ENVISIONING THE MODERN AMERICAN FISCAL STATE: PROGRESSIVE-ERA ECONOMISTS AND THE INTELLECTUAL FOUNDATIONS OF THE U.S. INCOME TAX

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At the turn of the twentieth century, the U.S. system of public finance underwent a dramatic, structural transformation. The late nineteenth-century system of indirect taxes, associated mainly with the tariff, was eclipsed in the early decades of the twentieth century by a progressive income tax. This shift in U.S. tax policy marked the emergence of a new fiscal polity—one that was guided not simply by the functional and structural need for government revenue but by concerns for equity and economic and social justice. This Article explores the paradigm shift in legal and economic theories that undergirded this dramatic shift in U.S. tax policy. More specifically, this Article contends that a particular group of academic economists played a pivotal role in supplanting the "benefits theory" of taxation, and its concomitant vision of the state as a passive protector of private property, with a more equitable principle of taxation based on one's "ability to pay"—a principle that promoted a more active role for the state in the distribution of fiscal burdens. In facilitating this structural transformation, these theorists were able to use the growing concentration of wealth and the ascendancy of new economic ideas as justifications for using a progressive income tax to reallocate the burdens of financing the burgeoning American regulatory, administrative, and welfare state.

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> The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist.
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> —John Maynard Keynes

INTRODUCTION

At the turn of the twentieth century, the U.S. system of public finance underwent a dramatic, structural transformation. The late nineteenth-century system of indirect national taxes, associated mainly with the tariff and regressive excise taxes on alcohol and tobacco, was eclipsed in the early decades of the twentieth century by a graduated federal income tax that soon accounted for more than half of all federal tax revenues.[1] A similar, albeit less pronounced, shift occurred at the state and local level where the income tax soon came to challenge the dominant reliance on property taxes.[2] This shift

1. 2 U.S. BUREAU OF THE CENSUS, DEP'T OF COM., HISTORICAL STATISTICS OF THE UNITED STATES, COLONIAL TIMES TO 1970, at 1106–08 (1975), *available at* http://www2.census.gov/prod2/statcomp/documents/CT1970pl-01.pdf [hereinafter HISTORICAL STATISTICS OF THE U.S.]; U.S. TREASURY DEP'T, ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF FINANCES FOR THE FISCAL YEAR ENDED JUNE 30, 1971, app. at 12 (1971). In 1880, 90 percent of federal government revenues came from the combination of customs duties (56 percent) and internal excise taxes (34 percent). HISTORICAL STATISTICS OF THE U.S., *supra*, at 1106–08. By 1930, income taxes accounted for approximately 59 percent of all federal government receipts. *Id.* at 1106–07.

2. At the state and local level, the income tax initially supplied only a small portion of government revenues. But over time, the income tax enabled state and local governments to rely less on the property tax. In 1890, nearly 80 percent of state and local government receipts were derived from the property tax, and by 1932 that figure had dropped to about 60 percent. 6 U.S. BUREAU OF THE CENSUS, DEP'T OF COM., 1967 CENSUS OF GOVERNMENTS, NO. 5, at 17 (1967).

in U.S. tax policy toward the direct and progressive taxation of income marked the emergence of a new fiscal polity—one that was guided not simply by the functional and structural need for government revenue, but by concerns for equity and economic and social justice.

Although the early versions of the national and state-level income tax laws—with their high exemption levels and moderate rates[3]—raised only a small percentage of total government revenues and affected a relatively small group of wealthy citizens,[4] these early income tax laws were the thin edge of the wedge.[5] Not only did exemption levels and rates change dramatically over the course of the twentieth century, but the revenues generated by the income tax soon became the lifeblood of the bourgeoning American regulatory, administrative, and welfare state. Indeed, by the end of the twentieth century, the progressive income tax had become the central foundation of modern American public finance, generating in fiscal year 2000 nearly 55 percent of federal receipts, and on average about 40 percent of state-level tax revenue.[6] While national emergencies—in the form of world wars and the Great Depression—hastened subsequent tax reforms that

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3. The 1913 federal income tax, which initiated the permanent national taxation of income, had a high exemption level of $3000 for single persons ($4000 for married couples), and began with a "normal" tax of only 1 percent that was graduated to a top "surtax" rate of 6 percent for incomes over $500,000. This law also contained a flat 1 percent tax on corporate net income. Tariff of 1913, ch. 16, § 2, 33 Stat. 114, 166, 169. Similarly, the Wisconsin income tax of 1911, which began the effective state taxation of income, had high exemption levels and low statutory rates. The Wisconsin tax was set at a graduated rate that ranged from 1 percent on the first $1000 above the exemption level of $800 for single taxpayers ($1200 for married couples) to a maximum rate of 6 percent on all taxable income in excess of $12,000. 1911 Wis. Laws 658.

Though the progressive rates of the 1913 federal income tax may appear moderate by twenty-first-century standards, at the time, this rate of progression was deemed by many to be a form of government confiscation. *See Anti-wealth Policy*, N.Y. TIMES, Sept. 2, 1913, *reprinted in* 6 JOHN D. BUENKER, THE INCOME TAX AND THE PROGRESSIVE ERA 372–74 (1985).

4. Scholars have estimated that "only about 2% of American households paid" the income tax during its first few years of existence. W. ELLIOT BROWNLEE, FEDERAL TAXATION IN AMERICA: A SHORT HISTORY 46 (1996); JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 78 (1985).

5. As the legal historian Lawrence Friedman has explained, "The income tax *was* the opening wedge for a major transformation of American society." LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 567 (1985).

6. U.S. BUREAU OF THE CENSUS, DEP'T OF COM., STATISTICAL ABSTRACT OF THE UNITED STATES: 2002, at 314 tbl.464 (2001), *available at* http://www.census.gov/prod/www/statistical-abstract-04.html; STATE PROFILES: THE POPULATION AND ECONOMY OF EACH U.S. STATE 169 tbl. IL-17 (Helmut F. Wendel et al. eds., 2d ed. 2002). During the late 1950s, the national income tax accounted for approximately 70 percent of federal government receipts, suggesting that the American historian George Mowry was correct to claim as early as the 1950s that "[t]he modern democratic social service state . . . probably rests more upon the income tax than upon any other single legislative act." GEORGE E. MOWRY, THE ERA OF THEODORE ROOSEVELT 263 (1958); HISTORICAL STATISTICS OF THE U.S., *supra* note 1, at 1105.

crystallized the new fiscal order, it was the turn-of-the-century transformation that established the intellectual and institutional foundations of the modern American fiscal state.

The structural transformation in American public finance, wrought by the rising prominence of the income tax, raises several fundamental questions about the making of tax policy at the turn of the twentieth century. How and why, for example, was this radical shift in American public finance possible? What were the historical factors that affected, and were affected by, this dramatic change in fiscal policy? And, perhaps most importantly, what role did the emergence of this new fiscal order play in the changing terms of American state-society relations?

In seeking to answer such critical questions, conventional historical accounts of the American income tax have generally focused on the need for government revenue as the primary explanatory factor. According to this view, the rise of the income tax can be best explained as a structural-functionalist response to the growing demands of the public sector, particularly during wartime emergencies.[7] Other common interpretations have examined the role of political parties and party competition over the issue of protectionism and tariff revenue in explaining why the corporate and individual income taxes were adopted when they were.[8] Still other studies, those that have set out to explore the redistributive potential of tax laws, have generally concluded that the roots and early development of the American income tax rest more with placating revenue demands than with issues of economic equity. For this last group of scholars, the income tax, like many other reforms of the Progressive Era, is viewed as a form of sophisticated conservatism—a clever ploy to domesticate potentially more radical forms of wealth redistribution.[9]

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7. *See* WITTE, *supra* note 4, at 67; Bennett D. Baack & Edward John Ray, *Special Interests and the Adoption of the Income Tax in the United States*, 45 J. ECON. HIST. 607 (1985). Scholars of state formation have long recognized the importance of wars and national crises to the political development of western nation-states, see, for example, JOHN BREWER, THE SINEWS OF POWER: WAR, MONEY AND THE ENGLISH STATE, 1688–1783 (1989); CHARLES TILLY, COERCION, CAPITAL, AND EUROPEAN STATES, A.D. 990–1990 (1990); Gabriel Ardant, *Financial Policy and Economic Infrastructure of Modern States and Nations*, *in* THE FORMATION OF NATIONAL STATES IN WESTERN EUROPE 164 (Charles Tilly ed., 1975).

8. *See generally* CHRISTOPHER HOWARD, THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES 49–50 (1997); ELIZABETH SANDERS, ROOTS OF REFORM: FARMERS, WORKERS, AND THE AMERICAN STATE, 1877–1917, at 160–72 (1999); RICHARD FRANKLIN BENSEL, THE POLITICAL ECONOMY OF AMERICAN INDUSTRIALIZATION, 1877–1900, at 159–61 (2000).

9. As the tax historian Robert Stanley has interpreted it, the income tax "represented not an expression of real economic democracy," but rather "a rejection of the far more fundamental institutional change advocated by intellectuals and street dissidents of both left and right." ROBERT STANLEY, DIMENSIONS OF LAW IN THE SERVICE OF ORDER: ORIGINS OF THE FEDERAL INCOME TAX,

While this concentrated focus on the functional demands for government revenue explains one element in the development of the income tax, it tells us only part of the historical story. Taxation has always been *both* about revenue *and* equity—about effectively raising government funds and fairly distributing fiscal burdens. The accepted narratives and interpretations that view the ascendancy of the income tax as primarily part of a revenue-generating process, or more cynically, as a conservative ruse to forestall more radical calls for economic redistribution, have marginalized the importance of the reallocative potential of taxation.[10] Put simply, the preoccupation with revenue has elided how the early evolution of income tax laws and policy was also driven by the desire to reallocate more fairly the burdens of financing a modern nation-state.[11]

This Article, by contrast, contends that the turn-of-the-century development of the income tax had sources in social concerns about justice, fairness, and the equitable distribution of fiscal burdens. More specifically, this Article claims that the intellectual campaign for an income tax was aimed at reforming the contemporary allocation of fiscal burdens and obligations. Common historical accounts that have focused on the failure of the income tax to redistribute wealth have obscured our understanding of what the rise of the direct taxation of income did, in fact, accomplish. The new fiscal order that emerged at the turn of the century was by no means a radical system of wealth redistribution, nor was it merely a conservative bulwark against more

1861–1913, at 231 (1993). Similarly, Morton Horwitz has claimed that limits placed on the state's taxing powers exemplify how "the impermissibility of redistribution embodied one of the central tenets of the nineteenth-century idea of the liberal state." MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1870–1960: THE CRISIS OF LEGAL ORTHODOXY (1992); *see also* GABRIEL KOLKO, THE TRIUMPH OF CONSERVATISM: A REINTERPRETATION OF AMERICAN HISTORY, 1900–1916, at 112, 129 (1963); JAMES WEINSTEIN, THE CORPORATE IDEAL IN THE LIBERAL STATE, 1900–1918, at 140–42 (1968). For more tax-specific historical works in this vein, see LOUIS EISENSTEIN, THE IDEOLOGIES OF TAXATION (1961); MARK H. LEFF, THE LIMITS OF SYMBOLIC REFORM: THE NEW DEAL AND TAXATION, 1933–1939 (1984); JAMES O'CONNOR, THE FISCAL CRISIS OF THE STATE (1973); Albert L. Ellis, The Regressive Era: Progressive Era Tax Reform and the National Tax Association—Roots of the Modern American Tax Structure (1991) (unpublished Ph.D. dissertation, Rice University).

10. The distinction between redistribution and reallocation is a subtle one. The Progressive-Era public finance economists championed an income tax to reallocate or spread the fiscal burdens of financing a modern nation-state among a larger group of citizens. Many of them did not envision a steeply graduated tax system working in conjunction with government transfer payments to redistribute wealth radically.

11. While there is an older historiography of American taxation that celebrates the achievements of the income tax, this literature is often infused with a tone of liberal triumphalism that depicts the creation and development of the income tax as part of a teleological march towards democratic progress. *See generally* ROY G. BLAKEY & GLADYS C. BLAKEY, THE FEDERAL INCOME TAX (1940); RANDOLPH E. PAUL, TAXATION IN THE UNITED STATES (1954); SIDNEY RATNER, AMERICAN TAXATION, ITS HISTORY AS A SOCIAL FORCE IN DEMOCRACY (1942).

radical reform. Instead, the modern American fiscal state that emerged in the early twentieth century dramatically altered the distribution of fiscal burdens along lines of both class and region. By replacing the nineteenth-century structure of regressive, indirect consumption taxes with a direct tax on income and other forms of wealth, the new fiscal polity shifted the burden of financing a modern, industrial state to those segments of society that had the greatest tax-paying ability, namely wealthy citizens in the North and Northeast. This transformation toward a more transparent and fairer system of taxation was a qualified achievement. Although it did not go as far as some progressive reformers had envisioned, this new fiscal polity laid the foundation for and held out the promise of a new, more progressive American tax regime.

Among the forces that helped forge the modern American fiscal state, perhaps none was more important than the intellectual movement supporting the direct and graduated taxation of income. To be sure, there were other salient factors that helped usher in this new fiscal order, including popular social movements and institutional changes.[12] Academic theorists alone could not have built the new fiscal polity. Nonetheless, the turn-of-the-century structural transformation in American public finance was guided mainly by a paradigm shift in the legal and economic theories that undergirded tax policy. It was academic political economists, with significant German training, who responded to the social and political circumstances of the times by leading the intellectual movement for a permanent, progressive income tax. In so doing, these theorists became the architects or visionaries of the modern American fiscal state.

This Article explores how these key American intellectuals, responding to their historical conditions, were able to apply their social and political theories to the development of American tax laws and policies. More precisely, this Article contends that a particular group of academic political economists played a pivotal role in supplanting the "benefits theory" of taxation, and its concomitant vision of the state as a passive protector of private property, with a more equitable principle of taxation based on one's "faculty" or "ability to pay"—a principle that promoted an active role for the positive state in the distribution of fiscal burdens.

12. The larger work-in-progress, from which this Article is derived, explores the multitude of idealistic and material forces that affected the emergence of the income tax at the turn of the twentieth century, including the influence of the legal profession and the popular social movements for tax reform. For an earlier version of this project, see Ajay K. Mehrotra, Creating the Modern American Fiscal State: The Political Economy of U.S. Tax Policy, 1880–1930 (2003) (unpublished Ph.D. dissertation, University of Chicago).

This historical shift in the economic and legal ideas that undergirded tax policy was reflective of a much larger transformation in American social thought at the turn of the century. For the move from benefits to ability to pay was part and parcel of what American intellectual historians have referred to as "the revolt against formalism"—a revolt that included a transformation in American liberalism away from its classical nineteenth-century emphasis on negative individual liberties toward a more progressive and revitalized conception that stressed an active role for the positive state.[13] Spurred by the modern forces of mass immigration, urbanization, and industrialization that created a much more interdependent world, this change in American liberalism, embodied in the Progressive Movement, had a profound impact not only on tax policy, but also on nearly every aspect of state-society relations. In the realm of tax law, as the historian James T. Kloppenberg has noted, "[t]he graduated income tax, based on the idea that everyone owes a debt to society proportional to his ability to pay, was perhaps the quintessential progressive reform."[14] Protective labor legislation, the rise of antitrust laws, the regulation of food and drugs, the expansion of suffrage to women, and the numerous other reforms produced during this crucial period in American history were all representative of the progressive reorientation of the relationship between society, economy, and the state.[15]

Furthermore, this paradigm shift in economic and legal theory was not simply a rhetorical move. Rather, it was an attempt to foment a kind of scientific revolution in thinking about how the burdens and obligations of

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13. *See generally* MORTON WHITE, SOCIAL THOUGHT IN AMERICA: THE REVOLT AGAINST FORMALISM (Beacon Press 1957) (1949). *See also* EDWARD A. PURCELL, JR., THE CRISIS OF DEMOCRATIC THEORY: SCIENTIFIC NATURALISM & THE PROBLEM OF VALUE (1973); LOUIS MENAND, THE METAPHYSICAL CLUB (2001); JEFF SKLANSKY, THE SOUL'S ECONOMY: MARKET SOCIETY & SELFHOOD IN AMERICAN THOUGHT, 1820-1920 (2002). For more on the changing face of American liberalism at the turn of the twentieth century, see Mary O. Furner, *Knowing Capitalism: Public Investigation and the Labor Question in the Long Progressive Era*, *in* THE STATE AND ECONOMIC KNOWLEDGE: THE AMERICAN AND BRITISH EXPERIENCES 241 (Mary O. Furner & Barry Supple eds., 1990). On the transatlantic aspects of this new form of liberalism, see JAMES T. KLOPPENBERG, UNCERTAIN VICTORY: SOCIAL DEMOCRACY AND PROGRESSIVISM IN EUROPEAN AND AMERICAN THOUGHT, 1870–1920 (1986); DANIEL T. RODGERS, ATLANTIC CROSSINGS: SOCIAL POLITICS IN A PROGRESSIVE AGE (1998). For a recent reinterpretation of this period of American liberalism, see NANCY COHEN, THE RECONSTRUCTION OF AMERICAN LIBERALISM, 1865–1914 (2002).

14. KLOPPENBERG, *supra* note 13, at 355.

15. *See generally* SIDNEY FINE, LAISSEZ-FAIRE AND THE GENERAL-WELFARE STATE (1956); MORTON KELLER, REGULATING A NEW ECONOMY: PUBLIC POLICY AND ECONOMIC CHANGE IN AMERICA, 1900–1933 (1990); STEPHEN SKOWRONEK, BUILDING A NEW AMERICAN STATE: THE EXPANSION OF NATIONAL ADMINISTRATIVE CAPACITIES, 1877–1920 (1982); ROBERT H. WIEBE, THE SEARCH FOR ORDER, 1877–1920 (1967).

citizenship ought to be allocated. Triggered by a community of rising economic specialists, this tectonic shift—like most paradigm shifts—was not simply a new scientific discovery nor an apolitical, wholly objective revision in describing modern social relations. Instead, it was "a special sort of change involving a certain sort of reconstruction of group commitments."[16] The Progressive-Era economists who brought the faculty theory to the fore were part of a new community of economic thinkers—coming together alongside the rise of the American research university. These academics were seeking to change the constellation of beliefs, commitments, and values within their own emerging academic discipline.[17] In the process, they were hoping to underwrite changes in tax policy that would help reallocate the fiscal burdens associated with modern, industrial capitalism.

For many of these economists, the benefits theory and the ability-to-pay principle were contending doctrines with radically different underlying social and political theories. The benefits doctrine stood for the antiquated proposition, they believed, that taxation was justified as a price paid for the goods and services provided by government in exchange for tax payments. Citizens, in essence, traded tax payments solely for the benefits that they received from the state. By contrast, the notion of faculty, or ability to pay, required that each citizen contribute to the common welfare of the state based on tax-paying capacity. Although accurately measuring a citizen's capacity to pay taxes was a controversial issue that remained elusive—then and now[18]—the progressive economists resolutely believed that their primary, pragmatic goal in advancing the income tax agenda was to demonstrate the social and political limitations inherent in the benefits principle. That is not to say they thought the benefits principle had no place in discussions about tax policy; their goal instead was to make more explicit the politics

16. THOMAS S. KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTIONS 181 (1996); *see also* THEODORE PORTER, TRUST IN NUMBERS: THE PURSUIT OF OBJECTIVITY IN SCIENCE AND PUBLIC LIFE (1995).

17. *See generally* MARY O. FURNER, ADVOCACY & OBJECTIVITY: A CRISIS IN THE PROFESSIONALIZATION OF AMERICAN SOCIAL SCIENCE, 1865–1905 (1975); THOMAS L. HASKELL, THE EMERGENCE OF PROFESSIONAL SOCIAL SCIENCE: THE AMERICAN SOCIAL SCIENCE ASSOCIATION AND THE NINETEENTH CENTURY CRISIS OF AUTHORITY (Johns Hopkins Univ. Press 2000) (1977); DOROTHY ROSS, THE ORIGINS OF AMERICAN SOCIAL SCIENCE (1991).

18. On the ongoing elusiveness of the ability-to-pay doctrine, see, for example, LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: TAXES AND JUSTICE 20–31 (2002); Joseph M. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-pay Principles*, 58 TAX L. REV. (forthcoming 2005); EISENSTEIN, *supra* note 9. For a concise recent discussion of one of the meanings of ability to pay, see generally Kirk J. Stark, *Enslaving the Beachcomber: Some Thoughts on the Liberty Objections to Endowment Taxation*, 18 CANADIAN J.L. & JURIS. 47 (2005).

implicit in the dueling tax notions. The public finance economists, like other progressive reformers, used the language of ethical duties and the idiom of social solidarity "less to clarify a political philosophy than to build a political constituency."[19]

In facilitating this theoretical shift in tax policy, these thinkers were responding to a number of social and intellectual forces. The growing concentration of wealth and corporate power, the cycle of economic crisis, and the resulting tension between social movements for reform—as well as the conservative reactions they elicited—all influenced academic ideas during the Gilded Age and Progressive Era. Likewise, the increasing prevalence of intangible wealth in the form of stocks and bonds, and the institutionalization of relatively new economic ideas about measuring value as a function of an individual's marginal utility, combined with material forces to provide reform-minded economists with rationales for promoting a progressive income tax. Led by Richard T. Ely, Henry Carter Adams, and Edwin R.A. Seligman, these economists were at the forefront of the battle to dismantle the orthodox theories of laissez-faire and to promote the adoption of new, more effective, and equitable forms of taxation.[20]

A century or so has passed since the progressive economists' intellectual campaign for a graduated income tax facilitated the structural transformation in American public finance. Though much has changed since then, some alarming similarities seem to have reemerged. As the subtitle of this Symposium

19. Daniel T. Rodgers, *In Search of Progressivism*, 10 REVIEWS IN AM. HISTORY NO. 4, Dec. 1982, at 113, 122. *See generally* BUENKER, *supra* note 3; Gina L. Keel, A Social Fiscal Science: The Progressive Origins of Federal Income Taxation (1998) (unpublished Ph.D. dissertation, Brandeis University).

20. In charting the role that these economists played in laying the intellectual groundwork for the new fiscal order, this Article is not meant to be a traditional history of disembodied ideas or a philosophical explication of the claims made by these historical figures. Instead, this Article seeks to historicize the ideas that underwrote the emergence of the modern income tax by placing these theories within their social, political, and economic context. The principal aim is to show how idealistic and material historical forces combined to facilitate the paradigm shift in tax theories at the turn of the twentieth century. The more normative task of uncovering the current philosophical arguments for and against progressive income taxes, and revealing the tensions within tax theories, is left to other articles published in this Symposium and elsewhere. *See, e.g.*, Marjorie E. Kornhauser, *Choosing a Tax Rate Structure in the Face of Disagreement*, 52 UCLA L. REV. 1697 (2005); MURPHY & NAGEL, *supra* note 18; Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417 (1952); CHARLES GALVIN & BORIS I. BITTKER, THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE? (1969); Jeffrey A. Schoenblum, *Tax Fairness or Unfairness? A Consideration of the Philosophical Bases for Unequal Taxation of Individuals*, 12 AMER. J. TAX POL'Y 221 (1995); Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905 (1987). On the inherent tensions within the tax theory of ability to pay, see Stephen Utz, *Ability to Pay*, 23 WHITTIER L. REV. 867 (2002).

suggests,[21] the turn of the twenty-first century has brought with it a new era of rising inequality. This era has placed into bold relief what some present-day commentators see as the possibility of a New Gilded Age in the United States, complete with a new generation of robber barons, a renewed visibility of material opulence and excess, and a new set of political and corporate scandals.[22]

Amid these circumstances, a story about the intellectual foundations of the American income tax may provide some important, if humbling, lessons for our own time. Given the recent rise of inequality and the current rhetorical calls for tax reform,[23] a tale chronicling the historical beginnings of the current American income tax system should be seen as a modest reminder of the aims and circumstances that animated the theoretical support for a new system of taxation. This narrative serves as a reminder, that is, of the historical and institutional parameters that constrain current policymakers.

Similarly, an intellectual history of the American income tax holds some sobering lessons both for those scholars who mistakenly assume, however implicitly, that the progressive income tax was originally meant to redistribute wealth and income in a dramatic way,[24] and for those tax scholars who recently have suggested a return to benefits theory as a possible means to bolster our current tax system.[25] This Article thus attempts to tell the story of how one group of socially engaged and reform-minded academics provided the intellectual support for a historic change in the American system of taxation—a change that continues to resonate today.

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21. Symposium, *Rethinking Redistribution: Tax Policy in an Era of Rising Inequality*, 52 UCLA L. REV. 1627 (2005).

22. For a sampling of the recent social and academic commentary identifying the rise of a new Gilded Age at the turn of the twenty-first century, see generally GODFREY HODGSON, MORE EQUAL THAN OTHERS: AMERICA FROM NIXON TO THE NEW CENTURY (2004); KEVIN PHILLIPS, THE POLITICS OF RICH AND POOR: WEALTH AND THE AMERICAN ELECTORATE IN THE REAGAN AFTERMATH (1990); THE NEW GILDED AGE (David Remnick ed., 2001); Nathan Glazer, *On the American Indifference to Inequality*, DAEDALUS, Summer 2003, at 111; Martin J. McMahon, Jr., *The Matthew Effect and Federal Taxation*, 45 B.C. L. REV. 993 (2004); Thomas Piketty & Emmanuel Saez, *Income Inequality in the United States, 1913–1998*, 118 Q.J. ECON. 1 (2003); Paul Krugman, *For Richer*, N.Y. TIMES, Oct. 20, 2002, (Magazine), at 62; *Meritocracy in America: Ever Higher Society, Ever Higher to Ascend*, ECONOMIST, Jan. 1–7, 2005, at 22.

23. DANIEL ALTMAN, NEOCONOMY: GEORGE BUSH'S REVOLUTIONARY GAMBLE WITH AMERICA'S FUTURE (2004); McMahon, *supra* note 22, at 993; Hal R. Varian, *Perhaps It's Time for a Thorough Tax Overhaul*, N.Y. TIMES, May 5, 2005, at C2.

24. *See, e.g.*, STANLEY, *supra* note 9; WITTE, *supra* note 4.

25. Deborah A. Geier, *Incremental Versus Fundamental Tax Reform and the Top One Percent*, 56 SMU L. REV. 99, 119 (2003); Deborah A. Geier, *Letter to the Editor, Time to Bring Back the "Benefit" Norm?*, 102 TAX NOTES 1155 (2004); Herwig J. Schlunk, *Double Taxation: The Unappreciated Ideal*, 102 TAX NOTES 893 (2004); Herwig J. Schlunk, *I Come Not to Praise the Corporate Income Tax, But to Save It*, 56 TAX L. REV. 329 (2003). For another critique of the recent reemergence of the benefits theory, see Dodge, *supra* note 18.

This Article is divided into three parts. To comprehend the significance of the transformation in American public finance that the establishment of the federal income tax occasioned, Part I contains a brief description of the nineteenth-century system of indirect taxes, and an explanation of the historical factors that led to the decline of this old fiscal order. Part II focuses on the public finance economists of the turn of the century and their efforts to use the logic of faculty theory to underwrite the movement for a progressive income tax. This part begins with an introduction of the common background and experiences that united this young generation of professional economists; it then charts how these theorists were able to apply their new visions of political economy to tax policy, as they helped establish the intellectual foundations of the modern American fiscal state. Part III investigates the resistance—from both the political left and right—that these theorists faced in promoting a progressive income tax based on the notion of ability to pay. This last part also explores the enduring impact that these ideas had on the development of tax laws and policies. Finally, the Conclusion explains why, at the dawn of the twenty-first century, a historical tale about the intellectual foundations of the modern American income tax remains poignant.

I. THE OLD FISCAL ORDER AND ITS GRADUAL DEMISE

Given the current predominance of the direct tax on income, it is easy to overlook the extent to which indirect taxes, particularly import duties, dominated federal revenues throughout the nineteenth century. On average, revenues from the tariff accounted for approximately 85 percent of the annual federal budget during the antebellum period.[26] Although the crisis of the Civil War temporarily introduced a successful national income tax in the North,[27] indirect excise taxes on imports and everyday commodities such as sugar, alcohol, and tobacco remained the cornerstone of federal receipts throughout the last decades of the nineteenth century.[28] Of course,

26. HISTORICAL STATISTICS OF THE U.S., *supra* note 1, at 1106. "[During] the antebellum period, proceeds from the tariff fell below 75 percent of federal income only during the Jackson and Van Buren administrations, when brisk sales of federal land contributed significantly to the federal treasury." John Mark Hansen, *Taxation and the Political Economy of the Tariff*, 44 INT'L ORG. 527, 529 (1990).

27. BROWNLEE, *supra* note 4, at 26–27; STANLEY, *supra* note 9, at 27–32; WITTE, *supra* note 4, at 67.

28. As late as 1890, more than 90 percent of federal government revenues came from the combination of customs duties and internal excise taxes. HISTORICAL STATISTICS OF THE U.S., *supra* note 1, at 1106–08.

federal government spending at this time was rather paltry. The federal budget was relatively small, with spending limited to the military and the legacy of the Civil War.[29] Nevertheless, as federal government spending increased at the turn of the century, the indirect system of taxation continued to dominate, at least until the First World War.[30]

This system of indirect taxation affected nearly every aspect of daily consumption. The breadth of goods that fell under the tariff's duty list in the late nineteenth century was indeed astonishing. The Tariff Act of 1883, for instance, placed a levy on fourteen different categories of products including: "Chemical Products"; "Earthenware and glassware"; "Metals"; "Wood and Wooden wares"; "Sugar"; "Cotton and cotton Goods"; "Hemp, jute, and flax Goods"; "Wool and woolens"; "Silk and silk Goods"; "Books [and] papers"; and the catch-all category of miscellaneous "Sundries."[31] The schedule for "Provisions" alone consisted of such everyday necessities as "Beef and pork; Hams and bacon; Cheese; Butter; and substitutes thereof; Lard; Wheat; Rye and barley; Oats; Corn-meal; Oat-meal; Rye-flour; Potato or corn starch; Potatoes; Rice; Hay; Honey; Hops; Milk; Salmon and other fish; Pickles and sources, of all kinds; Vegetables; Vinegar; Chocolate; Dates, plums and prunes; Oranges; Lemons; Raisins," and a large assortment of nuts.[32] Although the "duty charges," or rates, were relatively low, ranging from "one cent per pound of beef and pork" to "four cents per pound of cheese,"[33] they had a significant impact on the daily cost of living in America.

The potential inflationary pressures occasioned by import duties and the overall indirect system of taxation were not lost on social and political commentators. Even opponents of the income tax, such as *The New York Times*, frequently observed how the "essential character of our protective policy . . . artificially and cruelly increase[s] the cost of clothing, of bedding, of shelter, of tools, and of a thousand necessaries of daily life."[34] Though it

29. In 1890, for instance, the federal government spent more than 20 percent of its budget on the military, 11 percent on servicing its debt, much of which was acquired during the Civil War, and over 33 percent on Civil War pensions—that quintessential protowelfare state measure. *Id.* at 1114. For more on the history of Civil War pensions, see generally THEDA SKOCPOL, PROTECTING SOLDIERS AND MOTHERS: THE POLITICAL ORIGINS OF SOCIAL POLICY IN THE UNITED STATES (1992).

30. In 1916, for instance, revenues from the tariff and indirect excise taxes accounted for nearly 60 percent of federal receipts. HISTORICAL STATISTICS OF THE U.S., *supra* note 1, at 1106–08. On the political history of the early income tax laws, see generally JEROLD L. WALTMAN, POLITICAL ORIGINS OF THE U.S. INCOME TAX (1985).

31. Tariff Act of Mar. 3, 1883, ch. 121, § 2502, 22 Stat. 488, 495–502, 505–14.

32. *Id.* at 503–04.

33. *Id.* at 503.

34. *Taxing Food*, N.Y. TIMES, June 1, 1891, at 4.

was unclear, as economic analysts at the time noted,[35] whether the tariff ultimately was shifted to consumers, many ordinary Americans believed that taxes were responsible for the rising cost of living. As *The New York Times* editors noted, this popular perception could have grave political implications for lawmakers. "[T]he prompt rise in prices of the common necessaries of life," an editorial written during the height of the 1890 tariff debates observed, "is bringing the Republican tariff home to the masses of voters in a way highly unsatisfactory to those who made that tariff."[36]

For many policymakers and economic commentators, increasing prices were just one of the adverse effects of the indirect tax regime. A revenue system based on customs duties and excise taxes also proved to be unstable, inflexible, and unfair. It was unstable because receipts varied with the vicissitudes of international trade and social consumption patterns. It was inflexible because it gave government actors little leverage over the source of funds. And it was unfair because the bulk of the burden appeared to fall on those with limited economic resources. These drawbacks became particularly pronounced during times of national stress and strain, when crisis often required governments to access revenue quickly and effectively. Writing in the wake of the Panic of 1893, during the last great recession of the nineteenth century, University of Chicago labor economist Robert Hoxie observed that "the customs revenue system, through inherent inflexibility and instability, is incapable of serving as an adequate source of public revenue in times of emergency."[37] Because moments of national crisis were crucial testing grounds, "[n]o nation could be found willing to base its finances on a system that must fail it in time of stress," Hoxie continued.[38] "This conclusion then is really equivalent to a general condemnation of the customs revenue system as the main source of a national income."[39]

In addition to its internal defects, the tariff was also criticized because its protection of domestic industries undermined the economic ideals of free trade. For economists and reformers weaned on the treatises of Adam

35. Edwin Seligman, himself an authority on the incidence of taxes, observed that the factors that determined the incidence of import duties

> are so numerous and so complex that an investigation of the actual effects of a tax upon any one class of commodities would require for its proper solution, not only an acquaintance with the details of theory itself, but also an intimate knowledge of all the forces influencing the supply of, and the demand for, the commodities affected.

EDWIN R.A. SELIGMAN, THE SHIFTING AND INCIDENCE OF TAXATION 374 (1899).

36. *Object Lessons in Tariff*, N.Y. TIMES, Oct. 9, 1890, at 8.

37. Robert F. Hoxie, *Adequacy of the Customs Revenue System*, 3 J. POL. ECON. 39, 71 (1894).

38. *Id.*

39. *Id.*

Smith and John Stuart Mill, the benefits of comparative advantage had made free trade an obvious choice.[40] There were, of course, many American economic thinkers who favored protecting "infant industries." Henry C. Carey, the Pennsylvania publisher and economic writer, trained generations of antebellum students to believe in the virtues of a high protective tariff.[41] But after the Civil War, when the inherent flaws of the tariff and indirect consumption taxes became more readily apparent, free-trade thinking came to dominate, at least within the academy. The leading American economic treatises, written by Amasa Walker and Arthur Latham Perry, supported free trade, as did a number of popular tracts and pamphlets written by tariff reformers.[42] Though there was a handful of young, progressive economists who favored protectionism, such as Simon Patten, free-trade ideas seemed to dominate American academic discourse by the end of the nineteenth century.[43]

Yet despite this seeming convergence around free-trade ideas, the protective tariff remained a central part of American economic and foreign policy throughout the turn of the century. The political and economic powers behind protectionism not only had access to the ears and pockets of influential lawmakers, they also were able to muffle the voices of some of the leading economic thinkers. Organizations such as the American Iron and Steel Association, the Boston Home Market Club, and the American Protective Tariff League disseminated pro-tariff pamphlets, raised campaign funds, and lobbied lawmakers on behalf of protectionism.[44] With powerful economic interests exerting pressure on the tariff question, even the foremost authority on the tariff, the Harvard economist F.W. Taussig, was hesitant in completely repudiating protectionism.[45]

The regional politics behind tariff reform only seemed to reinforce the resiliency of protectionism. The tariff had long been an issue endemic in

40. *See* JUDITH GOLDSTEIN, IDEAS, INTERESTS, AND AMERICAN TRADE POLICY 81–136 (1993); JOANNE REITANO, THE TARIFF QUESTION IN THE GILDED AGE: THE GREAT DEBATE OF 1888, at 9–10 (1994).

41. *See* HENRY C. CAREY, THE FINANCE MINISTER, THE CURRENCY AND THE PUBLIC DEBT 11–15 (1863); 1 HENRY C. CAREY, PRINCIPLES OF POLITICAL ECONOMY (1837); 3 JOSEPH DORFMAN, THE ECONOMIC MIND IN AMERICAN CIVILIZATION, 1865–1918, at 6–7 (Augustus M. Kelley ed., 1969).

42. REITANO, *supra* note 40, at 57–58.

43. GOLDSTEIN, *supra* note 40, at 88. For a more thorough investigation of the historical development of free-trade ideas and the opposition they faced from antiquity to the twentieth century, see generally DOUGLAS A. IRWIN, AGAINST THE TIDE: AN INTELLECTUAL HISTORY OF FREE TRADE (1996).

44. REITANO, *supra* note 40, at 115–16.

45. *See* 3 DORFMAN, *supra* note 41, at 270–71; F.W. TAUSSIG, THE TARIFF HISTORY OF THE UNITED STATES (1898).

American politics, pitting the northeastern Republican interests that favored protectionism against the more agrarian political base of the Democratic Party. Incessant logrolling over revisions to the duties list, and the ability to link tariff revenues to particular spending programs, permitted lawmakers to exploit the differences in regional interests. After the Civil War, Republicans were able to widen and tighten their hold over the protective tariff by appealing to new sets of constituents. By adding items such as wool, hides, and grains to the duties list, northeastern Republicans were able to bring western and midwestern farming interests into the protectionist fold.[46] Moreover, Republicans used revenues from the tariff to underwrite the nation's first proto-welfare provisions: Civil War pensions.[47] Because only Union Army veterans were eligible for these pensions, Republicans were able to solidify their support for the tariff in the North and West, while further marginalizing the resistance of southern Democrats.[48]

Despite these economic and political factors, the popularity of the tariff began to wane at the turn of the century. Because economic ideas alone were not enough to erode the traditional reliance on the indirect system of taxation, other, more material conditions helped to hasten the demise of the *ancien* tax regime. Foremost among these factors was the deterioration of the Republican Party's political coalition supporting protectionism.[49] Increasing federal government surpluses, an aging population of Civil War veterans, and a mature industrial economy with large corporations searching for overseas markets all contributed to the skepticism surrounding protectionism.[50] Democrats and progressive Republicans began questioning whether the protective tariff created more detriments than benefits. The rising cost of living and the increasing concentration of wealth and corporate capital, tariff opponents claimed, were directly tied to the Republican agenda of high import duties. The growing consolidation of large corporations, and the increasing fortunes of their owners, seemed to confirm that the protective tariff had outlived its usefulness as a device to shield infant domestic industries from international competition.[51]

A similar, though less pronounced, deterioration of the old fiscal order was occurring at the state and local level at about the same time. Throughout

46. SANDERS, *supra* note 8, at 217–19.

47. RICHARD F. BENSEL, SECTIONALISM AND AMERICAN POLITICAL DEVELOPMENT, 1880–1980, at 60–103 (1984); SKOCPOL, *supra* note 29, at 112–14.

48. *See* PAUL WOLMAN, MOST FAVORED NATION: THE REPUBLICAN REVISIONISTS AND U.S. TARIFF POLICY, 1897-1912 (1992); REITANO, *supra* note 40, at 119; Hansen, *supra* note 26.

49. SANDERS, *supra* note 8, at 164.

50. WOLMAN, *supra* note 48, at xii, 2–3.

51. SANDERS, *supra* note 8, at 217–36

the nineteenth century, the general property tax—a measure that began as a levy on real property and then later included personal property—dominated state and local revenues. As late as 1890, the property tax accounted for over 70 percent of state revenues and roughly 90 percent of local receipts.[52] Over time, however, structural changes in the economy gradually began to erode the ability of the general property tax to provide sufficient revenue, particularly in the face of increasing government demands for funds.[53] With the institutional development of finance capitalism, new forms of intangible wealth—namely stocks, bonds, and other financial assets—became increasingly prevalent.[54] As they did, the administration of the property tax, which had always been open to malfeasance of one sort or another, became even more arbitrary, as wealth held in the form of financial assets often eluded property tax assessment. Preoccupied by the failings of this levy, tax reformers focused their early efforts on discrediting this antiquated tax.[55]

As support for the tariff and property taxes waned, other pressures compelled governments at all levels to consider alternative forms of financing. If the demise of the old tax regime was diminishing the supply of government funds, geopolitical and demographic forces were having the opposite effect on the demand for government resources. Although interest payments on the national debt began to decline in the last decades of the nineteenth century, as the Civil War debts were retired and the number of Civil War pensioners was gradually declining, the federal government was becoming increasingly active at home and abroad in the decades straddling the turn of the century.[56] The Spanish-American War and the beginnings of an overseas U.S. military empire required increased funds, as did the rise and maintenance of new regulatory and administrative agencies.[57] State and local governments faced similar pressures, as ships teeming with new

52. GEORGE C.S. BENSON ET AL., THE AMERICAN PROPERTY TAX: ITS HISTORY, ADMINISTRATION, AND ECONOMIC IMPACT 83 (1965).

53. *See generally* GLENN W. FISHER, THE WORST TAX? A HISTORY OF THE PROPERTY TAX IN AMERICA (1996); JON C. TEAFORD, THE RISE OF THE STATES: EVOLUTION OF AMERICAN STATE GOVERNMENT 42–68 (2002).

54. WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA 4–5 (1997).

55. C.K. YEARLEY, THE MONEY MACHINES: THE BREAKDOWN AND REFORM OF GOVERNMENTAL AND PARTY FINANCE IN THE NORTH, 1860–1920, at 39–41 (1970); *see* text accompanying *infra* notes 184–186.

56. *See generally* FINE, *supra* note 15; WILLIAM A. WILLIAMS, THE TRAGEDY OF AMERICAN DIPLOMACY (1959).

57. By 1900, spending on the Department of Army and Navy constituted the single largest category of federal spending, amounting to almost 40 percent of total spending. HISTORICAL STATISTICS OF THE U.S., *supra* note 1, at 1115.

immigrants brought demographic pressures to bear on dilapidated systems of infrastructure and social services. The calls for public spending were especially strong at the state level during the "halcyon days of the urban promoters," when "boosters of each city believed that the best way to guarantee prosperity in the future was to create the state's smoothest streets, fastest transportation system, most efficient garbage removal, biggest schools, and best fire and police protection."[58]

These two issues—the decreasing supply of financial resources and the increasing demand for government revenue—combined to create a kind of fiscal crisis in governance at the turn of the century. With policymakers and legislators searching for alternative ways to meet the mounting demands placed upon the public sector, economists competed with other, more organized political coalitions in attempting to shape tax policy. Some interest groups, namely corporations, sought to limit state spending and make the administration of government more rational and routinized—and hence more business-like.[59] Other groups, like the reform-minded economists, suggested more fundamental changes, including the adoption of income taxes.

The mismatch between the supply of funds and the demand for increased government spending combined with another factor, the growing disparity of wealth, to spur the turn-of-the-century transformation in American public finance. As modern economic historians have suggested, the distribution of wealth in the United States became increasingly concentrated in the late nineteenth century.[60] Commentators at the time were well aware of this trend in inequality. In 1893, the federal statistician George K. Holmes employed data from the 1890 census to estimate that 91 percent of the nation's families owned less than 30 percent of the national wealth, while 9 percent controlled the remaining 70 percent.[61] Although Holmes was no proponent of radical wealth redistribution, he warned that "there is always the danger that [the

58. DAVID P. THELEN, THE NEW CITIZENSHIP: ORIGINS OF PROGRESSIVISM IN WISCONSIN, 1885–1900, at 133–34 (1972). With the onset of the depression of the late 1890s, many Wisconsin cities increased their public spending as they "demonstrated a sense of obligation to their unemployed by hiring them as street sweepers and by undertaking larger public works projects that also required manpower." *Id.* at 62.

59. *See generally* R. RUDY HIGGENS-EVENSON, THE PRICE OF PROGRESS: PUBLIC SERVICES, TAXATION, AND THE AMERICAN CORPORATE STATE (2003); TEAFORD, *supra* note 53.

60. Simon Kuznets, *Economic Growth and Income Inequality*, 45 AM. ECON. REV. 1, 19 (1955); Richard H. Steckel & Carolyn M. Moehling, *Rising Inequality: Trends in the Distribution of Wealth in Industrializing New England*, 61 J. ECON. HIST. 160 (2001). For a concise summary of the economic history literature on this topic, see Clayne Pope, *Inequality in the Nineteenth Century*, in 2 THE CAMBRIDGE ECONOMIC HISTORY OF THE UNITED STATES 109 (Stanley L. Engerman & Robert E. Gallman eds., 2000).

61. George K. Holmes, *The Concentration of Wealth*, 8 POL. SCI. Q 589, 592 (1893).

rich] will get too large a hold upon the wealth, the resources and the labor of the country," in which case "the most effective and practicable remedies are progressive taxes on incomes, gifts and inheritances."[62] Only through such measures could society ensure "a distribution . . . most conducive to social welfare."[63]

The results of empirical studies conducted by Holmes and others reached nearly every corner of American society.[64] Writing in the pages of the *American Federationist*, the official newspaper of the American Federation of Labor, Eltweed Pomeroy commented on how American society had reached an unprecedented level of inequality. Citing to some of the leading empirical studies of the day, Pomeroy confidently concluded, "Today the sun looks down on the most unequal and inequitable distribution of wealth that has probably ever been seen."[65] Among the primary causes of this new concentration of wealth, Pomeroy identified "indirect and inequitable taxation, and special and monopoly privilege" as the most significant.[66]

Many social critics even went so far as to attribute the visible poverty and class conflict of the times to this growing disparity of wealth and opportunity. Indeed, the Panic of 1893, which triggered an ensuing depression, exacerbated the visibility of growing poverty and class conflict. Marked by many economic historians as "among the most severe" depressions in the United States, the business contraction of the mid-1890s brought with it an unemployment rate of approximately 20 percent, a bank failure rate that was surpassed only by the Great Depression, and a rate of general business failures that was utterly astounding to most contemporary commentators.[67] The economic depression, in turn, exacerbated the tensions within industrial relations, triggering further strikes and labor unrest. It was against this backdrop of growing dissatisfaction with the existing sources of revenue,

62. *Id.* at 599–600.

63. *Id.* at 600. Holmes was also no proponent of the environmental explanation for poverty. He believed that "the defects of human nature" helped explain the maldistribution of wealth. *Id.* at 599. "There is a large element of the population unfitted to save or to earn much, and unqualified to use and keep considerable wealth," Holmes wrote. *Id.* "Until the race improves this class out of existence, there will be an extreme of poverty—the penalty of shiftlessness, improvidence, a want of economy and deficient industry." *Id.*

64. *Id.*; *see also* CHARLES B. SPAHR, AN ESSAY ON THE PRESENT DISTRIBUTION OF WEALTH IN THE UNITED STATES (1896).

65. Eltweed Pomeroy, *The Concentration of Wealth and the Inheritance Charge*, AM. FEDERATIONIST, July 1895, at 1.

66. *Id.*

67. CHARLES HOFFMANN, THE DEPRESSION OF THE NINETIES: AN ECONOMIC HISTORY 4, 57–58, 109, 285–97 (1970); GERALD T. WHITE, THE UNITED STATES AND THE PROBLEM OF RECOVERY AFTER 1893 (1982).

increasing pressure for more government spending, and concerns over rising inequality and class conflict, that the Progressive-Era economists made their mark in molding the theoretical parameters of the modern American fiscal state.

II. THE PROGRESSIVE PUBLIC FINANCE ECONOMISTS

The professional economists who led the campaign for an income tax at the turn of the century were part of a larger cohort of academic social scientists who were seeking to dismantle the orthodox theories of laissez-faire that dominated classical and neoclassical visions of law and political economy. Responding to the material forces of modernity that had eroded notions of self-reliant individualism, this rising class of professional social scientists sought to demonstrate, through their writings and teachings, the mutual interdependence of modern social relations. With the establishment of the American Economic Association (AEA) in 1895, these economists were among the first group of social scientists to sever their ties to the general antebellum field of moral philosophy and place their discipline on a new professional standing. And like the other professional social scientists of their generation, these young economists believed that their economic expertise would place their ideas and policies above the fray of everyday politics. Though their vision of "science" often varied from the views of other academics, the new generation of economists implicitly claimed that their objective, apolitical knowledge legitimated their pronouncements.[68]

From the beginning, the young generation of economists who founded the AEA sought to use their training to address the social concerns of the day. Calling themselves the "new school" of American political economy, these young maverick intellectuals challenged the reigning system of economic thought.[69] Eschewing timeless universalisms, these academics resolutely believed that economic relations were embedded in a larger social and institutional matrix—a matrix that was often constituted by law and legal processes. Although seeds of this institutionalist strand of American economic thought did not fully blossom until the 1920s and early 1930s, alongside American legal realism, many of the leading new school economists were eager

68. For more on the professionalization of the social sciences, see generally sources cited *supra* note 17.

69. For more on the "new school" of American political economy, see generally FINE, *supra* note 15, at 212–21; FURNER, *supra* note 17, at 59–80.

to use the law to exercise the "ethical agency" of state power.[70] Many of these ethical or proto-institutionalist economists were indeed part of what legal historians have identified as the "First Great Law & Economics Movement."[71]

Among this first generation of professionally trained economists, there were several who were interested in public finance. Occupying influential teaching posts throughout the country, academics such as Henry Carter Adams, Richard T. Ely, and Edwin R.A. Seligman dedicated much of their careers to the empirical and theoretical study of taxation. Adams, who spent the majority of his academic career at the University of Michigan (after a tumultuous experience at Cornell),[72] focused his early scholarship on public finance and wrote some of the earliest, most influential American treatises on budgets and public debts.[73] When he was appointed chief statistician of the Interstate Commerce Commission in 1887, Adams's attention turned away from fiscal issues to the regulation of railroads, the topic for which he is best remembered today.[74]

Ely, likewise, began his academic career with an interest in public finance. He investigated state and local tax issues as a member of the Baltimore and Maryland tax commissions while he was a junior faculty member at the Johns Hopkins University.[75] And, like Adams, he turned his attention to other matters later in his career. When he joined the University

70. FINE, *supra* note 15, at 216–19; FURNER, *supra* note 17, at 69–75. In drafting the initial charter of the American Economic Association (AEA), Richard Ely explicitly proclaimed that the state should be viewed as an "ethical agency whose positive aid is an indispensable condition of human progress." RICHARD T. ELY, GROUND UNDER OUR FEET: AN AUTOBIOGRAPHY 136 (1938). Ely's language for the charter led to an enormous controversy at the founding of the AEA that helped define the fault lines between the "new school" and the orthodox political economists. For more on the founding of the AEA, see generally ROSS, *supra* note 17, at 110–12; A.W. Coats, *The American Economic Association and the Economics Profession*, 23 J. ECON. LITERATURE 1697 (1985). In contrast to Coats and Ross, Thomas Haskell has argued that the AEA, as the locus of new school reformism, was first and foremost a professional organization and not a vehicle for social change. HASKELL, *supra* note 17, at 187–88.

71. *See generally* Herbert Hovenkamp, *The First Great Law & Economics Movement*, 42 STAN. L. REV. 993 (1990); BARBARA H. FRIED, THE PROGRESSIVE ASSAULT ON LAISSEZ FAIRE: ROBERT HALE AND THE FIRST LAW AND ECONOMICS MOVEMENT (1998).

72. *See infra* notes 115–116 and accompanying text.

73. A.W. Coats, *Henry Carter Adams: A Case Study in the Emergence of the Social Sciences in the United States, 1850–1900*, 2 J. AM. STUD. 177 (1968); 3 DORFMAN, *supra* note 41, at 164–74; Joseph Dorfman, *Introduction* to TWO ESSAYS BY HENRY CARTER ADAMS (Joseph Dorfman ed., 2d ed. 1969). For a complete bibliography of Adams's publications, see S. Laurence Bigelow et al., *Henry Carter Adams*, 30 J. POL. ECON. 201–11 (1922).

74. Marvin B. Rosenberry, *Henry Carter Adams*, 16 I.C.C. PRAC. J. 10, 19–21 (1948).

75. ELY, *supra* note 70, at 172–73 (1938); RICHARD T. ELY, TAXATION IN AMERICAN STATES AND CITIES (1888); JOHN PRENTISS POE & RICHARD T. ELY, REPORT OF THE TAX COMMISSION OF BALTIMORE (Baltimore, King Bros. 1886).

of Wisconsin faculty—where he spent the majority of his career—he began focusing his energies more on labor economics and industrial relations.[76]

By contrast, Seligman, who spent nearly his entire adult life associated with Columbia University, first as a student and then as a faculty member, was committed throughout his career to the study of taxation.[77] He began his lifelong commitment to the American "science of finance" with a series of articles in the late 1880s and several significant tax treatises in the following decade; [78] he ended his career as "the leading tax expert of his time," with his life's work spanning "the entire arc of tax reform theory."[79] As one of the editors of the Columbia-sponsored *Political Science Quarterly*, and the editor assigned to the topic of public finance for a Columbia Press book series, Seligman became the de facto translator of continental texts on fiscal policy early in his career.[80] He would later recount to Wesley C. Mitchell, one of his Columbia colleagues, that this "mere accident of departmental organization" would lead to his lifelong commitment to the study of taxation.[81] To be sure, there were other thinkers who contributed to the emerging American literature on public finance. But it was Adams, Ely, and especially Seligman who were not only representative of their generation of economic thinkers, but were also the pivotal historical figures guiding the paradigm shift in tax theory.

76. ELY, *supra* note 70, at 190–94.

77. Seligman received his undergraduate education, his doctoral training, and a law degree from Columbia University before joining the faculty of Political Economy. Franek Rozwadowski, *From Recitation Room to Research Seminar: Political Economy at Columbia University*, *in* BREAKING THE ACADEMIC MOULD: ECONOMISTS AND AMERICAN HIGHER LEARNING IN THE NINETEENTH CENTURY 196 (William J. Barber ed., 1982).

78. Seligman's first set of publications, ostensibly about taxation, focused on the railroads. *See* Edwin R.A. Seligman, *Railway Tariffs and Interstate Commerce Law*, 2 POL. SCI. Q. 223 (1887); Edwin R.A. Seligman, *Railway Tariffs and Interstate Commerce Law II*, 2 POL. SCI. Q. 369 (1887). Defending the Interstate Commerce Commission in these articles, Seligman described how railroad rates were similar to taxation and hence should be governed by the principle of "ability to pay"—the notion that "a rich man ought to pay more than a poor man." *Id.* at 249.

79. HIGGENS-EVENSON, *supra* note 59, at 78.

80. Among the many books Seligman reviewed for the *Political Science Quarterly*, several were by his German teachers. *See* Edwin R.A. Segliman, Book Review, 1 POL. SCI. Q. 143 (1886) (reviewing GUSTAV COHN, SYSTEM DER NATIONALÖKONOMIE (1885)); Edwin R.A. Segliman, Book Review, 4 POL. SCI. Q. 543 (1889) (reviewing GUSTAV SCHMOLLER, ZUR LITTERATURGESCHICHTE DER STAATS-UND SOZIALWISSENSCHAFTEN (1888)); Edwin R.A. Segliman, Book Review, 5 POL. SCI. Q. 171 (1890) (reviewing ADOLPH WAGNER, FINANZWISSENSCHAFT (1889)).

81. Wesley C. Mitchell, *Tribute*, *in* EDWIN ROBERT ANDERSON SELIGMAN, 1861–1939, at 60 (1942); *In Memoriam: Edwin Robert Anderson Seligman*, 54 POL. SCI. Q. 480 (1939).

A. Common Experiences

What united Adams, Ely, Seligman, and many of the other ethical or proto-institutionalist economists were their personal backgrounds and their experiences coming of age during the turbulent decades of the late nineteenth century. Though Ely, Adams, and Seligman were each reared in rather different environments, they all shared, at an early age, an interest in social reform. Ely was raised in the agricultural region of upstate New York by a family of ardent Presbyterians dedicated to egalitarianism and social change, who had hoped that young Richard would one day join the ministry.[82] Similarly, Adams was born and raised in rural Iowa, the son of a Congregational minister and abolitionist leader, who also aspired to mold his son into a minister.[83] Seligman, by contrast, was the child of an affluent, New York City German-Jewish family that was active in civic and social reform organizations, such as Felix Adler's Society for Ethical Culture.[84]

If their upbringings inclined these three men toward social change, their experiences with the harsh material realities of late nineteenth-century American life fortified their reformist tendencies. Not only did the forces of rapid industrialization and urbanization heighten the disparity of wealth, the uneven development of modern American capitalism also fueled class conflict and labor unrest during this period. The interchange of radical labor protests and conservative reactions fueled the tensions of the day. Tremendous industrial strikes, occasioned by periodic economic downturns, provoked anti-radical and anti-labor campaigns that heightened the anxiety surrounding the question of the role of an autonomous labor movement in an industrialized democracy. In 1886 alone, there were

82. ELY, *supra* note 70, at 13–15; BENJAMIN G. RADER, THE ACADEMIC MIND AND REFORM: THE INFLUENCE OF RICHARD T. ELY IN AMERICAN LIFE 2–6 (1966).

83. Coats, *supra* note 73, at 179–80; Dorfman, *supra* note 73, at 9.

84. William Weisberger, *Seligman, Joseph*, 19 AMERICAN NATIONAL BIOGRAPHY, 623–25 (John A. Garraty & Mark C. Carnes eds., 1999). Historians of economic thought have written at great length about how this generation of political economists, including Ely, Adams, and Seligman, were united by a religious fervor for social reform. But while all three of these thinkers were brought up in an environment where religion was important—for Ely and Adams, the evangelicalism of Protestantism, and for Seligman, reformed Judaism—they also shared the common trait of turning their backs on the religious zeal of their families. Ely and Adams attempted, but eventually gave up on, careers in the ministry, and Seligman turned his back on Judaism at a relatively early age. FURNER, *supra* note 17, at 49–56; ROSS, *supra* note 17, 102–04. According to his son, Eustace, Edwin Seligman had "broken with Judaism psychologically, intellectually and every other way" relatively early in his life. Interview with Eustace Seligman for the Columbia University Oral History Collections (Sept. 3, 1974) (on file with Butler Library, Columbia University).

approximately 1500 strikes; none was better known than the one leading to the Haymarket Riot and the subsequent backlash against the labor movement.[85]

The public salience of the "labor question" was not lost on these budding academics. After searching for work on the streets of New York, Ely resolved as early as 1880 to become an advocate for the working class.[86] When Adams began his graduate training at Johns Hopkins, he was struck, as he walked the streets of Baltimore, by the extent of urban poverty.[87] Although Seligman was the scion of a prestigious banking family, he was empathetic to the needs and wants of trade unionism, as his early scholarship on the cooperative movement and Christian socialists suggested.[88] Indeed, nearly this entire generation of American academics struggled with the longstanding dilemma of attempting to "bridge the world of educated opinion and that of the working masses."[89] For those who became interested in public finance, the distribution of fiscal burdens was an ideal topic to help bridge the chasm between highbrow theories and the material world of the masses.

B. The German Influence

Above all else, what eventually united Ely, Adams, Seligman, and other young progressive economists was their economic training in Germany. Following the path of their American mentors, a whole host of aspiring American academics made a sojourn to Germany to complete and often to complement their graduate school training.[90] As one of the oldest of the group, Ely helped initiate this transatlantic transfer of ideas and pedagogy. He attended the University of Heidelberg, where he completed his doctorate under the guidance of Karl Knies. Ely also brought the German seminar model of teaching back to Johns Hopkins, where he began his teaching

85. *See generally* MELVYN DUBOFSKY, INDUSTRIALISM AND THE AMERICAN WORKER, 1865–1920 (1975); P.K. EDWARDS, STRIKES IN THE UNITED STATES, 1881–1974 (1981); WALTER LICHT, INDUSTRIALIZING AMERICA: THE NINETEENTH CENTURY (1995); DAVID MONTGOMERY, THE FALL OF THE HOUSE OF LABOR 2 (1987).

86. ELY, *supra* note 70, at 164–65; RADER, *supra* note 82, at 16; ROSS, *supra* note 17, at 105.

87. ROSS, *supra* note 17, at 105; Letter from Henry C. Adams to Mother (Oct. 22, 1876), Correspondence Jan.–June 1878, Box 1, Henry Carter Adams Papers (on file with Bentley Historical Library, University of Michigan).

88. Edwin R.A. Seligman, *Owen and the Christian Socialists*, 1 POL. SCI. Q. 206 (1886).

89. LEON FINK, PROGRESSIVE INTELLECTUALS AND THE DILEMMAS OF DEMOCRATIC COMMITMENT (1997).

90. *See generally* JURGEN HERBST, THE GERMAN HISTORICAL SCHOOL IN AMERICAN SCHOLARSHIP: A STUDY IN THE TRANSFER OF CULTURE (1965); RODGERS, *supra* note 13, at 76–111; Joseph Dorfman, *The Role of the German Historical School in American Economic Thought*, 45 AMER. ECON. REV. 17 (1955).

career.[91] Adams, who received one of the first doctorates granted by an American university (Johns Hopkins), also completed his graduate studies at Heidelberg as well as the University of Berlin, where he studied with Adolph Wagner, one of Germany's leading authorities on public finance.[92] Seligman, who had family ties in Germany and often visited Europe during his childhood, also studied in Heidelberg and Berlin, under the tutelage of Wagner, Gustav Schmoller, and other well-known German economists.[93]

This shared intellectual connection to Germany was more than just a coincidence. Unlike some of their more conservative colleagues who also studied in Germany,[94] Ely, Adams, Seligman, and many of the other members of the new school were deeply indebted to their German training. The more radical American students, in fact, became great admirers of the scholars who made up the German Historical School of Economics. Ely, Adams, and Seligman each studied under some of these leading German scholars. Seligman, who had the greatest affinity for German culture, maintained a substantive correspondence with his teachers long after his days as a student.[95]

Historians of economic thought have disagreed as to the coherency and legitimacy of the so-called German Historical School of Economics. They have questioned whether it was really a "school of thought," whether it was, in fact, "historical," and even whether it was truly "German."[96] Still, most commentators agree that German academics such as Wilhelm Roscher, Gustav Schmoller, Karl Knies, and Adolph Wagner—to name only a few—coalesced as a group of intellectuals during the second half of the nineteenth century who came to question the metaphysical laws of classical political

91. ELY, *supra* note 70, at 41–47; RADER, *supra* note 82, at 18; William J. Barber, *Political Economy in the Flagship of Postgraduate Studies: The Johns Hopkins University*, *in* BREAKING THE ACADEMIC MOULD: ECONOMISTS AND AMERICAN HIGHER LEARNING IN THE NINETEENTH CENTURY, *supra* note 77, at 203, 209–10.

92. RODGERS, *supra* note 13, at 96–97; Barber, *supra* note 91, at 207–08; Dorfman, *supra* note 73, at 11.

93. Carl S. Shoup, *Edwin R.A. Seligman*, *in* INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES 163 (David L. Sills ed., 1968); Rozwadowski, *supra* note 77, at 196.

94. Arthur Hadley and F.W. Taussig, two conservative contemporaries of the new school economists, also studied in Germany but came away from their experiences with a very different attitude towards historicism. FURNER, *supra* note 17, at 54–55.

95. HERBST, *supra* note 90, at 134–35, 213; RODGERS, *supra* note 13, at 76–111; Dorfman, *supra* note 90; Notebooks from Classes in Berlin, Box #86, Lecture Notes Taken By Edwin R.A. Seligman, Edwin R.A. Seligman Papers (on file with Butler Library, Columbia University); Cataloged Correspondences with Gustav Schmoller and Adolph Wagner, Edwin R.A. Seligman Papers (on file with Butler Library, Columbia University).

96. Heath Pearson, *Was There Really a German Historical School of Economics?*, 31 HIST. POL. ECON. 547 (1999); Dorfman, *supra* note 90, at 17–28; HERBST, *supra* note 90, at 130; JOSEPH A. SCHUMPETER, HISTORY OF ECONOMIC ANALYSIS 808–14 (1954).

economy. Led by Roscher, who in the 1840s began the assault on deductive, a priori systems of economic thought, the subsequent generation of German academics contended that universal economic laws were incoherent outside of their social, political, and economic context.[97]

Like the German school of jurisprudence, which Roscher explicitly sought to emulate, the German historical economists believed that human societies were not governed by natural laws. Instead, Roscher and his colleagues contended that social and economic relations were contingent upon historical and institutional contexts. These scholars used the term "historical" in its broadest sense to highlight not only the significance of the past, but to renounce generalizing theories in favor of a fidelity to the particularity of actual events.[98] Similarly, they used the term "institution" to refer to a broad category of norms and other socially created constraints on human behavior. From this vantage point, scholars such as Schmoller critiqued the tenets of classical and neoclassical economic theory, and took a normative position on the role of the state in guiding the economy and society. In contrast to the laissez-faire commitment of classical theory, the German historical economists argued that the increasing complexity and interdependence of modern society required a changing and more active role for the positive state.[99]

It was this methodological emphasis on contingency, and the normative appeal to state action, that had the greatest influence on the young American political economists trained at the foot of the German Historical School. As historians have chronicled, many of the American scholars who traveled to Germany in the last decades of the nineteenth century came back to the United States with a more radical and fervent desire for reform.[100] In their role as academics, these progressive intellectuals adopted the pedagogical seminar style of the German universities and absorbed the substantive lessons of their German teachers. In the process, they helped forge not only a new view of economics, but a distinct form of American new liberalism that advocated using the powers of the state to address the numerous social dislocations of modern industrial society.[101]

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97. RODGERS, *supra* note 13, at 90–95; 3 DORFMAN, *supra* note 41, at 131–34; SCHUMPETER, *supra* note 96, at 807–09.

98. Pearson, *supra* note 96, at 548–49.

99. FURNER, *supra* note 17, at 48–49; RODGERS, *supra* note 13, at 76–111; ROSS, *supra* note 17, at 98–140. Other scholars, by contrast, have depicted the German historical school as a "coherent conservative critique of laissez-faire" that sought to perpetuate "patriarchy and absolutism as the best possible legal, political, and social shell for a capitalism without class struggle." GOSTA ESPING-ANDERSEN, THE THREE WORLDS OF WELFARE CAPITALISM 10 (1990).

100. RODGERS, *supra* note 13, at 76–111.

101. For more on American new liberalism, see sources cited *supra* note 13.

Nowhere was the influence of German historicism on American new liberalism more apparent than among those American scholars who were interested in fiscal policy. Ely, Adams, and Seligman, in particular, returned from their postgraduate experiences in Germany with a serious interest in understanding pubic finance, or what their German teachers referred to as *Finanzwissenschaft*, the "Science of Finance." Having read Schmoller's historical tracts and Wagner's calls for the need for a redistributive tax policy, Ely, Adams, and Seligman began to lay the intellectual foundations of American public finance theory. But first they had to translate the general philosophy of the German Historical School for an American audience. In keeping with the historicism they learned from their German mentors, these aspiring public finance economists attempted to graft continental ideas onto the stock of Anglo American thought; they sought, in other words, to make German economic theories congruent with modern American institutions and culture.

C. From Berlin to Baltimore: Transplanting German Ideas Onto American Soil

When he began teaching at Johns Hopkins, Ely became one of the first Americans to import the economic ideas of his German teachers to the United States. He identified the German Historical School as the model for the American new school of heterodox economists. Although he was careful not to dismiss completely the contributions of Adam Smith and the classical political economists, Ely described their ideas as outdated and proclaimed that a more scientific method, one that emphasized a historical and institutional approach, was now carrying the day.[102]

Other new school economists soon followed Ely's lead. In one of his first published essays, Seligman claimed that German scholars such as Roscher, Knies, and Hildebrand were the first thinkers to place economic ideas within a "truly scientific basis" by proclaiming "the necessity of treating economics from the historical stand-point."[103] Seligman contended that it was these German thinkers, and now their American counterparts in the new school, who discarded "the exclusive use of deductive method" and called for the "necessity of historical and statistical treatment."[104] It was they who

102. Richard T. Ely, *The Past and the Present of Political Economy*, 2 OVERLAND MONTHLY 225 (2d ser. 1883).
103. Edwin R.A. Seligman, *Change in the Tenets of Political Economy With Time*, 7 SCIENCE 375, 381 (1886).
104. *Id.*

denied "the existence of immutable natural laws in economics, calling attention to the interdependence of theories and institutions, and showing that different epochs or countries require different systems."[105] It was the German Historical School, Seligman continued, that abandoned any "belief in the beneficence of the absolute laissez-faire system," and maintained "the closer interrelation of law, ethics, and economics," while refusing to accept "the assumption of self-interest as the sole regulator of economic action."[106] Finally, and most importantly for Seligman, the new school shared with its German counterpart the need to address contemporary problems. Once it was free from the reigning orthodoxy of laissez-faire, "the new school, devoid of all prepossessions, devoted itself to the task of grappling with the problems which the age had brought with it."[107] These were the main principles, Seligman argued, that their German mentors had bequeathed to the new school of American political economy.[108]

The American new school was not, however, a simple imitation of German historical economics; suggesting that it was would belie the true lessons of historicism. Both schools of thought were rather a function of historically specific social and economic conditions. Thus, the message of the German Historical School was a manifestation of an industrial era. Similarly, Seligman explained, "[t]he new school is the product of the age, of the *zeitgeist*, not of any particular country; for the underlying evolutionary thoughts of a generation sweep resistlessly throughout all countries whose social conditions are ripe for change."[109] Even English economists—those most ardent supporters of timeless economic and legal doctrines—Seligman argued, could not resist the force of the *zeitgeist*. John Stuart Mill "himself had gone through an evolution and was sincere enough to express his disbelief in the old economy, and to a certain extent in his own book."[110] This commitment to the relativity of economic and legal doctrines—a commitment that Ely, Adams, and Seligman acquired mainly during their German education—became an essential part of their overall fiscal vision.[111]

While Ely and Seligman embraced the process of transplanting German ideas onto American soil, others had a more tempered response. Adams, for instance, had always been skeptical of some of the more radical

105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.* at 382.
110. *Id.* at 381.
111. *Id.*

proposals of the German socialists, such as the idea that "all the children shall be brought up by the state."[112] Writing to his mother during his time in Germany, Adams described such proposals as "a dream of a new creation in which the nature of man as well as social organization must be entirely remodeled."[113] Such a communal view of society "cannot exist and spread in America," wrote Adams, "because we love our homes to [sic] much. Men are too exclusive in their habits to want commonality in everything."[114] Adams, more so than some of his new school colleagues, understood the institutional constraints posed by American political culture. In this way, he was more consistent in self-reflexively applying historicism to his own particular context.

Yet while Adams may have harbored some reservations about the reception of social democratic ideas by American culture, he was by no means an apologist for capital. On the contrary, during the labor turmoil of the Gilded Age, Adams, along with many of his new school colleagues, was an adamant supporter of the American labor movement and its calls for greater equality in industrial relations. For a younger, rebellious generation of thinkers, however, such support often came at a price. Adams's academic career, for instance, was dealt a serious setback in 1886 when his employment contract with Cornell was not renewed because of his public comments suggesting that labor deserved "proprietary rights" in industrial capital.[115] Coming on the heels of one of the most violent years of labor strife, when many Americans feared the rising tide of socialism, Adams's comments were interpreted by prominent Cornell alumni and administrators as unequivocal support for labor's "crusade against capital."[116] Adams

112. Letter from Henry C. Adams to Mother (Aug. 4, 1878), Correspondence Jan.–June 1876, Box 1, Henry Carter Adams Papers, (on file with Bentley Historical Library, University of Michigan) (copy on file with author).

113. *Id.*

114. *Id.*

115. Henry C. Adams, *The Labor Problem*, SCI. AM. SUPPLEMENT, Aug. 21, 1886, at 8861–63; FURNER, *supra* note 17, at 133–38.

116. Rosenberry, *supra* note 74, at 27; Dorfman, *supra* note 73, at 36. It appears that Adams did not believe that his public comments at Cornell were cause for concern. As late as the fall of 1886, many months after his public comments, Adams wrote Seligman about the controversy stating that he did not "have any reason to apprehend difficulty." Letter from Henry C. Adams to Edwin R.A. Seligman (Nov. 9, 1886), *quoted in* Joseph Dorfman, *The Seligman Correspondence II*, 56 POL. SCI. Q. 270, 270 (1941). Nevertheless, Adams did request that Seligman publish a positive review of Adams's *Outline of Lectures on Political Economy* in the next issue of the *Political Science Quarterly*, as a safeguard against the possibility of dismissal from Cornell. Letter from Henry C. Adams to Edwin R.A. Seligman (Nov. 17, 1886), *quoted in* Dorfman, *supra*, at 270–71. Seligman complied by having their mutual friend Edmund James review the text. James's favorable review emphasized the "conservative nature" of Adams's work. Edmund J. James, Book Review, 2 POL. SCI. Q. 186, 188 (1887) (reviewing HENRY CARTER ADAMS, OUTLINE OF LECTURES UPON POLITICAL ECONOMY (1886)).

was able, ultimately, to secure a position at the University of Michigan after assuring administrators there that he was no socialist.[117] Still, Adams's encounter with the political constraints on academic freedom colored much of his subsequent scholarship and informed his generation of American social scientists about the limits of academic freedom.[118]

In this regard, Adams was not alone. Ely and several other reform-minded economists faced similar political pressures during the 1890s.[119] Indeed, defining the limits of academic freedom became an essential part of the professionalization process.[120] Forced to realize that American professors did not enjoy the same intellectual liberty or political support as their German counterparts, the new school economists learned to temper their views on controversial issues. After his ordeal at Cornell, Adams, for instance, began to couch his otherwise more daring pronouncements on law and political economy with an appeal to "English liberty" and the long established cultural values of American institutions.[121] Surely, these collisions with political power during the early stages of the professionalization of the social sciences tempered nearly every aspect of the economists' theories, including their views on public finance. While it is doubtful that Ely, Seligman, or Adams wholly embraced the radically redistributive tax theories of their German mentors, any sympathy they may have had was certainly diminished after they witnessed firsthand how American society responded to academic support for anything remotely resembling socialism.

D. Drawing on the Undifferentiated Tradition of Benefits and Faculty Theories

When these German-trained public finance economists set out to construct the theoretical blueprints for the new fiscal polity, they were able to rely on a long tradition of tax principles. Neither the benefits principle nor the notion of faculty was unique to the historical development of the American income tax. Both of these doctrines had coexisted throughout

117. Dorfman, *supra* note 73, at 38.
118. FURNER, *supra* note 17, at 138–39.
119. *Id.* at 146–62; RADER, *supra* note 82, at 136–50.
120. FURNER, *supra* note 17, at 147–62.
121. Henry C. Adams, *Discussion of the Interstate Commerce Act*, 1 MICH. POL. SCI. ASS'N PUBLICATIONS 137, 143 (1893). For more on academic freedom in the United States during the late nineteenth century, see also WALTER P. METZGER, ACADEMIC FREEDOM IN THE AGE OF THE UNIVERSITY (1955).

the western world for centuries.[122] Frequently, the two were conflated into one general justification for a diverse set of levies. Indeed, the coterminous development of these disparate ideas over time shows how neither theory was ever able to replace the other completely. The task of the progressive political economists was thus two-fold. First, in the process of decoupling the two doctrines, they needed to delineate the divergent social theories that undergirded each of the two tax principles; and second, they needed to demonstrate why a progressive income tax supported by the notion of faculty was the historically legitimate form of taxation for a modern, industrial nation-state. In seeking the first objective, economists at the turn of the century were able to draw on a long, though often undifferentiated, intellectual tradition.

Although taxation has existed in one form or another since human societies first began to mobilize and allocate resources, systematic and self-conscious theories about taxation appear to be a more recent phenomenon.[123] To be sure, the ancient Greeks and Romans had a diversity of levies, from liturgical burdens to property taxes. Yet, these measures were often validated by a commingling of theories. The liturgical duties and property taxes borne by wealthy Athenians and Romans, for example, were viewed as both civic obligations required of the aristocratic class and as payments for the protection provided by the sovereign.[124]

Similarly, the medieval towns of Western Europe levied taxes based on both the capacities or membership duties of individual citizens, as well as the benefits they received from the government. The medieval property tax, for instance, was premised on a dual set of principles: On the one hand, taxes were based on social rank, determined by one's status in the feudal system, which suggested that taxes were a function of the benefits bestowed by the sovereign upon his subjects. On the other hand, the medieval "corporate

122. For a concise history of western tax theories, see generally HAROLD M. GROVES, TAX PHILOSOPHERS: TWO HUNDRED YEARS OF THOUGHT IN GREAT BRITAIN AND THE UNITED STATES (Donald J. Curran ed., 1974).

123. On the broad development of fiscal policies and structures in the west, see generally MARGARET LEVI, OF RULE AND REVENUE (1988); CAROLYN WEBBER & AARON WILDAVSKY, A HISTORY OF TAXATION AND EXPENDITURE IN THE WESTERN WORLD (1986).

124. M.I. FINLEY, THE ANCIENT ECONOMY 152–54 (1973); Maureen B. Cavanaugh, *Democracy, Equality, and Taxes*, 54 ALA. L. REV. 415, 461–63 (2003); LEVI, *supra* note 123; A.H.M. JONES, ATHENIAN DEMOCRACY 55–57 (1957). From roughly the third to the sixth centuries, taxes throughout the Roman Empire were based mainly on the passive context of land ownership, where property tax payments were deemed to be an indirect discharge of the emperor's debts to the army and civil service, and thus a form of payment for government protection and services; occasionally they were based on the active liturgical context, where taxes were a requirement of citizenship. WALTER A. GOFFART, CAPUT AND COLONATE: TOWARDS A HISTORY OF LATE ROMAN TAXATION, 105–06 (1974); *see also* A.H.M. JONES, THE LATER ROMAN EMPIRE 284–602 A.D. (1964).

levy," which was extracted from the urban freemen who lived outside the feudal ranks, was premised on the obligations of membership in organizations such as guilds or towns. Like the Greeks and Romans before them, medieval subjects thus viewed taxation under a combination of guises.[125]

The process of analytically differentiating between the benefits and faculty principles of taxation began with the seventeenth- and eighteenth-century social contract theorists. From Hobbes and Locke to Grotius and Pufendorf to Montesquieu and the Physiocrats, classical liberal thinkers concerned primarily with defining the relations between state and society started to privilege the benefits rationale. Locke succinctly summarized how the benefits principle was fundamentally based on the state's role in protecting private property: "[E]veryone who enjoys his share of the protection [of the state] should pay out of his estate his proportion for the maintenance of it."[126] Montesquieu concurred: "The public revenues are a portion which each subject gives of his property in order to secure and enjoy the remainder."[127]

While the early Enlightenment witnessed the initial ascendancy of the benefits theory, the two theories often remained undifferentiated. There was perhaps no better example of this than Adam Smith's well known and often-cited first maxim on taxation: "The subjects of every state . . . ought to contribute towards the support of the government, as nearly as possible in proportion to their abilities, that is in proportion to the revenue which they respectively enjoy under the protection of the state."[128] Subsequent

125. Dennis Hale, *The Evolution of the Property Tax: A Study of the Relation Between Public Finance and Political Theory*, 47 J. POL. 382, 385–90 (1985). As a supplement to this source of revenue, income taxes, occasionally set at graduated rates, were also evident throughout Europe during this period. Generally limited to income derived from labor, these wage taxes were founded on the more democratic spirit that "individual faculty or ability to pay taxes were supposed to be in some manner fixed by individual income." Edwin R.A. Seligman, *Progressive Taxation in Theory and Practice*, 9 AM. ECON. ASS'N 7, 19 (1894).

126. JOHN LOCKE, TWO TREATISES OF GOVERNMENT AND A LETTER CONCERNING TOLERATION 163 (Ian Shapiro ed., 2003) (1698). In advocating the superiority of benefits theory, many of these theorists concluded that real property was an inadequate measure of the benefits received from the state because too few citizens who received public benefits actually owned land. Theorists such as Hobbes and Locke thus used the benefits theory to support a tax not on property but on consumption. *See* Hale, *supra* note 125, at 391–92. On the evolution of consumption tax theories, see generally NICHOLAS KALDOR, EXPENDITURE TAX (5th ed. 1969).

127. BARON DE MONTESQUIEU, THE SPIRIT OF THE LAWS 207 (Thomas Nugent trans., Hofner Publ'g Co. 1949) (1748).

128. ADAM SMITH, THE WEALTH OF NATIONS 777 (Edwin Cannan ed., 1937) (1776). It was not only in the writings of political thinkers that these two theories were intertwined. When the French revolutionaries penned the *Declaration of the Rights of Man*, they, too, justified taxation based on a fusion of benefits and faculty principles: "A common contribution is essential for the maintenance of the public forces and for the cost of administration. This should be equitably distributed among all the citizens in proportion to their means." DECLARATION OF THE RIGHTS OF MAN AND CITIZEN art. 13 (1789) (France).

political economists, most notably John Stuart Mill, departed from Smith's conflation of the two theories to argue for a variant of the faculty theory, namely that "equality of sacrifice"—measured in terms of diminished individual utility—should be the touchstone for modern tax policies.[129] Still, for most of the nineteenth century, tax policy discourse remained wedded to justifying taxes in terms of both faculty and benefits.

Indeed, the continuous coexistence of these concepts over time illustrates how the history of ideas is seldom about the complete victory of one concept over another. As the legal historian Neil Duxbury has noted, "Ideas—along with values, attitudes and beliefs—tend to emerge and decline, and sometimes they are revived and refined. But rarely do we see them born or die."[130] Similarly, neither the benefits principle nor the faculty theory was created or destroyed at the turn of the twentieth century.[131] Rather, American tax theorists, building on the work of Mill, attempted to delineate these rationales in an effort to reveal what they believed to be the antiquated social theory underpinning the benefits principle.

American economists, however, did much more than just build on the theories of classical British political economy. They extended the political implications of these theories and adapted them to the historical conditions of turn-of-the-century America—just as their historicist training had taught. Whereas Mill and other British economists used the ability-to-pay logic to support proportional consumption taxes,[132] American theorists expanded the notions of social solidarity that they saw as the core of the ability-to-pay principle. As a result, they contended that in an era of increasing

129. JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY 804 (William Ashley ed., 1909) (1848); Utz, *supra* note 20, at 867. Mill wrote:

> As, in the case of voluntary subscription for a purpose in which all are interested, all are thought to have done their part fairly when each has contributed according to his means, that is, has made an equal sacrifice for the common object; in like manner should this be the principle of compulsory contributions: and it is superfluous to look for a more ingenious or recondite ground to rest the principle upon.

MILL, *supra*, at 805.

130. NEIL DUXBURY, PATTERNS OF AMERICAN JURISPRUDENCE 2–3 (1995).

131. Indeed, both benefits and faculty rationales continue to remain important for current, twenty-first century tax policy discourse. *See, e.g.*, MURPHY & NAGEL, *supra* note 18; Dodge, *supra* note 18; David G. Duff, *Benefit Taxes & User Fees in Theory and Practice*, 54 U. TORONTO L.J 391 (2004).

132. Mill reasoned that, for administrative reasons, capturing a citizen's ability to pay with an income tax could not be "estimated with any approach to fairness by a tax-collector." MILL, *supra* note 129, at 830. Similarly, he was skeptical that the scale of graduated rates was "capable of being decided with that degree of certainty on which a legislator or a financier ought to act." *Id.* at 807; *see also* HENRY SIDGWICK, THE PRINCIPLES OF POLITICAL ECONOMY Book III, ch. VIII, § 7 (3d ed. 1901) (1883).

concentrations of wealth, moderately graduated income taxes were the best way to capture a citizen's tax-paying capacity. While Mill employed radical ideas for a generally conservative agenda,[133] his American disciples acknowledged that they were using traditional principles for a much less conservative approach. By using a form of historicism to demonstrate why faculty doctrine should be privileged above benefits, the progressive economists were attempting to lay the foundation for a seismic shift in American economic and legal thought—a shift they hoped would support the emergence of more transparent and equitable forms of taxation.

E. Applying the New Political Economy to Tax Policy

In using their historicist approach to mold the legacy of Anglo American thinking about taxation, these American economists were operating on relatively new ground. During most of the nineteenth century, there was little scholarly discussion in the United States about the general economic principles of taxation beyond the politically controversial tariff.[134] The taxing powers of state and local governments in the United States were, of course, necessary to promote a "well-regulated" society,[135] and state and local sales and property taxes were topics of discussion among some social commentators.[136] Yet, few contemporary scholars considered the political and economic power that lay behind the federal government's ability to levy taxes. As late as 1880, Francis A. Walker, Adams's mentor at Johns Hopkins and a leading authority on political economy, could confidently claim, "The body of English literature in finance is shabby in the extreme."[137] The main explanation for the "feebleness and emptiness of the English literature in this department," Walker explained, was the lack of serious scholarly attention given to taxation.[138] "Most of our political economists have not dealt with the subject at all, or have done so very perfunctorily."[139]

The young, reform-minded economists set out to change all that. Proceeding from different intellectual origins, Adams, Ely, and Seligman

133. GROVES, *supra* note 122, at 38.

134. As Henry Carter Adams noted, one of the tasks of his generation of academics was to teach students "that there is more in Polit. Economy than the mere discussion of Free Trade and Protection." FURNER, *supra* note 17, at 130.

135. WILLIAM J. NOVAK, THE PEOPLE'S WELFARE: LAW AND REGULATION IN NINETEENTH-CENTURY AMERICA (1996). For more on the politically charged nature of the tariff, see BENSEL, *supra* note 8.

136. *See, e.g.*, FISHER, *supra* note 53, at 113–15.

137. Francis A. Walker, *The Principles of Taxation*, 2 PRINCETON REV. 92, 93–94 (1880).

138. *Id.* at 93.

139. *Id.* at 92.

began the American engagement with the "science of finance." They did so by applying the historicism of the new political economy to public finance issues such as the tariff, public debts, and of course the income tax. As one of the elder members of this new generation of thinkers, Adams initiated the scholarly engagement with fiscal policy. His doctoral dissertation was a historical analysis of the protective tariff, and his early treatises focused on public debts and the budgetmaking process.[140] In his dissertation, Adams illustrated how political pressures during the early years of the republic—namely the need to respond to Britain's attempts to curtail the naval powers of the United States—transformed the tariff from a simple revenue-generating instrument into a protectionist tool to combat British naval imperialism. This early manipulation of tax policy, Adams argued, led directly to the late nineteenth-century abuse of the tariff to protect domestic industry. Adams's normative message seemed clear: He wanted to ensure that "tariff reform means tariff for revenue only."[141] From the start, then, Adams was attempting to use his public finance scholarship to affect the making of tax policy. This desire to influence policymaking continued with Adams's subsequent treatises on public finance.

Tariff reform was only one of the areas of fiscal policymaking that attracted the attention of the progressive economists. In fact, redirecting tariff policy was just one step in their agenda for an income tax. The more important task was to apply a form of historicist political economy to the underlying principles of taxation. In criticizing the benefits theory, Ely, Adams, and Seligman singled out the anachronistic political implications of this principle. Citing to the work of the jurist Thomas Cooley, who like Adam Smith before him had conflated the benefits and faculty theories, Ely claimed that taxes could not be justified based on "the old fiction of reciprocity."[142] In defining "taxes," Ely was careful in explaining that they were "not exchanges" or "payments" for public goods and services.[143] "The sovereign power demands contributions from citizens regardless of the value of any services which it may perform for the citizen," Ely wrote.[144] In contrast to Montesquieu's

140. HENRY C. ADAMS, PUBLIC DEBTS: AN ESSAY IN THE SCIENCE OF FINANCE (1887); HENRY C. ADAMS, THE SCIENCE OF FINANCE: AN INVESTIGATION OF PUBLIC EXPENDITURES AND PUBLIC REVENUES (1898) [hereinafter ADAMS, SCIENCE OF FINANCE]. Even though one of the aims of *Public Debts* was to advance the study of public finance in the United States, the treatise gained an international audience and was even translated into Japanese.

141. HENRY C. ADAMS, TAXATION IN THE UNITED STATES, 1789–1816, at 79 (1884).

142. ELY, *supra* note 75, at 14.

143. *Id.* at 13.

144. *Id.* at 7.

well-known tax definition,[145] Ely claimed that his own designation clearly abandoned "the old legal fiction that taxes are paid for protection."[146] This antiquated defense for taxation was "so palpable an absurdity that it is strange that it could ever have gained the currency which it now enjoys."[147]

Adams echoed Ely's sentiments. The classical benefits theory, Adams wrote, ignored how "[t]he modern State . . . assumes duties far beyond the primitive functions of protection to life and property."[148] While such a "*quid pro quo* theory of taxation may have served fairly well under conceptions of governmental activity held in the early part of the century," Adams intoned, "it must be regarded at present as somewhat antiquated."[149]

Seligman went even further in condemning the social theory that buttressed the benefits principle. He argued that the benefits doctrine was based, at its core, on an outmoded conception of modern citizenship:

> It is now generally agreed that we pay taxes not because the state protects us, or because we get any benefits from the state, but simply because the state is a part of us. The duty of supporting and protecting it is born with us. In a civilized society the state is as necessary to the individual as the air he breathes; unless he reverts to stateless savagery and anarchy he cannot live beyond its confines. His every action is conditioned by the fact of its existence. He does not choose the state, but is born into it; it is interwoven with the very fibers of his being; nay, in the last resort, he gives to it his very life. To say that he supports the state only because it benefits him is a narrow and selfish doctrine. We pay taxes not because we get benefits from the state, but because it is as much our duty to support the state as to support ourselves or our family; because, in short, the state is an integral part of us.[150]

If there were any doubts where Seligman stood in regards to the benefits principle, these striking words laid such doubts to rest.

Progressive economists also disapproved of benefits doctrine because it was framed in an idiom of market relations. With their emphasis on the importance of ethical duty and social bonds, these theorists loathed how the benefits doctrine commodified the relationship between citizens and the

145. *See* text accompanying notes 126–128.
146. ELY, *supra* note 75, at 7.
147. *Id.* Ely defined taxes simply as "one-sided transfers of economic goods or services demanded of the citizens . . . by the constituted authorities of the land, for meeting the expenses of government, or for some other purpose, with the intention that a common burden shall be maintained by common contributions or sacrifices." *Id.* at 6–7 (emphasis omitted).
148. ADAMS, SCIENCE OF FINANCE, *supra* note 140, at 300.
149. *Id.*
150. EDWIN R.A. SELIGMAN, ESSAYS IN TAXATION 72 (1895).

state. Taxes "are one-sided transfers of goods or services, and are not mutual," Ely emphasized.[151] "The citizen pays because he is a citizen, and it is his duty as a citizen to do so. It is one of the consequences which flow from the fact that he is a member of organized society. . . . Only an anarchist can take any other view."[152] If citizens were part of a greater whole, taxation based on a notion of exchange or barter seemed wholly out of place. In sum, the progressive economists saw the benefits doctrine as a misrepresentation of the social obligations of citizenship.[153]

When it came to applying the benefits theory to the structure of a tax system—to the issue of whether the wealthy should pay more than the poor—the progressive economists argued that the benefits principle was intrinsically incoherent. The "give-and-take theory," as Seligman called it, left the issue of degrees of taxation "inconclusive."[154] In his 1894 treatise on progressive taxation, Seligman illustrated how advocates of the benefits principle could use this theory to defend both a progressive tax as well as a regressive one. Because "most of the public expenses are incurred to protect the rich against the poor," Seligman coyly noted, the benefits theory would dictate that "the rich ought to contribute not only actually, but relatively more."[155] Thus, if the justification for taxation under the benefits doctrine was the protection of private property, those with more property had more to protect and hence ought to have a larger tax burden.

Yet at the same time, proponents of the benefits theory could also demonstrate that "the very reverse is true."[156] Because "the millionaire who is able to hire his own watchmen, his own detectives, his own military guard, and who often relies more on his individual efforts than on the government for the protection of his property causes the state less expense than the man of smaller means who must depend entirely on the government,"

151. ELY, *supra* note 75, at 13.

152. *Id.*

153. More recently, political philosophers and legal scholars have made a similar claim about taxation, rights, and the social obligations of citizenship. *See generally* BRUCE ACKERMAN & ANNE ALSTOTT, THE STAKEHOLDER SOCIETY (1999); STEPHEN HOLMES & CASS R. SUNSTEIN, THE COST OF RIGHTS: WHY LIBERTY DEPENDS ON TAXES (1999); MURPHY & NAGEL, *supra* note 18; LINDA KERBER, NO CONSTITUTIONAL RIGHT TO BE LADIES: WOMEN AND THE OBLIGATIONS OF CITIZENSHIP (1998).

154. Edwin R.A. Seligman, *Progressive Taxation in Theory and Practice*, 9 PUBLICATIONS AM. ECON. ASS'N 7, 82 (1894).

155. *Id.* This treatise was based on some of Seligman's previously published work. *See* Edwin R.A. Seligman, *The Theory of Progressive Taxation*, 8 PUBLICATIONS AM. ECON. ASS'N 52 (1893); Edwin R.A. Segliman, *The Theory of Progressive Taxation*, 8 POL. SCI. Q. 220 (1893) [hereinafter Seligman, *Theory of Progressive Taxation*].

156. Seligman, *supra* note 154, at 83.

wrote Seligman, taxes based on benefits could mean that "the poor man should then pay relatively more than the rich man."[157] Even variants of the benefits doctrine that viewed taxes in terms of "the cost of services to government," and not "the value of protection" granted to individuals, were for Seligman "untenable."[158] Benefits doctrine, however it was defined, was "indefensible" because, as Seligman succinctly put it, "It is absolutely impossible to apportion to any individual his exact particular share in the benefits of governmental activity. The advantages are quantitatively immeasurable."[159]

To be sure, the faculty theory, as the progressive economists acknowledged, had its own problems when it came to addressing the rate structure of a practical tax system. Nonetheless, whereas proponents of ability to pay could unambiguously support some form of a graduated rate structure, benefits theory provided its advocates with an inconsistent rationale for setting practical tax rates. Moreover, Seligman claimed that certain individual payments for particular government services did not even deserve to be called taxes. He conceded that "some payments made by individuals for particular" government services "should represent as nearly as possible the cost of service to the government."[160] But these payments, Seligman concluded, "are not taxes."[161] They should be viewed, instead, merely as "fees or tolls."[162] This distinction was critical. It suggested that Seligman and his like-minded colleagues still believed that the benefits theory had an important, though subordinate, role to play in public finance discourse. There was no other way to define a toll, a fee, or a special assessment accurately without some reference to the benefits conferred by the state.[163] Yet when it

157. *Id.* at 83–84. Protection was not the only government benefit that the poor received in greater proportion. Seligman described how nearly every aspect of state services could be seen as inuring to the benefit of the poor more than the rich: "The rich man sends his children to private schools and colleges, the poor man has his family educated in public schools," wrote Seligman. *Id.* at 83. "The rich man has his street swept by a hired laborer, the poor man has his cleaned at the expense of the city." *Id.*

158. *Id.* at 85.

159. *Id.* Even the most libertarian of modern scholars have come to agree that taxation is justified in defraying the cost of "public goods." *See, e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM (1962); Richard Epstein, *Taxation in a Lockean World*, *in* PHILOSOPHY AND LAW 49–74 (Jules L. Coleman & Ellen Frankel Paul eds., 1987).

160. Seligman, *supra* note 154, at 85–86.

161. *Id.* at 86.

162. *Id.*

163. See Seligman's contribution to the discussion in Edwin R.A. Seligman et al., *Federal Taxes Upon Income and Excess Profits—Discussion*, 8 AM. ECON. REV. 36, 42–45 (1918). In describing how the benefits theory supported special assessments, Seligman likely had in mind the method that most municipalities used to finance their local improvements during the nineteenth century. For more on the role of special assessments in nineteenth-century urban public finance, see ROBIN L. EINHORN, PROPERTY RULES: POLITICAL ECONOMY IN CHICAGO, 1833–1872 (1991).

came to financing those public goods and services that were not divisible within a community or at the individual level, the best justification for such taxes was the criterion of ability to pay. Thus, according to Seligman, not only was the benefits principle inconsistent in structuring tax rates, in the end, it also failed to reflect the true meaning of a tax.

In countering the benefits notion, the progressive economists crafted slightly different versions of the ability-to-pay rationale. Adams, who believed in distinguishing between the theoretical justification for taxation and the "lawyer's point of view,"[164] relied on what he called a "contributory theory of a tax."[165] A progressive income tax was justified under such a theory because it embodied the ethical duty of social unity that citizens of a community owed to each other and to the larger commonwealth. Unlike the contending "purchase theory" or "benefit theory" of tax, which emphasized a solitary, atomistic, and consumeristic relationship between the citizen-taxpayer and the state, Adams explained that a contributory theory was based on "solidarity of social interest."[166]

In this context, Adams was careful in using "contribution" to connote that taxes should be seen as part of the organic or collective nature of the state. "[Contribution] implies that all the functions undertaken by the State are such as minister to common wants, and in large measure to wants which cannot be segregated or specialized to individuals or to classes," Adams wrote.[167] "A sense of organic unity and of interdependence, and a consciousness of common rights and common duties, go along with the idea of contribution."[168] Despite his brush with the political powers at Cornell,[169] Adams continued to believe that American institutions and culture could allow for the importance of social solidarity.

As Ely pointed out, the Massachusetts Tax Commission made a similar point as early as 1875 about "the correct doctrine of taxation."[170] The Commission's final report, to which Ely approvingly cited, stated that "a man is taxed not to pay the state for its expense in protecting him, and not in any respect as a recompense to the state for any service in his behalf, but

164. ADAMS, SCIENCE OF FINANCE, *supra* note 140, at 293. Although it is unclear precisely what Adams meant by this phrase, it is likely that he was contrasting the more empirical "lawyer's point of view," or "law in action," with the more theoretical perception of "law on the books." *Id.*
165. *Id.* at 301.
166. *Id.*
167. *Id.*
168. *Id.*
169. *See supra* note 116 and accompanying text.
170. ELY, *supra* note 75, at 14 n.2 (quoting from THOMAS HILLS ET AL., REPORT OF THE MASSACHUSETTS COMMISSION ON TAXATION (Boston, Wright & Potter 1875)).

because his original relations to society require it."[171] Ely believed that social cohesion, not any notion of radical individualism, justified taxation. "All the enjoyments which a man can receive from his property come from his connection with society," the Massachusetts report continued.[172] "Cut off from all social relations a man's wealth would be useless to him. In fact, there could be no such thing as wealth without society."[173]

Seligman took a slightly different approach in promoting the faculty theory. While he agreed with Adams and Ely that the social interdependence occasioned by modern industrial capitalism had displaced the logic of autonomous individualism, Seligman contended that the principle of faculty, in one form or another, had been evolving for centuries.[174] As one of the progressive economists most steeped in historical analysis—his treatises were well known for their coverage of the historical development of tax concepts—and as the theorist who popularized the notion of ability to pay,[175] Seligman believed that class dynamics were driving modern society as a whole to recognize the importance of creating an equitable tax system based on faculty.[176] "Amid the clashing of divergent interests and the endeavor of each social class to roll off the burden of taxation on some other class, we discern the slow and laborious growth of standards of justice in taxation, and the attempt on the part of the community as a whole to realize this justice," proclaimed Seligman.[177] "The history of finance, in other words, shows the evolution of the principle of faculty or ability to pay—the principle that each individual should be held to help the state in proportion to his ability to help himself."[178]

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171. *Id.*

172. *Id.*

173. *Id.*

174. EDWIN R.A. SELIGMAN, THE INCOME TAX: A STUDY OF THE HISTORY, THEORY AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD 4 (2d ed. 1914).

175. BUENKER, *supra* note 3, at 41.

176. SELIGMAN, *supra* note 174. Seligman employed a somewhat similar class-based economic determinism in his writings on the philosophy of history. *See* EDWIN R.A. SELIGMAN, THE ECONOMIC INTERPRETATION OF HISTORY (1902). For some contrasting views on Seligman's foray into the philosophy of history, see generally RICHARD HOFSTADTER, THE PROGRESSIVE HISTORIANS: TURNER, BEARD, PARRINGTON 197–200 (1968); ROSS, *supra* note 17, at 186–91; BRIAN LLOYD, LEFT OUT: AMERICAN PRAGMATISM, EXCEPTIONALISM AND THE POVERTY OF AMERICAN MARXISM, 1890–1922, at 86 (1997). *But see also* Clyde W. Barrow, *From Marx to Madison: The Seligman Connection in Charles Beard's Constitutional Theory*, 3 POLITY 379 (1992); PETER NOVICK, THAT NOBLE DREAM: THE "OBJECTIVITY QUESTION" AND THE AMERICAN HISTORICAL PROFESSION 94 (1988).

177. SELIGMAN, *supra* note 174, at 4.

178. *Id.*

F. An Early Salvo Against the Property Tax

When it came to applying the abstract ideas of faculty or ability to pay to concrete conditions, the progressive economists turned first to any easy target—the general property tax administered by state and local governments. While this levy was one of the earliest forms of American taxation, by the late nineteenth century it was garnering increased criticism from economic commentators.[179] Not surprisingly, the progressive public finance economists were at the forefront of the systematic analysis and evaluation of the property tax.

Ely was one of the first to investigate and empirically to discredit the property tax. He approached the issue with an inductive method when he was appointed as an economic expert to both the Baltimore and Maryland Tax Commissions in the mid-1880s. In pioneering the empirical study of municipal and state finance, Ely capitalized on his official position as a tax commissioner to gather data on numerous North American cities and several American states.[180] Ely was left appalled, from this work, by the "worthless" system of state and local taxation that existed at the time. Struck by how unfair the process of assessing property was in application, Ely dissented from the Commission's rudimentary recommendations for more stringent enforcement of the existing laws, and issued his own supplemental report calling for a radical overhaul of the state and local systems of taxation.[181]

At about the same time that Ely was evaluating the Maryland and Baltimore tax systems, Seligman was conducting his own international study of property taxation. Although the two scholars were working independently of one another, their evaluations of the general property tax were remarkably consistent. Adams and other young economists joined the dialogue about the inadequacies of the property tax in an era of rising intangible wealth.[182] Indeed, by the end of the nineteenth century, the property tax had become the favorite whipping boy of nearly every economic commentator.[183] But what set Ely and Seligman apart was how they applied

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179. *See, e.g.*, FISHER, *supra* note 53; YEARLEY, *supra* note 55; TEAFORD, *supra* note 53.

180. ELY, *supra* note 70, at 173–74.

181. Richard T. Ely, *Supplementary Report on Taxation in Maryland*, *in* REPORT OF THE MARYLAND TAX COMMISSION TO THE GENERAL ASSEMBLY 93–200 (Baltimore, King Bros. 1888); RADER, *supra* note 82, at 85–86.

182. ADAMS, SCIENCE OF FINANCE, *supra* note 140, at 489–506; Henry C. Adams, *Suggestions for a System of Taxation*, 2 MICH. POL. SCI. ASS'N PUBLICATIONS 60–61 (1894); *see also* Charles J. Bullock, *The Taxation of Intangible Property*, *in* STATE AND LOCAL TAXATION: SECOND INTERNATIONAL CONFERENCE (Columbus, 1909); YEARLEY, *supra* note 54.

183. FISHER, *supra* note 53, at 122–41; YEARLEY, *supra* note 55, at 37–38; TEAFORD, *supra* note 53, at 43–47.

a guiding historicism to their analysis of the property tax. Their examinations focused on how the property tax no longer corresponded to modern industrial conditions—how the property tax, because of changing historical conditions, no longer comported with what they saw as the touchstone of modern taxation: the principle of ability to pay.

While the ownership of real property was at one time a fair representation of a citizen's tax-paying ability, the progressive economists believed that with the rise of industrial capitalism, real property was no longer an accurate measure of faculty. The institutional convergence of large-scale manufacturing and finance capital at the turn of the century had profoundly altered the social conceptions of property.[184] The increasing prevalence of intangible personal property, in the form of stocks, bonds, and other financial assets, allowed citizens to conceal their wealth in what contemporary tax administrators referred to as "hidden assets." With real property no longer being the primary marker of wealth and tax-paying ability, the progressive economists believed that a tax on real property was insufficient in accurately gauging a citizen's social obligations.[185]

In this context, the progressive economists claimed that an income tax was highly superior to a tax on property, especially since the latter was, in essence, simply a weak proxy for the former. The income tax "is the fairest tax ever devised," Ely wrote in 1888 with some hyperbole, "it places a heavy burden when and where there is strength to bear it, and lightens the load in case of temporary or permanent weakness. Large property does not always imply ability to pay taxes, as taxes should come from income; even when assessed on property it is only an indirect device for estimating income."[186] Why not remove the indirect device of taxing property, Ely reasoned, and take a more direct approach at seizing one's ability to pay by imposing a state income tax.

Two years later, Seligman provided a more detailed critique of the property tax and its departure from the principle of ability to pay. In this early salvo against the property tax, Seligman made three principal points. First, he demonstrated that the property tax was not exceptional to American conditions, as many commentators had claimed.[187] Second, because it was not unique or timeless, the American property tax was susceptible to the forces of historical change. Third, and perhaps most importantly, Seligman

184. *See generally* ROY, *supra* note 54, at 122–41; YEARLEY, *supra* note 55.
185. SELIGMAN, *supra* note 150, at 24; HIGGENS-EVENSON, *supra* note 59, at 14.
186. ELY, *supra* note 75, at 288–89.
187. Edwin R.A. Seligman, *The General Property Tax*, 5 POL. SCI. Q. 24 (1890).

illustrated how the property tax was now flawed "because property is no longer a criterion of faculty or tax-paying ability."[188] With the changes in economic conditions, Seligman asserted that "[t]he standard of ability has been shifted from property to product."[189] Put simply, Seligman, like Ely, believed that the emergence of modern, industrial society meant that wealth could no longer simply be equated with property: "Not the extent but the productivity of wealth constitutes the test."[190] In other words, revenue or the flow of wealth—not its mere physical embodiment—was the true measure of one's ability to pay.

Finally, Ely and Seligman denounced the general property tax on administrative grounds. It was a levy that could not be effectively collected, they argued, because it could not get at the increasing forms of intangible wealth, and because "[i]t puts a premium on dishonesty and debauches the public conscience."[191] But most importantly, for Seligman, the property tax was no longer practical because "[i]t presses hardest on those least able to pay"—those who had their more limited assets largely in real property that could not be concealed from the property tax rolls.[192] In light of these problems, Seligman believed that the income tax was "infinitely superior in practice."[193] From all this, claimed Seligman with his characteristic zeal, one could conclude that "the general property tax is so flagrantly inequitable that its retention can be explained only through ignorance or inertia. It is the cause of such crying injustice that its abolition must become the battle cry of every statesman and reformer."[194]

In addressing the problems of the property tax, the progressive economists advocated the innovative idea of separating the sources of state and local government revenues. Ely and Seligman recommended that local governments apply the property tax only on real estate, which could not be easily hidden, and that state governments should rely on a graduated income tax to fund their needs.[195] This notion of separating or segregating revenue between state and local authorities became increasingly popular

188. *Id.* at 62.
189. *Id.*
190. *Id.*
191. *Id.*
192. *Id.*
193. *Id.*
194. *Id.*
195. *See id.* at 42–43. In a review of Ely's work, Seligman criticized Ely for exaggerating the business opposition to an income tax: "[I]t will be found on examination that many business men, especially in those localities where any attempt is made to enforce the taxation of personal property, are in reality not at all inimical to the income tax." Edwin R.A. Seligman, Book Review, 3 POL. SCI. Q. 691, 692 (1888) (reviewing ELY, *supra* note 75).

among tax experts. By the first decade of the twentieth century, the National Tax Association (NTA), one of the leading organizations of academics and government tax administrators interested in public finance, began touting the need to "separate the sources of revenue."[196] Seligman, as an active member of the NTA, was a critical catalyst in disseminating the ideas of the economists to policymakers. Indeed, he presented a paper on the issue of separating fiscal sources before the NTA.[197] But Ely, Seligman, and other economists took an even more active role in shaping state and local tax laws.

As economic experts appointed to state tax commissions, the public finance economists were able to ensure that their empirical studies and reformist theories had lasting impact. For Ely and Seligman, that meant their historicist thinking could guide the making of state tax laws. Working with the Baltimore and Maryland Tax Commissions, Ely's recommendations did not initially have much traction with lawmakers, but over time his ideas about reforming state and local tax administration and separating the sources of revenue did influence the tax laws of Maryland and other jurisdictions.[198]

Seligman had a more direct and immediate impact in New York. Acting first as a special consultant to particular tax bills in 1899, Seligman contributed his expertise on the creation of small, gap-filling tax laws, such as the special franchise tax on local pipes, wires, and tracks. Within a decade, however, he had become an important member of the state tax commission, where he was able to guide the process of separating the sources of tax revenue. As he proclaimed before the annual NTA conference, the Empire State, with his assistance, had achieved full separation of revenues by 1908.[199] By that time, the expenses of the state government were being financed entirely through levies on corporations, while property taxes were reserved solely for localities. When New York considered adopting a state-level income tax, Seligman once again applied his knowledge and his status as an economic expert to insure the adoption of New York's first income tax law in 1917.[200]

196. Lawson Purdy, *Outline of a Model System of State and Local Taxation*, 1 NTA PROCEEDINGS 54, 57 (1908); TEAFORD, *supra* note 53; FISHER, *supra* note 53.

197. Edwin R.A. Seligman, *The Separation of State and Local Revenues*, 1 NTA PROCEEDINGS 485 (1908); *see also* HIGGENS-EVENSON, *supra* note 59, at 79.

198. ELY, *supra* note 70, at 173–74. Ely claimed that "in Canada and as far away as South Africa," his "suggestions were adopted." *Id.* at 173.

199. Seligman, *supra* note 197, at 494; *see also* HIGGENS-EVENSON, *supra* note 59, at 79.

200. HIGGENS-EVENSON, *supra* note 59, at 79.

G. Historicizing the Income Tax

Discrediting the general property tax from a historicist perspective was a rather easy task for the economists. The more difficult undertaking was to show why a direct tax on income was more appropriate given the historical conditions of modern American capitalism. While Ely, Adams, and Seligman disagreed about how an income tax should be implemented, they remained united in analyzing tax policies from a historically specific point of view.

As we have seen, Ely favored a state income tax over the property tax because he believed the latter was simply an ersatz measure of a citizen's ability to pay. The income tax, he explained, was "beneficial because it places a heavy load only on strong shoulders."[201] But it was not only his dissatisfaction with the effectiveness of the property tax that led him to support an income tax. Ely also believed that a direct tax on income at both the state and national level was particularly necessary at a time when concentrations of wealth were making certain citizens increasingly disengaged from the political process. With the empirical studies of the growing disparity of wealth undoubtedly in mind, Ely commented on how the excesses of the Gilded Age occasioned "a considerable and increasing class living in great comfort on incomes of large proportions . . . who by insurance and various devices, protect themselves and their families for the future, and yet pay no taxes."[202] Though Ely did not elaborate on how members of such a leisure class could escape their fair share of taxes, he seemed to imply that the wealthy were able to hold assets that could be concealed from the property tax, and that because they had large incomes, the indirect excise taxes and import duties were only a minor inconvenience.

Indeed, Ely seemed to argue that the opaque nature of indirect consumption taxes was an obstacle to the promotion of good government. In shirking their fiscal responsibilities, the citizens who made up this leisure class, Ely claimed, were often "careless and indifferent about their public duties, knowing that their income is not affected by high or low taxation. They appear to pay nothing to government, and as it seems to cost them nothing, they too often care little for it."[203] In the absence of classical republican notions of civic virtue, it was no surprise to Ely and others that an indirect system of taxation only seemed to exacerbate the individual indifference toward everyday functions of government.

201. ELY, *supra* note 75, at 288.
202. *Id.* at 289.
203. *Id.*

The emerging leisure class was only part of the contemporary problem. Even more disconcerting for Ely was the class of "professional people," the "lawyers, physicians, and teachers," for example, who had "opportunities for personal cultivation and for gathering knowledge," whose "influence ought to be large and beneficial."[204] As long as this new class of professionals and managers was only tangentially affected by an indirect system of taxation, they too would remain detached from practical politics. A direct tax on income, Ely contended, was "precisely the kind of tax needed" to reengage citizens with the political process and to promote good government.[205] "It is beyond question," Ely concluded, that a fairly administered income tax "would change the attitude of a large portion of the community towards government."[206]

Adams interpreted the historical circumstances of late nineteenth-century America slightly differently. He acknowledged that industrial capitalism had created a new leisure class, as well as a sector of society with personal wealth rooted in professional salaries. But rather than wholeheartedly embrace an income tax as a way to promote good government, Adams cautiously questioned whether the monetary value of income was a sufficient "measure of the relative ability of citizens to pay for the support of the State."[207] Given the growing heterogeneity of income sources, Adams was skeptical that an income tax could truly capture a citizen's ability to pay. He conceded that "[t]he chief embarrassment which arises on account of the income tax lies in the difficulty of obtaining the correct statement of income."[208]

Writing in the wake of the Supreme Court's decision in *Pollock v. Farmers' Loan & Trust Co.*,[209] striking down the 1894 federal income tax, Adams was restrained in supporting the income tax. Still, he concurred with his progressive colleagues that ability to pay was the sound theoretical foundation for a modern tax system. "Assuming the ability to pay to be the just measure of payment," Adams intoned, "income is accepted as the surest test of ability."[210] He was skeptical, however, that in practice a direct tax on income could accurately measure a citizen's taxpaying faculty. "The difficulty of obtaining the correct statement of income," Adams noted, was aggravated

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204. *Id.*
205. *Id.* at 290.
206. *Id.* A similar argument linking tax payments with civic political engagement has been made by twenty-first century tax scholars. *See, e.g.*, Joseph J. Thorndike, *Hurst So Good*, N.Y. TIMES, Apr. 15, 2005, at A19.
207. ADAMS, SCIENCE OF FINANCE, *supra* note 140, at 360.
208. *Id.* at 357.
209. 157 U.S. 429 (1895) (holding that the 1894 income tax was a "direct tax," and therefore unconstitutional).
210. ADAMS, SCIENCE OF FINANCE, *supra* note 140, at 356–57.

by "the great variety of forms in which incomes exist."[211] During a simpler age, policymakers could be more confident that "incomes would be homogenous" and a given tax would lead to "the same treatment applicable to all."[212] But in a more modern, industrial world, "in society as it exists," wrote Adams in 1898, "incomes are not homogenous. They do not reflect the same industrial conditions or measure with accuracy the energy expended to secure them."[213] Adams had in mind at least three different kinds of income: "[I]ncome from services,"[214] by which he referred to wages, salaries, professional fees, and the like; "income from property,"[215] which itself could be divided into income from land in the form of rent and income from capital in the form of interest or profits; and finally, "income of property," by which he meant wealth transfers at death.[216]

In illustrating how modern economic conditions made the implementation of an income tax more challenging, Adams was not betraying the income tax movement or the faculty principle. Rather, he was seeking to weave a progressive, individual income tax into his more systematic analysis of public finance by relegating the income tax as a levy only on personal service income.[217] In some ways, he was being even more consistent than some of his colleagues in adhering to the principles of ability to pay. When Adams raised objections to the exclusive use of income as a measure of taxpaying capacity, he was doing so in order to show the limits of the income tax in accurately measuring a taxpayer's faculty. Given that the various sources of income "reflect diverse economic conditions and are subject to varying economic tendencies," Adams concluded, "the amount of money received during the twelve months is no satisfactory measure of the relative ability of citizens to pay for the support of the state."[218] Adams, it appears, was not willing to settle for using the income tax alone as a metric for one's taxpaying capacity. The income tax may have placed a "heavy load only on strong shoulders,"[219] to use Ely's vivid phrase, but that did not mean that this was the only load that strong shoulders could bear.

211. *Id.* at 357.
212. *Id.*
213. *Id.*
214. *Id.* at 357–58.
215. *Id.* at 358–60.
216. *Id.* at 360–61.
217. *Id.* at 386.
218. *Id.* at 360. Seligman raised a similar issue in his defense of progressivity. *See* text accompanying notes 234–236.
219. ELY, *supra* note 75, at 288.

Like Adams, Seligman also recognized the inadequacies of the income tax. But whereas Adams appeared to be disillusioned with the limited reach of the income tax in assessing tax-paying ability, Seligman accepted the levy as a practical step toward the ideal of taxing one's ability to pay. In this way, faculty or ability to pay was, for Seligman, an aspirational aim—an ideal type that could not be achieved in practice, but that could be a useful touchstone for policymakers. Given the changing historical conditions wrought by industrial capitalism, the income tax was a necessary and feasible step for the reform-minded economists because it helped establish an equitable distribution of tax burdens; it helped, as Seligman put it, to round "out the existing tax system in the direction of greater justice."[220]

In the process of promoting tax laws and policies in the direction of greater justice, Seligman applied a thorough-going historicism that set him apart from his like-minded colleagues. Unlike Ely and Adams, who soon turned their intellectual energies toward other issues, Seligman devoted his entire academic career not only to the topic of public finance, but also to an investigation of fiscal issues from a historical and comparative perspective. If taxation was his first priority, international economic history was a close second. He not only infused his tax treatises with discussions of historical antecedents and transatlantic comparisons, he also wrote widely on the history of economic thought.[221] In 1902, for example, Seligman published a relatively popular monograph on the philosophy of history, modestly entitled *The Economic Interpretation of History*.[222]

Seligman combined his interests in international economic history and tax policy in charting the global development of the income tax. In one of his best-known treatises, which was published in numerous editions and translated into several languages, Seligman set out to demonstrate that an urban industrial nation required a progressive income tax.[223] Applying a crude

220. Edwin R.A. Seligman, *The Income Tax*, 9 POL. SCI. Q. 610, 610 (1894).

221. During his retirement, Seligman sold his personal library to Columbia University for roughly $250,000; the collection became a majority of Columbia's holdings on the history of economic thought. Letter from Columbia Library to Edwin R.A. Seligman, Box #54, Miscellaneous, 1932–1937, Edwin R.A. Seligman Papers (on file with Butler Library, Columbia University); *see also* Joseph Dorfman, *Edwin Robert Anderson Seligman*, *in* 22 DICTIONARY OF AMERICAN BIOGRAPHY 606–07 (Harris E. Starr et al. eds., 2d supp., Scribner's 1958).

222. EDWIN R.A. SELIGMAN, ECONOMIC INTERPRETATION OF HISTORY (Columbia Univ. Press 1961) (1902). Much of the monograph was originally published in a series of articles in the *Political Science Quarterly*, which Seligman edited. *See* Edwin R.A. Seligman, *The Economic Interpretation of History I*, 16 POL. SCI. Q. 612 (1901); Edwin R.A. Seligman, *The Economic Interpretation of History II*, 17 POL. SCI. Q. 71 (1902); Edwin R.A. Seligman, *The Economic Interpretation of History III*, 17 POL. SCI. Q. 284 (1902).

223. SELIGMAN, *supra* note 174, at 4.

type of economic determinism, Seligman argued that theories of taxation had evolved over the centuries to meet the changing functional needs of society. What remained constant throughout this historical evolution was the criterion used by the state to determine the basis of taxation. That criterion, according to Seligman, was the principle of ability to pay.

Conveniently ignoring how his own historical research demonstrated the longstanding coexistence of both the benefits and faculty theories, Seligman claimed that a variety of different levies over time embodied the faculty principle. The standard of faculty had undergone several manifestations from its origins in preliterate society to modern times, but it remained the benchmark by which leaders were able to shape tax laws and policies. Using an evolutionary theory of historical change reminiscent of Darwinian gradualism, Seligman illustrated how different stages of economic development led to different types of taxes embodying the ability-to-pay metric.[224]

More specifically, Seligman set out five phases in the historical development of Western taxation, with the income tax as the fifth, and perhaps final, stage of fiscal evolution. Each type of levy corresponded with a different stage of political and economic development. First came the poll tax of primitive societies; next, the real property tax of agrarian cultures; and then, the indirect excise taxes of the early modern period. It was during the late seventeenth and early eighteenth centuries, when the general property tax became a "travesty of justice,"[225] that European countries turned to consumption taxes. This was the fourth stage of fiscal development, with "expenditure as the criterion of faculty."[226] But "with the growth of democracy," Seligman reasoned, "a system of taxation which inevitably results in undue burdens on the less fortunate members of society was destined to become unpopular and pass away."[227] Hence, in a variant of the fourth stage of development, occurring prior to the industrial revolution, "tax reformers and progressive governments reverted" to an alternative version of a property tax, assessed on the produce or yield from property.[228] This tax took the form of a levy on rental proceeds or a simple house tax—rather than a tax on the value of property itself.[229]

While the move to a "produce" tax was deemed by Seligman to be "a decided step forward" as "a test of faculty," it became insufficient when the

224. *Id.*
225. *Id.* at 11.
226. *Id.* at 10.
227. *Id.* at 12.
228. *Id.*
229. *Id.*

industrial revolution ushered in a new era of social and economic relations.[230] This new stage of development was a time of immense wealth disparities that required taxes to be graduated. As Seligman explained, "the immense increase in modern wealth and the appearance of prodigious fortunes have contributed to bring into prominence the idea of graduated taxation."[231] Since taxes on the yield from property were, in effect, intermediate steps at taxing the owners of wealth, and because individual yields could be dispersed, a tax on the net produce of property could not be progressively taxed.[232] Hence, they "could not permanently respond to the necessities of the situation."[233] It was the failings of previous tax regimes to keep pace with changing historical conditions that occasioned the transition to "the fifth and final stage" where "income was selected as the test of faculty."[234]

Although Seligman claimed that the income tax was the "final" stage in the development of tax laws, he went to great pains in his treatise to emphasize that the income tax ought not be viewed as the only accurate measure of tax-paying ability. The income tax, for him, was not without its faults. It left many thorny questions unanswered, such as what constituted income, whether all sources of income could be treated equally, and the all-important issue of "whether different amounts of income present identically the same criteria of ability to pay."[235] In addition to these substantive questions, the income tax also posed a host of administrative concerns, not the least of which was whether it could be executed without being overly intrusive.[236] In the end, Seligman admitted that although a tax based on income was perhaps the final stage of fiscal evolution, a system of taxation that accurately gauged an individual's faculty would remain an ideal beyond the reach of practical politics.

It was this pragmatic concession that compelled Seligman to apply historicism, in a self-reflexive manner, to his own ideas. Seligman's theory of fiscal evolution was therefore not a teleological one, with the income tax as some sort of whiggish culmination of progress. He recognized that the income tax, by itself, was no panacea for the complexities of a modern, industrial society.

230. *Id.* at 14.
231. *Id.* at 15.
232. *Id.*
233. *Id.*
234. *Id.*
235. *Id. at* 16.
236. In fact, the issue of fairly and accurately administering an income tax has been a dominant issue in tax policy since the American origins of the income tax during the Civil War. *See generally* Joseph J. Thorndike, *Reforming the Internal Revenue Service: A Comparative History*, 53 ADMIN. L. REV. 717 (2001).

Pinning all his hopes on the income tax would only make him as "unscientific" as the amateur economic commentators from whom he and his new school colleagues sought to distance themselves. Instead, he saw the income tax as a vital component in a larger matrix of policies promoting economic and social justice—a component that remained tied to the criteria of ability to pay. Seligman acknowledged the idealistic aspects of his theory when he wrote:

> While the system of taxation should endeavor, roughly at all events, to adjust itself to income in general, the income tax as such can form only a part, even though it may be a permanent part, of the system, the other elements of which must be based upon the remaining criteria of faculty in order to reach as close an approximation to justice as may be possible.[237]

Writing at a time when the future of the American income tax was still unclear, Seligman and his colleagues did not lose sight of their historicist methods. The income tax had come into its own as a necessary policy for a modern, industrialized nation. But that did not mean the income tax was or should be sacrosanct. For the progressive economists to give it such timeless, transhistorical prominence would be to betray their own historicism. Instead, because the income tax seemed to correspond with the level of political and economic development that existed in turn-of-the-century America, Seligman and his reformist colleagues became vocal advocates for the implementation of a permanent federal income tax. Yet at the same time, they recognized that conditions in other places and at other times might dictate different forms of fiscal policies.

III. IDEAS, POLITICS, AND THE EARLY DEVELOPMENT OF INCOME TAX LAWS

In their attempts to influence policymaking, the progressive economists realized that the power of their ideas, alone, was often not enough to change the laws and institutions that undergirded the American tax system. They needed to take a more active role in the political and policymaking process by participating as consultants and part-time tax commissioners, and by capturing the attention of lawmakers. As the economists and other social scientists were promoting their ideas, the American political system itself was undergoing a radical transformation. For it was during the turn of the twentieth century that the state of "courts and parties" was giving way

237. SELIGMAN, *supra* note 174, at 18.

to a more fractured and pluralistic system of American politics. The nineteenth-century dominance of party politics and patronage was being eroded by the rise of a more competitive political process, one that helped forge the modern fiscal, regulatory, and administrative American state.[238] With this shift in politics, reform-minded economists like Ely, Adams, and Seligman joined organizations like the NTA and formed other coalitions, such as the New York Tax Reform Association, to provide an outlet for their ideas—an outlet that they hoped could shape tax policy more directly.

To meet the challenges of the emerging political system, the progressive economists needed to defend their support for an income tax based on the faculty principle against opposition from both the political right and left. For political conservatives, wedded to a classical, night watchman view of the state, the move to a graduated income tax was equated with creeping socialism. The progressive economists observed firsthand, often to their personal detriment, the overwhelming power that such conservative critics held, particularly in delineating the bounds of academic freedom.[239] Addressing these opponents, the progressive economists sought to demonstrate that support for graduated income taxes could be compatible with traditional American notions of equality and fairness.

The reform-minded economists faced a more amorphous, though equally formidable, kind of opposition from the political left—where the Populist attraction to the single-tax ideas of Henry George appeared to distract important constituencies away from the income tax movement. In defusing this opposition, the economists sought to debunk the amateur economic analysis conducted by George and his disciples. They also attempted to unmask the "ultra-conservative" social theory that underpinned George's call for a single tax on land.[240] By navigating between these two political camps of opposition—between the conservative critics who equated a progressive income tax with socialism and the populist reformers who advanced a seemingly more radical form of taxation—the progressive economists combined their theories with other prevailing economic ideas of the times, namely marginal utility analysis, to show that a progressive income tax was, in fact, an assault on privilege that did not amount to a move toward state socialism.

238. *See generally* RICHARD L. MCCORMICK, THE PARTY PERIOD AND PUBLIC POLICY: AMERICAN POLITICS FROM THE AGE OF JACKSON TO THE PROGRESSIVE ERA (1986); JOEL SILBEY, THE AMERICAN POLITICAL NATION, 1838–1893 (1991); SKOWRONEK, *supra* note 15. For a recent review essay challenging the continuing dominance of the "party-period" paradigm for nineteenth-century American political history, see generally Richard R. John, *Farewell to the "Party Period": Political Economy in Nineteenth Century America*, 16 J. POL'Y HIST. 117 (2004).

239. *See* text accompanying notes 115–120.

240. ELY, *supra* note 75, at 16.

A. The Conservative Opposition to Income Taxes

From the political right, conservative commentators railed against the income tax and the notion, in particular, of progressivity as a violation of the natural laws of equality and uniformity. One of the most outspoken critics was David A. Wells, the former commissioner of Internal Revenue during the Civil War. As a popular writer during the late nineteenth century, Wells was well known as a free-trader and an opponent of government intervention in the economy.[241] To be sure, Wells was no stranger to the importance of using taxes to fund an army and build a nation. But he, like many of the old guard, laissez-faire academics, was adamantly opposed to the use of progressive income taxes. As early as 1880, when national lawmakers considered the possibility of reviving the Civil War income tax, which had expired eight years earlier, Wells spoke out against graduated income taxes. Except in the extreme case of war, Wells argued that there was no place in a free republic for any form of a graduated income tax based on the ability to pay.[242]

Nearly all income taxes in the western world had some sort of exemption level, and most had graduated rates. But for Wells, exemptions and progressive rates spelled the worst sort of government discrimination. "Any government, whatever name it may assume, is a despotism, and commits acts of flagrant spoliation," Wells declared, "if it grants exemptions or exacts a greater or lesser rate of tax from one man than from another."[243] As a former federal tax official, Wells also believed that administering a permanent national income tax was "impracticable."[244] But his most fundamental objection, articulated in an 1880 article for the popular *North American Review*, was that any discrimination in taxation was by definition "purely arbitrary," and hence "an act of charity which every American ought to reject upon principle and with scorn."[245] Believing that progressive taxes of any sort were a form of emasculating charity, Wells concluded that "[e]quality and manhood, therefore, demand and require uniformity of burden in whatever is the subject of taxation."[246] Several years later, when the *Pollock* decision

241. *See, e.g.*, David A. Wells, *The Meaning of Revenue Reform*, 113 N. AM. REV. 104 (1871); *see also* 3 DORFMAN, *supra* note 41; COHEN, *supra* note 13, at 88–95.

242. David A. Wells, *The Communism of a Discriminating Income Tax*, 130 N. AM. REV. 236 (1880).

243. *Id.* at 328–39.

244. *Id.* at 241.

245. *Id.* at 259–60.

246. *Id.* at 260. Ironically, while Wells was linking tax equality and uniformity with masculinity, women were already using their status as taxpayers to fight for full citizenship. See, for example, Carolyn Jones, *Dollars and Selves: Women's Tax Criticism and Resistance in the 1870s*, 1994 U. ILL. L. REV. 265; KERBER, *supra* note 153, at 81–123.

began to act as a lightening rod for protests over the distribution of fiscal burdens, Wells reiterated his opposition to a progressive income tax.[247] Indeed, throughout his writings, Wells resisted any law that sought to alter "the distribution of wealth by direct or indirect compulsion," or any measure that "diminished the incentives for personal accumulation."[248] Although Wells did not specifically argue that taxation should be based solely on the principle of benefits, his commitment to limited government and unfettered individualism echoed the notion that taxes were only justified as a price for the protection of private property.

Conservative hostility to the income tax was perhaps most vociferous in the academy, where old guard defenders of classical political economy joined Wells in denouncing progressive income taxes. At the time, there was perhaps no greater academic proponent of the naturalness of classical political economy than William Graham Sumner, a professor of political and social science at Yale. Sumner was, of course, one of the traditional political economists that the new school theorists singled out as an enemy of reform.[249] Like Wells, Sumner disparaged the protective tariff as a form of state capitalism; he also believed that income taxes aimed at reallocating fiscal burdens were an example of unnecessary state intervention in the natural struggle for all "to get capital." The only thing that one could expect from government was a minimal amount of protection of historically based rights. This, of course, implied that citizens had only a limited responsibility to pay for such protection.[250]

The comments of writers like Wells and Sumner were not mere rhetoric. Indeed, the conservative challenge to the income tax was most palpable within the institutions of power, particularly the judiciary. Justice Stephen J. Field's concurring opinion in *Pollock* clearly illustrated how many elite members of society viewed the progressive income tax as the first step down a slippery slope toward class warfare. Referring to the mildly

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247. David A. Wells, *Is the Existing Income Tax Unconstitutional?* 19 FORUM 537 (1895).

248. David A. Wells, *Influence of the Production and Distribution of Wealth on Social Development*, *in* PRACTICAL ECONOMICS 235, 248 (New York, G.P. Putnam's Sons 1885).

249. In helping to create the American Economic Association, Ely sought "to create standards, endorse methods, and establish a social mission which would eliminate the 'Sumner crowd' from the profession of economics." FURNER, *supra* note 17, at 69; *see also* MENAND, *supra* note 13, at 303. For an interesting reinterpretation of Sumner's role in the development of American social thought, see SKLANSKY, *supra* note 13, at 105–36.

250. W.G. Sumner, *Protective Taxes and Wages*, 136 N. AM. REV. 270 (1883). *See generally* W.G. SUMNER, WHAT SOCIAL CLASSES OWE TO EACH OTHER (Harper & Bros. 1883). Sumner passed this belief in libertarian individualism to one of his best students, Irving Fisher, who would go on to become one of the next generation's leading economists and supporters in favor of consumption taxes. ROSS, *supra* note 17, at 180.

progressive rates of the 1894 income tax law,[251] Field's concurring opinion in *Pollock* articulated this growing anxiety. "The present assault on capital is but the beginning," wrote Fields.[252] "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."[253] Whereas the progressive economists saw class tensions, exacerbated by the growing disparity of wealth, as the impetus for a more equitable distribution of fiscal burdens, Fields and other supporters of laissez-faire viewed this same tension in more millennial and catastrophic terms.

B. The Populist Opposition: Henry George's Single Tax

Although Wells, Sumner, and Fields were certainly not alone in either opposing a progressive income tax, or in associating such levies with a gendered view of masculinity, other more populist voices were not so reluctant to call on the state's taxing powers to address the growing disparity of wealth in the nation. But even these calls were a cause for concern among the reform-minded economists. The most strident of these voices came from Henry George, a journalist turned economic commentator, who tapped into the American anti-monopoly tradition to propose his own type of fiscal solution that was at odds with both the income tax and the principle of ability to pay.

In a hugely popular book, George advocated that the government impose a levy only on increases in land values—a single tax on what George referred to as the "unearned increment" of appreciated land. After his book, *Progress and Poverty*, burst onto the scene in 1879, the popularity of the tract led many social movements to take up the call for a single tax.[254] And as early as 1885, Richard Ely observed that "tens of thousands of laborers have read *Progress and Poverty*, who have never before looked between the two covers of an economic book."[255] Throughout the 1880s and 1890s,

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251. The 1894 law levied a rate of 2 percent on incomes above $4000. Act of Aug. 27, 1894, §§ 27–37, 28 Stat. 509, 553–60.

252. Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 607 (1895) (Fields, J., concurring).

253. *Id.*

254. HENRY GEORGE, PROGRESS AND POVERTY: AN INQUIRY INTO THE CAUSE OF INDUSTRIAL DEPRESSIONS AND OF INCREASE OF WANT WITH INCREASE OF WEALTH . . . THE REMEDY (Robert Shalkenbach Found., 1955) (1879). For more on George and his times, see CHARLES A. BARKER, HENRY GEORGE (1955); STEPHEN B. CORD, HENRY GEORGE: DREAMER OR REALIST? (1965); JOHN L. THOMAS, ALTERNATIVE AMERICA: HENRY GEORGE, EDWARD BELLAMY, HENRY DEMAREST LLOYD, AND THE ADVERSARY TRADITION (1983).

255. 2 PHILIP S. FONER, HISTORY OF THE LABOR MOVEMENT IN THE UNITED STATES 120 (1955) (quoting Richard T. Ely). The book's supporters proudly proclaimed that "no other American work in political economy had ever sold more than 1,000 copies during the first year." BARKER, *supra* note 254, at 330.

and well into the early twentieth century, the single tax became a popular social movement demanding a tax on land, specifically ground rent, as the exclusive source for all government revenue.[256]

George's single tax on land was a simple, if not simplistic, idea aimed at curbing land speculation and forestalling more radical attempts at tax reform. Because George believed that land was the source of all wealth, he argued that it should be taxed as common property. Combining such diverse sources as the teachings of the Bible and Aristotle, George concluded that the "unearned increment" on land came from the growth of populations—from society itself—rather than individual effort, and thus the state had an obligation to reclaim such unearned increment on behalf of society.[257]

The rhetoric of reclaiming the value created by society had a socialistic ring to it. But George was no socialist. Instead, he held a rather conservative view of individualism, arguing that the fruits of individual labor belonged to the individual and that the state had very little role to play in economic or social matters beyond levying a single tax on land. With a severely circumscribed role for the state, George believed that there was little need for any tax beyond one on the unearned increment of rent. It was only the people's natural share in wealth that he sought to tax as revenue for an otherwise limited government.

Though George's idea of using a single tax to address nearly all the ills of modern capitalism caught on with many grassroots movements at the turn of the century, it did not fit neatly into either of the predominant views of governance. Neither the laissez-faire proponents who abhorred almost any kind of tax, particularly one on land—the most sacrosanct of private property—nor the advocates for a more robust positive state, could see much merit in George's ideas. At its core, though, George's single tax prescription appeared to be a narrow application of the benefits principle: Landowners owed a duty to the state because it was the state that protected the private property rights of landowners. This reciprocal relationship was the essence of the benefits theory. Although George's ideas appealed to many among the producing classes because of his populist appeals attacking land speculators and monopolists, the single tax itself was premised on a conservative, if not reactionary, view of individualism.

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256. On the continuing popularity of the single tax movement, see generally ARTHUR P. DUDDEN, JOSEPH FELS AND THE SINGLE TAX MOVEMENT (1971); ARTHUR N. YOUNG, THE SINGLE TAX MOVEMENT IN THE UNITED STATES (1916); Peter Speek, The Single Tax and the Labor Movement (1915) (unpublished Ph.D. dissertation, University of Wisconsin).

257. GEORGE, *supra* note 254, at 299–394.

Given George's commitment to individualism, it was no surprise that socialists approached the single tax with a great deal of ambivalence. As Ely's remark suggests, *Progress and Poverty* was wildly successful among the working class.[258] Nonetheless, many socialists saw the single tax for what it was: a rearguard response to the changes wrought by industrial capitalism. Karl Marx himself castigated George's bestselling book as "simply an attempt, decked out with socialism, to save capitalist domination and indeed to establish it afresh on an even wider basis than its present one."[259] Socialists, in the end, disagreed with the fundamental premise behind the single tax; whereas they saw the eternal conflict of industrialism as a battle between labor and capital, George seemed to counterpoise it as a struggle between labor and land.

While George's appeal among grassroots social movements became a significant distraction for some supporters of the income tax,[260] the rising community of professional economists did not take his "unscientific" and amateur analysis of economic conditions seriously.[261] For them, a more potent intellectual challenge from the left came in the guise of their German mentors who had been advocating for a more radically redistributive form of taxation. Leading this charge was Adolph Wagner, the Berlin economist with whom many of the progressive economists had studied during their German sojourn.[262] Wagner's calls for using taxes to address directly the vast inequalities in wealth had a far more receptive audience in Germany than in the United States, where his American disciples were careful and cautious in decoupling progressive income taxes from state socialism.

258. *See* text accompanying *supra* note 255.

259. BARKER, *supra* note 254, at 356 (quoting Karl Marx).

260. *See generally* Ajay K. Mehrotra, *"More Mighty Than the Waves of the Sea,": Toilers, Tariffs and the Income Tax Movement, 1880–1913*, 45 LAB. HIST. 165, 177 (2004).

261. In 1890, when the American Social Science Association devoted an entire conference to the single tax, Seligman joined other professional economists in berating George's "schemes" as "repugnant to our moral sense and repellant to our logic." BARKER, *supra* note 254, at 565–67. Seligman was one of the few academic political economists, after Francis Walker, who carefully and extensively analyzed George's writings. Charles Bullock, the Harvard economist, confided to Seligman that "in opposition to the single tax, I should not know what to reprint for students of finance, if your discussion was not available." Letter from Charles Bullock to Edwin R.A. Seligman (June 2, 1905), Cataloged Correspondence, Edwin R.A. Seligman Papers (on file with Butler Library, Columbia University). Similarly, Marx castigated George's economic reasoning as a form of "Yankee advertisement." BARKER, *supra* note 254, at 394–96.

262. RODGERS, *supra* note 13, at 91, 94–95. One of the principal themes of Wagner's *Finanzwissenschaft* was the advocacy of progressive income taxes in order to redistribute income. *See* Kenneth Barkin, *Adolf Wagner and German Industrial Development*, 41 J. MOD. HIST., 144, 151 (1969). Much of Wagner's scholarship has remained in the original German, but for a brief sample of his ideas that have been translated into English, see Adolf Wagner, *Three Extracts on Public Finance* (Nancy Cooke trans.), *in* CLASSICS IN THE THEORY OF PUBLIC FINANCE 1, 1–15 (Richard A. Musgrave & Alan T. Peacock eds., 1958).

C. In Defense of Progressivity: Navigating Between the Opposition

Faced with these critiques from the political right and left, the reform-minded economists attempted to navigate between these poles in advancing the income tax cause. Challenging the ideas of their German mentors, the progressive economists maintained—just as they had when they first introduced German historicism to an American audience—that American political culture posed some serious institutional constraints. Wagner's recommendations for using steeply progressive income taxes to address the ills of industrial capitalism, for example, were thus too radical for American ways.

New school economists admitted that their former instructor appropriately identified the social aspects of fiscal policy—that taxes ought to be used for much more than just government revenues. But they feared that Wagner and his socialist supporters promoted a level of state intervention that was wholly distasteful to most Americans. Even Seligman, who discredited benefits theory because it discounted the social connections between the individual and the state, recoiled at the implication of Wagner's redistributive tax policies. "From the principle that the state may modify its strict fiscal policy by considerations of general national utility, to the principle that it is the duty of the state to redress all inequalities of fortune among its private citizens, is a long and dangerous step," Seligman warned.[263] "It would land us not only in socialism, but practically in communism."[264]

The fundamental problem for Seligman and his colleagues, then, was that many commentators and old-guard political economists erroneously assumed that "progressive taxation necessarily implies socialism and confiscation."[265] Citing explicitly to the work of David Wells, Seligman argued that "[i]t is quite possible to repudiate absolutely the socialistic theory of taxation and yet at the same time advocate progression."[266] Decoupling progressive income taxes from state socialism thus became one of the principal aims of the reform-minded economists.

This was no easy task. As part of the professionalization process, many of the young, reform-minded economists were forced to moderate their more radical views in light of larger political pressures. Many social scientists faced the harsh reality that the institutional powers behind the American research university were not always tolerant of ideas that ran counter to the views of administrators, alumni, and benefactors. They were well

263. Seligman, *Theory of Progressive Taxation*, *supra* note 155, at 222.
264. *Id.*
265. *Id.*
266. *Id.*

aware that the "socialistic" tag often blinded people to the logic and reasoning behind plausible reforms. This tension between academic freedom and the confining political climate of the times was heightened when the public finance economists were considering the need for progressive taxation. Just when Adams's brush with the Cornell alumni seemed to be receding into the past, other academic economists were coming under increased scrutiny by the administrators and the alumni of their institutions. Ely, who by 1894 was teaching at Wisconsin, endured a public trial of his ideas before he was eventually exonerated.[267] A member of the University of Wisconsin Board of Regents accused Ely not only of teaching socialism and anarchism, but also of participating in local strikes and boycotts. Ely recoiled at the allegations. Rather than defend his right to academic freedom, he recanted much of his radicalism, highlighting instead the moderate and conservative tendencies of his writings.[268] Within this environment, it was incumbent upon the intellectual supporters of graduated taxes to create some distance between their ideas and the conventional impressions of socialism.[269]

Adams, who had firsthand experience with the limits of academic freedom, met this charge head on when he sought to explain how moderately progressive income taxes in fact were compatible with industrial capitalism. Describing the socialist ideal as "a society in which government is the one great industrial corporation," Adams claimed that it would be irrational for a socialist to support progressive taxation.[270] "It would be logical for one who defends the institution of private property, and who believes in the theory of voluntary initiative in industry, to advocate progressive taxation as an essential condition to the maintenance of those industrial relations in which his ideal of society may be realized," wrote Adams.[271] "[B]ut for the socialist, whose theory of social organization is opposed to that of voluntary association, such an advocacy is illogical and absurd."[272] Progressive taxes that reallocated fiscal burdens without radically redistributing wealth, Adams seemed to imply, were wholly consistent with American institutions and culture.

267. FURNER, *supra* note 17, at 143–58.

268. For a more detailed account of Ely's trial, see 1 MERLE CURTI & VERNON CARSTENSEN, THE UNIVERSITY OF WISCONSIN: A HISTORY, 1848–1925, at 508–27 (1949); RADER, *supra* note 82, at 136–52.

269. FURNER, *supra* note 17, at 143–62; RADER, *supra* note 82, at 130–58; Dorothy Ross, *Socialism and American Liberalism*, *in* PERSPECTIVES IN AMERICAN HISTORY 64 (Donald Fleming ed., 1978).

270. ADAMS, SCIENCE OF FINANCE, *supra* note 140, at 344.

271. *Id.*

272. *Id.*

While there is little doubt that political pressures forced the progressive economists to temper their reformist inclinations, it is unlikely that they ever embraced the radically redistributive notions held by their German mentors. The American new school economists abhorred the radical individualism inherent in classical political economy, but many of them continued to believe that economic progress was driven mainly by private industry rather than state action.

It was this allegiance to the productive powers of capital that led them to restrain their advocacy for a redistributive tax policy. Indeed, the tax theorists were especially concerned about not disturbing what Adams referred to as the "patrimony of the state," by which he meant the economic productivity of private industry.[273] In typical historicist fashion, Adams admitted that the "patrimony of the State is not a thing that is fixed, but that it changes with the ideas of political and industrial rights entertained by the people."[274] Nevertheless, Adams made preserving economic incentives a fundamental part of his fiscal vision. The "first fiscal axiom of the Science of Finance," Adams declared, is that "[a] sound financial policy will not impair the patrimony of the State."[275] Though Adams was genuinely concerned about the growing disparity of wealth in the nation, he harbored an even greater fear that steeply progressive tax rates would somehow jeopardize the seemingly eternal nature of the state. As he stated, "the patrimony of the State consists in a flourishing condition of private industries."[276]

Other progressive public finance economists echoed Adams's comments. They appeared to concur that progressive taxes could create the risk of distorting economic incentives. But they were careful not to overstate the case. Retreating on the issue of progressivity—on the need, that is, for a graduated rate structure—could signal the death knell for the faculty theory. As Seligman explained, the vital political tension behind the calls for an income tax was expressed in the choice between proportional and progressive taxes, and the resolution of this choice turned on "the fundamental question as to the basis of taxation—the theory of benefits or the theory of ability."[277] Put simply, the reform-minded economists believed that they could not defend the income tax and the principle of faculty without defending the need for some level of progressivity. Seligman did this by using a historicist perspective to combine

273. *Id.*
274. *Id.* at 6.
275. *Id.* at 4 (emphasis omitted).
276. *Id.* at 5.
277. Seligman, *Theory of Progressive Taxation*, *supra* note 155, at 224.

traditional Anglo American thinking on taxation with marginal utility analysis, an increasingly popular economic idea in the American academy.

As a variant of neoclassical economics, marginalism emerged as the predominant theory in American economics at the turn of the century. Unlike classical theory, which held that the value of an item was determined by the costs incurred to create it, marginalism demonstrated that the value of a commodity depended upon the subjective worth, or utility, a consumer placed on such a commodity. This value, in turn, depended upon how much of the commodity the consumer already had. Thus each additional unit of a commodity, including money, was believed to be of lesser value than the previous unit.[278]

The notion that the value of an item was determined at the margin of diminishing returns was not unique to American conditions. European thinkers, building on the classical ideas of David Ricardo, had throughout the mid- and late nineteenth century applied new mathematical approaches to measuring value based on the concept of diminishing returns. The British economist Alfred Marshall helped synthesize the ideas of prior theorists, and John Bates Clark, Seligman's colleague at Columbia, popularized and expanded the application of marginal utility analysis in the United States.[279]

The application of Clark's notion of marginalism to tax policy reached its apex, not surprisingly, through the work of Seligman. But at about the same time, other reform-minded economists in the United States and Britain independently were using the particular idea of the diminishing marginal utility of money to justify progressive taxes. Thomas N. Carver, a professor of political economy at Oberlin College and later Harvard, and F.Y. Edgeworth of Oxford, not only refined marginalist theories but also used a version of the "minimum sacrifice" idea to support a "moderately progressive system of taxation." By turning the utilitarian principle of "the greatest good to the greatest number"[280] on its head, Carver reasoned that "the evils of taxation are twofold, the sacrifice to those who pay the taxes, and the repression of the industry and enterprise which they occasion."[281]

278. *Marginal Utility*, ROUTLEDGE DICTIONARY OF ECONOMICS 285–86 (Donald Rutherford ed., 1992); ROBERT H. FRANK, MICROECONOMICS AND BEHAVIOR 23–24 (4th ed. 2000).

279. *See* JOHN BATES CLARK, THE PHILOSOPHY OF WEALTH (Augustus M. Kelley Publishers 1967) (1886); ALFRED MARSHALL, PRINCIPLES OF ECONOMICS (1890); *see also* ROSS, *supra* note 17, at 172–75. Joseph Schumpeter identified Clark as "the master of American marginalism." SCHUMPETER, *supra* note 96, at 868–70. For more on the rise of marginalism, see generally Symposium, *Papers on the Marginal Revolution in Economics*, 4 HIST. POL. ECON. 267 (1972).

280. Thomas N. Carver, *The Ethical Basis of Distribution and Its Application to Taxation*, ANNALS AM. ACAD. POL. & SOC. SCI. 79, 80 (1895).

281. *Id.* at 99.

Policymakers needed to be aware of both of these evils and balance the two against each other when they structured a tax system. They needed to realize that, on the one hand, an equality of sacrifice among individuals meant that each taxpayer would pay a proportional yet varying amount of taxes, insuring that the proper work incentives remained intact. At the same time, a minimum amount of total aggregate sacrifice suggested that the wealthy should pay more taxes because they received less utility from their last, or marginal, dollar. In Carver's words: "The minimum amount of repression is secured by imposing an equal sacrifice on all members of the community, but the minimum amount of sacrifice is secured by collecting the whole tax from those few incomes which have the lowest final utility."[282]

Though he agreed with Carver's theoretical conclusions, Seligman was much more pessimistic about the practical application of progressivity given some of the administrative obstacles the concept faced in the United States. Seligman wholeheartedly agreed that "progressive taxation is to a certain extent defensible as an ideal, and as the expression of the theoretical demand for the shaping of taxes to the test of individual faculty."[283] Still, he conceded, "it is a matter of considerable difficulty to decide how far or in what manner the principle ought to be actually carried out in practice."[284]

In terms of pure economic theory, Seligman confidently believed that marginalism explained why progressive taxes were neither a defense of status quo inequalities nor a form of socialist confiscation. Progressivity, seen from the perspective of marginalism, was the theoretical crystallization of faculty theory. In reconciling marginalism with the faculty principle, Seligman explained that "[t]he elements of faculty [were] two-fold: (1) those connected with acquisition or production, [and] (2) those connected with outlay or consumption."[285] On the production side, it seemed rather self-evident that one with a large fortune or income had "a decided advantage in augmenting his possessions."[286] In this case, "faculty may be said to increase faster than fortune or income," suggesting the need for something "more than [a] proportional rate of taxation."[287]

The analysis from the consumption perspective was a bit more complicated. Here, the faculty theory rested on a version of equal sacrifice, which

282. *Id.* at 97; F.Y. Edgeworth, *The Pure Theory of Taxation*, 28 ECON. J. 550, 550 (1897). For a comparison of Carver and Edgeworth and their views on progressive taxation, see Hovenkamp, *supra* note 71, at 1002–08.

283. Seligman, *supra* note 154, at 199.

284. *Id.*

285. Seligman, *Theory of Progressive Taxation*, *supra* note 155, at 245.

286. *Id.*

287. *Id.* at 246.

itself was based on the notion of diminishing marginal utility. Building on the work of European theorists who refined marginal utility analysis, Seligman illustrated how the individual benefits received from the consumption of different items dictated the need for a progressive system of taxation:

> Since the intensity of our wants and therefore their final utility decreases as we ascend from the lower or more pressing to the higher or less urgent wants, and since larger incomes supply the means of satisfying these less intense wants, a strictly proportional tax would involve smaller sacrifices in the case of the larger incomes. Strict equality of sacrifice in the sense of relatively proportional diminution of burden thus involves progressive taxation.[288]

In theoretical terms, the principle of faculty required progressive rather than merely proportional taxes.

Using marginal utility analysis to defend the progressive income tax posed some theoretical problems, however. While most economic thinkers and perhaps even policymakers could agree that the last dollar held by the Astors or Vanderbilts was worth much less than the last dollar held by a common member of the working class, marginalism at its core rested on a rather problematic interpersonal comparison of utility. Though it would not be difficult to make the case at the extremes, it was much more challenging to differentiate the subjective utility that different citizens within the middle class placed on their last dollar. Despite this theoretical challenge, the reform-minded economists maintained that an adherence to the notion of faculty required a progressive rather than a proportional rate structure. If the problem of interpersonal comparisons of utility complicated the setting of optimal rates, it did not completely undermine, at least for the turn-of-the-century economists, the superiority of a progressive rate structure.

More practical constraints, however, tempered the progressive public finance economists' calls for progressive income taxes. Above all else, these economists were pragmatists. They were constantly concerned about how tax laws and fiscal policies would operate in concrete situations and how changes in tax law and other institutions would alter individual behavior. Not only did the individualistic beliefs of American political culture operate as one set of impediments, but these German-trained theorists realized that the federal government in the United States lacked the national administrative capacity of its European counterparts. In contrasting the progressive income tax with the general property tax, Ely, for one, claimed

288. *Id.* at 239.

that both levies required an enhanced administrative apparatus, and that an income tax would be less intrusive than the general property tax.[289]

Seligman, in defending progressivity, was not so sanguine. More than any of his colleagues, he was well aware of the administrative hurdles that a progressive income tax needed to overcome—not the least of which was setting the degree of progression. "Theory itself cannot determine any definite scale of progression," wrote Seligman.[290] "And while it is highly probable that the ends of justice would be more nearly subserved by some approximation to a progressive scale, considerations of expediency as well as the uncertainty of the interrelations between various parts of the entire tax system should tend to render us cautious in advocating any general application of the principle" of progressivity.[291] Even when it came to defending one of the most fundamental applications of the faculty principle, Seligman could not abandon his faith in the importance of having tax laws and policies comport with social and institutional contexts. "It remains to investigate as to how far the principle" of progressivity "is applicable to the conditions surrounding us in America to-day," wrote Seligman in 1894.[292] "But, in last resort, the crucial point is the state of the social consciousness and the development of the feeling of civic obligation."[293] Ultimately, for Seligman, economic theory could not trump historical content.

D. The Progressive Economists and the Making of the American Income Tax

While the progressive public finance economists may have agreed that, as Seligman noted, "the state of social consciousness" would dictate whether American society would be receptive toward progressive income taxes, this did not mean that the economists themselves had no role to play in shaping "social consciousness" and in developing "the feeling of civic obligation."[294] Indeed, it was during pivotal moments of social change that reform was in fact possible. "It is always on the borderline of the transition from the old social necessity to the new social convenience that the ethical reformer makes his influence felt," wrote Seligman.[295] "Unless the social

289. ELY, *supra* note 75, at 290–91.
290. Seligman, *supra* note 154, at 200.
291. *Id.*
292. *Id.*
293. *Id.*
294. *Id.*
295. SELIGMAN, *supra* note 222, at 131.

conditions . . . are ripe for the change, the demand of the ethical reformer will be fruitless."[296] As we have seen, reform of state and local taxation became possible in the early years of the twentieth century mainly because social dissatisfaction with the property tax and the need for increased state government revenue combined with the ideas posited by the academic economists to separate the sources of state and local tax revenue.[297]

Similarly, at the national level, the progressive economists were able to advance their vision of a new fiscal state only when social conditions were ripe. Thus, while Ely, Adams, and Seligman had been writing and lecturing for decades about the need for taxes based on the notion of ability, it was not until the tumultuous process of ratifying the Sixteenth Amendment to the Constitution—between 1909 and 1913—that they were able to see their ideas come to fruition at the federal level. By then, of course, Seligman had become the dominant academic voice calling for a moderately progressive income tax based on the notion of faculty. As the legal historian Herbert Hovenkamp has demonstrated, Seligman had a profound influence on judicial policymaking throughout the first half of the twentieth century.[298] But the professor had an equally important, even more direct role during the institutional establishment of the American income tax system.

Even before 1909, when the Sixteenth Amendment was first introduced, Seligman in particular spoke up in support of a national income tax. Like many other tax experts, he believed that *Pollock*, the Supreme Court case striking down the 1894 federal income tax, was wrongly decided.[299] Seligman played a small, behind-the-scenes part in advising each of the parties to that case. Clarence Seward, one of the attorneys representing the taxpayers who opposed the law, requested Seligman's assistance in determining the original intent behind the Constitution's direct tax clause.[300]

296. *Id.*

297. *See* text accompanying notes 179–200.

298. Hovenkamp, *supra* note 71, at 1008–09. Since "Seligman's books on taxation read as much like legal treatises as economic texts," wrote Hovenkamp, "they seemed to the courts to be as much 'law' as 'economics.'" *Id.*

299. Edwin R.A. Seligman, *Is the Income Tax Constitutional and Just?* 19 FORUM 48 (1895). *Pollock* has been both vilified by an older generation of scholars as an example of conservative constitutionalism, and acknowledged more recently by revisionist historians as a potential Jacksonian attack on congressional efforts at maintaining "state capitalism." For the former, see ROBERT G. MCCLOSKEY, THE AMERICAN SUPREME COURT 140–44 (1960); SIDNEY RATNER, TAXATION AND DEMOCRACY IN AMERICA 193–214 (1967); ARNOLD M. PAUL, CONSERVATIVE CRISIS AND THE RULE OF LAW: ATTITUDES OF BAR AND BENCH, 1887–1895 (1960). For an example of the revisionist view, see STANLEY, *supra* note 9, at 136–75.

300. Letters from Clarence Seward to Edwin Seligman, (Jan. 22, 1895; Jan. 28, 1895) (copies on file with author); *see also* Mehrotra, *supra* note 12, at 192–200.

Seligman explained how his historical research and his legal analysis verified that an income tax was, in fact, constitutional. Although he was not an originalist, Seligman believed that during the colonial period and throughout the drafting of the Constitution there was no clear legal meaning attached to direct or indirect taxes.[301] This was probably not what Seward and his colleagues were hoping to learn from the professor, and they conveniently ignored his counsel.[302] By contrast, Seligman concurred with the government lawyers that a string of previous Court decisions had already analyzed the direct tax clause,[303] holding that it applied only to land and poll taxes, not to income taxes.[304] Like the government lawyers, Seligman did not expect the Court to strike down the 1894 income tax law. When it did, a surprised Seligman turned his energies towards supporting a constitutional amendment that would overturn *Pollock*.

Even before the decision was handed down, Seligman published an article in the popular journal *Forum*, taking on the principal objections to the 1894 law.[305] In a previous issue of that journal, David Wells had recycled his earlier opposition to progressive income taxes.[306] Wells claimed that graduated rates were a form of discrimination contrary to the notion of "uniformity" embodied in the Fifth Amendment.[307] Responding directly to Wells, Seligman maintained that the constitutional restriction on uniformity applied not to the classification of a tax but to its geographical application. "Uniform throughout the United States," wrote Seligman, meant that "the same rate of taxation should be imposed on all the States."[308] Because Seligman did not think that

301. In his treatise on the income tax, Seligman wrote that "there was no agreement at all as to the use or meaning of the newer term 'direct tax'" during the period leading up to the Constitution. SELIGMAN, *supra* note 174, at 561. "As a matter of fact, the term was scarcely employed at all before 1787." *Id.*

302. In their oral arguments on behalf of the taxpayer, Seward and his colleagues claimed that "[a]t the date of the Constitution (1787), the words 'direct taxes' and 'indirect taxes' were household words. . . . They are to be found in the literature of the period. . . . They had been used in Europe as meaning taxes which fell directly upon property and its owner, like a land tax or a tax on incomes . . . ." *Argument of Mr. Seward for the Appellants*, Pollock v. Farmers' Loan Trust Co., 157 U.S. 429 (1895), *in* 12 LANDMARK BRIEFS AND ARGUMENTS OF THE SUPREME COURT OF THE UNITED STATES: CONSTITUTIONAL LAW 359 (Philip B. Kurkland & Gerhard Casper eds., 1975).

303. Letter from James C. Carter to Edwin Seligman (Mar. 20, 1895) (copy on file with author).

304. Springer v. United States, 102 U.S. 586 (1880); Scholey v. Rew, 90 U.S. (23 Wall.) 331 (1874); Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533 (1869); Pac. Ins. Co. v. Soule, 74 U.S. (7 Wall.) 433 (1868); Hylton v. United States, 3 U.S. (Dall.) 171 (1796).

305. Seligman, *supra* note 299.

306. Wells, *supra* note 247.

307. *Id.* at 537.

308. Seligman, *supra* note 299. At about the same time, Seligman also published an academic paper analyzing the classification issue behind the uniformity restriction. *See* Edwin R.A. Seligman, *The Classification of Public Revenues*, 9 Q.J. ECON. 279 (1895).

objections to the law based on the Constitution's "direct tax clause" merited serious consideration, he casually confirmed that the settled legal precedents and the economic analysis meant that any attempt "to declare the income tax unconstitutional" as a violation of the Constitution's direct tax clause was "foredoomed to failure."[309] Seligman must have been aghast when he learned that the Court struck down the 1894 tax law precisely along these lines.

Nearly fifteen years later, when Congress introduced the Sixteen Amendment, Seligman wasted no time in declaring his support for it. This time he not only published an article in support of the amendment, he also testified before the New York State Legislature during the ratification process. At his first appearance before the legislature in 1910, Seligman attempted to defuse the highly critical comments leveled by Governor Charles Evan Hughes, an old friend and law school classmate.[310] In an earlier message before the legislature, Hughes had objected to the amendment's language empowering Congress "to lay and collect taxes on income from whatever source derived."[311] Hughes, like many others, believed that the phrase "from whatever source derived" gave Congress the power to destroy the fiscal powers and the political sovereignty of the individual states by taxing their debt obligations.[312] Seligman disagreed. He joined others, including prominent Republican politicians such as Elihu Root, the U.S. Senator from New York,[313] in attempting to assure New York lawmakers and other state officials throughout the country that the amendment was not designed to allow the federal government to supersede the fiscal power of states and localities.[314]

Despite these assurances, the amendment could not survive the initial resistance of the Republican majority in the New York Assembly. The resolution was put to a vote in the Assembly three times during the 1910 session, and all three times the Republican majority resoundingly defeated it. Because New York was a pivotal state in the ratification process—mainly because it was the most influential of the wealthy Northeast states

309. SELIGMAN, *supra* note 299.

310. Letter from Charles Evans Hughes to Edwin R.A. Seligman (Apr. 4, 1904) (on file with Butler Library, Columbia University).

311. U.S. CONST. amend. XVI.

312. In his speech, Hughes proclaimed that placing "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." BUENKER, *supra* note 3, at 255.

313. *Root on Income; Senator Upholds Levy in Letter to Albany Solons*, WASH. POST, Mar. 1, 1910.

314. BUENKER, *supra* note 3, at 278–80.

hostile to reallocating tax burdens—income tax supporters realized that they would have to get New York's approval if they expected other states to ratify the amendment.[315] This appeared to be a historical moment. According to Seligman and many other income tax advocates, New York lawmakers appeared oblivious to the ripening of social consciousness and public support for the amendment. As an ethical reformer operating at the threshold between the "old social necessity" and the "new social convenience,"[316] Seligman set out to neutralize the opposition to the income tax amendment.

Soon after the resolution was rejected by the New York Assembly in 1910, Seligman reaffirmed his views with an article directly supporting the amendment. Writing in the pages of the *Political Science Quarterly*, Seligman used his historicism to scrutinize the opposition's general reliance on original intent, and to dissect Hughes's specific hostility to the amendment. "The conditions which existed when the constitution was framed are no longer existent," Seligman wrote.[317] "During the last century . . . the development of the underlying economic and social forces has created a nation, and this development calls for uniform national regulation of many matters which were not dreamed of by the founders."[318] With Hughes's comments no doubt in mind, Seligman concluded that economic and legal progress should not be hindered by antiquated attachments to the ideas of state and local self-governance. "Let us not make a fetich of 'self-government,'" Seligman argued, "and let us not oppose central authority in those cases where self-government means retrogression rather than progress."[319]

It is difficult to gauge precisely the influence of Seligman's comments; nonetheless, he was convinced by 1910 that a vast majority of the American people supported a national income tax. He was, in fact, quite prescient. For when the political winds changed direction the following year, delivering the New York legislature to the Democrats, the income tax amendment received new and considerably greater attention. Although Governor Hughes had by then become a member of the U.S. Supreme Court, his dire warnings continued to resonate among state lawmakers across the country. Seligman appeared once again before the New York Senate; this time he explicitly rejected Hughes's arguments against the amendment and reminded Republican legislators of the significance of the

315. *Id.*
316. Seligman, *supra* note 222, at 131.
317. Edwin R.A. Seligman, *The Income Tax Amendment*, 25 POL. SCI. Q. 193, 213–14 (1910).
318. *Id.* at 214.
319. *Id.*

1911 elections and his earlier comments.[320] "It was my good fortune," Seligman stated in his 1911 testimony, "to say to the Senate committee that though I was as good a Republican as any of those present, I believed the party would be snowed under at the polls, if it refused to accept the amendment. The Republican Party was snowed under and one of the reasons was its failure to observe my warning."[321]

Seligman's rebuke of Hughes's earlier warning was no less blunt. Essentially, Seligman reiterated that Hughes and his ilk did not realize that: (1) the proposed amendment would simply restore the constitutional status quo pre-*Pollock*; (2) a tax on the interest from state bonds would not, in a relative sense, harm the fiscal fortunes of state governments; (3) even if the federal government limited the fiscal powers of states and localities, the increased revenue of an income tax would benefit all, not just the federal government; and (4) the political will of the people, representing the spirit of the age, was behind the amendment.[322]

Seligman peppered his second argument, the economic analysis, with a personal attack on Hughes. He explained that an income tax that taxed the interest from all bonds at equal rates would not harm the market for such securities. "When you have precisely equal taxes on all forms of property of income," explained Seligman, "you don't affect the value of them at all."[323] Emphasizing the illogic of Hughes economic comments, Seligman concluded: "If any of my students at Columbia had made the same mistake as Governor Hughes, I should have flunked him dead."[324] In rebuffing Hughes's earlier message, Seligman was able to help galvanize the pro-income tax forces by lending them the prestige and prominence of a well-known expert in the field—an expert who was not afraid to tell lawmakers or even a former Governor what he believed. Seligman's position against his old friend Hughes seemed to be vindicated several years later in the 1915 Supreme Court decision of *Brushaber v. Union Pacific Railroad Co.*,[325] when a

320. *Corrects Hughes on Income Tax*, N.Y. TIMES, May 21, 1911, at 12; *Says Hughes Made Mistake*, WASH. POST, May 21, 1911, at 13; BUENKER, *supra* note 3, at 286–88.

321. BUENKER, *supra* note 3, at 288. During that same testimony, a Republican member of the Judiciary Committee attempted to impeach Seligman's expertise in taxation. Holding up a public finance text, he asked the professor whether he had read the whole book through. The question caused a great deal of amusement among the onlookers, and some embarrassment for the legislator, when he realized that he was holding up one of Seligman's own treatises. *Corrects Hughes on Income Tax*, *supra* note 320, at 12.

322. SELIGMAN, *supra* note 174, at 595–610.

323. *Says Hughes Made Mistake*, *supra* note 320, at 13.

324. *Corrects Hughes on Income Tax*, *supra* note 320; *Says Hughes Made Mistake*, *supra* note 320.

325. 240 U.S. 1 (1924).

then Justice Hughes assented to a unanimous decision that essentially refuted his earlier position on the general power of the Sixteenth Amendment.

E. An Enduring Legacy of Tax Reform

If Seligman's role in the ratification process was the most conspicuous example of the influence of progressive economic ideas on the making of tax law and policy, he and his like-minded educators left a lasting legacy of reform in other, less obvious ways. For it was in their role as teachers that the progressive economists had perhaps their greatest impact on the development of American public finance. As instructors and writers, they helped mold the next generation of scholars and policymakers. Disciples and students like Thomas S. Adams and Robert Haig became tax experts in their own rights.

T.S. Adams was one of Ely's first external hires when he arrived in Madison, and he soon became a coauthor for Ely's popular textbook.[326] As many modern tax scholars have recognized, Adams became an influential scholar and policymaker both at the state and national level during the early development of the American income tax. He was a member of the Wisconsin Tax Commission when it administered the first effective, modern state income tax in 1911.[327] After his time in Madison, Adams went on to work as an economic advisor to the U.S. Treasury Department during World War I, where he helped supervise the administration and effectiveness of controversial measures such as the excess profits tax.[328] Toward the end of the war and thereafter, he also played a crucial role in developing the American position on international taxation.[329]

Robert Haig, Seligman's most successful student, also carried his mentor's historicist message to subsequent discussions about tax policy. After completing a dissertation under Seligman's supervision on the history of the

326. RICHARD T. ELY ET AL., OUTLINES OF ECONOMICS (3d 1916).

327. *See generally* W. ELLIOT BROWNLEE, PROGRESSIVISM AND ECONOMIC GROWTH: THE WISCONSIN INCOME TAX, 1911–1929 (1974); Mehrotra, *supra* note 12, at 265–335.

328. *See generally* W. Elliot Brownlee, *Economists and the Formation of the Modern Tax System in the U.S.: The World War I Crisis*, *in* THE STATE AND ECONOMIC KNOWLEDGE: THE AMERICAN AND BRITISH EXPERIENCES, *supra* note 13, at 403; W. Elliot Brownlee, *Social Investigation and Political Learning in the Financing of World War I*, *in* THE STATE AND SOCIAL INVESTIGATION IN BRITAIN AND THE UNITED STATES 323 (Michael J. Lacey & Mary O. Furner eds., 1993).

329. *See generally* Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L.J. 1021, 1027 (1997); Thomas Earl Geu, *Professor T.S. Adams (1873–1933) on Federal Taxation: Déjà Vu All Over Again*, 10 AKRON TAX J. 29 (1993).

Illinois property tax,[330] Haig remained in nearly constant contact with his old teacher, conducting empirical field research for him on the property tax in Canada and the British excess profits tax of World War I.[331] Toward the end of Seligman's career, Haig eventually joined him as a colleague at Columbia. But Haig's greatest intellectual debt to Seligman was most visible in Haig's early attempts to define the concept of income. In his enormously influential 1921 essay, *The Concept of Income*, Haig not only credited Ely, Seligman, and others for providing the intellectual foundation to address the challenging issue of defining taxable income, he also reminded his readers that this definition was historically contingent.[332] Haig modestly suggested that what would become his pathbreaking definition of income was, in fact, a refinement of earlier theories. Haig defined income as "the money value of the net accretion to one's economic power between two points of time," and he declared that "it will be readily agreed that this definition . . . constitutes then the closest practicable approximation of true income."[333] But lest one believe that Haig had forgotten the historicism of his mentor, he poignantly added that "[t]he concept of *taxable* income is a living, mutable concept which has varied widely from time to time and from country to country with the conditions under which it has had to operate."[334] Seligman could not have put it better himself.

Haig and T.S. Adams were just two of the more prominent examples of how the social and economic theories supporting the income tax flowed to the next generation of thinkers. To be sure, there were numerous other reformers who acknowledged the intellectual debt that they owed to this first generation of progressive American public finance economists.[335] Ultimately, though, the progressive economists, through the sociology of knowledge, left an enduring legacy not only with the practical tax reforms they were able to

330. ROBERT M. HAIG, A HISTORY OF THE GENERAL PROPERTY TAX IN ILLINOIS (Univ. of Illinois Studies in the Social Sciences, 1914).

331. *See, e.g.*, Letters from Robert Haig to Edwin R.A. Seligman (Aug. 1, 1917; Aug. 17, 1917; Sept. 6, 1917; July 22, 1919; July 30, 1919; Sept. 6, 1937) (copies on file with author).

332. Robert M. Haig, *The Concept of Income—Economic and Legal Aspects*, *in* THE FEDERAL INCOME TAX 1–28 (Robert M. Haig ed., 1921).

333. *Id.* at 7.

334. *Id.* at 27.

335. Isaac Rubinow, the foremost expert on social insurance in the early twentieth century and an early proponent of social security, for instance, learned about German compulsory worker's insurance from Seligman. RODGERS, *supra* note 13, at 242–43. On the pivotal role of progressive economists in enacting social insurance programs during this period, see generally DAVID A. MOSS, SOCIALIZING SECURITY: PROGRESSIVE-ERA ECONOMISTS AND THE ORIGINS OF AMERICAN SOCIAL POLICY (1996).

achieve, but perhaps more importantly through their contributions to that most fluid yet significant sector of society—the realm of ideas.

CONCLUSION

By the 1920s, the paradigm shift in tax theory initiated by the progressive public finance economists began to crystallize. Toward the end of the First World War, Seligman himself could proudly proclaim that in justifying a tax, as opposed to a toll or special assessment, "the criterion is always ability to pay."[336] Over time, subsequent generations of tax theorists echoed this claim, as the American system of public finance became increasingly reliant on the income tax. Indeed, by the 1950s, not only did the income tax appear to be entrenched as the principal source of federal government revenue,[337] but the notion of ability to pay had become axiomatic among many tax scholars. Some mistakenly presumed that its "universal acceptance" stretched back well before the turn of the century.[338] Although some legal scholars more recently have come to question the substantive content of the notion of ability to pay,[339] as well as the use of income as the proper tax base,[340] even these present day theorists resolutely adhere—often implicitly—to the notion of tax-paying ability as a compelling, albeit indeterminate,[341] guide for policymaking.

336. *See* Seligman et al., *supra* note 163, at 43. Despite conceding that the benefits principle could still explain the need for fees and special assessments, Seligman boldly proclaimed that the ability-to-pay theory had vanquished the benefits principle when it came to tax policy discussions. "No achievement of modern finance is more enduring and certain than the distinction that has been made by economists and lawyers alike between special assessments and taxes," wrote Seligman. *Id.* "And nothing is more firmly established than the substitution of the ability theory for the old benefit theory in taxation." *Id.*

337. By 1954, individual and corporate income taxes accounted for approximately 70 percent of total federal government revenue. HISTORICAL STATISTICS OF THE U.S., *supra* note 1, at 1105.

338. In 1955, Nicholas Kaldor took it for granted that "[t]axation according to ability to pay for the last hundred years or more has been a universally accepted postulate, not only among political and economic writers, but amongst the public at large." KALDOR, *supra* note 126, at 26.

339. Utz, *supra* note 20.

340. For the classic arguments for a consumption-based tax system, see, for example, KALDOR, *supra* note 126; William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 113 (1974). More recent calls for a progressive consumption tax from academics include, for example, EDWARD J. MCCAFFREY, FAIR NOT FLAT: HOW TO MAKE THE TAX SYSTEM BETTER AND SIMPLER (2002); Daniel N. Shaviro, *Replacing the Income Tax With a Progressive Consumption Tax*, 103 TAX NOTES 91 (2004). For a brief history of American attempts to enact a progressive consumption tax, see Steven A. Bank, *The Progressive Consumption Tax Revisited*, 101 MICH. L. REV. 2238 (2003) (reviewing MCCAFFREY, *supra*).

341. Utz, *supra* note 20, at 877 ("Ability to pay, when disconnected from the utilitarian analysis of welfare, provides a compelling guide to at least some income tax issues, although on the whole its results are indeterminate.").

The seemingly self-evident nature of the principle of ability to pay is a current result of the theoretical shift that fostered the turn-of-the-century structural transformation in American public finance. This transformation was brought about by a combination of material and idealistic forces. For it was a fusion of the functional need for increased government revenue, together with the desire for creating a fairer and more transparent system of taxation, that eventually led to the intellectual ascendancy of the American income tax. Indeed, throughout their efforts and achievements, the reform-minded public finance economists were concerned mainly about the equitable distribution of tax burdens, with what they referred to as rounding "out the existing tax system in the direction of greater justice."[342] Through their scholarship, teaching, and public lectures, these Progressive-Era economists guided a paradigm shift in the theories that undergirded American taxation—a paradigm shift away from benefits theory toward the principle of ability to pay.

In so doing, these economists helped to inject a sense of redistributional reasoning into the prevailing fiscal order. Though they did not go as far in advancing radically redistributive progressive taxes as some of their German mentors, or even other American reformers, they did bring a vigorous defense of justice and equity to an otherwise anemic American dialogue about taxation. In their unyielding support for tax reform, they demonstrated that contemporary political, social, and economic conditions dictated that the American system of fiscal governance required a permanent progressive income tax. In this way, these political economists became the visionaries and architects of the modern American fiscal state—they drew the blueprints for a new, more equitable fiscal polity.

By guiding the theoretical shift in tax policy, these fiscal architects provided the intellectual foundation upon which others could build. And build they did. Government administrators and the social movements for tax reform, each in their own way, engaged the theories of academic political economists as they supplied the institutional and social support for the emerging fiscal polity. Subsequent events and conditions throughout the twentieth century hastened this process. The First World War, for example, occasioned the rise of national administrative capacities that insured the longevity of the new fiscal state. And as early as the start of the 1920s, at the conclusion of the Great War, the income tax came to dominate federal revenues.[343]

342. Seligman, *supra* note 220, at 610.

343. By 1923, well over 60 percent of federal government receipts came from income taxes. HISTORICAL STATISTICS OF THE U.S., *supra* note 1, at 1106–08.

Though the reach of the income tax laws was scaled back during the general retrenchment of the interwar period, the larger trend towards direct and progressive taxation was accelerated in response to the national emergencies of the Great Depression and the Second World War.[344] The exigencies of World War II, in particular, provided the impetus for transforming the income tax, through the process of withholding, from a "class tax" to a "mass tax." These tax reforms, to be sure, were crucial to the consolidation of the new fiscal order. But the roots of these subsequent changes could be traced back to the turn-of-the-century transformation in public finance, for it was then that the ideas and theories of the Progressive-Era economists combined with a particular set of material conditions to establish the intellectual and institutional foundations of the modern American fiscal state.

Recounting the intellectual history of the American income tax is not a story of mere antiquarian interest. Rather, at a time when national discussions about fundamental tax reform appear to echo the past, and when our current hybrid income tax system seems to be in some peril, the ideas and historical circumstances that gave shape to the initial creation of this system are highly relevant to the present. By investigating how and why the notion of faculty or ability to pay came to dominate the justifications for a progressive income tax, this Article has attempted to illuminate the ideas and events which, over time, have combined to create the intellectual and institutional parameters within which current tax laws and policies are made. In this sense, this historical study does not contain an explicit normative lesson for current scholars and lawmakers, nor is it an attempt to recapture the timeless origins of the modern American income tax. Instead, the more subtle aim has been to unearth the implicit historical forces that have shaped the institutional limits and possibilities that confront present-day policymakers. Some factors emerged in the recent past, such as the leveling of exemptions and the use of withholding. Others are more remote. Together these factors are crucial for understanding contemporary issues.

This story about the intellectual construction of the American income tax, moreover, holds some humbling lessons for scholars, reformers, and policymakers in our own time. For those historically minded scholars who have bemoaned the failure of the U.S. income tax to radically redistribute wealth,[345] the efforts of Ely, Adams, Seligman, and others to reform the nineteenth-century system of

344. On the World War II transformation, see generally BROWNLEE, *supra* note 4, at 89–100; DAVID M. KENNEDY, FREEDOM FROM FEAR: THE AMERICAN PEOPLE IN DEPRESSION AND WAR 1929–1945, at 623–26 (1999); *see also* Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax during World War II*, 37 BUFF. L. REV. 685 (1989).

345. STANLEY, *supra* note 9; KOLKO, *supra* note 9; WEINSTEIN, *supra* note 9.

indirect taxes should be seen as a modest reminder of what was accomplished by the establishment of the income tax. While redistributing wealth in a dramatic way, through a combination of steeply progressive rates and government transfer payments, was not the principal aim of the turn-of-the-century theorists, their ideas and actions did have an enduring impact on reallocating the fiscal burdens of financing a modern nation-state.

Similarly, for those current tax theorists who have attempted to revive the benefits principle,[346] the intellectual debate that framed the creation of the American income tax may prompt some reconsideration about the political implications of the benefits theory. The progressive economists, with their historicist leanings, would have been loath to suggest that either the benefits or faculty principles—or for that matter, the income tax itself—were timeless, transhistorical touchstones for tax policy. Ely, Adams, and Seligman might be surprised, however, by the current use of the benefits principle to support the prevailing tax system. For in explicating the larger social and political theories that undergirded the contending principles of taxation at the turn of the twentieth century, these economists sought to reveal how the benefits doctrine contained within it a rather narrow and limiting view of modern citizenship—a view that may ultimately belie the normative goals of current tax scholars who see in the benefits principle a potential bulwark for current tax policies. Although a limited return to the benefits theory may be useful in retaining the current corporate income tax,[347] a wholesale acceptance of the quid pro quo notion underlying the benefits principle would surely restrict the scope of the modern regulatory, administrative, and welfare state.

To be sure, much has changed since the Progressive-Era economists mounted their assault on the old fiscal order. Given the twenty-first century concerns about security, especially in a post-9/11 world, the benefits of protection provided by the state have taken on a new valence that may justify a reexamination of the theories underpinning the benefits principle. Still, for Ely, Adams, and Seligman, the intellectual project of advancing the faculty theory was based on restructuring the American system of public finance—on transferring the fiscal obligations of financing a modern state onto those with the greatest tax-paying ability. In the process, these reform-minded academics were also attempting an even more fundamental transformation. Operating within the institutional constraints of American political culture, these theorists were seeking to alter the meaning of modern citizenship as they attempted to redefine the relations between state, society, and economy.

346. *See supra* note 25.
347. *Id.*