the 1932 surtax was graduated from 1 per cent on the excess of net income above \$6,000 to 55 per cent on the net income over \$1 million, the 1934 surtax began at 4 per cent on net income over \$4,000 and rose to a maximum rate of 59 per cent on net income over \$1 million. The earned income credit which the 1924, 1926, and 1928 Acts had provided and which had been repealed in 1932 was restored in 1934. The credit allowed, however, was 10 per cent instead of 25 per cent, and applied to earned income not in excess of \$14,000.

The effect of these changes was that the sum of the normal tax and maximum surtax rates (4-59) was the same as under the 1932 Act (8-55). But the rearrangement in structure resulted in making the personal income tax more sharply progressive through a decrease of taxes for those with incomes between \$5,000 and \$9,000 and an increase for those with net incomes above \$9,000. The rate of the tax on corporate net incomes was left at 13¾ per cent, but the 1933 NIRA capital-stock tax of one tenth of 1 per cent and excess-profits tax of 5 per cent upon the excess of 12½ per cent of the adjusted declared value of its capital stock were retained. Only railroads were allowed to file consolidated returns, and an additional tax of 2 per cent was charged for the privilege. This was to prevent corporate tax evasion.

An entirely new method of dealing with capital gains and losses was introduced. The antiprogressive character of the earlier law was

²⁶ Anderson, *op. cit.*, 137-40; L. H. Kimmel, "Liquor Excises and Federal Revenues," *New York Journal of Commerce*, January 24, 1941, Supplement, 10, 51.

²⁷ 48 *U.S. Stat. at Large*, 680. For detailed comment, see Blakey, *op. cit.*, 347-65.

decreased by reducing the advantages enjoyed by individuals in the higher surtax brackets. The optional special rate of 12½ per cent on gains from sales of capital assets held over two years was abolished. The regular tax rates were applied to percentages of gain or loss from the sale of capital assets, which varied according to the length of time the assets had been held from a maximum of 100 per cent of assets held for not more than one year to a minimum of 30 per cent of assets held more than ten years. Deductions of losses from sales or exchanges of capital assets were limited to the amount of the capital gains of the same tax year plus \$2,000. No provision was made for carrying forward net losses to succeeding years. Attempts were made to restrict deductions for taxes, contributions, and losses from wagering transactions and sales or exchanges of property between members of a family and between an individual and a corporation in which he owned more than 50 per cent of the outstanding stock. To prevent individuals with large incomes from incorporating and escaping the surtax on portions of the corporation income not paid out to individuals through dividends, salaries, interest, or any other medium, an additional surtax was levied on the undistributed net income of personal holding companies. The rates were 30 per cent on the first \$100,000 of undistributed net income and 40 per cent of the amount in excess of \$100,000. But this surtax did not apply if all shareholders included their several shares of this corporate income, whether distributed or not, in their individual returns. Since the 50 per cent penalty tax on excessive corporate surpluses had been difficult to administer, Congress provided a penalty surtax upon improperly accumulated surpluses similar to that on personal holding companies, except that the corresponding rates were 25 and 35 per cent. To head off tax avoidance to corporate reorganization, Congress omitted the 1932 provision permitting a corporation through reorganization to distribute to its shareholders stock or securities in another corporation, a party to the reorganization, without any tax being imposed on the shareholder.²⁸

The federal estate tax, which had been increased in 1932 through the superimposition of an additional tax upon the 1926 tax, was raised still higher in 1934. The 1933 crisis inspired Congressman Samuel B. Pettengill of Indiana and Senator La Follette to propose increases in the estate tax as a means of redistributing wealth and securing more

²⁸ See Hynning, *Taxation of Corporate Enterprise*, 39ff., on the economic importance of holding companies, consolidated returns, and undistributed profits.

revenue, which Congress adopted. The 1934 Act replaced the 1932 additional estate tax, but not the 1926 basic rates, with a schedule of rates which lifted the combined maximum rate to 60 per cent on the excess above \$10 million of net estate. The 1932 exemption of \$50,000 was kept. The 80 per cent credit given for the payment of state death duties was restricted as in 1932 to the 1926 tax rates and did not apply to the additional tax. The tax applied to the estates of decedent residents, whether American citizens or not, and to the estates of United States citizens, whether residents or not. But real estate situated outside the United States was not included in the taxable estate. The changes introduced made the net estates over \$70,000 bear increased burdens. Corresponding increases were made in the gift tax rates so that they continued to be, as in 1932, about three fourths as high as the estate tax rates. The new rates, however, were applicable only to 1935 and later years, and not to 1934.²⁹

Among the other provisions of the 1934 Revenue Act were protective duties imposed on coconut and allied oils for the purpose of checking imports from the Philippines in order to aid American dairy interests. To placate the Filipinos, the revenue collected on Philippine oils was to be put in a separate fund and given over to the Philippine Treasury. Although certain excises on luxury and consumption items were repealed, those on gasoline, cigarettes, and first-class postage were either retained at the same rate or increased.

Although the 1934 Revenue Act was a step forward socially in its curtailment of tax avoidance devices and its increases in the higher brackets of the income, estate, and gift taxes, the administration could have raised these rates still higher and obtained much larger receipts. Attempts by Senators La Follette, Norris, and Huey Long to increase the income tax rates beyond those already accepted were voted down as too radical. The reason for Roosevelt's opposition to increased taxes at this time was that the British reduction of the income tax that spring, had excited much envy among American businessmen, and that the public debt seemed less a danger than the nominal figures suggested because of the reduced interest on the debt, the social security reserve fund, and the increase in tax collections.³⁰

²⁹ R. H. Montgomery and Roswell Magill, *Federal Taxes on Estates, Trusts and Gifts 1935-36* (New York, 1936), 105ff.; Myers, *Hereditary American Fortunes*, 337-44.

³⁰ Paul Studenski, Ed., *Taxation and Public Policy* (New York, 1936), 49-53.

Radical Pressures vs. Great Wealth

But conditions changed so speedily that by the end of another year Roosevelt was ready to champion one of the most radical tax measures ever presented by a President. The great strength of the "Share-Our-Wealth" movement of Huey Long, the Townsend old-age pension plan, and Father Coughlin's League of Social Justice had aroused much apprehension in Washington by the spring of 1935. Roosevelt had also been greatly disturbed by the Supreme Court's nullification of New Deal measures that same spring. These factors and the pressure from such advocates of social welfare taxation as Herman Oliphant, counselor to the Treasury, and Senators La Follette and Norris helped to induce Roosevelt to send to Congress on June 19, 1935, his notable message on tax revision.³¹

In order to prevent an unjust concentration of wealth and economic power, Roosevelt recommended changing the federal tax system drastically. He proposed that vast inheritances be checked through the passage of inheritance, succession, legacy, and gift taxes on all very large amounts received by any one legatee or beneficiary. He also suggested that social unrest be checked by increasing the graduated surtaxes upon great personal incomes beyond the existing \$1 million limit. In view of the great economic power of large corporations and their tendency to achieve monopoly, he proposed that the principle of graduated taxation be extended to corporations. He urged that the existing flat corporation income tax of 13 $\frac{3}{4}$ per cent be replaced by a tax graduated according to the size of income from 10 $\frac{3}{4}$ per cent on the smaller corporations to 16 $\frac{3}{4}$ per cent on the largest corporations. To prevent evasion through subsidiaries or affiliates, he suggested the taxation of dividends received by corporations outside bona fide investment trusts. He also advised the simplification of corporate structures through the elimination of unnecessary holding companies and unwieldy corporate surpluses. Finally, he asked for the submission and ratification of a constitutional amendment empowering the federal government to tax the income on future issues of state and local securities and enabling the state and local governments to tax the income on future issues of federal securities.³²

A great public furor was created by Roosevelt's tax message. Conservative circles damned it as a scheme for "soaking the rich." Liberals

³¹ *Ibid.*, 53-54; Raymond Moley, *After Seven Years* (New York, 1939), 300-14.

³² Franklin D. Roosevelt, *The Public Papers and Addresses* (5 v., New York, 1938), 4: 270-77.

praised it as an advance toward social justice. Huey Long announced he would swing his 200,000 Share-Our-Wealth clubs to the support of Roosevelt if the latter's tax plan were enacted into law. The pressure from Long, Progressives such as La Follette and Norris, and Republicans suspicious of Roosevelt's sincerity stimulated the President into getting the Democratic Congressional machine to force through his tax proposals. If one considers the important and complicated issues involved and the vehement opposition of big business, Congress drafted and passed the tax bill with great rapidity. On August 30, 1935, it became law.³³

Taxes for the Diffusion of Wealth

The Revenue Act of 1935³⁴ embodied most, although not all, of the key proposals of Roosevelt. While the normal income tax and exemptions of the 1934 Act were unaltered, the surtax rates were increased on the amounts of net income over \$50,000. The 1934 surtax rates had been graduated from 4 per cent upon the net income over \$4,000 to 30 per cent on that over \$50,000 to 59 per cent on income over \$1 million. The 1935 rates ranged from 31 per cent on income over \$50,000 to 73 per cent on income over \$1 million and 75 per cent on income over \$5 million. La Follette had tried in vain to have the surtax rates on income over \$8,000 increased and the personal exemptions lowered from \$2,500 to \$2,000 and from \$1,000 to \$800. He was motivated by the desire to increase the federal revenue so as to meet the growing federal expenditures and by the wish to make effective Roosevelt's plea for the diffusion of wealth. The increase in the surtax rates was severely criticized by conservatives as discouraging incentive and drying up capital. New Deal economists also pointed out that these rates encouraged tax avoidance through investment in tax-exempt securities and suggested that it might have been wiser to have waited until a constitutional amendment doing away with tax-exempt bonds had been ratified.

The tax on the net income on corporations was changed from a flat tax of 13¾ per cent to a tax graduated as follows:

12½	per cent upon net incomes not in excess of \$2,000
13	“ “ “ “ “ of \$2,000—\$15,000
14	“ “ “ “ “ \$15,000—\$40,000
15	“ “ “ “ “ in excess of \$40,000

³³ Blakey, *op. cit.*, 366-82.

³⁴ 49 *U.S. Stat. at Large*, 1014.

This graduation was not as extensive as the President had suggested. As a partial substitute the excess-profits tax, which he had not mentioned, was increased and graduated. The 1934 tax of 5 per cent on net income in excess of 12½ per cent of declared capital was raised to a tax of 6 per cent of net income in excess of 10 per cent and not in excess of 15 per cent of the adjusted declared value of the capital stock, and to a tax of 12 per cent of the net income in excess of 15 per cent of the adjusted declared value. Concurrently, the capital stock tax was increased from \$1.00 to \$1.40 for each \$1,000 of the declared value of the stock. Since corporations were allowed to deduct from gross income 90 per cent of the dividends they received, the tax on intercorporate dividends amounted at most to 1.5 per cent on all dividends received. This tax was not as high as the Senate and the Treasury desired in their effort to comply with the President's drive to prevent evasion of the graduated tax upon corporated incomes by holding companies. Nor was his recommendation for an exemption of bona fide investment trusts acted upon.

The 1934 penalty surtax on excessive corporate surplus was kept at 25 per cent and 35 per cent of the retained net income although Roosevelt favored an increase. But the penalty tax rates upon personal holding companies used presumably to avoid the income surtaxes were increased to accord with the 1935 surtaxes. The tax rates on the undistributed adjusted net income of such companies ranged from 20 per cent upon amounts not over \$2,000 to 60 per cent upon amounts over \$1 million.²⁵

In addition to the existing federal estate tax, the President had advocated new federal inheritance taxes and correlated gift taxes. In line with the movement against inherited economic power carried on by the Populists, Progressives such as the elder and younger La Follette, and demagogues like Huey Long, he advocated a tax upon great accumulations of wealth which led to the perpetuation in a relatively few individuals of great and undesirable concentration of control over the employment and welfare of many others. Although the House voted for inheritance taxes ranging from 4 to 75 per cent, the Senate felt that the great administrative difficulties involved justified its eliminating these new taxes. The compromise enacted into law was that the exemption for the estate tax be reduced from \$50,000 to \$40,000 and that the additional estate tax rates of the 1934 law be raised. The 1934 rates had ranged from 1 per cent on the first \$10,000 of net estate to 60 per cent upon the amount over \$10 mil-

²⁵ Cf. Hyning, *op. cit.*, 53ff.

lion. The 1935 rates were graduated from 2 per cent on the first \$10,000 to 69 per cent on the amount between \$20 million and \$50 million and to 70 per cent on the amount over \$50 million. These rates were superimposed upon the basic 1926 rates, and the 80 per cent credit for state death duties applied only to these rates. These increases, like those in the surtaxes, were denounced by conservatives as confiscatory and destructive of ambition, ability, and enterprise, but were defended by liberals as making for a broader distribution of wealth and as not adversely affecting the mechanism of production.³⁶

Roosevelt drove home to the public the importance of the gift tax in a press conference on July 31, 1935. He informed the country that fifty-eight persons reporting incomes of \$1 million or more for 1932 had paid no tax whatever to the federal government on 37 per cent of their net incomes. They had paid no tax on this portion of their income largely because they had invested in tax-exempt securities. Furthermore, one family, believed by some to be the Rockefellers, had divided its holdings into 197 separate family trusts which, the President alleged, was for the purpose of reducing their income taxes and surtaxes. He also revealed that while Congress was passing the 1932 gift tax law one taxpayer transferred about \$100 million in tax-free gifts, and another taxpayer transferred about \$50 million in tax-free gifts. Another estate, he disclosed, was reduced through gifts from \$100 million to about \$8 million within two years of the owner's death. A few days after these revelations John D. Rockefeller, Jr., transferred part of his fortune to relatives in order presumably to escape the higher gift and estate taxes which Roosevelt had proposed to Congress according to certain reports.³⁷

The rates of the gift tax in 1934 had been graduated from three fourths of 1 per cent upon amounts not over \$10,000 to 45 per cent upon amounts over \$10 million. The 1935 Act increased these rates so that they ranged from 1½ per cent upon amounts not over \$10,000 to 52½ per cent upon amounts over \$50 million. The general exemption was lowered from \$50,000 to \$40,000. Socially admirable as these advances in rates were, a number of loopholes for tax evasion were still left in the 1935 law. Congress also failed to eliminate tax-exempt government securities by not acting upon the President's recommendation for a constitutional amendment.

Estimates of the social significance of the Act varied from enthusiastic approval by liberals, who held it as a distinct turning point in

³⁶ Myers, *op. cit.*, 344ff.; Montgomery and Magill, *op. cit.*, 105ff.

³⁷ Roosevelt, *op. cit.*, 4: 312-14; Lundberg, *op. cit.*, 466.

the use of taxation for the decentralization of wealth, to denunciation by conservatives as grossly unfair, unconstitutional, and vitiated by "soak the rich" and "share-the-wealth" principles.³⁸ A judicious verdict by a noted historian was: "As a revenue producer, the Act worked no wonders. As a stick to beat off the storm troops of Senator Long and Father Coughlin, it was not without force."³⁹ But few of these critics pointed out that the Social Security Act of August 14, 1935, reduced the progressive effect of the Revenue Act of August 30, 1935, by the payroll tax burden placed upon workers earning \$3,000 a year and less. The quarter of a billion dollars a year raised through the income, estate, and gift taxes checked the concentration of wealth to the extent of one half of 1 per cent of the estimated annual national income at the time. But the social security payroll taxes, although they were allocated for the benefit of the contributing workers, were borne by low income groups which could not afford the loss of purchasing power entailed by this regressive type of taxation.

The Undistributed Profits Tax of 1936

The nullification of the AAA by the Supreme Court on January 6, 1936, eliminated about \$500 million of anticipated annual revenue. Three weeks later Congress passed, over the President's veto, the bill for the immediate payment of the soldiers' bonus amounting to about \$2,237 million, or to a nine-year annual amortization charge of \$120 million, in addition to \$160 million already in the budget presented on January 3. On March 3 the President sent a special message to Congress proposing revolutionary changes in the federal method of taxing corporate incomes. He suggested consideration of a tax "which would accomplish an important tax reform, remove two major inequalities in our tax system, and stop 'leaks' in present surtaxes." This new tax was one on undistributed corporate income, and was to be accompanied by the repeal of the present corporate income tax, the capital-stock tax, the related excess-profits tax, and the exemption of dividends from the normal tax on individual incomes. The rate on undistributed corporate income was to be graduated and be so fixed as to yield approximately the same revenue as would have been yielded if corporate profits had been distributed and taxed in the hands of stockholders. The new tax was estimated as being able to yield

³⁸ Blakey, "Revenue Act of 1935," *American Economic Review* (December, 1935), 25: 687-89.

³⁹ Beard, *op. cit.*, 192.

\$620 million. To meet the temporary need for \$517 million, he suggested a "windfall" tax on "certain taxpayers who shifted to others the burden of processing taxes which were impounded and returned to them or which otherwise would have remained unpaid" and a light excise for two or three years on the processing of certain agricultural products.⁴⁰

After much public and Congressional debate, especially in the Senate, Congress passed a bill embodying a large part of the President's suggestions, but not the radical changes recommended by Rexford Tugwell and Herman Oliphant, the leftist advisers of Roosevelt on this matter, and at first adopted by the House.⁴¹ The Revenue Act of June 27, 1936,⁴² left the rates of the individual income tax, estate tax, and gift tax practically as they were in the 1934 Revenue Act as amended by the 1935 Act. The graduated tax on the net incomes of corporations was retained as a normal tax, but the rates on the lower brackets were reduced. The capital-stock tax was kept but was reduced from \$1.40 to \$1.00 per \$1,000 of stock. The correlated excess profits tax was left at the same rates as those of the 1935 statute.

The important innovation was a new surtax imposed on corporations with the intent of forcing them to distribute their profits. The rates were graduated according to the ratio of undistributed profits to adjusted net income. The latter was defined as net income minus the normal corporate income tax and interest from obligations of the federal government and government corporations. Special credits were given to holding company affiliates and national mortgage associations. Undistributed net income was defined as adjusted net income minus the sum of the dividends paid out by corporations in cash or otherwise and the credit allowed in cases of contracts made prior to May 1, 1936, restricting the payment of dividends. The rates were graduated from a minimum of 7 per cent of the amount of "undistributed net income" not in excess of 10 per cent of the "adjusted net income" to a maximum of 27 per cent of the undistributed net income in excess of 60 per cent of the adjusted net income.

In the application of the surtax on undistributed profits, the taxable corporate income was divided into brackets, and each portion of the undistributed profits was taxed at the specified rate. The total tax on undistributed profits was the sum of the various taxes imposed on the

⁴⁰ Roosevelt, *op. cit.*, 5: 102-07.

⁴¹ Blakey, *Federal Income Tax*, 401-27; Alfred G. Buehler, *The Undistributed Profits Tax* (New York, 1937) is the most extended and authoritative study on the subject.

⁴² 49 *U.S. Stat. at Large*, 1648.

different brackets. If a corporation paid out its entire net income in cash dividends, it was not liable for the undistributed profits tax. On the other hand, if a corporation paid out no dividends, it was subject to the maximum tax rates on undistributed profits in addition to the normal corporate income tax.

The rates of the special penalty tax on improperly accumulated corporate surplus were reduced by 10 per cent in the case of corporations subject to the undistributed surtax. In the case of corporations not subject to this tax, the penalty tax was kept at the same rate as under the 1935 Act. Congress had no desire to inflict an excessively harsh combination of taxes. This may also explain why the surtax rates on the undistributed net income of personal holding companies were reduced 12 per cent on each undistributed net income bracket of the 1935 statute. The upshot was a minimum 8 per cent tax on the undistributed adjusted net income not over \$2,000 and a maximum 48 per cent tax on the amount over \$1 million. The percentage of intercorporate dividends subject to the normal tax, however, was increased from 10 per cent to 15 per cent.

Few taxes have evoked such a storm of passionate and partisan controversy as that on the undistributed profits tax. Spokesmen for corporations objected strenuously on the ground that the tax made for economic instability, interfered with corporate policies, destroyed the sanctity of the surplus, retarded business recovery, and encouraged extravagant federal expenditure. On the other hand, Professor Tugwell, in his volume *The Industrial Discipline* (1933) and in his personal advice to the President, advocated the tax as a means of reducing excessive corporate savings, increasing consumer spending, and stabilizing business. He, Oliphant, and others believed the tax would give the stockholders more influence in the formulation of corporation dividend and corporation saving policies and would help remove certain abuses in corporation finance. The verdict of many impartial experts was that the tax's merits and evils were exaggerated by the administration and business respectively. In their eyes a moderate tax on undistributed profits would be justified if the normal profits tax were not raised excessively and if the excess-profits tax and the capital-stock tax were repealed.⁴⁸

⁴⁸ Buehler, *op. cit.*, 14-17, 34-37, 267-70.



Changes in New Deal Strategy Since 1936

THE tax policies of the New Deal were responsible for much of the opposition of the "economic royalists" to the re-election of Roosevelt in 1936. The tax on undistributed profits, Raymond Moley said, "had thrown the business community into paroxysms of fright."¹ But the Republicans were forced by public sentiment to adopt a policy distinguishable in rhetoric only in minor degrees of emphasis from that of the Democrats. The Republicans paid Roosevelt "the tribute of borrowing his policies while denouncing his philosophy."² But Roosevelt won the election by carrying the offensive into the enemy's camp. Although he stirred the masses through his blunt criticism of the economic royalists, and his promises of extension of democratic principles to the economic sphere, actually Roosevelt was far from advocating the thoroughgoing reconstruction of the social order which Norman Thomas and Earl Browder, with their very different attitudes toward the democratic process, advocated. Roosevelt's desire to preserve capitalism from revolution through reform was expressed in his first campaign speech: "Wise and prudent men—intelligent conservatives—have long known that in a changing world worthy institutions can be conserved only by adjusting them to the changing time. . . . I am that kind of conservative because I am that kind of liberal."³

The results of the election were a landslide victory for Roosevelt, who had an 11 million plurality over Landon and carried every state but Maine and Vermont. Landon obtained almost 17 million votes;

¹ Raymond Moley, *After Seven Years*, 316.

² *London Economist*, "The New Deal," 148.

³ Roosevelt, *Public Papers*, 5: 390.

William Lemke, the Union party candidate endorsed by Father Coughlin, about 900,000 votes; Norman Thomas, 193,000, somewhat over one fifth of his 1932 total; and Earl Browder, 80,000, three fourths of the 1932 Communist total. But the significant fact about the election was the increased cleavage in the class support for the Republican party as against the Democratic. In 1928 both parties had depended largely upon bankers and manufacturers for their contributions. In 1932 the bankers contributed as heavily to the Democrats as in 1928 although the number of manufacturers dropped considerably. In 1936, however, the bankers and brokers deserted the Democratic fold so that only 3.3 per cent of the contributions of \$1,000 or more came from this group compared to 14.7 per cent in the case of the Republicans.

The Democratic expenditure for 1936 was over \$5 million and that of the Republicans over \$10 million. The strongest supporters of the latter were the leading New York banking and investment houses, the big industrialists, especially in steel and chemicals, owners of chain stores and mail-order houses, and nearly all the great publishers, including Hearst. The Democrats drew their financial support from the C.I.O. unions, the legal profession, the liquor and tobacco interests, Democratic officeholders, and southern conservatives. A few industrialists, bankers, oil men, publishers, and merchants also contributed heavily. Statistical studies show that nearly twice as large a percentage of the population of the lower third of the income scale voted for Roosevelt as did so in the upper third.⁴

Roosevelt struck the keynote for the social reform phase of his second administration when he said in his second inaugural speech on January 20, 1937: "I see one-third of a nation ill-housed, ill-clad, ill-nourished. In our seeking for economic and political progress as a nation, we all go up—or else we all go down—as one people."⁵ That

⁴ Beard, *America in Midpassage*, 299-338; W. F. Ogburn and L. C. Coombs, "Economic Factors in the Roosevelt Elections," *American Political Science Review* (August, 1940), 34: 719-27. The Republicans received \$855,520 from the du Pont family, \$514,102 from the J. Howard Pew family, \$187,000 from the Rockefellers, \$130,775 from the Mellons, \$103,011 from I. C. Copley, \$97,300 from Ernest T. Weir, \$77,625 from the Whitneys, \$76,156 from Max C. Fleischmann, \$67,706 from the J. P. Morgans, \$59,500 from the Guggenheims, \$59,000 from the Milbanks, \$55,000 from George F. Baker, and \$50,000 from William Randolph Hearst.

The Democratic party received \$770,218 from labor organizations, \$102,500 from Walter A. Jones, \$51,000 from James W. Gerard, \$50,000 apiece from Henry L. Doherty and Mrs. Doris Duke Cromwell, \$26,500 from the Joseph E. Davies, \$26,000 from the Schencks, \$25,000 apiece from Curtis Bok, M. D. Biddle, and L. B. Manning, \$28,500 from the Reynolds Tobacco Co., and \$20,000 from Nathan and Percy Straus and Joseph M. Patterson, respectively. Lundberg, *America's Sixty Families*, 480-86.

⁵ Beard, *op. cit.*, 342.

spring he launched his hotly debated attempt to pack the Supreme Court, and induced Congress to pass substitute bills for the AAA, NRA, and other Acts declared unconstitutional by the Court. But he took no action on the wave of sit-down strikes which until the end of June spread unionization in so unorthodox and effective a manner as to arouse fears of a social revolution among conservatives. Then he spoke out against the strikers, despite the C.I.O. campaign contributions, by condemning them and their unreasonable employers as jointly responsible for the disturbed social scene.⁶

Roosevelt's Attack on Tax Avoidance and Evasion

Although the President in his Budget Message to Congress in April, 1937, warned that the deficit for the fiscal year would be great, he made no demand for immediate tax revision until June 1. Then he stressed the need for preventing evasion of the income tax laws and cited a letter from Secretary Morgenthau on eight devices for evading the income tax and three major instances of inequalities in the law which permitted individuals and corporations to avoid their equitable share of the tax burden. Eminent economic royalists were shown to have used legal but morally questionable means, such as foreign holding and insurance companies, domestic personal holding companies, family partnerships, multiple trusts for relatives and dependents, and pension trusts. In spite of the Court fight and strong opposition from the press and Republican Congressmen, a bill was passed by Congress which became law on August 26, 1937. The Revenue Act of 1937⁷ raised the tax rate on the undistributed adjusted net income of personal holding companies from 8 to 65 per cent on income not over \$2,000 and from 48 to 75 per cent on the amount over \$2,000. The definition of a personal holding company was changed so as to prevent a company from escaping by making slight changes in the character of its income. Similarly, personal holding company income was redefined to include gains from exchange of stock, income from estates or trusts and personal services or talents, compensation for the use of property, rents, and mineral oil or gas royalties except under certain conditions. New rules were laid down for taxing the undistributed income of foreign personal holding companies, for restricting permissible deductions for losses from sales or exchange of property, and for eliminating the \$1,000 exemption for-

⁶ *Ibid.*, 339-69, 535-43.

⁷ 50 *U.S. Stat. at Large*, 813; Blakey, *Federal Income Tax*, 428-35.

merly granted for trusts. Other provisions imposed a 10 per cent tax on income from United States sources received by nonresident aliens and dealt with the exemption of personal holding companies from the surtax for improperly accumulating surpluses and the provisions for mutual investment companies. Finally, an extension for two years was given to special taxes on specific goods and services, including the federal tax on gasoline, which were about to expire.

The 1937 Revenue Act was a step forward in closing some of the loopholes in the income tax laws, but it failed to deal with such important tax avoidance devices as tax-exempt securities, undistributed profits, capital gains, single premium life insurance policies issued by fictitious companies, pension trusts, community property laws, percentage depletion, and multiple trusts for accumulating income. The new penalty rates on personal holding companies probably caused many of them to dissolve because of the expense. The tax leakage prevented by the 1937 law was estimated at \$50 to \$100 million, but tax attorneys still saw plenty of ways for their clients to escape paying the price for civilized society.⁸

New Deal Tax Concessions to Business in 1938

After Congress had ended the memorable session in which the Court fight and the attack on tax evasion had taken place, a business recession set in. The special session called by Roosevelt for November, to consider a national hours and wages bill and other measures, dissolved in December with very little accomplished because of conflicts within the Democratic party between the conservatives and the liberals. When Congress reassembled early in January, 1938, it received no proposals from the President for extending the New Deal program or tackling the recession. But the campaign against the undistributed profits tax which corporations and businessmen had been waging since 1936 now had the opportunity to achieve its goal. The House Ways and Means Committee presented to the House a bill with a much-reduced surtax on undistributed corporate profits and a new penalty tax on closely held corporations. The House, influenced by conservative arguments, refused to accept this new tax but approved most of the other provisions in the bill. The conservatives in the Senate, headed by Pat Harrison of Mississippi, redrafted the House bill and completely eliminated the undistributed profits tax.

⁸ R. G. and G. C. Blakey, "Revenue Act of 1937," *American Economic Review* (December, 1937), 27: 702-04.

Although La Follette and Democratic leader Barkley protested against this omission, the Senate gave its approval. A compromise was worked out between the House and the Senate by means of which the House secured the retention of the reduced undistributed profits tax, but the Senate succeeded in limiting its operations to the years 1938 and 1939. The President was greatly disappointed by Congress's action, and on May 27, 1938, he broadcast a speech in which he expressed his disapproval of the curtailment of the undistributed profits tax and the treatment of capital gains. Like Cleveland when confronted by the 1894 tariff bill, Roosevelt escaped the dilemma of signing or vetoing the bill by allowing it to become law without his signature.⁹

The Revenue Act of April 26, 1938,¹⁰ although its most conspicuous feature dealt with the tax on undistributed profits, was a comprehensive tax law and superseded all prior acts. The 1936 special surtax on undistributed corporate net income had ranged from 7 per cent on the first 10 per cent of income retained to 27 per cent on the income retained in excess of 60 per cent of the total income. Joined to this tax was the normal tax on corporate net income which was graduated from 8 per cent on the first \$2,000 of net income to 15 per cent on the amount over \$40,000. The 1938 statute provided that corporations earning \$25,000 or less were to pay a tax of 12½ per cent on the first \$5,000 of net income; 14 per cent on net income over \$5,000 and not over \$20,000; and 16 per cent on the next \$5,000. Corporations earning more than \$25,000 of net income were to pay a tax graduated from 16½ per cent to 19 per cent in accordance with the percentage of profits retained. This provision was to apply only to the years 1938 and 1939. The maximum penalty for the retention of profits thereby became 2½ per cent of adjusted net income. In the 1936 law the maximum had been 27 per cent. Corporations with net incomes just over \$25,000 were allowed to pay the above rate or an alternative one computed by an intricate method, whichever was lower. Special treatment was provided for banks, insurance companies, and mutual investment companies.

The penalty surtax on improperly accumulated corporate surplus was increased from 15 to 25 per cent on the first \$100,000 of retained income and from 25 to 35 per cent on the amount over \$100,000. The burden was also placed on the taxpayer of proving that the surplus was not accumulated to prevent the imposing of the personal income surtax on individual shareholders. The surtax on personal holding

⁹ Blakey, *Federal Income Tax*, 436-53.

¹⁰ 52 *U.S. Stat. at Large*, 447.

companies was kept at the same rates as in the 1936 statute, but some relief provisions were granted while the definition of a personal holding company was extended to include the smaller transportation companies. The capital-stock and excess-profits tax rates of 1936 were left unchanged and their provisions only slightly amended.

The only important change in the tax on individual income related to the computation of taxable gain or loss from the sale of capital assets. The 1934 method for taxing capital gains had depended upon the time the asset was held before the gain was realized. Gains from assets held for less than one year had been taxed on a 100 per cent basis; gains from assets held one to two years on an 80 per cent basis, with a proportional decline to 30 per cent on gains from assets held ten years or longer. This procedure was discarded after four years because of its alleged effect in influencing artificially the holding and sale of securities. The 1938 plan is similar in its main outlines to the plan which was in effect for ten years or more prior to 1934. Under the 1938 law, capital gains and losses for individuals were grouped in two separate classes: those arising from the sale or exchange of short-term assets, held eighteen months or less; and those arising from assets held more than eighteen months.

Short-term capital gains were taxable in full at the regular normal and surtax rates. Short term capital losses were allowed only to the extent of short-term capital gains, but, if these losses exceeded the gains in any one year, the net loss was allowed to be carried forward for one year to an amount not in excess of the net income for that year. The following percentages of the gain or loss from the sale of a long-term capital asset were to be taken into account in computing net income: 66 $\frac{2}{3}$ per cent if the asset had been held for more than eighteen months but not for more than twenty-four months; 50 per cent if the asset had been held for more than twenty-four months. Long-term capital losses were deductible only from long-term capital gains, and no carry over of net long-term capital losses was permitted.

The individual taxpayer was given the privilege of reducing his taxable income by the amount of his net long-term capital gain, on which he was to pay 30 per cent if this, plus his normal tax and surtaxes, would be less than paying on the entire amount at the normal and surtax rates. In the case of a net long-term capital loss, the amount of the loss had to be added to net income and 30 per cent of the amount of the loss deducted from the tax. Corporations were allowed to offset capital gains against capital losses only to the extent of \$2,000,

and were not given the benefit of the carry-over accorded to individuals.

No changes were made in the federal estate and gift taxes except that the annual gift tax exemption for donors of individual gifts was reduced from \$5,000 to \$4,000 for each gift, and gifts in trust were allowed no exemption. A total exemption of \$40,000 each for estate and gift taxes was allowed as before. The importance of these taxes as checks upon the future centralization of wealth was underlined for the general public by rumors that John D. Rockefeller and Andrew W. Mellon had been able to escape the transfer of wealth to the state through large gifts and endowments which had reduced their taxable estates in 1937, the year of their death, to about \$25 million and \$37 million respectively.¹¹

Various "nuisance" taxes, first levied in 1932 as emergency measures, were repealed, but the tax on distilled spirits was increased from \$2.00 to \$2.25 a gallon. Among the finance provisions which the President recommended but which failed to be passed were taxation of income from public securities and the salaries of governmental employees, federal assistance to states for public school education, and legislation aimed at the prevention of profiteering in time of war and the equalization of the burdens of possible war. The Roosevelt administration was especially disappointed by the failure of Congress to enact a special tax of 20 per cent on the income of closely held corporations whose stockholders greatly increased their wealth year by year without paying to the government more than a normal corporation tax, and who escaped very large sums of personal income tax payments.

The judgment of some tax authorities on the Act was that the revision of the profits tax and the capital gains and losses provisions were in themselves no guarantee of recovery, but might help to transform a coming recovery into a longer lasting prosperity. But they felt that the recovery would be initiated by other factors and that the tax revision would not lead to new large capital investments so long as tax-exempt securities attracted the taxpayers of the higher income brackets.¹² On the other hand, economists critical yet favorable to the New Deal, such as Alvin A. Hansen of Harvard, pointed

¹¹ Myers, *Hereditary American Fortunes*, 360-61.

¹² Gerhard Colm, "The Revenue Act of 1938," *Social Research* (September, 1938), 255-82. Cf. G. Colm and Fritz Lehmann, *Economic Consequences of Recent American Tax Policy* (New York, 1938) and Schumpeter, *Business Cycles*, 2: 1040ff.

out that American corporations tended to retain too large a percentage of their earnings and that a tax on excessive undistributed profits would act as an incentive to investment in plant and equipment. The tax would also help to achieve equality of taxation between partnerships and corporations and to prevent tax evasion by wealthy individuals. They also asserted that the business recession in 1937 was not due mainly to the undistributed profits tax and that its partial or complete repeal was no guarantee of continued prosperity.¹³ The taxation of capital gains as part of taxable net income they defended as not affecting in any important way new capital investments because anticipatory real investments were being predominantly made by large corporations out of their surplus earnings. The various changes in the capital gains and losses provisions were regarded as distinct improvements in the main, although certain arbitrary distinctions and the limited carrying forward provisions were criticized.¹⁴

Deficit Spending in 1938-39

While Congress was trying to check the course of the business recession of 1937 through its tax revision statute of April 26, 1938, Roosevelt had become convinced of a different solution. Such New Dealers as Thomas Corcoran, Benjamin Cohen, Leon Henderson, Isador Lubin, Robert Jackson, and Herman Oliphant succeeded in persuading him of the need for renewing large public spending and for an attack upon the evils of monopolistic control in industry. On April 14 Roosevelt renewed the program for deficit spending which he abandoned late in 1936 and 1937 in an effort to balance the budget and to conciliate private business. He informed Congress in a special message that the administration was not responsible for the recession, declared that the federal debt could only be paid if the nation received a vastly increased citizen income, and asked that more money be put in the hands of the consuming public through additional appropriations to the WPA, the Farm Security and National Youth Administrations, the CCC, and the RFC. He announced that additional bank resources available for the credit needs of the country would be created through the desterilization of about \$1,400 million of Treasury gold. He also called for an increase in the national purchasing power through the construction of additional housing proj-

¹³ Alfred G. Buchler, *Public Finance* (New York, 1940), 548-49; Hansen, *Fiscal Policy and Business Cycles*, 383-89.

¹⁴ *Ibid.*, 389ff.; Blakey, "Revenue Act of 1938," *American Economic Review* (September, 1938), 28: 456-58.

ects, the renewal of public works projects, additional highway appropriations, and flood control measures.

Congress enacted legislation conforming to the President's wishes in all important matters affecting deficit spending, while going counter to his wishes in the capital-gains and profits-tax revision. The consequence of these and later huge expenditures was that production and the national income started slowly upward from July, 1938, and rose continuously, although irregularly, until September, 1939. The outbreak of the second World War changed the economic situation and caused a shift from recovery to defense financing. But there can be little doubt that the expansion of governmental expenditure in 1938 and 1939 played an important role in checking the recession and bringing about business revival.¹⁵

The deficit spending policy which Roosevelt embarked upon was not based upon the same theory as the 1933-35 spending program. That was pump-priming, deficit spending undertaken as a means of promoting recovery by stimulating private investment which was temporarily depressed. The basis for the new spending program was the theory that deficit spending was needed to compensate for the lack of private investment, the incapability of private capitalism to provide full employment. John Maynard Keynes's intellectual bombshell, *The General Theory of Employment, Interest, and Money* (1936), furnished the justification for the New Deal economists who argued that the monopolistic structure of the American economy and the accompanying overconcentration of wealth and income made necessary deficit spending—as long as underemployment prevailed—and measures designed to correct the centralization of economic power.¹⁶

Two weeks after the inauguration of the new spending policy, Roosevelt sent to Congress a notable plea for an investigation into the growing concentration of private wealth and power in the United States and laid down a program for the restoration of a democratic competitive order. This was the foundation for a vigorous assault upon the bottlenecks of business under the lively direction of Thurman Arnold—an assault which may vindicate the seemingly passé ideals of Brandeis and the elder La Follette, but which has to combat the influences unleashed by America's participation in the second World War. After Congress adjourned in June, Roosevelt launched

¹⁵ *New International Yearbook*, 625-31, 744ff.; Villard, *Deficit Spending*, 333-41. Joseph Alsop and Robert Kintner, *Men Around the President* (New York, 1938).

¹⁶ Williams, "Deficit Spending," *op. cit.*, 57ff. Cf. Arthur E. Burns and Donald S. Watson, *Government Spending and Economic Expansion* (Washington, D.C., 1940).

a campaign to purge the conservative Democratic Senators and Congressmen who had helped to defeat the New Deal policies after 1936. Although he had little success in swinging the votes against his opponents in the 1938 fall election, he regarded this attempt as necessary to preserve the integrity of the New Deal program.¹⁷

The tax legislation passed by Congress in the spring of 1939 reflected the reform spirit of Roosevelt and the conservative tendencies of the Congress elected late in 1938. In his annual message to Congress on January 4 Roosevelt defended the New Deal and urged a program of national defense against the threat of the fascist dictatorships. The next day he sent to Congress a notable Budget Message for the fiscal year 1940. He estimated that the total expenditures would amount to about \$9 billion, including more than \$1,390 million for national defense and over \$2,266 million for recovery and relief. His critics criticized his spending policy as based on the gospel that "it is the deficit of today that makes possible the surplus of tomorrow." But Roosevelt frankly accepted the Keynesian thesis about the stagnation of private investment and the desirability of using deficit spending as a lever for raising the national income. "If government activities are fully maintained," he contended, "there is a good prospect of our becoming an \$80 billion country in a short time. With such a national income, present tax laws will yield enough each year to balance each year's expenses."¹⁸

The conflict between Roosevelt's spending theory and the orthodox views of conservative Democrats and Republicans came to a head in a few months. On May 22 the President defended his spending policy, ridiculed the "economy bloc," and declared that his opponents were the radicals and his New Deal adherents the conservatives so far as the preservation of the capitalistic system is concerned. A month later he announced a new \$2,800 million "investment" or self-liquidating expenditure plan. This was cut in half by the Senate and rejected completely by the House as being too radical a break with "sound" public finance. Yet, although Congress pleased the majority of businessmen by opposing Roosevelt on this and other New Deal measures, it authorized the expenditure of more than \$13 billion, including nearly \$2 billion for defense and \$1,775 million for relief, a record peacetime total. Of this amount, roughly \$10½ billion was earmarked for spending for the calendar year 1939, but the actual

¹⁷ Beard, *op. cit.*, 371-80; *New International Yearbook*, 1938, 743-45, 759.

¹⁸ *New York Times*, January 5, 6, 1939.

net expenditure was about a billion less because of the self-liquidating post-office appropriations.¹⁹

Tax Codification

To swing the gigantic expenditures needed for defense, relief, and ordinary (the normally accepted) government activities, the Roosevelt administration relied upon the already established taxes and direct borrowing in the money market. On February 23 Secretary Morgenthau attempted to conciliate business by predicting no new taxes and hinting at modification of the existing taxes. The next day Harry Hopkins, who had been made Secretary of Commerce in January, continued this conciliation policy by presenting a program designed to encourage private capital to invest through a revision of taxes, which tended to freeze necessary flow of capital. In this same period was achieved the simplification of the federal income tax law through an Internal Revenue Code. This removed the inconsistencies in the various laws and simplified the references from one to another. This legal achievement was accomplished through the work of the Joint Committee on Internal Revenue Taxation, the Treasury, and the Department of Justice. The Code became law on February 10, 1939.²⁰

Taxes on Government Salaries and Tax-Exempt Securities

The next tax measure adopted was the Public Salary Tax Act of April 12, 1939. Previously the federal income tax had not been imposed upon the salaries of state officials and employees or of federal judges taking office on or before June 6, 1932, or on interest from many federal, state, territorial, and municipal securities. The Treasury estimated in 1939 that at least \$16 million of additional revenue would be collected from the taxable incomes of state and local employees. No estimate had been made of the amount of state income taxes payable by federal employees. The net volume of securities which were partially or totally exempt from the federal income taxes had grown from \$5,283 million in 1914 to \$65,600 million in 1939. Individuals held an estimated \$19 billion of all such issues, or 29 per

¹⁹ *Ibid.*, May 23, June 23, August 1-3, 1939; January 2, 1940; *New International Yearbook*, 1939.

²⁰ *New York Times*, February 24, 25, 1939; 53 *U.S. Stat. at Large*, Part I.

cent. Large estates of \$100,000 and over held most of the tax-exempt securities issued. Estates over \$1 million held 62.8 per cent of wholly exempt federal bonds, 56.8 per cent of all state and local bonds, only 21.5 per cent of taxable private bonds, and 42.4 per cent of capital stocks. Wealthy individuals were able to sacrifice on part of their holdings high interest rates and speculative returns for assured incomes and freedom from high taxation. By 1937 active banks and insurance companies had also come to own more than 37 per cent of all tax-exempt government securities.

Such tax exemption of government securities favored the wealthy by breaking down the progressive character of the income tax-rate structure. For a married man with a net income of \$500,000, a 3 per cent, fully tax-exempt security afforded the same return after payment of his federal income tax as a taxable security yielding 10.7 per cent. On the other hand, for a man with an income of \$5,000, a 3 per cent, tax-exempt security was the equivalent of only a 3.2 per cent taxable security. The discontinuance of such tax exemption, the Treasury contended, would promote social justice and at the same time would greatly increase government revenues. The opposing side, represented most prominently by Professor H. L. Lutz of Princeton, defended the continuance of tax-exempt securities on the highly debatable ground that they lowered the costs of government, did not interfere with the normal flow of risk capital, and did not seriously affect the progressiveness of the income tax.²¹

Roosevelt had recommended to Congress as early as June 19, 1935, that these tax exemptions for government securities and salaries be ended. When Congress failed to submit to the states a constitutional amendment embodying his proposal, he suggested on April 25, 1938, legislation ending these exemptions for the future. This was in line with recommendations which had been made by Presidents Harding and Coolidge and all the Secretaries of the Treasury since 1919, but Congress took no effective action until 1939. In 1938 the Supreme Court handed down two important decisions which greatly modified the intergovernmental tax immunity which the Court had built up over the past century.²² The Court upheld the imposition of a federal income tax on employees of the Port of New York Authority and the levy of a federal excise tax on admissions to state university football

²¹ Anderson, *Taxation, Recovery, and Defense*, 189-99. Cf. H. L. Lutz, *Fiscal and Economic Aspects of the Taxation of Public Securities* (New York, 1939); Tax Policy League, *Tax Exemptions* (New York, 1939).

²² Department of Justice, *Taxation of Government Bondholders and Employees*, 191ff.

games.²³ These decisions reflected the position taken by Justice Holmes in 1928: "This Court . . . can defeat an attempt to discriminate or otherwise go too far without wholly abolishing the power to tax. The power to tax is not the power to destroy while this Court sits."²⁴

These decisions inspired Roosevelt to ask Congress in January, 1939, for immediate legislation which would make subject to federal and state taxes private income from all future government salaries and from all government securities thereafter issued. He exposed the hitherto prevailing judicial distortion of the Income Tax Amendment with the pointed statement: "It is difficult for almost all citizens to understand why a constitutional provision permitting taxes on 'income from whatever source derived' does not mean 'from whatever source derived.'" ²⁵ Shortly after this the Court struck another powerful blow at the exemption of governmental salaries from taxation. By a 6 to 2 vote, the Court sustained a New York State tax on the salary of an employee of the Federal Home Owners' Loan Corporation.²⁶ This meant that the Court through the accession of New Deal judges had become so liberalized that it would not raise a constitutional prohibition against the application of the federal income tax to state bondholders, officers, and employees. Although the spokesmen for the Roosevelt administration urged Congress to draft a comprehensive statute so that all disputed questions of constitutionality could be argued before the Court, Congress passed a measure which lacked any provision taxing income from governmental securities. This omission was due to a desire to avoid arousing too powerful state opposition and to avoid pressure from conservative investors in tax-exempt securities. The bill became law on April 12, 1939.²⁷

The Public Salary Tax Act ²⁸ provided that the federal income tax should be extended to the salaries paid after January 1, 1939, by the states and their political subdivisions, and to the compensation of federal judges who took office before June 6, 1932. The consent of the United States was given to nondiscriminatory state taxation of the compensation of federal employees and officers received after December 31, 1938. The Act also specified that no tax upon the compen-

²³ *Helvering v. Gerhardt*, 304 U.S. 405; *Allen, Collector v. University of Georgia*, 304 U.S. 439.

²⁴ *Panhandle Oil Co. v. Knox*, 277 U.S. 218.

²⁵ *New York Times*, January 20, 1939.

²⁶ *Graves v. O'Keefe*, 306 U.S. 466.

²⁷ *Blakey, Federal Income Tax*, 454-71.

²⁸ 53 *U.S. Stat. at Large*, 574.

sation of state officers and employees was to be collected for any taxable year beginning prior to January 1, 1939. The states were forbidden to tax the compensation of federal officers and employees received prior to the same date.

The new source of revenue open to the federal government by this statute was important as indicating a departure from the traditional independence of the federal and state governments and the practice of intergovernmental tax immunity. But the amount of revenue which this new source would yield was not very large, and the really tremendous revenues from tax-exempt securities were not even tapped at a time when they would have been of great aid to both the federal and local governments.

Repeal of the Undistributed Profits Tax

While the Public Salary Act was a partial victory for the Roosevelt attack on the tax-exempt groups, the Revenue Act of June 29, 1939, was not. The campaign by big business against the undistributed profits tax was continued even after the great reduction in the rates imposed by the 1938 Revenue Act. Their desire to be free of New Deal social controls and the hangover from the 1938 recession led spokesmen for such pressure groups as the National Association of Manufacturers and the United States Chamber of Commerce to appear before the House and Senate committees which were considering tax bills. They argued that corporations were being penalized for following businesslike methods and that corporations should be encouraged to save for a rainy day. G. H. Houston, president of the Baldwin Locomotive Works, said the levy would help destroy the system of private enterprise. Winthrop W. Aldrich, of the Chase National Bank, and Owen D. Young, of General Electric, testified that the tax would hinder the flow of investment capital.²⁹ Their views were shared by Secretary Morgenthau and Undersecretary John W. Hanes, who favored close co-operation with the business community.

Roosevelt, however, insisted that the undistributed profits tax be continued unless Congress could find a substitute which would encourage distribution of dividends as well. The resulting log-jam was broken only when Roosevelt yielded on the retention of the tax in exchange for Congress's strengthening the penalty sections for undue accumulation of corporate surpluses. After such an understanding was worked out through the mediation of Morgenthau and Hanes, Con-

²⁹ Blaisdell, *Economic Power and Political Pressures*, 119-20.

gress passed its tax revision bill without much debate and with practically no opposition.³⁰

The new Revenue Act³¹ had as its chief feature the repeal of the undistributed profits tax. The tax rates on individual income remained the same as those in the 1938 Act, except for the provisions on capital gains and losses. With the abandonment of the profits surtax, the 1938 flat-rate tax of 16½ per cent on corporate income was raised to a flat rate of 18 per cent on all corporations with net incomes over \$25,000. But these corporations were also given the alternative of a tax of \$3,525 plus 32 per cent of the amount of the normal tax net income in excess of \$25,000, if that amount were lower than the flat tax. For corporations with net incomes of not more than \$25,000, the 1938 graduated tax range from 12½ to 16 per cent was retained.

Congress also liberalized the treatment of corporate losses. Long-term capital losses of corporations were allowed to be deducted not only from long-term capital gains, but also from other income. The deduction of short-term capital losses was permitted only to the extent of short-term capital gains. Corporations were also granted permission to carry over their net short-term capital losses to the succeeding taxable year. Moreover, the restriction of deductible corporate capital losses to the amount of the gains plus \$2,000 was repealed, except for domestic and foreign personal holding companies. Individuals and corporations, with a few exceptions, such as mutual investment and personal holding companies, were allowed to carry over their net operating losses from a trade or business for two years, beginning in 1940. In order to protect authors and others who realize in one year all or most of the income from the work of several years, a new provision was enacted. This levied a tax on individual compensation received in one year for personal services covering a five-year period or more, so that after December 31, 1938, the tax would not be greater than the sum of the taxes which would have been levied if the compensation had been received in equal annual portions over the period covered.

No changes were made in the rates of the estate and gift taxes or of the capital-stock and excess-profits taxes. Corporations were permitted to make a new declaration of capital-stock value for 1939 and 1940, but not to decrease the value. The existing excise taxes and postal rates were left unchanged and were extended in most cases to 1941.

³⁰ Blakey, *op. cit.*, 471-77.

³¹ 53 *U.S. Stat. at Large*, 862.

Evaluations of the Revenue Act depended in large part upon the attitude taken toward the undistributed profits tax. Such economists as Professors James D. Magee and Joseph A. Schumpeter approved its abolition as an aid to capital expansion and business enterprise in general.³² Other authorities, such as Professors Buehler and Hansen, defended the tax vigorously as a regulatory measure and as a revenue measure, if moderately assessed.³³ On the question of the changes in the capital gains and losses provisions, nearly all the experts agreed as to their desirability.

A month after the passage of the 1939 Revenue Act Congress passed a bill amending the Social Security Act. This was another effort on the part of the Treasury to conciliate business. The most important changes were the reduction in the tax for contributory old-age insurance and the decrease in the size of the old-age reserve fund. These amendments also won the approval of liberals and radicals who criticized the payroll taxes as bearing too heavily upon the workers and consumers and thereby retarding recovery.

³² H. G. Moulton, J. D. Magee, and C. Lewis, *Capital Expansion, Employment, and Economic Stability* (Washington, D.C., 1939); Schumpeter, *op. cit.*, 1030-42.

³³ Buehler, *Public Finance*, 544-49; Hansen, *op. cit.*, 383-89.



America Faces the Second World War

THE entire American economy and political system was affected most profoundly when the German invasion of Poland on September 1, 1939, at last fully launched the second World War. One essential element in the foreign policy of the Roosevelt administration from March 4, 1933, has been a consideration for world economic recovery and peace. The Hull Reciprocal Trade Agreement Acts of 1934, 1937, and 1940, the recognition of Soviet Russia in November, 1933, and the Good-Neighbor Policy toward Latin-American countries had all been oriented in that direction. The Roosevelt administration, however, had dealt a heavy blow to international economic co-operation in July, 1933, when Roosevelt repudiated the program of the London International Economic Conference for currency stabilization because he desired to promote a speedy recovery within the United States through devaluation of the currency and a rise in domestic prices. This action accelerated the world-wide movement toward extreme nationalism and autarchy, and was not redeemed by the three-cornered currency stabilization program worked out in 1936 by the United States, England, and France.

Isolated America and the Threat of Fascism

The international position of the United States had been further complicated by a conflict within the United States on the question of what policies were most in accord with the national interests. The shadow of a second World War had been cast on Europe and America by Hitler's accession to power in 1933. The disillusionment of Americans with Wilsonian idealism, their lack of faith in the democratic character of the French and English governments, the Nye Committee's exposures concerning the important role of certain re-

actionary groups in our past foreign policy, and the widespread wish to save America before trying to save the world—all these and various other factors led many to an isolationist foreign policy. The Johnson Act of April, 1934, prohibiting loans to any foreign government in default to the United States, the first Neutrality Act, forbidding the export of munitions to belligerents, and the resolution of February, 1936, putting a ban on American loans to belligerents were all designed to keep the United States out of foreign entanglements.

Roosevelt opposed this isolationist trend, out of hatred for the menace of fascism to American security, to world civilization, and to his most cherished social ideals. Nevertheless, he consented to the January, 1937, ban by Congress on the export of munitions to a country at civil war and thereby helped to overthrow the Spanish Loyalist government. In doing this, he went counter to his general policy of opposition to the fascists because of the pressure from pro-Franco groups in the United States and from the Conservative government in Great Britain. In May, 1937, Congress made travel by American citizens on belligerent vessels unlawful as an additional safeguard against American involvement in war.

But this series of measures designed to isolate and insulate the United States became increasingly impaired after the spring of 1938. The seizure of Austria by Germany in March, Hitler's threats over the Sudetenland, the Munich Pact of September 29-30, 1938, German annexation of Czechoslovakia in March, 1939, Italian conquest of Albania in the following month, the Nazi Soviet Pact of August, 1939, German invasion of Poland on September 1, and the declaration of war on Germany by Great Britain and France two days later gradually awakened the United States to the need for a change in its foreign policy.¹

On September 21, 1939, Roosevelt urged Congress to repeal those provisions of the Neutrality Act under which he had been compelled to proclaim an embargo on arms, munitions, and airplanes intended for England, France, and other belligerents in the European War. His denunciation of the arms embargo as most vitally dangerous to American neutrality, security, and peace led Congress on November 3 to open the American munitions trade to belligerents on a cash-and-carry basis. The international situation grew darker, however, with

¹ Beard, *America in Midpassage*, 381 ff., gives a critical interpretation of Roosevelt's foreign policy from the point of view of a continental or hemispheric defensive policy. Raymond Leslie Buell, *Isolated America* (New York, 1940) presents the case for American participation in the war against fascism.

increasing rapidity. At the end of November Soviet Russia invaded Finland in an attempt to gain territory Russia felt was necessary for its protection against Germany. But Russia's resort to *Machtpolitik* was outdone when Germany invaded Denmark and Norway in April, 1940, and then overran Holland and Belgium in May. By June the German military machine had smashed the defeatist French government into submission and had forced the British army into a gallant but disastrous retreat from the European continent. From July, 1940, until June, 1941, England withstood German air attacks on the British Isles and on the approaches to its empire in the East without the military assistance of any major power.²

Defense Expenditures and Taxes

These cataclysmic changes provided the setting in which the federal expenditure-revenue policies of 1940 and after were worked out. Roosevelt in his Budget Message to Congress on January 4, 1940, estimated that the net deficit for the fiscal year ending June 30, 1941, would be \$2,876 million and that the 1941 national defense expenditure would be about \$1,940 million. But the defense expenditure estimates were raised in June to \$3,250 million and in August to \$5 billion. By August 5, 1940, Congress appropriated over \$14 billion for defense purposes, not including the cost for compulsory military training and for putting the National Guard into active military service. Secretary Morgenthau felt these appropriations endangered the \$45 billion debt limit and feared that they would reduce the \$1,300 million working balance for the Treasury that spring.

The President had given a persuasive and able justification of the deficit spending policy and had advocated that specific tax legislation be enacted to finance the emergency national defense expenditures of \$460 million for the fiscal year 1940-41, but Congress disregarded his request until late in May. Under the spur of the German invasion of Holland and Belgium, and of a special plea by Roosevelt on May 16, Congress overcame its economy-mindedness and drafted a bill raising the national debt limit by \$3 billion and increasing the federal revenue by more than a billion dollars. The debate in Congress was limited, except for some lively discussion in the Senate on the proposal by Connally of Texas for special income taxes with very high rates to go into effect upon America's entering into war, and on La Follette's suggestion for a tax on corporate excess profits similar to those in oper-

² *New York Times*, September, 1939-June, 1941, *passim*.

ation in 1918. Neither of these measures was embodied in the law signed by the President on June 25, 1940.³

The first Revenue Act of 1940⁴ made "permanent" income tax changes, imposed "temporary" (five-year) defense taxes, authorized \$4 billion of defense obligations, and amended the Public Salary Act of 1939. The income tax changes involved reduction of the personal exemptions from \$2,500 to \$2,000 for a married person or head of a family and from \$1,000 to \$800 for single persons. The \$400 credit for each dependent remained untouched. The surtax rates on the incomes of individuals were increased on the surtax net income over \$6,000 and not over \$100,000. Despite the fact that the rates on incomes above \$100,000 were not raised, those with such incomes paid higher taxes on their total income because of the additional levy on the lower brackets of their incomes. The tax rates on corporate net income were increased by 1 per cent to a graduated range from 13½ per cent on the first \$5,000 net income to 19 per cent on the net income over \$25,000.

The "temporary" defense taxes, levied for a period of five years, were mainly increases of 10 per cent in the tax rates on individual and corporate incomes, gifts, estates, excess profits, capital stock, and personal holding companies. The rates of forty-three excise taxes were raised from 10 to 50 per cent, and the taxes on such luxury and consumption goods as distilled spirits, wines, cigarettes, and playing cards were raised from about 8 to 30 per cent. The revenue yield from these defense taxes for a full fiscal year was estimated at \$679 million. The revenue from the defense taxes was to be set aside by the Secretary of the Treasury for retiring the \$4 billion of short-term public debt obligations, with maturities not exceeding five years. Finally, the Act amended the Public Salary Act so as to prevent the application of penalties for tax deficiencies due from state and local officers for any tax year beginning before January 1, 1939, provided that the deficiency was attributable to compensation paid indirectly by the United States.

The June, 1940 Revenue Act was criticized by liberal economists for making a flat 10 per cent increase in the surtax rates and adding a defense tax of 10 per cent on the total tax as accentuating rather than correcting the existing inequities. Congress especially favored net incomes ranging from \$5,000 to \$50,000, favored those from \$50,000

³ R. G. and G. C. Blakey, "Two Federal Revenue Acts of 1940," *American Economic Review* (December, 1940), 30: 724-28.

⁴ 54 *U.S. Stat. at Large*, 516.

to \$100,000, and left almost untouched incomes from \$2,000 to \$5,000. No excessive taxes were imposed upon those with net incomes above \$100,000.⁵ These defects in the Act provoked Senator La Follette into calling it: "The most inequitable tax bill enacted by Congress in the last decade."⁶

The Revival of the Excess-Profits Tax

The increasing danger of American involvement in a war against Nazi Germany, especially after the collapse of France in mid-June, stimulated the movement for the prevention of war profiteering. After the first World War the American Legion had sponsored a series of bills designed to tax all wartime incomes at rates which would take practically all profits above a very modest minimum. The bills introduced in Congress from 1935 on by Congressman McSwain and Senators Nye and Bone were designed to tax all or nearly all wartime profits and to prevent the creation of another set of war millionaires.⁷

During the June, 1940, Congressional debate on the National Defense Tax bill the Senate Naval Affairs Committee discovered that the navy had awarded, without competitive bidding, a billion dollars' worth of shipbuilding contracts on the first World War basis of costs plus 10 per cent. Congress thereupon revised the Vinson-Trammell Act of 1934 so as to lower the profit limits on plane and ship contracts, of 12 and 10 per cent respectively. The Act of June 28, 1940, reduced the profit limitation to 8 per cent on the cost of competitively bid contracts and 7 per cent on those negotiated privately. These limitations applied not to the return on capital, but to the margin of profit on the contract, and the profit permitted was clear profit. The government agreed to cover the cost both of the work done and of any additional facilities needed. But those with shipbuilding and plane interests objected strenuously to the curb on the profit incentive and indulged in what radicals called a sitdown strike of capital.⁸

On July 1 Roosevelt sent a special message to Congress requesting the immediate enactment of "a steeply graduated excess-profits tax, to be applied to all individuals and all corporate organizations without discrimination." This was in accord with the promise he had made

⁵ Anderson, *Taxation, Recovery and Defense*, 262.

⁶ Stone, *op. cit.*, 163.

⁷ Tobin and Bidwell, *Mobilizing Civilian America*, 187-91. Cf. Arthur Feiler, "Conscription of Capital," *Social Research* (February, 1941), 8: 1-23.

⁸ I. F. Stone, *Business as Usual* (New York, 1941), 160-65.

on May 22 that "Not a single war millionaire will be created in this country as a result of the war disaster." But on July 10 the pressure from the plane and ship interests induced the President to promise the repeal of the June 28 profit limits. He also agreed to pass laws which would enable companies building new plants or installing new equipment to amortize them in five years. This provision would allow the companies to deduct 20 per cent of the cost of the new plant or equipment from their taxable net income. Nevertheless, the companies held back from signing government contracts because, some critics believed, they hoped to enjoy the new tax favors and to prevent passage of an excess-profits tax. If this was their strategy, it failed to prevent the passage of such a tax, but may have aided the introduction of various escape devices into the excess-profits tax law.⁹

Congress spent three months in debates, revision and compromise on the divergent plans of the Treasury, the House, and the Senate before it passed the first genuine excess-profits tax bill since 1921. It became law on October 8, 1940.¹⁰

The Second Revenue Act of 1940¹¹ suspended the 8, 10, and 12 per cent profit limitations imposed by the Vinson-Trammell Act of March, 1940, and by the Merchant Marine Act on contractors for naval vessels, airplanes, and certain other equipment. This suspension was intended to restore enough of the profit motive to cause an expansion of the defense industries. The normal tax on corporations with net income above \$25,000 was fixed for the taxable years after December 31, 1939, at the lesser of the following: (1) 22.1 per cent of normal tax net income, or (2) \$3,775, plus 35 per cent of the amount of normal tax net income above \$25,000. This and the defense tax of the First Revenue Act of 1940 made the total normal tax 24 per cent for such corporations.

All corporations not specifically exempted had to pay a tax on their adjusted excess-profits net income after December 31, 1939, at the following rates:

First \$20,000	25 per cent
Next \$30,000	30 per cent
Next \$50,000	35 per cent
Next \$150,000	40 per cent
Next \$250,000	45 per cent
Over \$500,000	50 per cent

⁹ *Ibid.*, 166-70; *New York Times*, May 23, July 2, 1941.

¹⁰ *Blakey, op. cit.*, 728-35.

¹¹ 54 *U.S. Stat. at Large*, 974.

A corporation's profits earned in fiscal years beginning after December, 31, 1939, were defined as excess if they exceeded a specific exemption of \$5,000 and a credit computed, at the choice of the taxpayer, by either the net income or invested capital method. The net income formula gave a credit of 95 per cent of the net income for the average base period (1936-39), plus 8 per cent of the net capital addition, or minus 6 per cent of the net capital reduction for the taxable year. Long term capital gains and losses were to be excluded in computing income, and credit for dividends received was to apply without limitation to the dividends of the stock of domestic corporations. The credit on the invested capital standard was 8 per cent of the taxpayer's invested capital for the taxable year. Half of the amount of the borrowed capital was to be included in computing invested capital, but long-term capital gains and losses were to be excluded. Affiliated corporations had the privilege of making a consolidated return for the taxable year, but only one specific exemption of \$5,000 was allowed for the entire affiliated group.

The crucial term "invested capital" was defined as ownership capital paid in (monetary and other forms) or accumulated during the life of the corporation, minus distributions not made from earnings; plus one half of the corporation's borrowed capital or funds; minus investment in the stock of other corporations and in securities the interest on which was not included for corporation income tax purposes. The 50 per cent limitation on borrowed capital was induced by the fear that corporations could too easily expand their borrowed capital for the sole purpose of avoiding the tax. Corporations with an excess-profits net income not above \$5,000 were exempt. No special provisions were made for monopoly elements already under regulation. Consequently a corporation might make a high rate of profit on that part of its capital devoted to meeting government contracts, yet escape the profits tax if the rest of its business pulled the average rate of return below the statutory percentage, or pulled the absolute amount below the level set by the base-period method.

The cost of "emergency facilities" certified as necessary for national defense, whether or not used directly for a government contract, might be written off in sixty months instead of having to be spread over a longer period under the ordinary provisions for depreciation and obsolescence. The ordinary federal income tax was deducted in arriving at income subject to the excess-profits tax. No averaging of income over two or more years was permitted, but Congress allowed a carry-over, not only of actual loss, but also, under the relief provisions enacted March 7, 1941, of the amount by which the profit fell

short of the normal profit. Such a loss or profit deficiency (from the taxpayers' point of view) could be carried forward as an offset against the income of the two succeeding years.

In general, as Professor Carl Shoup pointed out, the 1940 profits tax was designed primarily to reach profits which were due to the defense program and was not envisaged as a permanent part of the federal tax system. The tax was liberal to corporations which had reached a high degree of maturity by 1940, but it promised to weigh heavily on new corporations and in some cases on the expansion of existing corporations. The provisions for computing base-period net income were generous in comparison with the standard of the former profits taxes, but severe burdens were imposed on new firms through the use of an 8 per cent rate under the invested-capital option, the refusal to allow for variations in risk, and the steepness of the rate graduation. Professor Shoup suggested that more revenue might be obtained from the tax in the future by a decrease in the established rates and a greater insistence on the invested-capital method. The base-period method, he proposed, should be used only as an option in favor of the government, with adequate safeguards for the taxpayer, coupled with some increase in the percentage allowed as a standard return.¹²

Conflicting Forces in the 1940 Election

While Congress was debating the excess-profits tax, the 1940 presidential campaign got under way. The Republicans nominated Wendell L. Willkie, an able lawyer and public utilities executive, on a platform centered on the restoration of business freedom from governmental restrictions. The Democrats nominated Roosevelt for an unprecedented third term on a platform stressing the social welfare activities of the New Deal. Norman Thomas presented the Socialist party's program for the creation of a socialistic America through the democratic collectivization of the basic industries, which, he maintained, could be achieved only by America's keeping out of the European War. Meanwhile the Communist party repudiated its 1936 pro-New Deal position because of the change in Russian foreign policy, and renominated Earl Browder on a platform militantly opposed to American participation in the "imperialist" European war.

After one of the most virulent and passionately conducted cam-

¹² Carl Shoup, "Taxation of Excess Profits III," *Political Science Quarterly* (June, 1941), 56: 246-49.

paigns in American history Roosevelt was re-elected. He carried thirty-eight states with 449 electoral votes and overwhelmed his opponents. The Republicans and their affiliated organizations spent almost \$15 million in their effort to defeat the New Deal, while the Democrats and their allied groups spent almost \$6 million. These sums were the largest ever expended in a presidential election and were an indication of the intensity of feeling among the partisans of both sides. The Hamiltonian-Jeffersonian cleavage between the two groups which had become apparent in 1936 was carried even further in 1940. The Democratic party failed to regain the support of any of the bankers and brokers who had deserted the party in 1936, and lost that of most of the manufacturers. On the other hand, the Republican party received about the same percentage of its large contributions from bankers and brokers in 1940 as in 1936, and gained increased support from manufacturers. The main financial contributors to the Democratic party were officeholders, mostly diplomats, and organized labor. Among the others were brewers and distillers, oil men, newspaper, radio, and advertising interests, and professional men, mainly lawyers.¹³

The election of Roosevelt in 1940 determined that for four momentous years the major control would be vested in a party predisposed to a more equal division of wealth and power rather than in a party dominated by a Hamiltonian justification of great centralization of wealth and political power in the hands of an elite. But tied to the domestic issue of liberalism versus conservatism was the inescapable and interpenetrating question of foreign policy: Should the United States give financial and industrial aid to Great Britain and the other countries fighting Nazi Germany? Should the United States go to war if that were considered necessary to stop Nazi conquest? Roosevelt realized that the American people were not ready to go to war, but were responsive, as he put it in a speech on December 29, 1940, to a program of "dynamic non-belligerence," which included all possible aid to Great Britain and other foreign democracies.¹⁴

The American Defense Economy

The financial aid for which Britain had asked the United States early in December, 1940, was granted on March 11, 1941, when

¹³ Louise Overacker, "Campaign Finance in the Presidential Election of 1940," *American Political Science Review* (August, 1941), 35: 701-26; *New International Yearbook*, 1940.

¹⁴ *New York Times*, December 30, 1940.

Roosevelt signed the Lend-Lease Act. The German conquest of Greece in the spring of 1941 and the invasion of Russia on June 22 made the gigantic defense program which Roosevelt had persuaded Congress to launch in 1940 the most important factor in American life. The first peacetime conscription in American history began in October, 1940, and started the transformation of the United States into a military society as well as a defense economy. In the summer of 1941 the use of the American navy to convoy supplies to Iceland and the order "to shoot at sight" Nazi submarines was another step forward by the federal government toward active participation in the war against Nazi Germany.

To defeat Nazi Germany either through exclusively economic aid to Great Britain, Soviet Russia, and all other groups resisting the Axis Powers, or through military participation in the war, the United States was compelled to reorganize its economy. The major objective of this new war economy was the mobilization of all resources in order to have all the military and nonmilitary goods and services needed for helping others and ourselves to win victory. The momentous character of these problems has been appreciated by the Roosevelt administration and the intelligent public. The most sincere friends of democracy have realized that the character of our individualistic economy created difficulties and blocks to the needed economic expansion of output and calls upon all for a reconsideration of the implications of wide-scale economic planning. Moreover, along with the need for greater participation of labor and the consumer in the decisions on priorities of goods and services and conditions of production goes the question of prices and profits. The distribution of wealth and income is affected by the price and profits controls established, and human welfare is determined by the judgments reached on the relative importance of military versus nonmilitary commodities and services, of guns versus butter.¹⁵

In order to finance the tremendous purchases of guns, tanks, planes, ships, and other military equipment, Congress appropriated during the fiscal year of 1941 \$6,080 million, and during July and August, 1941, an additional \$2,084 million was appropriated. Even at that time, it was apparent that the annual defense expenditures for the coming years would be several times greater than the total cost of World

¹⁵ Cf. Seymour E. Harris, *The Economics of American Defense* (New York, 1941) and I. Mendershausen, *Economics of War*. F. Stone, *Business as Usual*, and Thurman Arnold, *Bottlenecks of Business* (New York, 1940), are scathing indictments of big business activities during the first year of defense.

War I.¹⁶ It was predicted that the minimum cost for World War II would be \$100 billion and that the cost might rise to several hundred billion. The ensuing developments made even these estimates seem conservative.

Plans for Financing the War

To the extent that a belligerent nation is unable to draw on stocks accumulated in the past, to find some other nation to pay for its war costs, or to shift the burden to future generations by depleting the national capital, the country has to carry its own burden. Various alternatives arise: resort may be had to taxes or loans, or to a varying ratio of one to the other. The type of tax chosen will determine on whom the burden is to fall. Taxes on individual incomes, inheritances, gifts, on corporate income or excess profits, on general sales or on specific lines of business differ in their effects. Similarly, one must distinguish between loans from the general public on a voluntary and a compulsory basis. Finally, the financing of government expenditures may be achieved through the issuing of paper money or through borrowing from the commercial banks and general public.¹⁷

Among the numerous plans for solving the fiscal problems of the war three stand out. One is that presented by John Maynard Keynes in his brilliant and provocative study, *How to Pay for the War* (1940). His project for adapting the distributive system of a free community to the limitations of war has three avowed objectives: 1. The provision of an increased reward as an incentive and recognition of increased effort and risk, to which free men unlike slaves are entitled. 2. The maximum freedom of choice to each individual of how he will use that part of his income which he is at liberty to spend. 3. Mitigation of the necessary sacrifice for those least able to bear it.¹⁸

The plan Keynes presented for achieving these objectives had four elements: 1. The withdrawal from immediate consumption of a part of each individual's income through forced government loans so as to prevent the accumulations of funds in the hands of consumers. These loans would be returned with interest after the close of the war, when the increased purchasing power thus made available would benefit the depressed economy. 2. The funds thus collected and used

¹⁶ National Industrial Conference Board, *Economic Record* (September 24, 1941), 3: 396; *New York Times*, January 8, 1942.

¹⁷ Albert G. Hart and Edward D. Allen, *Paying for Defense* (Philadelphia, 1941), 12; Mendershausen, *op. cit.*, 142-43.

¹⁸ J. M. Keynes, *How to Pay for the War* (New York, 1940), 7.

during the war would be paid after the war by a capital levy which would make it unnecessary to burden the nation with a staggering debt. 3. To protect people with very low incomes an exempt minimum is provided, a sharply progressive scale of deferred payments based on income increments would be used, with a system of family allowances to ease the burden on those who have no satisfactory margin above the barest necessities of life. 4. Provision for an "iron ration" of absolute necessities which would not be permitted to vary in cost or consumption as general prices change.¹⁹ 5. High progressive income taxation.

Another plan, which the Nye investigation brought before the public, was that presented by John T. Flynn, publicist and economist. His pay-as-you-go plan sought to eliminate the opportunity for swollen war profits, the economic dislocation of the war era, and the postwar calamity of deflation by requiring that no future war should be fought on borrowed money but should be paid for substantially by current taxes on corporate and personal incomes. He proposed an excess-profits tax on all profits above 6 per cent of the adjusted declared value of invested capital. The tax on personal incomes was to be such as not to permit even the topmost tax-free income to exceed \$10,000.²⁰

The third prominent plan was a flexible finance program to which contributions were made among others by Professors Gerhard Colm and Alvin Hansen, Dr. Richard Gilbert, and Marriner Eccles of the Federal Reserve Board. This plan had at least three distinguishable phases, each geared to fit into a different aspect of the changing economic situation resulting from the preparedness and defense program. The beginning period of the economic transformation for defense would require borrowing in the capital market and raising the debt limit in order to use great sums of money immediately for plant expansion, part payment of industrial orders, reorganization of the military services, and continuation and expansion of the public works vital to preparedness. The borrowing in the existing capital market could be done on the most favorable terms and would prevent restriction of mass purchasing power during the time the slack in employment was being taken up. The second defense period, characterized by high employment and use of resources, would permit a large proportion of the preparedness costs to be paid out of taxes on income and wealth.

¹⁹ J. M. Keynes, *How to Pay for the War* (New York, 1940), 8ff.

²⁰ Anderson, *Taxation, Recovery, and Defense*, 245-46; John T. Flynn, "An Approach to the Problems of War Finance," *Annals American Academy of Political and Social Science* (January, 1936).

Stress would be laid on increased use of the personal income and estates taxes and on a war excess-profits statute. The third period of full employment and maximum production for defense would involve incipient or actual scarcity, pressure for price rises, and the danger of inflation. To prevent this, it was proposed that the personal income tax be broadened by lowering exemptions and increasing rates, that the excess-profits tax be revised to curtail profits drastically, that high excise taxes be placed on automobiles, radios, gasoline, refrigerators, and other luxury consumption goods, and that a general "turnover" tax be enacted. This last tax was to be based on the "value added by manufacture," with tax credits allowed for federal and state payroll taxes in force, and tax exemptions for the necessities of life. The proposed tax rate would be 4 per cent at the beginning, but if more money were needed to supplement other revenues the rate would be advanced to obtain the required sum. In all three periods it would be probably necessary to borrow, but such loans would be made so far as possible from financial institutions in order to free their capital for social use.²¹

This type of flexible finance program was adopted by the President in his Budget Message to Congress on January 8, 1941, for the fiscal year ending June 30, 1942. He estimated the expenditures required for national defense for this period at \$10,811 million, and total expenditures for defense and nondefense activities at about \$17½ billion. Of this total 62 per cent was for national defense. The remainder was for ordinary governmental activities and for the continuance of the social security, agricultural, public works, and WPA programs. This preservation of the New Deal social services was consciously planned by Roosevelt as contributing to total defense in terms of the health and morale of the people and as continuing the reformist program he had espoused before 1940. On the momentous question of how to finance the national defense program Roosevelt said that a pay-as-you-go tax policy would involve very drastic and restrictive taxation, curtail consumption, and interfere with full use of productive capacities and idle labor. He therefore favored a financial policy aimed at collecting progressive taxes out of a higher level of national income. Although he had no complete estimate of the extraordinary taxes necessary to pay off the cost of emergency defense and to aid in avoiding inflationary price rises, he suggested that Congress enact additional tax measures based on the principle of the ability to pay and on readjustment of the federal-state-local fiscal system. The President also suggested that the statutory debt limit be raised, if not abolished,

²¹ Anderson, *op. cit.*, 246-49.

in order to permit the extensive borrowing needed to supplement the revenue from taxes.²²

Congress complied with the President's last request by passing an act, signed by the President on February 19, 1941, increasing the debt limit from \$49 billion to \$65 billion. The act also removed all exemption privileges from federal taxation for federal obligations. The speed with which Congress passed this measure was proof of the power that foreign danger had over the fears of most businessmen concerning the perils of a mounting public debt. On March 27 the President signed a \$7 billion defense bill intended to put into effect the Lend-Lease Act enacted two weeks before.²³

Action on Roosevelt's proposals for increased taxes began in the spring. The Treasury presented a program designed to raise about \$3,600 million of additional revenue through great increases in the tax rates on personal and corporate income, on estates, and on certain luxury and mass consumption commodities. The Treasury also demanded changes in the excess-profits law in order to reach over \$1 billion of hitherto exempted excess business profits. The House Ways and Means Committee, headed by Robert L. Doughton of North Carolina, adopted many of the Treasury proposals as modified by the criticisms of Leon Henderson and Marriner Eccles. But pressure from business groups led the Committee to reject the plea of the Treasury and the President to eliminate the "average-earnings" base-period method of computing excess profits. On August 4, 1941, the House passed Doughton's bill by a vote of 369 to 40. The bill was described as the greatest tax bill ever imposed by a civilization upon its people. The one important amendment to the bill made by the House was the elimination of the mandatory joint tax return by husband and wife, which the Committee regarded as an important means of reducing tax evasion.²⁴

The Senate Finance Committee, with the conservative Senator George of Georgia as its Chairman, changed the House tax bill in many respects. The Committee pleased the President by adopting his suggestion that the exemptions from the personal income tax be lowered. On the other hand, the Committee displayed its economic conservatism by dropping from the House excess-profits tax the special 10 per cent levy on companies making more profits than they had

²² *New York Times*, January 9, 1941.

²³ *Ibid.*, February 20; March 12, 28, 1941.

²⁴ *New York Times* and *PM*, August 8 to September 21, 1941. See Conference Board *Economic Record* (July 24, 1941), 3: 315-19, and Harris, *op. cit.*, 186-88, 321-27, for criticism of the bill.

been making before the defense emergency, but not enough to be subject to the regular 1940 excess-profits tax. The Committee also rejected the Treasury's suggestion for curbing inflation through taxes on new automobiles and other commodities using materials needed for national defense. The Senate, however, accepted most of the Committee's recommendations and passed the record tax bill by a vote of 67 to 5 on September 5. The bill became law on September 20.²⁵

Revenue for Defense in 1941-42

The Revenue Act of 1941 was hailed by the *New York Times* as "by far the heaviest and most broadly based tax levy ever adopted by this country" and "the most important contribution toward solving the paramount economic problem of rearmament: how to finance the tremendous government spending without plunging the country into a disastrous inflation." This feat, the *Times* pointed out, was to be achieved by the government's increasing the federal revenue by \$3½ billion to a total of about \$13 billion so that nearly 60 per cent of federal spending would be covered by taxes.²⁶ The 1941 Revenue Act²⁷ was notable as the largest single revenue measure in national history. The additional revenue was obtained by increases in the taxes on the incomes of corporations and individuals and on estates and gifts, the capital-stock tax, and many excise taxes. Various new excise taxes were also imposed.

The tax on individual incomes was increased through raising the surtax rates and lowering the personal exemption of a married person or a head of a family from \$2,000 to \$1,500 and that of a single person from \$800 to \$750. The \$400 credit for dependents was retained, but the allowance of this credit to the head of a family was restricted in certain cases. The 4 per cent normal tax on individual net income was kept in force. The surtax rates were greatly increased in all income brackets, especially in those under \$100,000. The surtax "cushion" was abolished by having the rates applied to the entire surtax net income, instead of exempting the first \$4,000 from the surtax. The surtax rates ranged from 6 per cent on the first \$2,000 of surtax net income to 77 per cent of the excess over \$5 million. These increases were made so as to bring in about one fifth of the total additional revenue. An optional simplified method of determining income taxes was

²⁵ *New York Times* and *PM*, August 8 to September 21, 1941.

²⁶ *New York Times*, September 18, 1941.

²⁷ Public Law 250—77th Cong., Ch. 412—18th Sess.

provided for persons whose gross income did not exceed \$3,000 and consisted solely of salary, wages, compensation for personal services, dividends, interest, rents, annuities, or royalties.

The normal tax on corporate net income above \$25,000 was raised from 24 per cent to 31 per cent. The surtax rates on corporations were raised to 6 per cent on the first \$25,000 of surtax net income and to 7 per cent on net income in excess of that amount. Their effect differed from that of an equivalent increase in the normal tax because they applied also to income from partially tax-exempt securities. The corporation surtax was also expected to yield about one fifth of the total additional revenue raised by the 1941 tax measure. In addition to these normal and surtaxes, corporations were required to pay an excess-profits tax 10 percentage points higher in each bracket than the 1940 rates. This change made the rates progress from 35 per cent on the first \$20,000 of "adjusted excess profits net income" to 60 per cent on the amounts over \$500,000. This tax Congress hoped would bring in almost one third of the extra revenue in the fiscal year 1942.

The Excess-Profits Tax

No change was made in the provisions of the excess-profits tax law under which corporations had the option of calculating the "normal profits" credit from which excess profits were measured with reference to the average-earnings base period, or to the invested capital. Congress thereby enabled corporations to decrease their taxes by choosing the method better suited to their needs. Companies which had a small capital and no debt, and which customarily made more than 8 per cent on their investments, could calculate their excess profits on the average-earnings basis. They could make 20 per cent or more on their capital investments and pay little, if any, excess-profits tax. Companies with a large capital and large debt could calculate their excess profits on the invested-capital basis. They could then double or triple their average earnings for the base period 1936-39 without being threatened by the excess-profits tax.

To many progressives the bark of the 1941 excess-profits tax seemed very much worse than its bite. They remembered that only five of the twelve large integrated steel companies had paid excess-profits taxes for 1940 and that despite the excess-profits tax the eighteen leading aircraft and aircraft parts companies had earned almost three times as much in 1940 as in 1939. The average rate of profit in 1940 for 925 leading manufacturing companies surveyed by the National

City Bank of New York was 10.5 per cent. These critics saw no justification for allowing corporations to make unusual profits from the defense boom or to escape making a tax sacrifice commensurate with that of the individuals in the low income brackets. Moreover, these liberals argued that the heavier taxes should be imposed on corporate profits when the need for more drastic tax legislation was realized.²⁸

On the other hand, the 1941 law increased the amount of excess-profits taxes payable by large corporations by lowering the rate of return allowed on statutory invested capital over \$5 million from the 1940 level of 8 per cent to 7 per cent. A substantial increase in revenue, partly offset by a smaller decline in the normal corporation tax, was obtained by reversing the sequence in which corporation income tax and excess-profits tax liabilities were determined. Under the 1940 law the corporation normal tax was computed first and was allowed as a deduction both in computing normal profits and current profits subject to excess-profits tax. Under the 1941 law the excess-profits tax liability was computed first and the normal and surtax were not allowed as deductions. Moreover, the exemption from excess-profits taxes on income derived from the mining of certain metals needed for national defense, e. g., tungsten, quicksilver, manganese, and tin, was terminated. Corporations choosing the invested-capital method were allowed to increase by 25 per cent the amounts otherwise includible in equity-invested capital for new capital paid in during the taxable year. But this new capital allowance was subject to a number of limitations aimed at preventing unjustified tax reductions through the inclusion of amounts resulting from mere adjustments in existing capital, including borrowed capital, of the taxpayer or a group of controlled corporations.

The 1940 capital-stock tax of \$1.10 (including the special defense tax) for each \$1,000 of the declared value of the capital stock of a corporation was increased to \$1.25, and the separate 10 per cent defense tax was eliminated. Increases were made in the federal taxes on estates and gifts; the separate 10 per cent defense tax levied in 1940 was eliminated; but no other changes were made in these taxes. The total tax rates on estates from 1935 to 1940 had been graduated from 2 per cent on the first \$10,000 of net estate to 70 per cent on the amount over \$50 million. The 1941 rates were raised so that the combined 1926 basic and the 1941 "tentative" rates ranged from 3 per cent on the first \$5,000 of net estate to 77 per cent on the amount over

²⁸ E. D. Kennedy, "The Big Fish Get Away," *New Republic* (September 29, 1941), 105: 398-99; Stone, *op. cit.*, 169-70.

\$50 million. They became effective only with respect to the estates of persons dying after September 20, 1941. The tax on gifts effective from 1936 to 1939 inclusive had progressed from 1½ per cent upon amounts of net gifts not over \$10,000 to 52½ per cent upon amounts over \$50 million. The gift tax rates imposed by the 1941 law ranged from 2¼ per cent on the first \$5,000 to 57¾ per cent on the amounts over \$50 million, and went into force in 1942.

Finally, the 1941 Revenue Act made permanent various excise taxes first levied in 1932 or 1940, increased the rates of nearly all the existing excise taxes, and imposed a new tax on certain retail sales and on the use of boats and motor vehicles. The list of taxable articles sold by manufacturers or importers was expanded, the rates increased, and additional taxes were levied on facilities, admissions, and occupations. Among the articles taxed were those using scarce resources needed for defense production, such as automobiles and tires. Other excises fell on luxury, amusement and sporting goods and services, such as distilled spirits and admissions to places of amusement. These excise and miscellaneous taxes were expected to yield over one fourth of the additional revenue raised by the 1941 measure. The justification given for their imposition varied from the need for curtailing consumption of articles competing with defense requirements to the purely practical need for increasing federal revenue through taxes provocative of the least tax resistance.²⁹

Proposals for Future Taxes: The Issues Involved

Four days after Roosevelt signed the pathbreaking tax law of 1941, Secretary Morgenthau of the Treasury indicated the need for revising the law. He advocated that all corporation profits over 6 per cent on invested capital be taxed away by the government for the period of the emergency.³⁰ He explained that in the emergency, when young men were being asked to serve their country at a dollar a day and to give up all they had, business was not being asked to do any more than its share by giving up its profits over 6 per cent. This suggestion was part of a plan which the Treasury Department was evolving during the fall and winter of 1941 for meeting the increasing defense expenditures through a new tax bill for 1942. Other proposals which received wide attention were that the personal income and social se-

²⁹ Hart and Allen, *Paying for Defense*, 110-21, and Simons, *Personal Income Taxation*, 39-40, criticize most taxes on mass consumption as unfair to the low income consumers.

³⁰ *New York Times*, September 25, 1941.

curity taxes be increased and extended to include groups not formerly covered. To expedite this yield, collection at the source for both types was advocated. The desirability of these suggestions was debated in the press and among experts, but no Congressional action was taken in view of the September tax increases and the anticipated 1942 Congressional elections.³¹

In the winter of 1941-42 these words of a great English economist reflected the mood of many individuals: "We are at the start of a journey whose end we cannot foresee. Yet once again the young and gallant, our children and our friends, go down into the pit that others have digged for them. . . . We wait and watch and—those who can—we pray. As an economist I have not the power, nor, as a man, the heart, to strain through a night so black to a dawn I shall not see."³² But all of us who desire to live as free men must take heart and use what power we have to plan the economic and military measures necessary to achieve victory over fascism. This is the first task, the indispensable condition for either preserving or creating the type of social order we value and hope to enjoy.

Whether victory will be won and what shape American society will take during and after the war period will depend upon many factors. Increased efficiency and expansion of both the military and industrial systems require breaking the bottlenecks created by monopolistic interests, by outmoded traditions, and by persons in authority with inflexible habits, partiality toward privileged groups, and hostility to democracy in action. Only if the ruling groups in the countries fighting fascism display intelligence and sincerity in pursuing their professed war and peace aims will the energies, abilities, and initiative of their peoples be amply released. Half-measures will not suffice to spur the masses to make the sacrifices needed for victory over Nazi Germany and the Axis Powers.

The American people's hope for a social order that will assure them economic security and determination of their way of life must not be weakened by a defense program which permits unnecessary deprivation through ineffectively controlled inflation and profiteering. The consequent increases in wholesale prices and the cost of living would not only seriously contract the real income of the working and middle classes but would lead to increased inequality in the distribution of wealth and income. Such increased concentration of economic power

³¹ Conference Board *Economic Record* (September 24; October 24, 1941), 3: 395-96, 441-48; *New York Times*, October 29; November 6, 1941.

³² Pigou, *Political Economy of War*, 169.

would not only arouse social discontent and weaken morale when an "all-out" effort would be needed, but would also obstruct the emergence of a more democratic society after the war.

Therefore the action taken on taxation and related economic matters is of the utmost importance.³³ The amount of taxes to be levied during and after the war period will depend upon the length of the war, whether the United States will send an expeditionary force abroad, the extent to which aid will have to be given to other countries, the felt need for extending social services and for fighting a postwar depression through public works, and the fear of too large a public debt.³⁴

Changes in the Tax Burden

A critical study of the changes in distribution of the federal tax burden upon the American people discloses that prior to 1913 the tax burden had little relation to the individual's ability to pay. Tariff duties and excises furnished nearly all the federal revenue and represented a heavier burden upon the lower income classes than upon the higher income classes. With the introduction of a federal income tax in 1913, a federal estate tax in 1916, and an excess-profits tax in 1917, the regressive character of the federal tax system was decreased, especially through high surtax rates on upper bracket incomes. After the first World War the reductions in the tax rates on personal and corporate incomes and the repeal of the excess-profits tax secured through the pressure exerted by the business groups behind Mellon greatly lessened the tax burden upon the high income and wealthy classes. Under the impact of the Great Depression this burden was increased through higher income and estate tax rates imposed in 1932. Between 1934 and 1940 the federal tax burden upon all income groups had risen to about the level of the first World War period in order to finance first the New Deal economic program, mainly before 1941, and then the preparedness-defense program. But this effort to prevent increases in economic inequality was counterbalanced by the fact that during the same period federal consumption taxes, especially those on liquor and tobacco, doubled and amounted to two thirds of the

³³ Harris, *The Economics of American Defense*, 321-44; Stone, *Business as Usual*, 185ff., point out how inflation may be curbed through investment, price, and commodity controls.

³⁴ Carl Shoup, *Federal Finances in the Coming Decade* (New York, 1941) presents the most carefully elaborated set of estimates concerning the cumulative possibilities in federal finance for the decade 1941-51. See also "Billions for Defense," *Annals American Academy Political and Social Sciences* (March, 1941).

total yield of the income, estate, and corporation taxes combined. These consumption taxes and the social security payroll taxes reversed the trend toward a more progressive federal tax structure which had begun with the federal income tax of 1913. Congress and the Roosevelt administration were influenced by the need for large revenues to sacrifice to a certain extent considerations of maximum social welfare to those of expediency. The justification given was that most, if not all, of the revenue abstracted from the low income groups through consumption and payroll taxes was returned to them through federal grants and services.³⁵

One tax burden upon the consumer which the Roosevelt administration has not lessened to any great extent is that levied by the high protective tariff, inherited from the prior Republican administrations. The Hull Reciprocal Trade Agreements, initiated in 1934, lowered the tariff rate on about 19 per cent of American imports by percentages varying from very minor changes to the full authorized 50 per cent. But the fear of retarding industrial activity at home during the depression caused Congress and the Roosevelt administration to limit both the number of significant items selected for concession treatment and the amount of the concessions granted. The consequence was that although American foreign trade increased after 1934, the Hull program was responsible for only a slight increase in export and import trade. But the program undoubtedly helped to liberalize international commodity movements and to prevent the restrictions and discriminations against American foreign trade begun in the nineteen-twenties and thirties from being developed still further. In view of the world conditions during this period the United States made a gain in trade greater than it would have had if there had been no Hull program. To that extent the tax-paying consumer benefited.³⁶

Relative Tax Burdens of Different Income Classes

The analysis of the distribution of income in the United States in 1935-36 made by the National Resources Committee revealed that of the 29,400,300 families in the United States:³⁷

³⁵ *Treasury Report* (1940), 1-22, 466ff., 642-45. Cf. Hansen, *Fiscal Policy and Business Cycles*, 125-34.

³⁶ Grace Beckett, "Effect of Reciprocal Trade Agreements Upon Foreign Trade of United States," *Quarterly Journal of Economics* (November, 1940), 55: 80-94; Herbert Feis, *The Changing Pattern of International Economic Affairs* (New York, 1940), 92-98.

³⁷ National Resources Committee, *Consumer Incomes in the United States* (Washington, D.C., 1938), 2-3, 18-19. The distribution of income among the 10 million

Over 4 million families, or more than 14 per cent of the total, had incomes less than \$500.

About 12½ million families, or more than 41 per cent of the total, had incomes less than \$1,000.

About 19 million families, or more than 64 per cent, had incomes less than \$1,500.

Over 25 million families, or more than 87 per cent, had incomes less than \$2,500.

Only about 1 million families, or 2.8 per cent, had incomes in excess of \$5,000.

About 270,000 families, or 0.97 per cent, had incomes in excess of \$10,000.

The upper 20 per cent, with incomes above \$2,050, received 51 per cent of the aggregate family income of almost \$48 billion.

These facts indicate the importance of a distribution of the tax burden among the people in the different income brackets, which will have regard for the individual's ability to pay and the maximum social welfare. Recent studies of the total American tax structure, federal, state, and local, in 1939 show that families and single individuals in the lowest income group had an average income of \$346, yet paid 22 per cent of their income in hidden taxes and consumers' levies. Although the families and single individuals having incomes of \$20,000 or more paid out 37.8 per cent of their income in taxes, no reasonable progression was indicated in the tax burdens of the different income classes. Groups with incomes from \$1,000 to \$10,000 were the most favored by the tax laws prior to 1941. But the data do not indicate that the upper income groups were excessively burdened, although they paid a higher percentage of their income in taxes than other income groups. The higher income classes possessed great income reserves above their needs and luxuries. The highest income group, averaging \$47,600 a year and including only 0.3 per cent of all income classes, enjoyed 8.4 per cent of all income and set aside 30.4 per cent of all positive savings made by the American people, even though this group paid 17 per cent of all taxes.²⁸

single men and women, constituting 8 per cent of the total population, resembled very closely that for the families, except for considerably greater concentration in the lower brackets. *Ibid.*, 30. For a statistical critique see Merwin, *op. cit.*, 67-72.

²⁸ Anderson, *op. cit.*, 172-75; Tarasov, *Who Pays the Taxes?*, 6, 27-33.

EFFECT OF THE AMERICAN TAX SYSTEM ON THE
VARIOUS INCOME CLASSES—1939³⁹

Income classes range	Mean income	Percentage of all income units	Percentage of income paid out in taxes		
			Federal	State and local	Total
Under \$500	\$346	17.0	7.9	14.0	21.9
\$500 to \$1,000	847	29.5	6.6	11.4	18.0
\$1,000 to \$1,500	1,381	22.1	6.4	10.9	17.3
\$1,500 to \$2,000	1,929	13.1	6.6	11.2	17.8
\$2,000 to \$3,000	2,689	11.3	6.4	11.1	17.5
\$3,000 to \$5,000	4,121	4.6	7.0	10.6	17.6
\$5,000 to \$10,000	7,741	1.5	8.4	9.5	17.9
\$10,000 to \$15,000	12,872	.4	14.9	10.6	25.5
\$15,000 to \$20,000	19,477	.2	19.8	11.9	31.7
\$20,000 and over	47,600	.3	27.2	10.6	37.8
Total	1,602	100.0	0.2	11.0	20.2

The taxes imposed by the Revenue Act of 1941 increased the contributions made to the federal government by all income groups, especially by those in the \$2,000 to \$10,000 brackets, and made the progression in the tax burden upon the various income classes somewhat more reasonable.

The war of the United States against the totalitarian powers, officially begun on December 8, 1941, will undoubtedly cause Congress to levy more and heavier taxes in its effort to finance adequately the war program we are waging.⁴⁰ The study we have made of the crucial role of taxes in past wars leads us to remember that the specific *ends* to which the revenue is applied are equaled in importance by the *means* used to raise that revenue. The Civil War and the first World War demonstrated that the extent to which wars waged to preserve and to extend democracy achieved their goals was determined to a large degree by taxes levied with a view to promoting greater economic justice and equality. Our study of the federal tax system has shown that it takes too large a percentage of low incomes as compared with the high incomes, and too large a percentage of the income of persons with many dependents as compared with the income of persons with few dependents. The war emergency will force the imposi-

³⁹ Anderson, *op. cit.*, 175.

⁴⁰ *New York Times and Wall Street Journal*, December 8-9, 1941, January 8, 1942.

tion of higher taxes on all income groups. But it is well to keep in mind that the morale of the people will be best preserved if the heavier taxes levied on those with low incomes will be exceeded by the burdens imposed progressively on those in the higher income brackets. Sales taxes on nondefense goods, even if disguised as excises levied for revenue and productive of revenue, are to be avoided as much as possible (except as inflation controls) because they add to the overload which existing taxes impose on the lowest income groups and do not curtail sufficiently consumption spending by the high and middle income groups.

The first World War showed how desirable heavy excess-profits taxes and excises on commodities made scarce by defense are from the point of view of satisfying popular demand for prevention of profiteering as well as the need for revenue. Their yield, however, is insufficient for defense needs. Greater revenue can be secured and the ends of social welfare can be furthered by various drastic tax reforms. Both the income and estate taxes could be rendered more efficient and more productive through lowering exemptions, increasing rates progressively, preventing evasions, and stopping such loopholes as tax-exempt securities and unreasonably high undistributed profits.⁴¹ Past emergencies have stimulated inventiveness and led to the overcoming of vested interests in the face of common dangers.

What we lack on the economic front, John Maynard Keynes has pointed out, is not material resources but lucidity and courage. We need the lucidity both to understand the threat of fascism to all civilized values and to see the enormity of the task of vanquishing it. We need the lucidity and the courage to propose "a plan conceived in a spirit of social justice, a plan which uses a time of general sacrifice, not as an excuse for postponing desirable reforms, but as an opportunity for moving further than we have moved hitherto toward reducing inequalities."⁴² From such far-reaching extensions of democracy at home will come the incentive for victorious action and the guarantee for a more humane society.

⁴¹ Cf. Anderson, *Taxation, Recovery, and Defense*, 262-66; Arthur Feiler, "Conscription of Capital," *Social Research* (February, 1941), 8: 1-23; Hart and Allen, *op. cit.*, 23-25, 100ff., 259-62.

⁴² Keynes, *How to Pay for the War*, 1.



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The government materials upon which this study has been based are so numerous that it is impracticable to list them all, especially since complete citations appear in the text at the proper places or references are given which would enable the reader to find the complete citation easily. Hence, only the main titles or classes under which this material can be found, and the outstanding special reports, are given below:

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Appendix

TABLE 1. Receipts of the Federal Government for the Fiscal Years 1860-73, 1913-41 *

Year	Ordinary receipts					Surplus (+) or deficit (-) of ordinary receipts covered into the Treasury compared with expenditures chargeable against ordinary receipts
	Internal revenue		Sales of public lands	Surplus postal receipts covered into the Treasury	Total ordinary receipts	
	Income and profits taxes	Miscellaneous				
1860	63,187,512		1,778,558	1,098,538	56,064,008	64,852,575
1861	30,482,120		879,659	1,037,146	41,998,931	49,859,227
1862	69,059,262		124,474	2,178,854	81,967,436	80,267,277
1863	102,316,153		598,533	3,829,244	112,697,291	123,961,081
1864	84,979,261		598,533	38,314,151	123,891,915	277,068,023
1865	179,046,632		663,031	69,044,134	249,384,802	448,270,704
1866	176,417,811		1,163,678	47,023,086	224,604,575	505,211,015
1867	164,464,000		1,348,715	48,737,179	214,549,901	448,291,758
1868	194,048,427		4,020,344	28,318,515	217,314,178	481,671,469
1869	206,528,374		3,380,482	28,469,865	248,378,727	528,973,828
1870	216,370,287		2,368,647	31,599,736	248,338,670	528,973,828
1871			14,436,952	24,518,689	374,106,968	394,022,294
1872			306,410,666	57,392,663	774,111,220	994,720,756
1873			308,659,733	55,940,370	734,673,167	1,018,807,733
1874			71,281,275	66,787,373	697,910,527	951,658,992
1875			184,937,253	81,769,011	1,124,534,545	1,994,592,237
1876			497,684,980	81,903,301	1,784,324,795	3,490,530,911
1877			1,460,082,297	247,940,012	3,664,562,865	5,293,845,261
1878			1,076,170	561,333,686	2,152,257,135	3,779,198,285
1879			1,460,082,297	1,076,170	6,694,565,889	7,258,242,573
1880			1,390,379,823	1,530,439	4,109,114,151	6,098,424,226
1881			1,145,125,064	895,391	4,007,135,481	5,259,993,198
1882			945,965,333	658,508	4,012,044,702	4,729,674,948
1883			522,223	670,727,345	4,012,044,702	4,729,674,948
1884			623,534	642,788,033	3,780,188,680	4,504,964,961
1885			754,253	544,931,967	3,962,758,660	4,504,964,961
1886			621,187	544,931,967	3,962,758,660	4,504,964,961
1887			394,631	678,006,094	4,042,348,136	4,723,682,077
1888			314,568	678,006,094	4,042,348,136	4,723,682,077
1889			285,744	821,220,641	4,033,250,225	4,730,197,893
1890			285,744	821,220,641	4,033,250,225	4,730,197,893
1891			250,392	851,573,369	4,177,941,702	4,883,425,890
1892			116,749,973	116,749,973	3,189,638,632	3,846,192,615
1893			161,646	230,392	2,036,728,437	2,539,973,360
1894			161,646	179,316,504	2,036,728,437	2,672,328,199
1895			86,757	179,316,504	2,036,728,437	2,672,328,199
1896			219,272,338	1,115,896,615	3,028,840,237	3,662,285,216
1897			71,218	2,106,316,517	5,028,840,237	7,205,201,310
1898			95,643	2,986,631,892	8,854,613,227	12,946,150,769
1899			218,461	1,877,517,937	6,104,526,626	8,293,278,278
1900			72,358	273,039,121	6,387,127,673	6,732,514,465
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TABLE 2. Expenditures of the Federal Government, 1865-75, 1913-41 *

Year	Expenditures chargeable against ordinary receipts										Total ordinary and postal expenditures
	Ordinary										
	Civil and miscellaneous	War Department (including Indians and Alaska (Canada))	Newly Department	Indians	Pensions	Postal deficiencies	Interest on the public debt	Total ordinary navy expenditures	Public debt retirements chargeable against ordinary receipts	Total ordinary receipts against ordinary receipts	
1860	18,088,680	18,408,787	11,414,068	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	9,781,070	72,411,655
1861	17,844,782	18,208,149	11,414,068	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	8,430,308	74,977,013
1862	17,844,782	18,208,149	11,414,068	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	8,430,308	74,977,013
1863	17,844,782	18,208,149	11,414,068	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	10,357,101	75,297,878
1864	20,805,018	20,901,843	12,612,966	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	11,776,629	75,004,477
1865	44,811,538	45,823,843	12,612,966	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	15,338,244	59,470,090
1866	41,115,438	42,449,702	11,354,118	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	18,306,637	61,441,475
1867	38,408,938	39,224,418	11,354,118	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	18,306,637	57,538,075
1868	38,408,938	39,224,418	11,354,118	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	18,306,637	57,538,075
1869	38,408,938	39,224,418	11,354,118	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	18,306,637	57,538,075
1870	38,408,938	39,224,418	11,354,118	2,049,191	1,102,926	2,880,840	3,177,318	63,130,846	63,130,846	18,306,637	57,538,075
1871	62,768,024	63,372,157	21,240,817	7,061,759	28,548,408	4,178,000	117,357,840	277,817,953	277,817,953	21,463,350	299,007,483
1872	180,802,304	182,128,711	123,262,892	20,308,189	173,063,480	1,077,399	22,899,108	724,511,963	724,511,963	261,081,508	985,593,471
1873	170,520,231	172,340,134	114,635,684	20,140,181	173,063,480	1,077,399	22,899,108	724,511,963	724,511,963	261,081,508	985,593,471
1874	201,520,231	203,190,134	141,635,684	20,140,181	173,063,480	1,077,399	22,899,108	724,511,963	724,511,963	261,081,508	985,593,471
1875	191,732,022	193,377,430	131,635,684	17,570,254	159,372,531	6,509,000	21,808,840	724,511,963	724,511,963	261,081,508	985,593,471
1876	1,144,448,023	1,177,040,870	238,631,737	20,998,063	190,318,426	6,509,000	21,808,840	724,511,963	724,511,963	261,081,508	985,593,471
1877	1,144,448,023	1,177,040,870	238,631,737	20,998,063	190,318,426	6,509,000	21,808,840	724,511,963	724,511,963	261,081,508	985,593,471
1878	1,144,448,023	1,177,040,870	238,631,737	20,998,063	190,318,426	6,509,000	21,808,840	724,511,963	724,511,963	261,081,508	985,593,471
1879	6,627,728,263	6,700,073,769	3,912,710,745	48,442,130	217,189,622	2,221,068	150,343,277	12,068,702,471	12,068,702,471	31,134,234	12,099,836,705
1880	1,021,683,085	1,031,683,085	738,021,456	40,516,832	271,344,264	114,534	1,020,215,622	6,403,344,841	6,403,344,841	8,011,730	6,411,356,571
1881	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1882	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1883	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1884	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1885	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1886	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1887	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1888	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1889	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1890	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1891	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1892	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1893	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1894	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1895	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1896	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1897	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1898	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1899	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1900	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1901	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1902	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1903	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1904	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1905	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1906	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1907	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1908	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1909	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1910	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1911	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1912	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1913	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1914	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1915	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1916	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1917	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,128,458	999,144,731	3,375,927,900	3,375,927,900	422,964,691	3,798,892,591
1918	1,118,078,428	1,118,078,428	620,373,836	41,473,808	290,411,416	130,1					

TABLE 3. Tax Changes from 1913-40 *

RATES, EXEMPTIONS, AND CREDITS

Title of tax	Taxes in effect Dec. 31, 1913	Act of Oct. 22, 1914	Revenue Act of 1916 (Sept. 8, 1916)	Act of Mar. 3, 1917	Revenue Act of 1917 (Oct. 3, 1917)	Revenue Act of 1918 (Feb. 24, 1919)	Revenue Act of 1921	Revenue Act of 1924	Revenue Act of 1926	
										Revenue Act of --
Income tax:										
On individuals:										
Personal exemptions:										
Married or head of family	\$4,000	No change	No change	No change	\$2,000	No change	\$2,500	\$2,500	\$2,500	\$2,500
Single	\$2,000	No change	No change	No change	\$1,000	No change	No change	No change	No change	\$1,500
Credit for dependents					\$200	No change	\$400	No change	No change	No change
Normal tax rate:										
1st \$2,000 of net income in excess of certain credits	1%	No change	2%	No change	No change	6%	4%	2%	4%	1½%
2d \$2,000 of net income in excess of certain credits	1%	No change	2%	No change	4%	6%	4%	2%	4%	1½%
Next \$4,000 of net income in excess of certain credits	1%	No change	2%	No change	4%	12%	8%	4%	4%	3%
Over \$8,000 of net income in excess of certain credits	1%	No change	2%	No change	4%	12%	8%	6%	6%	5%
Income tax:										
On individuals:										
Personal exemptions:										
Married or head of family	\$1,500	\$2,500	No change	No change	No change	No change	No change	No change	No change	\$2,000
Single	\$1,500	\$1,000	No change	No change	No change	No change	No change	No change	No change	\$800
Credit for dependents	\$400	No change	No change	No change	No change	No change	No change	No change	No change	No change
Normal tax rate:										
1st \$4,000 of net income in excess of certain credits	1½%	4%	No change	No change	No change	No change	No change	No change	No change	No change
2d \$4,000 of net income in excess of certain credits	3%	8%	4%	No change	No change	No change	No change	No change	No change	No change
Over \$8,000 of net income in excess of certain credits	5%	8%	4%	No change	No change	No change	No change	No change	No change	No change

* Report of the Secretary of the Treasury, 1940, pages 466-79 and 530-33. Footnotes of original table omitted. See text of book for qualifications.

TABLE 3. *Continued*

Title of tax	Taxes in effect Dec. 31, 1913	Act of Oct. 22, 1914	Revenue Act of 1916 (Sept. 8, 1916)	Act of Mar. 3, 1917	Revenue Act of 1917 (Oct. 3, 1917)	Revenue Act of 1918 (Feb. 24, 1919)	Revenue Act of 1921	Revenue Act of 1924	Revenue Act of 1926
Income tax—On dividend On individuals—Con.									
Surplus	1% 6%	No change. No change.	No change. 13% \$20,000-\$40,000	No change. No change. No change.	No change. 63% \$5,000-\$7,500	No change. 65% \$5,000-\$6,000	No change. 50% (1921) \$6,000-\$10,000	1% 40% \$10,000-\$14,000	No change. 20% No change.
Minimum rate									
Maximum rate	\$20,000-\$20,000.	No change.	Over \$2,000,000	No change.	No change.	Over \$1,000,000	Over \$200,000	Over \$500,000	Over \$100,000.
applies to per- son of surtax net income.									
Maximum rate applies to per- son of surtax net income.	Exempt from normal tax.	No change.	No change.	No change.	No change.	No change.	No change.	No change.	No change.
Dividends								25% of normal net income.	25% of total tax on earned net income.
Earned income cred- it.								No change.	No change.
On corporations:								No change.	No change.
Specific exemption								No change.	No change.
Divided exemption								No change.	No change.

TABLE 3. Continued

Title of tax	1929	1932	1934	1935	1936	1937	1938	1939	1940
	Taxes in effect Dec. 31, 1913								
Act of Oct. 22, 1914									
Revenue Act of 1916 (Sept. 8, 1916)									
Act of Mar. 3, 1917									
Revenue Act of 1917 (Oct. 3, 1917)									
Revenue Act of 1918 (Feb. 24, 1918)									
Revenue Act of 1921									
Revenue Act of 1924									
Revenue Act of 1925									
Income tax—Continued. On corporations—Continued.									
Income tax	1%	No change	2%	No change	6%	12% for calendar year 1918, 10% for calendar years 1919-20	19% for calendar year 1921, 12% for calendar years 1922-23	12 1/2% for calendar year 1924	13% for calendar year 1925, 11 1/2% for calendar years 1926-27.
Income tax—Continued. On corporations—Con.									
Normal tax rate:	17%	13 1/2%	No change	12 1/2%	8%	No change	Net income of \$25,000 or less 1st \$3,000 of special class net income 12 1/2%	Normal tax net income of \$25,000 or less 1st \$3,000 of normal tax net income 12 1/2%	Normal tax net income of \$25,000 or less 1st \$3,000 of normal tax net income 12 1/2%
Next \$13,000 of net income	17%	13 1/2%	No change	13%	11%	No change	Next \$13,000 of special class net income 14%	Next \$15,000 of normal tax net income 14%	1st \$3,000 of normal tax net income 13 1/2%
Next \$28,000 of net income	17%	13 1/2%	No change	15%	15%	No change	Over \$20,000 of special class net income 16%	Over \$20,000 of normal tax net income 16%	Next \$15,000 of normal tax net income 14%
Over \$40,000 of net income	17%	13 1/2%	No change	15%	15%	No change	Net income over \$25,000 less:	Over \$20,000 of normal tax net income 16%	Next \$15,000 of normal tax net income 14%
Surplus on undistributed profits:							(a) 15 1/2% of dividends received credit, and	Normal tax net income of \$25,000 or less 1st \$3,000 of normal tax net income 12 1/2%	Normal tax net income of \$25,000 or less 1st \$3,000 of normal tax net income 12 1/2%
Undistributed net income equal to:							(b) 2 1/2% of dividends paid credit, but not in excess of 2 1/2% of adjusted net income.	Next \$15,000 of normal tax net income 14%	Next \$15,000 of normal tax net income 14%
1st 10% of adjusted net income							(Above corporation taxes shall not apply to any taxable year beginning after December 31, 1939.)	Over \$20,000 of normal tax net income 16%	Over \$20,000 of normal tax net income 16%
Next 10% of adjusted net income								Normal tax net income 15%	Over \$20,000 of normal tax net income 15%
Next 20% of adjusted net income								Normal tax net income 17%	Normal tax net income 17%
Next 20% of adjusted net income								18% of normal tax net income.	Normal tax net income 17%
Over 60% of adjusted net income									Normal tax net income 19% of normal tax net income.

TABLE 3. Continued

Title of tax	Taxes in effect Dec. 31, 1913	Act of Oct. 22, 1914	Revenue Act of 1916 (Sept. 8, 1916)	Act of Mar. 3, 1917	Revenue Act of 1917 (Oct. 3, 1917)	Revenue Act of 1918 (Feb. 24, 1919)	Revenue Act of 1921	Revenue Act of 1924	Revenue Act of 1926
	Excess-profit taxes: On individuals: Salaries and income from business having no invested capital in excess of \$5,000. Net income from business having invested capital: Net income equal to 15% of invested capital, less credit. Net income in excess of 15% of invested capital but not in excess of 20% of invested capital. Net income in excess of 20% of invested capital but not in excess of 25% of invested capital. Net income in excess of 25% of invested capital but not in excess of 35% of invested capital. Net income in excess of 35% of invested capital. Net income in excess of 35% of invested capital. On corporations and partnerships: Net income in excess of the sum of (a) \$5,000 and (b) 8% of the actual invested capital. Net income from business having no invested capital or not more than a nominal capital in excess of credit.					8% 20% 25% 35% 45% 60%	Repealed Jan. 1, 1918. Repealed Jan. 1, 1918.		
Title of tax	1925	1922	1923	1924	1925	1926	1927	1928	1929
Excess-profit taxes: On corporations: Net income in excess of 10% but not in excess of 12 1/2% of adjusted declared value of capital stock Do. 12 1/2-15% Do. over 15%					6% 6% 12%	No change. No change. No change.	No change. No change. No change.	No change. No change. No change.	No change. No change. No change.

TABLE 3. Continued

Title of tax	Taxes in effect Dec. 31, 1913	Act of Oct. 22, 1914	Revenue Act of 1916 (Sept. 8, 1916)	Act of Mar. 3, 1917	Revenue Act of 1917 (Oct. 3, 1917)	Revenue Act of 1918 (Feb. 24, 1919)	Revenue Act of 1921	Revenue Act of 1924	Revenue Act of 1926
Capital stock tax: For \$1,000 of fair average value of the capital stock for the preceding year.			50%	No change	No change	\$1	No change	No change	Repealed June 30, 1926.
Estate tax: Specific exemption			\$50,000	No change	No change	No change	No change	No change	\$100,000
Rate of tax			1%	No change	No change	1%	No change	No change	No change
Minimum rate			10%	14%	2%	No change	No change	No change	No change
Minimum rate applies to portion of net estate not exceeding			\$50,000	15%	25%	No change	No change	No change	27%
Maximum rate applies to portion of net estate			Over \$5,000,000	No change	Over \$10,000,000	No change	No change	No change	No change
Credit for State death taxes paid—credit not to exceed								25% of Federal tax	50% of Federal tax
Gift tax: Specific exemption									
Annual exclusion								\$5,000 each calendar year	
Rate of tax								Gifts not exceeding \$500 to any one person	
Minimum rate								1%	
Minimum rate applies to portions of net gifts not exceeding								25%	
Maximum rate applies to portions of net gifts								\$50,000	
								Over \$10,000,000	

SUPPLEMENT—Tax Treatment of Capital Gains and Losses

PART I. INDIVIDUALS

Revenue Act of—	Income year	Gains from sale or exchange of assets	Treatment of—
1913.....	Mar. 1, 1913, to Dec. 31, 1914.....	Included with other income subject to full normal and surtax rates.	Losses from sale or exchange of assets
1916.....	1916.....	do.....	Not allowed.
1917.....	1917.....	do.....	Allowed only to the extent of the gains from such sales.
1918.....	1918 to 1921.....	do.....	Do.
1922.....	1922 to 1923.....	do.....	Allowed in full against income of any kind.
1924.....	1924.....	Included with other income subject to full normal and surtax rates.	Assets held 2 years or less
			Allowed in full against other income, but not against capital gains
			Assets held over 2 years
		At the election of the taxpayer, capital net gains were taxable at 12½% in lieu of the normal and surtax rates; but if such election were made the total tax, including the tax on capital net gains, would in no case be less than 12½% of the total net income.	Allowed in full against income of any kind.
1924.....	1924.....	Same as 1921 act.....	Assets held 2 years or less
			Allowed in full against income of any kind.
1924.....	1924 to 1927.....	Same as 1924 act.....	Assets held over 2 years
1928.....	1928 to 1931.....	do.....	Do.

Could be segregated from ordinary net income, and a tax credit of 12½% of the capital net loss taken, but in no case could the tax be less than the tax (computed at normal and surtax rates) would be if the capital net loss were deducted from ordinary net income.

Same as 1924 act.

Do.

SUPPLEMENT. *Continued*

1932.....	Assets held 2 years or less	Losses from sales or exchanges of stocks and bonds were limited to the gains from such sales. It was provided, however, that such losses disallowed in 1 year (to an amount not in excess of the net income) could be carried over and applied against gains from such transactions in the succeeding taxable year. Other losses were allowed in full against income of any kind.
	Assets held over 2 years	
	Same as 1924 act.....	Same as 1924 act.
1933.....	Assets held 2 years or less	Losses from sales or exchanges of stocks and bonds were limited to the gains from such sales. Other losses were allowed in full against income of any kind.
	Assets held over 2 years	
	Same as 1924 act.....	Same as 1924 act.
1934 to 1937.....	Percentages of gains or losses recognized	Percentages
	Percent assets are held	
	1 year or less.....	100
	Over 1 year but not over 2 years.....	80
	Over 2 years but not over 5 years.....	60
	Over 5 years but not over 10 years.....	40
	Over 10 years.....	30
1934 to 1939.....	Net capital gains to the extent thus recognized are included in net income subject to full normal and surtax rates.	Net capital losses computed on basis of foregoing percentages are allowed in determining net income to the extent of the recognized capital gains plus \$2,000.

SUPPLEMENT. Continued

Revenue Act of—	Income year	Treatment of—	
		Gains from sale or exchange of assets	Losses from sale or exchange of assets
1938 to 1940.....	1938—.....	Percentages of gains or losses recognized	
		Period assets are held:	
		18 months or less.....	Percentages
		Over 18 months but not over 24 months.....	100
		Over 24 months.....	66⅔ 50
		Assets held 18 months or less	
		Capital gains not offset by allowed losses included with other income subject to full normal tax and surtax rates.	
		Capital losses allowed only to the extent of gains on such transactions but losses disallowed in 1 year (to an amount not exceeding net income) may be carried forward and applied against gains from such transactions in the succeeding taxable year.	
		Assets held more than 18 months	
		Net capital gains computed on basis of foregoing percentages are deducted from other income or 30% of such losses is credited against the tax, computed on net income before deducting the net loss, whichever method gives the greater tax	
		Net capital gains computed on basis of foregoing percentages are deducted from other income and subject to normal tax and surtax rates or segregated and taxed at 30%, whichever method results in lesser total tax.	

SUPPLEMENT. *Continued*

PART II. CORPORATIONS

Revenue Act of—	Income year	Treatment of—	
		Gains from sale or exchange of assets	Losses from sale or exchange of assets
1909-23.....	1913 to 1931.....	Included with other income subject to full rate.	Allowed in full against income of any kind.
1922.....	1922.....	do.....	Losses from sales of stocks and bonds held 2 years or less were limited to the gains from such sales. It was provided, however, that such losses disallowed in 1 year (to an amount not in excess of the net income) could be carried over and applied against gains from such transactions in the succeeding taxable year.
N.I.R.A.....	1933.....	do.....	Other losses were allowed in full against income of any kind limited to the gains from such sales.
1924-28.....	1924 to 1930.....	do.....	Other losses were allowed in full against income of any kind. Allowed only to extent of \$2,000 plus capital gains.
1930-40.....	1940—.....	do.....	Short-term losses (from sale or exchange of assets held 18 months or less) are allowed only to the extent of such gains, but losses disallowed in one year (to an amount not in excess of the net income) may be carried forward and applied against gains from such transactions in the succeeding taxable year.
			Long-term losses (from sale or exchange of assets held for more than 18 months) are allowed in full against income of any kind.



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