The New Fiscal Sociology

Taxation in Comparative and Historical Perspective

Edited by Isaac William Martin,
Ajay K. Mehrotra, and Monica Prasad

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THE NEW FISCAL SOCIOLOGY

Taxation in Comparative and Historical Perspective

The New Fiscal Sociology: Taxation in Comparative and Historical Perspective demonstrates that the study of taxation can illuminate fundamental dynamics of modern societies. The fourteen chapters in this collection offer a state-of-the-art survey of the new fiscal sociology that is emerging at the intersection of sociology, history, political science, and law.

The contributors include some of the foremost comparative historical scholars in these disciplines and others. The editors conceptualize the institution of taxation as a changing social contract. The chapters address the social and historical sources of tax policy, the problem of taxpayer consent, and the social and cultural consequences of taxation. They trace fundamental connections between tax institutions and macro-historical phenomena – wars, shifting racial boundaries, religious traditions, gender regimes, labor systems, and more.

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Dedicated to the memory of Charles Tilly

The New Fiscal Sociology

TAXATION IN COMPARATIVE AND HISTORICAL PERSPECTIVE

Edited by

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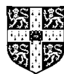
CAMBRIDGE
UNIVERSITY PRESS

CAMBRIDGE UNIVERSITY PRESS
Cambridge, New York, Melbourne, Madrid, Cape Town, Singapore,
São Paulo, Delhi, Dubai, Tokyo

Cambridge University Press
The Edinburgh Building, Cambridge CB2 8RU, UK

Published in the United States of America by Cambridge University Press, New York

www.cambridge.org
Information on this title: www.cambridge.org/9780521494274

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First published in print format 2009

ISBN-13 978-0-511-59526-4 eBook (EBL)

ISBN-13 978-0-521-49427-4 Hardback

ISBN-13 978-0-521-73839-2 Paperback

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Acknowledgments

This volume first began to take shape at the conference "The Thunder of History: Taxation in Comparative and Historical Perspective," which was held at Northwestern University on May 4–5, 2007. We would like to begin by thanking everyone who worked to make that conference a success, and most particularly Elisabeth Anderson, without whose hard work we could not have pulled it off.

Many people and institutions contributed financial support to this project. It is a great pleasure to thank them here. They include Ann Orloff of the Comparative Historical Social Sciences Program at Northwestern, whose funding and encouragement got this project started; James Mahoney, also of the Comparative Historical Social Sciences Program at Northwestern; Mary Pattillo and the Northwestern Sociology Department; Philip Postlewaite and the Northwestern Law School's Tax Program; and Fay Lomax Cook and the Northwestern Institute for Policy Research. Finally, it is our pleasure to acknowledge the exceedingly generous support of Andrew Wachtel and Simon Greenwold of the Weinberg College for Arts and Sciences at Northwestern University.

Many other people contributed ideas, encouragement, and criticism. We would like to thank all of the contributors to this volume, who generously lent their expertise to the improvement of chapters other than their own. We would also like to single out for particular thanks the conference participants and other scholars whose expert commentary improved particular chapters: Gergely Baics, Steven Bank, Robyn Boshers, Bruce Carruthers, Fay Lomax Cook, Joseph Cordes, Charlotte Crane, Jennifer Cyr, Daniel Ernst, Edward Gibson, Simon Greenwold, Michael Grossberg, Richard Hay, Laura Hein, Leandra Lederman, Mark Leff, James Mahoney, Jeff Manza, Malik Martin, Lorna Mason, Edward McCaffery, Leslie McCall, Erin Metz, Rime Naguib, Benjamin I. Page, Mary Pattillo, Simone Polillo, William Popkin, Philip Postlewaite, Jennifer Rosen, Audrey Sacks, John Calvin Scott, Len Seabrooke, James T. Sparrow, Nancy Staudt, Dave Steinberg, Arthur Stinchcombe, Kathleen Thelen, Joseph J. Thorndike, Andrew Wachtel, Celeste Watkins-Hayes, and several anonymous reviewers.

We would also like to thank the American Sociological Association's Fund for the Advancement of the Discipline, funded by the National Science Foundation, which supported a graduate workshop on the new fiscal sociology in conjunction with the 2007 conference. The participants in that workshop – Anthony Alvarez,

Martha Crum, Pablo Gonzalez, Malik Martin, Lorna Mason, Anna Persson, Simone Polillo, Audrey Sacks, John Calvin Scott, Michael Thompson, and Nicholas Hoover Wilson – offered insightful criticism of this project and, most important, inspired us by showing us what the future of fiscal sociology will look like.

We are also grateful for the editorial guidance of John Berger and his colleagues at Cambridge University Press. A longer version of Chapter 12 appeared in the *Southern Methodist University Law Review*, and we thank that journal for permission to reprint here. We are grateful to Cambridge University Press for permission to reprint from Charles Tilly's *Democracy*, and to the University of Chicago Press for permission to reprint from Robin L. Einhorn's *American Taxation, American Slavery* (copyright 2006 by the University of Chicago. All rights reserved).

We dedicate this book to the memory of Charles Tilly, whose example continues to inspire us.

Foreword

CHARLES TILLY

John Locke philosophized in the midst of political action. From 1683 to 1690, he spent the last years of the Stuart monarchy in continental exile. Charles II died in 1685, opening Britain's royal succession to a Catholic, James II. But resistance from a largely Protestant Parliament, backed by London financiers and a generally anti-Catholic English population, brought on a succession crisis. In 1688, invited by English magnates, William of Orange (husband of Mary, James's Protestant daughter, and chief executive of the Netherlands) invaded the British Isles. The ensuing civil war continued until 1691. In retrospect, people called the transfer of power to William and Mary the Glorious Revolution. In 1690, Locke accompanied Queen Mary on the ship that brought her from Holland back to England. He brought with him a manuscript, composed in exile, destined to be a founding document of the new regime: his *Treatise of Civil Government.*

Locke stated a contract theory of government with exceptional clarity and force. Government, he declared, rested ultimately on property and on consent of the governed. A viable vision of relations between rulers and ruled required a legislature – read Parliament – that spoke for the people, or at least for propertied men. The executive – read the Crown – enjoyed some autonomy, but ultimately remained subordinate to the legislature. Yet the supply of funds to support the executive's action posed a problem. The executive offered protection in exchange for financial support:

> 'Tis true governments cannot be supported without great charge, and it is fit every one who enjoys a share of the protection should pay out of his estate his proportion for the maintenance of it. But still it must be with his own consent, i.e., the consent of the majority giving it either by themselves or their representatives chosen by them. For if any one shall claim a power to lay and levy taxes on the people, by his own authority, and without such consent of the people, he thereby invades the fundamental law of property, and subverts the end of government. For what property have I in that which another may by right take when he pleases to himself? (Locke 1937: 94–5)

Locke makes two main points here: that a proper compact between rulers and ruled involves a fair exchange of protection for financial support; and that

the medium of negotiation between rulers and ruled should be a representative assembly.

No taxation without representation! Although the principle may seem banal to contemporary westerners, even in the Europe of the 1690s it declared a revolutionary counterfactual. Over most of human history, western or otherwise, rulers have extracted their means of rule from subject populations without consulting representative assemblies. Sometimes they have done so through simple predation or by bartering goods they already controlled for arms, labor power, and other means of rule. Yet they have done so mainly through one form or another of taxation – payments in money or kind that rulers could use to sustain their administrations, political control, and patronage.

Taxation raises a number of fascinating questions about political processes:

1. Although all of us sometimes feel that our governments are robbing us on behalf of unworthy causes, mostly we pay. So did our ancestors. How does tax compliance ever come about?
2. Like the Mongols, some regimes have lived largely by forcible seizure of resources from outsiders. Yet a state that depends on its own subject population for essential resources must assure that when it comes back a second time, the subjects will still pay. Brute force alone won't do the job. How do regimes compel or cajole their citizens to yield resources repeatedly?
3. Any regime's ambient economy strongly limits what forms of taxation could possibly yield net gains for rulers, but the form of taxation itself affects economic development. In the agrarian economy of China, the state could not rely on sales taxes and customs duties for revenue; over centuries of empire, taxes on rice solved the problem, especially when the state built up regional granaries to palliate supply failures. How does the interplay between economy and taxation work?
4. A durable tax regime rests on popular consent, however grudging. Popular consent to governmental performance almost constitutes a definition of democracy. To what extent and how does the development of taxation shape the likelihood and form of democratization?

A book published in 1965 sparked my own career-long obsession with taxation. In a massive, prescient, and unfortunately half-forgotten two-volume work whose title translates as *Sociological Theory of Taxes*, Gabriel Ardant laid out arguments on these questions that still deserve attention today (Ardant 1965; 1971–2). Ardant was an unusual scholar: a socialist, a collaborator of Pierre Mendès-France, and an *inspecteur général des finances*, the highest rank in the French fiscal civil service. When Charles de Gaulle took power in 1958, Ardant refused to resign despite his own antipathy to Gaullism. The de Gaulle regime then detached him from the domestic tax system to serve as fiscal advisor in Tunisia and other countries of the developing world. The *Théorie sociologique de l'impôt* laid out Ardant's conclusions from his broad comparisons of developing countries with France.

In a later essay, Ardant summed up his conclusions concerning the impact of taxation:

> As a matter of fact, the political repercussions of taxation are above all apparent during one particular period of history: the one which witnessed the development of the administrative framework of the modern state. Why was this so? Must one attribute it to the ignorance of the people of the times, or to their technical incompetence? To a certain extent this may be so. Nonetheless, even when they had capable finance ministers, rulers came up against an economy, the structure of which was poorly adapted to the levying of taxes by the state. Herein lies a basic phenomenon. An analysis of the system of taxation in contemporary times as well as in the past shows that *tax collection and assessment are indissolubly linked to an exchange economy.* The flow of goods and money are necessary for the understanding and especially for the evaluation of taxable materials. It is not enough to be aware of the volume of production because the economic structure sets a much lower limit. Agrarian societies of the past furnished the states with only minimal tax potential. (Ardant 1975: 165–6)

Thus, Ardant made two giant claims: First, that the effectiveness of any fiscal system depends intimately on its match or mismatch to the regime's ambient economy; second, that high-capacity contemporary regimes could only form if they built on exchange economies and created fiscal systems to profit from exchange. Ardant's prescient arguments set an agenda for today's students of fiscal sociology.

As the editors of this volume say, it is surprising, even shameful, that social scientists and historians have paid so little attention to taxation. It seems a dreary subject, all numbers and colorless bureaucrats. Yet we have three reasons to give taxation particular attention. First, over the long run it constitutes the largest intervention of governments in their subjects' private life, so much so that the history of state expansion becomes a history of violent struggles over taxes, and the history of state consolidation becomes a history of tax evasion by those who have the guile and power to frustrate the fisc. Second, follow the money: the circulation of resources from subjects to government-initiated activities provides a sort of CT scan for a regime's entire operation. Third, it dramatizes the problem of consent, John Locke's problem.

Recently, a relatively small but creative group of social scientists and historians have been rectifying the long neglect of taxation in their fields. They have started to build a cross-disciplinary effort we can call fiscal sociology, with the qualification that nonsociologists provide an important part of the theory and research. Displaying some of the best recent work, this volume accents three major questions in the description and explanation of taxation: the social bases of tax policy, the determinants of taxpayer consent, and the social consequences of taxation. These chapters establish the vitality and importance of recent work on the social and political processes involved in taxation.

1 The Thunder of History: The Origins and Development of the New Fiscal Sociology

ISAAC WILLIAM MARTIN, AJAY K. MEHROTRA, AND MONICA PRASAD

> The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history, stripped of all phrases. He who knows how to listen to its message here discerns the thunder of world history more clearly than anywhere else.
>
> – Joseph Schumpeter [1918] 1991

Everyone knows that taxation is important. Political scientists know that tax cuts are a major partisan battleground in the United States today, and that the rise of neoliberal ideology has propelled taxation onto the international policy agenda. Legal scholars know that the tax code has become the preferred vehicle for promoting an enormous variety of domestic policies – from social provisions to industrial policies to educational subsidies. Historians know that taxation has been a pivotal source of conflict and change from the American Revolution to the Reagan revolution, and that taxes have been central to the formation of civic identity across place and time. Sociologists know that nearly every issue with which they are concerned – the obligations of the individual to society; the powers and legitimacy of the state; the allocation of public and private resources; the rise of bureaucratic administration; the reproduction of class, race, and gender inequalities – runs through the issue of taxation.

There are good reasons why many scholars have recognized the importance of taxation. Taxes formalize our obligations to each other. They define the inequalities we accept and those that we collectively seek to redress. They signify who is a member of our political community, how wide we draw the circle of "we." They set the boundaries of what our governments can do. In the modern world, taxation *is* the social contract.

Some scholars also know that a new wave of multidisciplinary scholarship on taxation is poised for a significant intellectual breakthrough. In recent decades, scholars in economics, sociology, political science, history, and law – among other disciplines – have begun to recognize the central importance of taxation to modernity and produce innovative comparative historical scholarship on the sources

We are grateful for comments on this introduction from James Mahoney, Audrey Sacks, and participants of the *Thunder of History* conference.

and consequences of taxation (see, e.g., Steinmo 1993; Howard 1997; Kornhauser 1985, 1990; Avi-Yonah 2000, 2004; Bank 2003; Brownlee 1996; Zelizer 1998; Lindert 2004; Gould and Baker 2002; Mumford 2002). This research has the potential to challenge conventional understandings of the world in which we live. Current tax scholarship is overturning standard understandings of racial inequality (Moran and Whitford 1996; Brown 2007), gender and family (Jones 1988; Staudt 1996; Brown and Fellows 1996; McCaffery 1997; Kerber 1999; Alstott 2001), the origins of western democracy (Einhorn 2006a; Kwass 2000) and the welfare state (Howard 1997; Hacker 2002; Klein 2004), and many other things. We think that the field may be poised to rewrite conventional accounts of modernity itself by placing the social relations of taxation at the center of any historical or comparative account of social change.

We call this emerging field *the new fiscal sociology*. By using this name, we do not intend to claim the new field exclusively for academic sociology departments. The disciplinary affiliations of the contributors to this field – as of the contributors to this volume – span the fields of economics, political science, law, history, and public policy in addition to sociology. We chose the name *fiscal sociology* to honor the economist Joseph A. Schumpeter, who borrowed that term from his Austrian contemporary Rudolf Goldscheid (1917) to suggest a science that would transcend increasingly narrow disciplines and unite the study of economics with the study of history, politics, and society.

The well-known epigraph that begins this chapter summarizes the promise that Schumpeter saw in fiscal sociology. Schumpeter called for students of public finance to take a comparative and historical approach to their subject, and to treat tax policy as both a "symptom" and a "cause" of large-scale changes in the economy and society. "The public finances are one of the best starting points for an investigation of society, especially though not exclusively of its political life," Schumpeter explained. Of fiscal sociology he wrote, "much may be expected" (Schumpeter [1918] 1991: 101).

For most of the twentieth century, scholars in history and the social sciences with rare exceptions heeded only one part of Schumpeter's call: the admonition to treat taxation as a *symptom* of social change – a useful index, say, of democracy, capitalism, the rise of the state, or the modernization of society. In part, this was because Schumpeter himself emphasized the search for the "*symptomatic* significance of fiscal history" rather than its "causal" aspects (Schumpeter [1918] 1991: 101, emphasis in the original). Because of this, modern scholars discounted the role of taxation as a cause or engine of change, and privileged the symptomatic or reflective aspects of fiscal sociology.

There are many reasons why tax policy makes an excellent index of social change, and thus why scholars have been attracted to studying taxation. Data on tax revenues are abundant, relative to many of the other things that historians and social scientists are interested in. Tax records are among the earliest surviving written records (Webber and Wildavsky 1986), and tax revenues are among the longest-running statistical series in existence (see Mann 1980). Quantitative tax data of relatively high quality and comparability are available for an extraordinarily long swath of historical time and an unusually large number of countries. These

advantages make tax policy well suited for use as "a measurement instrument for societal-level analyses" (Lieberman 2002: 91), in applications that range from studies of the rise of the state to studies of inequality to studies of social solidarity (see, e.g., Mann 1980; Kraus 1981; Chaudhry 1997; Piketty and Saez 2003, 2006).[1]

What is new about the new fiscal sociology is its recognition that taxation has a theoretical or causal – and not just a symptomatic or methodological – importance. This stems from the definition of taxation itself. *Taxation* consists of the obligation to contribute money or goods to the state in exchange for nothing in particular.[2] To be sure, taxes are sometimes earmarked for particular uses, and in modern, democratic societies, taxation carries the implicit promise that the resources will be spent on public goods (Webber and Wildavsky 1986).[3] Nevertheless, a tax is not a fee paid in direct exchange for a service, but rather an obligation to contribute that the state imposes on its citizens and, if necessary, enforces.

Taxation, so defined, has several features that suggest it may have far-reaching consequences for understanding modern social life. First, taxation establishes one of the most widely and persistently experienced relationships that individuals have with their government and – through their government – with their society as a whole. Despite the fragmentation of modern societies into myriads of subcultures, roles, and status groups, paying taxes is one thing that everyone has to do, whether they are consumers, homeowners, wage earners, or investors. This generality makes taxation a crucial element in the development of the "imagined community" (Anderson 1983) of the modern nation-state. When we comply with our tax obligations, we do not know who in particular shares in our contributions; when we make use of roads, schools, and other public goods and services, we do not know from whose tax payments in particular we are benefiting. Taxation enmeshes us in the web of generalized reciprocity that constitutes modern society.

Second, taxation establishes a dynamic relationship between the taxpayer and the state, in which there always exists a potential conflict of interest. Taxation is

[1] The quality of tax records is, of course, highly variable, but – as Robin Einhorn points out in Chapter 9 – even inaccurate records may be inaccurate in symptomatic ways that provide invaluable evidence about the past.

[2] As early as 1888, the American political economist Richard T. Ely carefully defined taxes 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" (Ely 1888: 6–7). A century later, the World Bank (1988) similarly defined taxes as "unrequited, compulsory payments collected primarily by central governments." Our definition differs from Ely's and the World Bank's insofar as we define taxation as the socially recognized obligation to pay rather than the payment itself. This definition makes it possible to say, for example, that someone has failed to meet his or her duty to pay his or her income tax – a statement that would be meaningless if the tax were defined as the payment.

[3] A great deal of welfare spending is accomplished through payroll taxes that are earmarked for particular purposes. Many scholars suspect that one of the sources of welfare state resilience is the taxpayers' sense that they have "bought" rights to welfare state provision through such payments. However, there is no one-to-one correspondence between the costs any particular taxpayer pays and the benefits he or she receives: for example, a taxpayer who never uses the health services is still required to finance them.

perhaps the only state policy that can be counted on to generate frequent resistance throughout history and all over the world (see, e.g., Burg 2004). The degree of actual conflict between taxpayer and ruler varies across place and time, but the potential for conflict makes this a dynamic relationship. The state, the very guarantor of social order in the modern world, depends on a relationship that always contains the latent possibility of conflict and disorder. State authorities have historically responded to this latent potential for conflict with new forms of taxation and new forms of rule. The form of tax obligations is constantly changing as different taxpayers and different rulers seek to renegotiate the relationship to their advantage (see Tilly, Chapter 10). Because social order depends on the state, and the state depends on the resources provided by taxation, this relationship may be renegotiated, but it will not be severed. The possibility of tension will be continually reproduced rather than resolved.[4]

Third, taxation furnishes fungible resources to the state. In this respect, it is unlike other sacrifices that the state demands from its citizens (e.g., compliance with traffic laws), and even unlike other forms of state extraction (e.g., conscripted military service). The resources extracted through taxation are exchangeable for other resources; they make possible not just one state action, but most if not all of the state's activities. And the more extensive the activities of the state, the more extensive the reliance on taxation – and the broader the potential ramifications of changes in tax policy. Even the decision to decrease taxes – to diminish the obligation to contribute to the state – generates controversy and conflict. In modern states, therefore, taxation is not only a dynamic, potentially conflictual relationship, but one whose changing forms may have potentially far-reaching implications. The taxpayer's decision to evade or resist taxation may challenge the existing social order, as well as the very basis for enforcing social order – in a way that decisions to evade or resist speed limits, social policies, or sumptuary laws do not. The state's mode of establishing and enforcing taxation may shape the social order in its turn. The dynamic relations of taxation may thus influence an enormous range of social outcomes – from the extension of democracy to the formation of the family – as we detail later.

In short, the relations of taxation are pervasive, dynamic, and central to modernity. Why then did it take so long for social scientists to take up Schumpeter's project of fiscal sociology? Why were those scholars who initially responded to Schumpeter's clarion call mainly preoccupied with the reflective aspects of taxation and not its causal effects?Our answers begin with the fragmentation of classical public finance. In the rest of this chapter, we describe the classical roots of Schumpeter's project, and how the disciplinary fragmentation of the modern

[4] This is what distinguishes taxes from pillage. Ardant (1965: 35) illustrates this point by recounting a debate recorded among members of Genghis Khan's retinue. Having conquered China, the Khan was advised by one of his generals to slaughter the Chinese peasants and take their land for pasture; a perspicacious local advisor named Yelü Chucai persuaded him that he could instead generate more hay for his horses by letting Chinese cultivators live and imposing an annual tax. This policy was good for the Khan and good for the peasants. Yet it also allowed peasants to live again to fight another day – and thereby ensured that the conflict of interest between peasants and their exploiters would remain perennially unresolved.

research university and the accelerating specialization of intellectual life split the emerging fiscal sociology apart into several separate and isolated strands of scholarship. Finally, we describe the new fiscal sociology that weaves these strands together – and points the way toward the future of fiscal sociology.

THE CLASSICAL ROOTS OF FISCAL SOCIOLOGY

Schumpeter issued his call for a new fiscal sociology during the fiscal crisis occasioned by World War I, in the dying days of the Austro-Hungarian Empire (McCraw 2007; Swedberg 1991). His manifesto was itself the last gasp of classical political economy rather than the first breath of a new science. It seemed to mark the apogee of a long tradition of general studies of public finance instead of catapulting the start of an innovative field of study. The theorists of classical political economy had been broad-minded students of the social sciences as well as public finance. As Beverly Moran reminds us in Chapter 12, Adam Smith was a sociological as well as an economic thinker, who consistently studied taxes in comparative and historical perspective. Smith was just as interested in the social consequences of taxation as in its economic consequences, and he offered innovative analyses of how taxes could create conflict and provide the means for cementing feelings of inclusion in a common status of citizenship (Smith [1776] 1977). In the mid-nineteenth century, John Stuart Mill reminded his contemporaries that public finance had an institutional basis, and situated his discussion of public finance in the context of a broad theory of modernity and progress (Mill [1871] 2004).

Nineteenth-century European social theorists, for their part, were also catholic students of public finance. Tocqueville ([1856] 1955) famously traced the class conflict that erupted during the French Revolution to origins in the prerevolutionary tax code (see also Kwass 2000), and argued explicitly that England had avoided a violent revolution because English tax laws did not draw an explicit boundary between the nobility and the middle classes. Other early sociological theorists also devoted attention to the social sources and consequences of taxation. Herbert Spencer's *Principles of Sociology* devoted a chapter to the growth of taxation, which he attributed to the influence of war (Spencer [1876–96] 1967: 213). Adolph Wagner, a member of the nineteenth-century German Historical School of economics, linked a country's level of economic development to the increase in the relative size of its public sector and, hence by implication, its revenue-generating abilities (Wagner 1890). Karl Marx identified taxes as "the source of life" of the capitalist state, and he and Friedrich Engels advocated for steeply progressive income taxes in the *Communist Manifesto* (Marx 1852; Marx and Engels 1848). Emile Durkheim's dissertation on the *Division of Labor in Society* was, among other things, an extended argument that social development tends inevitably toward the confiscatory taxation of inherited wealth ([1893] 1984: 316–22; see also [1892] 1965: 533–4). Max Weber saw tax policy as a proving ground for his theories of state authority and social conflict. Paralleling Rudolf Goldscheid, Weber portrayed tax policy as an outcome of economic struggle among classes, parties, and status groups, and he offered the prophetic observation that modern democracies were more and more "cautious toward the propertied" because governments

increasingly must compete with one another to attract a tax base of mobile capital (1978 [1922]: 352).

Against this background, the mystery is not why Schumpeter dreamed of a fiscal sociology, but why his call went unanswered for so long. One reason is institutional rather than intellectual. Schumpeter wrote at a time when the forces of professionalization and academic specialization were sundering public economics from history and the other social sciences (Furner 1975; Ross 1991; Haskell 1977; Bender 1997). Academic entrepreneurs of Schumpeter's generation sought to distinguish these disciplines from one another by delineating areas of study proper to each. Many questions at the intersection of these disciplines consequently fell through the cracks that opened when they pulled apart. As Neil Smelser and Richard Swedberg write, sociological studies of economic life more generally "declined after 1920 and would not return to full vigor before the 1980s" (Smelser and Swedberg 2005: 11). Fiscal sociology declined as well.

The new scholarly division of labor created efficiencies, but it also had perverse consequences. For much of the twentieth century, most historians, sociologists, legal scholars, and political scientists did not ask questions about the social or institutional roots or consequences of taxation, because they had surrendered the study of public finance to economists. Economists did not ask questions about the social or institutional roots or consequences of taxation, because they had surrendered the study of such questions to sociologists and other social scientists. Progress in public finance came at the price of narrowing the field. As the field of public economics came to dominate the study of taxation, noneconomic questions seemed to fall away. Gone were the "detailed descriptions of tax rules or administrative issues that characterized many earlier public finance books," wrote Martin Feldstein approvingly, as he reflected on the contents of a 1959 textbook that was the so-called bible of public economics when he entered the field; their place had been taken by "graphs and algebra showing the partial equilibrium effects of taxes on prices and quantities and the associated effects on deadweight losses" (Feldstein 2002: xxvii). With the detailed descriptions of tax institutions went the theoretically informed study of their social origins and their social consequences.

THE FRAGMENTATION OF FISCAL SOCIOLOGY

The roots of today's new fiscal sociology lie in the separate scholarly traditions that followed this breakup. Schumpeter's prophetic essay had presented taxation as an actually existing social contract, the outcome of a historic bargain between rulers and ruled forged in a particular time and place. His essay raised several fundamental questions about that contract: Why does the bargain take particular forms? How is the bargain maintained – or what sustains taxpayers' consent to be taxed on an ongoing basis? And how does the fiscal bargain affect the culture and "forms of life" (Schumpeter [1918] 1991: 100) prevailing in a society? These questions did not vanish with the splintering of the social sciences.

For most of the twentieth century, however, the scholars who pursued these questions were isolated from each other. Small groups of scholars in academic

institutions outside of the United States, and in historically oriented corners of the professions of economics and law, nurtured relatively insular theoretical traditions. Each tradition emphasized one of Schumpeter's fundamental questions, to the near exclusion of the others. And – although most scholars sought to answer these questions by discovering universal laws about the interplay of taxation and fundamental social forces – each tradition drew on different classical sources and emphasized different forces. These traditions painstakingly assembled the building blocks of the syncretic new fiscal sociology, although their results were often unsatisfying on their own terms.

Modernization Theory and the Consequences of Economic Development

The first question of traditional fiscal sociology was why tax systems took a particular form; and the first strand of fiscal sociology argued that the answer lay in economic development. We call this strand *modernization theory* because it resembled and sometimes overlapped more general theories of modernization in sociology and political science (e.g., Rostow 1960). In fiscal sociology, modernization theory drew on work by early institutional economists, most notably the writings of Edwin R. A. Seligman (1895–1931, 1902, 1911), who was heavily influenced by the writings of the German Historical School (Mehrotra 2007). It was kept alive into the mid-twentieth century by scholars of economics and law who advanced it as the so-called progressive interpretation of American tax history (Blakey and Blakey 1940; Ratner 1942; Paul 1954), and by development economists from the United States and Western Europe who were called on to advise tax officials in developing countries in the context of decolonization and Cold War foreign aid. As W. Elliot Brownlee shows (Chapter 14), Carl Shoup was a leader among this group of development tax economists. Advisors like Shoup found themselves confronted with the questions of which tax policies were best suited to which social environments, and how tax institutions responded to social and economic change.

Scholars in this tradition sought in particular to explain how and why states develop modern tax systems, where *modern* was understood to mean a common set of tax instruments that were efficient, productive, and equitable. The answer was that economic development inevitably led societies to develop modern forms of taxation. Seligman gave this thesis its classic and most categorical statement: "Fiscal conditions are always an outcome of economic relations" (1895–1931: 1). And economic relations, it was assumed, followed a common developmental trajectory. Traditional agrarian societies at first produced relatively little surplus to tax. States in these societies were therefore likely to levy low taxes, and to levy those taxes mainly in kind – for example, as a share of the harvest – rather than in money. The growth of markets and the development of industrial production gradually made new kinds of taxes possible. Economic development increased wealth, making a greater surplus available to tax. The increase of trade made it possible for the first time to levy taxes on trade rather than on the produce of land. And development also provided a convenient way to measure the tax base – in the form of money prices (Eisenstadt 1963; Bird and Oldman 1964; Ardant 1965; Hinrichs 1966; Musgrave 1969; Seebohm 1976).

Economic development was also said to bring democracy (cf. Lipset 1959), which positively impelled states to implement modern taxes by multiplying the legitimate claims on the state's financial resources. Expanding markets created new demands for infrastructure – roads, schools, utilities – that required the state to raise ever larger sums for public goods (Wiseman and Peacock 1961). And political equality led to demands for redistributive taxation. Seligman's comparative and historical studies of nearly every aspect of taxation expressed this view of the relentless drive of egalitarian forces: the history of all tax policy was a series of successively closer approximations to an egalitarian ideal, of which the modern American tax state might have been the end point (Seligman 1895–1931). Subsequent progressive historians modified this seemingly whiggish assumption of a historical teleology – but retained the assumption that modernization brought democracy and equality in taxation. With the advent of widespread suffrage for the lower economic strata, "the people" triumphed over "the rich" or "the interests," democracy triumphed over privilege, and tax policy became increasingly egalitarian (Blakey and Blakey 1940; Ratner 1942; Paul 1954; Buenker 1985).

The great lacuna in modernization theory was its inability to explain variation in tax systems among modern societies. To be sure, modernization theorists did not always predict that societies would converge on the same tax system. The sweeping synthesis by Hinrichs (1966) argued that modernization would ultimately lead tax systems to diverge, because the growth and differentiation of modern economies allowed authorities more choices among policy instruments and "tax handles." Yet having pointed out the diversity of modern tax systems, Hinrichs and other modernization theorists threw up their hands. The residual variation that could not be explained by economic development was simply chalked up to "culture," understood to mean a set of preferences that were unique, unchanging, and ultimately inaccessible to scientific or historical explanation (see also Webber and Wildavsky 1986). With this linear view of historical change, modernization theory proved in retrospect to be highly ahistorical, ignoring the specificity of cultural and institutional factors that could produce tremendous variation within similarly developed economies and polities.

Elite Theory: Why People Consent to Taxes

The second school of traditional fiscal sociology focused on what might be called the "noncontractual basis" of the fiscal contract (cf. Durkheim [1893] 1984) – the institutionalized norms that led taxpayers to consent to a particular fiscal bargain. During the early and mid-twentieth century, applied studies of taxpayer compliance proliferated in the disciplines of law, criminology, accounting, psychology, and economics. The broader question of taxpayer consent, however, as Evan Lieberman points out in Chapter 6, encompasses not only individual compliance but also political acquiescence. Taxpayers who comply with taxes – in the narrow sense that they pay what is legally required – might nevertheless protest those taxes, vote to change them, or even take up arms against them.

Scholarship on taxpayer consent in this broader sense was largely confined to a tradition that drew on the classical Italian sociology of elites (Michels [1915] 1968;

Mosca 1994; Pareto [1916] 1963). We call this tradition *elite theory*.[5] The most influential text in this strand of fiscal sociology was probably the *Theory of Fiscal Illusions* written in the 1890s by the Italian economist Amilcare Puviani ([1903] 1973). Elite theory survived into the postwar era among European scholars of public finance (Laure 1956; Schmölders 1960; Volpi 1973). Under the influence of the economist James Buchanan, who encountered the Italian *scienza delle finanze* during a Fulbright year abroad, elite theory entered American public economics in the 1960s and was an important influence on the development of public choice theory (see Buchanan 1960). For American economists who were critical of the Keynesian consensus that dominated the profession in the post-World War II era, elite theory's disenchanted view of public officials was appealing, and this tradition of fiscal sociology provided powerful tools for questioning the benevolence and efficacy of state planning (Medema 2000; Morgan and Rutherford 1998).

Proponents of elite theory described a fundamental conflict of interest between rulers and subjects. Rulers sought to maximize their revenues. Subjects sought to keep resources for themselves. Why then would rational taxpayers consent to their own exploitation? The answer advanced by Puviani was that they had incorrect information (Puviani [1903] 1973). Rulers could exploit their subjects' pocketbooks most thoroughly by designing tax policies to exploit their subjects' perceptual biases.[6]

The imperative to conceal taxes explained many of the common institutional features of modern tax systems. Puviani's treatise took the form of a catalog of techniques by which policy makers could conceal the burden of taxation and exaggerate the benefits of public spending. By the 1970s, there was a small literature exploring the hypothesis that "fiscal illusion" explained why voters consent to heavy taxes (for critical reviews, see Gemmell, Morrissey, and Pinar 2002; Mueller 1989; Oates 1988).

Another strand of elite theory, drawing heavily on the economics and sociology of Pareto ([1916] 1963), led public choice scholars in the United States to explore the role of formal political institutions. Led by Buchanan and Gordon Tullock (1962), public choice scholars explored the constitutional rules that might allow democratically elected governments to be manipulated by rent-seeking bureaucrats, politicians, and special-interest groups. With the Leviathan captured by special interests, they argued, political leaders could use taxation to redistribute resources for the benefit of an elite minority. In subsequent decades, U.S. economic and political historians motivated by public choice theory and sympathetic to a growing conservative intellectual and political movement came to see the growth of taxation as an expression of the power of special-interest groups. They portrayed the creation of new tax powers and the suppression of tax protests as critical

[5] We call this stream of fiscal sociology *elite theory* to emphasize its continuity with the classical study of elites in Italian sociology and political science. It should not be confused with the *power elite theory* more familiar to American and British political sociologists, which treated the state as an instrument for powerful capitalist interests (Domhoff 1998; Miliband 1974; Mills 1956).

[6] In this way, elite theory can be seen as a forerunner of a more recent interest in behavioral public finance, which also attends to cognitive biases and limitations, although without seeking to privilege the position of elites. See McCaffery and Slemrod (2006).

episodes in the struggle of rent-seeking groups to expand their influence (Higgs 1987; Baack and Ray 1985; Beito 1989).

The tradition of elite theory no doubt contributed to many varieties of "new institutionalism" in the 1980s, and public choice theory continues to yield new insights into the political economy of taxation. Yet many scholars found the theory unsatisfactory for its neglect of the question of the historical development of institutions.[7] Its focus on explaining why taxpayers consent to a particular equilibrium left it ill equipped to study how institutions change over time, or why different societies might develop different sets of institutional arrangements. For broader insights into the patterns of institutional change, scholars of fiscal sociology turned back to modernization theory – or to a third tradition that emphasized war.

Militarist Theory: The Consequences of Taxes for State Capacity

The third tradition of post-WWII–era fiscal sociology followed Schumpeter's interest in the social and cultural outcomes of taxation. The development of sophisticated tools for measuring the economic consequences of taxation was one of the great triumphs of public economics in the postwar era, but few scholars took up Schumpeter's call to study social and cultural consequences. How did particular fiscal bargains affect civilizations, cultures, and ways of life? For Schumpeter, these were crucial questions of fiscal sociology. The third strand of postwar fiscal sociology posed these questions – and developed an answer that had been proposed by Schumpeter himself. The social consequence of taxation lay primarily in its importance for military conquest.

We call this tradition *militarist theory*, because scholars in this tradition argued that military competition and the development of taxation went hand in hand. Like elite theory, militarist theory had classical roots. It can be traced to Spencer's *Principles of Sociology*, and it later became popular among German and Austrian social theorists in the early twentieth century (Goldscheid [1925] 1962; Hintze 1975; Schumpeter [1918] 1991; Weber [1922] 1978). It gained new traction in the 1970s at a time when western political economies were confronting the socioeconomic dislocations associated with the end of Fordism. Consequently, modernization theory lost its cachet. Critics of modernization theory in the disciplines of history, sociology, and political science who sought to understand the pattern of European state formation turned to militarist theory instead (Finer 1975; Mann 1980; Tilly 1975).

The central question for militarist theory was to explain the rise of the modern bureaucratic state. In the classical version of this theory as expounded by Schumpeter, taxation was the key to the rise of the state, because taxation furnished the resources that allowed states to make war and eliminate their competitors. As Schumpeter told the story, the princely households of the European Middle Ages had drawn their funds not from taxes, but from personal dues owed to the princes as individuals and from the exploitation of their own lands. At the turn of the sixteenth century, however, "the growing expenses of warfare" rendered this system obsolete. As the costs of warfare escalated, princes turned to consultative bodies of

[7] For a general criticism of "rational choice institutionalism" along these lines, see Thelen (1999).

nobles and burghers – the estates – for more funds. Princes demanded the right to levy taxes for the common defense; in exchange, the estates won the right to administer the taxes and began to develop a public bureaucracy that was independent of the princely household. With the separation of the public purse from the prince's private household, "the tax state had arrived – its idea and its machinery" (Schumpeter [1918] 1991: 105). And the tax state was a machine for making war.

Although Schumpeter's essay was written during the Great War to illuminate a particular political conjuncture – in particular, to raise the prescient question of the consequences of mounting war debts for the stability of the postwar order in Central Europe – the Darwinian logic of his argument was easily generalized to other times and places. Subsequent scholars applied militarist theory to explain the evolution of the state throughout history. States at war need to mobilize resources rapidly. Moreover, the fiscal demands of war escalate over time, because states are in perpetual competition to develop the most advanced military force and thereby secure an advantage over their rivals. States that adopt the most productive taxes and institutionalize the most modern forms of tax administration are able to mobilize ever greater quantities of labor and materiel and therefore have the edge in this perpetual arms race. The historical sociologist Michael Mann spelled out the logic thus: "A state that wished to survive had to increase its extractive capacity to pay for professional armies and/or navies. Those that did not would be crushed on the battlefield and absorbed into others" (Mann 1980: 195). Victorious states achieved their victories by institutionalizing the most effective and efficient forms of resource extraction – meaning, in practice, taxation. Vanquished states had modern tax policies imposed on them by their conquerors. In the long run, military competition led all surviving states to converge on efficient and productive tax systems, and those tax systems in turn led to the militarization and bureaucratization of society.

Militarist theory had its weaknesses. Like modernization theory and elite theory, it had difficulty accounting for divergent tax structures among states that survived the winnowing of centuries of warfare. The theory also seemed to have little to say about the transition from the warfare state to the welfare state in the most developed economies of the twentieth century. These states increasingly put their tax institutions to work funding health, welfare, and educational establishments, eventually outstripping even their spending on defense. Explaining this fiscal trend seemed to require attention to economic development and political institutions – the stuff of modernization theory and elite theory.

THE NEW FISCAL SOCIOLOGY

The new fiscal sociology began when these three strands of research began to merge in the late twentieth century. The new scholarship built on the foundations laid by an earlier generation of scholars, but it also engaged with this earlier literature by questioning its premises and stretching its parameters. As previously noted, developments within each camp led authors to look to the others for new insights.

Developments outside of academia also played a part in bringing these separate streams of research together. Although the American tradition of tax resistance and

anti-statism seemed to be latent during the prosperity of the post-WWII period, these forces were on the resurgence during the last third of the twentieth century (Keller 2007; Zelizer 2003). A series of high-profile fiscal crises in American state and local governments and the emergence of property tax revolts in the 1970s consequently brought renewed attention to the classics of fiscal sociology (O'Connor 1973; Bell 1973; Musgrave 1980; Padgett 1981; Block 1981; Shefter 1985; McDonald 1986; Hansen 1983). Taxation also took on a new prominence in American national politics, as well-organized conservative interest groups exploited the intellectual exhaustion of Keynesianism (Gray 1998; Blyth 2002), the end of the "era of easy finance" (Brownlee 1996; Steuerle 2004), and the growing dissatisfaction with sub-national property taxes (Sears and Citrin 1985; Martin 2008) to assail the principle of progressive taxation, and to seek tax cuts as a means of de-funding the welfare state or "starving the beast" (Hacker and Pierson 2005b; Wilentz 2008). Outside of the United States, the increasing international mobility of capital led to fears of international tax competition, and – along with the influential U.S. Tax Reform Act of 1986 – contributed to what scholars have described as an international wave of tax reform in the 1980s and 1990s (Tanzi 1995; Steinmo 2003b; Swank, 1998, 2006). Similarly, the end of the Cold War brought a renewed focus on issues of development, political economies in transition, and the financing practices of failed states (Bird 1992; Burgess and Stern 1993; Turley 2006; Bräutigam, Fjeldstad, and Moore 2008). All of these developments drew new scholars from across the social sciences into the comparative and historical study of taxation.

The newcomers began to discover and weave together strands of fiscal sociology that had hitherto remained separate. Influential works by Charles Tilly (1985) and Margaret Levi (1988) explicitly drew the elitist and militarist traditions together in what Levi called a "theory of predatory rule" by war-making elites. As scholars of state formation and political power, these initial – and perhaps inadvertent – pioneers of the new fiscal sociology were drawn indirectly to taxation because it was a central part of their larger research agenda to understand and explain the sources and implications of state power, an agenda that was shared by many other historically-minded social scientists (Evans, Rueschemeyer, and Skocpol, 1985). Following this lead, other scholars have continued to test and refine the fiscal-military model of state formation with newly available data on early modern Europe (Brewer 1989; Ertman 1997; Bonney 1999; Kiser and Linton 2001), sub-Saharan Africa (Herbst 2000), the Levant (Heydemann 2000), China (Wong 1987), and the Americas (Bensel 1990; Centeno 1997; Edling 2003; Thies 2004, 2005, 2006; Sparrow 1996; Johnson 2005; Bank, Stark, and Thorndike 2008). Although the findings of this research program are not all easily summarized, much of the literature points to the need for synthetic models that explain patterns of tax policy development by the interaction of military competition with institutional features of the polity and with patterns of economic development.

A similar, though more conscious, institutionalist synthesis began to arise from the late 1980s through the early 2000s among scholars working on tax policy in democratic states of the twentieth century. Independent studies by the sociologist John L. Campbell (1993), the historians Elliot Brownlee (1996a, b), Robert Stanley (1993), and Martin Daunton (2001, 2002), and the political scientists John Witte

(1985), B. Guy Peters (1991), Ronald King (1993), and Sven Steinmo (1993) explicitly sought to bring together war, economic development, and political institutions into synthetic theories that would explain the development of the tax state. Unlike the earlier wave of fiscal-military theorists, this group of scholars explicitly saw their object as understanding not only state formation in general, but tax policy in particular. Despite differences, all of these scholars argued for a model of fiscal development that treated economic development as a motor force – but one that propelled the tax state along tracks that were laid down by political institutions and along a course that was set during wars and other moments of crisis.

Scholars from all of these traditions also began to turn from general history to comparative history. They abandoned blanket contrasts between tradition and modernity and the search for general covering laws of history. Instead, students of fiscal sociology today are more likely to puzzle over differences in tax policy across states or countries at similar levels of development, particularly because, as John L. Campbell notes in the epilogue to this book, variations in tax structure seem resilient even in the face of putative pressures to converge brought about by globalization (see e.g., Kiser and Laing 2001; Slemrod 2004; Swank and Steinmo 2002; Mumford 2002; Ganghof 2007; Livingston 2006; Sokoloff and Zolt 2006). These scholars characteristically use comparison to arrive at explanations for these differences rather than to search for universal laws. Even scholars who are not themselves comparativists have generally abandoned the pretense – common in earlier waves of fiscal sociology – that the tax history of any one society, such as the United States, illustrates a universal pattern.

Perhaps most fundamentally, the new studies differ in several ways from public finance as it is taught today in most departments of economics. First, the new fiscal sociology typically focuses on *informal social institutions*. Whereas much of contemporary economics and the political science of budgeting examines what John Carey has called "parchment institutions" (2000) – mainly constitutions and written laws – much of the excitement of the new fiscal scholarship comes from the discovery that taxation is deeply enmeshed in social relationships that are no less institutionalized for not being written down. Tax policy shapes and is shaped by patterns of public trust; patterns of social cleavage; institutions of family, religion, work, and leisure – the list is long and growing, as the contributors to this book illustrate.

Second, the new studies take historical sequence and context seriously. They often draw on theories of path dependence to argue that the development of social institutions is defined by critical junctures, positive feedback processes, divergent and contingent historical paths, and institutional continuities. Following Schumpeter's lead, the new fiscal sociology attends to the importance of seminal historical events in the unfolding of social and political processes.[8] Modernization theory had envisioned history as a linear path, with different societies following

[8] As Schumpeter explained, "The events of fiscal history" provide insight "into the laws of social being and becoming and into the driving forces of the fate of nations, as well as into the manner in which *concrete* conditions, and in particular organizational forms, grow and pass away" (Schumpeter [1918] 1991: 101, emphasis in the original).

lockstep (from the most traditional to the most modern). The new studies treat history instead as a garden of forking paths, with critical junctures – usually wars and economic crises – marking moments of choice.Once a society is committed to a certain developmental path, positive feedbacks may reinforce that choice. It is this insight that underlies this book's focus on historical explanation: We agree that effective explanations for many fiscal and social phenomena must be historical. The observation of an economic or political equilibrium at any single point in time is not sufficient to explain observed outcomes in a world where multiple equilibria are possible.

Third, the new studies often focus on phenomena that are properly measured at the level of the society rather than the individual. This book exemplifies this aspect of the field with studies of wars, durable social distinctions, religious traditions, gender regimes, labor systems, and other such macrosocial phenomena. In addition, the new studies show a corresponding interest in the relationship between taxation and the biggest questions of the social sciences – such as the rise of democracy, the development of the state, and the sources of social solidarity.

The new fiscal sociology promises to shed light on all of the classic questions raised by Schumpeter – the social sources of tax systems, the determinants of taxpayer consent, and the social and cultural consequences of taxation. Treated by separate traditions for most of the late twentieth century, these questions are now addressed by crosscutting literatures on economic development, political institutions, and war. In particular, the new fiscal sociology points toward a new theory of taxation as a social contract that multiplies a society's infrastructural power. While many details remain to be worked out, the new theory suggests that economic development does not inevitably lead to a particular form of taxation, but rather that institutional contexts, political conflicts, and contingent events lead to a diversity of tax states in the modern world; that taxpayer consent is best explained not as coercion, predation, or illusion, but as a collective bargain in which taxpayers give up resources in exchange for collective goods that amplify the society's productive capacities; and that because taxation is central not only to the state's capacity in war, but in fact to all of social life, the different forms of the tax state explain many of the political and social differences between countries.

By focusing on these three aspects of taxation – the state-based sources of tax policy, the development of taxpayer consent, and the implications of taxation – this volume illustrates the potential of the new fiscal sociology.

Part I. Social Sources of Taxation: American Tax Policy in Comparative Perspective

Part I examines the sources of the fiscal-social contract from the point of view of one of the contracting parties, the state. Why do particular states settle on particular tax policies? A central premise of the new fiscal sociology is that answering this question requires attention to particular histories. Our contributors illustrate this approach by focusing on the development of tax policy in one particularly well-known, distinctive, and influential case: the United States. We argued earlier that one of the hallmarks of the new fiscal sociology is the realization that particular

moments of history may set different societies down contingent paths that never converge. In what should be considered a vigorous demonstration of the promise of this approach, the contributions of the new fiscal sociology are painting a remarkable picture of the historical development of American political economy.

In a now well-known example, tax scholars have upended the standard account of the United States as an underdeveloped and stingy welfare state. Employing Stanley Surrey's path-breaking analysis of tax expenditures (Surrey 1973), scholars have demonstrated that the U.S. welfare state is not a laggard in comparative perspective, but merely unusually reliant on indirect spending via tax expenditures that skew toward middle- and upper-income people (Howard 1997; Adema 1999; Hacker 2002; Klein 2004). An equally compelling development – well known among tax scholars, but not common knowledge among students of the welfare state – is the finding that the United States had a more progressive tax structure for most of the twentieth century than the big, social democratic welfare states. This peculiar tax system can be traced to the beginnings of the modern American tax system and the Progressive-era impulse to use direct and graduated levies to shift fiscal obligations toward those U.S. regions and classes that had the greatest tax paying ability (Ratner 1967; Mehrotra 2005a; Morgan and Prasad, 2009). The result was that at least until very recently, the United States taxed capital at higher rates, and labor and consumption at lower rates, than the welfare states of Europe, including egalitarian outposts like France and Sweden (Steinmo 1993; Carey and Tchilinguirian 2003; Martinez-Mongay 2003; Mendoza, Razin, and Tesar, 1994; Lindert 2004; OECD 2001; Sørensen 2004; Volkerink and de Haan 2001). According to the best recent study of comparative tax progressivity, even if we put aside the question of national consumption taxes, the United States had a more progressive tax structure than France or the United Kingdom in 1970, although the neoliberal tax cuts of the 1980s have reversed the comparative progressivity picture (Piketty and Saez 2006; see Prasad and Deng 2009 on the measurement of comparative tax progressivity).

Together these observations about U.S. tax policy have had implications for several strands of comparative-historical research. First, they have helped to solve one of the most important puzzles in welfare-state scholarship: how the large social democratic welfare states have survived the internationalization of capital markets. They have done so because they rely on consumption taxes, which are not vulnerable to the globalization of finance or trade (Ganghof 2006; Lindert 2004). Second, these findings place contemporary American politics in a new light. It is only a slight exaggeration to say that domestic economic policymaking in contemporary America is all about taxation, in that the quest of the corporate lobbyists who descend upon Washington normally ends with a tax benefit of some kind(see Clawson, Neustadtl, and Weller 1998; Birnbaum and Murray 1988). This pattern suggests that the vigor with which lobbying is conducted in the United States may not be an index of the power of business, but rather of the cleverness of politicians and of their success at generating a structure that brings them steady campaign funds (Doerenberg and McChesney 1987; McChesney 1997; McCaffery and Cohen 2006). Third, some analysts have suggested that the greater progressivity of the American tax structure is a factor in the greater intensity of neoliberalism there (Wilensky 2002; Campbell and Morgan 2005; Prasad 2006).

In short, as Schumpeter predicted, looking at the American fiscal structure has revealed "the thunder of history" for students of comparative political economy. It has also put a new set of issues on the agenda: How the big welfare states came to rely so heavily on consumption taxes, and what this finding might tell us about the rise of capitalism in the advanced industrial countries and the developing world.

The contributors to this book attend to this new picture of American political economy and contribute to larger debates over how states settle on particular forms of taxation. We begin Part I with Joseph J. Thorndike's chapter on the New Deal. As Thorndike shows, the twenty-first-century conflicts over progressive taxation have deep roots in American tax history. Thorndike echoes the judgment of prior scholars that the New Deal was a key moment in the formation of the American tax state (see Leff 1984; Higgs 1987; Beito 1989; Amenta, Dunleavy, and Bernstein 1994; Coleman 1996; Brownlee 1996b). Yet one of the New Deal's key tax laws, the Revenue Act of 1935, did not establish major new revenue-raising capacity as the adoption of national consumption taxes in subsequent decades would do in European countries, nor did it reward interest groups. What it did was attempt to soak the rich – and thereby contribute to the entrenched mistrust and mutual hostility that was so characteristic of the relationship between wealthy American businesspeople and the state for much of the twentieth century. Thorndike traces the 1935 Act to the outcome of a competition between legal and economic experts in the Roosevelt administration and argues that Roosevelt's own preferences – rooted in prior conflicts – contributed significantly to defining the direction of policy. Thus, in this key state-building episode, political elites followed patterns of conflict laid down in earlier conflicts over policy and paved the way for future conflicts in turn.

We then turn to a dialogue between Andrea Campbell and Fred Block on the sources of the current period of seemingly continual tax cuts. Campbell finds the origins of this phenomenon in the connection between taxpayer attitudes and the rhetoric of elite politics. Campbell argues that American voters' attitudes toward taxation have generally corresponded to the level of taxation. She presents the first complete time series of data on American public opinion toward taxes since the 1930s and demonstrates that the percentage of voters who believed that federal income taxes were "too high" co-varied closely with the actual tax burden. Yet she also shows that discontent with taxes does not always translate readily into political behavior. Taxes became politically salient when elites introduced them onto the public agenda as a subject of political competition. Thus, following in the footsteps of Puviani, Campbell suggests that public officials can influence taxpayers' behavior at least somewhat independently of the actual costs and benefits of taxation. It is the combination of rising tax burdens and a new elite rhetoric that has put tax cuts at the center of the policy agenda since the 1970s – and that led to the dramatic tax cuts of 2001 and 2003.

How, then, did American political elites come to place tax cuts at the center of the policy agenda? Fred Block's chapter takes up the case of the Bush tax cuts of 2001 and 2003and attempts to explain what the analysis of public opinion leaves unexplained. Drawing on a historical analogy with the ideologies prominent in nineteenth-century England, Block argues that American political elites at the turn

of the twenty-first century cynically employed an individualistic ideology to forge a new coalition between religious conservatives and self-interested business elites. This electoral coalition is antitax because its individualistic ideology denies all social obligations that extend beyond the family. Block argues that this ideology – embraced by ordinary people as a comforting response to uncertainty in a globalized world – has kept tax cuts at the top of the federal agenda for the last thirty years.We might extend Block's argument by pointing out that when the economic cycle begins to turn downward, as it has in recent years, tax cuts frequently reemerge as a counter-cyclical measure to manage the national economy. Thus, regardless of whether tax cuts are pursued as an indirect way to shrink the size of government or to stimulate a beleaguered economy, tax cuts seem to have become a favored policy instrument, and debates over tax cuts have become a recurrent feature of the American political scene.

Finally, Christopher Howard examines those other hardy American perennials, tax expenditures – tax benefits that lead to indirect spending in the form of foregone revenues. Howard shows that tax preferences for social welfare objectives are an enormous and overlooked component of the American welfare state and that they are skewed toward middle- and upper-middle income groups. Building on his earlier work (1997), Howard's chapter explores how the dynamics of American party politics at the turn of the twenty-first century have led to the maintenance and, in some cases, expansion of tax expenditures that provide social provisions. Although Democratic and Republican lawmakers have disagreed about tax rates, they seem to have found common ground on the use of tax policy as social policy. These tax breaks, moreover, have helped constitute interest groups by providing the cognitive boundaries and common interests that cement new coalitions together (see also Hacker 2002; Steensland 2008).

Our contributors' observations question the thesis of "American exceptionalism," because they cast doubt on the interpretation of the United States as a weak, laissez-faire state.[9] Americans have been as willing to embed the market through state intervention as the European democracies are, but this embeddedness has taken other forms, particularly progressive taxation. Moreover, the United States does have a large welfare state, but instead of functioning as the welfare states of Europe do (first collecting revenue through taxes, and then disbursing those resources in the form of welfare payments), it works by foregoing tax collection in targeted ways. In challenging one set of stereotypes about American distinctiveness, these chapters also introduce a more sophisticated argument about ways in which the United States is different from Europe, and a new set of questions: Why did the United States adopt this "soak the rich" method of taxation rather than the national consumption taxes that finance Europe? Why have American political elites been unusually interested in tax policy at some moments and less so at others? What led the United States to its distinctive reliance on tax expenditures? Did tax reductions play a role in the economic crisis that began in 2007, and can the American state continue to convince creditors of its ability to raise tax revenue to pay its debts?

[9] For a recent summary of the sociohistorical literature challenging the traditional notion of the laissez-faire American state, see William J. Novak (2008).

The contributions in Part I add up to a rich picture of the American fiscal state. The American social contract is one that insists on progressive taxation – thereby provoking the conflicts over taxation that dominate the headlines and also permitting the tax expenditures that more quietly but perhaps more substantially delineate the features of economic life in this country. Our contributors would not argue that the American tax system presents the generic picture of modernity, as some progressive historians imagined; but the chapters on the United States in this book do exemplify general processes of path dependence that set different states on particular paths and thereby give rise to the diversity of tax states in the modern world. Tax policy is the outcome of particular political conflicts, and the lines of conflict were laid down by prior tax-policy choices. As we will see later, the outcome of these conflicts over tax policy may affect many other facts about political life, inequality, and state capacity – even those that seem remote from taxation.

Part II. Taxpayer Consent

Part II of the book examines the origins of the fiscal contract from the point of view of the taxpayer. The chapters in this part ask why people consent to particular tax systems. This question was the central concern of elite theory, and our contributors all recognize the importance of political elites and political institutions. In other respects, however, they exemplify the new fiscal sociology in their syncretic approach to the question. Several chapters explicitly draw together war, economic development, and political institutions to explain variation in consent. They also attend to institutionalized social divisions and political coalitions.

Perhaps most important the new fiscal sociology departs from the individualist premises of elite theory to argue that taxpayer consent is the product of a *social* contract. These scholars argue that taxation cannot be explained only as illusion or coercion, but should be seen instead as a collective fiscal bargain in which taxpayers may surrender resources willingly if they believe that those taxes fairly reflect the cost of providing for the public good. To say that taxpayers are concerned with fairness means that taxpayers are not concerned only with their own individual costs and benefits – all taxpayers' consent is crucially dependent on how they believe other taxpayers are treated.

The new fiscal sociology of taxpayer consent builds on the foundational contribution by Levi (1988), who proposed a theory of "quasi-voluntary compliance" to complement her theory of predatory rule. Levi posed the question of why taxpayers choose to comply with their obligations instead of evading taxes. In contrast to the standard model of tax compliance derived from the economics of crime – which treats the decision to comply as a straightforward function of the risk of detection and the cost of punishment – Levi drew on the elite theory tradition to argue that taxpayer compliance has a "voluntary" element. Taxpayers comply with their obligations when they perceive their tax obligation as a fair exchange for private or collective goods provided by the ruler. To be sure, tax authorities do exercise coercive authority – in this sense, compliance is *quasi*-voluntary – but Levi argued that the main purpose of coercion is to persuade the taxpayer that she is paying a

fair price by demonstrating that other taxpayers are being forced to pay it as well (1988: 54).

Levi's contribution left several crucial questions unanswered and thereby opened avenues for further inquiry. One such unanswered question is where norms of fair taxation come from. Recent comparative historical scholarship on tax protest and tax evasion has emphasized that people in different times and places have held very different ideas about what counts as a fair fiscal bargain. The new fiscal sociology has typically sought to explain these norms by showing historically how the policies and practices of governments have institutionalized particular expectations of government responsiveness (Lo 1990) or administrative practice (Bergman 2003; Martin 2008), or how they have channeled the flow of information (Wilensky 1975, 2002) in ways that may provoke evasion or protest. There is much work still to do on which policies acquire the weight of customary norms in which social and historical contexts.

Another unanswered question is how taxpayers define the collectivity whose welfare they wish to maximize. Taxpayers may consent to be taxed when they think it contributes to the collective good – but which collective? A pioneering effort by Lieberman (2003) identified moments of constitution-writing as the critical junctures when ideas about the collectivity are institutionalized. He argued that taxpayer consent in Brazil and South Africa in the twentieth century depended on different conceptions of race and nation that were encoded in their respective national constitutions at moments of national founding.[10] Other recent scholarship has identified tax policy itself as a source of social boundaries and political identities – so that taxpayers in regimes that depend heavily on progressive income taxes may come to identify themselves as members of an income-tax bracket, say, whereas taxpayers in consumption-tax-dependent regimes may arrive at a more broadly shared political identity (Wilensky 2002; Kato 2003; Morgan and Campbell 2005; Prasad 2005, 2006).

In Part II, our contributors continue to push these frontiers in the study of taxpayer consent. Evan S. Lieberman opens this section with a bold restatement of his theoretical argument that identities and social boundaries affect taxpayers' consent and hence state capacities. The perception of collective goods and the willingness to sacrifice for the collectivity requires a prior shared conception of the collectivity – a division of the world into "we" and "they," in-group and out-group. By contrasting tax policy with government responses to the acquired immunodeficiency syndrome/human immunodeficiency virus (AIDS/HIV) pandemic in two starkly contrasting collectivities – the nation-states of Brazil and South Africa– Lieberman underscores the importance of social and ethnic boundaries and historical processes. Taxpayers may be less likely to sacrifice if they lack a strong collective solidarity, or if they are unsure who might benefit from their tax payments. Alternatively, they may be more likely to accept a heavy burden of sacrifice if they believe that their taxes go to benefit their in-group. Lieberman explains how

[10] In contrast to much recent economic scholarship on taxation in multiethnic states (e.g., Alesina and Glaeser 2006), Lieberman takes ethnic boundaries to require explanation rather than taking them as historical givens.

historical racial conflict in South Africa increased tax compliance among whites, and enabled the development of comparatively high tax rates and an efficient and effective tax administration at an early and critical stage in the development of South Africa's tax system when white taxpayers believed that their taxes benefited other white citizens. By contrast, in Brazil, the historical absence of comparably rigid racial boundaries contributed to the development of less productive tax policies and weaker tax administration because taxpayers were less concerned about benefiting those of their own race. In-groups simply didn't exist in the same sense, and taxpayers therefore did not think in terms of benefits for their in-group. A contrary set of path-dependent processes unfolded in the realm of AIDSpolicy in those two countries. Lieberman's argument brings a sociological question into the heart of the cost-benefit calculation by asking who the relevant unit is for whom costs and benefits are being weighed. Lieberman points out that social boundaries are themselves historical creations; his argument implies that the consideration of history is unavoidable if we wish to explain why taxpayers consent.

In the following chapter (Chapter 7), Eisaku Ideand Sven Steinmoargue for the importance of another social factor in generating taxpayer consent: the social norm of trust in political elites. Their empirical case is well chosen to illustrate the potentially dire consequences when taxpayers do not consent to be taxed. Japan's remarkable turnaround from a model of fiscal discipline to a model of runaway deficits is a cautionary tale for current policy makers, and a major puzzle for contemporary tax scholarship. Ide and Steinmo argue that one factor that undermined citizens' willingness to pay taxes was their sense that the government could not be trusted to handle the revenue responsibly. And this mistrust, they argue, was borne of prior tax-policy choices. Having squandered the trust of citizens by embracing neoliberal fiscal policies and by repeatedly displaying preferential treatment toward the richest taxpayers, Japanese political elites lost the ability to demand sacrifices from common citizens. Their argument implies that the study of taxpayer consent must have a historical dimension, because consent at any given time is a response to prior policies, which themselves represented an accommodation with taxpayers' prior willingness to sacrifice. Moreover, their case study points out that taxpayer consent may be withdrawn in modern societies. If taxpayer consent were primarily a function of coercion or manipulation, as the elite theorists argued, these patterns would be hard to explain. Rather, this case suggests that taxpayers who object to the terms of the social contract, or who are dissatisfied with the inability of state actors to perform their civic obligations, are perfectly willing and able to withdraw their consent.

The new fiscal sociology suggests that social identities and norms affect whether citizens will acquiesce in a tax policy. Acceptance, however, is not necessarily compliance. Indeed, even during wartime taxpayer consent may be contested and ambiguous (Bank, Stark, and Thorndike 2008). In Chapter 8, Naomi Feldman and Joel Slemrod apply insights about social identities and norms to wartime tax compliance: When called upon to share in wartime sacrifice, will people pay or will they evade? Feldman and Slemrod test the conventional wisdom that taxpayers' sense of identification with their polity and their willingness to sacrifice should

be greatest during wartime with data on war and attitudes toward tax compliance in more than sixty countries since 1970. They find that people in states that have recently undergone wars do report slightly more support for tax compliance, but that war fatalities erode support for tax compliance. Their results suggest that, at least for the post-1970 period, war may indeed affect compliance attitudes, but that this effect is small and may be conditional on the destructiveness of the war. And in contrast to the assumptions of many previous studies (e.g., Rasler and Thompson 1985; Kiser and Linton 2001), their findings suggest that the more limited the war, as measured by fatalities, the greater the support for paying taxes. Feldman and Slemrod's work sheds new light on the "ratchet effect" that tax scholars have identified, in which tax revenue increases during wartime and never entirely returns to prewar levels.

Finally, in Chapter 9 Robin L. Einhorn presents a forceful argument for the thesis that taxpayer consent is cultivated by democracy and liberty. Einhorn asks why the Northern colonies developed more sophisticated tax bureaucracies than the Southern ones in pre-Revolutionary America. This deceptively modest question ends up turning well-established interpretations of American history upside down. Historians who focus on the rhetoric of the period argue that the South was more "democratic" than the North and therefore conclude that democracy was born out of slavery – that, in an echo of Lieberman's argument earlier, the presence of sharp social boundaries between groups functioned to increase within-group solidarity. Einhorn argues that this interpretation of American history mistakes the rhetoric of democracy for the real thing. She shows that in practice, Southern colonies were much less democratic in their governing procedures – and that the absence of democracy and liberty had far-reaching consequences for state capacity. The colonies of the South, despite their integration into world markets, showed little capacity to engage in tax assessment, because slave owners resisted any democratic inquiry into their affairs. By contrast, in Northern colonies where slavery was less prevalent and local democracy more robust, a political tradition of self-governance fostered more sophisticated tax structures and tax administration. Einhorn concludes, "The legitimacy of taxation does not depend on quantitative precision. It depends on the political flexibility that allows taxpayers to think they are being treated fairly." Taxpayer consent, in short, depends on democracy and liberty.

All of these chapters illustrate that consent is rarely secured with coercion alone. Where elite theory treated tax compliance as evidence that taxpayers were duped or coerced, the work of all of these contributors echoes Levi's argument that there is a voluntary element in the payment of taxes. For instance, the implication of Lieberman's work is that white taxpayers consented to being taxed in South Africa because they believed that it would benefit other whites – not only because they were coerced or duped into payment – and that coercion and manipulation were not enough to generate taxpayer compliance in Brazil in the absence of taxpayer consent. Ide and Steinmo's work points to the ability of taxpayers to withdraw their consent if they are not satisfied with the conditions of the social contract. Feldman and Slemrod's work is part of a tradition that asks whether a sense of

duty is part of taxpayer consent. By examining the links between war and taxpayer compliance, they show how the duration of conflicts, as measured by fatalities, can erode citizens' confidence in the state, and hence their consent to pay taxes. Einhorn's work also implies that taxpayer consent depends on taxpayers' sense that the methods of tax collection are just, which is a function of their liberty and ability to participate in the deliberations of government.

All of these chapters also stress that taxpayer consent – including both political acceptance and compliance with the law – depends on a social rather than an individual contract. Taxpayers think about the collective good. And their calculations are affected by characteristics of the society as a whole. If you want to understand consent to taxation, it is not enough to ask about individual costs or benefits. It is also necessary to ask questions like these: Is the society as a whole ethnically divided or united? Is it at war or at peace? Trusting or untrusting? Democratic or undemocratic? Slave or free? In short, our contributors suggest that taxation in democratic states is not primarily predation; it is the embodiment of a social contract.

Part III. The Social Consequences of Taxation

Militarist theory demonstrated that taxation shaped state capacity to wage war; our contributors extend fiscal sociology in new directions by exploring the consequences of taxation for other social and cultural outcomes. Of course, the investigation of the economic consequences of taxation itself is not new or distinctive. Public finance economists have long been preoccupied with measuring the incidence of taxes and how they "distort" economic decision-making. What is different about the new fiscal sociology is its focus on broader social, political, and institutional outcomes, such as family structure, state capacity, or ideals of justice. Even when our contributors turn their attention to inequality – a classic subject of the economics of taxation – they tend to take a sociological approach, reviving the Tocquevillian hypothesis that tax policy may not only affect the gradational distribution of income and wealth, but may also create and reinforce categorical social distinctions.[11]

The frontiers of research on social and cultural consequences of taxation are wide open. Recent research points in a wide variety of directions. Tax policy may shape the life course by shaping possibilities for marriage (McCaffery, Chapter 13), or pensions for retirement (Scott 2007; Zelinsky 2007). Tax policy affects the organization of health care markets (Hacker 2002), and may thereby have important consequences for public health. Social movement scholars have hypothesized that tax exemptions for not-for-profit corporations are an important factor channeling protest into particular organizational forms (McCarthy, Britt, and Wolfson 1991). American historians have noted how Southern segregationists during the late 1960s attempted to use tax exemptions and tax benefits for charitable contributions to create private "segregation academies" (Crespino 2007: 228). Comparative scholars of

[11] In Tocqueville's words: "Of all the various ways of making men [sic] conscious of their differences and of stressing class distinctions unequal taxation is the most pernicious, since it creates a permanent estrangement between those who benefit and those who suffer by it" ([1856] 1955: 88).

religion have pointed out that tax discrimination has been a crucial device for either restricting or encouraging the creation of religious institutions independent of the state – and they have hypothesized that tax policy may thereby affect the vitality of religion, in all its varied forms from collective worship to private belief (see Finke and Iannaccone 1993). Art historians and sociologists have argued that tax policies affect the possibilities for careers in artistic production and have hypothesized that tax policy choices may even affect the content of art – for example, a tax that affects the international trade in artworks selectively may thereby channel patronage toward particular artistic styles in particular periods (Becker 1982: 172). Historical studies of American suburbs have shown how federal tax policy literally has shaped the physical landscape, for instance, facilitating the post-WWII expansion of suburban shopping centers (Hanchett 1996). Scholars of economic development cite a state's failure to implement a social contract of taxation as one of the key reasons for underdevelopment (Kohli 2004: 8; Moore, 2004). And the ability to raise revenue through taxation underpins a state's ability to borrow at low interest on credit markets (Bräutigam, Fjeldstad, and Moore 2008), foreshadowing long-term consequences for the American state's recent commitment to tax reduction.

It is not surprising that scholars in so many disparate fields have noticed the potential relevance of taxation. As we argued earlier, taxation is central to modernity. The very centrality of taxation suggests that it will put its stamp on many elements of modern social life: in tax policy, the state codifies central cultural categories of a society and imbues them with the force of law and the power of economic incentives.

In Part III, our contributors pursue several new directions in the social and cultural impact of taxation. Charles Tilly's magisterial contribution sums up the case for seeing democracy itself as one of the consequences of taxation. In so doing, Tilly is reaching back to Tocqueville while showing us the future of fiscal sociology. The import of Tocqueville's argument about the French Revolution was not only that tax policy may create invidious social distinctions, but that tax policy may also create and reproduce the very category of political citizenship – the social boundary between those who are full political citizens and those who are not. Tilly's contribution to this book pursues this insight with a sweeping historical argument that state extraction of resources from society (of which taxation is a special case) is a facilitating condition for democratization. States that acquire their resources by production in state enterprises or sale of natural resources do not need to secure the active consent of their subjects. Yet states that acquire their resources by directly extracting resources from their subjects do. This type of direct extraction initiates a cycle of resistance, repression, and bargaining that may ultimately result in the creation of an institutionalized forum for negotiation between the state and its citizenry – the first step on the road toward full-fledged democracy. Taxpayer consent, for Tilly, is the contemporary manifestation of a grand historical bargain and comes only with an extension of political powers to taxpayers.

In Chapter 11, Edgar Kiser and Audrey Sacks investigate the consequences of forms of tax collection for state capacity. This is one of the most promising areas of the new fiscal sociology (see Lieberman 2002a), and surely one of the most

urgent. States that are unable to raise revenues may be unable to provide the most basic conditions for peace and prosperity. Kiser and Sacks show that bureaucratic tax administration in many states of sub-Saharan Africa are a poor fit for economies where the scarcity of resources and poor means of transportation and communication make it difficult for states to monitor and sanction tax collectors. Kiser and Sacks attribute the uncritical adoption of bureaucratic forms of tax administration to normative pressures for the adoption of the most "modern" tax administration.[12] They proceed to argue that under specifiable conditions, developing countries in the twenty-first century may actually benefit from tax-farming arrangements similar to those that served some rulers well in early modern Europe.

In Chapter 12, Beverly Moran asks what tax system would best realize the ideals that Adam Smith identified several centuries ago. She argues that Smith's ideals were crafted in response to the tax policies that were possible in his time – and that applying his first principles in a different context, we should therefore draw very different conclusions about what policy Smith would recommend. In making this argument about how tax policy may shape tax ideals, she too makes a normative prescription: that a tax structure dependent on wealth taxes would be more equitable in America than the current income-tax-driven tax structure. Inheritance laws ensure that past historical oppressions continue to contribute to the contemporary inequities in the distribution of wealth. Taxing wealth would therefore realize a substantive conception of equality and of justice.

Edward McCaffery's chapter presents new comparative data on the consequences of tax policy for the intimate sphere of the family. His chapter builds on work by many legal scholars that has shown how tax laws may help reproduce gender inequalities, and may contribute to political conflicts between dual-income couples and single-earner couples (Blumberg 1971; Jones 1988; Staudt 1996; Brown and Fellows 1996; McCaffery 1997; Alstott 2001).[13] McCaffery argues that several features of U.S. tax law favor unmarried couples or "traditional," single-earner families over dual-income, married couples with children. He documents that this bias was deliberately written into the law at a critical juncture after World War II. And he argues that once in place, this structural bias reproduced itself – and ensured ongoing conflict between "traditional," single-earner families that are advantaged under the law, and two-earner families that are not.

The final chapter written by W. Elliot Brownlee sounds a cautionary note. Although tax policy may affect society in many ways, it does not mean that tax experts are free to manipulate society as they wish. As Brownlee's chapter demonstrates, post-WWII Japan seemed to present a perfect laboratory for testing policy prescriptions that were designed to achieve goals of equity and economic growth. In the aftermath of the war, the U.S. government invited a group of

[12] Some of the modernization theorists explicitly warned that this might occur, cautioning experts against the risks of promoting "modern" tax policies in societies where the ambient economy would make them impossible to administer fairly (Ardant 1965; Musgrave 1969). Their theories generally implied, however, that such mismatched tax policies would result in negative feedback processes – chiefly tax resistance and evasion – that would tend to steer tax policies toward conformity with the capacities of the ambient economy.

[13] For an introduction to the Critical Tax Law literature, see Infanti and Crawford (2009).

American tax experts, led by economist Carl S. Shoup, to redesign Japan's tax system from the ground up. If ever social science had a hand in shaping the world, it should have done so here: These reforms were imposed by a victorious power on an unambiguously defeated rival; they followed a war that had made unprecedented fiscal demands and led to perhaps the most dramatic tax policy changes in history; the defeat had been a crisis of catastrophic proportions for the Japanese state; and Shoup and his team of economists were unusually prepared with analysis and prescription. Yet, Brownlee shows that the Shoup reforms did not endure. Although the occupation did force the Japanese government to adopt the reforms, business and other interest groups persuaded a subsequent government to roll them back. All the hard work of Shoup and his economists was unraveled. This case thus presents clear evidence that the exogenous shock of military defeat is not sufficient to remake a tax system wholesale. Tax policy writers may shape society – but not always as they wish nor under conditions of their choosing.

As the chapters in Part III illustrate, the study of the social and cultural consequences of taxation opens up new normative questions for social theory and the policy sciences. The traditional concern of "optimal taxation theory" with efficiency and vertical equity does not exhaust the goods that tax policy may secure. The tax policy that is optimal for economic growth or to maintain progressivity may not be optimal for military success, social solidarity, or democracy. As Beverly Moran (Chapter 12) points out, these concerns of the new fiscal sociology are in many respects a return to the broader normative concerns of the founders of public finance.

In concentrating on the consequences of taxation, this strand of the new fiscal sociology thus showcases a normative impulse that is increasingly present in the social sciences: the attempt to marshal the insights of historical work to the explicit aim of improving public policy. In imitation of the normative prescriptions of economics, but in disagreement with some of the assumptions and methods that characterize that field, many scholars wish to explore the potential of a historically oriented social science to contribute to public debates.[14] This approach has also met with fierce criticism and resistance. Critics worry that a preoccupation with current political relevance could obscure the attempt to understand social phenomena on their own terms and could damage the ability of the social sciences to serve as sites where partisan debates may be transcended (see Monroe 2005, for the debates in political science; Clawson et al. 2007, for the debates in sociology; and Novick 1988 for the long-standing debates in history, particularly with regard to public history). The contributors to this section of the book present all points of the spectrum on that debate: Kiser and Sacks, and Moran draw out normative prescriptions explicitly, whereas McCaffery implicitly advocates gender-neutral tax policy. Brownlee, on the other hand, implies that experts who wish to influence policy have to reckon with obdurate political realities.

[14] This wish for real-world relevance has been so strong in political science, history, and sociology that it has led in recent years to the founding of new flagship journals devoted to the publication and dissemination of research that speaks to pressing public issues (e.g., *Perspectives on Politics, Journal of Policy History,* and *Contexts*).

Together, the chapters in this book illustrate the ambition of the new fiscal sociology. Mainstream economics has taught us a great deal about how taxation affects relationships between buyers and sellers – and thereby affects economic growth and the distribution of income. The new fiscal sociology aims to shed light on how taxation affects nonmarket relationships, including kin relationships, symbolic relationships between in-groups and out-groups, and political relationships between rulers and ruled. And the new fiscal sociology asks us both to undertake historical research that is engaged in the important debates of the day and cautions us against the belief that scholars alone can remake the world.

THE FUTURE OF THE NEW FISCAL SOCIOLOGY

Fiscal sociology is growing rapidly and it will continue to do so. Consider, as a point of comparison, the political sociology of public spending on welfare. This field was small in 1975. Today it supports a large, growing, and lively interdisciplinary research community, and rightly so – social spending is a big deal. Scholars of social policy routinely explain the interest and importance of their subject by pointing out that spending money on social provision is "the principal domestic undertaking of states in the West" (Orloff 2005: 190), comprising a greater share of economic activity in the affluent countries than anything else that government does. Yet this claim is only true if one ignores the revenue side of the budget. If we follow the convention of welfare state research and measure the size of an activity by the sheer volume of cash transferred between state and society, then the principal domestic undertaking of states in the West is not spending money on social provision or on anything else. It is collecting taxes.[15] Outside of the most developed welfare states, the imbalance is even more striking. Taxation is one of the main things that most states do. The puzzle is that so many sociologists, historians, legal scholars, and political scientists have neglected it for this long.

Scholars will continue to study tax policy as an index of social, political, and economic change. But the future of fiscal sociology points beyond the study of taxation as an index or symptom of other changes, and toward an understanding of taxation as the central element in the social, political and economic development of the modern world: the actually existing social contract, the renegotiation of which transforms the relationship between state and society.

Schumpeter's high hopes for fiscal sociology reflected his conviction that tax policy enjoyed a special theoretical status, because tax policy more than any other

[15] We focus here on all taxation, not just taxation earmarked or intended for social spending, because taxation as a social activity of states has a great deal in common regardless of its intended or imputed purpose – and because taxation as such has formal and sociological similarities to government social spending. Both social transfers and taxes are legally obligatory, unremunerated economic transfers across the state-society boundary; indeed, from a certain point of view, social transfers are simply negative taxes. Yet they are dwarfed by positive taxes. In 2001, direct public spending on social provision in fifteen affluent European countries averaged 23 percent of Gross Domestic Product, or GDP. Tax revenues averaged 40 percent of GDP; taxes on income plus taxes on sales together account for a greater proportion of GDP than social spending. These statistics are from OECD (2007). They represent the countries that the OECD calls the "EU 15."

policy might shape the direction of social change. It might even be one of the great motor forces of history. For this reason, the study of taxation was not just a specialized subfield of policy history; it was the key to the whole. In his essay on the tax state, Schumpeter did not shy away from the strongest version of this claim:

> In some historical periods the immediate formative influence of the fiscal needs and policy of the state on the development of the economy and with it on all forms of life and all aspects of culture explains practically all the major features of events; in most periods it explains a great deal and there are but a few periods when it explains nothing.([1918] 1991: 100)

Schumpeter was surely overreaching, but how far was he overreaching? We will not know until scholars have explored the limits of what can be explained by fiscal policy. Tax policy does not explain everything that social scientists and historians are interested in. But we suspect that tax policy has shaped more of the theoretically important facts about social life and social change than scholars have guessed hitherto.

2 "The Unfair Advantage of the Few": The New Deal Origins of "Soak the Rich" Taxation

JOSEPH J. THORNDIKE

When he arrived at the White House in 1933, Franklin Roosevelt inherited a regressive tax system. Excise taxes – most levied on consumer goods – provided more than half of all federal revenue in fiscal year 1933. "It seems to me that our national anthem should begin with the words, 'Oh, say, can you pay?'" complained a writer for the *Saturday Evening Post*. "And so far as I am concerned, Yankee Doodle comes to town a-riding on a vacuum cleaner" (Phillips 1935: 27).

Leaders of the Roosevelt administration lamented this regressive system, but they didn't do much to change it. For the first two years of his presidency, Roosevelt ignored calls for progressive tax reform. In fact, the New Deal's first important tax innovation was a highly regressive food tax, enacted as part of the Agricultural Adjustment Act of 1933. However, in the summer of 1935, Roosevelt changed course, asking Congress for a range of new taxes on rich individuals and large corporations. Such measures were vital, he declared, to safeguard the nation's ideals as well as its economy. The growing concentration of wealth and economic power posed a serious threat to American democracy, even as it hindered economic recovery.

Compliant lawmakers gave FDR much of what he wanted, but not before a bruising battle with business groups. Indeed, business leaders were vigorous, voluble, and very nearly unanimous in their opposition to Roosevelt's tax plan. Some objected to specific provisions, defending the interests of a particular industry or company. Others mounted a broad attack, challenging the very notion of progressive taxation.

Which was no surprise, for business leaders understood the importance and ambition of New Deal tax reform – better, perhaps, than most subsequent historians. Studies of the New Deal tend to treat taxation as an afterthought, focusing on more dramatic – and perhaps less tedious – instruments of economic reform. But business leaders understood the reformist, even radical implications of the New Deal tax agenda. They were keenly aware that some New Dealers – including several close to the president – were advocates of *social taxation*: the creative use of tax policy to achieve social and economic reform.

The Revenue Act of 1935 – quickly dubbed the Wealth Tax – was a qualified victory for advocates of social taxation. The law increased income and estate taxes

on the rich, making the revenue system more progressive and curbing the growth of dynastic fortunes (at least in theory). The law also introduced graduated rates for the corporate income tax, an innovation designed to slow the growth of large corporations by saddling them with a higher tax burden than smaller competitors.

Nonetheless, many critics – including some of the president's most reliable supporters – considered the Wealth Tax a distinctly modest achievement. It raised new revenue with a narrow tax hike on the rich, but it left the growing federal deficit largely intact. It increased the burden on rich Americans, but it did little to ease the ones on lower- and middle-class taxpayers. In general, it revised the instruments of federal taxation, but it left the broad structures intact. For many advocates of fundamental reform, the act was a bitter disappointment.

Still, the 1935 revenue law was a pivotal victory for the New Deal – and a landmark in the history of American taxation. By establishing a resonant rhetoric of progressive reform, it helped shape later, more substantive tax debates. Just a few years later, when World War II made fundamental reform an economic necessity, this rhetoric ensured that progressive taxes (like the income tax) would beat out regressive alternatives (like the sales tax) to become the cornerstone of federal finance for the next half century. Since World War II, the United States has relied more heavily on progressive taxes than many other developed nations, including paragons of social democratic politics like Sweden (Steinmo 1989).

At the same time, however, the New Deal's "soak the rich" rhetoric also ensured that wartime taxes would retain a punitive cast. Lawmakers expanded the income tax to include most of the middle class, but they also retained steeply progressive rates. These rates, in turn, helped fuel the postwar tax debates that Andrea Campbell describes in Chapter 3. It seems likely that the political salience of federal taxation in postwar American politics is an outgrowth of its steeply progressive structure (Wilensky 2002).

More important, steep rates have fostered a proliferation of loopholes and tax preferences, including the sort of backdoor spending that Christopher Howard describes in Chapter 5. Roosevelt's victory in 1935 paved the way for progressive tax reform, but it also started lawmakers down a pernicious path of tax favoritism. Increasingly, policy makers have chosen to undermine statutory rates in piecemeal fashion, eroding the tax base and creating inequities among taxpayers. If the income tax eventually succumbs to that erosion, then some of the blame will belong to one of its greatest champions.

TREASURY EXPERTISE

Late in 1934, Franklin Roosevelt asked Secretary of the Treasury Henry Morgenthau for a brief memo on tax reform. Roosevelt wanted ideas on how the revenue system might be changed "to strengthen the economic structure and to conform more nearly to the social objectives of the new Administration" (Jackson and Barrett 2003). On December 11, 1934, Morgenthau brought the president a memo by Herman Oliphant, the Treasury's general counsel. Oliphant was Morgenthau's principal tax advisor, having come to Washington after teaching law at the University of Chicago, Columbia, and Johns Hopkins. Known to his admirers for

his enthusiasm, he was described by one journalist as having "a talent for the old-fashioned, camp-meeting type of moral indignation" (Lambert 1970: 176). His critics were less charitable. *Fortune* magazine called him a "brilliant, if somewhat inexperienced and dogmatic legal advisor" (Fortune 1934:141). Raymond Moley, an early member of FDR's Brains Trust, considered him something of an intellectual fraud (Lambert 1970).

Oliphant was a distinguished member of the legal academy, with a specialty in commercial law and a notable interest in theories of legal realism. Generally speaking, legal realists believed that the law was best studied using the empirical and functional methods pioneered by the social sciences. By grounding legal reasoning in real-world conditions, rather than abstract premises and legal doctrine, they sought to connect the law to its social and economic environment. When it came to revenue reform, legal realism led Oliphant to advocate bold new directions in the taxation of personal and corporate wealth. Tax policy, he insisted, could be made the vehicle for fundamental social reform, specifically targeting the accretion of economic power among a small group of companies and the people who ran them.

In his December tax memo, Oliphant offered several proposals to slow and perhaps even reverse the concentration of wealth and economic power (Oliphant 1934: 275). For instance, he proposed a new federal inheritance tax. Since 1916, the federal government had levied an estate tax on all the assets of a deceased individual before they were distributed to heirs. Targeted narrowly at the very rich, it was an important source of revenue, contributing $212 million in fiscal year 1935, or roughly 5.9 percent of total receipts (Joulfaian 1998). Now Oliphant was suggesting an inheritance tax that would collect an additional sum on the distributive shares of every estate as they passed to particular beneficiaries. Oliphant believed that using both forms of death taxation would help slow the growth of large fortunes – something the estate tax had been unable to do by itself.

Oliphant also suggested a trio of taxes to regulate the structure and ownership of American business. In particular, he recommended a tax to help stem the popularity of *holding companies* – business organizations whose principal assets were the stocks of other companies. Holding companies often produced nothing and sold nothing, instead making money from the dividends paid by companies they controlled. Their key advantage was the power they conferred on a small group of investors and managers. In the 1930s, many critics blamed holding companies for stock market woes, insisting that a small group of insiders could use the structure to manipulate stocks for their own advantage.

Oliphant developed a plan for taxing the dividends that one corporation paid to another. Under then-current law, dividends received by a corporation were not taxable to the recipient; only the company that earned the money in the first place paid any tax. Oliphant suggested that by taxing the money again when it passed to the holding company, an intercorporate dividend tax could make holding companies prohibitively expensive. That, in turn, would encourage a return to smaller business units.

In addition, Oliphant suggested that corporations be taxed according to the size of their profits. Although the dividend tax would discourage holding companies,

it might also prompt corporations to avoid the tax by simply merging with one another. The resulting businesses would be even larger than their predecessors, frustrating the whole purpose of the dividend tax. To prevent such combinations, Oliphant suggested a graduated tax on corporate income, with rates scaled to the size of a company's profit. With larger companies paying steeper rates than smaller competitors, consolidation would again become too expensive.

Finally, Oliphant recommended a tax on undistributed corporate earnings. Under existing law, earnings retained by a corporation were taxed only at the corporate level. Because they were never distributed in the form of dividends, they were never subject to the individual income tax. Critics like Oliphant argued that retained earnings were a principal means of tax avoidance among the rich; by letting money pile up within corporations, shareholders could shelter profits from the steep surtax rates of the individual income tax. Obviously, companies must be allowed to accumulate reasonable surpluses – enough to carry them through hard times or allow for investment and innovation – but excessive surpluses should be discouraged through punitive taxation.

Taken as a whole, Oliphant's tax program was provocative. It targeted individuals through the inheritance tax and corporations through the income, dividend, and undistributed profits taxes. If adopted intact, it promised to redistribute individual wealth and reshape the structure of American business. Oliphant believed these changes would benefit the entire country – including its richest citizens – by protecting democracy, encouraging social comity, and promoting recovery from the Great Depression. Yet he also understood that his program would be controversial. "While the measures here proposed involve no radical attack upon the fundamental character of the capitalist system," he warned Roosevelt in a moment of true understatement, "they may well be regarded otherwise at first in influential circles."

TAXATION FOR REGULATION

Using taxes to promote reform was hardly unprecedented. The income and estate taxes had both been enacted with frank social goals in mind. Indeed, tax experts understood that virtually every tax had nonrevenue effects, whether deliberate or inadvertent. Yet economic reform through the tax law was not usually pursued in such straightforward terms. Oliphant was clearly sympathetic to those liberal voices who had been calling for *social taxation* – the creative use of tax policy to remake society.

The *New Republic*, for instance, had long urged boldness on the tax front. "If consciously used as an instrument of policy," the editors wrote, "the taxing power is capable of a far more beneficial effect on the general life than it has ever before had." (New Republic 1933). Or as *The Nation* later explained, "Since a concrete policy of social taxation is by all odds the most important element of both reform and recovery, essential to the very survival of our economic system, we urge the administration to lose no time in squaring off to this fundamental task" (Nation 1935b). In general, advocates of social taxation supported redistribution of individual wealth, as well as efforts to regulate business through the tax system.

Supreme Court Justice Louis Brandeis was one of the most prominent champions of social taxation. Brandeis had argued for decades that large corporations, trusts, and syndicates were a threat to the nation and its economy. Through a variety of intermediaries – including Felix Frankfurter, Tommy Corcoran, and Benjamin Cohen – he urged Roosevelt to use the tax system as a means to regulate economic consolidation. Specifically, he endorsed steep income and inheritance taxes on individuals to prevent the accumulation of large, sterile, and potentially dangerous fortunes. He also urged taxes on business profits and intercorporate dividends to stave off corporate consolidation (Dawson 1980; Strum 1984).

In 1934, the Brandeis cohort within the administration had drafted a bill for special taxes on *tramp corporations:* companies that set up shop in states where they did no substantive business, usually for tax reasons. Corcoran and Cohen also developed a bill for Senator Burton K. Wheeler, D-Mont., that would have replaced the existing flat-rate corporate income tax with a graduated levy. Generally speaking, the Brandeisians wanted to hobble shady or undesirable corporate practices by taxing them out of existence. When it came to taxes, however, Frankfurter was the most effective advocate of Brandeis's anti-monopoly ideology. He used his close relationship with Roosevelt to carry the anti-bigness message directly to the White House. He also forged a strong working relationship with Oliphant, who drew many of his tax proposals – especially those focused on corporations – from the Brandeis bag of tricks. Henry Morgenthau did his best to thwart this trespass on Treasury turf; he was deeply suspicious of Frankfurter and resentful of his friendship with Roosevelt. But Oliphant's sympathetic ear gave Frankfurter – and, by extension, Brandeis – a back door into the department's policy process (Hawley 1995; Lambert 1970; Dawson 1980; Blum 1959; Murphy 1982).

TAXATION FOR REDISTRIBUTION

Social taxation was not popular among New Deal economists, at least those working in the Treasury. "The use of taxes for other than revenue purposes is not necessarily an evil," granted one Treasury expert in a 1934 memo. "But in all such cases great care should be taken to consider all possible effects, some of which may be undesirable and contrary to the ultimate goal originally contemplated."[1] Oliphant's tax plan, plainly designed to regulate the structure of American business and slow the concentration of wealth, was not the sort of proposal to win the support of Treasury economists.

Indeed, Treasury experts had developed their own agenda for progressive tax reform, and it differed substantially from the plans advanced by Oliphant and other champions of social taxation. Broadly speaking, the economists wanted to cut taxes on the poor whereas the lawyers wanted to raise taxes on the rich. The economists argued passionately for what might be called "low-end" progressivity:

[1] Shoup, Carl S. 1934. "The federal revenue system: Foreword and summary of recommendations." In Box 62; Tax Reform Programs and Studies; Records of the Office of Tax Analysis/Division of Tax Research; General Records of the Department of the Treasury, Record Group 56; National Archives, College Park, MD, edited by U.S. Department of the Treasury.

a reduction in regressive consumption taxes, paid for with new revenue from a much-broadened income tax. The economists opposed most excise levies and were visceral foes of a national sales tax. They believed a broader income tax, paid by the middle class as well as the rich, would allow the federal government to eliminate many taxes on the poor (Thorndike 2005).

However, Treasury economists were not the only administration experts working on tax reform in the mid-1930s; lawyers in the Bureau of Internal Revenue (BIR) were also hard at work, developing an agenda for "high-end" progressivity. Their goals were not inconsistent with those of the economists and their low-end progressivity. Both groups of tax experts wanted to shift more of the tax burden up the income scale. However, whereas the economists were focused on easing the burden for the poor, the BIR lawyers were more interested in soaking the rich.

The point man for high-end progressivity was BIR chief counsel Robert Jackson, who reported to Oliphant at the Treasury. In summer 1935, as Congress began debating the president's tax plan, Jackson supervised a series of studies on tax avoidance to bolster the case for progressive reform. These memos demonstrated that rich Americans were avoiding their fair share of the tax burden using a variety of avoidance techniques, almost all of them quite legal. The studies, moreover, were not abstract. Rather, they pried open the financial lives of America's super rich, using personal tax records available only to the BIR. In doing so, they removed progressive taxation from the abstract realm of the economists and thrust it into the sumptuous homes of the American upper class.

Perhaps the most striking memo was entitled, simply, "Income and Income Taxes." Prepared by Jackson's deputy, Samuel Klaus, it set out to evaluate the efficacy of the progressive tax system, with a particular focus on techniques of tax avoidance. "In general terms," Klaus wrote, "the problem was to investigate into the ratio between what persons of large wealth have taken out of the social product and what they have contributed to the support of government in the way of income taxes."[2] His conclusions were not happy ones, at least for anyone eager to see the rich pay their fair share.

Wealthy taxpayers – or nonpayers, as was often the case – made frequent use of one particular avoidance vehicle: tax-exempt securities issued by state and local governments. For decades, Treasury officials had been calling for the elimination of this exemption, but lawmakers had been unwilling to attack this sacred cow of the financial system. Many questioned whether the U.S. Constitution even permitted the federal government to tax state securities. More to the point, tax-exempt bonds were a cherished prerogative of state and local politicians across the nation. Few members of Congress were inclined to pursue the issue.

However, the Treasury kept trying, and the BIR memo was another in a long series of official studies to criticize the exemption. It was, however, more pointed than many earlier efforts. Jackson examined the tax returns of people earning more than $1 million in annual gross income. This was a small group, numbering

[2] Samuel Klaus, "Income and Income Taxes," 25 July 1935, Papers of Robert H. Jackson, Box 76, General Counsel, Bureau of Internal Revenue, Tax Studies – Income and Income Taxes, Library of Congress, Washington, DC.

just fifty-eight people in 1935. In several cases, Klaus pointed out, people in this group had very low taxable income, at least when compared to their huge tax-exempt income. Wall Street giant and outspoken New Deal critic E. F. Hutton, for instance, had reported $20,047 in net income for 1932, whereas his gross income, including returns from exempt securities, was more than $2.7 million. Vincent Astor had paid tax on just $101,150, a far cry from the $3.1 million he made overall. Former Treasury Secretary Andrew Mellon – who spent much of the 1920s decrying the exemption for state and local bonds – earned $3.5 million during his last year in office but paid taxes on just $1.2 million. Perhaps most striking, John D. Rockefeller, Jr. reported a taxable income of $5.2 million – no small sum except when compared with his total income of more than $22 million. Rockefeller alone had deprived the Treasury of more than $2 million in tax revenue by investing in tax-free bonds. Altogether, the taxpayers on Jackson's list paid $24.4 million in federal income tax during 1932, but they saved another $11.8 million by investing in state and local bonds. This lost revenue wasn't small change, totaling almost 3 percent of total individual income tax collections for fiscal year 1934. Viewed another way, the loss was equal to more than two-thirds of the revenue raised through the excise tax on entertainment admissions – a quintessentially regressive tax on the nation's lower and middle classes (U.S. Department of Commerce and Bureau of the Census 1975).

The BIR study concluded that exempt securities were costing the government too much money. Even more important, they were giving rich people a convenient means by which to avoid the steep surtax rates on individual income. Klaus offered a few additional thoughts, including some only incidental to the exemption issue. The figures in his study indicated that wealth was highly concentrated. The fifty-eight individuals represented only thirty families. One family alone – the Du Ponts – had five people on the list. Furthermore, most of the thirty families drew their wealth from single enterprises, including several new ones. "At least two of them are national retail merchandising enterprises," the study reported, "a more recent phenomenon in the United States." This was new money, "accounting for the lack of social position on the part of these families." Clearly, this was more than just a statistical sampling of the nation's rich families, with an eye toward closing the exempt securities loophole. The BIR staff was straying far afield to offer thoughts on the evolving social order. It would not be the last time.

Another section of the July 1935 memo explored the Du Pont family in special detail, seeking to illuminate how wealthy families used trusts and other legal devices to minimize their taxes. Rather than attempt a laborious survey of numerous taxpayers, the BIR staff focused on a single family, including not just blood relatives but also friends and colleagues. Investigation revealed that the Du Ponts had spread their considerable income over a large number of family members. When the income was split this way, it could sometimes elude the steep rates near the top of the income tax.

Trusts were extremely efficient, allowing grantors to retain use of their money, even as they divided it among various beneficiaries for tax purposes. There was nothing illegal about this arrangement, at least on its surface. Yet Jackson and his staff clearly disapproved, rejecting the notion that the hundreds of Du Pont

returns actually represented discrete taxpaying entities. In particular, they noted with disapproval that substantial income was being reported by minor children.

Despairing at the prospect of trying to trace the entire Du Pont fortune, BIR staff decided to focus more specifically on "those who might be said to control the Du Pont enterprise": a short list of just seven individuals including five family members, one son-in-law, and John Raskob, a close family friend and business associate (as well as a prominent Roosevelt critic). This list, the report acknowledged, had been derived from *Fortune* magazine, which published a detailed three-part study of the Du Pont family in late 1934 and early 1935. As a group, they had engaged in some fairly shady tax practices, "in some cases making them open to fraud charges." Between 1928 and 1932, they had managed to avoid about 20 percent of their theoretical tax liability by relying on trusts, tax-exempt bonds, and losses claimed for "hobbies" such as farming or horse breeding. Pierre S. Du Pont was the most aggressive avoider. Using five trusts, he had managed to save $1.3 million in taxes between 1928 and 1932. Irénée Du Pont, father of nine children, had also made good use of his progeny by dividing his income into small portions for the maintenance of his family. He had saved almost $1 million between 1928 and 1932. Lammot Du Pont, who also had nine children, had established trusts for all but the last, who was just one year old.

John J. Raskob was not a Du Pont, but having once served as Pierre S. Du Pont's secretary, he was a key player in the operations of the family enterprise. Raskob, strikingly, had not created any trusts. "His tax history, however, is none the less checkered," the report noted. In particular, Raskob was under investigation by the BIR for a series of wash sales: transactions in which depreciated securities were sold for the purpose of claiming a loss deduction, followed by an almost immediate re-purchase of identical stock. In Raskob's case, he was accused of colluding with Pierre S. Du Pont, as well as members of the Raskob family, to conduct wash sales that were difficult for tax authorities to identify.

All in all, the seven leaders of the Du Pont family had paid $13.5 million in taxes between 1928 and 1932; they had avoided paying, chiefly through the use of trusts, another $3.4 million. In actuality, these numbers were probably conservative; if the Bureau had possessed better information on the family's tax-exempt securities and wash sales, the figure would have been substantially higher. The trust device had created a gross inequality in the tax system, the report concluded. Rich taxpayers could escape steep surtaxes by putting their money into trusts and using the proceeds to support individual family members. Once segregated into smaller, bite-sized fortunes, the original mass of money was shielded from steep rates. Meanwhile, the wealthy donor typically maintained control of the donated assets, including voting rights for stock and the right to reclaim assets in the case of a beneficiary's death. "The wealthy man not only obtains exemption but suffers practically none of the disadvantages that might be expected to inhere in a segregation of assets," the report concluded. Meanwhile, "the ordinary and less wealthy person is disallowed the ordinary expenses involved in caring for his wife and his children."

Klaus's memo concluded with a remarkable section entitled "Wealth by Reputation." Seeking to determine how much rich people were actually paying, Samuel

Klaus surveyed the finances of roughly fifty taxpayers for the years 1928 to 1934. The list was compiled in strikingly haphazard fashion. Initially, it included the officers and directors of major American companies, to which were added numerous taxpayers from well-known wealthy families. The list also included some random figures, added at the behest of Jackson and his associates in the Treasury. Charlie Chaplin, Douglas Fairbanks, and Mary Pickford stood in for the Hollywood crowd. Paul Cravath, John W. Davis, and Frank Hogan represented the legal community. Under the heading of "inherited or invested wealth," the list included more than twenty names, including the Astors, the Wanamakers, the Whitneys, the Goulds, the Fricks, and the Fords. Finally, a few people were added for no apparent reason other than their prominence, including car manufacturer Horace Dodge, brewer Adolphus Busch, and circus maestro John Ringling.

The "Wealth by Reputation" study revealed a steep decline in annual income among the super rich during the early years of the Great Depression. Income among the very rich always varies widely from year to year, depending on capital gains, stock dividends, and similar irregular events. Yet the famous wealthy of Jackson's study clearly suffered during the Depression, at least compared to the heady days of the late 1920s. John D. Rockefeller went from an income of $37.8 million in 1928 to $2.5 million in 1933. Doris Duke's income fell from $8 million to $215,000. Walter Chrysler saw his income plummet from $5.7 million to just $600,000. Of course, there was no genuine hardship in the group, but the Depression had clearly taken a toll on the incomes of the rich and famous.

While Klaus was completing his study, Jackson was preparing his own memo on the "Effectiveness of Income Tax Law in Higher and Lower Brackets." The tax law was not effective in the upper reaches of the income spectrum, Jackson concluded, at least not compared to its functioning in the lower brackets. Rates set forth in the statute were consistently undermined by sophisticated tax avoidance, and the government had compounded the problem by enforcing the law poorly. Predictably, Jackson fingered tax-exempt securities as the primary source of inequity. Such securities were owned principally by wealthy taxpayers, since the tax advantages outweighed their relatively meager rates of pre-tax return. For people in lower brackets, the advantages were smaller, and hence not worth the sacrifice of a low interest rate. Exempt securities were threatening the vitality of progressive taxation, Jackson said. "By reason of this tax exemption shelter, the high bracket rates which have the appearance of being extremely severe are, in fact, moderated, and to a large extent, ineffective while the taxes in the small brackets are fully effective."[3]

Jackson also attacked the "hobby deductions" so prevalent among the rich. Titans of industry often reported their occupation as "farmer," allowing them to deduct maintenance costs for their large estates. Others reported their occupation as "racing," permitting them to take business deductions for their sporting interests. Smaller taxpayers could not generally avail themselves of such devices, if only because their hobbies could never remotely rise to the level of an occupation. The

[3] Jackson, Robert H. 1935. "Effectiveness of income tax law in higher and lower brackets." In Papers of Robert H. Jackson, Box 75, General Counsel, Bureau of Internal Revenue, Revenue Act of 1935; Washington, DC: Library of Congress.

revenue lost to this sort of evasion was substantial but not enormous. More important was the rank injustice. “It is an unsportsmanlike advantage which certain large taxpayers have taken,” Jackson wrote.

Preventing tax avoidance among the rich – or even detecting it – was notoriously difficult. “The evasion devices of the little fellow are often crude,” Jackson wrote, “based on curbstone or inexperienced advice, and accomplished only with the aid of his family or immediate employees.” Tax avoidance among the rich was a grand enterprise, planned for years “by a clinic of able counselors with many corporations, banks, and individuals in full cooperation.” The Bureau could readily track most penny-ante avoidance, but the avoidance transactions common among wealthy taxpayers were hard to unravel.

As a group, the BIR memos offered a damning portrayal of the tax system. The existing rate structure – quite progressive on its face – was being undermined by sophisticated tax avoidance among the rich. The outrage prompted by such revelations – among Treasury lawyers and later in the Oval Office – help explain the genesis of Roosevelt’s “soak the rich” tax proposals. Although drafted after Roosevelt had introduced his tax plan, the reports were prepared by the same experts who helped draft the tax message.

As he began his famous turn to the left in 1935, Roosevelt grew more interested in the tax shenanigans of his political enemies. Indeed, the president increasingly viewed tax policy in moralistic terms, denouncing tax avoidance as the moral equivalent of tax evasion. It was not a position shared completely by his legal advisors. Even Jackson took a consistently more measured approach. FDR, he later recalled, always understood that taxes were important, affecting the lives of every American, rich or poor. “But he viewed the taxation problem perhaps too exclusively as a social problem,” Jackson observed, “and not sufficiently as one in economics ” (Jackson and Barrett 2003).

POLITICAL IMPERATIVES

Roosevelt’s 1935 tax initiative is often explained as a response to Huey Long and his famous “Thunder on the Left.” In 1934 and 1935, Long was riding a wave of surging popularity, organizing a loose network of “Share Our Wealth” clubs around his proposals for radical social reform. Specifically, Long proposed a capital levy that would have limited personal fortunes to roughly $5 million; he later revised that number downward several times, eventually reaching $1.5 million. The resulting windfall in tax revenues would be used to provide a guaranteed minimum income of $2,000 to $3,000 for every American family, as well as old-age pensions and free higher education. Supposedly drawing his inspiration from the Freedman’s Bureau and its “40 acres and mule,” Long held out the prospect of a radical tax agenda hitched to the fortunes of average Americans (Lambert 1970; Williams 1989; Leff 1984; Amenta, Dunleavy, and Bernstein 1994).

Long had considerable popular support; in 1935, his organization claimed to have 27,000 local clubs and more than 4.5 million members. These numbers were certainly inflated, and the organization was extremely decentralized, amounting to little more than a mailing list. Its tax program, moreover, was little more than

a farce. As historian Mark Leff has pointed out, even the total confiscation of every estate worth more than $40,000 would not have yielded the $165 billion that Long promised to raise with his tax on millionaires. Yet Long's popularity was undeniable, and the persistent Depression only served to heighten it. Democratic chieftains, including Roosevelt, grew increasingly concerned that Long would mount a third-party candidacy in the 1936 presidential election (Johnson 1935; Lambert 1970; Leff 1984; Amenta, Dunleavy, and Bernstein 1994).

Meanwhile, restive liberals in Congress stepped up their pressure on Roosevelt, especially around tax policy. A group of House progressives, dubbed the Mavericks, pressed for a host of liberal priorities, including steeper income and estate taxes. In the Senate, Burton Wheeler offered his Brandeis-inspired plan for a graduated corporate income tax, and George Norris endorsed sharp increases in the taxation of large estates. Robert La Follette, perhaps the most outspoken congressional advocate of serious income redistribution through the tax code, chastised the White House for ducking the issue. "The administration of President Roosevelt has thus far failed to meet the issue of taxation," he declared. "Progressives in Congress will make the best fight of which they are capable to meet the emergency by drastic increases in taxes levied upon wealth and income" (Norris 1935; Leff 1984).

Editorial opinion in liberal journals was equally harsh, with writers chastising Roosevelt for dropping the ball on tax reform. *The Nation* bemoaned the low profile assigned to revenue issues. "No serious attempt has been made to devise a system which finances the governments – Federal, State, and Local – for definite social purposes," the editors complained. "Since a concrete policy of social taxation is by all odds the most important element of both reform and recovery, essential to the very survival of our economic system, we urge the administration to lose no time in squaring off to this fundamental task" (Nation 1935a). The *New Republic* struck a similar note, arguing that tax reform had enormous potential. "Ultimately no single feature of the administration's economic policy will be more important than its taxation program," the editors wrote. "If consciously used as an instrument of policy, the taxing power is capable of a far more beneficial effect on the general life than it has ever before had" (Groves 1934). In particular, the editors considered a tax on profits the best way to move investment decisions "from individual to social hands" (New Republic 1933).

Pressure from a disappointed Left, coupled with a potential third-party challenge from Huey Long or some other populist tribune, almost certainly prompted Roosevelt's new interest in tax policy during the first half of 1935 (Amenta, Dunleavy, and Bernstein 1994). Just as important, however, was his growing alienation from the business community. Tax policy was proving to be a particular sore point for many business leaders, who were alarmed by the "Share Our Wealth" arguments about wealth redistribution, not to mention calls for heavy taxation of corporate profits. Indeed, whereas liberals thought Roosevelt too timid on tax issues, conservatives suspected him of being far too bold, in his heart if not yet in his policies. The early part of 1935 brought an uptick in conservative criticism of Roosevelt's tax policy, despite the administration's failure to introduce any serious tax proposal during its first two years. Conservatives seemed to detect progressive

stirrings in the White House attitude toward taxes, and they were quick to denounce them.

In a well-publicized speech, Nicholas Murray Butler, president of Columbia University, insisted that inequality of income and wealth were not serious problems (New York Times 1934b). In fact, he contended, both were widely distributed within the United States. John C. Cresswill, a columnist for *The Magazine of Wall Street*, reported in early 1934 that wealth redistribution was an unspoken tenet of the Roosevelt agenda (Cresswill 1934). William Stayton, an organizer of the Liberty League, warned that FDR had every intention of redistributing wealth. And Bertrand Snell, Republican leader in the House of Representatives, insisted that the New Deal was designed to redistribute money from the thrifty to "those who have been and still are shiftless." Walter S. Landis, vice president of the American Cyanamid Company, complained that federal income taxes had lost their roots in "ability to pay" and shifted decisively into "soak the rich" territory. "Ignorance and misuse of the power to tax slowly are wrecking our economic structure, and the people who are hurt are the very ones the income and estate taxes were supposed to help – those who work for a living" (Lambert 1970).

Roosevelt was infuriated by such hostility. According to Hugh Johnson, the president was determined to make business leaders return to him "on their hands and knees" (Johnson 1935). Raymond Moley later attributed the 1935 tax proposal to the twin influence of business hostility and Long's threat from the Left. "It was at this point," Moley recalled, "that the two impulses – the impulse to strike back at his critics and the impulse to 'steal Long's thunder' – flowed together and crystallized" (Moley 1966, 1972; Leff 1984).

THE MESSAGE

The message that Roosevelt delivered to Congress on June 19, 1935, made a passionate case for steeply progressive taxation. "Our revenue laws have operated in many ways to the unfair advantage of the few," he told Congress. "They have done little to prevent an unjust concentration of wealth and economic power." The president offered his controversial collection of reform proposals, including heavier income taxes on the super rich, a new inheritance levy, and a graduated tax on corporate earnings. Americans, he warned, would demand such changes. "Social unrest and a deepening sense of unfairness are dangers to our national life which we must minimize by rigorous methods," he declared (all quotes from Roosevelt 1938).

The president did not seek a reduction in consumer taxes, a lightening of the burden on those least able to pay; revenue needs made such a cut impossible. Instead, he urged lawmakers to serve the cause of fairness by boosting the burden on those best able to pay. Heavier taxes on the rich were entirely justified, he argued, since the privileged few owed great debts to the less-privileged masses. "Wealth in the modern world does not come merely from individual effort," he contended, "it results from a combination of individual effort and of the manifold uses to which the community puts that effort." Individuals had no absolute right to the fruits of their labor, because it was not solely their labor in the first place.

As a start, Roosevelt urged lawmakers to enact a new inheritance tax. "The transmission from generation to generation of vast fortunes by will, inheritance, or gift is not consistent with the ideals and sentiments of the American people," he said. He also asked for heavier income taxes. Although declining to offer specific rates, he asked lawmakers to focus on the very top of the income scale. The top bracket began at $1 million, the president pointed out, but above that point, rates were essentially flat. "In other words," he explained, "while the rate for a man with a $6,000 income is double the rate for one with a $4,000 income, a man having a $5,000,000 annual income pays at the same rate as one whose income is $1,000,000." Additional graduation at the very top of the income scale seemed only reasonable.

Finally, Roosevelt offered his plan for a graduated corporate income tax. He was careful, however, not to frame his argument as a Brandeis-style attack on bigness. "The community has profited in those cases in which large-scale production has resulted in substantial economies and lower prices," he acknowledged. Yet size brought responsibility, including the duty to shoulder a larger share of the tax burden. Roosevelt invoked two distinct standards of tax justice: benefits received and ability to pay. To begin with, he said, large companies benefited from government services more than their smaller counterparts. They should pay more to support those services. In addition, however, large corporations were also better able to shoulder large tax payments than were their smaller competitors. "The smaller corporations should not carry burdens beyond their powers; the vast concentrations of capital should be ready to carry burdens commensurate with their powers and their advantages," he said. The president suggested replacing the existing flat rate of 13.75 percent with a graduated schedule ranging from 10.75 percent to 16.75 percent. He declined to specify how the brackets should be drawn.

Senate leaders reacted to Roosevelt's message with muted enthusiasm. "Those, like [Senate Finance Committee Chair] Pat Harrison, who felt that party loyalty compelled them to support it, bled inwardly," Raymond Moley later recalled (Moley 1972; Patterson 1967). However, Democratic leaders in the House were more supportive. Ways and Means Chair Robert Doughton, D-N.C., viewed the plan with some suspicion; like Harrison, he preferred to use taxes for revenue, not reform. However, Doughton was highly attuned to fairness issues, having long been an ardent foe of federal sales taxation. And he was a genuine fiscal conservative, with a strong predilection for balanced budgets. As such, he was willing to embrace the president's plan. (Lambert 1970: 210–11)

Outside the leadership, reactions were predictable. Liberal Democrats and progressive Republicans were enthusiastic. Senator George Norris, R-Neb., declared that "the tax program suits me 100 percent both on the inheritance tax and the corporation tax." And Senator Matthew Neely, D-W.V., hailed the message as a blow for social equity. "It is the beginning of the end of plutocracy," he said, "and a lifesaver for democracy" (Washington Post 1935a:1). Perhaps most important, Huey Long greeted the message with a loud "Amen," swaggering around the chamber, grinning, and pointing to his chest. At one point, observed a *New York Times* reporter, "Mr. Long stopped abruptly, grimaced, raised his eyes and almost waltzed" (New York Times 1935a; Leff 1984).

Meanwhile, Republicans were predictably livid, complaining the president had outlined a plan for confiscatory taxation that would imperil recovery and do little to balance the budget. Senator Arthur Vandenberg, D-Mich., offered a stinging indictment, insisting that Roosevelt's ideas didn't even amount to "a good soap-box formula." Rather, the message was a misguided effort to pander to the political Left. In truth, Vandenberg said, it would not satisfy the more radical voices, but it would go a long way toward prolonging the Depression. In the House, the few GOP voices that could be heard above the Democratic din were similarly outraged (Washington Post 1935b). Minority Leader Bertrand Snell, R-NY, dismissed the message as just so much electioneering. "I think it was a fine stump speech," he said. "It looks like the president is trying to get the jump on Huey Long and the other share-the-wealth people" (Washington Post 1935a).

Press reaction to the tax message was mixed, but critics carried the day. The *New York Herald Tribune*, always reliably conservative, complained that it was "composed of equal parts of politics and spite." The *Boston Herald* predicted it would "aggravate fear and uncertainty in the very quarters where the administration needs support in its reemployment efforts," meaning the wary business community. And the *Philadelphia Inquirer* contended that "the President without warning bears down upon the slowly reviving forces of returning prosperity with a tax program to lure hosannas from the something-for-nothing followers of Huey Long, 'Doc' Townsend, Upton Sinclair, and the whole tribe of false prophets" (newspaper quotes reported in New York Times 1935b). Critical reporters had little patience with the attack on business consolidation, as manifest in the new graduated corporate tax and the intercorporate dividend levy. "It looks to some like an effort to drive business back to the horse and buggy stage by penalizing large units," wrote Raymond Clapper in the *Washington Post* (Clapper 1935). The *New York Times* pointed out that revenue from Roosevelt's higher tax rates on millionaires would pay the government's bills for barely six hours (Paul 1954; Patterson 1967).

BUSINESS REACTION

The Ways and Means Committee soon organized hearings on the president's plan, and spokesmen for the business community flocked to the witness table (Committee on Ways and Means 1935). One witness after another complained that the tax bill was unwise, threatening to derail the economy even as it was just beginning to recover. Fred Clausen, chairman of the federal finance committee for the Chamber of Commerce, counseled lawmakers to lower taxes, not raise them. "The need is not new and higher taxes but more national income to tax," he said. If Congress needed more money, it should encourage business activity through a combination of moderate taxes and reduced expenditures. James Donnelly of the Illinois Manufacturers' Association agreed: "One of the principal obstacles now to an increase in business activity is the tax burden of unprecedented severity now being carried by all taxpayers, individual and corporate."

Confidence was a buzzword for business leaders, who insisted that industry needed more while the tax bill would create less. "[A] restoration of confidence

and increased volume of business will produce far more revenue than inequitable changes in the tax system which make for business unsettlement," predicted Julian D. Conover, secretary of the American Mining Congress. The pending tax legislation, agreed George McCaffrey of the Merchants' Association of New York, was terribly misguided. "In short this plan will impair business confidence when every attempt should be made to increase it."

Numerous witnesses attacked the premise of a graduated corporate tax, rejecting its implication that big corporations were somehow undesirable. Robert L. Lund, National Association of Manufacturers (NAM) chairman of the board, warned against any effort to limit the size of corporations. "[I]t would tend to return us, industrially, past the horse-and-buggy stage to the monkey stage of economic evolution," he declared. "Progress in business will cease. Advancement will be impossible. Business will be at a standstill."

Several witnesses, most of them from umbrella organizations, ventured to attack proposed increases in the personal income tax. E. C. Alvord of the Chamber warned that higher surtaxes would simply drive rich taxpayers to invest in state and local bonds, the interest from which was exempt from federal taxes. More generally, higher rates would curb the funds available for productive investment. "If through heavy taxes you take away the opportunity for profit from the persons who are able to finance enterprise, then you take away from these persons their incentive to invest." (Committee Chair Robert L. Doughton was unimpressed. "If you take away from the universe the law of gravitation," he retorted, "then you are bound to have chaos. But who proposes to do that?")

A few business witnesses also spoke to the new inheritance tax. John Day Jackson, publisher of the *New Haven Register*, predicted that it would force heirs of some family businesses to sell their companies. Roy Osgood of the First National Bank of Chicago suggested that large fortunes should be encouraged, not confiscated. Personal wealth was the happy result of productive enterprise, he said. Higher taxes might induce rich people to give away too much of their fortunes before death, thereby curtailing healthy business activity. "I make bold to say," he told the committee, "that the best justification of a capitalistic system is the fact that, by and large, wealth tends to come into the possession of people who are the best custodian of it."

Business leaders also denounced the tax plan as unfair. The graduated corporate tax would discriminate among companies within an industry, they said, and among stockholders in different companies. Meanwhile, the higher rates on income and inheritances smacked of blatant class legislation.

Clausen of the Chamber offered a compelling critique of the ability-to-pay argument as it applied to the corporate tax. Since the tax took no account of invested capital, it could not serve the standard of ability-to-pay. A company with $800 million in invested capital, he pointed out, might return 1 percent for an annual income of $8 million. Another company, with a capital investment of $600,000, might return 20 percent or $120,000. Clearly, the latter company had greater ability to pay because its owners were making a killing. "Almost any form of a graduated corporate income tax ignores capital investment and therefore ignores every accepted principle of income taxation," Clausen said.

A. M. Loomis of the American Association of Creamery Butter Manufacturers complained that the corporate reforms would create competitive inequalities within his industry. With some companies organized as corporations while others were operating as sole proprietorships, it was manifestly unfair to impose inconsistent burdens. "[H]ere is a tax that rests upon one-third of the industry, which finds itself in intimate competition with the other two-thirds." Such a levy, he said, amounted to "rank discrimination."

Other witnesses insisted that the graduated rates would discriminate among investors, they would create disparities among those with the same taxpaying ability but stock in different companies, as well as those with different abilities but stock in the same company. NAM spokesperson Robert Lund offered a distinct but similarly compelling critique of the graduated corporate tax. Companies, he pointed out, don't pay taxes; people do. The ability-to-pay standard was only sensible when applied to individuals. When used to justify graduated rate structures on corporate income, it yielded perverse results. Many large corporations had stockholders with small incomes, whereas some small businesses were owned by wealthy entrepreneurs; a graduated tax on corporate income would penalize the former and deliver a windfall to the latter.

Such fairness arguments were common among business leaders, but they reserved their most passionate testimony for the broad question of social taxation. One after another, they paraded before House and Senate committees to insist that taxes should not be used as an instrument of social reform. "If through taxation or other governmental action there be confiscation – outright or near – of the economic rewards of enterprising and prudent citizens, injustice may result," declared Fred Clausen. "The ends of social justice cannot be furthered by aggravating or multiplying individual injustices."

Another business witness, George Marklan of the Philadelphia Board of Trade, denounced tax hikes of all kinds, but especially those targeting the rich. "We are attempting to tax people who work, who create wealth and distribute wealth – we are attempting to tax them to support the incompetents and the ne'er-do-wells, and the will-nots, and it is time we stopped it." A spokesperson for the Ohio Chambers of Commerce insisted that the bill "is not a redistribution of wealth, it is a redistribution of poverty." Enacting it would imperil the nation's economy and its traditional respect for property rights. Reaching new heights of hyperbolic oratory, he suggested that confiscatory taxation was better suited to the Soviet Union. "Perhaps some of the oily propagandists whispering around Washington think Russia is a better country to live in than the United States," he said. "If so, the seas are open to them."

CONGRESSIONAL ACTION

The first legislative draft of Roosevelt's message came from Pat Harrison, who cobbled together a rough version in the first few days after the president dropped his bombshell. His plan hewed closely to FDR's proposal, included an inheritance tax with a $300,000 exemption and rates ranging from 4 to 75 percent; the top bracket applied only to inheritances of more than $10 million. The draft also

featured new surtax rates on incomes totalling more than $1 million; marginal rates ranged from 60 to 80 percent in this rarefied territory, with the top bracket kicking in at $10 million in annual income. Finally, Harrison's language included a new graduated rate structure for the corporate income tax, with rates ranging from 10.75 percent on incomes less than $2,000 to 16.75 percent on incomes more than $20 million. Taken together, this package was initially predicted to raise about $340 million annually; later projections put this figure lower. In any case, the yield was much smaller than liberals had hoped to see. Senate progressives, for instance, had been seeking at least a billion dollars in annual revenue. (Catledge 1935; New York Times 1935c; Waltman 1935)

However, the president had made clear his intention to keep these taxes narrowly focused on the very rich. The *New York Times* reported that just forty-six people made more than $1 million in 1934, giving the new surtax rates a very narrow base. The inheritance tax, with its $300,000 exemption, wasn't much better. Although Harrison wanted to reduce the exemption to $100,000, Roosevelt insisted on the higher figure, despite complaints from his own Treasury experts. “Our boys say that that is what killed the revenue,” Morgenthau told his boss. Roosevelt was unconcerned. “We will have to step it up steeper on the bigger boys,” he responded. (New York Times 1935d; Blakey and Blakey 1940: 378–9; Morgenthau 1933–1939: 161).

In the House, many Democrats wanted the new income surtax rates to kick in well below $1 million. The Treasury was reportedly sympathetic. When the House finally passed the bill, it included higher rates beginning at just $50,000. The House bill also included new graduated rates for the corporate income tax, but the range of graduation was quite narrow: 13.25 percent on the first $15,000 of net income and 14.25 percent on the remainder. Finally, representatives approved a new inheritance tax, just as Roosevelt had requested, with rates reaching 75 percent.

In the Senate, Harrison tried hard to craft a bill that would please the White House, including steeper graduation in the corporate tax rates. But he lost a key battle when the Finance Committee rejected the inheritance tax, choosing instead to raise existing estate tax rates. Ultimately, the Finance bill raised surtax rates on incomes of more than $1 million; added an extra 1.25 percent to the top rate of the newly graduated corporate income tax, bringing it to 15.5 percent; increased rates for the federal estate tax, and imposed an intercorporate dividend tax along the lines Roosevelt had requested.

The final bill passed by both Houses represented a compromise for all parties, including the president. It raised individual income surtax rates on incomes of more than $50,000 – a far lower threshold than Roosevelt had suggested but still very high. Contemporary estimates put the mean family income for 1935 at $1,631 (National Resources Committee 1941). The top rate jumped from 59 percent on incomes of more than $1 million to 75 percent on incomes of more than $500,000. This was a far cry from what Roosevelt had suggested; the president had sought to introduce graduation at the very top of the income scale, but lawmakers had pushed it much lower. The change reflected congressional worries about revenue adequacy, not fairness. By lowering the threshold – making rates steeper for the

very rich, not just the super rich – lawmakers were able to substantially increase the revenue yield from the bill.

Lawmakers agreed to a graduated rate structure for the corporate income tax, beginning at 12.5 percent for incomes greater than $2,000 and reaching 15 percent for those in excess of $40,000; there were four brackets in total. The estate tax exemption was cut from $50,000 to $40,000, whereas the top rate increased from 50 to 70 percent. Finally, the bill included a new intercorporate dividend tax, although companies were allowed to deduct 90 percent of their income from dividends. The remaining net income was taxed at graduated rates ranging from 20 percent on everything less than $2,000 to 60 percent for everything more than $1 million.

CONCLUSION

What had Roosevelt achieved? Not much, according to his critics. The Revenue Act of 1935 was projected to raise about $250 million annually, representing an overall tax increase of about 14 percent. That was substantial but far below what budget balancers had hoped to achieve. The law also failed to seriously redistribute either wealth or income. Targeted narrowly at the nation's richest taxpayers, it couldn't make a serious dent in the concentration of wealth. The new top rate for the income tax, for instance, applied to precisely one taxpayer for the first three years after the bill passed: John D. Rockefeller, Jr. Such rifleshot legislation was a poor substitute for serious efforts to redress inequality. "We have been so preoccupied with dramatic levies upon fabulous incomes and estates," observed economist Henry Simons, "that we have almost forgotten to tax the large ones at all" (Leff 1984).

The tax debate also strained Roosevelt's relationship with lawmakers. Harrison and Doughton were irritated at FDR's effort to ram the tax bill through with little concern for their legislative prerogatives. They and many like-minded Democrats, including a large group of southerners, were also uncomfortable with social taxation aimed more at reform than revenue. Raymond Moley later suggested that the 1935 tax debate marked a turning point for the Democrats: the beginning of a deep split between the party's urban, progressive, reformist wing and its more traditional southern branch (Moley 1972).

But Roosevelt's tax law did seem to be a political winner. The president had lost several key points, including his proposal for an inheritance tax. And the new corporate income tax was graduated more narrowly than Roosevelt had originally proposed. Yet FDR's tax initiative was never really about the details of his proposal. It was, in fact, about the rhetoric surrounding it. Roosevelt wanted to make a statement about fairness and economic justice.

The 1935 tax message was certainly an exercise in political expedience, designed to steal a march on FDR's populist rivals like Huey Long. But it was also a genuine statement of FDR's tax philosophy. The president believed deeply in progressive tax reform, especially at the high end of the income scale. Robert Jackson had demonstrated rampant tax avoidance among the rich, and Roosevelt was eager to combat such social irresponsibility. Like Jackson, he believed that tax avoidance was undermining the federal income tax, diluting its redistributive effect

by undermining its graduated rates. New taxes on wealth and business were a defensive measure, if only a symbolic one, designed to protect the system against the depredations of wealthy tax avoiders.

The Revenue Act of 1935 did not effect much overall redistribution of income or wealth; its failure to cut taxes on the poor – or raise taxes on the comparatively well-to-do members of the middle class – left existing distributions largely intact. However, the law did sharply boost the burden on the nation's economic elite, raising effective income tax rates on the top 1 percent of households from 11.3 to 16.4 percent (Brownlee 2000). And once they were on the books, high rates stayed there. When World War II prompted lawmakers to establish a new tax regime, they retained FDR's emphasis on taxing the rich. Even more striking, they left rates high even after the war ended. Not until the 1960s and 1970s did Congress make a serious effort to reduce statutory rates for those in the top brackets, and even then they left them relatively high. Once started down the path of "soak the rich" taxation, lawmakers proved unwilling to get off.

3 What Americans Think of Taxes

ANDREA LOUISE CAMPBELL

Although taxation constitutes one of the main linkages between citizens and government, the study of public opinion and taxes has generally taken a backseat to accounts of the elite politics of tax policy. Given that ordinary citizens rarely pay much attention to public affairs, and often know little about complex policy issues such as taxation, this customary emphasis on elites is understandable. Moreover, the conventional wisdom that people simply hate taxes suggests that studying public opinion toward taxation would be a less than enlightening exercise.

However, by utilizing newly available data on public opinion toward taxes,[1] I find considerable variation in tax attitudes over the past six decades and argue that much of this variation can be explained by objective conditions, chiefly the cost of taxes. From the very beginning of mass taxation, ordinary Americans have been sensitive to the level of taxes they pay: When costs are higher, they have more negative feelings about taxes; when taxes are lower, they are relatively more sanguine. This is true both cross-sectionally – as shown in an analysis of early attitudes among different income groups toward regressive and progressive taxes – and across time, as demonstrated with longitudinal data.

Moreover, the public's responsiveness to the cost of taxes has grown over time, with the relationship between tax attitudes and the level of taxes becoming tighter after the 1970s than it was before. This chapter will demonstrate that heightened

[1] I use two newly available sources of data. One is early survey data from the 1930s and 1940s, the era in which the tax regime we know today was established. Happily, for my purposes, the dawn of mass taxation coincided with the advent of modern survey research. Less happily, these public opinion data were unusable until recently for technical reasons: Gallup and other survey organizations used quota sampling rather than random sampling before 1950. Political scientists Adam Berinsky (2006) and Eric Schickler have rehabilitated these early surveys by devising a way to reweight the quota-sampled data to approximate a national random sample. The other data source is a cleaned and concatenated data set that I created of all of the available Gallup (since 1947) and General Social Survey (since 1976) polls that asked respondents whether they "consider the amount of federal income tax [they] have to pay as too high, about right, or too low." This makes possible an examination of public opinion toward taxes over time. I am indebted to Marilyn Milliken and Lois Timms-Ferrara of the Roper Center for Public Opinion Research and to Kate McNeill-Harman of MIT's Dewey Library for their assistance with the Gallup data acquisition.

I am grateful to Jennifer Cyr, Benjamin Page, James Sparrow, the Northwestern Conference participants, the volume editors, and the anonymous reviewers for their comments on an earlier draft.

elite rhetoric about taxes has increased the salience of taxes to the public, so that taxes became a greater influence on Americans' feelings about the political parties and played a stronger role in their vote choices. The adoption in the early 1940s of the highly visible and far-reaching progressive income tax as the main source of federal government revenues, rather than a less visible national consumption tax (see Chapter 2), set the stage for a highly contested politics of taxation. However, elite quiescence on the subject of taxes for many decades kept tax politics on the back burner. Then, in the 1970s, elected officials began discussing taxes publicly at much greater rates, and the issue of taxes became more prominent in the public mind. When a coalition of business and religious conservatives began to attack taxes in the 1980s and thereafter (see Chapter 4), the public was primed to join the tax-cutting bandwagon. Thus, studying the interaction between public opinion and elite rhetoric about taxes helps explain why taxes play such a central role in American politics.

HOW AMERICANS THINK ABOUT TAXES

We begin by thinking about what forces might shape individuals' attitudes toward taxation. Public opinion researchers have explored many sources of political preferences, including early socialization, group dynamics, and the larger political culture (Glynn et al. 1999). One school of thought argues that self-interest, or individuals' material stakes in policy matters, explains their attitudes toward them; those with greater stakes in a given policy are hypothesized to have distinct preferences compared to those whose interests are less implicated.

However, researchers looking for the influence of self-interest on attitudes have often failed to find such differential preferences. Women and men do not differ in their opinions on women's issues (Shapiro and Mahajan 1986; Mansbridge 1985); the elderly are not more supportive of Social Security spending than the nonelderly (Day 1990); and the unemployed are not more favorable toward jobs programs than the employed (Lau and Sears 1981; Schlozman and Verba 1979), to give a few examples (see Citrin and Green 1991 and Green and Gerken 1989 for reviews). Ignorance or limitations in cognition can diminish the influence of self-interest (Simon 1983), as can the tendency of individuals to choose other-regarding, altruistic, or ethical positions in some cases (Sen 1977; Stoker 1992).

However, tax attitudes appear to be different. Scholars have found many instances in which attitudes correspond with individuals' material stakes. Smokers are more likely to oppose cigarette taxes than are nonsmokers (Green and Gerken 1989). The elderly and those without children are more likely to oppose school bond referenda (Tedin 1994; Tedin, Matland, and Weiher 2001, among many other studies). Affluent homeowners were more likely to support California's Proposition 13 limiting the property tax (Sears and Citrin 1985). Middle-age workers at the height of their lifetime earning power have more negative attitudes about the progressive federal income tax than do the retired elderly or the low-wage young (MacManus 1995; Mayer 1993). In addition, on a survey about a variety of tax policies, homeowners in areas with steeper recent house price increases were more supportive of the home mortgage interest deduction, those who owned stock

expressed more support for the capital gains tax preference, and those with college-age children were more supportive of college-tuition tax credits (Hawthorne and Jackson 1987). Thus, tax attitudes seem to vary with personal characteristics that define one's stake in tax policy. Moreover, the level of taxation – another measure of stake – has been found to affect opinion on state and local taxes (Attiyeh and Engle 1979; Bowler and Donovan 1995; Lowery and Sigelman 1981). Hence taxation appears to be one arena in which the stakes are tangible, salient, and large enough that individuals know what their self-interest is and often express attitudes consistent with those objective stakes (see Citrin and Green 1991).

Because many people have real experiences with and genuine opinions about taxes (Hawthorne and Jackson 1987), they constitute an issue area where the influence of self-interest is a plausible expectation. We might expect people to be particularly conscious of the costs of taxes, because many arrive in the form of a lump-sum bill, like property taxes, or are totaled each year, like income taxes (we would expect taxes that are never totaled, like payroll taxes and sales taxes, to be relatively more popular, which they are, as we'll see next).

At the same time, tax policy is complex, and many taxes have mechanisms that reduce their visibility, such as withholding for income and payroll taxes. Given the well-known tendencies of many people to suffer from low information and cognitive biases, we might expect tax policy to be an issue area where individuals are vulnerable to the effects of elite rhetoric. Despite the tangibility of taxes, elites can set agendas, prime and frame tax issues. Individuals may be subject to elite cues that influence how important taxes are to them and what they think. This chapter uses data on federal taxes (for the most part) to show how variations in attitudes toward taxes can be attributed to their level (costs), but also how increasing elite attention to taxes has increased the salience of taxes among the public.

PUBLIC OPINION AT THE DAWN OF MASS TAXATION

The influence of tax costs and the role of self-interest are evident even in public attitudes expressed at the very outset of the current tax regime. Within a remarkably short period of time – less than fifteen years – the American tax system was fundamentally transformed into the modern tax system we face today. Little-examined public opinion data reveal what ordinary Americans thought of this profound shift.

In the late 1920s, most federal revenues came from tariffs and excise taxes, whereas most state and local revenues derived from property taxes. This revenue system shifted rapidly over the following decade and a half, with Americans confronting a new set of taxes. Many states adopted state sales and income taxes during the 1930s, as they turned property taxes over to strained local governments. The payroll tax for Social Security began in 1937, with more than half of the workforce paying it (U.S. House Committee on Ways and Means 1998, 6–8). And during World War II, perhaps the greatest change in the American tax system was adopted, as the federal income tax was transformed from a class tax that only 4 million households paid in 1939 to a broad-based mass tax paid by 45 million households

Table 3.1. *Most disliked taxes, 1939*

	Sales	Excise	Real estate/property	Income (Fed + State)	Social Security	Other
Total	43%	17%	11%	10%	4%	15%
Wealthy	21	8	13	34	8	16
Average+	25	20	11	22	6	16
Average	40	17	12	10	5	16
Poor+	48	21	7	7	3	13
Poor	50	19	10	3	3	15
On relief/OAA	62	11	9	3	1	13
Professionals	40	15	8	14	5	18
Businessmen	33	15	9	18	9	16
White-collar clerks	37	23	9	12	7	13
Skilled workers	41	24	8	10	6	11
Semi-skilled, laborers	46	18	5	8	2	20
Farmers	42	15	19	7	2	15
Sales tax state	62	9	8	8	3	11
No sales tax	16	29	15	14	6	21

Source: Gallup Poll USAIPO1939–0157, May 1939.

by 1945. Federal individual income taxes as a percentage of Gross Domestic Product (GDP) soared, from 1 percent in 1939 to more than 8 percent by 1945.

A number of valuable accounts of this period examine the views and strategies of lawmakers and other actors concerning tax policy making, describing the public relations and other efforts utilized to enhance public acceptance of these new levies (see especially Leff 1991; Jones 1989; and J. Sparrow 2008; also Blakey and Blakey 1940; B. Sparrow 1996). However, what did the public think of these taxes that they were paying for the first time?[2]

One of the earliest polls asking respondents about different kinds of taxes is a Gallup item from 1939: “What one tax do you most dislike to pay?” This was an open-ended question to which about half of respondents had no answer. Of the half that did reply, the recently passed state sales taxes were the least popular, cited by 43 percent of respondents, followed by excise taxes at 17 percent and property taxes at 11 percent (Table 3.1). Only then does the income tax appear, at 10 percent.[3]

During this era, Gallup did not ask a family income item, but instead had interviewers code an estimate of respondents’ socioeconomic status (SES).[4] Dislike

[2] Schiltz (1970) offers an extensive review of early public opinion about Social Security taxation, but I do not know of any studies focusing on early opinion about other kinds of taxes that show results other than national marginals.

[3] Gallup did not differentiate between federal and state income taxes in compiling the open-ended answers, although given the patterns by subgroup, either many respondents meant the federal income tax, or their state income taxes elicited similar expected patterns by socioeconomic status and occupation.

[4] The SES categories used in the May 1939 Gallup Poll were “wealthy” (3 percent of all respondents), “average +” (11 percent), “average” (35 percent), “poor +” (16 percent), “poor” (18 percent),

of the sales tax falls with SES, whereas dislike of the income tax rises with SES, just as we would expect for a regressive and progressive tax, respectively. Whereas only 21 percent of wealthy respondents disliked the sales tax the most, half of the poor and poor+ respondents did, as did almost two-thirds of those on relief or old age assistance. In contrast, the income group most likely to dislike income taxes was the wealthy, at 34 percent, with dislike declining monotonically with SES. Indeed, the wealthy are the only SES group to dislike income taxes more than any other kind of tax, an attitude that reflects the heightened income taxation they faced in the aftermath of the 1935 "soak the rich" tax bill (see Chapter 2). Of course, the income tax was confined only to the most affluent at this time. Excise taxes show a curvilinear pattern, in which the wealthy and those on relief or old-age assistance are less likely to dislike them, whereas those in the middle SES groups – who can afford products like cigarettes, liquor, and gasoline but who aren't so wealthy as to be unaffected by the excises – dislike them more. Finally, Social Security taxes are disliked by few – only 4 percent of respondents who had an opinion (2 percent of overall respondents). These findings are very much in line with Schiltz (1970), who finds widespread embrace of the new Social Security system, with a tendency of higher income groups to be slightly more negative about the program (here 8 percent of the wealthy but only 3 percent of the poor dislike the Social Security tax the most).

Among all occupations, the sales tax is the most disliked tax. For most, excises are the second most disliked, with the exception of businesspeople, who dislike income taxes more, and farmers, who understandably dislike property taxes more. Not surprisingly, ire toward the sales tax is particularly high among the half of respondents who live in the twenty-three states that had adopted a sales tax by the time the survey was taken. Nearly two-thirds of those states' respondents disliked the sales tax the most, whereas excise taxes are the most disliked in the other states.[5]

Thus, as of 1939, public opinion about taxes reflected the reality that most respondents faced. Most did not pay an income tax, and so ire was understandably directed toward the taxes that they did confront: sales and excise taxes. The wealthy responded to the steep income taxes they faced with the dislike we would expect after their taxes were hiked by the 1935 Revenue Act. Hence from the beginning of the modern tax regime, attitudes reflected the costs individuals faced.

World War II established the federal individual income tax as a broad-based levy, not merely a tax on the rich. The income tax had proven to be an effective revenue source during World War I even though it was levied on only a small percentage of the population – about 15 percent of households by 1918 (Brownlee 1985; Gilbert 1970). With the advent of World War II – which cost twice as much as a percentage of GDP as the earlier conflict – politicians again turned to the income tax and imposed it on a large majority of Americans: by war's end, 90 percent of the labor force submitted tax returns, with 60 percent paying federal income taxes

and "on relief–Home," "on relief–WPA" or "on Old-Age Assistance" (categories I combined for 17 percent total).

[5] Unfortunately, the May 1939 Gallup Poll did not include other demographic and political variables that might be of interest such as education or party identification.

(Brownlee 2004, 115). Revenue acts in 1940 and 1941 expanded the individual tax base by lowering exemptions; corporate tax rates were raised as well and an excess profits tax was established. The Revenue Act of 1942 expanded the tax system even more and was responsible for much of the revenue that financed the remaining years of the war (Vatter 1985). The personal exemption for married couples, which had been $2,500 before 1940, was now only $1,200. Moreover, Congress included a so-called Victory Tax on all gross incomes more than $624 and increased the lowest marginal tax rate from 10 to 24 percent (note that this lowest marginal rate was only four points below the top marginal rate created by the 1986 Tax Reform Act). This bill was much more regressive than the plan Treasury Secretary Henry Morgenthau had presented, which pursued increased revenues from the top of the income scale by increasing surtaxes on individual and corporate incomes, raising estate and gift taxes, and imposing higher excise taxes on luxury goods (Blum 1976). Congress had initially responded to the administration's plan with a sales tax, which would have been even more regressive than the bill passed. Even so, the 1942 Revenue Act hit lower-income families hard, especially industrial workers, "most of whom would now pay an income tax for the first time" (Blum 1976, 230).

However, when asked in a February 1943 Gallup Poll whether they thought the federal income taxes they would have to pay that year were fair, a remarkable 78 percent of all respondents said yes, 15 percent said no, and 7 percent said they did not know.[6] Given the structure of the tax, we might expect certain groups to be less likely to believe their taxes were fair: those paying for the first time; lower-income people, hit harder than would have been the case under Morgenthau's more progressive proposal; the wealthy (because the starting point for the top marginal bracket – 88 percent – was lowered from $5 million to $200,000); professionals and business executives, who according to Blum (1976, 222) "chafed over increased taxes" and shortages imposed by War Production Board and Office of Price Administration policies; and finally Republicans and Southerners, whose partisans in Congress disliked both Roosevelt and government spending beyond the war effort (Blum 1976).

Analysis of the February 1943 Gallup Poll reveals that the poor and those in less skilled occupations were somewhat less likely to say the tax was fair, as predicted, as were the wealthy (Figure 3.1).[7] However, in contrast to what historian John Morton Blum reported, professionals and semi-professionals were the occupational groups most likely to say the tax was fair, although business executives were quite a bit less likely to say so. Perceptions of fairness rose with education, but hardly varied by party identification. Those who said they would have difficulty paying their taxes and would have to borrow money or sell war bonds or stamps to meet their tax obligation were less likely to say the tax was fair. And Southerners were actually more likely to say the tax was fair (an effect that remains in multivariate analysis, holding other factors including income and partisanship constant).

[6] Gallup Poll USAIPO1943–0290, February 25–March 1, 1943.

[7] The fairness question was asked only of those respondents who thought they would have to pay taxes in March 1943 based on their 1942 income. The SES categories used in this survey were "wealthy" "average plus," "average," "poor," "on relief," and "on old-age assistance."

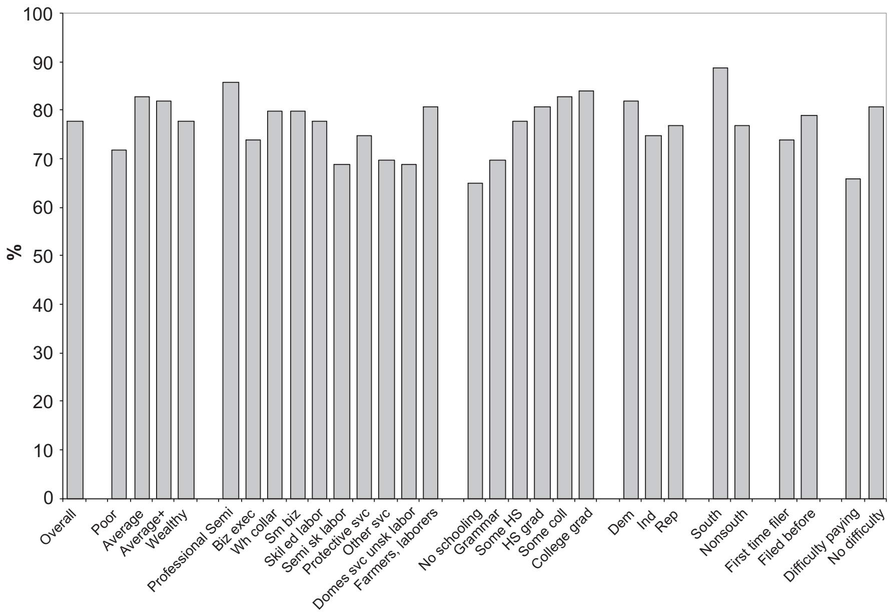


Figure 3.1. Federal taxes will have to pay this year are fair, February 1943. *Source:* Gallup Poll, February 25–March 1, 1943. *Note:* Figure shows percentage of respondents who believe the federal income tax they will have to pay is fair, asked of those who believe they will owe a tax on their 1942 income.

Most Americans thought the federal income tax was fair. Even among the hardest hit group – those who thought they would have difficulty paying – two-thirds thought the tax was fair. The high level of compliance suggested mass acceptance of income taxation, and Office of War Intelligence interviews of taxpayers were replete with mentions of patriotism and desire to help the war effort (J. Sparrow 2008). Nonetheless, when given the chance not to pay taxes in 1943, Americans leapt at it.

Until this point, most taxpayers had submitted a return and paid their income tax in a lump sum. This system worked well when only the affluent were taxed. However, once the broad masses were brought into the system, the expectation that people could pay in lump sums no longer held. Thus, the idea was floated to begin broad-based income tax withholding.[8] Payroll taxes for Social Security were already being withheld, so clearly the government had the administrative capacity. Beginning withholding presented a difficulty, however: In early 1943, individuals would have to pay their lump-sum tax obligation for 1942 and have their 1943 taxes withheld simultaneously. Beardsley Ruml, a member of the Federal Reserve

[8] The 1913 law creating the federal income tax enabled collection of taxes at the source, i.e., withholding. Corporations complained about high administrative costs, and withholding authority was withdrawn by Congress in 1917 upon the recommendation of Treasury Secretary William McAdoo and not reestablished until World War II. Instead, a policy of "information at the source" – requiring corporations to report salaries paid but not withhold the taxes themselves – was adopted in the Revenue Act of 1916 (Blakey 1917; Brownlee 1985).

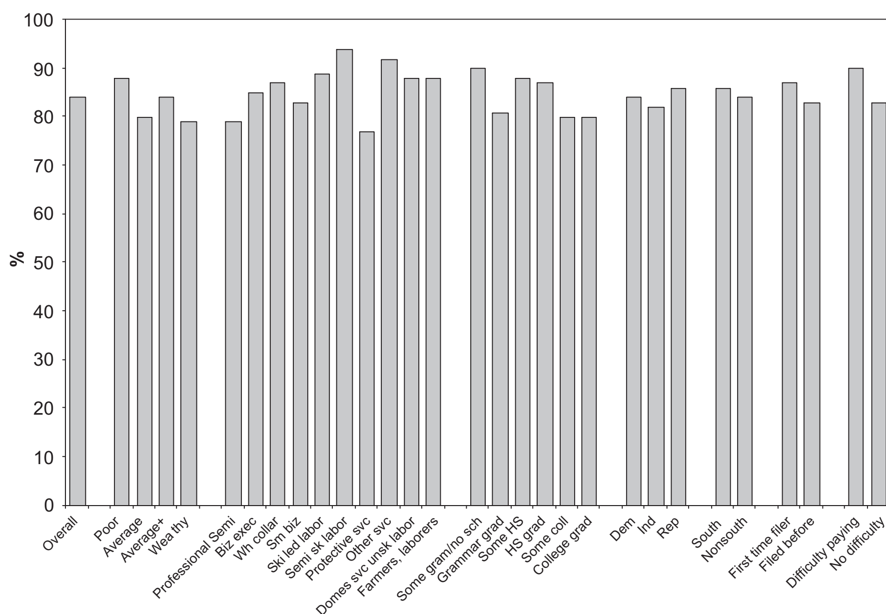


Figure 3.2. Approval of the Ruml plan by subgroup, February 1943. *Source:* Gallup Poll, February 25–March 1, 1943. *Note:* Figure shows percentage of respondents who approved of the Ruml plan, asked of those who had heard of it.

Board of New York and the treasurer of the R. H. Macy Corporation, hit upon a bold plan: forgive 1942 tax obligations and start over with 1943 withholding.

The increase in the tax base was so great that federal revenues did not fall, despite the forgiveness of 1942 taxes. Moreover, withholding brought much-needed revenues into the Treasury's hands sooner. Yet what did the public think? We might suppose that some would oppose the forgiveness of 1942 taxes: that the poor would resent forgiveness of the affluent's taxes, or that those who did not have to pay would resent the fact that those who were supposed to pay for 1942 suddenly would not have to. Roosevelt wrote Ways and Means Chairman Robert Doughton: "I cannot acquiesce in the elimination of a whole year's tax burden on the upper income groups during a war period when I must call for an increase in taxes . . . from the mass of our people" (Blum 1976, 242). Conversely, we might expect the more affluent to be delighted that a year's tax obligation might be wiped out. Indeed, the Treasury Department objected to the Ruml plan as an enormous windfall to taxpayers, especially business executives "whose earnings from war-related contracts had been extraordinary in 1942" (Blum 1976, 242).

What the data reveal is remarkable acceptance of the Ruml plan. As Figure 3.2 shows, 84 percent of Gallup respondents supported the plan in a February 1943 poll (the question was asked of all respondents who had heard of the Ruml plan), with large majorities of every subgroup approving. Variation by region, partisanship, and first-time filing status was particularly muted. There is more variation by SES, education, and especially occupation, but it is poorer persons and those in

less skilled occupations who were more supportive. Unsurprisingly, those who thought they would have trouble paying their 1942 taxes were more likely than others to support the plan (which would forgive their 1942 obligation). These patterns remain even when one limits the analysis only to those respondents who knew that the Ruml plan meant the forgiveness of 1942 tax obligations.[9] Moreover, approval was the same whether respondents actually owed taxes for 1942 or not; although I would have expected those who did not owe taxes for 1942 to approve at lower rates than those who did owe taxes (and would have them magically swept away), there is no difference – 79 percent of the former and 80 percent of the latter approved (among respondents who understood what the Ruml plan would do).

Thus, the dawn of mass taxation came with surprising calm. Although Americans readily embraced the chance to have their tax obligations forgiven via the Ruml plan, they were not greatly divided in opinion between taxpayers and non-taxpayers, and large majorities of taxpayers from every walk of life thought the federal income tax was fair. These public opinion data show that the calls for sacrifice in the face of war did not fall on deaf ears (Feldman and Slemrod, Chapter 8), and the inculcation of fiscal citizenship was enormously successful (J. Sparrow 2008). Although the United States covered slightly less of its total war costs through current taxation than did its allies, the increase in wartime tax levels over prewar levels was far greater (B. Sparrow 1996, 107).[10] The new tax regime marked a sea change, one enabled by the Depression and especially by war, and one that was accepted with remarkable equanimity.

THE MUTED TAX POLITICS OF THE 1950s AND 1960s

In many ways, the more interesting question is what happened with public regard toward taxes after the war. There was the need to tackle the large national debt, which Truman made a priority. On the other hand, taxes had been reduced after the other major tax-financed conflicts, the Civil War and World War I. We might expect the wealthy in particular to clamor for tax relief. After WWI, Republican administrations brought the top marginal rate down dramatically, from 77 to 25 percent. During WWII, the wealthy faced even steeper rates. By 1944, the top marginal rate had climbed back up to an all-time high of 94 percent on incomes of $200,000 and more.[11] The effective rate of taxation on the rich was the highest in history (Brownlee 2000).[12]

[9] The poll included both open-ended and closed-ended items measuring whether respondents knew what would happen with taxes under the Ruml plan; the pattern of responses remains the same when analysis is confined to the knowledgeable (by either measure).

[10] The proportion of war effort paid through current taxation was 46 percent for the United States, 57 percent for Canada, and 52 percent for Great Britain. The ratio of peak wartime taxation to prewar taxation was 8.8 for the United States compared to 6.0 for Canada and 3.4 for Great Britain (B. Sparrow 1996, 107).

[11] Online at: www.taxpolicycenter.org/TaxFacts/TFDB/TFTemplate.cfm?Docid=213.

[12] The effective income tax rate paid by the richest 1 percent of households was nearly 60 percent in 1944; by 1986, it was only 22 percent (Brownlee 2000, 60–1).

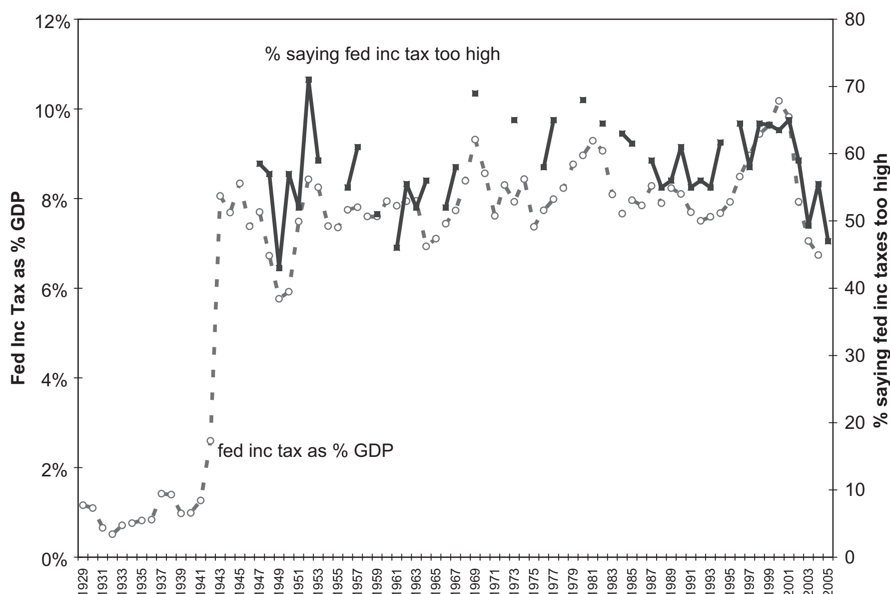


Figure 3.3. Federal income tax "too high" and federal income taxes as % GDP. *Sources:* Federal income tax too high from Gallup and General Social Survey; Federal income tax as % GDP from National Income and Product Accounts (NIPA) tables at the Tax Policy Center website.

Certainly there was some sentiment for tax reduction among the public. The percentage of Gallup respondents saying the income tax is fair fell by nearly twenty points, from 78 percent in 1943 to 59 percent in 1946.[13] The decrease was a bit higher among the wealthy – 24 percent – compared to 19 percent for average SES respondents. In a 1947 poll asking about big troubles since the war, high prices were most commonly cited, by 74 percent of respondents; whereas high taxes were number two at 31 percent. However, when asked whether taxes should be lowered or the federal budget balanced, or more aid given to Europe, opinion was either tied or tilted away from the tax-cutting position. And when asked in 1947 whether there was anything Congress should have done in the last term, 60 percent of respondents said "no" or that they had no answer; just 13 percent said Congress should have lowered taxes.

Thus, the public was fairly ambivalent about taxes. Clearly there was sentiment favoring tax reduction, but not an unequivocal majority. Some taxes were lowered: Congress repealed the excess profits tax as of January 1, 1946, reduced the corporate income tax, and passed some tax breaks for married couples and those with dependents (B. Sparrow 1996, 125). Federal individual income-tax receipts as a percentage of GDP fell quite rapidly, from 8.3 percent in 1945 to 5.8 percent in 1949, and the percentage of Americans saying their income taxes were too high fell as well, from 59 percent in 1947 to 43 percent in 1949 (Figure 3.3).

[13] Gallup Poll USAIPO1946–0366, February 28–March 5, 1946.

Then the Korean War intervened, and what is fascinating is the instant negative reaction among the public to the increased taxes, particularly in contrast to the widespread embrace of federal taxation for the financing of World War II. The top marginal rate, which had been lowered to 82.13 percent on incomes of $400,000 and more by 1948, rose again, to 84.36 percent in 1950, 91 percent in 1951, and 92 percent in 1952 and 1953.[14] However, more relevant for broad public opinion is that the tax rate on every bracket was raised: for example, the rate for the lowest bracket, incomes of $4,000 and less, increased from 17.4 percent in 1950, to 20.4 percent in 1951, to 22.2 percent in 1952 and 1953, with rates on higher brackets climbing even more sharply.[15] Federal income receipts climbed back up to 8.4 percent of GDP by 1952, and the percentage of Americans saying their income taxes were too high zoomed to 71 percent – up almost thirty points in just three years – the highest level of dissatisfaction ever recorded in the Gallup survey (indeed, a level of dissatisfaction not even reached at the peak of federal income taxation in 2000).

During the 1952 election, Truman ran on the slogan "You Never Had It So Good," telling voters that a Republican administration would make the same mistakes Hoover's had. However, Eisenhower ran on the theme "It's Time for a Change," criticizing the Truman administration on high taxes, high inflation, and communism (Sloan 1991, 57–8). The campaign's emphasis on taxes is quite clear in Figure 3.5, in which the number of mentions of taxes as an issue was very high in 1952, particularly on the Republican side, and especially in contrast to the quiescence of the tax issue for the following two decades.

However, once he achieved the presidency, Eisenhower did not lower federal income taxes significantly. His overriding concern was achieving balanced budgets and if possible reducing the national debt, checking inflation in the bargain (Stein 1996, Chaper 11). This led him to reject several tax-cutting opportunities, much to the consternation of congressional Republicans and even his own Treasury Secretary (Saulnier 1991; Sloan 1991). Upon assuming office in early 1953, Eisenhower asked Congress to put off several already scheduled tax decreases in light of a larger than expected budget deficit. He did the same in 1956 for decreases scheduled for the following year. Similarly, he ignored calls to cut taxes during the recession of 1957–8. In each of these instances, he made reference to fiscal responsibility – that although he thought taxes were too high and would have preferred to lower them, the time wasn't right, citing the burden greater deficits would place on future generations, the threat of deficit-driven inflation to the economy and to retirees on fixed incomes, or the need to maintain defense spending (Saulnier 1991).

Ultimately, Eisenhower did support some tax rollbacks that he had previously objected to for 1954 in light of the recession of that year. Some tax relief for small business was provided in 1957. And he did sign the 1954 Internal Revenue Act, a much-needed updating of the tax code reflecting the myriad changes in the

[14] Online at: www.taxpolicycenter.org/TaxFacts/Tfdb/Content/PDF/individual_rates.pdf.
[15] Online at: www.taxpolicycenter.org/TaxFacts/Tfdb/Content/PDF/individual_rates.pdf. At this time, the personal exemption was $600 for single persons and $1,200 for married couples; no tax was paid on that amount.

economy and society that had accumulated since the modern income tax began in 1913. However, the Act did not cut taxes much. Federal revenues remained less than 8 percent of GDP for the rest of the decade (and because the economy was booming, this meant that federal receipts were growing extremely rapidly). Moreover, state and local taxes, as well as payroll taxes, were increasing during this period.

And yet the American public responded positively. The percentage of Americans saying their federal income taxes were too high fell over the entire decade, from 71 percent in 1952, to 46 percent in 1961 as shown in Figure 3.3. There are two reasons for this equanimity about taxes.

First were the many felicitous effects of the postwar boom. Real personal income increased 3.8 percent a year between 1947 and 1957 (2.1 percent per capita), on an after-tax basis (Saulnier 1991, 76). That is, even though taxes were rising rapidly during this period, real wages were rising even more quickly. These handsome levels of disposable income blunted the apparent cost of the tax regime and additionally fueled a boom in spending, especially on high-ticket items like cars and durable consumer goods (Sloan 1991), a most welcome opportunity after the constrained consumption of the war years.

A second reason for the relative popularity of federal taxes at this time was that taxes figured very little on the public agenda. Historians writing about this period note the degree to which lawmakers agreed to agree on taxes (Brownlee 2004; Ventry 2002; Zelizer 1998). This era was marked by bipartisan consensus and relatively little discussion of taxes; taxes were simply not a prominent political issue. A variety of factors contributed to this muted politics. It was easy to agree on taxes when the economy was so flush and tax revenues so bountiful. Republicans also had come to terms with popular New Deal programs like Social Security and were not openly challenging the programs or their financing at this time. And the domination of the tax-writing committees by conservative Southern Democrats like House Ways and Means Chairman Wilbur Mills also enhanced the quiet on the tax front. These committees prided themselves on their technocratic rather than partisan orientation, which helped contain the politics around the issue.

I have coded a variety of elite documents to quantify what the historians have told us about the relative quiet around tax issues during the 1950s and 1960s compared to later eras. These documents include presidential nomination acceptance speeches, general election speeches and TV ads (speeches given and ads shown between September 1 and Election Day), and party platforms.[16] These are documents from campaigns – the moment we would expect tax politics to rear its head. What all of these sources show is that taxes were simply not a major topic in campaigns through the 1950s and even the 1960s. In the interest of space, I show only the results for nomination acceptance speeches and general election TV ads; the other sources reveal the same trends. Figure 3.4 shows the number of sentences in presidential nomination acceptance speeches concerning taxes. The word *taxes*

[16] The nomination acceptance speeches and party platforms are from Woolley and Peters (n.d.) and the compilations of the general election speeches and TV ads from the Annenberg School for Communication (2000).

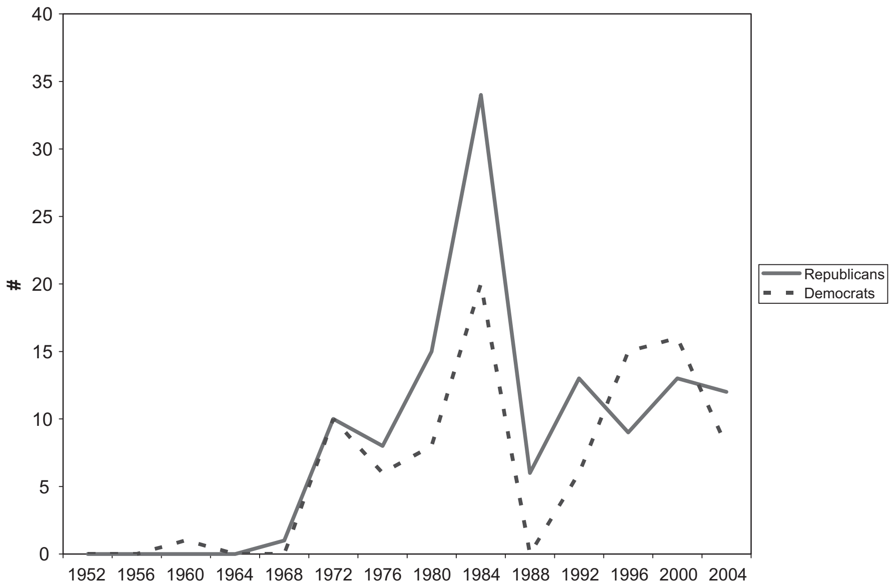


Figure 3.4. Presidential nomination acceptance speech tax mentions. *Source:* The author's content analysis of acceptance speeches as compiled by the Woolley and Peters American Presidency Project. *Note:* This figure shows the number of sentences in nomination acceptance speeches that mention taxes.

barely passed the lips of the major party nominees during the entire two-decade period from 1952 to 1968.

Similarly, Figure 3.5 shows the percentage of general election TV ads mentioning the words *tax* or *taxes.* As noted, Eisenhower's campaign mentioned taxes quite a bit during the 1952 race; 42 percent of his ads shown during the election season mentioned taxes. After that point, however, taxes were mentioned in very few ads by either party – less than 10 percent – until the 1970s, growing thereafter.[17]

An examination of the specific rhetoric used reveals differences with today's elite discourse as well. Statements in the Republican platforms of this era extol traditional conservative principles – government should not replace individual effort, limited government is preferable, government close to the people is good – not so much antitax sentiment per se.

Thus, ordinary Americans felt positively about taxes during this era, in part because their disposable incomes were rising, so high taxes were not as painful as they would become later, in part because partisan skirmishes about taxes were quite muted compared to what came later. In the absence of elite politicization, taxes did not become a heated issue. Thus, discontent about taxes fell even though levels were rising.

[17] Note that the Annenberg/Pew project compiling presidential discourse does not include material from Barry Goldwater's campaign in 1964. I have examined other accounts of his race, however, and found that although his campaign signals the beginning of the conservative movement, talk of taxes was relatively muted.

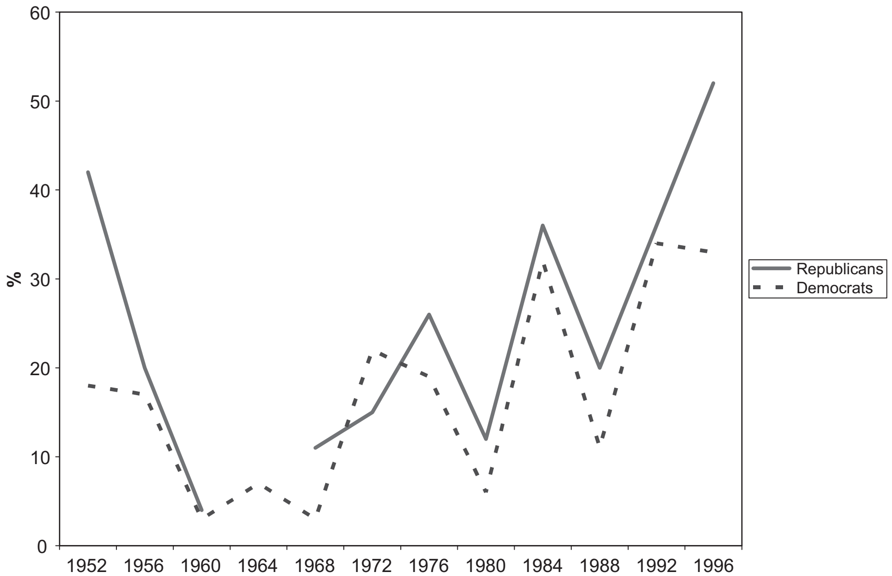


Figure 3.5. General election TV ads mentioning taxes. *Source:* Author calculations from the Annenberg/Pew Presidential Campaign Discourse Project archive. *Note:* This figure shows the percentage of all TV ads shown between September 1 and Election Day mentioning the words *tax* or *taxes.*

TAXES ON THE NATIONAL AGENDA: 1970s TO THE PRESENT

All of this began to unravel in the late 1960s, and particularly in the 1970s and 1980s. During the 1970s, worldwide economic slowdown, the oil shocks, and stagflation exerted their toll on incomes. Reality caught up with the tax increases implemented during the 1950s and 1960s – when wages were growing rapidly, these were neither economically nor politically problematic. However, with real wages flat or decreasing, and high inflation driving bracket creep, disposable incomes fell rapidly. This particularly affected the middle class; because there were so many brackets, people moved up into higher brackets quickly (between 1971 and 1978, there were twenty-five marginal tax rates for married couples filing jointly).[18]

Moreover, it was the combination of taxes that was taking its toll. The burden on the average family of direct federal, state, and local taxation increased by 98 percent from 1953 to 1974 (from 12 percent of an average income of $11,000 to 23 percent of an average income of $13,000, in 1974 dollars). During this two-decade period, the increased strain was due not so much to the federal individual income tax burden, which only rose 34 percent, but rather to the increases in other taxes, which were much greater: 77 percent for local property tax, 150 percent for state property tax, 436 percent for payroll tax, and 533 percent for state income tax (Advisory Commission on Intergovernmental Relations 1975, 3–6). These increases were smaller for higher-income families – at twice the average family

[18] Online at: www.taxpolicycenter.org/TaxFacts/Tfdb/Content/PDF/individual_rates.pdf.

income, the total burden increased only 52 percent, or half as much – resulting in a "narrowing of the gap" in direct tax burdens borne by average families compared to their upper-income counterparts. Moreover, these increases were accelerating: The rate of increase in the total tax burden families faced increased twice as fast in the decade after 1965 than it had in the decade before.[19]

At the same time that tax burdens were growing, Americans grew increasingly dissatisfied with what the government was doing. Events like Vietnam and Watergate shook citizens' trust in government.[20] The racialization of poverty undermined support for social welfare programs that appeared to be benefiting narrow groups (Cook and Barrett 1992; Edsall and Edsall 1992; Gilens 1999). Even popular programs like Social Security suffered politically. Fixes to Social Security passed in 1977 and 1983 made the program a worse deal for the affluent, raising their payroll taxes and lowering their net benefits, with a concomitant drop in support for the program within that group (Campbell and Morgan 2005). Government was taking in a lot of taxes and spending a lot of money, but spending it on other people, many Americans seemed to think. The percentage of National Election Study respondents saying the government wastes "a lot of money we pay in taxes" increased from 43 percent in 1958 to 78 percent in 1980. And the percentage of Gallup respondents saying their federal income taxes were too high grew tremendously during the 1960s, from 46 to 69 percent by the end of the decade, dropping to 58 percent in 1976, but rising again rapidly to 68 percent by 1980 (Figure 3.3).

These frustrations found voice in the tax revolt of the late 1970s. Property taxes had been increasing rapidly in many states. In California, the ballot initiative process enabled citizens to act on their frustrations by limiting property tax increases; similar measures were passed in a number of other states, and both state and federal elected officials were chastened (Martin 2008). Ronald Reagan rode the antitax sentiment into the White House and passed the Economic Recovery Tax Act of 1981, which cut taxes across the board and indexed the tax brackets to inflation. Deficits ballooned, and tax increases were passed over the next three years: the 1982 Tax Equity and Fiscal Responsibility Act, the 1983 Social Security amendments, and the 1984 Deficit Reduction Act. Then the tax system was fundamentally reformed by the 1986 Tax Reform Act, which created two tax brackets at 15 and 28 percent with a 33 percent bubble (the top marginal rate had been 50 percent), and increased corporate taxes to pay for the cuts in individual income taxes (Steuerle 2004).

In contrast to the 1950s and 1960s, taxes came to dominate campaigns and politics. In his 1988 nomination acceptance speech, George H. W. Bush pledged, "Read my lips: no new taxes." However, he reneged on his pledge by signing the

[19] Total tax burden as a percentage of median family income grew 4.4 percentage points from 1955 to 1965 (from 17.3 percent for families with one earner to 21.7 percent in 1965), but then grew twice as much – by 8.8 percentage points – from 1965 to 1975 (to 30.5 percent). These figures are from the conservative Tax Foundation (Claire M. Hintz, "The Tax Burden of the Median American Family," Special Report No. 96, March 2000). Liberal groups like the Center on Budget and Policy Priorities dispute some of the Tax Foundation's calculations; what is relevant is the accelerating upward trajectory.

[20] On trust and taxes, see Chapter 7 in this volume.

1990 Omnibus Budget Reconciliation Act (OBRA), which raised the top rate to 31 percent. That, and the poor state of the economy in 1992, did him in electorally. Talk of taxes continued during the 1990s, as Clinton toyed with a middle-class tax cut, although other issues intervened. The 1993 OBRA did increase the top marginal rate again, to 39.6 percent, and expanded the Earned Income Tax Credit (EITC), thus increasing progressivity. The 1997 Taxpayer Relief Act included a multitude of tax credits, including child credits, education subsidies, and Roth IRAs. Then tax politics reached its apotheosis with the Bush tax cuts of 2001–3, which reduced federal receipts to a level not seen since shortly after World War II by cutting rates across the board – to 10 percent at the bottom and 35 percent at the top – and by increasing child, childcare, and education credits, reducing the marriage penalty, cutting the estate tax (to zero in 2010), and reducing dividend and capital gains taxes to 15 percent.

Thus, taxes figured significantly in political and campaign discourse during this period. The old agreement to agree on taxes fell apart. Taxes became fair political game, and elite attention to them climbed. As Figures 3.4 and 3.5 show, taxes rose on the political agenda from the 1970s on, with increasing mentions in presidential nomination acceptance speeches and general election TV ads (there were also large increases in mentions in general election speeches and party platforms, not shown). Taxes were barely mentioned at all in presidential nomination speeches between 1952 and 1968, but rose thereafter, with 10 percent of all the sentences uttered by both parties' candidates mentioning taxes in 1972, to 15 percent and 34 percent by the Republican nominee, Ronald Reagan, in 1980 and 1984 (mentions by Democratic nominees increased as well, but to a smaller degree; see Figure 3.4). Similarly, the percentage of ads shown by Republican candidates mentioning taxes increased to 26 percent in 1976, 36 percent in 1984, and 52 percent in 1996, with Democrats following a similar pattern at slightly lower magnitude (Figure 3.5).

Not surprisingly, given the deterioration of objective conditions and increased elite attention to taxes, the salience of taxes grew among the public. Figure 3.6 shows the percentage of likes and dislikes of the political parties in the National Election Studies that concern taxes.

Over time, more and more of the way in which individuals think about the parties has to do with taxes, both what they like and dislike about the parties. In 1952, when taxes had climbed so rapidly and when Eisenhower was actively campaigning on the issue, more than 4 percent of all comments about the parties mentioned taxes. This fell over the rest of the decade, so that by 1958, there were almost no mentions of taxes when respondents discussed what they liked and disliked about the parties. During the other elections of the 1950s through the 1970s, total mentions concerning taxes never exceeded 3 percent. However, in 1984, nearly 4 percent of mentions referred to taxes, climbing to 5.5 percent in 1990, more than twice the level of earlier decades.

Another measure of the increased relevance of taxes to the American public is the heightened influence of tax attitudes on presidential vote choice. Figure 3.7 shows results from a multivariate analysis of Gallup and General Social Survey data in which presidential vote choice in elections for which data are available is modeled as a function of education, income, age, gender, race, party identification, and tax

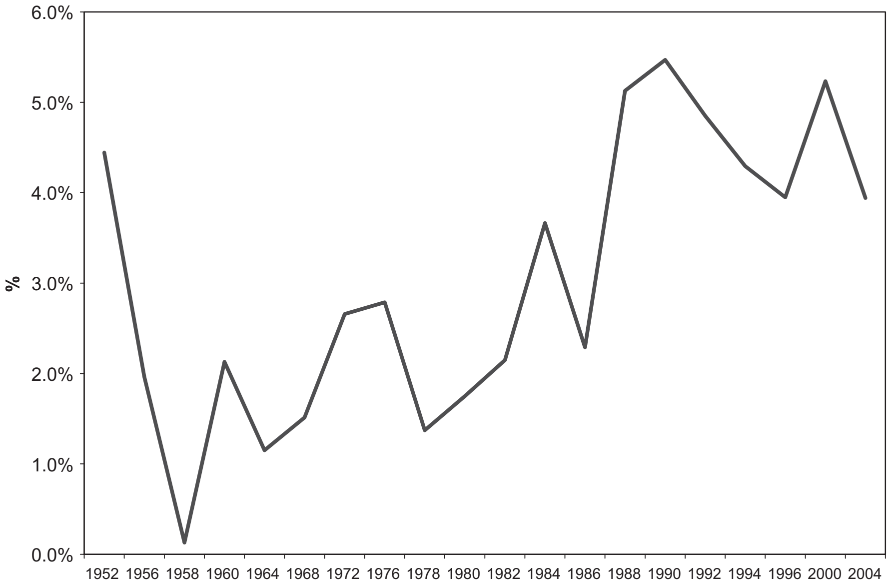


Figure 3.6. Tax mentions as percent of all likes and dislikes of the parties. *Source:* National Election Studies Cumulative File. *Note:* This figure shows the percentage of all likes and dislikes of the Democratic and Republican parties that concern taxes.

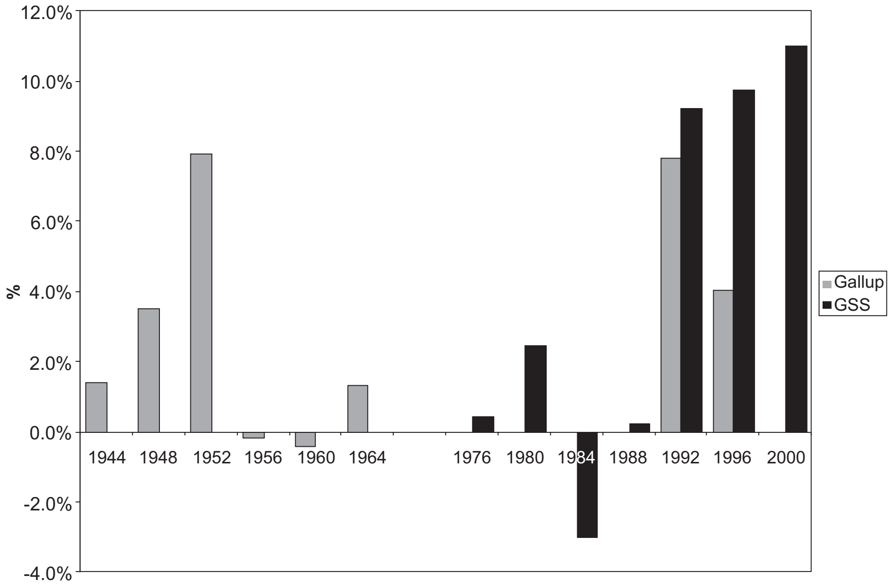


Figure 3.7. The influence of tax attitudes on presidential vote choice. *Source:* Gallup Poll (1944–64, 1992, 1996); General Social Survey (1976–2000) *Note:* This figure shows percent difference in likelihood of voting Republican between those who thought federal income taxes were too high versus those who thought they were about right, other variables held constant.

attitudes (whether the respondent said their income tax was too high as opposed to about right).[21] The figure shows the difference in the percentage likelihood of voting for the Republican candidate between those who said their taxes were too high versus about right, holding the other variables constant at their means. In 1952, the election in which Eisenhower emphasized tax issues, those who said their taxes were too high were 8 percent more likely to vote for Eisenhower than were those who said their taxes were about right. For the other elections of the 1950s and 1960s, tax attitudes had little influence on vote choice. By the 1990s, tax attitudes figured prominently in vote choice, with those who believed their federal income taxes were too high being nine to eleven points more likely to vote Republican than those who thought their taxes were about right, other factors being constant.[22]

Moreover, with increased politicization of taxes, the relationship between tax attitudes and tax levels (along with other economic conditions) has become stronger. Figure 3.8 shows the results of predicting tax attitudes as measured by the "too high" item with tax level and economic conditions.[23] Actual and predicted tax attitudes track quite closely. However, what is interesting is that the fit becomes tighter over time, with the absolute size of the residuals lower after 1972 (2.4 percent) than before 1972 (4.1 percent; difference significant at $p < .05$). That is, the relationship between the level of taxes and other objective conditions was closer after 1972, when elites discussed taxes more, than it was earlier, before they talked about taxes as much.[24] In addition, elite politicization of taxes seems to have made tax attitudes more negative than objective conditions would predict. Before 1972, tax attitudes were worse – more people thought taxes were too high – than the level of taxes would predict less than half the time. Yet after 1972, tax attitudes were more negative than conditions would predict almost two-thirds of the time.[25] Thus, increased elite attention to politics has made Americans more conscious of the costs of the taxes they pay – in the contemporary era, tax attitudes go up and down with the level of taxes with very little slippage. That loss of slippage makes

[21] So few people say their taxes are too low that we can treat the variable as a dichotomy, following Stimson (2004).

[22] I was surprised that tax attitudes did not figure more prominently in the 1980, 1984, and 1988 elections; perhaps that era primed the tax pump for the elections of 1992–2000. Also, during the Reagan presidency, tax attitudes by party were often reversed, I have found in other analyses; it was often Democrats who were more likely than Republicans to say their taxes were too high, presumably because of dislike of Reagan and disagreement with his taxing and spending policies. Here this is expressed in the 1984 election, when those who say their taxes are too high are less likely to vote Republican.

[23] The model predicts tax attitudes with tax level (federal income tax as a percentage of GDP), inflation, and change in real per capita income.

[24] Note, for example, the extremely tight fit in Figures 3.3 and 3.8 between tax levels and tax attitudes beginning with the 2001–3 tax cuts. Both tax revenues and dissatisfaction with taxes fell to levels not seen since shortly after World War II; just 43 percent of respondents said their federal income tax was too high in 2005. Of course, the loss of tax revenues equivalent to 3 percent GDP (Steuerle 2004) has contributed to record budget deficits. On the Bush-era tax cuts, see Bartels 2005 and Graetz and Shapiro 2005.

[25] Specifically, residuals were positive in the model – "too high" evaluations were greater than predicted by objective conditions – for 47 percent of the pre-1972 data points compared to 63 percent of the data points from 1972 on; 1972 chosen as the cutoff based on the changes in elite rhetoric shown in Figures 3.4 and 3.5.

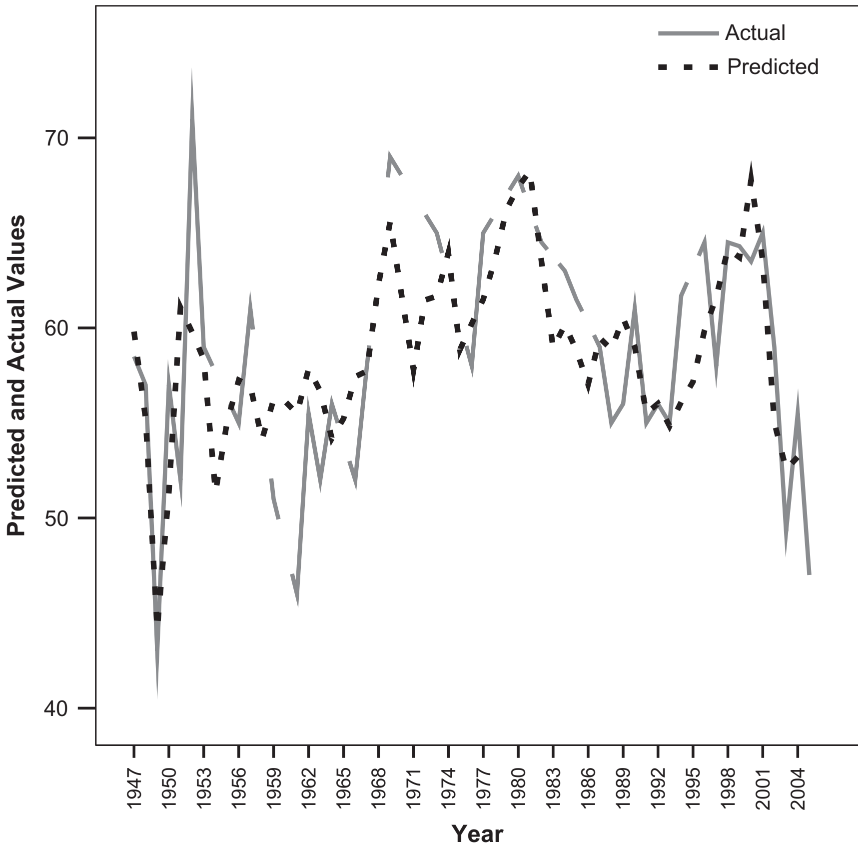


Figure 3.8. Predicting federal income taxes are too high with tax level and economic conditions. *Note:* Predictor variables for Too High are federal income tax as percent GDP, inflation, and change in real per capita income.

it very difficult to raise taxes without triggering discontent among the public. And that loss of slippage means unpopular choices ahead for elected politicians who must contend with both record budget deficits created by spending–revenue mismatches in the recent past and with trillions in unfunded public pension and health care obligations looming in the near future.

CONCLUSION

One legacy of choosing to fund the American state primarily with a highly visible progressive income tax rather than with a more obscured consumption tax (see Chapter 2) is that the public is more sensitized to tax levels than it otherwise might be. The relationship between actual tax levels and attitudes toward taxes is remarkably tight. And the relationship has become tighter over time as elite discourse about taxation has increased. The fateful early choice to depend on income taxes, along with politicians' increased attention to taxes as an election

issue, has a constraining effect on policy making. Politicians have little leeway to raise taxes without exciting public opinion. The income tax has proven visible, susceptible to politicization, and vulnerable as a revenue source, not only because it oscillates widely with the state of the economy as economists would tell us, but also because raising it is so immediately evident to the public. Politicians have only themselves to blame, as their increased discourse around taxes has resulted in taxes figuring more prominently in Americans' evaluations of the political parties and in their choices at the ballot box as well. The visibility of the federal government's main revenue source, along with politicians' choices to politicize taxes over time, help explain the prominence of taxes in American politics.

4 Read Their Lips: Taxation and the Right-Wing Agenda

FRED BLOCK

The last thirty years of U.S. political and fiscal history are strange indeed when looked at in comparative perspective. National politics has been dominated by a surprising coalition between religious conservatives and economic conservatives unified by market fundamentalism – a quasi-religious faith in the capacity of self-regulating markets to solve all social and economic problems (Block 2007). This ideology strongly opposes the growth of government and sees taxation as inevitably distorting private economic decisions. This coalition has made cuts in federal taxation its highest domestic priority.

This priority diverges sharply from hundreds of years of political history in which durable ruling regimes in all parts of the world have increased the capacity of government by strengthening the state's fiscal base (Tilly 1992). Even in more recent American political history, as Joseph Thorndike shows in Chapter 2, leaders have sought to protect the state's fiscal capacity. Why have conservatives in the United States recently pursued a strategy of implementing huge tax cuts that push the federal government into deficit financing? Why has such an unusual approach to governance gained sufficient political support to keep this coalition in power for decades?

The analysis offered here is intended to complement the arguments of Andrea Campbell in Chapter 3. As Campbell's data show, there is no simple correlation between public opinion on taxation and the extent of tax-cutting effort by the administration in power. Voters are sensitive to the uses of taxes as reflected in their willingness to shoulder higher tax burdens during World War II (see Feldman and Slemrod, Chapter 8). Moreover, public opinion on taxation is marked by deep ambivalence because voters routinely embrace the wisdom of Louisiana's Russell Long: "Don't tax you, don't tax me, tax that man behind the tree." The ambivalence exists because people want both the services that government provides and low personal tax burdens. To be sure, majorities supported Ronald Reagan and George W. Bush's first rounds of tax cuts, but many voters quickly experienced buyer's remorse when the budget deficit suddenly exploded. In other words, the

I am grateful to Athmeya Jayaram and John Kincaid for research assistance and to conference participants and the volume's editors for comments and suggestions. I am particularly grateful to Margaret Somers because many of the ideas elaborated here emerged from our joint work.

conservative coalition's thirty-year commitment to tax cutting, regardless of its impact on the deficit, has not had majority support in public opinion.[1]

In some cases, however, public policy reflects not majority opinion, but rather asymmetric mobilization – high levels of pressure by political minorities that is not matched by counterpressure from other groups. This is the case with tax cutting; it has been an obsession for certain key elements of the Republican coalition for the past thirty years. Grover Norquist has famously used the phrase, "Guns, babies, taxes" to emphasize the centrality of ending abortion, supporting gun ownership, and cutting taxes for the conservative base. Moreover, Norquist's organization, Americans for Tax Reform, has pressured elected officials to sign an antitax pledge that has made it difficult for them to respond to budget crises with tax increases (Medvetz 2006; Micklethwait and Wooldridge 2004).

Most important, whereas this powerful minority has prioritized tax cutting, its efforts have not been countered by a pro-taxation constituency that is comparably mobilized and politically influential. Although surveys consistently show that there are significant minorities who favor higher taxes and more redistribution through the tax system, these voters have not been an organized or effective political force. At the same time that many Republican political figures argue the case for tax cuts continuously, Democrats rarely make the positive case for strengthening the government's fiscal base. Walter Mondale did call for tax increases in his 1984 campaign against Ronald Reagan, but when he was badly beaten, Democrats took home the lesson that one should never propose tax increases (Steurle 1992). Even in 2008 when support for Republican positions was eroding, Barack Obama was careful to promise "middle-class" tax cuts.

Over time, this asymmetry can be expected to have an impact on public opinion. When conservative arguments for tax cuts are not publicly answered and rebutted, then these ideas gradually become common sense. The idea of relying on borrowing to fund the federal government gradually moves from being obviously irresponsible to normal. This is consistent with Bartels' (2008) argument that uninformed Democratic voters supported George W. Bush's tax cuts at much higher levels than well-informed Democrats. Parts of the public no longer recognize that continuous tax cutting represents a significant break from previous history. In short, although it is a minority of the electorate that is ideologically committed to tax cutting, the majority that has other priorities is internally divided and ultimately passive.

In focusing on the powerful minorities that have kept federal tax cutting at the center of national political debates, this chapter quickly confronts a conundrum. It is difficult to explain why tax cutting has become so central to the conservative coalition by looking at economic interests alone. Because many of the voters mobilized by the religious Right are not affluent, it is not clear why they are so enthusiastic about tax cuts that primarily benefit high-income households. Moreover, for the business side of the conservative coalition, their unstinting support for policies

[1] Data compiled in Bowman (2007) show a consistent public preference for deficit reduction over additional tax cutting from the 1980s to the present. To be sure, majorities approved of George W. Bush's handling of taxes in the first three years of his presidency, but see Hacker and Pierson (2005a) on the softness of that support.

that undermine the federal government's fiscal capacities represents a significant deviation from standard business politics.

Hence, this chapter seeks to explain the peculiarities of U.S. tax policy by means of a historical analogy. In *The Great Transformation*, Karl Polanyi ([1944] 2001) argued that the Industrial Revolution in England produced a surprising ideological response that had considerable impact on both public opinion and public policies. The response was the rise of an extreme version of laissez-faire doctrine that was articulated by Malthus, Ricardo, and other classical political economists. Polanyi described this doctrine as an attempt to deny "the reality of society" because it placed all responsibility on the individual for his or her lot in life. Because contemporary critics of taxation have self-consciously recycled many of the same highly individualistic laissez-faire arguments, I will argue that the same cultural dynamic is at work in both of these historical periods.

THE FISCAL CRISIS OF THE STATE

An excellent starting point to grasp the centrality of tax politics over the last four decades in the United States is James O'Connor's prescient 1973 book *The Fiscal Crisis of the State.*[2] O'Connor deserves recognition as one of the first scholars to revive interest in the pioneering fiscal sociology developed in Central Europe by Rudolph Goldscheid and Joseph Schumpeter in the first decades of the twentieth century. O'Connor turned to these sources out of frustration with the way that mainstream economics addressed issues of taxation and state budgets (see Chapter 1).

O'Connor's work grew from an understanding that the "guns or butter" dilemma that Lyndon Johnson faced between 1965 and 1968 as the Vietnam War escalated was not a temporary or transitory issue, but rather it reflected a systemic crisis. The core of the problem was that the demand for government outlays at all levels in the United States exceeded the revenue-generating capacity of the existing tax system and attempts to extract additional revenue were already beginning to generate growing public resistance. The military-industrial complex had dominated the federal budget since the Korean War, but demands for increased government spending for health, education, welfare, and infrastructure were rising sharply and were placing enormous strain on the budgets of state and local governments. (Campbell provides data on the growing tax burden during this period in Chapter 3; see also Martin 2008.)

O'Connor rejected the view that the U.S. tax system at that time was based on a "soak the rich" philosophy; he argued that the "average effective rate of taxation on the highest incomes is no more than 25 percent" because of various loopholes and incentives in the tax code (O'Connor 1973: 210).[3] Moreover, he strongly criticized the idea that "the benefits of state expenditures accrue more or less equally to

[2] Much of O'Connor's argument had initially been laid out in a series of articles in the inaugural issues of the new Left journal, *Socialist Revolution*, published in 1970.

[3] O'Connor's position rests on the argument that the combined U.S. tax and benefit systems do substantially less to mitigate inequalities of income than most other OECD countries (OECD 2005).

every taxpayer" (205) – particularly noting that the huge outlays for military purposes and to expand U.S. influence abroad disproportionately benefited large corporations and the wealthy.

From these premises, he correctly anticipated that the United States would face growing conflict over how to distribute the tax burden across different groups. As a person of the Left, he imagined that this tax revolt might give rise to a powerful socialist current in U.S. politics. However, he also envisioned that with pressure from below, elite groups might pursue a more centrist reform path that would reduce spending on the military-industrial complex and shift resources into what he called a "social-industrial complex." In this scenario, increasing outlays for scientific research, education, medicine, and for upgrading the skills and living standards of the poverty population could produce significant increases in overall productivity growth that would ease the fiscal crisis. In short, he saw some possibility that the United States would move more in the direction of Western European countries that shouldered less of a military burden and invested a high portion of tax revenues in the social welfare of their populations. Yet he was hardly optimistic that the forces who favored this reform path would have the political will and skill to prevail.

O'Connor's analysis anticipated both the dramatic spike in antitax sentiment recorded in public opinion polls in the 1970s (Campbell, Chapter 3) and the high degree of political mobilization around the property tax in that decade. As Isaac Martin (2008) effectively shows, both progressives and conservatives made serious efforts to exercise leadership over public discontent with the property tax. However, for reasons that Martin sees as fortuitous or almost accidental, it was conservatives who carried the day by their successful support of Proposition 13 in California. It was that victory that put tax cutting on the national agenda and led to the "permanent tax revolt" that still dominates Republican politics (Martin 2008).

Tax politics followed a fairly familiar pattern. Whenever a political system is unable to address a widely perceived problem over an extended period, it creates an opening for other parties to attack the problem by breaking with previously accepted approaches (Berman 2006). As the fiscal crisis intensified through the 1960s and 1970s, there were a variety of proposals for centrist or center-Left initiatives to carry out major reforms of the tax system. Nixon, for example, briefly considered replacing the property tax with a value-added tax (Martin 2008), but none of the presidents of this era could break the political logjam and get major legislation passed by Congress. This chronic failure to alleviate the fiscal crisis served to undermine the legitimacy of political leaders of the center and Left, and it created an opportunity for politicians of the Right to capitalize on this source of public discontent.

THE PERMANENT TAX REVOLT

This opportunity was effectively seized when Ronald Reagan gained the presidency in 1980 by advocating massive federal tax cuts that were pushed through in 1981. However, even after Reagan's initial success, it was hardly inevitable that

the Republican Party would choose to embrace a strategy of permanent tax revolt. Conservatives could have decided to define Reagan's tax cuts as having solved the problem of overly burdensome taxation and then have turned to other issues. Instead, the core groups in the conservative coalition decided to make a war on taxes the center of their political agenda continuously from the late 1970s down to the 2008 election when John McCain promised to make George W. Bush's tax cuts permanent (Martin 2008; Micklethwait and Wooldridge 2004).

There is no question that embracing the permanent tax revolt has a number of obvious advantages to the conservative coalition. First, putting opposition to taxes at the top of the conservative agenda makes life very difficult for the Democrats when they do gain control of the White House. After Bill Clinton won the presidency, the Republican coalition fought ferociously against his proposed tax increases. Although Clinton's initial budget passed without any Republican votes, continuing Republican opposition kept him from implementing expensive new spending programs that might have consolidated political support for the Democrats (Shoch 2008). When Bill Clinton famously declared that the era of big government was over, he was inadvertently acknowledging the success of conservative antitax mobilization.

Second, the promise to reduce the tax burden on big corporations and high-income individuals has been a very effective strategy for filling Republican campaign coffers for the past thirty years. In virtually every election cycle (with the exception of 2008), total Republican campaign fundraising has greatly exceeded that of the Democratic Party (Bartels 2008). Moreover, across this period, there has been a dramatic upward shift in the percentage of total personal income that goes to the top 1 percent of households. One study shows that percentage rising from 10 percent in 1981 to 21.8 percent in 2005 (Bartels 2008). There is little doubt that many of these high-income households have recognized the Republicans' role in their prosperity by making very substantial campaign donations (Johnston 2003, 2007).

Third, continuous Republican tax cuts provide a favorable terrain for conservative attacks on forms of social spending that have strong public support. Public opinion data show that Medicare, Social Security, and even some of the programs that particularly benefit lower-income households are politically popular. Yet in the harsh budgetary environment created by systematic tax cuts, it becomes more feasible to attack these programs through "salami tactics" of continuous small cuts (Krugman 2003). To be sure, George W. Bush was unsuccessful in 2005 when he campaigned for a partial privatization of the Social Security system on the grounds that the system faced future insolvency. However, the Democrats have not been able to prevent a steady stream of cuts to health care spending that have weakened the Medicare and Medicaid systems.

The most striking success of these salami tactics has been the gradual defunding of public higher education, which has been financed primarily at the state level. Up until the 1970s, many state governments were able to invest heavily in creating public colleges and universities that provided broad access to higher education at relatively low costs to students. However, as the fiscal crisis intensified, particularly under Reagan, state governments faced a much more difficult budgetary

environment. They have responded over almost thirty years by steadily increasing tuition and fees for students in public colleges and universities. The result has been a rising financial barrier to higher education for poor and working-class students. Although there is still public support for broad access to higher education, conservatives have used the "permanent tax revolt" to achieve one of their important policy objectives (Newfield 2008).

THE GLOBAL CONTEXT

Despite these advantages, the conservative strategy also has considerable disadvantages because it has involved pushing through large across-the-board federal tax cuts without implementing parallel cuts in government expenditures. To be sure, both Reagan and George W. Bush shifted the priorities of federal spending in favor of defense and away from social programs. However, the total size of government spending increased and their administrations relied heavily on borrowing to pay for that spending (Micklethwait and Wooldridge 2004; Stiglitz 2003).

Usually, this is not a viable strategy for a political party in power. Governments are often tempted to curry favor with voters by pursuing dramatic tax cuts, but they are constrained by the difficulties of financing the resulting budget deficits. Both domestic and international investors tend to see rising government deficits as an indicator of fiscal mismanagement and a cause of future inflation that would erode the value of government debt. As investors become reluctant to hold that debt, the interest rate that the government must pay on new debt rises, further increasing the cost of new borrowing. Few governments are able to withstand the pressures that come when their bonds are heavily discounted in the marketplace; they quickly announce policies to shrink the deficit and restore confidence in their fiscal management.

Yet the Reagan administration found in the early 1980s that foreigners were willing to finance the mounting government deficits that resulted from the combination of tax cuts and dramatically increased military spending (Krippner 2003). Similarly, the administration of George W. Bush relied on foreign bond purchases to finance its deficits from 2001 onwards. To be sure, both administrations ultimately faced some pressure to limit their deficits. In 1986, Reagan agreed to a tax reform package that broadened the tax base and starting in 2004, the Bush administration demonstrated greater restraint on its domestic spending proposals. Yet in comparative terms, these pressures were far weaker and slower to take effect than is usually the case.

The explanation is that other nations have been willing to facilitate U.S. government deficits because of the peculiarities of the international financial system in this period. The dollar remains the central currency of the global financial system and the United States has been running a large balance-of-payments deficit at the same time that it has had a chronic federal budget deficit. If other nations were to exert pressure on the United States to curtail its twin deficits, the United States would be forced to contract its economy, lower its imports, and produce a potentially dangerous slowdown in the global economy. Instead, other nations have chosen to tolerate the U.S. deficits; they finance the payments deficit by

lending the United States the money to cover the shortfall in federal revenues (Arrighi 2007).

For China and other East Asian exporting powers that have maintained a large trade surplus with the United States, the calculation is even simpler. Purchasing large quantities of U.S. government debt is the price they pay for continuing to be able to expand industrial exports to the United States. Because the exports create more jobs for their people and expand their nations' industrial base, accumulating a lot of U.S. debt appears to be a reasonable trade-off.

For more than twenty-five years analysts have questioned how long this pattern can be sustained. At some point, the U.S. dollar is likely to face a major sell-off in the foreign exchange market. When that happens, governments that hold huge dollar reserves will face substantial losses as the dollar is devalued. If they move to reduce their exposure, the pressure on the dollar will intensify. Nevertheless, for some time, the world economy has tolerated a gradual decline of the dollar's relative value even while foreigners continue to participate as codependents in the U.S. addiction to deficit financing (Arrighi 2007; Block 2003).

THE RIGHT-WING COALITION

The Republican coalition that has embraced the logic of the permanent tax revolt consists of two main groups – business conservatives and religious conservatives. For business conservatives, the support for a long-term strategy of financing the federal government through debt represents a break with conventional business politics. Business interests in most countries have generally opposed resorting to deficit financing on a long-term basis because it erodes the restraints on governmental growth. The fear is that when the political pendulum inevitably swings, a business community that has allowed a conservative administration to run huge deficits will have less credibility in opposing a progressive administration that employs deficit financing for different ends.

Nor is supporting tax cuts that erode the state's fiscal capacity generally in the long-term interests of business. Over the last two centuries, businesses in market societies have relied on increases in state spending to provide such critical economic inputs as an educated labor force and continuing advances in scientific knowledge. Moreover, Peter Lindert (2004) has shown that as long as tax systems are carefully designed, high levels of social spending in European welfare states have been consistent with strong and continuing economic growth. Contrary to the claims of market fundamentalism, the welfare state can be good for business (Hall and Soskice 2001; Swenson 2002).

Most important, the strategy of consolidating political power by tax cutting seems an unlikely way to court the support of the median voter revered by political scientists. Certainly at the top of the income distribution, the gains from tax cuts might be large enough to dazzle voters, but the gains accruing to median voters from the Reagan or Bush tax cuts were relatively small. For example, Bush's 2003 tax cut gave the average millionaire a tax saving of $100,000, but families in the middle of the income distribution received only $217 (Hacker and Pierson 2005b: 46).

Given the normal caution of business communities, it is surprising that business conservatives in the United States embraced market fundamentalism and threw their political weight behind a radical tax-cutting agenda. To be sure, across this period, business interests were not equally enthusiastic about every proposed piece of tax-cutting legislation. Sometimes, business interests were hesitant about large reductions in individual tax rates, because their preferences were for greater tax cuts for business. However, in both the 1980 election and from 1996 to 2006 when the Republicans controlled the Congress, the majority of big business campaign donations went to the Republican Party and to Republican candidates who made tax cutting their highest priority (Clawson, Neustadtl, and Weller 1998; see also http://opensecrets.org).

Corporate support for the tax-cutting agenda goes back to a sharp turn in business politics that took place during the 1970s (Block 2007). From the United States' entrance into World War II in 1941 through the Nixon administration, the dominant political orientation of the U.S. business community had been supportive of the expansion of government capacity and authority. There were pockets of highly ideological businesspeople who refused to make peace with the New Deal and its legacy, but this was a small minority. Most of the people who ran the large corporations and banks in the 1950s and 1960s accepted the reality of big government and acknowledged that the state played a necessary role in stabilizing the economy and the social environment in which business operates. Disagreements persisted over the level of state spending and the nature of regulatory initiatives, but these were fought out toward the center of the political spectrum (Hodgson 1976).

All of this changed because of the Vietnam-era failures of Presidents Lyndon Johnson and Richard Nixon between 1964 and 1974. Because both Johnson and Nixon were extremely skillful career politicians, their inability to lower levels of social conflict over ten years were deeply threatening to the business community. Facing a continuous challenge by a range of different social movements and a troubled inflationary economy, big business made a major shift in its political allegiances. It formed a coalition with social and religious conservatives that was designed to move the Republican Party to the right. Market fundamentalism was both the glue that held this conservative coalition together and the justification for the tax cuts and rollback of government that the coalition embraced.

This return by the U.S. business community in the 1970s to the market fundamentalist ideas that had been overturned by the New Deal involved a healthy element of cynicism. Most large firms recognized their ongoing dependence on the federal government, and they continued to spend billions for armies of lobbyists to get favorable tax treatment, additional subsidies of various sorts, lucrative government contracts, support in their overseas operations, and protection by regulatory agencies that they see as necessary and essential (Block 2007).

The hypocrisy has only intensified over the last twenty-five years. Since the early 1980s there has been a dramatic escalation in the federal government's initiatives to subsidize private-sector research and development efforts through its support of research carried out in university and federal laboratories and through direct financing of private-sector research. Although historically federal efforts

had been largely restricted to the defense sector and the health sector, current programs impact the entire civilian economy. For example, the Bush administration increased funding for the National Nanotechnology Initiative that provides billions of research and infrastructure support for business firms pursuing research at the molecular level (Block 2008).

Nevertheless, business firms find market fundamentalism to be extremely useful as a political weapon to resist the idea that business and government should establish relationships characterized by reciprocity. If everyone knows that firms receive a whole series of important and necessary services from government, then it is logical to insist in exchange that corporations act as good citizens who cheerfully fulfill their tax obligations, respect regulatory limits, and volunteer to help the society solve problems such as excessive dependence on fossil fuels.

By embracing market fundamentalism instead, firms are able to pretend that they get nothing of value from government, so logically it is inappropriate for government to make demands on them. This provides necessary cover to push for continuous reductions in corporate taxation. They can also act as though all regulations are an undue burden, which makes it easier to block those regulatory initiatives that might damage the immediate bottom line.

Some of the businesspeople who embraced the Right Turn (Ferguson and Rogers 1986) in the late 1970s probably envisioned it as a short-term expedient. They thought that the economy needed a period of austerity and high-interest rates to reduce inflation and to diminish the expectations of both employees and those reliant on government programs. They assumed that after this cold bath, things would return to the previous reality and they could return to more centrist policies and ideologies.

However, political coalitions take on a life of their own, and once business was firmly aligned with the Republican Right, a shift back to the center was not that easy to accomplish. Part of the story is that the Right Turn involved the creation of a whole elaborate set of institutions – think tanks, coalitions, and policy organizations – all of which were effectively staffed with people loyal to the right-wing agenda. Furthermore, when the Republicans gained control of Congress in 1994, the new Republican leadership was systematic in the pressures it exerted on business lobbyists and trade groups to subordinate their own interests to conservative rule. At one point, Tom DeLay pulled a major piece of business legislation off the Congressional agenda just to punish a trade group for hiring a Democrat to serve as the group's leader (Block 2007).

At the same time, changes within business starting in the 1980s intensified the pressure on firms to produce strong quarterly results to keep their share prices from declining. In this short-term-oriented environment, business leaders quickly realized that political investments could often produce the most immediate economic returns. A new tax break, a favorable regulatory ruling, a big government contract, or a relaxation of accounting standards might be just the thing to help the firm hit its numbers in that particular quarter. In short, in the era of managed earnings, investing in the conservative coalition paid firms immediate dividends (Bogle 2005; Jacobs 1991).

By 2006, broad disillusionment with the policies of George W. Bush, especially the mishandling of the Iraq War, had spread to the business community. In the Congressional mid-term elections and again in the run-up to the 2008 presidential election, there was some shift of business campaign donations in favor of incumbent Democrats (see http://opensecrets.org/). It remains unclear, however, whether this represents a temporary or a longer term defection of business from its conservative coalition allies. The positions on issues of taxation and regulation of the leading Republican candidates for the 2008 presidential nominations suggest that the party's leadership believes that the old coalition can be restored with no significant change in its market fundamentalist ideology.

THE RELIGIOUS RIGHT

The business community's support of market fundamentalism and tax cutting has had such profound influence on policy because these ideas have also been embraced by a powerful social movement that has influenced millions of voters. The religious Right, working through clergy and churches, has been able to mobilize an army of grassroots activists. These activists captured the Republican Party apparatus in many states and played an essential role in mobilizing voters to support conservative candidates (Block 2007; Micklethwait and Wooldridge 2004).

Although it is easy to understand why these religiously motivated activists care deeply about abortion, homosexuality, and a culture of permissiveness, it is harder to understand why they have embraced market fundamentalism and tax cutting. This is the problem that has preoccupied analysts from Thomas Frank (2004) to Larry Bartels (2008). Part of the explanation lies in the parallels between religious fundamentalism and market fundamentalism. Both doctrines posit a polarized conflict between good and evil, and their adherents have little patience for ambiguity or complexity. The religious Right decries moral relativism and situational ethics in favor of the absolute moral standards enshrined in the Ten Commandments. In a parallel fashion, market fundamentalism posits an absolute separation between government and the private economy (Goldberg 2006).

Another element of the explanation is geographic and racial. The heartland of the religious Right coincides with the states of the old Confederacy that harbor a long-standing hostility to the power of the federal government. In the aftermath of the civil rights movement, when Southern voters abandoned the Democratic Party in huge numbers, they embraced Republican politicians who echoed the traditional state's rights rhetoric of Southern Democratic politicians. Because the federal government in that period was clearly aligned with the aspirations for equality of African Americans and women, hostility to federal taxation had an obvious appeal to conservatives who resisted racial and gender equality. In fact, the issues were directly linked by the Internal Revenue Service's denial of tax-exempt status to segregated private academies created to circumvent enforced school integration (Crespino 2007; Lassiter 2007).

However, this is not the whole story because the religious Right has also thrown its weight against taxation at the state level. The classic instance was in 2003 when

Alabama's Republican governor pushed for a major state tax increase targeted at the wealthy by invoking the language of the New Testament and asking "Who would Jesus tax?" His initiative was fiercely opposed by the religious Right and the measure was soundly defeated at the polls with many low-income voters casting ballots against their own self-interest (Wilson 2003).

The last part of the explanation is that market fundamentalism and conservative strands of Christianity converge around a radically individualistic worldview. Economic conservatives believe that the market appropriately rewards individuals for their level of personal effort, and it is for that reason that so-called governmental interference with the market (either through minimum wage legislation or welfare provision) distorts incentives and discourages individual initiative. In a similar way, conservative Christians believe that individuals are responsible for their ultimate salvation. As the song goes: "You must walk that lonesome valley and you must walk it by yourself." Market fundamentalism puts these two ideas together in advancing policies that convey that "You Are On Your Own" – that each individual is responsible for his or her own fate (Bernstein 2006).

This overlap of the two belief systems has been particularly evident in the case of welfare policy. The religious Right and the business Right were both strong critics of the historic U.S. welfare program – Aid to Families with Dependent Children – on the grounds that generous welfare provision perversely encouraged laziness and promiscuity. Policies that Congress enacted in the 1996 welfare legislation that require the poor to work and control their sexuality might appear to be cruel, but their supporters argue that these programs are actually compassionate because they provide powerful incentives for individuals to be self-disciplined and moral (for a deeper analysis of these arguments, see Somers and Block 2005).

However, the agreement also carries over to tax policy. If the market rewards individuals justly, then it is wrong for government to use the tax system to change that distribution. In embracing this view, religious conservatives are not necessarily ignoring the New Testament's language about the priority that should be given to the poor. They insist, however, that the responsibility for the poor should be exercised by individuals through personal acts of charity. Although secularists tend to see tithing and taxation as fundamentally similar because they both involve setting aside funds to take care of others, many of the religious see the two as radically different. Tithing is freely chosen by the individual as an affirmation of his or her personal obligation to the Lord. Taxation, however, is not freely chosen, and the funds go to a government that many Christian conservatives view as having a long history of hostility to their religious beliefs (Goldberg 2006).[4]

In other words, much of the religious Right is suspicious of any effort to elevate or sanctify the demands of secular government because such demands interfere with the sovereignty of the individual who must remain free to make his or her own choices. To be sure, the same people have no hesitancy in favoring severe penalties for those who make the wrong choices as, for example, in the case of abortion.

[4] This also helps to explain the puzzle of George W. Bush's steadfast refusal to ask the public to sacrifice in support of the war on terrorism. He understood that his conservative base believes in sacrifice when it is freely chosen but not when it is imposed by secular authorities.

Yet, there they simply fall back on the claim that the laws and the punishment they favor were divinely devised and not related to any shared human endeavor.

It is hardly obvious why this kind of radical individualism has become so resonant for many conservatives in this recent historical period. In the past, Evangelical Christianity has been linked to social movement activities, such as abolitionism, the Social Gospel, and the civil rights movement, that have emphasized interdependence and shared responsibility. Why is it that in recent years, this religious fervor has moved in the opposite direction?[5]

HISTORICAL PARALLELS

A closer examination of the key forces in the conservative coalition has not yet answered the question as to why these groups have become so focused on tax cutting as a political program. Instead, we have encountered two new puzzles. The first is why the business community in the United States responded with such intense panic to political changes in the 1960s and early 1970s. The second is why a radically individualistic ethos has been so central to the revival and political mobilization of Christian conservatives over the last three decades. We can get some leverage on these questions by looking at an earlier historical period that saw quite similar ideological developments.

Market fundamentalism first emerged as a significant political force in the first decades of the nineteenth century in England. Just as in our own era, those ideas were embraced by an unusual political coalition between business interests and religious conservatives. This alliance campaigned with great intensity for abolition of the system of poor relief that had long provided assistance at the local level to those without adequate resources to take care of themselves. Because poor relief was financed by local taxes imposed on property holders, this campaign was also a sustained effort to reduce the tax burden on more affluent taxpayers (Block and Somers 2003; Somers and Block 2005).

The inspiration for this campaign came from the writings of T. R. Malthus and particularly from successive editions of his *Essay on the Principle of Population* that had first been published in 1798. Malthus insisted that England's unique system of poor relief explained why it had so many more paupers than other nations. The fact that local parishes were providing support for the children of the poor was producing an expansion of population that exceeded the carrying capacity of the land. Moreover, the problem was compounded because the availability of support was destroying the work ethic of the laboring classes, which would inevitably diminish productivity and output. Abolishing the Poor Law, according to Malthus, would inevitably reduce poverty as the poor would be forced to return to the historic practices of self-restraint that had kept population in balance with resources. (Malthus [1798] 1970; Somers and Block 2005).

[5] Wayne Baker (2005) draws on data from the World Values Surveys to argue that public opinion in the United States has been unique in shifting toward greater traditionalism and greater individualism.

In short, Malthus and his followers embraced a radical individualism that insisted that individuals bear complete responsibility for both their economic and religious fortunes. The problem with poor relief as well as more ambitious redistributive schemes is that they were inconsistent with natural law, which required individuals to engage in a Darwinian struggle for survival.

In his classic account of these early nineteenth-century debates, Karl Polanyi ([1944] 2001) identified Robert Owen, the industrialist and early socialist, as the primary counterpoint to Malthus. Polanyi credited Owen with "the discovery of society" – the recognition that the Industrial Revolution had dramatically intensified human interdependence. As a consequence of these tighter social connections, working people found themselves thrown out of work or suffering catastrophic income declines as a result of changes occurring hundreds or thousands of miles away. Owen saw the need for new political initiatives that would contain and regulate the impact of market forces on people's lives. His "discovery of society" was a direct attack on the market fundamentalist ideas of Malthus and his followers who insisted that self-regulating markets could do the work of coordinating the dispersed economic efforts of millions of individuals.

Owen was also highly critical of the individualized outlook that dominated the Evangelical Christianity of his period:

> But the fulcrum of his thought was his criticism of Christianity, which he accused of 'individualization' or of fixing the responsibility for character on the individual himself, thus denying, to Owen's mind, the reality of society and its all-powerful formative influence upon character. (133)

For Owen, the primary task in an interdependent epoch was not to reform the individual, but to reshape social institutions so that interdependence did not produce exploitation and domination. Polanyi was particularly enamored of Owen's statement:

> Should any causes of evil be irremovable by the new powers which men are about to acquire, they will know that they are necessary and unavoidable evils; and childish, unavailing complaints will cease to be made. (268)

By the new powers, Owen was referring to both new industrial technologies and new governance institutions.

For Polanyi, there was no question that Owen was the hero in this encounter. Owen represented all of those who were willing to face the reality of increasing social interdependence and devise new institutions to manage it. Nevertheless, Polanyi recognized that it was Malthus's views that came to dominate the political landscape. Moreover, it was easy to grasp their appeal to the rising middle classes; market fundamentalist ideas legitimated the aggressive accumulation of wealth while allowing the successful to wrap themselves in the garments of religious righteousness. Yet Polanyi devoted little attention to explaining why the same ideas also appealed to many members of the working class.

E. P. Thompson (1963) struggled with this same question in his extended chapter on Methodism, the major evangelizing denomination of that period, in *The Making*

of the English Working Class. Pointing to the limits of the analyses of Weber and Tawney, Thompson wrote:

> For it is precisely at this time that Methodism obtained its greatest success in serving *simultaneously* as the religion of the industrial bourgeoisie . . . and of wide sections of the proletariat. Nor can there be any doubt as to the deep-rooted allegiance of many working-class communities to the Methodist Church. How was it possible for Methodism to perform, with such remarkable vigour, this double service? (355–6)

Thompson's most persuasive arguments emphasize that for an increasingly mobile working class, denominations such as Methodism that were aggressively evangelizing provided some sense of community and an important source of mutual aid in a context where older forms of association had been disrupted or destroyed and newer forms – such as trade unionism– had not yet emerged. He also argues that the extreme emotionalism of Methodist worship provided a sense of consolation to people feeling displaced and threatened by powerful social changes. He writes:

> There is a sense in which any religion which places great emphasis on the after-life is the Chiliasm of the defeated and the hopeless. (381–2)

In other words, why not focus on personal redemption and deny the reality of society when that reality is oppressive and unlikely to change for the better?

RETURNING TO THE 1970s

The relevance of the historical analogy should be clear. The same dynamic that occurred during the birth of industrial society in England in the early nineteenth century was repeated as the United States went through a transition from industrial to postindustrial society in the 1970s and 1980s (Block 1990; Brick 2007). What these two historical epochs have in common is a dramatic intensification of social interdependence in which the fate of individuals are increasingly at the mercy of economic and social developments that take place faraway, even on the other side of the world. Whether analysts describe the underlying cause as postindustrialism or globalization, most commentators agree that starting in the late 1960s, ordinary U.S. citizens became far more vulnerable to disruptions in their ordinary patterns of life than had been typical for the calmer decades immediately after World War II.

The various shocks of the 1970s are well known. They include dramatic increases in the price of oil, a sudden upward shift in food prices, an intensification of competition from imports that started a wave of plant closings that would continue for decades, and an intensification of computer-led technological change. Taken together, these shocks made it considerably more difficult for individuals to plot their own life courses because it became uncertain whether particular jobs, particular occupations, or even industries would continue to exist (Block 1990).

However, the shift is deeper than the existence of shocks and uncertainties. Think, for example, how the shift in recent decades to systems of lean production initiated by the Japanese has changed workplaces. With standard industrial-era

mass production, long production lines produced hundreds of thousands of automobiles or other products that were basically identical. In lean production, in contrast, innovations designed to improve the product and cut costs occur continuously during production runs. Engineers, technicians, blue-collar workers, and nearby subcontractors engage in an almost constant dialogue about possible modifications that could be made to the product. This is one of the key rationales for just-in-time inventory control systems; they help avoid wasting money on accumulating and storing parts that might quickly be rendered obsolete (Womack et al. 1990).

This shift intensifies the interdependence of all of the participants in the production process. Nobody is left alone to do his or her own thing for very long; each person's labor is impacted by the next person's and vice versa. Continuous improvement means continual renegotiation of the division of tasks and responsibilities. Moreover, this heightened interdependence stretches beyond the boundaries of the firm. Arm's length contracting with suppliers is replaced by relational contracting that involves continuous negotiations about the precise specifications and production processes for all but the most commodified parts.

Daniel Bell (1973), the pioneering theorist of postindustrial change, had anticipated that the emergence of a postindustrial order involved higher levels of social interdependence and required new forms of governance:

> In a sense, the movement away from governance by political economy [by which he meant the principles of free market exchange] to government by political philosophy for that is the meaning of the shift – is a turn to non-capitalist modes of social thought. (298)

Bell was echoing Robert Owen in suggesting that the new technological powers that were being unleashed necessitated the creation of new institutions of governance to manage the heightened social interdependence.

It was precisely this context to which those who participated in the Right Turn in the United States from the 1970s were responding. Not surprisingly, they turned for inspiration to the very ideas that Robert Owen had challenged. They revived both market fundamentalism and a highly individualized version of Evangelical Christianity. Their intellectual heroes – Milton Friedman and Friedrich Hayek – identified themselves as the twentieth-century descendants of the libertarian tradition begun by Malthus and Ricardo. Moreover, politically active Christian conservatives explicitly rejected the Social Gospel of mainstream Protestant denominations and defiantly returned to the very same Evangelical thinkers that Owen had denounced for their unapologetic individualism. (These connections are elaborated in Block and Somers 2003; Somers and Block 2005. The most influential contemporary writer to return to the early nineteenth century has been Olasky 1992.)

The clearest expression of this coalition's denial of society were the words of Margaret Thatcher, the British Prime Minister whose election in 1979 had been a harbinger of the Right Turn that was about to take power in the United States as well. In an interview in 1987, she spoke for millions of others in rejecting the idea of society as a meaningless abstraction:

> I think we've been through a period where too many people have been given to understand that if they have a problem, it's the government's job to cope with it. 'I have a problem, I'll get a grant.' 'I'm homeless, the government must house me.' They're casting their problem on society. And, you know, there is no such thing as society. There are individual men and women, and there are families. And no government can do anything except through people, and people must look to themselves first.

Her words perfectly capture the insistence of Christian conservatives and market fundamentalists that personal responsibility and self-discipline are the only truly effective response to social problems.

Just as in the early nineteenth century, the choice by the wealthy and by corporate leaders to deny the reality of society and embrace market fundamentalism was a strategy by which they could avert new forms of regulation and new types of taxation that would restrict their freedom and limit their accumulation of wealth. It allowed them to take the offensive and be self-righteous about their wealth-maximizing maneuvers. However, just as in the earlier period, the dynamic for the less affluent who were swept up in the resurgence of the religious Right is necessarily more complicated.

Again, as Thompson argued, evangelical congregations provided many who were being displaced and dislocated by economic trends with a community and some important forms of mutual aid (Block 2007). At the same time, the "Chiliasm of the defeated and the hopeless" also has its appeal to those for whom the reality of society has turned dark and hopeless. Arlie Hochschild (2005) has written of the contemporary Evangelical focus on the end times:

> We can understand the appeal of the idea of a Rapture, though not, or not only, in the believer's terms. There is a world literally coming to an end – the industrial world of the well-paid blue-collar worker. It is a world to which the working man and woman have already sacrificed much time and from which the promised rewards are disappearing. Belief in the Rapture provides, I would speculate, an escape from real anxiety over this very great earthly loss. Internet images of the Rapture often portray thin, well-dressed white people rising up into heaven to join awaiting others. The excluded are welcomed. The rejected are accepted. The downwardly mobile become upwardly mobile.

However, I would also emphasize a third argument that has to do with the simultaneity of the postindustrial transition and efforts to establish equal rights for women and racial minorities. Each of these upheavals, by itself, would have been difficult and produced enormous social strains. Yet when they were layered on top of each other, as they have been in the United States, the social and psychic sense of dislocation has been particularly intense. Segments of the population have felt themselves simultaneously losing ground to both new strata of highly educated knowledge workers and previously devalued groups, especially African Americans. In response, denying the reality of society and embracing the radical individualism of conservative Christianity has been a way to both preserve a certain sense of worth and express resentment against those other groups (Frank 2004; Goldberg

2006). The permanent tax revolt communicates an unwillingness to cooperate with these resented groups.

These linkages are evident in the political priorities of the Texas Christian Coalition (TCC), which has exerted considerable influence within the Texas Republican Party. The TCC's stated purpose is to defend Christian and traditional values. However, in addition to opposing abortion and homosexuality and favoring school prayer, the group is against the federal income tax and wants it replaced with a sales tax or a flat tax. The group also believes that "Educational policy should be left in the hands of local schools, without the influence of federal bureaucrats" (Lamare, Polinard, and Wrinkle 2003, 65). This statement is a reflection of the protracted battles over school integration and the federal government's denial of tax exemption to nonsectarian segregated academies (Crespino 2007). There is a kind of secessionist impulse at work; the group's supporters want to minimize their connections – both fiscal and interactional – to those people who do not share their specific values (Goldberg 2006).

CONCLUSION

This chapter has argued that tax cutting became such a central part of Republican politics in the United States over the last three decades because it was a way of expressing the resistance of powerful constituencies to the deep transformations that were occurring in U.S. economy and society. Yet this was not simply an exercise in symbolic politics; it had very real and dramatic consequences. The political forces aligned behind market fundamentalism and tax cutting were able to block the kinds of social and economic reforms that would have made it possible for the society to cope more effectively with new technologies and greater global economic integration.

By its nature, the argument advanced here is necessarily speculative. However, one possible test of its persuasiveness is what the historical analogy with nineteenth-century England suggests about the future of politics in the United States. In England, the period in which the denial of the reality of society was dominant was relatively brief – lasting from the French Revolution through the 1830s. Yet the passage of the Malthus-inspired New Poor Law in 1834 precipitated a mass anti-Poor Law movement that signalled the decline of Methodism and other conservative denominations and the rise of mass working-class politics (Block and Somers 2003). Moreover, the alliance between Christians and business interests proved to be only temporary as churches defected from laissez-faire and emphasized the social dimension of the Gospels. By the 1840s and 1850s, John Stuart Mill was the leader of a new generation of political economists who distanced themselves from the market fundamentalism of Malthus and Ricardo.

It would seem that the dynamic of change was basically generational. The acute stresses of the transition to heightened social interdependence were experienced most acutely by older cohorts. However, the new generations, born between 1795 and 1834, experienced the new industrial society and the greater level of social interdependence as a taken-for-granted given. As more people of that new generation come of age, the political power of denial weakened. A more realistic politics

became possible as a growing percentage of the electorate grew skeptical of the market fundamentalist prohibitions on governmental action.

There are some indications that a similar generational dynamic is under way in the United States. Support for conservatism and market fundamentalism among younger cohorts of voters appears to have fallen precipitously in recent years. A new generation that grew up with the Internet and social networking websites does not seem worried by heightened interdependence but actually embraces it (Winograd and Hais 2008). Public opinion polls provide some indication that these younger cohorts are less suspicious of taxation. A Kaiser Family Foundation survey in 2003 found that only 35.4 percent of respondents between ages 18 and 29 wanted to abolish the estate tax as compared to 52.6 percent among those ages 30 to 49 and 69 percent among those ages 50 to 64. Similarly, a survey commissioned by the Rockefeller Foundation in 2008 found that among the 18 to 29 age-group, 86 percent agreed that more government programs should help those struggling under the current economic conditions, as contrasted to 58 percent of those who were age 65 and older.

However, political change is never automatic. Generational change creates possibilities, not inevitabilities. Mounting a durable challenge to conservative hegemony requires embracing greater interdependence and advancing a new governing philosophy that refutes market fundamentalism directly (Block 2006). The only escape from the sterile political debates of the past thirty years is to affirm directly the "reality of society."

5 Making Taxes the Life of The Party[1]

CHRISTOPHER HOWARD

This volume is designed to facilitate cross-national comparisons of taxation. Because the chapters in this section focus on different periods in U.S. history, we can track change over time as well. During the 1930s, the main advocates of progressive taxation were members of the Roosevelt administration, liberal Democrats in Congress, and liberal media outlets such as *The Nation* and *The New Republic.* Their main adversaries were businesses and the rich, which made sense considering that they were basically the only ones paying income taxes at the time. Tax politics was an ongoing battle between political elites and economic elites (see Chapter 2). Between the 1940s and 1960s, elected officials broadened the base of the income tax and increased tax rates. Nevertheless, the general public exerted little influence on tax policy, and political elites continued to be the central actors. When elected officials started to talk more about taxes in the 1970s, the public became more involved. Taxes became a bigger influence on voting behavior, and citizens became more concerned about the level of taxation (see Chapter 3). In this context, it became easier for conservative elites to mount a sustained drive to cut taxes, which began with Reagan and continued through the George W. Bush administration (see Chapter 4).

Like Fred Block, I am interested in tax politics during the late twentieth and early twenty-first centuries. However, the story I tell is rather different. Instead of analyzing how Republicans tried to cut tax rates, this chapter shows how Democrats and Republicans used the tax code to make social policy. The key instrument was the tax expenditure, which refers to any tax credit, tax deduction, or other special provision in the tax code that reduces what individuals or companies pay in income tax.[2] Whereas Block shows how tax cuts appealed to economic or religious conservatives, I will demonstrate that elected officials have used tax expenditures to help millions of middle and upper-middle-class citizens. Such behavior is perfectly rational in a nation where political participation, including voter turnout, varies directly with income and education (Jacobs and Skocpol 2005; Stanley and Niemi 2008; Verba, Schlozman, and Brady 1995). When making tax policy, public officials

[1] An earlier version of this chapter was presented at The Thunder of History: Taxation in Historical and Comparative Perspective Conference, Northwestern University, Evanston, IL, May 4–5, 2007. Joseph Cordes, Richard Hay, and especially Ajay Mehrotra provided helpful comments and suggestions.

[2] *Tax expenditures* are popularly known as tax breaks, tax loopholes, or tax incentives.

may well be concerned about the general public (see Chapter 3), but they arguably pay more attention to the most active members of the polity.

Political scientists are trained to ask, "Who gets what from government?" This question comes up constantly, for example, in the study of social policy. Specialists in tax policy remind us to ask, "Who pays?" as well. This chapter addresses both questions. The first section demonstrates that tax policy is intimately connected to social policy in the United States. The obvious link is through the financing of social programs, especially the choice of payroll taxes versus general revenues (Campbell and Morgan 2005; Derthick 1979; Skocpol 2000). Although this subject has not received the attention it deserves, it will not be discussed much here. The other crucial link, often overlooked, is the tax expenditure. Tax expenditures are widely considered to be equivalent to direct expenditures. Allowing homeowners to deduct mortgage interest payments from their taxable income is the same as collecting taxes on their full income and then issuing homeowners a benefit check. The heavy reliance on tax expenditures is one of the defining features of the American welfare state. As we shall see, tax expenditures are central to housing, health, retirement, and income support policies in the United States.[3]

The second part of this chapter shows how party politicians use the tax code to make social policy in the United States. Over the last few decades, Democrats and Republicans have struggled to forge a durable majority. The result, more often than not, has been divided government. Sharing power has meant gridlock in some policy domains and interesting coalitions in others. With respect to tax expenditures, the two parties have managed to put aside their differences. They have allowed the largest tax expenditures to keep growing and created new tax expenditures. Although their reasons have differed, Democrats and Republicans have agreed that using tax policy to make social policy is good politics.

CONNECTING TAX POLICY TO SOCIAL POLICY

The classic function of taxation is generating the revenue needed to support government. Taxes are seldom popular, which is why we sometimes say that revenue is "extracted," like an infected tooth, rather than "raised" like a child. Taxes are unpopular in part because they may be used to transfer resources from one group to another. Individual income taxes are a main source of revenue for the U.S. government, and one of the most progressive forms of taxation in the United States. The wealthiest fifth of the nation pays more than four-fifths of all income taxes (DeNavas-Walt, Proctor, and Smith 2007; U.S. Congress, Joint Committee on Taxation 2007). Their tax dollars help to finance Medicaid, welfare (i.e., Temporary Assistance for Needy Families [TANF]), food stamps, public housing, and many other social programs for people with limited incomes.[4] These social programs are highly redistributive. Not surprisingly, they are often quite controversial.

[3] The OECD refers to this subset of tax expenditures as Tax Breaks with Social Purposes (TBSPs).

[4] The sources of government revenues vary over time and by level of government. In 1940, excise taxes were much more significant than individual income taxes; now, excise taxes are a small fraction of total revenues. At the state level, sales taxes are currently an important source of general revenues, which are used to finance some of these social programs (e.g., Medicaid and TANF).

Another chronic problem, mentioned in Chapter 1, is that taxpayers do not know exactly what their taxes will finance. Public support for taxation may therefore be tenuous, and tax avoidance may spread. To deal with this problem, public officials often earmark taxes for specific uses (Patashnik 2000). Some of the largest U.S. social programs – notably Social Security, Medicare Part A, disability insurance, and unemployment insurance – are financed primarily by payroll taxes that are deposited in special trust funds.[5] Taxpayers are supposed to have greater confidence in these programs and feel entitled to benefits. Depending on the specific program, these taxes are flat or regressive. Social Security, the largest of these programs, taxes payroll at a single rate up to a certain income ($102,000 in 2008). Earnings above that threshold are not taxed at all, making the tax regressive.

Although payroll taxes are a major source of revenue for the American welfare state, no new payroll taxes have been adopted since the 1960s. According to Campbell and Morgan (2005), conservatives gradually succeeded in focusing attention on the additional taxes that any new program would entail rather than the additional benefits. In this context, liberals found it easier to finance new programs out of general revenues, which were progressive, than out of regressive payroll taxes. That way, the costs would be borne by the rich and not the working and middle classes. The State Children's Health Insurance Program (SCHIP), established in 1997, was a good example.

Tax expenditures offer a second solution to the problem in taxation of known costs and uncertain benefits. Tax expenditures are similar to payroll taxes in that they identify a specific good or service to be subsidized. There is, however, a key difference that makes tax expenditures more attractive politically. Rather than collect taxes and distribute benefits, governments can selectively reduce the tax burden of those who behave in socially desirable ways or who experience certain social problems. In effect, tax expenditures allow public officials to address specific problems by cutting taxes, not raising them. That is a very seductive proposition to anyone aspiring to elected office, especially in a polity attuned to tax burdens.

Little wonder, then, that the American welfare state features a wide range of tax expenditures. The most recent analysis published by the U.S. Congress, Joint Commission on Taxation (2007) reveals huge subsidies for housing – $74 billion for home mortgage interest, $29 billion for capital gains on home sales, and $17 billion for property taxes on homes in 2007. Employers can deduct their health insurance premiums, which currently save them more than $100 billion each year in income taxes. Their contributions to employees' retirement pensions cost the government even more in foregone revenues. Most families with dependent children receive either the Earned Income Tax Credit (EITC; $45 billion) or the Child Tax Credit ($45 billion), and sometimes both. Deductions for charitable contributions cost the national treasury about $42 billion in 2007. Social Security and Medicare benefits are not fully taxed, which cost the government an estimated $22 billion

[5] Medicare Part A covers hospitalization. Part B covers more routine doctor care and is financed by a combination of general revenues and individual premiums. Part D covers prescription drugs and is financed like Part B.

and $40 billion, respectively. Altogether, the United States spends as much on tax expenditures with social welfare objectives as it does on traditional social programs targeted at the poor and near-poor (U.S. Congress, Joint Committee on Taxation 2007; U.S. Census Bureau 2007). Imagine a map of the United States that started on the Eastern Seaboard and extended west to the Rocky Mountains, then stopped. That is what the American welfare state would look like without tax expenditures. If we add in favorable tax treatment of capital gains, which subsidize the owners of valuable assets, then the sum total grows by another $180 billion.[6]

In previous research (Howard 1997, 2007), I have tried to demonstrate how this "hidden welfare state" of tax expenditures challenges the conventional wisdom about U.S. social policy. The United States, for example, is supposed to have a small welfare state compared to other affluent democracies. This is considered important evidence of American exceptionalism(Kingdon 1999; Lipset 1996). Such comparisons are based on traditional social programs, financed by payroll taxes or general revenues. Including hundreds of billions of dollars of tax expenditures should improve the relative standing of the American welfare state. To be fair, we need comparable figures for other welfare states, and those are not easy to derive given differences in how countries classify tax expenditures and estimate their cost. The latest estimates from the Organisation for Economic Co-operation and Development (OECD) show that the United States does indeed rely on tax expenditures more than other welfare states. In 2001, tax expenditures with social welfare objectives amounted to 2.1 percent of Gross Domestic Product (GDP) in the United States.[7] Only Germany (1.6 percent) was close. Belgium (0.5 percent), Canada (0.8 percent), France (1.1 percent), Japan (1.1 percent), and the United Kingdom (0.2 percent) trailed well behind. Scandinavian welfare states hardly use tax expenditures at all to make social policy. As a fraction of GDP, social spending in the United States is still lower than in Europe, but the gap is smaller after we incorporate tax expenditures (Adema and Ladaique 2005).[8]

Tax expenditures have a bigger impact on the distribution of social spending. The elderly are usually portrayed as the main beneficiaries of the American welfare state, and rightly so. Social Security and Medicare are the two largest social programs, and they provide income support, medical care, and some long-term care for senior

[6] If anything, these figures may underestimate the cost of tax expenditures. The president's Office of Management and Budget, using somewhat different assumptions and techniques, has been known to publish higher estimates. Moreover, some analysts count the revenue lost from not only national income taxes, but also state income taxes and payroll taxes, which significantly increases the cost of tax expenditures (Selden and Gray 2006; Sheils and Haught 2004). And some state governments offer tax benefits similar to those found in the U.S. tax code, albeit much smaller in size.

[7] These figures exclude tax benefits for pensions, which the OECD has yet to develop a way of comparing across countries. Given the magnitude of such tax expenditures in the United States, the true figure is probably in the range of 2.5 to 3.0 percent of GDP.

[8] On the other hand, some welfare states tax social benefits more than others. The Scandinavian welfare states tend to be high on this list and the United States is low. If we calculate social benefits net of taxation, then the American welfare state is also less of a laggard (Adema and Ladaique 2005). Because the United States has a larger GDP than most nations, a smaller share of its economy may be worth as much as a larger share of, say, the German or Dutch economy. If we calculate social spending per person, rather than as a fraction of GDP, then the size of the American welfare state is quite typical of European welfare states (Howard 2007).

citizens.[9] Roughly a quarter of Medicaid spending goes to long-term care for the elderly poor. Easily half of traditional social spending is thus directed at senior citizens.[10] The poor and the disabled are the other main beneficiaries in the American welfare state. Individuals who fit in none of these categories constitute the "missing middle" of the American welfare state (Skocpol 2000). These individuals are neither rich nor poor; they are wage-earners, often with children. Unlike Europeans, these Americans do not have national health insurance or family allowances. Should they lose their jobs, these Americans find it more difficult to qualify for unemployment benefits, and whatever they do receive will be comparatively small.

In fact, the government helps many members of the "missing middle" – just not the same way as most European welfare states. Tax expenditures are the primary policy tool used to help working-age adults and families in the United States. As mentioned earlier, the health benefits tied to employment are heavily subsidized by the tax code. Because most Americans have private health insurance, this tax expenditure benefits more people than Medicare and Medicaid. The various tax breaks for their homes cost much more than everything the government spends on rental housing for the poor. The Child Tax Credit and EITC perform the same function as European-style family allowances and cost more than welfare and food stamps put together.

Nevertheless, tax expenditures help some families more than others. Table 5.1 shows the distribution of several tax expenditures by income group. Those groups correspond roughly to the poor (less than $20,000), the lower-middle class ($20,000 to 40,000), the middle class ($40,000 to 75,000), the upper-middle class ($75,000 to 200,000), and the rich (more than $200,000).[11] In some cases, notably the EITC, almost all of the benefits are targeted at people with limited incomes. Social Security benefits are distributed widely, so the benefits of not taxing all of those benefits as regular income are spread out as well. However, these are the exceptions.

The main beneficiaries reside in the upper half of the income distribution. The pattern is clearest in housing. Almost no one earning less than $40,000 a year claims the home mortgage interest deduction. For them, the standard deduction on their tax form is almost always larger than the sum of their itemized deductions, including mortgage interest. Members of the middle class receive about one-eighth of the total mortgage deduction. The lion's share goes to the upper-middle class (55 percent) and the rich (30 percent). A typical rich family receives $5,200 a year to subsidize its mortgage payments; a typical middle-class family gets only $900. In the colorful words of one analyst, "The deduction is the perfect break for bobos in paradise" (quoted in Lowenstein 2006). The deduction for real estate taxes has much the same distribution. Basically, U.S. housing policy involves helping

[9] These programs also serve a variety of groups who are not elderly. However, the elderly receive about 80 percent of total Social Security benefits (the rest go to survivors) and about 85 percent of Medicare benefits (the rest go to the disabled and patients with end-stage renal disease).

[10] Compared to other affluent democracies, the United States devotes a larger share of social spending to the elderly (Lynch 2001).

[11] These categories seem reasonable considering that the median household income in 2006 was about $48,000, whereas the mean income was a little more than $66,000. The rich as I've defined them constitute the top 4 to 5 percent of all households (DeNavas-Walt, Proctor, and Smith 2007).

Table 5.1. *Distribution of selected tax expenditures*

Tax expenditure	Estimated Cost (2006)	Share by income class				
		<$20,000	$20–40,000	$40–75,000	$75–200,000	$200,000 +
Home mortgage interest	$65.5 B	0.1%	1.8%	12.7%	55.4%	30.0%
Child Tax Credit	45.4	4.6	24.7	34.4	36.3	0.0
EITC	43.3	53.1	41.1	5.7	0.0	0.0
Charitable contributions	39.0	0.1	1.3	9.3	39.7	49.6
Real estate taxes	24.5	0.1	1.8	14.2	61.6	22.2
Untaxed Social Security benefits	21.6	13.6	24.7	43.9	16.2	1.6
Extraordinary medical expenses	7.9	0.5	7.0	30.4	53.1	9.0

Notes: Share figures may not total to 100 percent because of rounding; apart from the two tax credits, the rest are tax deductions; the figures for untaxed Social Security benefits also include a small portion of untaxed railroad retirement benefits.

Source: U.S. Congress, Joint Committee on Taxation 2007.

fairly privileged families afford four-bedroom houses in the suburbs. It is hard to overstate the importance of these tax subsidies considering that homes are the single largest asset for most Americans. The income tax code influences the distribution of income today and wealth tomorrow.

The tax code encourages people to donate to charities, and the main beneficiaries are again the well-to-do. The government spends nearly $20 billion each year on taxpayers who earn more than $200,000 and make charitable contributions. The Child Tax Credit, a cornerstone of family policy, gives more help to families earning at least $75,000 than to families earning less than $40,000. Even the tax deduction for extraordinary medical expenses is skewed in favor of the middle and upper-middle classes. If anything, one would expect the benefits to be reversed given that lower-income groups experience more health problems and have worse health insurance coverage.

Important tax expenditures are missing from Table 5.1 because they do not appear on individual tax returns and are therefore more complicated to estimate. Foremost among these are tax breaks for health and pension benefits, which are deducted from employers' taxable income. A number of analysts have examined these benefits and concluded that they do indeed favor more affluent workers. These workers are management consultants, doctors, lawyers, software engineers, skilled factory workers, government employees, and, yes, even college professors. In general, employees are less likely to have health insurance if they work for a small business; earn below-average wages; are in retail or service occupations; work part-time; or are employed in the private sector as opposed to the public sector. The clerk at the shoe store, the woman who runs a daycare center out of her home, the landscaping crew – many of these people will not have health insurance. The Congressional Research Service calculates that only 16 percent of families earning less than $16,200 a year had health insurance from their employer in 2003, compared to 86 percent of families earning more than $81,000 (Hungerford 2006). The average family earning $25,000 a year essentially received a $400 subsidy for their health insurance, courtesy of the tax code; this figure included those who had coverage and those who did not. The average family earning more than $100,000 received a tax subsidy of almost $1,500 (Selden and Gray 2006; Sheils and Haught 2004).[12]

According to a recent study, about half of all workers participate in a tax-favored retirement plan. Yet the odds of any given worker participating in such plans vary tremendously by income. Only one out of five people earning less than $20,000 participate, compared to almost four out of five earning more than $80,000. The disparity is even more pronounced among 401(k) plans, which are gradually replacing traditional defined-benefit plans. More than half of all workers earning more than $80,000 have a 401(k) plan, compared to just 6 percent of workers earning less than $20,000. On average, members of the more affluent group contributed around $5,000 to their 401(k)s; members of the less affluent group contributed about $750 each (Congressional Budget Office 2006). Whereas

[12] Author's calculations are based on Exhibit 2 in Sheils and Haught (2004), which includes the cost in foregone income taxes and payroll taxes. My figures take into account only foregone income taxes.

most senior citizens rely on Social Security for most of their income, the richest seniors supplement Social Security with sizable company pensions. The tax code thus helps to foster a certain amount of inequality among retirees .

It is not hard to explain why most tax expenditures benefit the haves and the have-lots. The individual income tax, even after the Bush tax cuts, is still one of the most progressive sources of revenue in the United States. The rich, who constitute a small fraction of all taxpayers, generate more than half of all income tax revenue. Individuals earning less than $30,000, however, essentially pay no income tax at all. The combination of the standard deduction, personal exemptions, and the EITC eliminates their tax liability (U.S. Congress, Joint Committee on Taxation 2007). By the same token, tax expenditures typically help the affluent more because their tax rates are higher. A $1,000 tax deduction is worth more to someone in the 33 percent tax bracket than to someone in the 15 percent bracket. Finally, many of the goods and services subsidized by the tax code, such as housing and health insurance, are too expensive for many people to purchase, or if they do, are often bought in lesser amounts.

How might one change the upward skew of tax benefits? The EITC offers a few lessons. First, it is possible to cap eligibility at a certain level of income. A married couple with two children was ineligible for the EITC if its annual income was more than $39,783 in 2007 (roughly twice the federal poverty line). Single workers with no children were eligible as long as their income was less than $14,590, or about 133 percent of their poverty line.[13] Officials could place similar caps on other tax expenditures. In the words of a former Internal Revenue Service commissioner, "Why would you want an abnormally large subsidy for people who have abnormally large mortgages?" (quoted in Lowenstein 2006).[14] Second, the EITC is one of the few refundable tax expenditures. If the value of the EITC exceeds the total income tax obligation, which it does for most recipients, then the government issues a tax refund.The Child Tax Credit is partly refundable, which helps explain why these benefits are distributed more evenly than most tax expenditures (Table 5.1). Deductions for home mortgage interest, real estate taxes, and extraordinary medical expenses are not refundable, but certainly could be.

By looking more closely at U.S. tax policy, then, our understanding of U.S. social policy changes. One well-known group of social programs is financed by general revenues, paid mostly by the affluent. The beneficiaries are the poor and near-poor. Economists sometimes use a modified Suits index to measure the progressivity of spending programs. The values range from +1 (completely progressive) to −1 (completely regressive). By this measure, Food Stamps (0.91), TANF (0.85), Supplemental Security Income (0.78), and Medicaid (0.59) – all financed by general revenues – are very progressive (Hungerford 2006). A second group of programs, fewer in number but larger in size, is financed by payroll taxes. Although payroll taxes can be regressive, the benefits are usually distributed progressively. Social

[13] The thresholds or the EITC can be found at the Internal Revenue Service website (www.irs.gov/individuals/article/0,,id=150513,00.html).

[14] True, the home mortgage interest deduction is limited to the first $1,000,000 of debt, but this cap does not affect many homeowners.

Security benefits replace a higher fraction of previous wages for low earners than for high earners. The benefit formula more than compensates for the impact of payroll taxes, meaning that Social Security reduces income inequality (Smith, Toder, and Iams 2003/2004). Compared to Social Security, Medicare's funding is less regressive. The Medicare payroll tax applies to all wage and salary income, and part of Medicare is financed through more progressive income taxes. Medicare benefits are not skewed toward the rich. Almost three-quarters of noninstitutionalized Medicare recipients have incomes less than $30,000 (Cubanski et al. 2005). Both kinds of programs, backed by general revenues or payroll taxes, help reduce poverty and close the gap between rich and poor.

Tax expenditures are different. They have the progressive financing characteristic of means-tested social programs. Both rely heavily on individual income taxes. Nevertheless, the distribution of benefits could hardly be more different. In the visible welfare state, the land of welfare and Social Security, means testing is explicit and designed to limit benefits paid to more affluent citizens. In the hidden welfare state, means testing is more indirect: less affluent individuals are not formally excluded from the tax benefits attached to housing, health care, and retirement pensions, but in practice they seldom benefit. One needs substantial, not limited, means to thrive in the hidden welfare state. The major tax expenditures do redistribute income but, with the exception of the EITC, not from rich to poor. Most tax expenditures redistribute from the rich and the upper-middle class to the middle and upper-middle classes. They help close the gap between the haves and the have-lots rather than between the have-nots and the have-lots. Normally we expect social programs to fight inequality and poverty. Tax expenditures address inequality in the upper half of the income distribution and generally do little to reduce poverty.[15]

PARTY POLITICS AND TAX EXPENDITURES

Over the last few decades, party control of government has shifted back and forth in the United States. In some years, Democrats have controlled both houses of Congress and the White House; in other years, Republicans have done so. The more common pattern has been divided government, sometimes with a Democratic president and sometimes with a Republican. The two parties have been so evenly matched that small shifts in the electorate have had large impacts on election results. And, over the last few decades, party politicians have become more enamored of tax expenditures. As opposition has grown to new payroll taxes, officials have approved a number of new tax expenditures with social welfare objectives. They have also helped existing tax expenditures expand. My argument is that these trends in party competition and policy making are related.

Historically, the development of the American welfare state has been closely linked to the balance of power between Democrats and Republicans (Howard 2007). New social programs were created more often in the mid-1930s and

[15] This pattern also means that tax expenditures do little to address racial inequalities of income and wealth, and may even compound them (Moran and Whitford 1996).

mid-1960s than in any other period in the twentieth century. The New Deal produced Social Security, unemployment insurance, a national minimum wage, and Aid to Families with Dependent Children (the forerunner of TANF). The Great Society included Medicare, Medicaid, food stamps, and Head Start. These were the exact moments when Democrats enjoyed huge majorities in Congress and liberal Democrats occupied the White House. Many scholars have attributed the expansion of European welfare states to the rise of socialist and social democratic parties after World War II (Esping-Andersen 1985; Huber and Stephens 2001). In the United States, the Democrats have been the major party of the Left. In contrast, when Republicans were ascendant, social programs typically faced cutbacks. The first major cuts to means-tested programs (in 1981) occurred right after President Reagan took office and Republicans took control of the Senate. Soon after Republicans' historic victories in the 1994 congressional elections, legislators passed a sweeping welfare reform law that was designed to reduce the number of recipients and cut spending. No one pressed harder for privatizing Social Security than President George W. Bush.

The usual distinctions between left and right do not help us much when studying tax expenditures. A number of new tax expenditures – individual retirement accounts (Nixon), the EITC (Ford), the low-income housing tax credit (Reagan) – were created while Republicans occupied the White House. The Child Tax Credit, a tax break for companies that hired welfare recipients and other disadvantaged workers, and another tax break for postsecondary education all emerged in the 1990s when President Clinton shared power with a Republican Congress. Moreover, regardless of which party held power, tax expenditures have grown. In real terms, the value of tax breaks for homeowners almost doubled between 1980 and 2005. Tax subsidies for employer health and pension benefits tripled in size (U.S. Congress, Joint Committee on Taxation 1981, 2007). Expansion, not retrenchment, has been the story of the hidden welfare state in an era of divided government.

This pattern may surprise readers who know something about U.S. tax policy. After all, the defining events of recent years were the Tax Reform Act of 1986 and the Bush tax cuts of 2001–3. Because both cut marginal tax rates, both indirectly reduced the value of tax expenditures. If your annual mortgage interest was $5,000, the tax deduction was worth less if your tax rate was 25 percent than if it was 35 percent. Although the 1986 Act directly targeted a number of tax expenditures for elimination or reduction, most of these provisions had little to do with social policy. They involved commerce, such as repealing the investment tax credit and closing down various real estate tax shelters. Tellingly, when officials limited the deductibility of consumer debt, they preserved the home mortgage interest deduction (Birnbaum and Murray 1988). Although the 1986 Act did trigger a large and significant drop in the size of most tax expenditures, it was not sustained. As the government added new tax expenditures, expanded existing provisions, and raised marginal tax rates on the affluent (in 1990 and 1993), the overall cost of tax expenditures started growing again. By 2000, tax expenditures represented a larger share of GDP than they had in the mid-1970s. That share has dropped in the wake of the Bush tax cuts, but not by much (Hungerford 2006).

The record of growth is also surprising given that Republicans have gained power in recent decades, and congressional Republicans have become more conservative (Hacker and Pierson 2005b). Despite their reputation as enemies of the welfare state, Republicans have been instrumental in creating and expanding tax expenditures. President Nixon insisted that a new tax break for individual retirement accounts be included before he signed off on the massive Employee Retirement Income Security Act (ERISA) pension reform bill. During his time in office, President Reagan cut spending on welfare, low-income housing, and food stamps. He also endorsed, openly and unequivocally, the EITC and approved the first major expansion to it in 1986. President Bush, Sr. made it clear that he opposed national health insurance; instead, he offered tax credits for health insurance. The GOP Contract with America (1994) called for excluding teenage mothers from welfare, compelling more welfare mothers to work, and imposing lifetime limits on welfare benefits – all in the name of personal responsibility. The same Contract proposed a new $500 child tax credit. President George W. Bush followed in his father's footsteps by proposing tax credits for health insurance. When the major tax expenditures for health and pension benefits and for housing have come under attack – admittedly, not a common occurrence – Republicans have been quick to defend them (Howard 1997, 2007).

This doesn't exactly sound like the party of small government. To understand the curious behavior of Republican officials, we need to appreciate Republican voters. In 1984, when Republicans controlled the White House and the Senate, most rank-and-file Republicans felt that their income taxes were too high. A minority (about one-third) of self-described Republicans said that government should try to reduce income differences between rich and poor. No surprises there. Nevertheless, these same Republicans felt positively toward key parts of the welfare state. Only a small fraction said that government was spending too much on Social Security. They were more likely to say that the government was spending too little. We see the same results with health care, education, and assistance to the poor: more Republicans said the nation was spending too little rather than spending too much.[16]

Was 1984 some sort of aberration? No. If we move forward to 1994, the year that Republicans won control of both houses of Congress, we find 70 percent of ordinary Republicans saying their income taxes were too high. Support for income redistribution was still low. And yet Republicans remained fairly strong supporters of spending on Social Security, health care, education, and assistance to the poor. Move ahead one more decade, to 2004, and the picture hadn't changed much. If anything, Republican support for Social Security and health care had grown.

To be responsive, Republican officials have had to find a way to cut taxes and spend more on social programs. Tax expenditures are ideally suited to accomplish these seemingly antagonistic objectives. Tax expenditures appear to reduce the size of government while enlarging the scope. Moreover, tax expenditures generally do little to reduce the gap between rich and poor, which is a virtue in the eyes of most Republicans. Given that Republicans tend to be more affluent than the average American (Stanley and Niemi 2008), it makes good sense for Republican

[16] These figures are based on analysis of the General Social Survey, available at http://sda.berkeley.edu.

officials to embrace tax expenditures for home mortgage interest, job-related health insurance, retirement pensions, charitable contributions, and the like. Tens of billions of dollars spent each year on these programs are going directly to their constituents.

Republican officials have another important reason for supporting tax expenditures. As many studies have shown, Republican officials are often more conservative than Republican voters, and much more conservative than the median voter. These officials complain loudly about government creating a culture of dependency. Many of them would genuinely like to roll back the welfare state and limit the scope of government (Edsall 2007; Hacker and Pierson 2005b; Skocpol 1996). They have had some success in retrenching means-tested programs, notably in 1996. Yet Republicans have found it very difficult to attack some social programs directly. Cutting Social Security will raise the ire of the AARP and senior citizens; cutting Medicare will aggravate groups representing the elderly, doctors, and hospitals (Campbell 2003; Oberlander 2003). In those instances, they have used the tax code to contain existing programs, a bit like using plastic booms to limit an oil spill in the water. If you cannot eliminate or retrench traditional social programs, maybe you can slow them down.

Social Security grew dramatically, for example, in the late 1960s and early 1970s as Congress approved a series of major benefit increases. A number of Republicans, Senator Jacob Javits foremost among them, felt they had to make private pensions larger and more widely available in order to dampen demand for future expansion to Social Security. In 1974, they managed to enact a major overhaul of laws (ERISA) affecting company-based pensions and to introduce a new tax break for individual retirement accounts. Twenty years later, a new generation of Republicans criticized how much government spent on paid childcare, but they were unsuccessful in eliminating these programs. The better solution, in their view, was helping families stay home to raise their own children – hence the new Child Tax Credit. Many Republicans have embraced the EITC in order to prevent, or at least minimize, increases in the minimum wage (Howard 2007).[17] Tax expenditures thus help GOP officials achieve their own policy objectives and meet the needs of millions of Republican voters.

Some Democrats have embraced tax expenditures enthusiastically and others less so. The so-called New Democrats, the more moderate wing of the party, have viewed tax expenditures as a less bureaucratic means of achieving their policy objectives. If the main job of government was steering, not rowing, then using the tax code to influence individual and corporate behavior made good sense. Politically, greater reliance on tax expenditures would help the Democratic Party shed its tax-and-spend image without abandoning issues that mattered to its core supporters. And tax expenditures could help the party reach out to more affluent voters in ways that traditional means-tested social programs could not. President

[17] Republicans have also used the tax code to prevent substantial innovation in social policy. If millions of middle-class Americans have health insurance through their workplace, there won't be much pressure to adopt health insurance. Therefore, the government must preserve tax benefits for employer health insurance.

Clinton was the most prominent of the New Democrats. He wanted to create or expand tax expenditures for a wide range of social problems. The combination of Clinton and congressional Republicans was instrumental in passing the Child Tax Credit. Both Clinton and Reagan increased the value of the EITC and the number of families eligible for it. The Democratic Leadership Council, the official home of New Democrats, issued a blueprint for domestic policy in 2006. Key planks in their American Dream Initiative included a refundable tax credit for college tuition, larger tax incentives for retirement pensions, and greater access to mortgage interest deductions for less affluent homeowners.[18] As a general rule, the more liberal wing of the Democratic Party has preferred more direct forms of government intervention. However, they were outnumbered and sometimes had to accept tax expenditures as "the only game in town" (Rep. Pete Stark, D-CA, cited in Howard 1997: 166). The combination of Republicans and New Democrats made it too difficult to enact national health insurance, paid parental leave, or other pieces of the liberal agenda.

A realistic look at the electorate made tax expenditures even more attractive. Although Democrats have long been associated with the poor and near-poor, these groups do not carry significant clout in national elections. In the 2000 and 2004 elections, people earning less than $30,000 accounted for less than one-quarter of all voters. Voters earning more than $75,000, meaning the upper-middle class and the rich, accounted for a larger share. Even though Democrats fared better among lower-income voters, winning 60 percent, they won more votes from the well-to-do (Stanley and Niemi 2008: Table 3.5). Democrats need the support of white-collar professionals, and they know it (Judis and Teixeira 2002). Historically, Democratic candidates have also done well among organized labor, and unionized firms have typically offered generous health and pension benefits to their workers. From time to time, academics have suggested curbing the tax benefits for health care, an idea that few elected officials have endorsed. The architects of the Clinton health plan backed away from this idea out of deference to labor (Hacker 1997). Tax expenditures thus allow Democrats to help labor and more affluent professionals, two key elements of their coalition.

CONCLUSION

Debates over taxes can be highly partisan. Democrats and Republicans argue constantly over the proper level of taxation. Over the last few decades, Republicans have been loath to support any tax increase. Their top priority has been cutting taxes (Block, Chapter 4). The failure of President George Bush to win reelection in 1992 after breaking his "no new taxes" pledge has been interpreted as proof that Republicans must not raise taxes. President Clinton's first budget failed to win the vote of a single Republican in Congress, mostly because it raised taxes. Democrats have not been particularly effective in arguing against tax cuts or on behalf of tax increases. They have tried instead to reframe debates over taxation by invoking the deficit; higher taxes are needed because they lower the budget deficit (Graetz and

[18] The American Dream Initiative is available at www.ndol.org/documents/ADI_Book.pdf.

Shapiro 2005; Pierson 1998). That is quite different from saying that higher taxes are needed to finance important government programs.

The two parties have also clashed over the distribution of the tax burden. In 2001, President George W. Bush proposed one of the biggest tax cuts in U.S. history. Although Bush claimed the move would benefit all Americans, the big winners were the rich. Republicans knew how hard it would be to win Democratic support for such a proposal and decided to make their adversaries irrelevant. "Democrats were almost nonplayers in the development of the tax cuts. Instead of striking a bipartisan deal, Republicans used the powers of their congressional and White House leadership to control the language of the debate and the policy alternatives considered" (Hacker and Pierson 2005: 63–4). Many Democrats have been trying ever since to reverse some of the Bush tax cuts. During the most recent presidential campaign, the candidates sparred often over tax policy, with Republican John McCain promising to preserve the Bush tax cuts and Democrat Barack Obama calling for higher taxes on the wealthy. When analysts write about the growing polarization of American politics (e.g., Hacker and Pierson 2005b), these features of tax policy provide good evidence.

When the discussion turns to tax expenditures, however, the two parties can find common ground. Both Democrats and Republicans have a vested interest in the well-being of the middle and upper-middle classes. Whereas the rich may be small in number but politically engaged, and the poor and near-poor may be large in number but less engaged, the middle and upper-middle classes are large and engaged.[19] Their support is crucial in national elections. Democrats and Republicans can use tax expenditures to help these individuals afford health insurance, pay off their mortgages, and save for retirement. Those are very tangible benefits. In some ways, tax expenditures represent plan B for both parties. Many Republican officials might want deep, across-the-board tax cuts, but they cannot always overcome the power of elected Democrats or ignore the views of Republican voters. What Republicans can do is reduce taxes selectively. For their part, some Democratic officials may want a European-style welfare state, but they are in the minority. At times, the best they can do is offer tax subsidies to some Americans for health care, childcare, housing, and the like.

At the start of this chapter, I pointed out some of the differences between my understanding of recent tax policy and Fred Block's. Let me conclude by noting an important similarity. Party politics is not the only reason why tax expenditures have become so important in the United States. Interest groups, especially business interests, have certainly been part of the story. Through the tax code, the government helps subsidize a number of goods and services provided by the private sector. These organizations understand all too well how important tax breaks are for their business. Anyone who tries to curb tax expenditures for housing will quickly find themselves pitted against the National Association of Home Builders, the National Association of Realtors, the Mortgage Bankers Association, and the major construction unions. When employers buy health insurance for their

[19] Under certain conditions, the two parties may use tax expenditures to win support from less affluent Americans. See the analysis of the politics of the EITC in Howard 1997.

workers with tax-favored dollars, those insurers develop a stake in tax expenditures. Employers themselves benefit because tax breaks for health and pension benefits help their companies attract and keep skilled workers, and may reduce demand for higher wages. The EITC picks up support from the National Restaurant Association and the American Hotel and Motel Association, whose members employ many low-wage workers. For these companies, the EITC acts like a wage subsidy, paid by taxpayers (Geewax 2005; Howard 1997; Pierce 2005).

Taken together, all four chapters in this section prove that political and economic elites have been central to tax policy in the United States since at least the 1930s. The bigger change has been in the role of ordinary citizens. Compared to the middle of the twentieth century, the public pays more attention to taxation, and elected officials care more about what the public thinks (Campbell, Chapter 3). The politics of taxation is no longer limited to the rich and powerful; it involves the entire population, with special attention to those who are politically active.

6 The Politics of Demanding Sacrifice: Applying Insights from Fiscal Sociology to the Study of AIDS Policy and State Capacity

EVAN S. LIEBERMAN

INTRODUCTION: INSIGHTS FROM THE TAX STATE

Joseph Schumpeter's stirring conclusion in a 1918 text, that "the spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history," serves as a mantra for a large body of fiscal sociological scholarship.[1] However, the statement is, of course, hyperbole. Even the most ardent student of fiscal history could not read, as if off a tarot card, all of a state's or a society's actions or the content of its culture from its fiscal system. Among other reasons, this is true because the development of tax systems are largely path-dependent processes – once developed, they are resistant to significant change, even when the initial conditions that produced those outcomes no longer exist. And although the extent of citizen consent or resistance to fiscal demands from the state is likely to indicate a state's overall authority, the challenges of taxing are distinct and independent from other aspects of governing. This chapter seeks to understand the extent to which insights gleaned from fiscal sociological analyses can provide theoretical and empirical guidance for explaining the development of other state capacities requiring a substantial degree of citizen compliance and consent.

There is prima facie evidence to suggest that the study of taxation may provide only limited insights into the rise of other state powers. Specifically, many states that tax well do other things poorly, and vice versa. Indeed, the motivation for comparing the development of taxation capacity to other state capacities in this chapter was generated from seeming contradictions in the body of my own scholarly work.[2] One research project investigated the rise of the tax state primarily in the cases of Brazil and South Africa (Lieberman 2001, 2003), and another focused on government responses to the human immunodeficiency virus/acquired immunodeficiency syndrome (HIV/AIDS) pandemic (Gauri and Lieberman 2006; Lieberman 2009). Retrospectively, one can find a reversal of outcomes across the two studies: Although South Africa's tax state was found to be far more

[1] See Campbell 1993 for an excellent review of an earlier generation of scholarship.

[2] Thanks to Deborah Yashar and Nancy Bermeo for pushing me to explicitly account for these seeming contradictions. However, the motivation for the study also forces me to be shamelessly self-referential in the text, for which I apologize in advance.

progressive and efficient than Brazil's, Brazil developed one of the most impressive and aggressive responses to AIDS in the world, whereas South Africa became known for its laggard and backward approach to the epidemic. If a country's tax system is such a good indicator of state capacity and authority, why would these sets of capacities develop in such different ways across the two countries? Compounding the puzzle, both studies identified *social boundaries* as a central explanatory variable, highlighting the effects of the two countries' quite distinctive approaches to racial heterogeneity.

I use the specific puzzle of these contrasting findings to answer the larger question of the potential for fiscal sociology to serve as a general foundation for exploring the origins of consent. It is organized into three sections: First, I specify a basic typology for theorizing about the state: Both taxation and AIDS policy share a demand for sacrifice from citizens, as distinct from many other types of policies. The state's ability to elicit sacrifice is a distinctive set of capacities from those related purely to service delivery or disbursement. Second, I identify a set of factors that shape the likelihood of sacrifice based on prior research on the tax state. Specifically, I focus on the effects of political communities and the boundaries of social identities. Third, I present a brief meta-analysis of studies relating social boundaries to taxation and AIDS capacities in Brazil and South Africa, which allows me to identify more nuanced conclusions about the social and political determinants of state development.

I do not attempt to provide a single or complete explanation for the relative successes and structures of modern states. And yet, fiscal sociology, as envisioned by Schumpeter and as expressed by the various chapters contained in this volume, does provide some foundational insights. For example, some leading assumptions about the nature of state behavior are clearly incomplete: Coercion or predation alone cannot account for the relative success in overcoming the free rider and collective action problems of gaining consent; successful states require a strong degree of quasi-voluntary compliance from citizens (Levi 1988). Moreover, citizens ought not to be conceived purely as utility-maximizing individuals making self-interested calculations, but as members of social groups affected by the psychosocial motivations of group-based competition. Rather than conceiving of fiscal relations as akin to a set of market transactions, fiscal sociology suggests we ought to study the rise of the state in terms of social relations. Information, preferences, and strategies are all constrained by the nature of social ties and divides. In turn, these affect the content of what political philosophers refer to as the "social contract" that is negotiated between the state and society.

UNPACKING STATE AUTHORITY: DISBURSEMENTS AND SACRIFICES

Scholars of comparative politics have long pursued the Weberian agenda to understand the rise of the modern state, including questions about state efficacy, and the sources of success and failure in broadcasting and maintaining authority over large numbers of people. And although a variety of bureaucratic functions and indicators of state capacity have been examined, arguably the most illuminating approach has been the study of taxation, or the rise of the "tax state." Building on the

foundational observations of fiscal sociologists Joseph Schumpeter and Rudolph Goldscheid, more recent scholarship has taken on the challenge of explaining differences in levels and structures of taxation (Chaudhry 1997; Cheibub 1998; Herbst 2000; Ross 2004; Kato 2003; Brownlee 1996a; Campbell and Allen 1994; Levi 1988; Steinmo 1993; Lieberman 2003; Kasara 2007), patterns of avoidance and evasion (Slemrod 1992; Lieberman 2002b; Fjeldstad 2006), and the allocation of tax capacities across levels of government in federal or partially decentralized polities (Treisman 1999; Choi 2006).

Fiscal sociologists highlight that when a government can convert private resources into public ones, it has demonstrated substantial power within its territory, providing a basis for further exploration. In this volume, for example, Kiser and Sacks (Chapter 11) pose larger questions about the relative weakness of African states to broadcast their authority in terms of tax capacities, and they generate testable hypotheses about the role of agents and monitoring costs. Einhorn (Chapter 9) explains the relative capacity of American states to tax as a function of the scope of two institutions: democratic government and slavery. These studies pose deep questions about the rise of governments, and because tax policies and collections can be measured with some precision, they are posed in a manner that is amenable to social science analysis, reflecting the promise of fiscal sociology more broadly.

To what extent can insights from these studies be extended? To answer this question, we must identify a relevant theoretical descriptor that could encompass a broader range of activities than just taxation. Increasingly, government bureaucrats and global governance authorities such as the World Bank have been describing and measuring virtually all aspects of state action in terms of *service delivery*, assessing performance in terms of the degree to which key tasks are completed. Such an approach might suggest that collecting taxes is no different from removing refuse or paying out Social Security benefits. Ironically, some modern tax collection agencies have begun to refer to taxpayers as "clients," suggesting that the agency is providing a "service." Yet such rhetoric cannot hide the fundamental tension implied by efforts to tax: collectors aim to extract money from individuals and private entities and those agencies provide nothing of value in return. Tax collectors have the unpleasant task of asking people to do something that they inherently do not want to do. Tax agencies may advertise the benefits governments provide, but for the most part, such goods and services are wholly beyond the control of the taxing authority. This is the crux of disaggregating state power: Specifically, we can think of a great many government policies as being of one of two types: disbursements and sacrifices.[3]

Disbursements are transfers of public resources into goods and services that citizens almost universally want.[4] In most cases, disbursements can be understood as

[3] This is far from an exhaustive typology. For example, many government policies involve procedural issues about policy making and conflict resolution. My goal here is simply to distinguish sacrifice policies from their obvious counterparts.

[4] Of course, certain sets of citizens will oppose the provision of such goods in particular circumstances, such as a major road next to one's home, or cutting right through it, but even such individuals tend not to oppose roads in general.

primarily usable or consumable goods, such as roads, schools, water and sanitation systems, or unemployment insurance, but they can also be symbolic or informational goods, such as messages of national pride, or information about the value of education. They may be public goods or selective goods. Most people want to consume such goods most of the time, and at the very least, they almost never object to their provision (setting aside the issue of who pays). That does not mean everyone supports policies to provide them – in fact, proposed disbursements are routinely resisted for a variety of reasons, including concerns about available resources, and priorities. All else being equal, citizens and organized interests are likely to try to prod governments to provide the disbursements that they value the most. Disbursement policies primarily involve government giving, spending, or enabling citizens, and in the absence of budget constraints, we would expect governments to provide more and more of these. When state agents carry out these tasks as planned, their work is generally appreciated. Although competition over disbursements can be central to political life, the state's ability to provide these goods – holding constant available financial resources – says little about the nature of the state's authority or power over the citizenry.

By contrast, *sacrifices* are policies and practices that seek to convert private resources into public ones. Most notably, this is done through the payment of taxation. Scholarly interest in the state's ability to tax tends to be motivated either implicitly or explicitly by a prior assumption about human behavior – that under ordinary circumstances, individuals are unlikely to give up substantial portions of income or wealth without some guarantee of some direct benefit in return. And yet, demands for taxation are legally compulsory, made as unrequited payments to the state (World Bank 1988: 79). Moreover, there is often a substantial time lag between the collection of new resources and the public return in terms of how such resources are used, requiring substantial trust on the part of citizens that the state will use resources wisely and as promised (Ide and Steinmo, Chapter 7). Why would any citizen or group of citizens consent to paying? Indeed, responses to demands for taxation have varied widely across time and space: In some polities, income earners pay a full half of their annual income over to the state with little protest. In other places, people revolt. And in still others, they merely ignore the state's demands, or they remain completely unaware of the obligation in the first place.

Although taxation is the most consistent form of sacrifice demanded, it is not the only one. Other examples include military conscription and recruitment (Levi 1997), as well as policies that involve private restraint or behavior change that serve the public good, such as curtailing smoking, driving within speed limits, or restraining from colluding with competitors (antitrust laws). These may be directly economic/fiscal in nature, or behavioral/regulatory in nature. Sacrifice policies may involve cultural change, such as the learning of a new language, or the revelation of embarrassing facts in the sense that certain behaviors are identified as causing public harm. The state may demand sacrifices of individual privacy, liberty, or autonomy, with its requests for private information. Holding all else constant, sacrifices are intrinsically and initially desired by almost no one, and state leaders try to avoid their imposition. Nonetheless, they may be demanded or supported by those with faith in their consequences or understanding of their necessity for fiscal

balance. Parents may willingly send their children off to war – possibly to make the so-called ultimate sacrifice – but presumably only because they believe the war is just. Citizens may willingly learn the dominant language because they believe it will provide long-term opportunities, but the near-term burdens of conformity are clearly a form of sacrifice.

Sacrifices may be reminiscent of costs and disbursements of benefits, but I avoid these terms because they imply a short-term and individual/consumer-based market logic that rarely holds true at the level of public policy. The sting of sacrifice is evident far before any benefits can be observed, and because many of the benefits are public goods, even those who have not sacrificed may consume what is provided. As a result, unlike in the case of market exchange, there exist cooperation and collective action problems particularly when sacrifices are initially demanded. The politics of making initial demands for sacrifice policies involves convincing large swaths of society or political elites within society that a significant new need truly exists, and that there is a moral or normative obligation to contribute or to comply given one's status as member of a community. This is why the most revealing periods for analysis are during the policy making and original implementation stages, when information about the long-term effects of such policies for oneself and for society at large are still uncertain. I am not suggesting that delivery is irrelevant: In later stages of state-building, both the extent and the quality of goods and services provided are likely to influence the trajectory of policy making and compliance. Moreover, the state's monitoring and coercive powers may have a strong influence on levels of compliance. Nonetheless, during critical early periods when state leaders attempt to establish new functions, they require a substantial degree of societal consent that they can legitimately make such demands.[5]

AIDS POLICY AND TAXATION AS VARIETIES OF SACRIFICE

Ordinarily, AIDS policy and taxation are not immediately recognizable as similar types of policies. The former is more typically recognized as fitting within the domain of health policy, and the latter in public finance and economic policy. Taxation has been at the core of the modern state, whereas AIDS policies are only a recent invention in response to an epidemic that became visible in the early 1980s. Revenues generated from taxation may easily be used for a wide variety of purposes, whereas the fungibility of AIDS-related policies is limited to a more narrow range of public health concerns beyond this particular disease.[6] However, as the basis for relationships between states and societies, AIDS policy and tax policy share important similarities in that at the core both involve significant

[5] Levi 1988 introduces the critical idea of "quasi-voluntary" *compliance*, identifying the state's need for citizens to comply even beyond the threat of coercion. I extend this notion more generally to *consent* in order to capture citizen acceptance of policies demanding sacrifice.

[6] I am grateful to the editors and an anonymous reviewer for making this point. However, the ultimate effects of AIDS policies on more general patterns of state–society relations remain to be seen. Where citizens have actively complied in such programs, the state may have new information and resources to influence family planning and sexual behaviors as well as new access to personal information about citizen health and the prevalence of disease.

Table 6.1. *Understanding the initiation of taxation and AIDS policies as forms of sacrifice*

	Building tax capacity	Building government AIDS capacity
The sacrifices (material, psychic)	Give up private income, wealth	Modify, refrain from pleasurable sexual activity Modify childbirth, feeding Accept uncomfortable public discussion of sex, drug use, germ theory of disease
Additional sacrifices (liberty, privacy)	Transfer private information about economic activity over to the state	Transfer private information about personal behavior over to the state
Potential for coercion and its limits	Fines/jail for nonpayment (but difficult to enforce)	Restrictions on movement, compulsory testing (but may be resisted and ineffective)
Potential free rider/ collective action problem	If everyone else pays, an individual can benefit from state expenditure without making sacrifices	If everyone else modifies behavior, can benefit from reduced risk of infection, impact on economy, without making sacrifices
Individual quid pro quo for sacrifice	None (except for benefits of staying within the law)	Personal protection Personal treatment (but must accept nature of the problem; and may be stigmatized for taking action)

demands for sacrifice. Both sets of policies aim, at least in part, to provide certain types of public goods. (In this sense, public health policies designed to curb the spread of infectious disease are quite distinct from policies that might pay for the treatment of particular health conditions, such as heart disease.) Recognizing similarities in the political challenges of AIDS policy as akin to taxation sheds light on how and why these important capacities vary so widely across countries. Major decisions about policy are rarely the product of some "pure"[7] scientific or technical justification, but a question of politics and political interpretations. As stated in Chapter 1 and echoed throughout this volume, the extent of enacting and implementing such policies has depended largely on deeper social structural conditions.

Although it would be tempting to assume that everyone would want aggressive AIDS policies to protect themselves from a deadly epidemic, widespread examples of state and societal resistance to such policies demand further explanation. In fact, most AIDS policies can easily be understood as involving significant sacrifices (see Table 6.1). Because the predominant mode of transmission of HIV is

[7] See Epstein 1996 on the characterization of AIDS policy as "impure science" in the United States.

sexual contact, the primary sacrifice involved with government AIDS policies has involved acceptance of new information and admonitions for behavior changes in this area, including public sexual education campaigns, the use of condoms, or discussions about abstinence and partner reduction. Within societies, such campaigns can be upsetting because they implicate members of society in the practice of sexual behaviors that they often would prefer to remain completely private. And to be frank, *safe sex* generally means less or less pleasurable sexual activity.

AIDS policies have also involved the testing of the blood of their citizens, and monitoring their knowledge of the epidemic and their sexual behaviors, which has often been viewed as a nuisance or potentially embarrassing and quite frightening. AIDS policies have included direct interventions in the process of childbirth, including mandating additional blood tests, placing HIV-positive pregnant women on drug therapies, requiring that they deliver babies by cesarean section in order to prevent viral transmission, or demanding that they refrain from breast-feeding.[8] Unless these various prevention measures are uniformly and collectively practiced, those that practice them may easily be identified as being HIV-positive. In turn, this may lead to their being shunned by neighbors and family members, creating strong disincentives for consenting to such policies. There must be a general acceptance that these policies are generally warranted, and a strong sense that once implemented, most others will comply. At the core, the initiation of many AIDS-related policies implies that private acts have dramatic consequences in terms of one's own health and well-being, as well as that of others, and this may be a transformative realization where a notion of public health is not already well institutionalized. Even AIDS treatment policies require cultural transformation in the sense that members of society must be willing to subject themselves to testing, and to accept modern scientific notions of a viral infection and the potential efficacy of an anti-retroviral drug, as compared to other traditional forms of healing.

As part of the process of developing its capacities, states require a great deal of information about citizens. In the case of taxation, states require information about the extent of property, wealth, and financial flows; and in the case of HIV/AIDS, they require information about the incidence and prevalence of infections within society, as well as the prevalence of behaviors and social structures that affect the likelihood of further transmissions. Both sets of information require that the state closely monitor people within society, and members of society may not trust the state to use such information for their benefit.

Both for taxation and for AIDS, the initial development of state capacities is largely dependent upon the willing or voluntary acceptance of and compliance with demands for sacrifice. Again, I do not believe that citizen inclinations to comply with these types of government policies can be modeled through reliance on a logic of consumer demand and supply. The fact that we may be able to find an abundance of compliant taxpayers in places where government services are good,

[8] Most recently, however, new scientific evidence has shown that exclusive breast-feeding reduces the chance of HIV transmission more than the mix of formula-feeding and breast-feeding.

or perceived to be good,[9] or to find that AIDS prevention and treatment services are successful where people actively and openly highlight the threat of AIDS, are merely post hoc observations of the results of deeper social processes that required sacrifice prior to state action or the observable benefits of compliance.

The flip side of compliance is resistance, and states are more likely to develop strong capacities when they do not meet significant resistance to their claims to authority. Often, such resistance is not even expressed by constituents, because leaders make calculations about likely resistance based on their own knowledge of social and political dynamics. Citizens will willingly accept sacrifice only when they are convinced of its potential benefits or the moral rationale of the demand. They resent and resist such sacrifices if they believe they and the people they care about are unlikely to face such calamity. People will be particularly resentful if they believe that the very risk itself arises through the deliberate and avoidable actions of others, and it is not merely randomly produced. They will also resist sacrifice if they do not trust that the resources will be used as intended (Levi 1988, 1997; Braithwaite and Levi 1998).

Of course, citizen willingness to comply with state demands is not the only determinant of state efficacy because states, by definition, maintain a coercive apparatus. Although violence or threat of violence and incarceration are often effective tools for gaining compliance and are central pillars of authority (Weber 1968), coercion is costly and can be self-defeating in the case of taxation (Levi 1988: 50; Sheffrin and Triest 1992; Kinsey 1992) and has been increasingly discarded as a tool in the AIDS epidemic with most international authorities recommending noncoercive measures. Coercion in the form of quarantine continues to be used for certain modern public health concerns (such as severe acute respiratory syndrome [SARS]), but for HIV/AIDS, it has been considered impractical, particularly because most people do not present with symptoms until they have been infected for seven to ten years. There has been increasing international consensus that such quarantine would be both a human rights violation and ineffective as a policy strategy.[10] Nonetheless, some coercive measures, including mandatory tests for entry and exit across national borders, as well as punishments for knowingly putting others at high risk of infection through sexual contact, remain widespread.

Thus, both taxation and AIDS policies promise uncertain future benefits that are likely to improve the collective welfare if cooperation and compliance are widespread. There are, however, key differences: Individuals who practice safe sex, for example, are likely to avoid infections, and HIV-positive individuals who begin drug treatment, are likely to enjoy a marked improvement in quality of life directly associated with their own actions that is not typical for individual

[9] See Lieberman (2002b), which demonstrates that the positive correlation between individual-level satisfaction with services and inclinations toward tax compliance in South Africa falls away once individual attitudes toward other race groups are incorporated in a statistical model.

[10] The Cuban quarantine program was an obvious exception to the human rights/AIDS paradigm. That program was initiated extremely early in the epidemic, and Cuba now has the lowest rate of HIV infection in the western hemisphere. In response to international condemnation, the Cuban government discontinued this program but continues to have an extremely active and effective AIDS capacity.

taxpayers, for which there is no quid pro quo. Tax-evading citizens may be able to enjoy a free ride off other taxpayers, but HIV-positive individuals cannot take a free ride off someone else getting tested and taking pills. However, HIV-negative individuals could potentially get a free ride off the protective strategies of others – enjoying a largely infection-free environment without modifying behavior. And more generally, the prior steps in getting citizens to follow this logic, and to support (and not resist) incursions into their private lives require that they be willing to accept the fundamental narrative of the threat of HIV/AIDS. In this sense, it is similar to getting citizens to believe that war or a significant security threat is imminent. Indeed, as Feldman and Slemrod demonstrate in Chapter 8, war does help to increase the willingness to sacrifice on the part of citizens, helping to overcome the free rider problem posed by taxation.[11] More generally, states require a plausible narrative to demand sacrifice, whether those demands are to accept the need for a massive AIDS campaign or to pay taxes.

THEORIZING ABOUT THE DETERMINANTS OF SACRIFICE: THE ROLE OF BOUNDARIES

What explains patterns of sacrifice? If, as I have argued, the political challenge of imposing a strong government AIDS program is truly similar to that associated with tax extraction – even if far from identical – there is good reason to believe that similar types of factors would influence the development of capacities across time and space. Several factors are likely to matter, including international trends and influences[12] and the particular sets of resources available within a country at a moment in time. A central idea is that citizens are more likely to support demands for sacrifice when they perceive a strong duty to act associated with sentiments of duty or patriotism (Scholz and Pinney 1995; Levi 1997). Major expansions of state capacity tend to follow precipitating crises that motivate the demand for sacrifice. The classic statement of this argument is, of course, Tilly's (1975, 1992) notion that "wars make states," a notion that is empirically examined in Chapter 8 in the cross-country analysis of tax collections by Feldman and Slemrod.

However, the interpretation of the extent of threats, including war, and the associated appropriate level of sacrifice are almost never clear-cut, and this suggests we ought to investigate the bases of collective fear and concern. Even war – as is abundantly clear in the contemporary "war on terror" – is a social construction created out of the political manipulation of risk (Lustick 2006).

Although largely neglected by political scientists, scholars from other fields, including sociologists, anthropologists, and psychologists, have gone a long way toward demonstrating that perceptions of risk, and in turn the state's bargaining power to impose sacrifice, are socially constructed – the product of objective factors and their translation in the political arena. In a series of essays spanning several

[11] See also Kiser and Linton 2001.

[12] In the case of AIDS this is obvious, but there have always been global trends in taxation as well, including the widespread introduction of income taxes in the 1910s and 1920s and the diffusion of value-added taxes in the 1980s and 1990s.

decades, Mary Douglas has found that the public understands risks differently from experts, and it is a fallacy to think that public perception of risk is the sheer aggregation of actual dangers facing individuals in that society (Douglas 1992: 11, 40). Psychologists employing a range of experimental and survey methods have arrived at similar conclusions – that although danger may be real, risk is a far more complex sociopolitical construct (Slovic 1999; Slovic et al. 2004). In addition to rational calculations about risk, humans are likely to use heuristics of affect to make quick decisions about the riskiness of various options. The critical influence of emotion and feeling in developing perceptions of risk leave it open to political manipulation (Slovic et al. 2004). Influential members of society and polity may argue that the exact same objective dangers are small or large, concentrated or widespread, caused by random acts of nature or deliberate or immoral behavior on the part of particular actors. Presented with the exact same set of facts, two different actors may describe their understanding of the problem in completely different ways and take different actions.

So what shapes perceptions of risk or danger such that they would be induced to accept sacrifice? In prior work on the politics of taxation (Lieberman 2001a, 2003), I developed a set of theoretical propositions, which I called the *model of identity and sacrifice*. That model was primarily designed to account for differences in the state's ability to collect taxes. More recently, as I have attempted to understand differences in patterns of government aggressiveness on AIDS, I have generalized this model to other forms of sacrifice. What I have found in both sets of research is that citizen willingness to accept sacrifice, which in turn allows a central government to exert its authority, depends heavily on the construction of social boundaries (Lamont and Molnár 2002; Tilly 2005: 7–9). Migdal (2004: 5) highlights that boundaries, "signify the point at which something becomes something else . . . at which 'we' end and 'they' begin." In this sense, *groupness* is contingent upon the existence of the formal and informal rules that help to sort out membership, providing guidelines about who is in and who is out. To be certain, such feelings of collective identity are malleable and may be shaped by the precipitating crises that motivate initial calls to sacrifice, but preexisting boundary institutions are still likely to shape the interpretation of objective dangers as posing significant risks or not.

In the earlier work on taxation, I highlighted the effects of exclusion within ethnically diverse societies characterized by high degrees of ethnic chauvinism. Exclusion of a proximate out-group helped to promote in-group cohesion, and this helped members of the in-group to view their fates as collectively pooled, and in turn, states found it easier to tax citizens of the in-group. Particularly in the early stages of developing a new state capacity, and contrary to a theory of predation, state leaders are not likely to exact disproportionate sacrifice from their political opponents, because they are most likely to resist. Rather, in times of crisis, particularly in early stages of state formation, they are most likely to make demands on their own supporters, for whom they may be able to convey credible messages of shared moral obligation and collective fate.

Based on this more limited application, and from other scholarship highlighting the relationship between boundaries of citizenship and state authority (Bendix

1964; Herbst 2000; Tilly 2005), there is good reason to hypothesize that the structure of social identities within a polity would be generally important for how citizens are likely to evaluate claims to sacrifice.[13] People tend to lack good information about their own individual risk profiles and are likely to seek out information about new threats and policies as well as appropriate beliefs and civic behavior in terms of group membership.[14] In this sense, the nature of intra-societal relations is critical for the state's ability to command sacrifice. Put simply, the stronger the collective identity and the weaker the lines of internal division, the more likely it is that citizens will sacrifice as long as the benefits of that sacrifice can be credibly restricted to group members. Citizens are more willing to sacrifice when the benefits are easily perceived to go to "us." This is quite distinct from a consumer model of behavior, because the costs and benefits are pooled, and the collective action problem is solved through a sense of moral obligation to group members. Social psychologists have consistently found that in the context of obvious in-group/out-group contrasts, group members will search for ways to improve the position and status of their group relative to the other (Tajfel and Turner 1986; Brown 2000).

In the case of AIDS, there are similarities as well as some important differences in the ways in which boundaries of social identity are likely to affect the development of state capacities. In the face of a looming epidemic, citizens should be more willing to accept the relevant demands for sacrifice when society is not clearly divided in terms of distinctive groups with differentiable risk profiles. That is, in homogeneous societies, and in heterogeneous societies where social boundaries are extremely weak or permeable, we ought to expect a citizenry that is more accepting of proposed policies. Under such conditions, reported infections within society are likely to be understood as potentially threatening to all of us, and official state demands for new sacrifices, including a recognition of the public health consequences of private acts, are likely to be considered credible. Alternatively, if a society is so divided, with strong internal boundaries, groups of citizens are likely to deemphasize their own group's problem: in the case of lower-prevalence groups, they are more likely to perceive themselves to be insulated through endogamous practices; and in the case of higher prevalence groups, they are less likely to mobilize risk because the act of highlighting the problem may be perceived to bring shame to their own group.[15] Strong ethnic boundaries, particularly when they fragment society into multiple groups, provide incentives for elites and citizens to resist HIV/AIDS policies, even when increasing levels of AIDS-related mortality

[13] A significant literature identifies the negative relationship between ethnic heterogeneity and public goods provision, including Easterly and Levine 1997; Alesina et al. 1999; Posner 2004. However, the mechanisms posited in those works generally apply for disbursements, in which it is assumed that preferences for particular goods vary across ethnic groups. In the case of sacrifice, all groups are likely to have intrinsic aversion to the policies, such that a better specified theoretical explanation is required.

[14] Scholz and Pinney 1995: 291 refer to a "duty heuristic" that can be particularly important in low information environments.

[15] An argument similar to that made in the context of African American responses to AIDS by Cohen 1999.

and morbidity and external pressures from the international community provide greater incentives to accept such sacrifices.

Central governments that attempt to act on HIV/AIDS in the context of strong and multiple ethnic boundaries may inspire ethnically based political conflicts. If governments opt to tailor their messages and policies to particular high-risk ethnic groups – the equivalent of a targeted tax – they may be seen as stigmatizing those groups, generating the types of resistance described earlier. If they opt for universal as opposed to targeted appeals, they may be challenged for being careless and insensitive to group differences or to needlessly wasting resources by addressing low-risk groups. In either case, the costs of action are likely to be higher than in societies where social boundaries are not particularly important.

To be certain, a wide range of other factors also affect the development of tax and AIDS capacities. For example, scholars have demonstrated that political institutions within well-developed democracies (Steinmo 1993; Steinmo and Tolbert 1998); the mobility of assets (Bates and Lien 1985); and political geography (Herbst 2000) have affected fiscal histories in distinctive ways. Research on the development of AIDS capacities is much less well developed, but of course there is good reason to believe that the quality of public health institutions, the size of the epidemic in neighboring countries, and other social and political factors influence state and societal responses. For both sets of capacities, domestic resources and international pressures are also important determinants of capacity.

THE DETERMINANTS OF TAXATION AND AIDS POLICY IN BRAZIL AND SOUTH AFRICA

Building upon the two central points made in the previous sections – that taxation and AIDS policy are both fundamentally questions of sacrifice, and that both are strongly affected by the composition of social boundaries and the associated notions of political community – it stands to reason that we would observe strong similarities between tax capacities and the nature of government responses to AIDS. In fact, this is not always the case, and the challenge of explaining why such capacities may diverge helps to further refine our understanding of the determinants of the state's ability to elicit sacrifice, and particularly the effect of social boundaries on such outcomes. The general logic of boundary politics, in which groups attempt to promote solidarity and esteem relative to other relevant groups, holds across policy areas. However, the effects of that logic in the development of so-called weak or strong capacities are structured by the ways in which precipitating crises get understood in particular historical and policy contexts.

In this final section, I offer a brief meta-analysis of two studies exploring the determinants of these capacities in Brazil and South Africa. Although the findings of each study demonstrates the power of boundaries as a determinant of fundamental social processes and policy outcomes, together they challenge the robustness of general theoretical assertions about the negative effects of ethnic or social diversity on the development of the state or the overall provision of public goods.[16] Grand-scale

[16] As is claimed by Easterly and Levine 1997, for example.

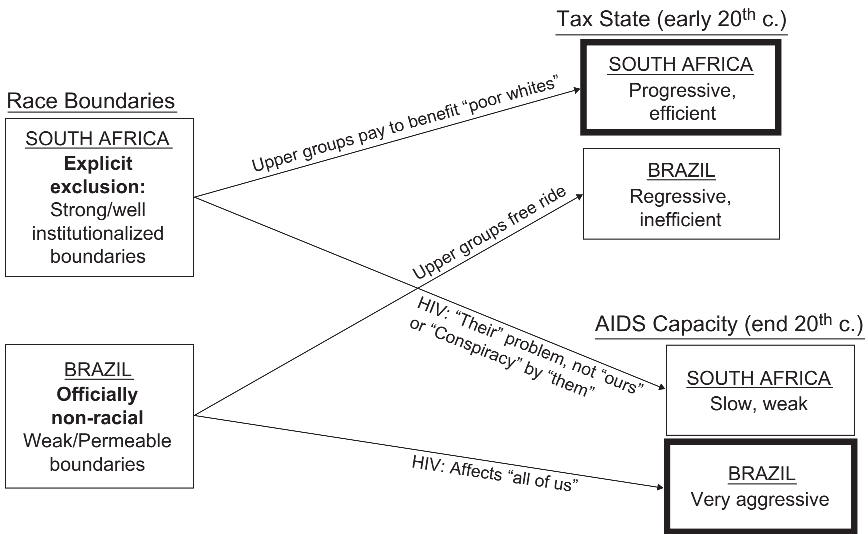


Figure 6.1. The effect of boundaries on state capacity.

theory must be calibrated with mid-range propositions in order to develop accurate models of politics and society.

First, it is useful to indicate that comparative analysis of these two countries proves to be particularly illuminating because they share a number of analytically relevant similarities, including timing and patterns of economic development, high levels of ethnic and racial diversity combining large African populations with several different European settler groups, and similar geo-strategic positions within their respective regions. Based on per capita income and various human development indicators, including standard measures of inequality, these two countries are and have been remarkably similar (World Bank 2006b). Both countries made transitions from authoritarian to democratic regimes as part of the third wave of democracy – Brazil in the mid-1980s and South Africa in the early 1990s. All of these similarities help generate prior expectations that the scope and quality of respective state authorities would be more or less similar.

However, if one accepts the fiscal sociological conclusion that the fiscal history of a state is fundamentally a history of the state more generally, the comparison generates a particular paradox: During the course of the twentieth century, South Africa developed a highly progressive and efficient tax state, whereas Brazil developed a largely regressive and inefficient one. On the other hand, in the late twentieth century, Brazil has developed one of the most impressive and aggressive responses to HIV/AIDS in the world, whereas South Africa's, for most of the history of the AIDS pandemic, has been among the most lackluster.

In both studies, it was found that a central determinant of the outcome was the very different ways in which the race question has been addressed in the respective countries (see Figure 6.1), leading to very different types of social boundaries.

In the case of Brazil, following the end of race-based slavery at the end of the nineteenth century, the government opted against any race-based codification of citizenship in the development of its new republic, particularly as embodied in its 1891 Constitution. In subsequent generations, governments would attempt to minimize or even outlaw racial discrimination or codification of any kind. In fact, the government and various social and political leaders have at various times promoted marriage and sexual contact across the color bar, through a strategy of "whitening" (Skidmore 1995). Although skin color has continued to be strongly correlated with income and status, and there have always been observable forms of racism in twentieth-century Brazil, race has not been a significant basis for overt social or political organization in the country – certainly not to the degree found in South Africa (or the United States). In Brazil, racial boundaries have been very weak and permeable: dozens of different labels are used (Turra and Venturi 1995; Telles 2004), and depending on context, Brazilians will describe their racial identities in very different ways.

By contrast, in the case of South Africa, race became the basis for citizenship in the formation of its new republic at the conclusion of the Boer War, as codified in the country's 1909 constitutional document. A series of draconian acts and practices would restrict suffrage, office-holding, property ownership, movement, and sexual contact along racial lines. Of course, domestic and international challenges to apartheid would lead to the dismantling of that system, the first multiracial elections in 1994, and the development of new policies and practices to integrate the country. Nonetheless, racial categories have remained particularly important for politics and the functioning of the state as part of a more general process of redressing the past. Although identities are not completely fixed in South Africa, the four central racial identities of black/African, white/European, Colored (South Africa's "mixed" race category), and Asian/Indian have remained quite consistent throughout the twentieth century, and the boundaries that divide these groups are quite strong. Unlike in Brazil, where a person might describe his or her racial identity in several different ways within the course of a year, in South Africa, racial identities tend to be far stickier, with rare adjustments within a lifetime.

Because the detailed analyses and evidence are presented in the original studies, I will not fully repeat those here, but the central arguments about how boundaries affected state capacities each depended on the construction of risk and the obligations of sacrifice relative to other groups.

Tax State

The development of the tax state in Brazil and South Africa occurred largely during the interwar period of the twentieth century. Tax structures were developed as a function of the two states' relative abilities to enact and implement progressive income taxes.

In the case of South Africa, deliberate racial exclusion allowed whites, although previously divided along linguistic and class lines, to see their fate as shared, and in particular, for wealthy whites to recognize a moral and strategic obligation to improve the lot of poorer whites, to be collectively distinguished from natives or

black Africans. In the context of external pressures for new income taxes, particularly during the two world wars, upper class groups accepted high rates of taxation, they paid willingly, and the state collected very large shares of total revenues from this direct tax. Once this capacity was developed, even as the state would increasingly redistribute resources to the black population, particularly after the 1994 multiracial elections, white taxpayers were already "in the tax net," and they had little ability to avoid or evade their tax obligations without relatively easy detection. Early patterns of quasi-voluntary sacrifice cast a long shadow on the future.[17]

In Brazil, during analogous periods of state-building, the wealthiest sectors in society lacked a strong collective solidarity (for example, one that might have been rooted in collective race chauvinism or otherwise) that might have glued them together, or to those who might benefit from their sacrifices. During the early part of the century, they were particularly divided along state (*estado*) and regional lines, and did not easily recognize any compelling imperative for collective action or downward redistribution. Although the state also tried to raise significant income taxes, the fundamental free-rider problem raised its head, and wealthy Brazilians resisted the state imposition of taxation by challenging new policy ideas, and by avoiding and evading the taxes that were enacted. In order to raise revenue, the state was forced to turn to less visible and more regressive tools.

AIDS Capacity

In the case of HIV/AIDS, differences in race politics, structured by early patterns of nation-building, also proved important. However, by the 1980s, when the AIDS epidemic was recognized, social boundary institutions created in these countries during the first half of the century had evolved. The apartheid model of a white South Africa was crumbling, giving way to a racially divided society and polity in an international arena that would no longer tolerate a purely racial basis for citizenship when people of multiple race groups were occupying a single territory. In Brazil, although race-based inequality and discrimination persisted into the last decades of the twentieth century, linguistic unification of the country was virtually complete and race-mixing had a long track record. These developments proved consequential for the politics of HIV, which had the additional property of being an infectious disease, transmitted largely through sexual contact.

In South Africa, the first cases of AIDS were identified among relatively affluent, white, homosexual men. Given the strength of racial boundaries that had developed in South Africa, many black South Africans initially viewed the epidemic as a "white" problem. On the other hand, once the epidemic began to explode among blacks in the 1990s, whites came to see it as a "black" problem, and used

[17] To be clear, my claim is that institutionalized white supremacy had a positive effect on the tax compliance of white citizens because the state was established to restrict citizenship to whites only. In this volume, Einhorn finds that tax capacity was weak in the states of the American South – where white supremacy was also well institutionalized – but in this case, she finds that Southern elites feared that the development of a democratic state would lead to the demise of slavery. This reinforces the more general point that consent and quasi-voluntary compliance require that the state be seen as a champion of a social group's interests.

AIDS as a rationale for further protecting themselves from close contact, in some cases justifying the maintenance of separate public facilities and blood donations. Throughout the history of the epidemic, public health statistics have always been reported in terms of separate race groups, undermining the possibility of thinking about AIDS as a truly national (i.e., not experienced differently by different race groups) phenomenon.

Even as rates of infection reached the double digits, black political leaders – including state presidents Nelson Mandela and Thabo Mbeki – refrained from aggressively demanding behavior change within their constituencies, fearing that it would imply collective reputational damage to their group as somehow immoral, unpure, and so on. Early conspiracy theories, including the slogan that AIDS was an "**A**frikaner **I**nvention to **D**eprive us of **S**ex," found a home in later denialist positions that HIV did not really cause AIDS or that traditional, African remedies could be just as effective as Western medicine. Although the danger of AIDS has been extremely visible in South Africa for a very long time, there has been a remarkably low mobilization of risk on the part of political elites, who have interpreted scientific and medical reports through the lens of boundary politics. Substantial survey evidence has also demonstrated that citizens have not perceived or expressed substantial risks. The combination of insulation from risk and reluctance to be seen as the affected group can be interpreted as resistance to sacrifice, leading to the extremely slow development of this important state capacity.

In Brazil, where race has not been socially or politically relevant to nearly the same degree, and the state has been reluctant to collect and to disseminate information about race, the initial reporting of an outbreak came to be understood as a truly national problem. Particularly in the first two decades, no one thought about the problem as a "white" or "black" epidemic, because racial identities tend to be fluid, and Brazilians consistently report high rates of intermarriage. The fact that a white person might be infected would be equally frightening to a "black" Brazilian[18] and vice versa, because patterns of intimate contact, through which the virus spreads, are multiracial in that country. Thus, when political activists and motivated public health experts mobilized and pressured the central government to respond to the epidemic – just as analogous actors had done in South Africa – there was no boundary bloc to the idea that the risk was real and shared. There were no political points to be scored by claiming that the virus was due to the immoral behavior of one group or another, or that certain sectors were safe, and so citizens were relatively more willing to accept the sacrifices of testing, behavior change, and so forth. The stigma of AIDS could be reduced because it affected "all of us," and a significant AIDS capacity could be developed.

Discussion

Thus, in these two sets of comparative analyses, boundary politics help to account for some of the variance in the development of state capacity through the level of

[18] These are not the exact terms in racial discourse in Brazil, but are useful here simply for analytic purposes.

sacrifice that could be expected from citizens. When the problem affected "us," or the associated sacrifice would be beneficial to "us," greater sacrifices were possible, allowing the state to develop a stronger capacity. Otherwise, states have been unable or politically unwilling to demand sacrifice. Yet the meta-analysis also highlights a number of important nuances to the development of the modern state.

First, timing matters. The structure of the modern tax state was formed largely during the interwar period in Brazil and South Africa, whereas responses to HIV/AIDS emerged during the last quarter of the twentieth century. If the South African or Brazilian tax states had been developed *de novo* in the 1990s, we would likely have seen very different results in both countries. Particularly in South Africa, it is hard to imagine that we would have observed the same willingness to make deep financial sacrifices once the glue of white solidarity was no longer available, and whites could not organize to use the resources of the state for their own collective benefit.

Second, particular state capacities are likely to develop as strong or weak depending on the willingness to sacrifice on the part of particular segments of the population relevant for that capacity. For example, the South African state's capacity to tax was well developed only with respect to one section of the population, namely the white population. The collection of taxes from blacks has been historically quite poor for a variety of reasons, including campaigns of tax boycotts owing to unjust treatment. Yet in fiscal terms, because income and wealth have been so heavily concentrated in white hands, this has implied the successful collections of most of the available tax base. Ironically, this has meant that the black government initially found it easier to collect from whites than from blacks because of the systems of tax administration developed in previous generations. (More recently, tax compliance among black South Africans has improved substantially.) In Brazil, efforts to tax the wealthy, a stratum that also tends to be light-skinned, have largely been a failure, and it is now extraordinarily difficult to reform a complex tax system built over several generations.

Third, the nature of the precipitating threat obviously influences the meaning and interpretation of social boundaries as relevant for willingness to sacrifice. For example, the political reactions to AIDS must be understood in terms of the fact that for the history of the epidemic, the problem and the mode of transmission (sex with multiple partners, IV drug use, etc.) have been stigmatized. As a result, political leaders have been disinclined to act for fear of group association with these stigmas, and in the context of intergroup competition within societies, these apprehensions have been compounded. If the nature of HIV and AIDS had been due to completely different factors – say airborne emissions from mining operations – the political response would surely have been different.

CONCLUSION

The central contribution of this chapter has been to identify what can and cannot be learned about state–society relations through fiscal analysis. There is no doubt that comparative and historical analyses of tax systems provide enormous insights into the state's abilities to command authority over society. Taxation is not merely

a technical matter, but a highly political one that cannot be well understood narrowly within the logic of market exchange. As such, the politics of taxation must be understood in terms of group dynamics and moral obligations, and the prism of social identity becomes particularly relevant for understanding how and why some states are better able to collect than others.

Insights about the development of the tax state can and should be extended to other relevant areas of analysis. In the contemporary era, the state's ability to combat the AIDS pandemic is obviously of paramount importance. Cross-policy comparison highlights the various ways in which states attempt to make incursions into the most private domains of social life. Social boundaries also matter for the development of policy and capacity in this domain as calculations about risks of infection, and the potential reputational damage from association with the virus, are likely to be made in terms of group heuristics. Inclinations toward blame and shame of other groups can lead to less aggressive policy responses.

Although study of the tax state can provide great insights into politics, society, and culture, as fiscal sociologists have long claimed, we should not be wooed into believing that fiscal history provides a crystal ball for understanding all aspects of state development. As we disaggregate our investigations of the development of political authority across function and time, distinctive drivers of cooperation and compliance inevitably emerge. This helps explain why strong tax states are not omnipotent, and weak tax states are not entirely ineffective in other ways. Future research ought to consider additional nuances across policy areas and to test these propositions across larger numbers of cases in space and time.

7 The End of the Strong State?: On the Evolution of Japanese Tax Policy

EISAKU IDE AND SVEN STEINMO

Japan has long been held up as a model of fiscal discipline and budget restraint. Indeed, Japan has held the remarkable distinction of being the country with the lowest budget deficits and the lowest levels of public spending of any of the rich Organisation for Economic Co-operation and Development (OECD) nations almost the entire postwar period. Even in the 1960s and 1970s, for example, when most other advanced capitalist democracies were building extensive welfare states, Japan continued to practice spending restraint while it was experiencing economic growth rates nearly double the OECD average. Many assumed that it was precisely the strength of state institutions (or the bureaucrats who populated them) that accounted for both the high levels of economic growth and the remarkable budgetary constraint experienced by this country (Borrus et al. 1982; Pempel 1979; Savage 2000; Thurow 1992). Indeed, Japan was sometimes held up as a premier example of a successful democratic "strong state" (Johnson 1982; Samuels 1994; Thurow 1992).

In the early twenty-first century, however, Japan's position looks altogether different. Not only has the country suffered more than a decade of poor economic performance, but in addition the budget has apparently grown out of control. In 2006, for example, the budget deficit was approximately 30 trillion yen – or 6 percent of Gross Domestic Product (GDP). Even more surprisingly, the total national debt has accumulated to 160 percent of GDP.

The following figures graphically demonstrate the extent to which Japan's fiscal situation has changed in the past thirty years (Figure 7.1) and how badly Japan has done in this regard when compared to other advanced capitalist nations (Figure 7.2).

In this chapter, we seek to explain this remarkable change in fiscal fortunes. How and why did Japan move from being a country of remarkable fiscal discipline and balanced budgets to becoming a country known for spiraling deficits? Why, indeed, is it so difficult to get Japanese taxpayers to consent to higher taxes? We submit that the answer to this question lies in the specific policy choices made by successive Japanese governments in the 1990s. During the so-called lost decade, Japan faced both political and economic crises. During these years, the government made the budget situation significantly worse by pursuing neoliberal fiscal policy that disproportionately benefited wealthy taxpayers. Much like the

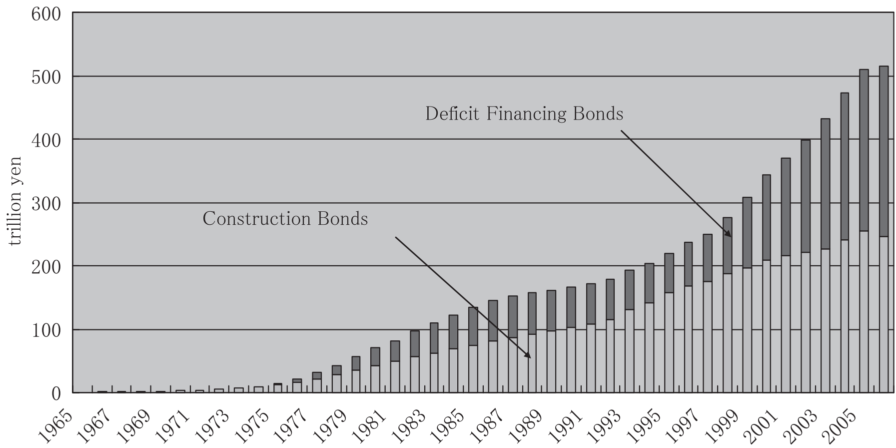


Figure 7.1. Japan's debt mountain. *Source:* "Current Japanese Fiscal Conditions and Issues to be Considered," Ministry of Finance.

tax policies followed during the Reagan and George W. Bush administrations (see Block, Chapter 4), these policies indirectly but significantly undermined citizens' confidence in their government. Consequently, the public has been deeply skeptical of the government's subsequent arguments that increases in taxes were necessary to balance the budget or fund the growing demands of Japan's nascent welfare state.

We believe this story is interesting and important in and of itself. We also believe that the Japanese case (like the American) demonstrates the connection between social welfare policy and taxation policy. With the exception of wartime tax efforts

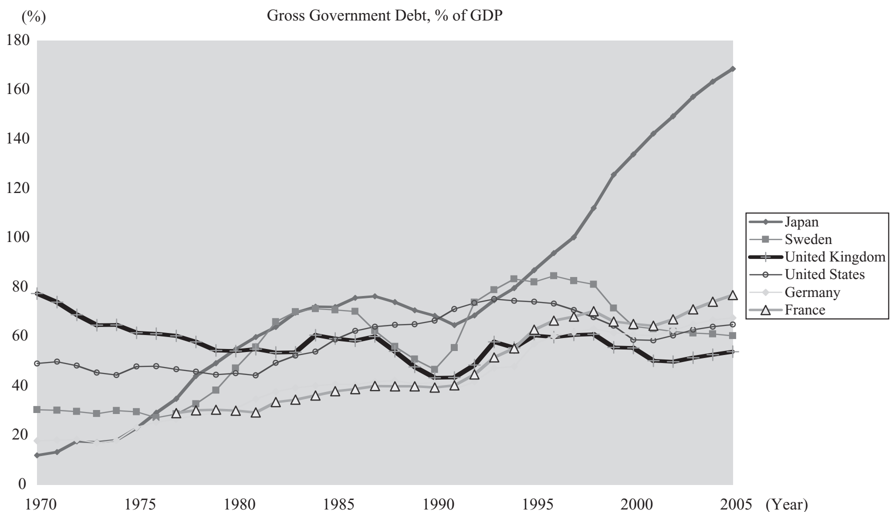
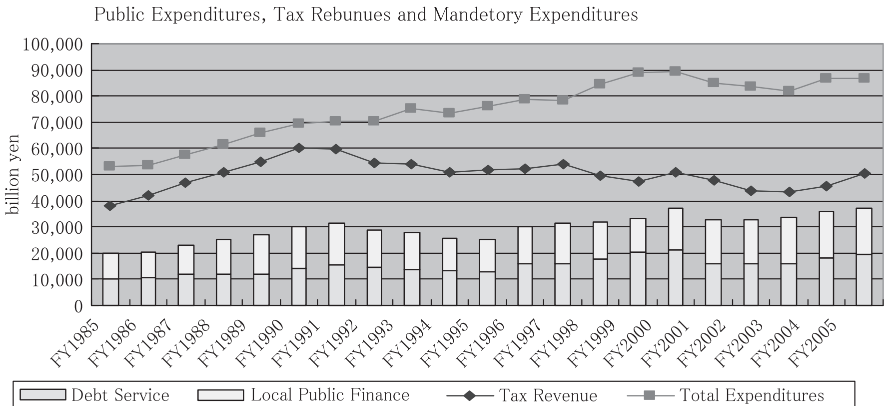


Figure 7.2. Gross government debt, several countries, 1970–2005. *Source:* OECD. National Account of OECD Countries, Online Database, OECD, Paris, 2006.



Data: Ministry of Finance statistics monthly.

Figure 7.3. Taxes and spending, Japan 1985–2006[1].

(see Feldman and Slemrod, Chapter 8), it is very difficult to get citizens to support increases in taxation unless they have developed relatively high degrees of trust in their public institutions. As we will see, this has not happened in Japan. A well-worn explanation for why the United States has had such low levels of taxation is that citizens do not trust their government to use that money wisely, or they believe that the tax burden is not distributed fairly. We believe that this argument applies to the Japanese case as well. Our argument here is that although Japanese citizens may have been ambivalent about taxes in earlier decades, in the context of the regressive tax cuts distributed over the past decade and a half, and absent a well-funded and generous social welfare system like those found in Europe today, Japanese voters have strong incentives to vote for politicians who promise to cut or at least hold back their taxes.

Unlike their European counterparts, however, by the time Japan reached economic maturity in the 1970s and 1980s, it had not built a modern social insurance system (nor the tax structures that finance them). Instead the lion's share of social welfare responsibilities was carried by corporations and families. The consequence is that today Japanese elites find themselves in the ironic position where Keidanren (Japan's major employer federation) is demanding very significant tax increases,[2] at the same time that the public is demanding significant increases in core welfare state functions such as health care and pensions (see Table 7.3 later in chapter), and yet the government appears incapable of providing their constituents with either.

It is common in Japan today to hear that Japan's high levels of public debt are a product of runaway spending. Certainly, it is clear that public spending has increased over the past twenty years in Japan, but as Figure 7.3 demonstrates, the

[1] *Local public finance* refers to transfers from the central government to local authorities.
[2] Keidanren argues that the state must pick up more of the social welfare functions that companies have traditionally borne. They have specifically advocated a doubling of the VAT in order to finance these programs (Kyodo News 2004).

massive budget gap seen in Japan today is as much a product of declining revenues as it is of increasing spending. Yet even this perhaps obvious fact continues to highlight the question: Why have public authorities in Japan allowed spending to outstrip revenues to such an extent in recent years?

Our main argument is that citizens do not trust either politicians or bureaucrats to raise taxes fairly or to spend their money efficiently. No country's citizens enjoy increased taxation, but the particular problem facing Japanese governments today is that they can and are punished by voters if they attempt to do so. This, we believe, is because they pursued policies that redistributed the tax burden downward and this shift was particularly resented by Japanese voters. During the economic crisis and housing bubble collapse of the 1990s, several tax cuts were introduced, but for the most part they did not benefit the average voter. Instead, the tax cut benefits went to upper income earners and corporations. It should come as no surprise, really, that the taxpayers simply will not believe their government any longer.

JAPAN'S UNIQUE (TAX) POLITICAL ECONOMY

It is important to appreciate the extent to which Japan has followed a different pattern from either European social democracy or Anglo-American liberalism: It has been a highly egalitarian society (at least since World War II) and pursued highly progressive tax policies on the one hand, and eschewed liberal social and economic freedoms that are core elements of American style capitalism on the other. The Japanese model was instead built on the principles of strong social responsibility and team spirit. Specifically, this has meant that although some sectors in the economy have been specifically favored and promoted, all segments of the economy could clearly see that they too benefited from this growth. Economic equality, then, was core to Japan's economic success (Tachibanaki 2005). It is interesting to note, however, Japan never constructed a large social welfare state: Family and employers carried these burdens while the state was left to encourage economic development and build infrastructure.

In short, Japan developed its own version of a historic compromise between capital and labor – but in the Japanese version, companies themselves became key instruments of social welfare policy in exchange for economic promotion and social peace. Tax policy was a key component of this compromise (e.g., low taxes on workers and consumption; high taxes on capital, profits, and high-income earners).

TAXES AND THE JAPANESE MODEL

The foundations of the Japanese tax system were established during the wartime crisis in 1940. As in several other countries (see Feldman and Slemrod, Chapter 8), in order to compensate for defense expenditure, government leaders concentrated most of the fiscal revenues in the central government and instituted a revenue structure remarkably similar to those developing elsewhere in the modernizing world: Progressive income taxes based on a pay as you earn (PAYE) system, and corporate profits taxes were introduced as the revenue base shifted from a largely

excise consumption-based tax system to progressive-income-based system built on the principle of "ability to pay" (Steinmo 1993).

After the war, these egalitarian principles became even more important for Japanese taxation. The American reformers in charge of Japan in the immediate postwar years clearly believed that social and economic equality were essential components of a successful democratic society (Milly 1999: 95–130). In their view, the gross economic inequality of prewar Japan was partially responsible for the rise of fascist ideology and power, or at least the failure of democracy to develop.[3] The occupation forces believed that a broad-based income tax system would help create a more egalitarian society and give working people a direct stake in their government, making them more directly interested in political affairs. Thus, whereas redistributive policies grew in response to the growing power of unions and leftist political parties representing workers or the poor in the West, there was little indigenous pressure for such policies in Japan.

Unfortunately, the Allied reformers did not adequately appreciate the differences between the American and the Japanese economies in the immediate postwar years (see Brownlee, Chapter 14; Estevez-Abe 2002: 164–5). First, the problem was that Japan was so poor. The second problem was that it was still a largely agricultural economy, and small farmers (even those who were less poor) were able to avoid paying income taxes. Given these economic realities and the political realities they implied, tax authorities effectively allowed the rural poor to be exempted from tax collection. Instead, the growing corporate sector (especially export-oriented manufacturing firms) and their employees had to be relied upon to generate tax revenues. The simple logic went that these firms should be expected to pay high taxes in exchange for the government's protection and promotion of their economic interests internationally.[4]

Many authors have explored the details of Japan's remarkable postwar economic performance (see, e.g., Curtis 1999; Hiwatari 1989; Pempel 1982; Yamamura and Streeck 2003). Virtually all agree – and perhaps more important, virtually all Japanese citizens believe – that there were two key elements to Japan's success. First, successive Japanese governments (or perhaps more accurately, the elite bureaucracy in concert with the Liberal Democratic Party [LDP]) managed the Japanese economy in a highly sophisticated and efficient way. They practiced remarkable budgetary restraint, holding back both taxes and spending in order to direct economic resources to the most productive export-oriented sectors of the Japanese economy. Tax policy was a key instrument actively manipulated by the government to advance these goals.[5] Second, Japan developed one of the world's most egalitarian political economies. The government strongly pushed the ideology that Japan

[3] Recent work by Toshiaki Tachibanaki and others demonstrates that Japan was indeed one of the most unequal societies in the modernizing world at this time (Tachibanaki 2005: 70–85).

[4] This understanding has been confirmed through a large number of elite interviews in both the public and private sector. Still, it is important to note that there was never any official policy justifying this trade-off. See also Johnson 1982.

[5] We will not detail the specific instruments here. Both personal and corporate taxes were manipulated specifically by the Ministry of Finance (MoF) as well as by the Ministry of International Trade and Industry (MITI). In addition, consumption taxes were specifically managed to encourage certain

must pull together after the war and understand itself as a collective enterprise (Garon 1997). The essential logic here was that certain groups (industries and even specific companies) would be consciously advantaged by government policy, but everyone should benefit from this system. Economic growth would be both promoted and widely distributed in this system.[6]

In the 1960s and 1970s, then, the Japanese tax system shared many basic similarities to tax structures in other advanced industrial democracies: The main pillars of the tax system were the progressive income and profits taxes, social insurance charges, property taxes, and tariffs and excises. Moreover, the system was broadly progressive (high-income earners and companies faced significantly higher rates than workers, farmers, and small businesspeople).

Still, there were important differences. First, taxes on low-income workers, farmers, and the self-employed were extremely low, whereas taxes paid by wealthy individuals and companies were very high by international standards. Second, Japan had no broad-based consumption tax system – even at the local level. Finally, because of these two factors, overall tax revenue was extremely low. In 1965, for example, taxes accounted for only 17 percent of GDP in Japan, but more than 26 percent of GDP in the average OECD nation.

JAPAN'S (SMALL) WELFARE STATE

Just as in the United States, low tax revenues in Japan made it difficult to increase spending on social welfare policy. Although there were some advocates for social welfare spending in the bureaucracy and also in several of the political parties (including the LDP) in the 1970s, social insurance policies were kept quite minimalist. Instead, families or employers were expected to bear these costs (see Figure 7.4; Miura 2002; Osawa 2001).[7] Because workers in large firms especially had many of their social insurance costs covered by their employers, social spending and tax policies targeted small producers, farmers, and the self-employed – not the unemployed, poor families, or those otherwise left behind in the capitalist economy. The Japanese firm, in short, had become the employee's welfare state. These workers, at least, did not need and did not want an expanded public welfare state. Figure 7.4 shows the remarkably high levels of welfare costs borne by Japanese firms.

These figures should also be seen in contrast to the relatively low levels of public spending on social welfare in Japan as compared to other OECD nations (see Table 7.1).

Japanese workers employed in the large, successful firms not only received higher wages than those outside the economically successful core, the problem was that

consumption patterns (and even promote specific domestic products at specific times). (For further information on this, see Akaishi and Steinmo 2003; Jinno 1999; Murakami 1987; Pechman 1986).

[6] The most direct tax policy implications of this ideology were that income tax rates for the wealthy should be very high and that tax revenues should be collected from the richer companies, workers, and regions and specifically redistributed through what they called the "Local Allocation Tax" to the poorer regions of the country. (See Akaishi and Steinmo 2003; DeWit and Steinmo 2002).

[7] The exception was health insurance, which was considered as a different case because medical care could not be provided in traditional ways as the country modernized.

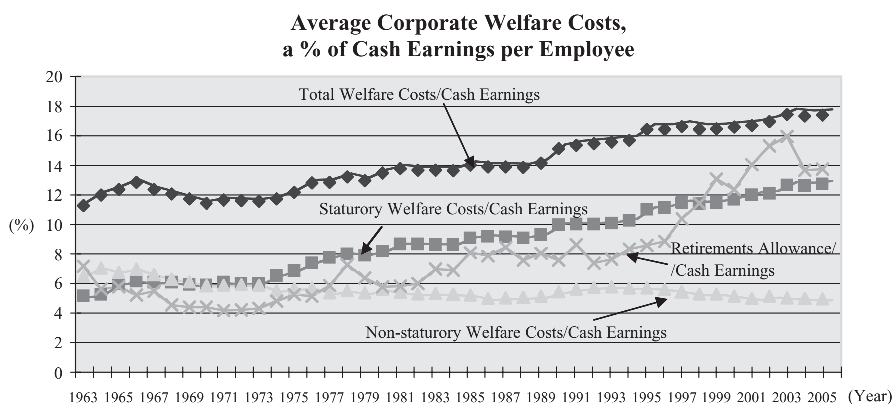


Figure 7.4. Japan's corporate welfare expenditures. *Source:* "Survey on Corporate Welfare Expenditures for FY 2001," Nippon-Keidanren 2002.

they also paid higher taxes. Eventually, they came to resent this. Recall that the most significant redistributive policies funded by the Japanese state were directed at small business owners, farmers, and rural workers (who paid few, if any, taxes). The result was that Japanese unions came to see their interests in almost exactly the opposite way as European and even American unions. Whereas in other countries unions saw public spending as a mechanism to increase levels of consumption on the part of workers and the poor, Japanese unions saw public spending as subsidies to the unproductive but politically powerful rural and small business interests.

CONSUMPTION TAXES

The Ministry of Finance (MoF), as the guardians of the public budget, found itself squeezed between three conflicting budgetary realities by the late 1970s: First, Japan was a maturing (and aging) society in which public commitments had been made to help finance individual pensions and health care. Although a large share of pensions and social security for employees in large firms was paid by the companies, the state effectively financed these costs for farmers and employees in many small firms. Second, they believed that the enormous economic growth witnessed over the past twenty years was unlikely to be sustained – even after oil prices stabilized – and this meant that the automatic revenue growth that Japan had benefited from over these years would not be able to keep up with spending demands. Finally, as noted earlier, there was essentially no political or public support for broadening the income tax base. Quite the contrary; there was powerful support for expanded tax cuts for workers, farmers, and small businesspeople. In short, the government needed more revenues – but the tough question was where to get them? The simplest answer to this problem in Europe had been to introduce and expand general consumption taxes. As we shall see later, however, this was not such an easy option in Japan.

Seeing the European patterns, MoF officials also began to promote the idea of consumption taxes in Japan as well. They repeatedly tried to convince several

Table 7.1. *Social expenditure of the GDP in 2001 (%)*

	Old age	Survivors	Incapacity	Health	Family	ALMP	Unemployment	Housing	Others	
France	10.6	1.5	2.1	7.2	2.8	1.3	1.6	0.9	0.4	28.5
Germany	11.7	0.4	2.3	8.0	1.9	1.1	1.2	0.2	0.5	27.4
Italy	11.3	2.6	2.1	6.3	1.0	0.5	0.6	0.0	0.0	24.4
Sweden	9.2	0.6	5.2	7.4	3.8	1.4	1.0	0.6	0.6	29.8
UK	8.1	0.6	2.5	6.1	2.2	0.3	0.3	1.5	0.2	21.8
U.S.	5.3	0.8	1.1	6.2	0.4	0.2	0.3	a	0.5	14.8
OECD-21	7.9	1.0	2.5	6.1	1.9	0.7	1.1	0.4	0.5	22.0
Japan	7.3	1.2	0.7	6.3	0.6	0.3	0.5	a	0.2	16.9

Source: OECD Social Expenditure Database 2004.

key senior members in the LDP that the current system would collapse under the weight of Japan's aging society. They finally convinced Prime Minster Ohira to introduce a value-added tax (VAT) proposal to the Diet just before the general election in 1979. Unfortunately for the prime minister, this was a huge political mistake. Public opposition to the tax swelled immediately and the LDP took a drubbing in the election. Worse yet, the VAT and the "unimaginable mental stress" brought in part by the anti–tax revolt and challenge to his leadership led Mr. Ohira to a heart attack and sudden death in June of that year. Needless to say, the VAT did not become law. MoF was forced to shift its policy position from introducing new taxes to cutting back on public spending – at least in the short run.

Ultimately, economic growth proved to be a salve that raised revenues, trimmed deficits, and satisfied voters in the early 1980s. Despite these growing revenues, officials continued to be acutely aware of the long-term fiscal crisis looming on the horizon. They therefore engaged in a very public aging society campaign that MoF officials conducted throughout the 1980s, and that had apparently worked. By the end of the decade, the majority of Japanese voters now seemed to agree to the introduction of a new tax in favor of securing the social security system. Taking all these factors into consideration, Prime Minister Takeshita agreed to introduce a modest (3 percent) general consumption tax in 1988, which was to become effective in April 1989.[8] To his surprise, however, the tax proposal evoked huge political protests by "housewives" who apparently did not agree with the majority and were instead worried about their food budgets. Eventually the PM was yet another casualty of these conflicts and was forced to resign in April 1989.[9] In July of that year, the LDP was decimated in the national election and for the first time in Japanese democratic history, they no longer controlled the Diet.[10]

Although there were many issues that contributed to the LDP's electoral losses, a central issue was tax reform. The problem was that voters believed that consumption taxes were unfair and specifically punished the LDP for the proposal. It is interesting that one of the key groups to mobilize against this tax reform were Japanese "housewives" who believed they already paid too high prices for food and other consumables. A consumption tax, they believed would benefit producers at the cost of the average family.[11] At the same time, small shopkeepers and farmers also opposed the tax because they (correctly) believed that such a tax would inevitably bring their real incomes into the light and make it easier for tax authorities to levy taxes on them. In short, although many Japanese supported increases in

[8] It is important to note, however, that this was scarcely the broadly based tax that MoF officials had hoped for: In fact, the tax that finally made it through the Diet was riddled with loopholes and inefficiencies. Most important, it advantaged small businesspeople by exempting them from paying the tax if their revenues were below a specific level. In the end, this acted as a direct subsidy to many of these businesses because they often collected the tax from consumers and then did not pay the tax to the authorities. Perhaps unsurprisingly, housewives who would end up directly making this subsidy made up the most potent political opposition.

[9] Takeshita was also involved in a major bribery scandal that swept over the LDP in 1989.

[10] This defeat was in the election of the House of Councilors. In the election of July 1993, they dropped the reins of government for the first time since their formation of a party.

[11] It was well known by this point in Japan that consumer goods cost much more in Japan than elsewhere because of the protections offered Japanese producers.

social programs, they did not want them financed through this seemingly regressive form of taxation. Seventy-six percent of voters opposed this tax and 91 percent felt that the government did not adequately explain why this tax was necessary.

FROM BOOM TO BUST: RETHINKING THE JAPANESE MODEL

The 1980s were very good years for Japan's economy. Growth continued to expand, incomes rose across the board, indeed by some measures Japan grew to having the highest per capita Gross National Product (GNP) in the world. Increasingly, the Japanese model was admired and even envied by a large range of political economists and politicians. We now know, of course, that the exuberance went over the top. Japanese investors and politicians alike increasingly came to believe that you simply could not lose money investing in the Japanese economy or Japanese real estate.[12] Consequentially, values spun into the stratosphere. It was widely said, for example, that the value of the emperor's palace and grounds in central Tokyo was worth more in per square meter price than the entire state of California![13] This was clearly absurd, and it came as no surprise that eventually this bubble would pop. Of course it did in 1990.

The government's first response was to prop up the existing system as much as possible by lowering interest rates, subsidizing banks, and engaging in massive public works spending. Remember that Japan has a very limited social welfare state in the Western sense. Instead, the economy depended on a complex network of interlocking companies and relationships. Although many argued that Japan should use the crisis as an opportunity to reform a number of policies and institutions (e.g., the postal-savings system, overinvestment in public works projects, inefficient retailing and farming industries) there was very little sentiment in favor of creating a fundamentally liberal political economy. Quite the contrary – the Japanese were deeply proud of their system. They had achieved phenomenal economic growth and a high degree of social stability and equality. Surely, most people (elites and citizens alike) understood that there were some problems in the system: too much waste in public works, too little competition in many sectors of the economy, and (eventually) too many banks that were insolvent because many businesses could not pay back the loans they had generated during the high growth/high optimism years. However, now was scarcely the time to radically change the system. Quite the opposite; now was the time to pull together, rely on each other, and sacrifice collectively.

Unfortunately, only in hindsight is it plain to see that this economic crisis would not go away so easily. Lacking this vision and largely believing that their system was essentially sound, the government attempted to bridge the economic crisis by issuing more and more government bonds. The top priority seemed to be to maintain employment. This effectively meant floating loans across the economy

[12] The Nikkei 225 Stock index, for example, increased from 11,542 in December 1984 to 38,915 in December 1989 and then plummeted to 15,951 in June 1992. The commercial land price index for land in large cities increased from 38.4 in 1986 to 103.0 in 1989 and then fell to 7.4 in March 1993.

[13] It was also often said that the value of land in Tokyo was so high ($0.3 million USD per square meter) that the land in Tokyo was worth more than all the land in the United States.

and building public works around the country. As the economic crisis stretched into the decade, however, confidence in the Japanese model began to wane. Certainly, the continued economic recession in itself undermined many people's faith in the model, but in our view it is impossible to understand the next stage of Japanese fiscal policy without also appreciating the role that neoliberal ideology played in an increasingly insecure Japanese state. In the early stages of the crisis the government's first response was to fall back on the second budget and expand public works construction as well as to subsidize otherwise failing banks. Over time, however, this program simply did not seem to be enough. It is in this context that the international economists developed a near consensus that government intervention in the economy is destructive to the economy. Specifically, taxes on the supply side of the economy were particularly bad.

Japan had always stood as a contrary example to the neoliberal argument, and many experts were anxious to argue that Japan's economic troubles proved that they had been right all along.[14]

Thus, as Japanese governments became more and more desperate, at the urging of many of their advisors (who had by now generally had at least some economics training in American graduate programs) they moved toward accepting increasingly neoliberal ideas of fiscal management.[15]

Two key problems emerged for the neoliberals in Japan, however. First, as we pointed out earlier, Japan already had one of the lowest tax burdens in the developed world and social welfare programs were clearly already underfunded. Social services are far more restricted in Japan than in Europe or America and social spending was (and is) at the bottom of the OECD tables. In other words, cutting back on wasteful welfare spending (and politically vulnerable targets), was difficult precisely because there wasn't much spending in these areas. Second, although one could convince Japanese politicians in the LDP that cutting taxes was a good thing, it was quite another to convince them that they should cut back on programs that specifically benefited their (largely) rural and poor constituencies. Cutting taxes (especially if this would help Japan get out of the long recession) was political candy for Japanese politicians (just like politicians everywhere; see Steinmo 1993). Cutting back on subsidies to farmers and public works projects in the periphery and other powerful constituents, however, was quite another matter. The results were not unlike the consequences of the 1981 tax cuts offered in the United States—the biggest budget deficits in the country's history.[16] According to Professor Hiromitsu Ishi, the various tax cuts in the 1990s lost more than 17 trillion yen in revenues ($128 billion USD; Ishi 2002: 2).

Up until this point, the Japanese tax system was highly progressive. Given the ideological bias of neoliberals and their commitment to market fundamentalism,

[14] See, for example, *Economist*, "A Magician in Japan," April 28, 2001 (Katz 2003).

[15] In 1986, a prestigious advisory body, "Study Group of Economic Structural Adjustment for International Cooperation," presented a famous report, which oriented the governmental policy toward the neoliberal model, to the prime minister.

[16] The balance-of-debt financing bonds issuance changed almost 65 trillion yen from 1986 to 1995 and gradually increased until 1997. However, in 1998, its amount broke through 100 trillion yen and reached 296 trillion yen in 2006.

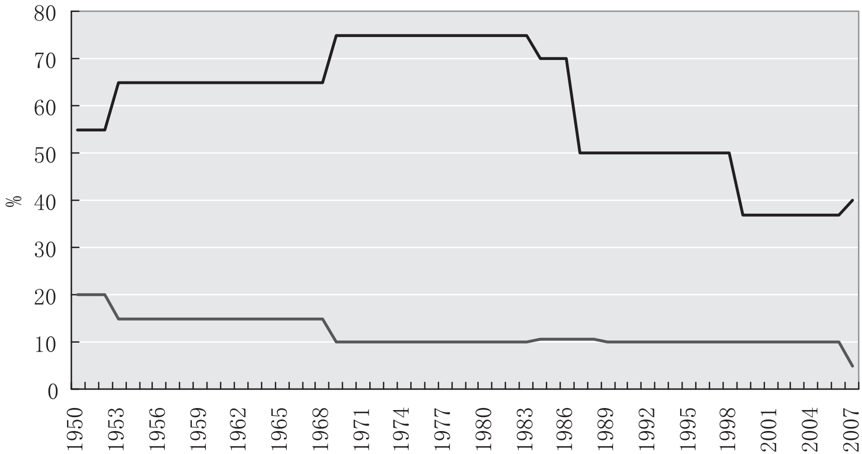


Figure 7.5. Top and lowest marginal rates of income tax. *Source:* "Survey on Corporate Welfare Expenditures for FY 2001," Nippon-Keidanren 2002.

one should perhaps not be surprised that the best tax cuts would benefit upper-income earners and owners of capital (see Block, Chapter 4). Figure 7.5 shows the evolution of tax rates in this era.

The obvious consequence of these rate cuts was that the income tax became progressively more hollowed out. The problem, of course, was that – whatever the ideological fascination with the supply side – Japan's impending demographic crisis continued to loom. Although many Japanese elites saw huge tax cuts that they could presumably use to finance their own social security, most Japanese citizens were in far more precarious circumstances. The logical conclusion given these political and fiscal realities was to broaden the consumption tax (which of course the MoF had been pushing for nearly twenty years).

Thus, after much consternation, the MoF finally convinced the new Prime Minister Murayama to increase the basic consumption tax rate from 3 to 5 percent and to broaden the tax base.[17] Even before this tax was introduced, there was a political firestorm against it. Although some of the base-broadening features of this reform were scaled back, the measure was still pushed through the Diet in 1994. A consumption tax[18] increase was implemented in 1997; unfortunately for the government, instead of aiding revenue collection, the most immediate effect of the tax was to reduce consumer spending, which it is widely believed further drove the economy into recession. By the end of the decade, Japan's GNP growth stretched into the negative area and soon deflation was the greatest economic worry.

[17] Previously, small firms were essentially exempted from paying the tax. This offered these firms a competitive advantage that often allowed them to collect the tax and simply not report it to the tax authorities. A local consumption tax was introduced in this reform, and a national consumption tax rate, 1 percent of 5 percent, was shared with local governments. That is, it was decided that 25 percent of consumption tax revenue was to be transferred to local governments.

[18] According to the OECD classification, the Japanese consumption tax is a kind of VAT. However, the invoice system was not introduced and a tax was imposed on the deemed value added, and it is called a *consumption tax*.

Table 7.2. *Trust in politics and opinion on consumption tax increase*

Politics						
Do you trust today's politics?	yes	20%	no	68%	others	12%
Do you think that people's opinion is reflected to the Diet?	yes	8%	no	86%	others	6%
How much do you trust politicians?	trust*	30%	not trust**	67%	others	3%
Consumption tax increase						
Do you support it?	yes	18%	no	76%	others	6%
Does government explain enough to the people about it?	yes	5%	no	91%	others	4%

* strongly (1%) and ID some extent (29%).
** not much (55%) and distrust (12%).
Source: "Asahi-Soken Report," Asahi Shimbun Company, August 1996.

SOCIOPOLITICAL STRUCTURAL CHANGE AT THE END OF THE 1990s AND INCREASING INCOME INEQUALITY

In our view, however, these short-term effects were not the most significant consequences of the consumption tax increase. Instead, by the end of the 1990s, the Japanese sociopolitical basis had tottered and this confirmed Japanese citizens' worst fears.

First, the policy choices of the government in 1997 were considerably out of synch with public opinion. According to the interviews conducted at the Ministry of Finance in early 2001, Japanese citizens clearly accepted a tax increase for expansion of welfare expenditures, whereas they refused one for fiscal reconstruction. However, the government increased the consumption tax in 1997 and simultaneously raised the medical care premium without expanding welfare expenditures. In addition, the government enforced a fiscal reconstruction, which was strongly refused by the people. To begin with, the people complained about the process of introducing consumption taxes as Table 7.2 demonstrates. The government implemented tax increases in a way that went against public opinion. As a result of these political choices, the people came to distrust politicians. A 2003 poll by the NHK Broadcasting Culture Research Institute ("Research on consciousness of the Japanese people") demonstrates that people's feelings of powerlessness toward politicians rapidly increased after 1998. Of course, we do not have access to the individuals surveyed in these polls to ask them exactly why their attitudes toward government took such a dramatic decline, but interviews with policy makers and academics alike confirm that the increased skepticism toward government was

Table 7.3. *Income redistribution in Japan*

	Initial income	Redistributed income		Redistributed by tax*		Redistributed by social securities**	
	Gini A	Gini B	Improvement A-B/A	Gini C	Improvement A-C/A	Gini D	Improvement A-D/A
1981	0.3491	0.3143	10.0%	0.3301	5.4%	0.3317	5.0%
1984	0.3975	0.3426	13.8%	0.3824	3.8%	0.3584	9.8%
1987	0.4049	0.3382	16.5%	0.3879	4.2%	0.3564	12.0%
1990	0.4334	0.3643	15.9%	0.4207	2.9%	0.3791	12.5%
1993	0.4394	0.3645	17.0%	0.4255	3.2%	0.3812	13.2%
1996	0.4412	0.3606	18.3%	0.4338	1.7%	0.3721	15.7%
1999	0.472	0.3814	19.2%	0.466	1.3%	0.3912	17.1%
2002	0.4983	0.3812	23.5%	0.4941	0.8%	0.3917	21.4%

* Initial Income Tax.

** Initial Income + Medical Expenditure + Social Security Benefit (Including Pension) – Social Security Premium.

Source: "Research on Redistribution," History of Health, Labour, and Welfare.

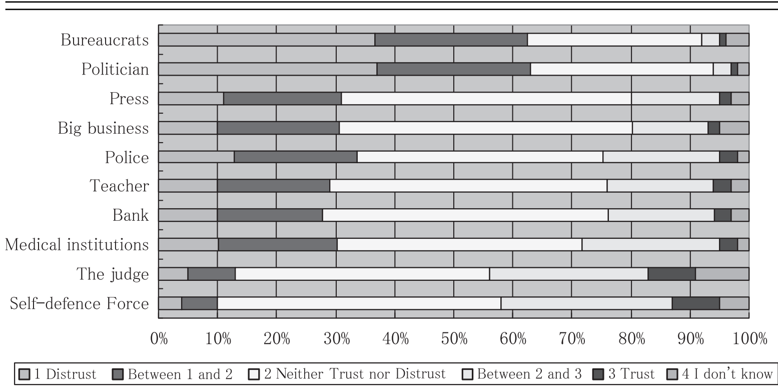
driven by both a series of public scandals and a growing feeling that the government was acting in the interest of companies and their executives rather than average Japanese workers and their families.[19]

Second, the repeated tax cuts combined with consumption tax increases unquestionably contributed to the growing inequality in Japan during the 1990s. With the reform of 1999, the Japanese income tax system has only four income tax brackets (10 percent, 20 percent, 30 percent, and 37 percent). Because of these tax cuts, the progressivity of the tax system has been significantly undermined. As Table 7.3 shows, redistribution through taxation was decisively weakened. The recipients of social security expenditures are mostly limited to the aged; that is, income differences between generations and resultant social instability are rapidly increasing today.

Third, bribery scandals damaged people's trust in bureaucrats (Amyx, Takenaka, and Toyoda 2005). In 1996, a huge bribery scandal involving the ministry of health and welfare was exposed and in the following year an administrative vice-minister of the ministry of transportation was also arrested. In addition, in 1998, more than 100 bureaucrats of the MoF, which has occupied a powerful position from the prewar era until recent times, were arrested or punished. It is interesting to see how far the once highly respected elite bureaucracy as well as politicians had fallen into disrepute in Japan by the end of the century. As Table 7.4 shows, even "big business" and "the press" have nearly twice as high ratings as do politicians and bureaucrats. We can see this tendency in time series also. According to the research by a private institute in 2000, trust in all professions had deteriorated over

[19] The comments of Professor Hiromatsu Ishi, the head of the government tax commission from 2002 to 2006, summarized these views: "Of course I can't prove it, but it is well known that tax policies of the 1990s increased resentment toward government." Interview with author, September 26, 2008.

Table 7.4. *Social trust in the professions in 2004 (n = 1438)*

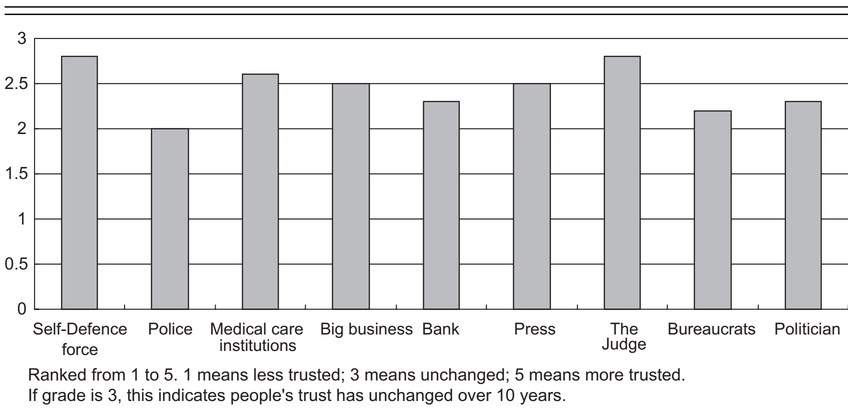


Source: "Research on the Trust in Politicians, Bureaucrats, Big Business and Police, etc.," Central Research Services, Inc., 2004.

these ten years ("Research on Trust in Politicians, Bureaucrats, Big Business, and Police etc.," Central Research Services [$n = 1474$]). Table 7.5 indicates that this was especially true in the case of government employees such as police, bureaucrats, and politicians. The decline was radical compared to other groups such as employees in the self-defense forces, medical institutions, big businesses, banks, the press, and judges. In 2008, 74 percent of the respondents point out that politicians and bureaucrats should make efforts to restore people's trust. In 2000, this percentage was just 53 percent.

Fourth, under economic globalization, the Japanese employment system was also required to change. Reducing new hires promoted the replacement of regular workers with nonregular workers, especially young people. In fact, the job-leaving rate has decisively increased today, and the issue of middle-age layoffs had a

Table 7.5. *Change in social trust in professions, 1990 to 2000*



Source: "Research on the Trust in Politicians, Civil Servants, Big Businesses and Police, etc.," Central Research Services, Inc., 2004.

serious impact on Japanese society. As Vogel pointed out, it is true that the frame of the Japanese employment system was maintained (Vogel 2006), but it is also true that firms boldly implemented layoffs. This was actively done from 1997 to 1998, because of the severe financial crisis triggered by the Asian currency crisis.

In this way, policy mistakes and resulting sociopolitical changes occurred at the end of the 1990s. As Brownlee in Chapter 14 shows, even in the occupied and economic crisis era, Carl Shoup's efforts to transform the Japanese fiscal system failed, and the Japanese tax system maintained continuity between the prewar and the postwar eras. In the prewar period, social bonds in the rural areas played a significant role as a social safety net and public trust in the government was robust. The characteristics of the prewar sociopolitical structure succeeded into the postwar era. In today's crisis, by contrast, fundamental changes have severely undermined citizen's confidence in the Japanese system.

REFORM AND REVENUE

By the early years of the twenty-first century, Japan's public debt was considered to be a major crisis by the MoF. The problem for them, however, was that no one was willing to make the sacrifices necessary to deal with this crisis. Leading Japanese politicians in the LDP simply refused to confront the pending fiscal gap between Japan's aging society on the one hand and its highly inefficient tax base on the other. The very popular Prime Minister Junichiro Koizumi, for example, was clearly aware of the problem but was unwilling to tackle it directly. Instead, he repeatedly declared that he would not raise taxes during his tenure in office. Undoubtedly, this commitment was one of the sources of Koizumi's popularity. As we saw in the opening of this chapter, however, the budget crisis simply would not go away.

Koizumi did, however, appoint the reform-minded Professor Hiromitsu Ishi to chair the government's Tax Commission and directed the commission to look to Japan's long-term tax reform between 2002 and 2005. The commission quickly focused on the need for what they called "a more sustainable" tax system. The commission included MoF officials, academics, as well as representatives of interest organizations, and they rather quickly came to agree with MoF's basic argument that significant increases in the consumption tax would be necessary and that they should also go in concert with base-broadening measures in the income and corporation tax. Eventually even the Japanese Employer Federation (Keidanren) came to support this specific proposal and even declared their support for eventually developing a European-style VAT with rates as high as 15 percent.

However, a negative feedback cycle regarding Japanese taxation prevented the tax increases. People did not have confidence in the government that it would spend money for the correct purpose, so they required fiscal consolidation not through increased taxes but through spending cuts. Needless to say, cutting expenditures reduced the income of the lower classes and increased inequality. Today, many countries, but certainly not all, have exacerbated these economic trends by cutting taxes and social spending, thus making the distributions of real income even more unequal than they would have otherwise been (Atkinson 1999; Steinmo 2003b). Japan also appears to be a country that falls into this pattern. Furthermore,

neo-liberal philosophy and the growing budget deficit caused the government to fear committing more money to improving the welfare services. This also expanded income inequality. Eventually, increasing income inequality promoted people's fears and social instability, and this constrained or reduced the ability of elites to shape public opinion (see Andrea Louise Campbell, Chapter 3). Formerly, the MoF strongly desired a consumption tax increase in 1994, and it eventually realized such an increase, but today tax increases have become one of the taboos of Japanese politics.

Koizumi's term was limited, of course, and it was widely expected that the next LDP government would take the necessary steps to increase taxes. On September 26, 2006, Shinzo Abe was elected prime minister in a special session of the Japanese legislature. Abe was considered a safe choice by most LDP supporters and no one truly expected him to engage in a radical domestic agenda. At the same time, however, most policy analysts believed that he would have virtually no choice but to introduce tax increases to help build a more sustainable tax system. Instead, he fired Hiromitsu Ishi and promised to follow Koizumi's tax policy agenda.[20]

Why would Abe follow such an agenda? The obvious answer is that he knows his Japanese history: Prime ministers who increase consumption taxes are run out of office and their party is punished by voters. The LDP experienced two complete defeats: in the election of 1979 when Prime Minister Ohira announced a general consumption tax and again in 1998 when Prime Minister Hashimoto implemented a consumption tax increase. In addition, in 1980, 1987, and 1989, three cabinets, which proposed the introduction of consumption taxes or introduced them, were forced to resign. It is far safer (at least from the point of view of reelection-minded officials) to avoid the political backlash and let future generations worry about paying the bill. Japan, in other words, may truly have become "Americanized."

CONCLUSION

Japan has long been an economic enigma for political economists. A small, resource poor, and geographically isolated country rebuilt itself with remarkable speed and efficiency after the near complete devastation of World War II. Today it is one of the most productive, technologically advanced nations on earth. Japan accomplished this remarkable economic feat at the same time that it went from one of the most unequal societies in the advanced world to becoming one of the most egalitarian countries in the world. The country's progressive tax structure and a remarkably egalitarian society were commonly understood as key components of the surprisingly successful Japanese model. Today, of course, there are those who doubt the logic of this explanation for Japan's success. However, there is no doubt that economic equality continues to be an important part of Japan's self-image and

[20] In September 2007, Prime Minister Abe resigned and Yasuo Fukuda came into power. Fukuda delayed the consumption tax increase because he believed the Japanese economy was gradually deteriorating in 2008, and more important, the general election of the House of Representatives would be held in 2009.

is still considered by most, including those who wish to live there, a key feature of the society.[21] In many ways, it can now be said that Japan may be following in the footsteps of the United States and Britain and becoming an increasingly unequal society.

The Japanese economic system depended on deference to hierarchical authority, team spirit, and very strong norms against shirking. Each of these factors was reinforced during the postwar "economic miracle" by the fact that wages, income, and wealth were widely and highly egalitarian, both within the firm and across society. (For example, in 1982 the annual income of Japan's richest man was only 330 times greater than that of an ordinary white-collar employee. In the United States at the same time, the difference was more than 7,000 to 1.) Employees committed themselves to their employers and were in turn rewarded with lifetime employment, good wages, and significant social welfare benefits provided by the employer.

Beginning with the now infamous bubble economy of the 1980s, the reality of Japanese equality began to change. The enormous growth in values of both real estate and equities significantly advantaged many and contributed to an explosion of wealth among those who were simply lucky enough to be in the right place at the right time. Of course, the bubble burst and some of these fortunes collapsed. The government's response to the economic crisis made matters worse. Desperate for solutions to Japan's economic crisis, the Nakasone government emulated Reagan and Thatcher and slashed tax rates – especially for the highest income earners. Not only did these tax cuts directly increase the budget deficit, they also exacerbated the growing inequality in Japanese society. Consequently, they undermined the citizens' faith in government. Now, when the government asks its citizens for sacrifice, they are denied. Citizens in Japan (much like in America) simply do not trust either appointed or elected officials to do the right things with their money. Moreover, as Fred Block suggests in Chapter 4, policies that specifically benefit the most well-off tend to undermine the basic social contract upon which the modern tax system was constructed. When the ability-to-pay principle is undercut, the willingness to pay seems to go with it.

This narrative, then, provides even further evidence of the argument often noted in the literature on the political economy of taxation: Citizens will consent to tax increases in times of crisis and war (see Feldman and Slemrod, Chapter 8) or when they feel they will benefit from public spending (Steinmo 1993). In other words, taxing and spending are two sides of the same coin.

Japan currently stands at a crossroads. At the time of this writing, yet another government has fallen because of its inability to lead and successfully govern this small nation. We find it more than ironic that this country, which has long been noted for its solidarity and respect for hierarchy, today seems so ungovernable. Although there is no way of proving this argument, we suggest that a road to reform would be to reverse the regressive policies of the past decade and a half and attempt, at least, to regain the social and economic equality for which Japan was once famous.

[21] See Toshiaki Tachibanaki's (2005) fascinating analysis *Confronting Income Inequality in Japan* (Tachibanaki 2005) for a careful examination of the evolution of economic equity in Japan.

To be sure, the economic changes witnessed over the past fifteen years are working to undermine the traditional relationship between the employee and his or her firm. At the same time, the traditional family structure (where the wife takes care of the elderly parents of her husband) is eroding. Many believe that Japan will need to develop public social welfare policies to aid those who formerly got assistance from their families and firms. The rub is that the economic changes and policies pursued by the government in recent years have exacerbated these problems and, as we have shown, substantially contributed to both growing inequality and the decline in citizens' trust of their government. In short, equality was the glue that held the Japanese system together and without this glue Japan could easily continue to fall apart.

8 War and Taxation: When Does Patriotism Overcome the Free-Rider Impulse?[1]

NAOMI FELDMAN AND JOEL SLEMROD

The history of the state is closely entwined with war. For example, Mann (1980: 197) estimates that between 1130 and 1815, the English state spent somewhere between 75 and 90 percent of its financial resources on the acquisition and use of military force. Today, although the nonmilitary responsibilities of governments have vastly expanded, war making and national defense remain a central responsibility of most governments. That military activities use resources is well known. What has been less studied is the extent to which popular wars may build social identity and thereby reduce the cost of government mobilization of resources and the extent to which unpopular wars may do the opposite.

This chapter explores the relationship between citizens' willingness to comply voluntarily with tax obligations and the perceived military threat to a country, as well as the relationship between citizens' willingness to comply and their attitudes toward ongoing military action. To the extent that military threats lead individuals to identify with their government, society, and country, the tax authority can reduce enforcement efforts because the citizens' willingness to voluntarily comply acts as a substitute for the threat of detection and penalties. Taxpayer consent to taxation at a particular moment would therefore be due, in part, to the accumulation of conflicts and their nature over time. As Eisaku Ide and Sven Steinmo argue in Chapter 7, taxpayer consent hinges in part on those aspects of a nation's history that determine the collective willingness to sacrifice. As these wartime sacrifices increase over time, the overall burden inflicted on an individual also grows. An important question is how individuals react to this increased burden – whether by consenting to taxation because of increased social solidarity or by not consenting to taxation as an expression of discontent. This relationship is relevant to fiscal policy because taxpayer consent to taxation affects the marginal social cost of raising resources, and therefore the optimal financing of extraordinary war expenditures.

We explore the link between military conflict and tax compliance attitudes by examining cross-country data on interstate conflicts from 1970 to the present

[1] We benefited greatly from the able research assistance of Joanne Hsu and Tomislav Ladika, and from comments received on an earlier version of the paper presented at the National Bureau of Economic Research (NBER) Conference on the Economics of National Security. The NBER also provided financial assistance.

from the Correlates of War Militarized Interstate Disputes data set, and on attitudes toward tax evasion from the World Values Survey. The results suggest that positive attitudes toward tax compliance increase with the number and length of conflicts that a country faces, but decrease in the number of fatalities incurred in these conflicts. These findings are broadly consistent with the idea that military conflicts promote positive attitudes toward tax compliance, but that this response can be eroded as fatalities grow.

THE ECONOMICS OF TAXATION AND TAX COMPLIANCE

The Economics of Taxation

The economics of taxation has both a positive and normative wing.[2] Research in the positive wing addresses the consequences of tax systems – how do alternative tax systems affect such things as labor supply, corporate investment, portfolio choice, economic growth and, ultimately, the well-being of residents. Understanding the consequences of tax policy is arguably the foremost comparative advantage of economists, and has critical implications for all other related questions.[3] The principal empirical methodology has been the statistical examination of historical data, and the main methodological challenge is the identification of the causal relationships among economic variables in the absence of controlled experiments; the counterfactual – what would have happened absent the tax policy under study – is never known. The conceptual framework is that individuals make choices that maximize their well-being, as they define it; because the tax system affects the relative price and rewards of the means to achieve that well-being, it thereby affects choices. Businesses make choices to maximize their profits subject to the technological constraints; because taxes affect the relative costs and rewards of their actions, it affects business behavior as well. Finally, because prices and wages are determined by the interplay of supply and demand and the tax system affects supply and demand, the tax system affects (pretax and aftertax) prices, and through this channel the tax burden may be shifted away from whom, according to the statutes, the tax is "on"; the theory of tax incidence addresses who will bear the burden of a tax system and how the shifting of the tax burden plays out.

Although the underlying conceptual framework can recognize other-regarding behavior such as altruism, the standard model presumes that individuals are free riders with respect to their behavior. In making decisions they ignore the impact on others, through the government budget, of the amount of taxes they remit to the government.

The normative side of the economics of taxation addresses how well alternative ways of raising revenue meet explicit criteria. The standard criterion is a (social

[2] The related fields of political economy and public choice address how governments make policy choices, and how government institutions should be structured to increase the likelihood that governments will make good decisions.

[3] See Slemrod (2006) for a discussion of the relationship of the consequences of taxation to the evaluation of alternative policies.

welfare) function of individuals' well-being (utility), as the individuals themselves see it, where the function may reflect various trade-offs between the sum of utilities and the distribution of well-being (i.e., different degrees of egalitarianism). How egalitarian is the society is usually taken to be outside of the model and, therefore, is an input to the normative exercise: For any given degree of egalitarianism, what is the optimal tax system? The optimal extent of redistribution and the optimal extent of government expenditure depend inter alia on the marginal social cost of raising funds, which increases in the magnitude of distorting behavioral responses to the tax system, such as reduced labor supply or increased tax avoidance and evasion. Other things being equal, a higher marginal social cost – perhaps affected by taxpayers' willingness to forego their free-rider impulses – makes government redistribution and spending less attractive.

The Economics of Tax Compliance: Deterrence[4]

No government can announce a tax system and then rely on taxpayers' sense of duty to remit what is owed. At first, some dutiful people would undoubtedly pay what they owe, but many others will not. Over time the ranks of the dutiful would shrink, because they see how they are being taken advantage of by the nondutiful. For this reason, paying taxes must be made a legal responsibility of citizens, with penalties attendant on noncompliance. However, even in the face of those penalties, substantial tax evasion exists – and always has. The history of taxation is replete with episodes of evasion, often notable for their inventiveness. During the third century, many wealthy Romans buried their jewelry or stocks of gold coin to evade the luxury tax, and homeowners in eighteenth-century England temporarily bricked up their fireplaces to escape notice of the hearth tax collector.[5]

The standard economics framework for considering an individual's choice of whether and how much to evade is a deterrence model from Allingham and Sandmo (1972), who adapted Becker's (1968) model of the economics of crime. In this model taxpayers are completely amoral, deciding whether and how much to evade taxes in the same way they would approach any risky decision or gamble – by maximizing expected utility – and considering the legal penalties no differently than any other contingent cost. Successful tax evasion benefits the taxpayer because it saves on taxes, but detected tax evasion results in paying what is owed plus (interest and) a penalty. Optimal tax evasion, from the individual's standpoint, depends negatively on the (assumed to be fixed) chance of getting caught and penalized, the size of the penalty for evasion, and the individual's degree of risk aversion.[6]

[4] Some of the material in this section is adapted from Slemrod (2007).

[5] Webber and Wildavsky (1986: 141).

[6] It is interesting to note that nearly all of the literature about whether attitudes affect compliance applies to individual taxpayers, although in most countries the bulk of taxes is remitted (as opposed to borne, in the sense of ultimate incidence) by businesses, either because the taxes are levied on business entities or because taxes are withheld by the employer. Whether a company's tax compliance behavior reacts similarly to that of an individual is a fascinating and unresolved question.

The most compelling empirical support for the deterrence model is the clear negative correlation across types of income between, on the one hand, the noncompliance rate and, on the other, the presence of enforcement mechanisms such as information reports and employer withholding that determine the likelihood of the tax authority detecting noncompliance.[7] Klepper and Nagin (1989) first showed that, across line items of the U.S. income tax, noncompliance rates are related to proxies for the traceability, deniability, and ambiguity of items, which are in turn related to the probability that evasion will be detected and punished. According to the latest tax gap estimates done by the Internal Revenue Service (IRS) for tax year 2001, there is a huge variation in the rate of misreporting as a percentage of actual income by type of income. The misreporting rate is only 1 percent for wages and salaries, and just 4 percent for taxable interest and dividends. Of course, wages and salaries, interest, and dividends must all be reported to the IRS by those who pay them; in addition, wages and salaries are subject to employer withholding. In contrast, self-employment business income is subject to neither information reporting nor withholding, and its estimated noncompliance rate is sharply higher – an estimated 57 percent. All in all, the IRS (2006) reports that the net misreporting rate is 53.9, 8.5, and 4.5 percent for income types subject to "little or no," "some," and "substantial" information reporting, respectively, and is just 1.2 percent for those amounts subject to both withholding and substantial information reporting.

Field experiments offer another source of evidence. Slemrod, Blumenthal, and Christian (2001) analyzed the results of a randomized controlled experiment conducted by the State of Minnesota Department of Revenue. They found that low- and middle-income taxpayers who received a letter promising a certain audit reported slightly more, but statistically significantly more, income than those who did not receive such a letter, and the difference was larger for those with greater opportunities to evade. Surprisingly, high-income taxpayers receiving an audit threat on average reported lower income; the authors speculate that sophisticated, high-income taxpayers view an audit as a negotiation, and view reported taxable income as the opening (low) bid in a negotiation that does not necessarily result in the determination and penalization of all noncompliance.

Other Influences on Tax Compliance

Although the deterrence approach has dominated the economics literature, some have argued that it misses important elements of the tax evasion decision in such a way that the model predicts a compliance rate much lower than what we actually observe. For example, Feld and Frey (2002: 5) assert that it is "impossible to account for tax compliance in terms of expected punishment." The dismissive argument goes as follows: Given the average probability of audit (now about 1 percent in the United States for individual returns), the penalties typically assessed

[7] The effect on noncompliance of the penalty for detected evasion, as distinct from the probability that a given act of noncompliance will be subject to punishment, has not been compellingly established empirically.

for noncompliance (typically 10 percent of the amount underpaid), and what we know about the degree of risk aversion from other contexts, noncompliance should be much, much higher than it apparently is.

Yet, this dismissive argument is not persuasive, because the low average audit coverage rate vastly understates the chances that the average dollar of unreported net income would be detected. A wage or salary earner whose employer submits the employee's taxable income and Social Security number electronically to the IRS, but who does not report that income on his or her own personal return, will be flagged for further scrutiny with a probability much closer to 100 percent than to 1 percent. Thus, the low rates of noncompliance for labor income by no means patently contradict the deterrence theory.[8]

Nonetheless, there is certainly evidence that there is more to the story of tax evasion than amoral cost–benefit calculation, and there is a substantial literature that seeks to explain such behavior. For example, Frey (1997) argues that it is important to differentiate between the intrinsic motivation, under which taxpayers comply with tax liabilities because of "civic virtue," and extrinsic motivation in which they comply because of threat of punishment. He suggests that increasing extrinsic motivation – say with more punitive enforcement policies – may "crowd out" intrinsic motivation by making people feel that they pay taxes because they have to, rather than because they want to. In an experimental setting, Lubell and Scholz (2001) find that the level of cooperation in certain settings declines significantly when penalties are introduced, suggesting that the increased deterrence motivation did not compensate for the change in how people frame their decision brought about by the higher penalties.

Some laboratory experiments have found that subjects respond not only to the probabilities and stakes of a tax evasion game, but also to the context provided to them, as in Spicer and Becker (1980) and Alm, Jackson, and McKee (1992). In particular, it may be that tax evasion decisions depend on perceptions of the fairness of the tax system. If, the argument goes, perceived tax equity strengthens the social norm against evasion, then evasion becomes more costly in terms of bad conscience (if not caught) or bad reputation (if caught). Falkinger (1995) elaborates on this argument, whereas Cowell (1990) reports on experiments that fail to find links between perceived inequities in the tax system and noncompliance.

In Bordignon (1993) there is a relationship between the individual and the government that involves exchange rather than mere coercion. The taxpayer computes the terms of trade between his or her private consumption and the government provision of public goods, and evades (up to his or her level of risk aversion or up to the level he or she feels reestablishes fairness) if he or she finds these terms unfair. Unfairness in this model reflects an inadequate level of goods provision with respect to the required tax payment, an unfair tax structure, or evasion by other taxpayers. As Andreoni et al. (1998) point out, though, an individual can also find unfairness that is due to the provision of the wrong goods – that is, someone such

[8] Whether the 57 percent noncompliance rate of nonfarm sole proprietors is less than the deterrence theory predicts is less clear; Andreoni, Erard, and Feinstein (1998: 821–2) argue that it is.

as Thoreau may avoid taxes because he thinks government policy wrong. Yet, as Daunton (1998) argues, this is not a simple matter. Expenditures on warfare might be tolerated in a patriotic period but rejected during another period characterized by antimilitarism.

These patterns suggest that a form of reciprocal altruism may be at work, where the taxpayer's behavior depends on the behavior, motivations, and intentions not of any subset of particular individuals, but of the government itself. Levi (1998: 91) argues that if citizens believe that the government will act in their interests, that its procedures are fair, and that their trust of the state and others is reciprocated, then they are more likely to become "contingent consenters" who cooperate in paying taxes even when their short-term material interest would make free riding the individual's best option.

Some survey evidence provides support for this view. Torgler (2003) and Slemrod (2003) show there is a positive relationship across countries between survey-based attitudes toward tax evasion on the one hand and professed trust in government, and Slemrod (2003) finds that the same relationship holds across individuals within the United States and Germany. A 2002 poll in the Czech Republic indicated that a person would be more likely to evade taxes if that person believed government services were substandard (Hanousek and Palda 2004).[9]

If perceptions matter for tax compliance, a natural question is to what extent tax compliance behavior can be manipulated by the government to lower the cost of raising resources. Appeals to conscience go back at least to Hammurabi's reign in ancient Babylon, when the tax collector sent the following notice when payments were late: "Why have you not sent to Babylon the 30 lambs as your tax? Are you not ashamed of such behavior?" (Webber and Wildavsky 1986: 58). As discussed next, appeals to patriotism to induce citizens to pay their taxes (and often, buy war bonds) are common in recent times.

That such campaigns are successful during nonwar times in swaying taxpayers from their (otherwise) optimal compliance strategy has not, however, been compellingly demonstrated. In a randomized field experiment with Minnesota taxpayers in a peacetime setting, Blumenthal, Christian, and Slemrod (2001) find no evidence that either of two written appeals to taxpayers' consciences had a significant effect on compliance. One letter stressed the beneficial effects of tax-funded projects, whereas the other conveyed the message that most taxpayers were compliant. Torgler (2004), based on a controlled field experiment in Switzerland, also found that moral suasion has hardly any effect on taxpayers' compliance behavior.

The difficulties of separating out whether people pay their taxes because they feel they ought to or whether they fear the penalties attendant to not doing so is well illustrated by some evidence from a recent survey sponsored by the Internal Revenue Service Oversight Board (2006). Whereas 96 percent of those surveyed in 2005 mostly or completely agreed that "It is every American's civic duty to pay their fair share of taxes," 62 percent also said that "fear of an audit" had a great deal or somewhat of an influence on whether they report and pay their taxes "honestly."

[9] Some of this association may be due to ex-post rationalization of noncompliant behavior.

In this chapter, we take seriously the idea that compliance with tax obligations may be the result of citizens' attitudes toward government, and that there may be a source of motivation missing from models of tax compliance. Akerlof and Kranton (2005) characterize this missing characteristic as *identity* – a person's self-image, identification with his or her society and government authority. The hypothesis is that when citizens identify with the country and their role in society, they incur a loss of utility if they do not follow society's rules and act in the interest of their country. Moreover, the more an individual identifies with his or her country, the less he or she needs to be rewarded monetarily (in other words, a lower tax burden) for participating and contributing to society. Akerlof and Kranton (2005) term this *motivational capital* in the context of employee–firm relations, where it is the responsibility of the firm to motivate its employees to use their skills in the interest of the firm; we explore the extent to which it also applies to the citizen–government relationship, and focus on how that relationship is affected by war.

WAR AND TAXATION

Related Positive Literature

Scholars have examined many aspects of how war affects public finances. In an influential book, Peacock and Wiseman (1961) argued that the increase in taxation caused by wars has a ratchet effect, so that postwar levels of taxation do not return to their prewar levels. One interpretation of this is that the need for extraordinary war expenditures engenders institutional changes in tax administration that cause a permanent reduction in the cost of raising funds, and so has a hysteresis effect on the optimal level of government funding. A good example of this mechanism is the fact that income tax withholding was introduced in the United States in 1942–3 and was not eliminated after the war.

An alternative, demand-side explanation for the ratchet effect is that the sacrifices exacted by war are regressive and after they end, there is a political demand for changes in government policy to reward those who sacrificed. Lucassen and Zurcher (1998: 415) note that "in exchange for the willingness of the populations to fight and keep on fighting, hard-pressed governments had to make promises of social justice ('A land fit for heroes to live in'). In the aftermath both of the First World War and the Second World War these promises were at least partly fulfilled, leading to the welfare state after 1945." Even if society wants to reward only those families that made especially large sacrifices, it is difficult to target the reward.[10]

For both taxation and conscription, during wartime, governments often invest a substantial amount of resources into propaganda that stresses a "we're in this together" mentality, which is designed partly to overcome free-riding impulses. Bank, Stark, and Thorndike (2008) have recently produced a magisterial history of U.S. wartime sacrifice. The U.S. secretary of treasury during World War I, William Gibbs McAdoo called this "capitalizing patriotism." Kang and Rockoff (2006)

[10] Note, though, that the U.S. GI Bill of 1944 and generous military pensions are examples of targeted compensation to those who served in the Armed Forces.

discuss the U.S. World War I experience, and Jones (1989) discusses American fiscal propaganda during World War II. Polenberg (1972) notes that the sale of war bonds in the United States during World War II illustrated the fine line between voluntarism and compulsion. In 1942, most of President Roosevelt's advisors favored a compulsory savings plan, but the president decided instead to institute a voluntary plan. Those who wanted a compulsory plan argued that a formal and impartial compulsory plan would, in fact, be less oppressive than the haphazard and unequal community pressure that would be applied to a voluntary program.

Extraction, in the form of public service announcements is also utilized in peacetime, although its effectiveness with respect to taxpaying has not been compellingly demonstrated. Putnam (2000) notes that World War II, like earlier major wars in U.S. history, ushered in a period of intense patriotism nationally and civic activism locally: membership in civic associations rose after both major wars of this century. He goes on to suggest that the strong generational effects in the decline in civic engagement after World War II may be due to the replacement of a cohort of men and women whose values and civic habits were formed during a period of heightened civic obligation with others whose formative years were different.[11] A heightened civic obligation, if carried over to attitudes toward taxation, provides yet another explanation for the Peacock–Wiseman ratchet phenomenon.

Many countries, during wartime and peacetime, have a *draft*, which is an (earmarked) tax with its own peculiar equity, efficiency, as well as administrative and enforcement, aspects. Like taxpaying, military service is subject to a free-rider problem, and the cost of raising resources via conscription is reduced if free riding is restrained. Levi (1997) addresses military service as one way in which democratic governments demonstrate their immense power to tax and examines why at some times and in some places there is widespread draft evasion and at other times and places there is considerable patriotism and volunteering. In this context, it is fascinating to note that during World War I in the United States a system was devised to make conscription look as much like volunteering – even like voting – as possible. Local civilian volunteers would first register eligible young men in much the same way as persons registered to vote; in fact, registration was even held at each precinct's voting location (Ellis and Noyes 1990: 190).

Related Normative Literature

As Thomas Paine observed, war requires higher taxes (eventually).[12] The optimal mix of taxation and borrowing has attracted the attention of many prominent public finance economists (e.g., Hicks, Hicks, and Rostas 1941; Haig 1942; Edgeworth 1915). The modern literature is dominated by the "tax smoothing" hypothesis presented in Barro (1979), which argues that efficient financing would equalize

[11] Putnam (2000: 275–6) stresses that he does not believe that war is a necessary or praiseworthy means of accomplishing civic reengagement. He advocates the search for a "moral equivalent of war" that has its positive consequences without the glorification of martial virtues or mortal sacrifice.

[12] "War . . . has but one thing certain, and that is to increase taxes" (Paine [1787] 1908).

across time the marginal cost to society of taxes. Barro shows that, if that marginal cost is an unchanging function of the tax rate, efficient financing requires equal tax rates over time and, therefore, large use of debt financing in times of extraordinary government expenditure – mostly wartime. This assertion, though, relies on the presumption that the marginal cost to society of taxes is an unchanging function of the tax rate. It is important to note, however, that the social cost of taxation is lower when taxpayers voluntarily comply, because then less resources must be employed to enforce and monitor that the appropriate tax remittances are made. Thus, if, as much anecdotal evidence suggests, during a (popular) war citizens' "willingness to voluntarily comply" with their tax liabilities is higher for any given tax rate, then it is optimal to tax more during wartime instead of smoothing.[13] In other words, when citizens identify with their place in society and country, the government can reduce enforcement efforts because the presence of identity acts as a substitute for the threat of detection and penalties. Thus, we consider the government's ability to motivate its citizens through such identification as a valuable asset of the government as well as a possible object of investment.

HOW DOES WAR AFFECT ATTITUDES TOWARD TAX EVASION?

Empirical analysis of the determinants of tax compliance faces a difficult challenge. In the words of a colleague, it is straightforward except that "we cannot measure the left-hand side variables, or the right-hand side variables."[14] This has not completely deterred analysis, but it has demanded a certain kind of empirical creativity. The remainder of this chapter presents some new empirical analyses that are designed to shed light on the extent to which war and military activities affect tax compliance attitudes and behavior. Because there are not quantitative measures of tax compliance that can be reliably compared across countries or even reliably compared within a country across time, these empirical analyses will, by necessity, be indirect. In this section, we study the determinants of cross-country, survey-based measures of attitudes toward tax evasion rather than evasion itself; there is, though, some evidence that indicates that these attitudinal measures are correlated, if not causally related.

Data

In this section we use cross-country, multiyear data to examine the proposition that aspects of war affect attitudes toward tax compliance. Our empirical analysis requires quantitative information on citizen attitudes toward tax compliance and interstate conflicts as well as fiscal and demographic information. In what follows we describe our sources of each of these three types of data, and the problematic aspects of each.

[13] This caveat is recognized in a footnote (fn. 6: 943) in Barro (1979), which states: "Such an effect [any special relation of collection costs to the contemporaneous government spending level] might arise if, e.g., the influence of war on 'patriotism' lowers the administrative costs of raising taxes during wartime."

[14] See Slemrod and Yitzhaki (2002) for a selected review of empirical analyses of tax compliance.

The data on attitudes toward tax compliance (TC) come from the four waves of the World Values Survey (WVS) administered in 1981, 1990, 1995–7, and 1999–2000. The WVS facilitates cross-national comparisons of values, norms, and attitudes. The survey was conducted, with limited national modifications, in twenty-three, forty-four, forty-nine, and more than sixty countries, respectively, in the four waves. It asked about attitudes toward work, family, religion, politics, and contemporary social issues and gathered demographic data as well. Although the data are subject to the usual reservations concerning attitude surveys, and, in particular, cross-country attitude surveys, they have been widely and fruitfully used by political scientists, sociologists, and economists.[15]

We focus on the WVS question that refers to people's attitude toward compliance with tax obligations. The precise wording is:

> Please tell me whether you think that cheating on taxes if you have the chance can always be justified, never be justified, or something in between. (scale from 1 = never justified to 10 = always justified)

We rescale it to 0–1, with a value of 1 reflecting that cheating is never justified, so that the rescaled variable measures how favorable is the respondent's attitude toward compliance rather than toward noncompliance. For the country-level regressions, we use the weighted average of responses for each country-wave. In other research, this variable has been shown to have an association with the size of the informal economy and with the size of the government sector.[16]

Our main independent variables of interest, taken from the Militarized Interstate Disputes database of the Correlates of War (COW) project (Ghosn, Palmer, and Bremer 2004), are a number of indicators of the degree and level of military conflicts a particular country has faced. We have collected data on all conflicts involving two or more states that started in 1970 or later.[17] These data sets include the start and end date of the conflict, a measure of the total fatalities suffered by each side involved in the conflict, and the originator of the conflict. Other variables include the highest hostility level and highest military act that each state engaged in. The hostility level is measured on a 1 to 5 scale defined as follows: 1 = No militarized action, 2 = Threat to use force, 3 = Display use of force, 4 = Use of force, 5 = War. In what follows we consider only disputes of a hostility level of 3 or higher to be conflicts. The fatality level is measured on a 1 to 6 scale defined as follows: 0 = None, 1 = 1 to 25 deaths, 2 = 26 to 100 deaths, 3 = 101 to 250 deaths, 4 = 251 to 500 deaths, 5 = 501 to 999 deaths, 6 = more than 999 deaths. We use the midpoint of the bracketed (1–5) measures, and 1,500 fatalities for category 6, as an approximation of the number of fatalities in a particular conflict. The origin

[15] For an extensive, albeit incomplete list of its use in research, see Inglehart, Basanez, and Moreno (1998).

[16] See Torgler (2003) and Slemrod (2003).

[17] Intrastate conflicts, although potentially important to the issues this chapter addresses, have not yet been analyzed. COW's Intrastate Militarized Disputes data set has information on civil wars starting in 1970, including the start and end year of the war, the name of the dissenting group, the winner of the war, the type of civil war, total fatalities in the conflict and fatalities suffered by the pro-government side, and whether another country intervened in the war.

measure equals one if the country originated the conflict, and zero if not. This is not precisely an either/or measure, because for many conflicts both participants are listed as originators.

We construct several alternative measures of the extent of external conflict for each country, for each of the four waves of WVS data, by calculating the sum over the previous decade of the following:[18]

1. Number of different conflicts (*total conflicts*)
2. Number of conflict-years (*conflict-years*)
3. Number of fatalities per capita (*fatality-fraction*)
4. Indicator variable for whether or not a conflict is self-originated
5. Indicator variable for whether or not the conflict ended in victory

In addition, we consider a binary indicator of whether or not a country faced any conflict (*any conflict*). Note that *conflict-years* is often less than *total conflicts* because many conflicts last less than one year. If military conflicts increase identification with the state, then we would expect that countries that face a higher number of conflicts to have higher tax compliance. It is less clear, however, what effect military fatalities would have on tax compliance.[19] The higher fatalities are, the less popular a given conflict may become, which may, in turn, lead to less tax compliance.

We include as control variables a number of nonwar-related variables that might arguably influence tax compliance in addition to our main variables of interest. As a measure of economic development, we include the logarithm of the real Gross Domestic Product (GDP) per capita, and that variable squared. To see if the level of resources exacted from the population affects attitudes, we look at the fraction of GDP devoted to government expenditure, and that variable squared. Some of these have been examined in previous studies of tax compliance attitudes, such as the country's literacy rate, the average age of the respondents, and the fraction of the respondents who are male. Finally, we also include a number of country-level variables that reflect the ethnic and religious heterogeneity of the population as well as an indicator variable for the level of freedom in the country. The heterogeneity variables are defined as Herfindahl indices, equal to $1 - \Sigma s_{ij}^2$, where s_{ij} is the share of ethnic or religious group i $(i = 1 \ldots N)$ in country j. These measures reflect the probability that two randomly selected individuals from a population belong to different ethnic or religious groups (Alesina et al. 2003). Arguably, countries that have a more homogeneous population are more likely to have citizens that identify with the state and consequently higher tax compliance.

[18] Although the choice of a decade as the time frame is arbitrary, the results we report are robust to other, shorter time frames. It is also possible that attitudes are affected over a much longer period, especially by extraordinary conflicts such as World War II. The extent to which these unmeasured longer-term influences are correlated with the measured shorter-term effects could bias the estimated effect of the latter.

[19] There is a substantial literature on the effect of military fatalities on public support for a military operation and on presidential approval. For example, Feaver and Gelpi (2004: 7) find that the U.S. public will "accept" casualties if they are deemed necessary to accomplish a declared mission, but not if people think the national interests are not engaged. They find mixed support for the fact that casualties positively affect presidential approval for successful military operations, but negatively affect approval when the operation is viewed as unsuccessful (143).

Finally, a variable is included to reflect the potentially very different processes that determine government spending and social identity in countries with varying levels of social freedoms; the variable is coded as one if the country is not free, two if partially free, and three if free.

In our baseline analyses, we estimate the model ignoring the panel aspect of the data (i.e., using ordinary least-squares regression on a pooled cross-section). In all specifications, binary indicators for the WVS waves are included, and standard errors are clustered at the country level. Table 8.1 contains a description of the variables we use, and Table 8.2 contains some summary statistics.

Country-Level Results

The results in Table 8.3 show that the existence and amount of military conflict over the preceding decade is generally estimated to be positively correlated with attitudes toward tax compliance. Having any conflict in the preceding decade is associated with 0.012 percentage points higher tax compliance, although we cannot reject the hypothesis that the true coefficient is zero with a high degree of confidence. Given that average tax compliance for the sample of countries used is 0.84, this represents an increase of about 1.4 percent. As shown in columns 2 and 3, one additional conflict or conflict-year are both associated with an increase in the countrywide average tax compliance fraction of about 0.003 percentage points. Again, given the average measure of attitudes toward tax compliance for the sample of countries of 0.84, these estimated coefficients amount to an approximate 0.32 to 0.35 percent increase in tax compliance for every additional conflict or conflict-year. Alternatively, we can also interpret the results as for every unit increase in standard deviation of *total conflicts* (7.4 conflicts), there is an associated increase in attitudes toward tax compliance of more than one quarter of a standard deviation (more specifically, 0.02/.074 = 0.27 standard deviations). The estimated coefficients are significant at a 1 and 10 percent level of significance, respectively.[20] Whether or not a conflict is self-initiated (columns 7 and 8) does not appear to influence tax compliance. In addition, whether or not the conflict ended in a "win" for the country does not appear to influence tax compliance.

In contrast, the specification shown in column (4) reveals that the fraction of fatalities to population is negatively correlated with tax compliance. An increase of 0.001 in the percent of fatalities to population is associated with a decrease in the countrywide average tax compliance fraction of 0.003, or 0.35 percent, when evaluated at the average tax compliance level as defined earlier. Alternatively, a one standard deviation increase in the percent of fatalities to population is associated with a one-eighth of a standard deviation decrease in tax compliance. The estimated coefficient is significant at a 1 percent level of significance. Column 5 illustrates that when we control for both the number of conflicts and the percent of fatalities to population, the estimated results are quite robust – that is, the number of conflicts is positively and significantly correlated with attitudes toward tax

[20] Similar estimates of 0.003 and 0.004 are found in a first difference model (not shown here), where each additional conflict or conflict-year is correlated with a 0.36 and 0.48 percent increase in tax compliance, respectively. These estimates are significant at a 5 percent level of significance.

Table 8.1. *Data sources for cross-country analysis of tax compliance attitudes*

Variable	Description	Source
TC (Tax Compliance)	= 1 if never justified, = 0 if always justified (in increments of 0.1)	World Value Survey (1981, 1990, 1995, and 2000)
Average male	Fraction of male respondents	World Value Survey (1981, 1990, 1995, and 2000)
Average age	Average age of respondents	World Value Survey (1981, 1990, 1995, and 2000)
Log (GDP)	Log of GDP	World Development Indicators (World Bank)
G/GDP	Ratio of nonmilitary government spending to GDP	Government Finance Statistics Yearbooks (1982, 1992, 2000, 2002)
Status	= 1 if country is not free, = 2 if partially free, = 3 if free	Freedom House
Literacy	Literacy rate (male and female)	World Development Indicators (World Bank)*
Any conflict	= 1 if the country experienced any military conflict, zero otherwise	Correlates of War-MID3 (COW)
Total conflicts	Number of total conflicts	Correlates of War-MID3 (COW)
Conflict-years	Sum of length of all conflicts (in years)	Correlates of War-MID3 (COW)
Fatality-fraction	Percentage of fatalities to population	Correlates of War-MID3 (COW)
Self-originated conflicts	Total conflicts interacted with a binary indicator for whether or not the conflict was self-originated	Correlates of War-MID3 (COW)
Self-originated conflict-years	Conflict-years interacted with a binary indicator for whether or not the conflict was self-originated	Correlates of War-MID3 (COW)
Total conflicts won	Total conflicts interacted with a binary indicator for whether or not the conflict ended in victory	Correlates of War-MID3 (COW)
Ethnic heterogeneity	Ethnic heterogeneity; Equal to one minus the probability that two random people have the same ethnic background in a particular country	Alesina et al. (2003)
Religious heterogeneity	Religious heterogeneity; Equal to one minus the probability that two random people have the same religious background in a particular country	Alesina et al. (2003)

Notes: $N = 125$.

* There are missing data for a number of Western European countries; the United States and Australia were replaced with 0.99.

World Development Indicator and Correlates of War variables are calculated as ten-year averages leading up to the relevant WVS wave.

Table 8.2. *Summary statistics for cross-country analysis of tax compliance attitudes*

Variable	Mean	Std. dev.	Minimum	Maximum
TC	0.84	0.07	0.64	0.98
Log (GDP per capita)	8.34	1.34	5.17	10.50
G/GDP	0.41	0.16	0.08	0.74
Ethnic fractionalization	0.32	0.23	0.04	0.93
Religious fractionalization	0.42	0.24	0.004	0.86
Freedom status	2.50	0.63	1.0	3.0
Literacy	90.8	14.2	39.3	99.8
Average age	41.4	4.6	28.9	47.6
% Male	0.49	0.05	0.25	0.85
Total conflicts	4.54	7.36	0.0	47.0
Fatality-fraction (in %)	0.0005	0.004	0.0	0.04
Any conflict	0.72	0.45	0.0	1.0
Self-originated conflicts	3.9	6.51	0.0	37.0
Conflict-years	2.27	4.29	0.0	2.23
Self-originated conflict-years	1.74	3.32	0.0	16.20
Total conflicts won	0.62	1.25	0.0	5.0

$N = 125$.

compliance, and fatalities are negatively and significantly correlated with these same attitudes.

A number of other explanatory variables show a statistically significant relationship with tax compliance. (The logarithm of) GDP per capita is estimated to have an inverted U-shape, but is not a statistically significant association with tax compliance attitudes. A higher literacy rate is associated with decreases in tax compliance. Average age and the average fraction male are both found to have a weakly statistically significant positive relationship with tax compliance. Of special interest to public finance economists is that the ratio of government expenditure to GDP has a U-shaped relationship, so that initially, the expenditure ratio is negatively correlated with attitudes toward tax compliance and then, after some level, turns positive. The turning point is approximately 0.55, which is near the average government expenditure ratio of the highest-spending Western European nations. Finally, neither the heterogeneity variables nor the level of political freedom is found to have any statistically significant effect on attitudes toward tax compliance.

Country Fixed-Effects

If the regression analysis controls for time-invariant individual country effects, thus identifying the compliance attitude only from variation across time within each country, the independent variables are generally no longer statistically significant. Because most of the variation in our dependent and independent variables is derived from cross-country comparisons, there is little variation in our variables available to identify our parameters. As a result, although the fixed-effects model

Table 8.3. *Cross-country analysis of tax compliance attitudes: pooled cross-section*

	TC							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Log (GDP per capita)	0.062	0.102	0.092	−0.006	0.030	0.106	0.114	0.099
	(0.081)	(0.078)	(0.081)	(0.066)	(0.056)	(0.078)	(0.079)	(0.081)
Log (GDP per capita)^2	−0.004	−0.007	−0.006	0.000	−0.002	−0.007	−0.007	−0.006
	(0.005)	(0.005)	(0.005)	(0.004)	(0.003)	(0.005)	(0.005)	(0.005)
G/GDP	−0.606	−0.618	−0.682	−0.576	−0.626	−0.617	−0.575	−0.669
	(0.238)**	(0.211)***	(0.228)***	(0.247)**	(0.226)***	(0.209)***	(0.212)***	(0.228)***
G/GDP^2	0.488	0.557	0.593	0.472	0.577	0.563	0.517	0.578
	(0.279)*	(0.244)**	(0.264)**	(0.281)*	(0.257)**	(0.240)**	(0.243)**	(0.264)**
Ethnic fractionalization	−0.034	−0.025	−0.032	−0.011	−0.016	−0.026	−0.023	−0.033
	(0.051)	(0.050)	(0.052)	(0.056)	(0.055)	(0.050)	(0.050)	(0.052)
Religious fractionalization	0.001	−0.013	−0.003	−0.003	−0.012	−0.010	−0.006	0.003
	(0.036)	(0.033)	(0.033)	(0.037)	(0.033)	(0.033)	(0.033)	(0.032)
Freedom status	0.016	0.022	0.016	0.018	0.020	0.025	0.027	0.017
	(0.018)	(0.018)	(0.018)	(0.018)	(0.017)	(0.018)	(0.018)	(0.018)
Literacy	−0.001	−0.002	−0.002	−0.002	−0.002	−0.002	−0.002	−0.002
	(0.001)*	(0.001)**	(0.001)**	(0.001)**	(0.001)**	(0.001)**	(0.001)**	(0.001)**
Average age	0.003	0.004	0.004	0.003	0.004	0.004	0.004	0.004
	(0.002)*	(0.002)**	(0.002)**	(0.002)	(0.002)*	(0.002)**	(0.002)**	(0.002)**
% Male	0.154	0.166	0.159	0.054	0.095	0.170	0.174	0.161
	(0.106)	(0.102)	(0.107)	(0.094)	(0.091)	(0.101)*	(0.102)*	(0.108)

Any conflict	0.012							
	(0.014)							
Total conflicts (10)		0.027			0.037	0.033	−0.042	
		(0.007)***			(0.011)***	(0.008)***	(0.041)	
Conflict-years (10)			0.030					−0.020
			(0.017)*					(0.067)
Fatality-fraction				−2.546	−2.323			
				(0.896)***	(0.771)***			
Total conflicts won (10)						−0.066		
						(0.053)		
Self-originated conflicts (10)							0.082	
							(0.048)*	
Self-originated conflict-years (10)								0.066
								(0.088)
Constant	0.614	0.425	0.490	0.969	0.784	0.390	0.339	0.448
	(0.366)*	(0.353)	(0.364)	(0.296)***	(0.263)***	(0.352)	(0.363)	(0.370)
Observations	125	125	125	120	120	125	125	125
R-squared	0.32	0.38	0.34	0.35	0.41	0.38	0.39	0.35

Notes: Columns (4) and (5): Sample restricted to those countries missing at most one observation of fatalities. Results robust to whether this observation is replaced with zero or a positive number of fatalities. Robust standard errors, clustered on country, in parentheses.
* significant at 10%.
** significant at 5%.
*** significant at 1%.

in general estimates coefficients somewhat comparable in magnitude and sign to the pooled cross-country model, the standard errors are much larger, making it impossible to reject the null hypothesis that the coefficients equal zero.

Discussion

The data analysis suggests that, other things being equal, the number of conflicts and conflict-years are positively correlated with tax compliance, whereas the number of fatalities is negatively correlated with tax compliance. These preliminary results support the hypothesis that issues of national security spill over into attitudes toward tax compliance. Thus, to the extent that military conflicts promote identity, it may be considered a substitute for resources that would otherwise be used in tax enforcement. The negative relationship with fatalities, however, illustrates that particular consequences of military conflict may serve to undermine this positive effect by decreasing the support of the taxpaying populace.

Somewhat surprisingly, whether or not a conflict was self-originated or ended in victory was not found, in general, to affect attitudes toward tax compliance. Note, though, that for many military conflicts both sides are recorded as originators, suggesting that it is often not easy to distinguish the attacker from the attacked. Moreover, because there are very few wins and losses in the sample (the far majority of conflicts end in stalemate or some other inconclusive end), it is empirically difficult to estimate the effect of winning or losing on attitudes toward tax compliance.

CONCLUSION

The standard economics modeling of tax compliance – that it is the result of a weighing of expected benefits and costs by free-riding citizens – is called into question by the intense stakes and sacrifice potentially required during wartime. If, as much evidence suggests, many taxpayers are willing to suspend their decision calculus during a popular war, then the social cost of raising taxes is reduced and, other things being equal, tax financing of war expenditures is more appropriate than otherwise. Whether interstate military conflicts and citizens' attitudes toward these conflicts have a material affect on tax compliance has not, though, been empirically established, and this chapter describes an attempt to address that question. The results suggest that, across countries, interstate military conflicts increase positive attitudes toward tax compliance, but military fatalities undermine it.

9 Liberty, Democracy, and Capacity: Lessons from the Early American Tax Regimes

ROBIN L. EINHORN

The idea that the study of early American history offers anything useful for contemporary policy makers, at home or abroad, is rather a stretch. To think about rewriting the American portions of W. W. Rostow's *Stages of Economic Growth* today is to think about recommending the equivalent of murdering Indians and enslaving Africans to encourage the "take-off into self-sustained economic growth" (Rostow 1960). At the same time, however, the federal structure of the American polity offers opportunities for comparative historical research with built-in controls over some of the variables. My work on eighteenth-century American tax policy exploits these opportunities by comparing colonies with much common experience: overwhelmingly Protestant settler populations, similar relationships to the same imperial bureaucracy, and comparable levels of integration into the commercial systems of the Atlantic economy. Yet these colonies (and the states that succeeded them after 1776) produced strikingly different tax structures. As the U.S. Treasury Secretary Oliver Wolcott, Jr., would notice in 1796, the tax systems of the North were more sophisticated than the tax systems of the South, taxing larger ranges of property in more sophisticated ways. In particular, the northern colonies (and then states) were much more likely to possess enough administrative capacity to assess the value of property (Einhorn 2006a).

An explanation of this difference requires us to look at the other differences between the northern and southern colonies (states). The most obvious contrast is well known: the far greater reliance on slavery in the South. At the outbreak of the Revolution, slaves were 4 percent of the northern population (New Hampshire to Pennsylvania) and 37 percent of the southern population (Delaware to Georgia). Historians now often stress the fact that slavery existed across the new United States, but enslavement of 2 percent of the population in Massachusetts and Pennsylvania had completely different implications from enslavement of 40 percent in Virginia and 60 percent in South Carolina (Berlin 1998). Simply put, the northern colonies (then states) were much freer societies. Less well known than the North's greater liberty was its greater democracy. Northern governments were more democratic than southern governments, most dramatically at the local level. From the seventeenth to the nineteenth century, local officials were elected in the North

(often annually) and appointed in the South (often for life).[1] A third traditional contrast is more familiar than accurate. As historians have come to recognize the thoroughly commercial nature of the southern staple-crop economies, they have abandoned the old idea that the North was more capitalistic. Quasi-aristocratic pretensions to the contrary, tobacco planters and their enslaved workers participated in some of the most advanced commercial systems of the eighteenth century (McCusker and Menard 1985; Greene 1988). Thus, the more sophisticated tax structures of the North were associated with more liberty and democracy – but not more commercialization.[2]

Put another way, liberty and democracy produced stronger and better government in early American history. Whatever significance this finding may have for the historical sociology of state-building, it has profound implications for early American history. First of all, even before turning to the issue of administrative capacity, this link between liberty and democracy challenges a hoary line of interpretation: a traditional story in which the leading champions of democracy in early American history were southern slaveholders. As far-fetched as it sounds when stated so bluntly, this is what historians have believed until very recently (hence the phrase *Jeffersonian democracy*). The most sophisticated version of this argument, captured brilliantly in the work of Edmund S. Morgan (1972; 1975), is that slavery promoted the growth of American democracy by dissolving class conflicts among whites. Because they were not "threatened by a dangerous free laboring class," the slaveholding elites of the revolutionary era – especially the celebrated Virginians – could afford to champion democracy more fully than their northern (and British) counterparts could.[3] What Morgan called the "American paradox," however, is a paradox only if we accept its Jeffersonian premise – that there actually was more democracy in the South than in the North (see Einhorn 2006b).

That is where the history of taxation reveals Schumpeter's "thunder of history" for early America. There was more antidemocratic rhetoric in the North, as many historians have shown, but there was also more democracy – in the literal sense of decision-making by representatives elected to defend the interests of diverse constituents.[4] Attention to tax history requires attention to the structure and capacity of governments at various levels. Once we have acquired a clearer understanding of the governments of early America, we can abandon the rhetorical

[1] The pattern of northern election and southern appointment was complete in the eighteenth century, but note that local officials continued to be appointed rather than elected in Virginia until 1851 and South Carolina throughout the antebellum period.

[2] Greene 1988 goes so far as to say that the South was more commercial than the North. It is tempting to stress the North's better systems of roads and then canals and railroads, but critical to remember that the South had much better river transportation for staple crops.

[3] Jefferson himself bears much of the credit (or responsibility) for the persistence of this view, with historians repeating his own attacks on his northern political opponents – as monarchists, aristocrats, and his personal hybrid "monocrats." Peterson 1960 is fascinating on Jefferson's long-term appeal in the United States.

[4] The antidemocratic rhetoric almost certainly reflected the democracy itself. Northern elites grumbled about political challenges from which southern elites were all but immune. See Einhorn 2006b.

paradoxes to look at the history of actual politics. The result, as my research shows, is that the freer societies with the more democratic governments also had the more competent governments. No matter how many times southern politicians attacked strong governments as inherently aristocratic and corrupt or praised weak governments as inherently democratic and pure (the key "Jeffersonian" ideas), American governments actually were stronger, cleaner, and more competent where there was more liberty and democracy. This relationship makes perfect sense. Democracies, after all, should be the political systems in which ordinary people support active uses of the governments that belong to them. The fact that early American politics followed this straightforward logic is arresting only because of the enduring influence of Jeffersonian rhetoric in the United States.[5]

The proof of these general statements lies in the historical details: in the tax systems, the government structures, and the administrative capacities of particular colonial governments. The remainder of this chapter, therefore, will describe the tax history of four of them – Massachusetts, Virginia, Pennsylvania, and South Carolina – and how they coped with the unprecedented costs of the American Revolution. Social scientists may wonder how the following sketches could be novel. American politics is hardly a new field of study. U.S. historians, however, have come to realize that the study of political institutions has fallen far behind the study of political rhetoric. For decades, scholarship dominated by debates about ideology (mainly the relative significance of republicanism and liberalism) has either ignored institutions or relied on studies that were generations out of date (see esp. John 1997). "Bringing the state back in" to this history has had momentous consequences, of which the most important is a new appreciation of the significance of slavery (Richards 2000; Fehrenbacher 2001; Einhorn 2006a; Graber 2006). The issue here is not racial solidarities, racial exclusions, or the oppression and resistance of African Americans. The issue is the impact of the institution of slavery on the structure, operation, and development of American government.

MASSACHUSETTS

Massachusetts had a sophisticated tax system throughout the colonial era. Even though it was regressive, this system inspired little generalized criticism. It entailed regular wrangling, but hardly any corruption. Taxpayers had trouble paying and collectors fell behind, but there were few – if any – instances of outright theft by tax officials.

In 1646, the Massachusetts assembly (General Court) introduced the town-based "country rate" tax system the colony used until the 1690s.A *rate* consisted of a 2.5-shilling poll tax plus a penny-per-pound tax on the value of "all personall

[5] And, we might add, the persistence of an elitist ("mugwump") association of corruption with democracy, as in old-fashioned studies of urban machine politics. Bridges 1997 is a powerful demonstration of the bankruptcy of this view. Still, my point is not that democratic governments must be less corrupt than undemocratic governments, but that they actually were less corrupt in colonial America. For details on the evidence for this assertion, see Einhorn 2006a, Chaps. 1–3. For Jefferson's influence on historical interpretations, see Lynd 1967, Chaps. 6, 10.

& real estates." Every year, each town elected a tax commissioner who, with the annually elected selectmen, made a list of all males aged sixteen and up,

> and a true estimation of all personall & real estates, being, or reputed to be the estate of all & everie the persons in the same town . . . according to just valuation . . . so neer as they can by all lawful wayes and means which they may use. *viz*: of houses, lands of all sorts as well unbroken up as other [except town common lands], mills, ships & all small vessells, merchantable goods, cranes, wharfes & all sorts of cattle [livestock] & other known estate whatsoever; as also all visible estate either at sea or on shore.

The resulting tax, which financed both the colony and individual towns, was a combination poll tax and property tax: a 2.5-shilling poll tax on all adult males "except Magistrates and Elders of Churches" and men "disabled by sicknes, lamenes, or other infirmitie" plus a penny-per-pound tax on the property. The system simplified matters with fixed valuations for livestock, but made them more complex with a "faculty tax" based on the estimated incomes of artisans who "by the advantage of their arts & trades are more enabled to help bear the publick charge than common laborours and workmen." The law also included a county-level equalization process in which the town commissioners of each county met to "duly and carefully examin" their local assessments and correct them by majority vote "according to the true intent of this order" (Shurtleff 1853–4, Vol. 2: 173–4; Farrand [1648] 1929: 9–10).[6]

Incremental reforms in the 1650s shifted more of the tax burden onto wealthier taxpayers. In 1651, the General Court addressed what remained a huge problem in U.S. property taxation until the twentieth century – the taxation of commercial wealth that was less accessible to assessors than agricultural wealth – by ordering that property of "marchants, shopkeepers, and factors shall be assessed by the Rule of common estimation, according to the will and doom of the assessours, having regard to their stock & estate, be it presented to view or not, in whose hands soever it be." To protect the merchants against this discretionary "will and doom," in turn, it added an appeals process: "If any such merchants find themselves overvalued, if they can make it appear to the Assessours, they are to be eased by them, if not by the next County Court." The General Court also shifted burdens more directly. In 1653, it cut the poll tax from 2.5 to 1.67 shillings, and in 1657 it slashed the fixed livestock valuations to benefit the farming majority (Shurtleff 1853–4, Vol. 3: 221, 320, 426; Massachusetts [1660] 1949–51: 14).

King Philip's War (1675–6) and the early phases of King William's War (1689–90) pushed the country rate system beyond its limits, as the General Court levied twenty-six rates in the first war and thirty-seven in the second. Each additional rate doubled the poll tax, magnifying its regressive impact on the poor (Breen 1980:

[6] It seems clear that the faculty tax on artisans was rarely collected. Burbank H.H., n.d., "The Taxation of Polls and Property in Massachusetts. I," 14, New England Tax Materials 1658–1850 Collection, v. 1, Baker Library, Harvard Business School, 14. From 1634 to 1646, Massachusetts had levied a pure property tax, with General Court committees apportioning total burdens to towns and annually elected town officials distributing them to individuals by valuing their "goods, stock, & land." Shurtleff 1853–4, Vol. 1: 120, 166, 168.

88, 103). Because there was no apportionment mechanism, moreover, high colony taxes invited equalization problems. Town officials could undervalue property and relieve polls with generous "sicknes, lamenes, or other infirmitie" exemptions, and ratify these results at their county equalization meetings. The General Court could only pile on additional rates as the yield of each fell and the geographic distribution of its tax burdens grew ever less rational.

After Massachusetts became a royal colony in 1691, it reshaped its tax system in ways that introduced regular political jockeying at the General Court level. The new tax on "polls and estates" remained the backbone of the Massachusetts tax system into the twentieth century. It took awhile to work out the details, but by 1700, the new system was in place. It included colonywide apportionments, poll taxes fixed in each levy, and property taxes on the assessed value of "all houses, lands, stock, goods, and merchandizes and other estates whatsoever" including slaves (Massachusetts 1869–1922, 1: 30). For real estate, the new system switched from assessing by value to assessing by annual income. This was a general practice in England (in the local rates charged to occupiers of real estate), but in the English economy, most occupiers were renters and the rents measured the incomes (Cannan 1912). What this practice offered Massachusetts, where most occupiers were owners, was a way to underassess agricultural land. After trying out several multipliers, the General Court settled on six times the annual rent in 1700. Where there was no rent, assessors were to "estimate" what properties "may reasonably be sett or lett for in the places where they lye" (Massachusetts 1869–1922, 1: 413). This procedure had three results: (1) six years of annual rent probably was less than half the market value of real estate; (2) when annually elected local officials estimated rent on owner-occupied land, we can assume they erred on the side of low valuations; and (3) because urban real estate was rented more often, it probably was assessed at a higher fraction of its value (Burbank n.d. 21a–b, 23a–25a).

For personal property, meanwhile, farmers gained much lower livestock valuations than those of the country rates, probably less than half the livestock's value. Commercial assets, however, were subjected to "the rule of common estimation at the best discretion of the assessors," which meant "shipping, goods, wares, merchandizes and trading stock and estate," plus artisan incomes and slaves, were supposed to be assessed at market value (Massachusetts 1869–1922, 1: 92, 167; Burbank n.d. 24–5). We can assume they were not (it is an axiom of property taxation that no property is ever assessed at its full market value), but by 1700, the urban interests enjoyed no tax breaks like the legislated undervaluations of agricultural property. The urban interests fought back, winning lower valuations for financial assets, ships, and trading stock. Then, in a 1730 win for farmers and artisans, the General Court expanded the artisan income tax to embrace all "income by trade or faculty" (Massachusetts 1869–1922, Vol. 2: 572; Burbank n.d. 24, 26–29). The important point is less who won or lost in each decision than the fact that these were the political decisions of an assembly where town representatives defended their constituents' interests.

This political process was even clearer when the General Court turned to apportionment. The Massachusetts statute books are filled with lengthy annual lists of

towns and tax quotas that reflected an equalization solution based on colonywide political negotiation. Large lower-house committees conducted the first bargaining rounds, other town representatives weighed in when reports reached the floor, and towns sent streams of petitions arguing that local circumstances (always bad) warranted quota reductions (Massachusetts 1869–1922, Vol. 4: 336, 544–5, 631, 783). The negotiations rested on data compiled in colonywide valuations. Town officials compiled the data, presumably protecting local interests, while town representatives fought fiercely over whether to order new valuations and, once they saw the data, whether to use them.

The "country rates" and the tax on "polls and estates" were not exactly the same, but they had a lot in common. By 1775, local assessors in Massachusetts had been valuing various forms of property for 130 years and the General Court had been apportioning its taxes to towns for 75 years. There had been incremental changes along the way, as different groups used the political process to win more favorable tax treatments. There was also a lot of politics. To imagine the seventeenth-century country rates in operation, we must imagine the officials and taxpayers agreeing on (and haggling over) individual assessments of the value of tracts of land, ships, mercantile goods, and "other known estate whatsoever." For the eighteenth-century tax on "polls and estates," we must imagine this plus the political wrangling in the General Court over apportionments and valuation rules. In fact, it is not hard to imagine the Massachusetts townspeople doing these things. Yet, as we will see presently, the capacity to perform such administrative and political feats was not generally shared across colonial America.

VIRGINIA

Virginia had nothing like either the country rates or the tax on polls and estates. Its main tax instrument was a poll tax on "tithables," which were defined as free men plus enslaved men and women. This tax was established in 1624, immediately after the Crown took over from the bankrupt Virginia Company. To send an agent to England and "for defraying such publique debts our troubles have brought upon us" (reprisals against Indians for a major 1622 massacre), this first assembly levied fourteen pounds of tobacco on "every male head above sixteen years of adge now living." In the 1640s, adding greater precision, the assembly defined the taxpayers as the "masters" of families, making them "responsible for all the public duties, tithes and charges, due from all persons in their familys," and identifying "tithable" members of these families: "all negro men and women, and all other men from the age of 16 to 60." There were minor changes later, but the poll tax on tithables had assumed the form it retained until the American Revolution (Hening [1819–23] 1969–71, Vol. 1: 124, 159, 281, 284, 286–8, 292).

At the same time Massachusetts was introducing its "country rates," Virginia was trying but failing to introduce property taxation by supplementing the poll tax with taxes on land and livestock (to fund reprisals against a major 1644 Indian attack). This 1645 tax was very simple: twenty pounds of tobacco on each tithable person plus four pounds on every hundred acres of land, four on each cow, four on each sheep, two on each goat, and thirty-two on each horse. Virginia, however,

could not manage even such rudimentary property taxation. In 1646, announcing that the property lists were defective, the assembly ordered new lists made and double rates charged to taxpayers who concealed property in the first round. It tried exhortation (stressing the cost of the Indian war) and administrative reform (new collectors), but gave up on property taxation in 1648, reverting to its "anncient and vsual" practice of taxing tithables "by the pole, equally" (Hening [1819–23] 1969–71, Vol. 1: 329–30, 337, 342–3, 356).

Nor did the poll tax on tithables work effectively, despite its simplicity (flat numbers of pounds of tobacco per head). Especially in the seventeenth century, the colony's tax laws chronicle a series of problems, focused on corruption. In 1644, it was sheriffs refusing to produce accounts. In 1645, it was sheriffs committing "extortion" and "convert[ing] a great part" of the tax "to their private benefit." In 1661, it was the "fraud of sheriffes in bringing in their lists" and what should have been a predictable evasion: that "diverse persons purchase [white] women servants to work in the ground that thereby they may avoyd the payment of levies" (solved, briefly, by identifying white female agricultural laborers as tithables). In 1663, it was payment in bad tobacco, "such refuse contemptible goods as are not vendible but at under rates." In 1672, it was taxpayers lying about the ages of teenagers. In 1691, it was sheriffs exploiting taxpayers by picking "their own advantagious times" to demand payment (Hening [1819–23] 1969–71, Vol. 1: 284, 295; Vol. 2: 19, 170, 186, 296, Vol. 3: 47). The problem here was the endemic corruption of county governments where officials were appointed rather than elected.

These complaints ended with the seventeenth century, mainly because Virginia restructured its tax system to reduce poll taxes sharply (when the rates rose again in the 1760s, the complaints returned). The innovation was a tax on exported tobacco, which bypassed the county sheriffs, though the assembly also hoped it could solve two economic problems. It ordered the tax paid in money by the English merchants who came to buy Virginia's tobacco – to inject scarce currency into the economy and encourage Virginians to produce "other vsefull and beneficiall comodities" than the taxed tobacco. When the English shippers refused to post bonds for their payments, the assembly had to repeal the tax. However, Virginia's power in relation to the tobacco shippers shifted in 1660 with the Stuart Restoration (Virginia leaders supported the royalists throughout the English Civil War). Charles II now "graciously" approved the tobacco export tax, which royal customs officers collected and remitted to the colony. Virginia invited the king to take over part of its tax administration, and the king accepted the invitation (Hening [1819–23] 1969–71, Vol. 1: 491, 523; Vol. 2: 176; Morgan 1975, 345–6; Bruce [1910] 1964, 592–5).

Still, Virginia did not abandon its poll tax, even as various officials attacked it on equity grounds. In 1663, the governor and council advised the Burgesses to replace the poll tax with a land tax, because "the most equal way of paying taxes is by laying a levy upon land and not upon heads," but the Burgesses refused even to consider this suggestion. The Burgesses found the poll tax acceptable now that it was supplemented by a trade tax collected by royal officials. (Hening [1819–23] 1969–71, Vol. 2: 178, 204). For almost a century after the 1660s, Virginia expanded its revenue base by expanding its trade taxes. The tobacco export tax was the first

of a series in which Virginia enlisted the Crown to collect its taxes. It added a tax on imported servants in 1679, with different rules for "christian servants" and African slaves, and a tax on imported liquor in 1684. By 1701, it was reenacting these duties at regular intervals. The renewal laws all touted the productivity of the trade taxes, explaining to Crown officials, all the way down to 1769, that taxpayers preferred them to the "grievous and burdensome" poll tax, which was grievous and burdensome primarily because Virginia lacked the local administrative capacity to collect it (Hening [1819–23] 1969–71, Vol. 2: 468; Vol. 3: 23–4, 212–13).[7]

Virginia's taxes remained primitive. There had been two reform bursts. The internal one (1645 property tax) failed completely. The external one (outsourcing collection to the Crown) worked, but also revealed the limitations of the Virginia polity. In its 150-year colonial history, Virginia never asked its tax officials to measure the value of anything! Unable to depend on the ability or honesty of the county sheriffs, even when they were just collecting flat-rate poll taxes on "tithables," the assembly invited the Crown to bail it out. Virginians later told another story about their relations to the empire, in which they had always defended their political autonomy, but without administrative capacity, political autonomy could never be more than a fiction. Massachusetts lost an almost total autonomy with its 1691 royal charter, but remained much more independent of the Crown than Virginia. Massachusetts also had something else Virginia lacked: a tax politics. In Massachusetts, local officials and taxpayers were used to haggling over assessments; farmers, artisans, and merchants were used to manipulating valuation rules; and town representatives were used to hammering out apportionments. By the outbreak of the revolution, Virginians had never done any of these things.

PENNSYLVANIA

At first glance, the history of taxation in the Quaker colony seems paradoxical: low taxes but a comprehensive and sophisticated tax structure. In a levy called the "land tax," the colony and its local governments collected a limited poll tax from single men and taxed the value of "real and personal estates" as assessed by annually elected local assessors. The main elements of this structure were in place by the first years of the seventeenth century and most persisted into the nineteenth. Taxation was less regressive in Pennsylvania than in other colonies because Pennsylvania levied no across-the-board poll tax, but Pennsylvania resembled Massachusetts in the ability of its local officials to value property and in exhibiting minimal political corruption (Einhorn 2006a, 286n.15). Because Pennsylvania spent little on war until the late-1750s (reflecting Quaker pacifism), because its local governments did not finance religion (reflecting Quaker distrust of a "hireling clergy"), and because it earned substantial nontax revenue from a successful public bank,

[7] Unsurprisingly, the gentry never proclaimed that the problem was their own administrative incompetence. They just kept repeating that trade taxes were less "grievous and burdensome" than the poll tax on tithables (Hening 1819–23, Supp.: 47, 237, Vol. 4: 394, Vol. 6: 251, Vol. 8: 343). Still, an economic interpretation of this grievous burden (its regressivity) requires us to ignore the similar incidence of the poll tax and the leading trade tax (on exported tobacco): one taxed the labor that produced the tobacco; the other taxed the tobacco itself.

Pennsylvania's sophisticated tax structure cannot be explained as a response to heavy fiscal demands.

Pennsylvania's "land tax" had two unique features: the way it handled taxable property and its tax on "single freemen." Both extended targeted tax breaks for debt, marriage, and child-rearing. The assessors determined the "clear value" of a taxpayer's estate, meaning its value after subtracting debts, exempted household goods and tools ("implements used in trade and getting a livelihood"), and, in the early years, exempted anyone whose net ("clear") estate came in below a figure such as thirty or fifty pounds (Beckman 1976, 203–4, 216, 219, 235; Mitchell and Flanders 1896–1915, 35, 114–15, 280, 374, 389–90, Vol. 3: 83, 128). Rather than a flat floor, the exemption for the poor was a tax break for parents. The assembly first articulated this policy in 1693 in its first land tax, which exempted people "who have a great Charge of Children and become Indigent in the world & are Soe farr in Debt, that the Cleare vallue of their Reall and Personall Estate doth not amount to Thirty pounds." Later laws effectively left the results to negotiation between local assessors and taxpayers, allowing exemptions or partial abatements by instructing assessors to value property "having due regard to such as are poor and have a charge of children" (Beckman 1976, 204, 219; Mitchell and Flanders 1896–1915, Vol. 4: 14). Whereas poor parents were favored, poor single men were penalized. The "single freemen" tax was a steep, regressive levy on unmarried men who owned less than the amount of property that otherwise would trigger an exemption. In the 1725 version, single men older than age twenty-one with a "clear" estate less than fifty pounds paid the equivalent of a tax on thirty-six pounds of property, no matter how little they owned (Mitchell and Flanders 1896–1915, Vol. 4: 14).

There was one more major tax break. Until 1755, Pennsylvania did not tax unimproved land. This exemption seems to have reflected what Barry Levy (1988) calls the Quaker family strategy: trying to keep children in the sect by launching sons into adulthood with property. The 1693 version treated unimproved land as a burden, directing assessors to have "a due Regard" for "the many Tracts of Uncultivated and unprofitable Lands which produce rather a Charge than Profitt to the Owners thereof." The 1725 law was more straightforward, exempting "all unsettled tracts or parcels of land," including those "formerly accustomed to be rated in assessments." In 1755, however, the assembly changed its policy, taxing unimproved land that had acquired new social meaning. Now, speculators were accumulating "large tracts . . . merely in expectation of receiving hereafter higher prices for private advantage." Instead of helping parents launch sons locally, these holdings were chasing sons away, forcing "great numbers of people . . . to leave this province and settle in other colonies where lands are more easily purchased, to the manifest injury and charge of the public" (Beckman 1976, 204; Mitchell and Flanders 1896–1915, Vol. 4: 14, Vol. 5: 205).

The taxation of unimproved land was one of several major tax changes during the French and Indian War, and it was entangled in a complicated political struggle between the assembly and Thomas Penn (son of William). As the colony's most important land speculator, but also its proprietor, Penn demanded that his land be exempted from the assembly's war taxes (he lost). Meanwhile, in 1758, Pennsylvania

switched its assessment base from value to annual income ("clear yearly value of the estates within this province"), with "yearly value" based on net rental income ("clear value of the rents aris[ing] out of the premises") or, in the case of owner-occupied property, "estimated by the assessors according to their discretion and judgment." The assembly also added a more detailed list of taxable assets. Taxpayers had been reporting land (including amounts "sowed with corn"), unfree people ("bound servants and negroes, with their ages"), and livestock ("cattle, horses, mares and sheep"). Now, they also reported other real estate ("grist-mills, saw-mills and all other mills, forges, furnaces, mines, house rents, ground rents") and, for a new faculty tax, all "trades or occupations, and all offices and posts of profit" (Mitchell and Flanders 1896–1915, Vol. 4: 14, Vol. 5: 340, 342).

The heavy taxes for the French and Indian War tested the limits of local responsibility for taxation in Pennsylvania. In 1764, the assembly narrowed the discretion of assessors by issuing more detailed instructions. It framed valuation ranges for real estate (such as thirty to sixty pounds per hundred acres for meadow in Bucks and Chester counties) and set flat valuations for livestock and unfree people (white servants at two and a half pounds, "negro or mulatto slaves" at four pounds). These rules were to be applied using printed forms, but the assembly abandoned the forms two years later on the grounds that printing and distributing them wasted money. The fact is that Pennsylvania's local communities did not need printed forms. Taxpayers and annually elected assessors could work out acceptable burden distributions, as they had been doing for local taxes with only vague formal instructions since the 1690s. What they needed from the assembly was a response to the new problem raised by colonywide war taxes: an equalization mechanism to ensure comparability among the local assessments. Finally, during the Revolutionary War, the legislature addressed this problem the way Massachusetts had for a century. The legislature apportioned its taxes to the counties in flat sums, which county officials distributed to local taxpayers (Mitchell and Flanders 1896–1915, Vol. 6: 345–58, Vol. 7: 55–6, Vol. 8: 378; Vol. 9: 230–2, 360–1, Vol. 10: 210, 326–7). Pennsylvania did not tax very much in the colonial era, but its local communities levied sophisticated taxes effectively.

SOUTH CAROLINA

If Pennsylvania exhibited the paradox of a low-tax polity establishing a sophisticated tax structure, South Carolina exhibited a different paradox: a polity of slaveholding masters doing the same thing. South Carolina assessed commercial property throughout its history. It valued urban real estate (town lots, buildings, wharves), stock-in-trade, and financial assets. However, South Carolina did not value most of its wealth – the agricultural wealth of its plantation economy. It levied flat taxes on each slave and each hundred acres, ignoring improvements to rural land. Because South Carolina did not suffer from an administrative incompetence like Virginia's, however, its flat-rate taxes can only be attributed to the preferences of its masters.

The centerpiece of the South Carolina tax system was an annual law called the Tax-Act, consisting of the property tax and an appropriation schedule. The

property tax was designed to avoid regular political negotiations like those at the heart of the Massachusetts tax on "polls and estates." First, although the Tax-Acts apportioned the total levies between Charleston and the rural parishes (taken together) from 1719 to 1758, the ratio changed only once over these forty years (Charleston paid one-sixth until the 1740, one-fifth after that). The tax rates were also rigid. The rural rates on land and slaves rose and fell with the levies, but were always equal to each other, as in ten shillings on each hundred acres and "all negroes and other slaves." After 1758, with colonywide tax rates, ad valorem rates on commercial property were always pegged at half the flat rates on agricultural property, as in ten shillings on land and slaves and five shillings per hundred pounds of urban real estate, stock-in-trade, money-at-interest, and professional income. If the average hundred acres and average enslaved human being were both worth fifty pounds, this would have been a uniform tax on the average value of all forms of taxed property. Yet, its odd rigidity suggests that although South Carolinians excelled at administration, they worked hard to avoid doing politics.

The property tax was the heart of the South Carolina tax system and changed in response to large-scale changes in the wealth structure. Thus, in the seventeenth century, when the colony was a mere commercial outpost, the tax was an ad valorem levy on all property and income, stressing commercial wealth and salaries of proprietary officials. In the 1710s, with the advent of the rice-based plantation economy, a major reform created separate rural and urban taxes, with flat rates on land and slaves in the country and ad valorem taxation in Charleston. As the mercantile and plantation elites merged into the super-rich merchant-planters of the late colonial era, the colony extended ad valorem taxation to financial assets in rural areas and, in 1759, all but abolished the rural–urban split. The surge of smallholding farmers into the South Carolina backcountry in the 1750s and 1760s was the only major economic change that inspired no tax reform, presumably because it was also the only one that did not reshape the wealth structure of the lowcountry elite.

The seventeenth-century tax was very sensitive to forms of wealth. The oldest surviving tax law levied five hundred pounds for defense against a Spanish attack in 1686, "equally assessed, imposed and leavyed upon the severall inhabitants, merchants and others . . . according to their several estates, stores, and abilities, and according to the profits indifferently computed of every publicque officer . . . by his respective office or any other imployment whatsoever." The colony levied this tax with others on imports (liquor and slaves), exports (skins and furs), and taverns until the Yamasee War (1715–16), attempting to adapt it as agricultural operations developed. Thus, in 1703, the assembly itemized taxable agricultural wealth: "the number of neat cattle, horses, sheeps, swine; white servants with their trades and time they have to serve; slaves, their sexes, ages, trades, and capacities; the quantity of lands, the place the same lyes in, and the buildinges and improvements thereon."[8] After trying this again in 1704, however, South Carolina avoided property taxation

8 Cooper and McCord 1836–73, Vol. 2: 16, 207–8. See also ibid, Vol. 2: 24, 64, 86, 96, 110, 162, 177–8, 182–3, 229–31. The citation Tax-Act (year) refers to laws that Cooper and McCord missed, but which are in the Jenkins collection (see the full citation of Massachusetts 1660 in References).

until the Yamasee War, surviving on paper money emissions, imposts, and plunder (literally instructing its soldiers to sell any enslaved Indians they could capture). In 1716, however, realizing that ad hoc extensions to the old system were not working, the assembly framed a new law to avoid valuing agricultural wealth (Cooper and McCord 1836–73, Vol. 2: 257–9, 324–7, 341, 352–4, 618, 627–9, 663).

The 1716 Tax-Act levied flat taxes on rural land and slaves and ad valorem taxes on a range of property in Charleston. Rural assessors took sworn statements of taxpayers' holdings of land and "negroes or Indian slaves, men, women or children." They then charged five shillings on each hundred acres, calculated how much that raised, and levied the rest of the rural total as a flat tax "on all the negroe and Indian slaves, mustees and mulattoes . . . without any manner of difference or distinction of age or sex, save that any Indian slave being reputed of much less value than a negroe" warranted a 50 percent tax break. In Charleston, meanwhile, the tax was levied on the assessed value of all "real and personal estates, negroes, stocks, and abilities."[9] The assembly levied this tax almost every year from 1716 until 1758. It dispensed with the rural assessors in 1723, but assimilated town and country by valuing rural commercial wealth (storekeepers' stock-in-trade, financial assets) and ending the assessment of town-based slaves. However, a 1731 attempt to value rural land failed completely, although the assembly extended the deadline three times and then scolded local officials who "valued all the lands in their respective parishes at one price" (Cooper and McCord 1836–73, Vol. 3: 73, 207–10, 308–9, 319–22, 320–2, 439; *Tax-Act* [1747], 4–5, 8–11; *Tax-Act* [1752], 10–11). South Carolina could value all manner of urban and commercial wealth, but it simply could not value the wealth at the heart of its plantation economy.

As the Yamasee War had prompted the colony to create this tax structure, the French and Indian War prompted the next major change, whose essence was higher taxes in Charleston. The assembly removed the cap on the town's contribution and levied a series of rates that ostensibly applied everywhere: flat rates on land, slaves, and "free negroes," all equal to each other, and ad valorem rates on urban real estate, commercial stock-in-trade, financial assets, and occupations – all pegged at half the flat rates (except annuity income, taxed slightly more heavily). It explicitly extended the occupation tax to the town's artisans by naming "handicraft Trades" along with the factorage, faculties, and professions (*Tax-Act* [1755], 3–4; *Tax-Act* [1756], 4; *Tax-Act* [1758], 4–5; *Tax-Act* [1759], 4–5). This tax was controversial. Charleston taxpayers complained that they paid most of the ad valorem taxes, whereas backcountry settlers attacked the single flat acreage rate levied on frontier farms and lowcountry rice plantations. Both wanted across-the-board ad valorem. The lowcountry planters who dominated the assembly refused to oblige, though they mollified the critics as the imperial crisis escalated. From 1770 to 1777, the colony relied solely on imposts and paper money emissions (Becker 1980,

[9] The assembly addressed the resulting racial-classification loophole in the rural tax: to "prevent all doubts and scruples that may arise what ought to be rated on mustees, mulattoes, &c. all such slaves as are not entirely Indian shall be accounted as negroe." Cooper and McCord 1836–73, Vol. 2: 666–71, Vol. 3: 71–7. For the urban tax, town officials handled the town lots and houses owned by taxpayers who usually lived in the country; whereas rural officials handled the rural land and slaves owned by Charleston residents. Ibid, Vol. 2: 667; Vol. 3: 92.

99–104; Brown 1963, 139–40; Nadelhaft 1981, 13; Weir 1983, 305–12; Greene 1963, 403–16). South Carolina had the administrative capacity to assess commercial wealth even without democratic local government (the assembly appointed most local officials), but South Carolina could not send assessors onto plantations to value agricultural wealth. From the "rice revolution" to the American Revolution, it taxed its plantation economy with flat-rate taxes on land and slaves.

REVOLUTION

Of these four colonies, only Virginia tried to implement a major tax reform during the Revolutionary War. In 1777, it attempted a reform that was far more radical than – and almost as complete a failure as – its property tax of the 1640s. Suddenly, Virginia's local officials were directed to assess the value of many forms of property and then to use these valuations to collect extremely high taxes. They were supposed to do all this as British warships blockaded the coast, marauding armies pillaged across the countryside, African Americans abandoned the plantations, and paper money depreciation wrecked the financial system.

The initial problem was that the tobacco export tax was useless when trade stopped, first because of the "nonimportation" protests and then with the British naval blockade. Virginia had to tax directly, although it did not have to do quite what it tried to do: an ad valorem tax on land, buildings, "slaves, mulatto servants to thirty one years of age, horses, mules, and plate," salaries, and financial assets. There was also a flat tax on cattle and hikes to tavern and marriage licenses, a carriage tax, and the tax on exported tobacco. Nor was the poll tax forgotten, although the new tax regime required a change. Now, the tax was levied on "tithables" older than age twenty-one except soldiers and sailors – and "except also slaves and mulatto servants to thirty one years of age, who, being property, are rated ad valorem as aforesaid." Any taxpayer who did not take an oath to support the revolution would be charged double, all prior taxes due before 1784 were declared void, and the colony also imposed its traditional poll tax (Hening [1819–23], 1969–71, Vol. 9: 349–50, 365, 369).

The big question was how Virginia would manage the valuation of property. In probably the most radical part of the plan, the commissioners in charge of the process ("able and discreet men" who owned eight hundred pounds of "visible property" and did not hold specified jobs creating conflicts of interest) were elected by local "freeholders and housekeepers." The commissioners divided their counties into districts and appointed two assessors per district, "discreet men" who were to visit everyone in the district to take sworn property lists and value the property at what they thought it would "sell for in ready money" (Hening [1819–23], 1969–71, Vol. 9: 351–4, 547, 549). This looked good on paper, but it didn't work, partly because of wartime chaos but mainly because Virginians had never done anything like this before. So, in 1779, Virginia gave up on valuing its two principal forms of wealth. For slaves, it simply abolished assessments, levying a flat five pounds on "all negro and mulatto servants and slaves" (but with discounts on those who "shall be incapable of labour, and become a charge to the owner"). For land, it adopted a harebrained plan of Thomas Jefferson's, which abandoned valuation while pretending to continue to do it. Now, county commissioners were to hold

meetings where they divided land into categories and had each local assessor swear to "what he thinks each several kind of the said land would sell for by the acre,"

> which several opinions, together with their own [the commissioners] shall state in writing for each kind of land separately, and shall add together the several sums at which the same kind of land is rated by the different commissioners and assessors, and then *divide the aggregate sum by the number of persons whose opinions were stated*, and shall take the quotient or result, or such sum near thereto, as to avoid the difficulty of fractions may be approved by a majority of the said commissioners and assessors, as the average price of such kind of land (emphasis added).

In 1780, this assessment by opinion poll demonstrated its versatility – to cope with the currency depreciation, the legislature directed the local officials to average their opinions of the prices that categories of land "would have sold for" in 1774![10] The amazing part is the Virginia leaders thinking that they could suddenly implement such a radical tax reform. It was one thing for northern states to value property during the war. They faced the same currency problems, but their assessors did not have to be instructed – as Virginia's were in 1779 – to value land at the price it would yield if sold "in moderate quantities as happens in the ordinary course of things" rather than the price if all the land in a county were dumped on the market at once (Hening [1819–23], 1969–71, Vol. 10: 9–10). Soon, Virginia retreated. In 1781 and 1782, it junked the opinion polls, the elected commissioners, taxes on financial assets, and valuations of everything except land. From then until the 1840s, it levied a crude ad valorem land tax, a poll tax on free men and slaves, and flat taxes on cows, horses, carriages, taverns, and billiard tables (Hening [1819–23], 1969–71, Vol. 10: 501–2, 504–5, Vol. 11: 140–2, Vol. 12: 431; Einhorn 2006a, 48–51, 227–8).

Massachusetts coped with the revolution with less dramatic measures that continued the tax politics its groups had waged for more than a century. In 1777, while Virginia struggled to introduce valuation for the first time, Massachusetts cleaned up its valuation rules. Now, each form of property (land, buildings, livestock, merchandise, financial assets, shipping, plate) was valued at its "price" on November 1. The same rule applied to an expanded income and profit tax, on "incomes from any profession, faculty, handicraft, trade or employment; and also on the amount of all incomes and profits gained by trading . . . and by means of advantages arising from the war, and the necessities of the community." The last phrase referred to price-gouging profits, although because these profits involved farmers charging urban consumers high food prices, we can assume that rural assessors enforced them gently (Massachusetts 1869–1922, Vol. 5: 756, 1163).[11]

[10] Hening [1819–23], 1969–71, Vol. 10: 10–12, 243, 285; Boyd 1950–2000, Vol. 2: 223–4, a footnote to the bill that includes the quoted language and identifies the opinion poll as Jefferson's "innovation." For Jefferson's problematic relationship to arithmetic, Smith 1999.

[11] In 1781, the war profiteers and price gougers disappeared from the tax laws, replaced by a new political deal that lasted until the 1820s: real and personal estate assessed at 6 percent of its value except unimproved land assessed at 2 percent, with incomes and profits (purportedly) assessed at full value. Massachusetts 1869–1922, 86, 519–20; Einhorn 2006a, 226. Apportionment politics also intensified as the state senate demanded an unprecedented role. Town petitions continued to recite reasons to reduce local quotas, some reflecting war-related hardships, others rehearsing politics-as-usual. Massachusetts 1869–1922, Vol. 5: 828–37; Hall 1972.

The 1780 state constitution acknowledged the utility of the colonial inheritance with a minor reform, requiring decennial revaluations as long as Massachusetts continued to levy the tax on "polls and estates" (Handlin and Handlin 1966: 450).

In the end, of course, nothing was enough. The General Court's struggle to finance the revolution ended famously in Shays' Rebellion in 1786. Yet, what is often lost in stories about the national significance of Shays' Rebellion is the audacity of the General Court in trying to tax very heavily to pay its creditors at par. Massachusetts could levy taxes that hurt. An intransigent legislature pushed its tax system too hard in the postwar depression (the currency shortage and a backlog of private debts), but it had a working tax system to push, one that triggered action by experienced local officials. Annual elections, moreover, let the voters make their preferences known quickly. In spring 1787, in turnout triple that of the previous year, the voters purged the politicians who had provoked the rebellion, at which point the state pardoned the rebels, cut the taxes, and suspended lawsuits for private debts – the main rebel demands all along. Things clearly had gotten out of hand, but the Massachusetts polity could arbitrate its major conflict of interest (between commercial groups who wanted the debt paid and agrarian groups who could not bear the tax burdens to pay it), and actually did arbitrate it before the U.S. Constitution and assumption of state debts solved the underlying problem (Hall 1972: 227–55, 295; Richards 2002).

Pennsylvania made few changes to its tax system during the Revolutionary War. When Oliver Wolcott examined its land tax in 1796, he found a structure that had changed very little in thirty years, despite the adoption of two entirely new constitutions (in 1776 and 1790), vast fiscal demands, and bitter political struggles. Taxes levied monthly rather than annually reflected the depth of the wartime emergency. So did a new military exemption from the single freeman tax. The Quakers had identified marriage as the duty that poor men owed to society, but poor men now were exempted as husbands or soldiers. The state returned to assessment by value (rather than yearly value), adding new attention to personal property owned by the rich (gold and silver plate, pleasure carriages, commercial "wares and merchandise"). With apportionment of state taxes to the counties solving the equalization problem, however, Pennsylvania no longer needed the detailed rules it had adopted for the French and Indian War. Now, assessors were directed simply to value assets at what they "would sell for in ready money" or "at and for so much as they would bona fide sell for, or are worth" (Mitchell and Flanders 1896–1915, Vol. 9: 23, 101–2, 362, Vol. 10: 330, 389).

Nor did South Carolina change its tax system during the war. In 1777, the legislature passed a Tax-Act exactly like the last colonial Tax-Acts. The old opposition renewed, but only Charleston won timely relief. In 1778, the legislature accompanied a tenfold hike of the rural flat rates with only a fourfold hike of the urban ad valorem rates, recouping some of the losses with a new flat tax on carriages and double taxes on Tory property. The backcountry came into its own after the war ended and, in 1784, won something resembling an ad valorem land tax: a schedule of twenty-two fixed per-acre valuation categories ranging from six pounds ($26 USD) for the best low-country land to one shilling (twenty cents) for the worst backcountry land. This reform redistributed burdens as part of a larger

political deal. Lowcountry planters, who still controlled the legislature, accepted tax hikes because the new state constitution tied future reapportionments to the distributions of both white population and taxable property (Cooper and McCord 1836–73, Vol. 4: 365–6, 413–14, 487–8, 529, 627–8; Nadelhaft 1981: 126–7, 135–8).

South Carolina did not start sending assessors onto the plantations to value the wealth of its masters. The state now levied categorical taxes on agricultural land, flat taxes on slaves and carriages, ad valorem taxes on urban wealth, poll taxes on free blacks, and no taxes on financial assets, buildings, or improvements to real estate. Because it taxed some commercial wealth, this tax structure remained more sophisticated than Virginia's. Because it taxed the two leading forms of wealth (land and slaves) without valuing them, however, it did not compare with the systems of Massachusetts or Pennsylvania. Democratic local governments with annually elected assessors clearly explain part of the difference between North and South. They legitimized property valuations by ensuring that "the people" controlled them on the ground. Yet, the South Carolina experience shows that local government was not the whole story. South Carolina may have had the administrative capacity to value tangible wealth, but it chose not to value land, buildings, irrigation works, livestock, carriages, or enslaved people. When Charleston and the backcountry demanded ad valorem taxes to shift burdens toward the lowcountry planters, the planters agreed to pay – but not to tolerate the intrusions of officials onto their plantations.

CONCLUSION

Thirty years ago, at the height of the "new social history," historians who used tax lists to reconstruct the distribution of wealth in colonial America were struck by their deficiencies. The southern lists of "tithables" seemed reliable and were used to develop population estimates, but the northern property valuations seemed to contain systematic biases: undercounts of poor men and underassessments of elite wealth (Lemon and Nash 1968; Warden 1976). We can notice the higher standard to which the northern sources were held – and wonder if twentieth-century Internal Revenue Service issues of *Statistics of Income* would present more accurate pictures – but the key point is that these biases suggest the strengths more than the weaknesses of the northern tax systems. The legitimacy of taxation does not depend on quantitative precision. It depends on the political flexibility that allows taxpayers to think they are being treated fairly. Thus, as Gary B. Nash found (1979: 117–18), the tax rolls of colonial Boston missed many poor men because the town's annually elected assessors granted poll tax exemptions generously. The result understates the degree of inequality looking back, but it reduced the regressivity of taxation at the time (as underassessments of wealth increased it). We might call this behavior corruption, but it was very different from the outright theft in Virginia – or North Carolina—whose officials stole the tax proceeds with a regularity that provoked an armed insurrection in the 1760s (Kars 2002; Kay 1965, 1969). Really, however, we ought to identify this northern behavior as politics. In the case of the Boston poll tax, we might even call it democracy.

As a rule, the northern tax systems were not less regressive than the southern tax systems. Their spending regimes may have been more progressive, particularly as a result of lower official salaries, but the democracy at issue in this chapter was not located at the assembly level and did not translate directly into the tax bills of rich and poor.[12] It was located at the local level, where it translated into the ability of officials to negotiate with their constituents about the details of sophisticated policy regimes. Nor is the administrative capacity at issue here a matter of fiscal productivity. Roger Brown's figures (1993: 14) for state performance in meeting the requisition quotas of Congress from 1781 to 1788 show no obvious sectional pattern. The states paid an average of 37 percent. The leaders were New York (67), Pennsylvania (57), and South Carolina (55), followed by Virginia (44), Massachusetts and Delaware (39), Maryland (29), Rhode Island (24), New Hampshire and Connecticut (20), and New Jersey (19), with North Carolina (3) and Georgia (zero) at the bottom.[13]

The main significance of a comparative approach to the colonial and state tax systems is its demonstration that the colonies and states where local officials were elected and most people were free developed more sophisticated public policy regimes, or, in more abstract terms, that democracy and liberty produced stronger and more competent government in early American history. Although the Jeffersonian story of this period presents the South as a place where slavery elevated white non-elites ("*herrenvolk* democracy") – and the North as a place where non-elites groaned under oppression – attention to the structure of political institutions offers us a clearer picture of where democracy actually existed in this time and place.

For social scientists, the moral of this story is that more democracy and liberty produced stronger and better government. For historians, its main implication is that too much of the way we have thought about U.S. political history reflects the influence of the stories that slaveholders told to support their own political struggles (Lynd 1967, Chaps. 6–10; Finkelman 2001; Einhorn 2006a). To free ourselves from their narratives may help to free us from their enduring influence on our politics. Slaveholders mistrusted government, except when they needed it to protect their so-called property. They also mistrusted democracy because, whenever they saw it – in the North when they were building national governments in the revolutionary era, in their own states when they faced antebellum demands for suffrage and apportionment reforms – they worried that majority rule would threaten the institution of slavery (Einhorn 2002; Einhorn 2006a, Chap. 6). They were savvy

[12] Morgan 1975, 204–9, emphasizes the salaries. This difference also informed intense debates in Congress over the pay gap between privates and officers in the Continental Army. Southerners demanded large differentials that offended the egalitarian sensibilities of New Englanders. The later struggle over pensions for the officers was similar.

[13] A state's ability to supplement property taxes with import taxes was the most important key to its tax productivity. This is why Rhode Island and New York killed the "impost" that might have saved the Articles of Confederation. Generally, however, states fell short on the quotas because their taxpayers could not bear the costs. The form of a state's property tax did not determine the amount of money its legislature decided to send to Congress.

enough to flatter the white "common man" and willing to let him vote, but they would not permit him to govern. Majorities could not decide how to tax and authorities could not intrude onto plantations where slaveholders ruled as sovereign masters. The fact is that slavery was not compatible with democracy, even in an attenuated "*herrenvolk*" form. It was, after all, the majority's decision in a democratic election that finally precipitated the secession crisis.

PART THREE. THE SOCIAL CONSEQUENCES OF TAXATION

10 Extraction and Democracy

CHARLES TILLY

You might not have noticed that the authoritarian Louis XIV indirectly opened a path toward democratization, and that the authoritarian Vladimir Putin might likewise be opening a path toward democratization. It will take some unpacking to show you the parallels between the two visibly vindictive autocrats, and even more to identify their possible long-run contributions to democracy. But at least the unpacking will reveal some promising ways of thinking about taxation, fiscal sociology, and state extraction more generally.

Recovering from the near-disintegration of France during the *Fronde* of 1648–53 and assuming personal power in 1661 with the indispensable backing of Jean Baptiste Colbert, Louis XIV spent half a century building up the French state's central capacity. Building on the administrative innovations of earlier chief ministers Richelieu and Mazarin, he replaced largely autonomous regional governors with intendants who served at the king's pleasure. He battered, shrank, and subdued the large enclaves of Protestant power that had survived sixteenth-century wars of religion. He incorporated the once fractious French nobility into the rituals of his opulent court. He put down rebellions against state intervention – including fiscal intervention – so ferociously that they almost disappeared after having torn the country apart repeatedly before 1653. Although instead of simply stepping up the level of taxation he and Colbert widely adopted such expedients as forced loans and sales of offices, Louis XIV built a fiscal system that delivered revenues to support international wars of unprecedented cost and intensity.

Political regimes vary in many dimensions: size, wealth, geopolitical position, formal structure, and much more. For our understanding of the sorts of political transformations initiated by Louis XIV and Vladimir Putin, it helps to begin with two fundamental dimensions: state capacity and democracy. State capacity means *the extent to which interventions of state agents in existing non-state resources, activities, and interpersonal connections alter existing distributions of those resources, activities, and interpersonal connections as well as relations among those distributions.* (State-directed redistribution of wealth, for example, almost inevitably involves not only a redistribution of resources across the population but also a change in the connection between the geographic distributions of wealth and population.) In a high-capacity regime, by this standard, whenever state agents act, their actions

affect citizens' resources, activities, and interpersonal connections significantly. In a low-capacity regime, state agents have much narrower impacts no matter how hard they try to change things. Louis XIV built up French state capacity from the pitiful levels of the mid-seventeenth century to the might that awed all of Europe by Louis's death in 1715.

What of democracy? In 1661, to be sure, French people experienced nothing like democracy at anything larger than a local scale. Let us think of democracy as the extent to which the people subject to a given state's authority exercise broad, equal, binding, and protected voice when it comes to state performance. If popular voice becomes broader, more equal, more binding on state performance, and better protected against arbitrary action by state agents, democratization is occurring. De-democratization, in these terms, involves narrowing, rising inequality, decreased binding of state action by popular voice, and/or declining protection of that popular voice against state agents' arbitrary action. By these standards, Louis XIV wrought a substantial de-democratization of the French regime while enormously increasing his state's capacity. Visualizing a two-dimensional space with low-capacity non-democracy in the lower left-hand corner and high-capacity democracy in the upper right-hand corner, we can trace Louis's trajectory upward on the capacity axis and backward on the democracy axis, thus producing a net movement into the quadrant of high-capacity non-democracy.

How, then, might we imagine Louis XIV as opening a path toward democracy? Isn't the claim a contradiction in terms? Once we distinguish between short-run and long-run transformations of regimes, not necessarily. I will elaborate the distinction and my argument below. For now, let me call your attention to four features of the Louis XIV story: (1) the buildup of central state power; (2) the state's increasing priority of access to state-sustaining resources such as taxes, labor power, and military means; (3) reduced scope and strength for competing centers of autonomous coercive power; and (4) increasing dependence of support for state activities on citizen compliance, however grudging and coerced.

How do the four features matter for the eventual development of democracy? In the long run, no regime can sustain relatively broad, equal, binding, and protected popular voice without substantial central capacity. That capacity implies priority in access to state-sustaining resources. Existence of competing centers that exercise autonomous coercive power such as private armies and great landed estates inhibits any such enforcement of democratic decision-making. And reliance of the state's routine activities on citizen compliance (rather than, say, external sponsorship or state monopolies of precious goods) entails incessant bargaining (however asymmetrical) over the means of state activity in the short run. It also entails at least the possibility of organized resistance in the long run.

Do you begin to see why authoritarian Vladimir Putin might, despite himself, open a longer-term path to Russian democracy? Remember the background of Putin's rise to power. Russia once lived a vital, vigorous moment of democratic hope. Aspirations rose impressively in 1988. At that point, to be sure, the Russian Republic still dominated the Soviet Union rather than existing as an independent state. Russian Mikhail Gorbachev, general secretary of the USSR's Communist Party and (since that year) chairman of the Supreme Soviet's presidium, was then

leading the drive toward *glasnost'* (political openness) and *perestroika* (economic and political rebuilding). During the historic nineteenth party conference that opened at the end of June 1988, Gorbachev delivered an intensely hopeful three-and-one-half hour address.

The sober *Annual Register* summarized Gorbachev's speech as rejecting Stalinism, and calling for a new society that would preserve the benefits of socialism:

> Although it was impossible to describe such a society in a detailed way, a socialism of this kind would be a system of 'true things.' The purpose of all social development, from the economy to spiritual life, would be the satisfaction of popular needs. There would be a dynamic and advanced economy based upon a variety of forms of property and worker participation, combining a broad measure of central planning with a great degree of autonomy for individual enterprises. The basic needs of all would be provided, including health, education, and housing, but individual talent would also be rewarded, where appropriate, in both moral and material terms. A society of this kind would have a high degree of culture and morality, and would be managed by a system of 'profound and consistent democracy.' (Annual Register USSR 1988: 106)

Gorbachev claimed to be setting the Soviet Union, including his own Russia, on the path to democratization. The *Annual Register's* reporter noted, however, that economic performance was declining in the USSR, and that widespread demands for autonomy or even independence were arising among the Union's non-Russian nationalities. Despite Gorbachev's promotion of openness and rebuilding, no smooth transition to democracy had begun at a national scale.

Nine years later, in 1997, the Soviet Union had splintered, and Russia had gone through fierce struggles for political control. Playing Russian nationalism against Gorbachev's effort to preserve what remained of the Union, Russian party leader Boris Yeltsin had seized power in 1991. In 1993, Yeltsin had consolidated his grip by putting down a right-wing parliamentary coup. Yeltsin had then won the presidential election in 1996, but by 1997 his health was already faltering, a fact that caused feverish maneuvering for influence within the presidential circle. The *Register* then broadcast little good news about the domestic political situation:

> Continuing into 1997, the struggle was conducted between the country's major financial-industrial groups, embracing the largest banks, key sectors of the economy and the newspapers and television stations in which they had acquired a controlling interest. The wider political situation was one of relative stability, apart from a far-reaching government reshuffle in the spring; but this was set against a background of continuing economic decline and widening social differences, accompanied by an increase in organized crime and corruption. (Annual Register Russia 1997: 135–6)

At that point, nearly autonomous economic oligarchs were profiting from their seizure of former state assets, private security forces (many drawn from former state security services and disbanded military units) were consolidating control over protection, and ordinary Russians were clinging to whatever shreds of the socialist safety net remained (Fish 2005; Ledeneva 1998; Varese 2001; Volkov 2002).

By this time, Russia's fledgling democracy had fallen on hard times.

An enfeebled Yeltsin resigned the presidency at the end of 1999, opening the path to his prime minister, Vladimir Putin. A career intelligence officer who had headed the Federal Security Bureau (the KGB's postcommunist successor), Putin spent no effort promoting democracy. During his victorious electoral campaign of 2000, he even refused to debate his rival candidates. Yet his public statements stressed the necessity of restoring a strong state and a properly functioning market. He also promised strong action against the "Islamic fundamentalists" he portrayed as threatening Chechnya and other sections of the Caucasus. Soon after taking office, he reduced the powers of regional governors, started restraining the mass media, and undertook a broad effort to tame the country's "oligarchs" – the capitalists in business and media who had made billions and acquired enormous autonomy during the 1990s. Putin emphasized state capacity at the expense of democracy (Fish 2005).

Reinforcement of central control continued. As the *Annual Register* of 2004 put it:

> Russia ended the year on a trajectory towards a more authoritarian state, and it seemed unlikely – despite the hopes of the liberal groups that had largely been sidelined in Russian politics – that the country would repeat the experience of its neighbor Ukraine and see the political establishment give way before a popular revolution. Developments in Russia in 2004 were dominated by two factors: the government's response to the terrorist reprisals carried out by Chechen separatists beyond the borders of the republic, most horrifically in September against children in the school of Beslan in North Ossetia; and the government's campaign against the "oligarchs" to regain control over energy interests, epitomized by the Yukos saga. The campaigns against Chechnya and against the oligarchs generally won popular approval. (AR Russia 2004: 105)

Consider the Putin government's arrest, prosecution, and imprisonment of Mikhail Khodorkovsky, head of Yukos, the country's largest privatized energy company. It exemplified Putin's relentless campaign to recapture control over oil and gas supplies as a means of consolidating his personal political power and eliminating wildcat capitalist "oligarchs" from his possible political opposition. Soon the state-controlled energy corporation became the world's largest producer of natural gas. With nearly a quarter of the world's known natural gas reserves, Putin's Russia is using its energy to buttress its international influence. As of 2006, Slovakia was importing 100 percent of its gas from Russia, Bulgaria 94 percent, Lithuania 84 percent, Hungary 80 percent, Austria 74 percent, Germany 40 percent, Italy 30 percent, and France 25 percent (Schmitt 2006: 61). Clearly, the state's monopolization of energy supplies was lending it tremendous clout both domestically and internationally.

Russian citizens felt the domestic clout. In 2004, Putin's government extended its surveillance of media as it began prosecuting both academics and businesspeople who showed signs of mounting political opposition or embarrassing state authorities. In April 2004, for example, the Moscow City Court sentenced 41-year-old Moscow researcher Igor Sutyagin to fifteen years in prison for high treason and espionage. During the later 1990s, Sutyagin had helped run a Canadian-sponsored

research project on civilian-military relations in twelve post-Soviet and post-Warsaw Pact countries, including Russia. Sutyagin had no access to military or intelligence secrets. Working from Moscow's Institute of USA and Canada Studies (once a major center of planning for *glasnost'* and *perestroika*), Sutyagin organized interviews with leaders across twelve countries using a standardized survey instrument. The court convicted him – unjustly, by all external accounts – of passing state secrets to British and U.S. intelligence.

In 2005, the Putin government passed a series of state-strengthening laws. The new laws abolished direct election of governors, ended single-constituency voting in parliamentary elections, tightened requirements for registration of political parties, and raised the threshold for party representation in parliament. The government also began considering laws to restrict radically the autonomy of non-governmental organizations. Human rights organizations working in the Caucasus found themselves under extreme pressure, with the Russian–Chechen Friendship Society the object of criminal cases for inciting racial hatred and violating tax laws (Human Rights Watch 2006: 3). In terms of breadth, equality, protection, and binding voice, Putin's regime was visibly de-democratizing Russia.

Russia moved toward democratic territory after 1985 while losing substantial state capacity, then began reversing its direction in both regards. Each year, New York-based Freedom House uses an elaborate questionnaire to rate every independent regime in the world on political rights and civil liberties, with scores on each running from 1 (best) to 7 (worst). In 1991–2, Freedom House placed Russia at 3 each on political rights and civil liberties – certainly not democratic by Freedom House standards or ours, but far more than the regime's 6 and 5 for political rights and civil liberties in 2005 (Freedom House 2005). A fixed 2004 presidential election in which Putin received 71.4 percent of the vote to 13.7 percent for his nearest competitor removed even openly contested elections from Russia's claims for recognition as a democracy. Responding to Russia's snuffing out of opposition voices, Freedom House shifted the regime's overall classification from Partly Free to Not Free for 2005.

Freedom House's ratings catch Russia's de-democratization, but miss the arc of state capacity: from high in the period before the Gorbachev reforms to declining during the Yeltsin years, then back sensationally to high levels under Putin. The two trends obviously connected; Putin's regime was aggressively expanding state capacity as it squeezed out democracy. Yet in one surprising regard, Putin may have been promoting longer-term changes that will eventually facilitate Russian democratization. Although he was permitting the Russian military dangerously broad autonomy in the Caucasus, he was also subordinating capitalists who had acquired extraordinary independence to state control. If, in the future, the Russian state again becomes subject to protected, mutually binding voice in dialogue with a broad, relatively equal citizenry, we may look back to Putin as the autocrat who took the first undemocratic steps toward that outcome.

How so? Remember the four elements of Louis XIV's story: (1) buildup of central state power; (2) the state's increasing priority of access to state-sustaining resources such as taxes, labor power, and military means; (3) reduced scope and strength for competing centers of autonomous coercive power; and (4) increasing

dependence of support for state activities on citizen compliance, however grudging and coerced. The first three clearly apply to Putin's Russia.

The fourth element is more complex and controversial. In the short run, Putin has reduced, not increased, his state's reliance on citizen compliance for state-sustaining resources; so long as he controls the sale of gas and oil, he can afford to ignore Russians' widespread evasion of taxes and other obligations. He need not think, furthermore, that anti-regime mobilizations led by such heroes as chess champion Garry Kasparov pose serious threats to his means of government, however much they hurt Putin's international image and his demand for internal order. Nevertheless, the very monopolization of crucial energy resources raises the post-Putin question: Once the president leaves Russia's political scene, will another strongman simply succeed him, or will the very concentration of state control over sustaining resources facilitate some broader coalition's seizure of state power?

In order to place that surprising possibility into theoretical and comparative perspective, we need to step back for a broader look at state-sustaining resources. Here, in machine-gun bursts, is my larger argument:

1. No one can run a state without social arrangements that produce and reproduce resources supporting administration, political control, and patronage.
2. Available resources vary with the ambient economy; historically, those resources have included:
   - coercive means, including weapons, jails, and organized specialists in violence
   - labor, especially skilled and/or effectively coordinated labor
   - animals, especially domesticated food- and/or work-producing animals
   - land, including natural resources located in and upon it
   - commitment-maintaining institutions such as religious sects, kinship systems, and trade diasporas
   - machines, especially machines that convert raw materials, produce goods or services, and transport persons, goods, services, or information
   - financial capital – transferable and fungible means of acquiring property rights
   - information, especially information that facilitates profitable, safe, or coordinated action
   - media that disseminate such information
   - scientific-technical knowledge, especially knowledge that facilitates intervention – for good or evil – in human welfare.
3. Later items on the list have become more prominent as supports for state capacity in recent centuries, but the earlier items on the list have by no means lost their significance across most of the contemporary world; the state's incomplete control over coercive means, labor, animals, and land, for example, remains crucial to the system of rule in the world's largest democracy, India.
4. Rulers failing to acquire reproducible access to later resources on the list will eventually give way to competitors, internal or external, who do acquire that access.

5. Rulers have three main ways of acquiring such resources: (a) produce them in their own enterprises, (b) seize them and exchange them for state-sustaining resources (e.g., oil for weapons), or (c) extract them from subject populations that already hold and/or produce the resources.
6. Options (a) and (b) reduce the reliance of rulers on citizen consent and incentives for bargaining with civilian populations, hence constitute impediments to democratization, conceived of as increased breadth, equality, protection, and bindingness of popular voice. Although (c) by no means guarantees democratization, it opens a possible path to democratization.
7. Historically (with taxation being the most obvious process), most of the world's democratization over the last two hundred years has resulted in part from (c), whereas (a) and (b) have mostly inhibited democratization.
8. Nevertheless, if through a transfer of power (e.g., revolution or conquest) arrangement (a) or (b) becomes subject to popular collective control, that transfer likewise opens a path toward democratization.

Let us return to that list of possible state-sustaining resources in the ambient economy: coercive means, labor, land, and so on. Analysts of state formation generally assume – rightly, I think – that the distribution, ownership, and relative prevalence of such resources in a state's setting strongly limit the forms of power that rulers can build.

Empires, for example, typically depend on agrarian economies and acquire their means of rule not through direct administration of those economies but through some combination of support from regional magnates and exaction of tribute from vulnerable adjacent populations. Mongol empires supported themselves largely through tribute exacted by brutal force, but depended for survival on their access to tribute-yielding agrarian populations. Below county level, even the mighty Chinese Empire (which, incidentally, did pay tribute to the Mongols for several centuries) relied on compacts between its thin corps of bureaucrats and landlords throughout the empire.

City-states, in contrast, typically draw much more of their sustaining resources from financial capital accumulated through conquest and trade while extracting day-to-day subsistence from local populations of slaves or servants as well as from the agricultural workers of their nearby dependent territories, with the result that they buy elsewhere essential resources such as arms and troops. Although Italian city-states began the second millennium C.E. by closely coupling trade and predation in their relations with the Mediterranean and the Middle East, after 1400 or so they relied for armed force on militias and mercenaries financed both by exploitation of their subject populations and by their oligarchs' returns from trade. A simple inventory of state-sustaining resources thus takes us a long way toward systematic differentiation among modes of rule.

Items farther down the resource list, such as machines, financial capital, information, media, and scientific-technical knowledge, have gained increasing influence as the world has become richer. If the notion that scientific-technical knowledge might ever rival financial capital as a basis of state power strikes you as far-fetched, consider how the Persian Gulf emirate Qatar is investing income from its huge but

exhaustible supply of natural gas. The emir, Sheikh Hammad bin Khalifa Al-Thani, is investing billions in scientific education and research, with the project of making Qatar the Middle East's research magnet.

The emir's wife, Sheikha Mozah bint Nasser Al-Misnad, runs the Qatar Foundation for Education, Science, and Community Development, worth billions in its own right. She has committed the proceeds from an entire oil well, perhaps $80 million per year, to a scientific research fund. In a principality of eight hundred thousand people, the five hundred students at the fledgling university, Education City, stand every chance of becoming the national elite (Science 2006). If the emir's program succeeds, control over land (and in this case the fossil fuels beneath it) may well give way to control over scientific-technical knowledge as the chief basis of Qatar's state power.

Remember the options rulers have for acquiring state-sustaining resources: (a) produce them in their own enterprises; (b) seize them and exchange them for state-sustaining resources (e.g., oil for weapons); or (c) extract them from subject populations that already hold and/or produce the resources. Qatar and similar energy-rich states are relying mainly on option (b), acquiring state-sustaining resources by selling the products of monopolies over precious commodities. As their energy reserves decline, it will be fascinating to see how and how much they shift toward options (a) and (c).

Taxation follows option (c). State taxation poses pressing questions for political analysts because in general taxpayers receive little or no individual quid pro quo when they pay. They may receive nothing at all, or they may receive small shares of collective goods. Why should they ever contribute (Herzog 1989; Levi 1988)? Yet states have regularly built themselves up through taxation, forced or otherwise (Ardant 1971–2; Brewer 1989; Daunton 2001; Kozub 2003; Tilly 1992, Chap. 3; Webber and Wildavsky 1986). As they have extracted taxes, they have often initiated cycles of intervention, resistance, repression, and bargaining: state agents demand payment, citizens resist, the government applies armed force, but in the process of overcoming resistance kills off some leaders, buys off others, and announces justifications for the present intervention that imply rules for proper interventions in the future – in short, repression combines with bargaining.

Intervention-resistance-repression-bargaining cycles range from small-scale resistance to mass rebellion. Among other struggles, the French Revolution of 1789–99 involved just such a cycle. It ended with political reaction, but also with a regime that depended much more heavily on citizen consent than anyone could have imagined at the end of Louis XIV's reign eighty years earlier.

Intervention-resistance-repression-bargaining cycles impose hidden political costs on states: although they commonly increase the flows of resources to the state, they also make the state dependent on those flows and set terms for the next round of extraction. In both these ways, they subject states to public politics and facilitate popular influence over public politics. Without usually promoting democratic consultation in the short run, they set conditions for democratization in the long run. As we saw in the tale of Louis XIV, the shift of a state toward dependence on citizens' compliance with continued extraction increases the susceptibility of the regime to alternation between democratization and de-democratization.

Intervention-resistance-repression-bargaining cycles push regimes across the susceptibility threshold.

Such cycles continue in contemporary China. Thomas Bernstein and Xiaobo Lü have surveyed Chinese rural tax resistance and its resolution during the 1990s. Despite governmental secrecy on such matters, Bernstein and Lü accumulated substantial evidence of rising resistance to arbitrarily imposed taxes and fees. Moreover, the peasants sometimes succeeded, received concessions from local authorities, drew the attention of high state officials to local abuses, and renegotiated the terms of future extraction.

A famous series of struggles in Renshou, Sichuan, during 1992 and 1993 incorporated an intervention-resistance-repression-bargaining cycle of this sort. There local cadres continued to impose heavy taxes and forced labor for road-building on peasant households despite a state campaign for "burden reduction." When they could not get workers or cash, they seized household goods, including televisions, grain, and hogs. But under the leadership of peasant Zhang De'an, local people began fighting back. The county prosecutor tried to have Zhang arrested for tax evasion, but:

> Zhang publicly tore up the arrest warrant as seven to eight hundred peasants carrying farm tools and shoulder poles gathered in Xie'an township. They drove the arresting officers out and burned a police vehicle. Violence erupted in Xie'an township in January and February. Stores closed and the government was paralyzed. "Hundreds of peasants were said to have been involved in a 'guerrilla war' of throwing stones." Farmers marched to the county seat and jostled into the government compound, loudly demanding justice. This popular mobilization aroused the Sichuan Party and government leaders to send a work team to Renshou in February. Given the national offensive on excessive burdens, the provincial and Renshou county officials "affirmed that Zhang De'an was reasonable in giving publicity to the policy about lessening peasants' burdens and calling on people to refuse to pay the excess cash levy" (Bernstein and Lü 2003: 132–3).

Cadres fought back, and struggles continued in Renshou. By 1994, nevertheless, provincial and national authorities were clearly making concessions. They released peasants who had beaten cadres and police, replaced numerous officials, and contributed provincial funds for the building of local highways (Bernstein and Lü 2003: 136).

Let me be clear: the Renshou events did not establish that China was democratizing rapidly during the 1990s, much less that the Chinese state was collapsing. Because they provided a widely publicized model for state–citizen negotiation, nevertheless, they did activate a mechanism that subjected the state to public politics and, to a small degree, facilitated popular influence over public politics. In this case, the crucial mechanism was the intervention-resistance-repression-bargaining cycle. The accumulation of such confrontations and resolutions creates openings for democratization that did not exist before. As more Renshou-style cycles appear in China, the regime moves closer to broad, equal, protected, mutually binding citizen–state consultation – to democracy.

With the collapse of state socialism outside of China and North Korea, states that acquired their sustaining resources by producing those resources themselves practically disappeared. Except with regard to military force, China is moving rapidly away from any semblance of economic autonomy. But the second state-sustaining strategy – exchange of goods and services over whose production the state exerts monopolistic power – has survived and even thrived. Earlier we saw Vladimir Putin moving toward such a strategy by recapturing state control over oil and gas production that had largely escaped into private hands during the 1990s. After what seemed the near-collapse of the Russian state, Putin's strategy has allowed him to smash his domestic political opposition at the same time as he has reestablished Russia as a world power.

Putin has reversed a process that bedeviled many postcommunist regimes. Speaking especially of his native Bulgaria, Venelin I. Ganev has shown how after 1989, elite predation on the state's accumulated wealth and power reduced state capacity to the advantage of those elites. Instead of reinforcing state capacity for their own projects, competing elites seized control of state segments – privatized them – and undermined other state agencies that could hinder their private projects. Nor did they have to seek the grudging consent of ordinary people, whom the communist system had excluded from effective control in the name of collective popular power (Ganev 2007: 186). Under Yeltsin, Russia's equally predatory elites moved the regime in the same direction, but with ruthless effort Putin began to reverse the assault on state capacity as soon as he took office in 1999.

Over the same period, energy-rich states could avoid bargaining for citizen consent by seizing control over energy production (often in collaboration with obliging foreign capitalists), selling on international markets, buying coercive means on other international markets, and paying off their main local supporters with the surplus. For all his populist gestures, Venezuela's Hugo Chávez has used oil revenues with extraordinary effectiveness to bypass popular consent. We can witness similar strategies in a wide variety of so-called rentier states such as Algeria, Saudi Arabia, Myanmar, and (I speculate) Iran.

My complex argument actually builds on only two simple components. First, whether rulers acquire their means of rule by producing those means, buying them with monopolized goods, or extracting them from subject populations deeply affects the character of rule. Second, over the long run, democratization only occurs when rulers come to rely on citizen compliance for their means of rule.

The first component implies that students of fiscality could effectively strengthen their theories by considering the whole range of state-sustaining resources before closing in on taxation as a special, if very consequential, way of acquiring those resources.

The second component implies that students of fiscality are following the spoor of democratization and, for that matter, de-democratization. Together we can track down the causes of fundamental changes and variations in political regimes.

11 Improving Tax Administration in Contemporary African States: Lessons from History[1]

EDGAR KISER AND AUDREY SACKS

It is now unfashionable to seek lessons from history. The overstatements resulting from various stage theories of history, most prominently modernization theory, and the current emphasis on the uniqueness of historical cases, has soured most contemporary sociologists on that endeavor. This is unfortunate, because rejecting the excesses of modernization theory and recognizing that all historical cases are in part unique does not mean that we cannot learn anything from the past that can inform policy in the present and future. Historical sociologists will be unable to contribute to public sociology unless we are able to show how our knowledge of the past can be useful to contemporary policy debates. The attempt to bring historical sociology and public sociology together should benefit both, providing a much needed historical dimension to policy making and broadening the audience for historical analyses.

In general terms, to extract useful lessons from history, we need to accomplish two related tasks. First, we need general theories with abstract scope conditions that facilitate the transportability of models and causal mechanisms across time and space. Second, we need detailed empirical analyses of the relevant initial conditions in the past and present societies being compared, to both reveal how they are similar (the basis for comparison), and how they are different (allowing us to tailor our recommendations to fit the unique features of particular cases).[2]

We begin by using agency theory as a general model of tax administration (Kiser 1999; Klitgaard 1988; Rose-Ackerman 1978). A sociological version of agency theory, which embeds the core problems of agency relations within particular historical and institutional contexts, provides a useful analytical tool for understanding the administrative history of taxation. We model tax collection systems as agency relations in which the ruler is the principal and state officials, to whom authority to carry out state policies is delegated, are agents. This theory allows us

[1] Prepared for "The Thunder of History: Taxation in Comparative and Historical Perspective," Northwestern University, May 4–5, 2007. We would like to thank all participants at the conference, members of the African Studies Group at the University of Washington, Margaret Levi, and Erin Metz McDonnell for helpful comments on a previous draft.

[2] Brownlee (Chapter 14) shows that the lack of such detailed empirical knowledge doomed the Shoup reforms in post-WWII Japan.

to outline the general problems faced in tax collection, the range of institutional solutions available to mitigate these problems, and the conditions under which different solutions will be more or less effective. Our central proposition, derived from agency theory, is that when monitoring capacity is poor (because of poor communications, transportation, and record-keeping), decentralized and privatized administrative systems will be more efficient than centralized bureaucratic tax administration.[3]

Our most general empirical claim is that the conditions within which tax administrations in contemporary African states are embedded are in some important respects similar to those present in premodern states – both face structural conditions that limit their monitoring capacity. Thus, we can learn something about current administrative policies in the former by looking at the history of the latter. Centralized bureaucracies are not expected to work well in either case.

These arguments motivate the next two sections of this chapter, the first on the failure of centralized bureaucracy in colonial and postcolonial Africa and the second on the effectiveness of decentralized and privatized administrative systems in premodern states. We then turn to an empirical comparison of contemporary African and premodern states, showing that the structural determinants of poor monitoring capacity are similarly present in both cases, but noting several significant differences as well. Given the lack of adequate monitoring capacity and the resulting failure of centralized bureaucracies in the African context, it has recently become clear to many African rulers that they need to develop new models of tax administration. Over the past two decades, many of them have begun to replace centralized bureaucracies with partially decentralized and partially privatized administrative systems, in some respects similar to those used in premodern states. We conclude the chapter with an evaluation of these reforms, using brief case studies of Uganda, South Africa, and Kenya.

Contemporary African states are currently at a critical juncture, as they attempt to partially decentralize and privatize their tax administrations. This transition could have momentous consequences for both their states and their societies. Their earlier attempts to mimic the centralized bureaucratic structure of strong, developed states left their states weak and ineffective. Somewhat ironically, their best chance of increasing their state capacity is by decreasing the scope of central state administration by partially decentralizing and privatizing tax collection. If these reforms produce additional revenue, as agency theory suggests they will, African states will be better able to maintain stable democracies (see Tilly, Chapter 10) and provide needed infrastructure and welfare benefits for their citizens. Of course, this will only occur if the increases in administrative efficiency do not come at the price of equity and fairness (Levi 1988; Einhorn, Chapter 9), so we will address these potential problems. These reforms are still at a nascent stage so it is too soon to tell if they will produce positive results, but there are grounds for optimism.

[3] We define an efficient system as one that produces the highest net tax revenue. By net tax revenue we mean total tax revenue minus the costs of collection (administrative costs), corruption by officials, and evasion by taxpayers.

THE LIMITS OF CENTRALIZED BUREAUCRACY

Although bureaucracy is generally regarded as the most efficient form of agency, its limitations make it inefficient under certain conditions (Coleman 1990; Wilson 1989). The main agency problem rulers face is *information asymmetry* (agents know more about what they are doing than principals do), so monitoring problems are intrinsic to agency relations. Both Weber (1968) and contemporary agency theories (Adams 1996; Kiser 1994; Kiser and Schneider 1994) suggest that adequate monitoring capacity (the ability of rulers to gather information on the actions of officials) is a necessary condition for bureaucratization. When monitoring is ineffective and sanctions are weak, corruption of various forms will be high, *ceteris paribus* (Becker and Stigler 1974: 6–7). Because bureaucracy relies on weak sanctions like fixed salaries and dismissal, when monitoring capacity is poor, it is not expected to be efficient. Monitoring capacity will only be effective if its technological foundations – communications, transportation, and record-keeping – are well developed.[4] Centralized bureaucracies are expected to perform poorly in premodern states and in many contemporary, less developed states because they lack adequate technological foundations.

Unfortunately, but perhaps predictably, these theoretical insights did not guide decisions about the structure of administrative systems in contemporary, less developed states. Rulers' choices of which administrative models to imitate were shaped (one might say distorted) by the taken-for-granted legitimacy of the United States and Western Europe's centralized bureaucratic administrative systems. During the colonial era, tax administrations in less developed countries were modeled after the various forms of centralized bureaucracies that existed in the colonial countries. Not surprisingly, these administrative structures were ineffective given the vastly different conditions found in the colonies (Cohen 1979: 292; Wallis 1989: 8). Many administrative reforms took place throughout developing countries in the postcolonial period, but until recently they looked to tax systems in the developed world as their primary model (Gillis 1989: 2; Mansfield 1989: 140). Like the colonial systems before them, these centralized bureaucracies did not function effectively (Bird 1989: 230; Gillis 1989; Radian 1980: 203; Shaw 1981: 149).

The sources of these distortions have been outlined in cultural institutionalist theory. DiMaggio and Powell (1983: 152) argue that "organizations tend to model themselves after similar organizations in their field that they perceive to be more legitimate or successful." Cultural institutionalist theories also predict that actors are unlikely to tailor imported organizational forms to local circumstances. Strang and Meyer (1993: 505) stress the "similarity in content to known theoretical models," and argue that "variability in adopted content should be low."[5] Furthermore,

[4] Economic development improves technologies of communications, transportation, and record-keeping, and thus contributes significantly to centralization and bureaucratization (Ardant 1975; Kiser 1994; Weber 1968). Prior to the development of efficient communications, transportation, and record-keeping technologies, the size of states and empires made centralization and bureaucratization inefficient (Ardant 1975; Weber 1968).

[5] The institutionalist argument about "loose coupling" (Meyer and Rowan 1977) suggests a more nuanced account. The models that are borrowed may be only loosely coupled to what people actually do.

cultural institutionalists predict a particular type of inefficiency: overimitation. The thrust of many of Meyer's (Meyer, Boli-Bennett, and Chase-Dunn 1975; Meyer and Rowan 1977) arguments is that states often copy institutionalized rules and structures – from ways of organizing educational curricula to advanced weaponry – in order to enhance their legitimacy in the eyes of world actors. Yet, these institutions may not be effective in certain contexts. There is some evidence that this form of imitation occurred in the early history of contemporary, less-developed states. These states imitated contemporary centralized bureaucratic administrations that were entirely ineffective given their primarily agrarian economies and poor technologies of communication and transportation (Kiser and Baker 1994). It is now becoming clear to rulers of African states that new models of tax administration are necessary.

ALTERNATIVES TO CENTRALIZED BUREAUCRACY IN PREMODERN STATES

Premodern states rarely used centralized bureaucracies to collect taxes. Because of their poor monitoring capacity, rulers compensated by shifting residual claimancy to agents in order to increase their incentives to maximize net tax revenue.[6] They accomplished this in one of two ways: by decentralization (feudalism, prebendalism, administration by local notables; Weber 1968) or by privatization (tax farming; Kiser 1994).[7] The most common administrative equilibrium for premodern states was to adopt a type of decentralized patrimonialism for the collection of direct taxes and tax farming for indirect taxes (Kiser 1994).

Most premodern states tended to keep the size of their administrations small and administrative costs low by decentralizing the collection of direct taxes. Instead of using centrally hired and controlled officials at local levels, states allowed local units to collect their own revenue. Local political units (provinces, feudal manors, peasant villages, or towns) retained full autonomy to hire, fire, monitor, and pay officials. Local units were often also allowed to determine tax structures (who and what to tax); the state simply required these units to provide lump sum payments at regular intervals. In the most extreme form of decentralization, the local units would not send the money to the central state at all, but would spend it locally.

The privatized solution, tax farming, is a particular type of agency relation in which the tax farmer pays the ruler a fixed amount for the right to collect a

[6] Residual claimancy specifies which actor (in this case, the principal or the agent) has a claim to the "residual" (the variable part of the proceeds) in a joint venture. For example, when employees are paid fixed salaries, the employer is the residual claimant. When the employee is paid on commission, residual claimancy is split between employer and employee.

[7] Rulers of premodern states had other patrimonial options as well. First, they could attempt to mitigate their monitoring problems directly, either by rotating officials (which allows them to test whether poor performance is due to the particular official or environmental conditions, and limits the development of local network ties), or putting multiple officials in one position (collegial administration, which creates a situation in which collusion is required for corruption). Second, they could try to recruit officials who will be less corrupt even if monitoring is poor – personal ties are often used for this reason (long-term multifaceted relations are expected to decrease noncompliance), as are slaves and foreigners (because they are more dependent on rulers).

certain tax in a particular area, and then keeps the profit or absorbs the loss from the activity. The key feature of tax farming is that the agents have much greater incentives to maximize the volume of tax they collect than if they were paid fixed salaries. Thus, tax farming was most likely to be found when rulers confronted difficulties trying to monitor their agents.

There are ongoing debates about the efficiency of these patrimonial administrative systems, but it now seems clear that they worked better than centralized bureaucratic alternatives. Decentralized systems were more efficient in part because they substantially decreased the overhead costs of tax collection for the central state. States also profited from increased local knowledge. Moreover, lump sum payments placed the responsibility for the tax burden on communities, which resulted in higher taxpayer compliance. Neighbors monitored each other because households had to pay more taxes if their neighbors evaded taxes. It has often been argued that tax farming was inefficient in premodern states (Smith [1776] 1979: 434–6; Webber and Wildavsky 1986; Weber 1968: 965). Although it is true that tax farming, like decentralized administration, was no model of administrative efficiency, it was far better than the bureaucratic alternative in the context of premodern states. Rulers in several premodern states experimented with both tax farming and central administration for indirect taxes, and consistently chose the former because administrative costs, corruption, and tax evasion were each lower (Dietz 1932: 307–10; Jones 1974: 157; Kindleberger 1984: 161; Kiser 1994: 302–3; Thompson 1976; Wolfe 1972: 322).

HOW ARE CONTEMPORARY AFRICAN STATES SIMILAR TO PREMODERN STATES?

We have now shown that (1) there are good theoretical reasons to believe that decentralized and privatized administrative systems will be more efficient than centralized bureaucracies when monitoring capacity is poor; (2) centralized bureaucracies did not perform well in either premodern states or in contemporary, less developed countries; and (3) decentralized and privatized administrations outperformed centralized bureaucracies in premodern states. Together, these conclusions suggest that some types of partially decentralized and privatized administration might also work relatively well in contemporary African states if, in fact, they are embedded in structural conditions similar to those in premodern states. This section will demonstrate that in many respects they are, and at the very least they face conditions much more similar to premodern states than to contemporary developed states. However, there are significant differences as well, so any lessons we learn from premodern administration will have to be significantly modified if we are to apply them to the contemporary African context.

Similar to premodern European states, African states' revenue-raising capacity is generally low. On average, the tax-to-Gross Domestic Product (GDP) ratio in sub-Saharan Africa is around 21 percent, compared with the Organisation for Economic Co-operation and Development (OECD) average of about 32 percent (Fjeldstad and Rakner 2003: 12). In Tanzania and Uganda, the total tax share drops to about 10 percent. Historical data suggest that the tax share of many European

countries did not reach 15 percent of GDP until World War II – when incomes were substantially higher than they are in many African countries (Fjeldstad and Rakner 2003: 12). The poor revenue-raising capacity of premodern and contemporary African states is partly a consequence of the features of economic structure that they share. First, the agrarian sector is much larger in both premodern states and contemporary African states than in contemporary developed states, and this sector is notoriously difficult to tax. Second, like in premodern states, most producers in contemporary developing states are small enterprises, often lacking accounting and bookkeeping capabilities, which also makes tax collection difficult. The economic structures of premodern states and contemporary African states differ in a few ways. Large multinational corporations play an important role in contemporary African economies, and their power relative to the state creates particular problems for tax collection. Most African states now have separate Large Taxpayer Units focusing solely on large companies.

Most important, because they directly affect monitoring capacity, technologies of communications, transportation, and record-keeping in contemporary African states are at intermediate levels, better than in premodern states, but well below levels in contemporary developed states. For example, if we look at kilometers of roads/square kilometers of land area in contemporary African states, they range from .00 to .01 in Sudan and Mauritania to .98 in Mauritius, with a mean of .15 (World Bank 2006b).[8] Our particular cases range from .11 (Kenya and Uganda) to .29 (South Africa; World Bank 2006b). For comparison, contemporary France and the United Kingdom are at 1.6, whereas France in 1788 was at .09 and the late Roman Empire was at .03 (Hopkins 1980: 120; Smith 1967: 565). Of course, these raw numbers do not tell the full story – travel times in contemporary African states will still be faster than in premodern states because they are using cars, although they still lag far behind contemporary developed states. Furthermore, it is now possible to move information without physically moving people because of telephones and computers. Of course, this is much easier in the developed world than in Africa – in Uganda there are three telephone mainlines per 1,000 people (there are 9 in Kenya and 107 in South Africa) compared to 561 in France and 581 in the United Kingdom. In following worldwide trends, mobile phones are rapidly replacing landlines throughout Africa; for every 1,000 people, there are 135 mobile phones in Kenya, 724 in South Africa, and 53 in Uganda compared to 789 in France (World Bank 2006b). Moreover, in both historical and contemporary African cases, totals and averages do not tell the full story, because there are substantial subnational variations in transportation and communication capacity, especially between rural and urban areas.

A useful measure of data gathering and record-keeping capacity, another important determinant of monitoring capacity, is the World Bank's Statistical Capacity Indicator (World Bank 2006a). This indicator is compiled using information from several different international organizations about (1) the ability to use internationally recommended standards and methods; (2) the frequency of censuses/

[8] We acknowledge that Europe's topography is more conducive to building roads, telephones, and other infrastructure than Africa's, and the data do not account for this key difference.

surveys and completeness of registration; and (3) the availability and frequency of collection of key socioeconomic indicators. On a scale of 0 to 100, the mean for Africa is 55, compared to 88 for Argentina (OECD countries are not included, presumably because they would all rank near 100). Of our cases, Uganda rates 60, Kenya rates 65, and South Africa rates 87. With their diverse standards of data collection, very infrequent surveys and censuses, and vague information on economic indicators, premodern states would no doubt rank well below most, if not all, contemporary African states on this indicator. Thus, we can conclude that contemporary African states would rank in between premodern states and contemporary developed states on this dimension as well.

There are several ways that contemporary African states differ from premodern states that are relevant to tax administration. First, many African states receive substantial foreign aid that was not available to premodern states. In sub-Saharan Africa (excluding Nigeria and South Africa), aid was equivalent to almost 12 percent of the continent's Gross National Income (GNI) in 2003 (Fjeldstad and Moore 2006: 29). Several studies suggest that large amounts of unearned state income from foreign aid, as well as natural resources, reduce government incentives to raise its own revenue, unless reform is part of the package of conditions tied to aid and loans (Bräutigam 2000; Bräutigam and Knack 2004; Collier 2000). Foreign aid often comes with strings attached, among them revenue targets that may distort administrative procedures in various ways. In an effort to meet rigid revenue extraction targets set by the International Monetary Fund (IMF), states may rely more on coercion than trying to elicit "quasi-voluntary compliance" from their constituents (Gloppen and Rakner 2002: 38; Levi 1997).

Increasing globalization has produced worldwide epistemic communities in many areas, including tax administration. There is now a global reform program that is shaping the agenda for administrative reform in African states (Fjeldstad and Moore 2006). Globalization is also, in part, responsible for the worldwide diffusion of democracy and a discourse of human rights, which did not exist in premodern states (Boli-Bennett and Meyer 1978). Some sub-Saharan African countries, notably South Africa and Botswana, are making credible efforts to live up to their constitutional promise of human rights and democracy. In these countries, democratic institutions and international pressures to conform to norms of human rights may improve tax administration by decreasing societal tolerance of corruption. However, in most sub-Saharan African countries, a discourse of human rights and democracy is unfortunately only loosely coupled with actual state practices.

In spite of these differences, the long list of similarities between contemporary African states and premodern states suggests that African states should consider adopting administrative systems that worked well in premodern states. In fact, many contemporary African states are beginning to move in this direction by partially decentralizing and partially privatizing parts of their tax administrations. These reforms have been influenced by the "new public management" movement and a set of related arguments influenced by transaction costs theory and agency theory that have advocated applying private-sector management techniques to the public sector (Hope and Chikulo 2000: 26–7; Kaboolian 1998). Institutionally, donors have advocated decentralization and privatization as a way to decrease the

government corruption that often wastes their investments. Domestic and foreign human rights and democracy advocates often push for decentralization as a means to increase government accountability. These administrative developments are still in their infancy, and unfortunately there is as yet not enough data available to systematically evaluate their efficiency. Given the large number of variables that contribute to total revenue, including the state of the domestic and world economy and changes in the tax rate and structure, it is difficult to measure the contribution of decentralization and privatization to the amount of revenue collected. Accounting for these limitations, the next sections draw on existing empirical evidence to describe these administrative reforms and attempt to assess their consequences.

DECENTRALIZATION IN CONTEMPORARY AFRICAN STATES

In the last decade or so, many African states, including traditionally highly centralized Francophone countries, have begun to decentralize along several dimensions, drawing on a wider range of models than their colonial predecessors (Tordoff 1994: 556). The vast majority of African states have structures of subnational governance, including local governments at the lowest level, usually the districts, towns, or communes. Whereas central government taxes affect relatively few people directly (perhaps less than 5 percent of the total population), local government taxation affects many more (perhaps 30 percent). However, in spite of recent reforms, the degree of fiscal decentralization is especially low on the African continent compared to other developing states.

The movement toward decentralization has affected tax administration in some but not all African states. In 2002, the World Bank administered a survey to World Bank specialists of thirty sub-Saharan African countries in an effort to take stock of the status of decentralization across the region. The extent of decentralization was measured by three indices reflective of the three aspects of decentralization: political, administrative, and fiscal (Ndegwa 2002: 2). The data show only moderate levels of decentralization on the continent – two countries score high on the most general measure, eleven are moderately decentralized, and thirteen have low levels of decentralization. These data point to the beginning phase of a trend toward decentralization in Africa. Two specific indices are especially important for our argument: administrative decentralization and fiscal decentralization. Two African countries ranked high on the administrative decentralization scale (South Africa and Uganda), ten others were at a moderate level (including Kenya), and sixteen had low levels of decentralization (Ndegwa 2002: 4).[9] The degree of fiscal decentralization is measured by two indicators: the extent of fiscal transfers from the central government to localities; and, a score corresponding to the proportion of public expenditure controlled by the localities. In nineteen of the thirty countries,

[9] Unfortunately, the index of administrative decentralization does not distinguish between tax administration and other parts of state administration, so it can only be taken as a rough indication of the former.

local governments control less than 5 percent of total government expenditure (the average for other developing states is 14 percent). Only one country in Africa (South Africa) has a high degree of fiscal decentralization. The countries that score moderately high (i.e., where local governments control 5 to 10 percent of public expenditures) include Nigeria and Uganda. Countries with moderate levels of fiscal responsibilities affixed at the local level include Kenya, Ghana, and Senegal (Ndegwa 2002: 5).

Experiences from South Africa and Uganda suggest that attempts to decentralize tax administration have been limited.[10] Despite the provisions in South Africa's constitution to decentralize tax administration (Brosio 2000), the relationship between provinces and the center is characterized by a huge vertical imbalance. Provinces have limited revenue-raising powers and at present, they rely primarily on vehicle license fees, taxes on gaming, and some user fees. This revenue accounts for only 4 percent of total revenue, and as a result provinces are forced to rely on central government transfers for the vast majority of their revenue (Brosio 2000: 21). By contrast, local governments (i.e., municipalities) have greater revenue-raising power but have considerably less flexibility in expenditure.[11] At present, local government can tax four bases: property value, the turnover and the payroll of businesses operating in their areas, and the value of services consumed. User fees from electricity, water, sanitation, and other services associated with the municipal electricity undertakings comprise the majority of local revenue, an average of 52 percent. Local governments tend to cover around 85 percent of their expenditure from their own revenue sources (IDASA 2007).

Uganda has devolved significant expenditure and revenue responsibilities to local governments. Local governments determine tax rates and fees and collect property tax, market dues, business license fees, and the "graduated tax" (a combination of the poll tax, income tax, and wealth tax). Yet local governments are still highly dependent on transfers from governments and donors. According to a sample of twenty-nine districts (out of the thirty-nine existing that year) in FY 1995/96, local taxes and fees represented only 19 percent of total local government revenues, net of foreign donors' contributions (Brosio 2000: 22).

Despite the near universal presence of structures of decentralized governments, these data show the continued dominance of the centralized state. This is in part a consequence of the general insecurity of the African state, combined with poverty and inadequate capacity at the local level, which have given central authorities incentives to check centrifugal tendencies by strengthening the center (Ndegwa 2002: 16). The centralized structure the African state inherited from its European

[10] Because of limited space, we do not provide an overview of Kenya's decentralization structure. Briefly, in Kenya, local governments are the principal units. Since Kenya's independence in 1963, local governments have relied heavily on a local property tax and, since the late 1980s, on the local authority service charge, a combination of the payroll and business tax. Local governments receive very little intergovernmental transfers and their elected councils conduct their fiscal affairs with a higher than expected level of autonomy (Smoke 2001: 11–12).

[11] The ANC government is strongly encouraging local governments to pursue a policy of cost recovery, whereby they charge citizens market prices for crucial public services (Hoffman 2007).

colonizers, especially in French-speaking West Africa, has also constrained the states' ability to decentralize. At independence, representative local government was virtually nonexistent in French-speaking Africa. Anglophone African states sought to adapt the English model of local government, but the results were mostly disappointing. Many local councils proved inefficient and corrupt, and with inferior salary scales and poorer promotion prospects than those being obtained at the center, could not attract staff to match the quality of the civil service. Further, supervision of the local authorities was often inadequate (Tordoff 1994: 557).

The limited empirical evidence evaluating cases of fiscal decentralization in Africa points to mixed results. Theoretically, decentralization puts administration closer to the people, increasing their ability to control it.[12] There is evidence in the African case that this is true, because local governments are generally seen as more legitimate than national states (Moss, Pettersson, and van de Walle 2006: 6). In some cases, fiscal decentralization has corresponded to an increase in quasi-voluntary compliance with taxation demands, as well as an increase in administrative efficiency (see Lund 2007 on Tanzania). This evidence give us reasons to be optimistic about the future of decentralization in Africa.

The African experience with decentralization has been far from perfect, however. One of the negative consequences of decentralization of tax administration across Africa has been a huge growth in the number of local government revenue instruments (Brosio 2000: 23). Figures from 2003 for the Kamuli district in Uganda show that the district council sets 136 separate flat rate market dues, 81 separate flat rate business license fees, and in theory, at least, 22 different graduated tax bands (Fjeldstad and Rakner 2003: 7). There is also large variation in tax rates imposed by councils on similar revenue bases like agricultural products. This has led to extensive smuggling of agricultural goods across council boundaries (Fjeldstad and Rakner 2003: 7). Two other problems continue to plague efforts to decentralize tax collection: poor coordination between the various levels of government and heavy reliance on coercion. Lack of coordination between the central and local levels has led to duplication of taxes and inconsistencies between taxes imposed by local authorities and the national government's development plans. In Tanzania and Uganda, for instance, some local governments are imposing high taxes on export crops, which are inconsistent with the national government's policy of encouraging export production (Fjeldstad and Semboja 2000). Also, many local governments rely heavily on simple physical coercion to obtain the resources they need from their subjects and to ensure compliance (Fjeldstad and Rakner 2003: 8). Poll taxes (e.g., "development levy" in Tanzania and "graduated tax" in Uganda) are infamous for the use of coercion in their extraction (as was also often the case in premodern states), and for their lack of sensitivity in the timing of collection relative to the seasonal income of taxpayers. Coercive taxation methods that the masses perceive to be unfair have led to widespread tax evasion and resistance. One solution to coercive taxation methods is to implement easy anonymous ways for taxpayers to report abuse by local tax collectors to the central government. This is

[12] Local governments are also more prone to capture by local elites than central governments.

the cheapest way for the central government to monitor its agents and was used in many premodern states.

PARTIAL PRIVATIZATION IN CONTEMPORARY AFRICAN STATES: SEMI-AUTONOMOUS REVENUE AUTHORITIES

In the last fifteen years or so, there has been a trend toward creating Semi-Autonomous Revenue Authorities (SARAs) in Latin America and Africa.[13] Given that contemporary Africa's technologies of communications, transportation, and record-keeping are better developed than in premodern states but not as developed as contemporary developed states, we argue that centralized and partially privatized SARAs are a more appropriate organizational structure for tax administration in Africa than either complete decentralization and privatization of taxes, or centralized bureaucracy.[14] Although the extent of autonomy from the central state and particular features of institutional structure varies across countries, all of these organizations are partially privatized as the term *semi-autonomous* indicates compared to the complete privatization of tax farming organizations in premodern states.

The impetus for this radical reform was consensus among both international organizations and the leaders of African states about the causes of the poor performance of their tax administrations. First, salaries for officials in tax administration were much too low compared to those for comparable positions in the private sector (Due 1988: 164; Werlin 1979: 388–90). In Uganda in 1989, for example, the average public officials' salary was about 20 percent of the corresponding salary in the private sector (Fjeldstad 2005: 10–11). As a result, higher quality officials tended to leave the public sector for better paying jobs in the private sector (creating an adverse selection problem). Those who stayed tended to take bribes to supplement their inadequate salaries. Second, rigid civil service regulations made it difficult to dismiss officials for poor performance or corruption. Third, civil service regulations generally mandated uniform fixed salaries instead of performance-based pay, providing officials with very weak incentives for compliance. Fourth, civil service procedures generally limited the scope of possible reforms, and powerful entrenched officials were often able to block many needed reforms. What was needed was an organization that had the power to hire and fire employees, set salary rates to reward good performance and keep good employees, and reform its procedures in order to maximize efficiency; SARAs were seen as able to do exactly that (Devas, Delay, and Hubbard 2001; Manasan 2003–5: 1–2; Taliercio 2004). Brief histories of SARAs in Uganda, South Africa, and Kenya will help us evaluate the extent to which this institutional innovation has lived up to its considerable promise.

[13] In Africa, SARAs were created in Ghana (1985), Uganda (1991), Zambia (1993), Kenya (1995), Tanzania (1996), South Africa (1997), Rwanda (1998), and Malawi (2000).

[14] The first SARAs were modeled after central banks, although they generally had less autonomy (Jenkins 1994).

THE UGANDAN REVENUE AUTHORITY

The Ugandan Revenue authority (URA) is the oldest semi-autonomous revenue authority in sub-Saharan Africa, after Ghana's. It was formed after two government commissions outlined the inefficiency and rampant corruption in the Ugandan civil service (Therkildsen 2003: 7). The URA was created in 1991 as a government agency under the "general supervision" of the minister of finance (Taliercio 2004: 48), and given control of all major indirect taxes and some direct taxes (income tax, but not property or social security tax). It is partially privatized – legally separate from the state, can own its own assets, but financed by parliamentary appropriation.

The URA is delegated control over personnel decisions and operates in a very different manner from the civil service. It began with about 75 percent of its staff (1,700 former officials) coming from the Ministry of Finance, but 200 officials and 40 secretaries were fired almost immediately for corruption, and those retained were all working on a probationary basis (Taliercio 2004: 20). Freedom from civil service regulations also allowed the URA to hire foreigners for many important positions.[15] This practice was also common in premodern states – they turned to foreigners for their expertise and to avoid the problems associated with employing officials who had patronage ties in their home communities.

The URA increased salaries in order to attract private-sector professionals and to motivate ex-civil servants to improve their performance. Performance-based pay was used to increase incentives, but only in the form of group bonuses for exceeding revenue targets. The URA expanded the size of its staff, increasing it about 50 percent from 1991 to 2002 (from 1,450 to 2,186 employees). The combination of higher salaries and more officials led to unusually high collection costs. Between 1991 and 2002, collection costs as a percentage of revenues collected increased from 2.8 percent in 1991 to 5.3 percent in 2002 (Therkildsen 2003: 9). By comparison, collection costs for South Africa and Kenya's revenue authorities are about 1.1 percent and 1.2 percent, respectively (Taliercio 2004: 20–2).

Initially, the URA reform was quite successful. The shift to the URA, in part, led to an increase in revenues as a proportion of GDP from 7 percent in 1991 to 11.9 percent in 1999. A portion of this increase was due to changes in tax structure – introducing the value-added tax (VAT) and decreasing the number of exemptions – but some was clearly a product of increases in administrative efficiency. Since that time, however, there has been little progress. Revenue as a proportion of GDP increased to 13.6 percent in 2004, but is still less than the sub-Saharan average of 20 percent, in large part because of a failure of the URA to expand the tax base by registering more firms and individuals (Taliercio 2004: 33). More important, there are indications that corruption is increasing in the URA (Fjeldstad 2005: 2; Therkildsen 2003). In a survey of businesses operating in Uganda in 1998, 43 percent of the firms said they had paid bribes to URA officials (Gauthier and Reinikka 2001: 22). Senior managers seem to be especially implicated in corruption,

[15] The first Commissioner General (1991–7) was a Ghanaian, and later (2001–4) the URA was led by a Swede.

and the Customs Department is said to be especially inefficient, unable to control smuggling and the underdeclaration of assets (Fjeldstad 2005: 7; Obwona and Muwonge 2002: 27).

Some of the reasons for the lack of further improvement in administrative efficiency are internal to the URA. The initial increase in salaries has not kept pace with inflation, and there was only one salary increase between 1991 and 2001. The group bonus system provides weak incentives compared to an individual bonus system (Fjeldstad 2005: 9). The dismissal of employees for poor performance or corruption did not continue after the initial purge (Therkildsen 2003: 12). The lack of dismissals has allowed the patronage networks that dominated the civil service in Uganda to reemerge in the URA (Fjeldstad 2005: 12–14). Interviews with taxpayers by Transparency International in 2000 reveals that they perceive URA's hiring to be based more on clientelism rather than merit (cited in Therkildsen 2003: 13). The reemergence of patronage networks could explain the increase in the size of the URA, and the high collection costs that have resulted from it.[16] Early modern history suggests two ways to mitigate this problem. Two viable solutions that were common in premodern states to combat the endemic problem of patronage networks in tax administrations are rotating officials, especially, moving them away from areas in which they have local ties and hiring foreign officials.

Other determinants of the URA's declining performance are external. Political interference in the operations of the URA has increased over time. For example, the government has often prevented the URA from firing corrupt employees.[17] The government has also failed to provide the funds necessary to increase salaries to keep up with inflation, or to pay group bonuses even when they have been earned by the URA (between 1991 and 1999, the URA reached the level necessary for bonuses five times, but they were only paid once; Uganda Revenue Authority [URA] 2002: 18). One solution to this problem would be to increase the autonomy of the URA, by allowing them to fund their expenses by retaining a percentage of the tax they collect similar to premodern tax farmers.

THE SOUTH AFRICAN REVENUE SERVICE

Although South Africa has a more efficient tax administration than many less developed states (Lieberman 2003), as in Uganda, the initial impetus for creating a SARA in South Africa was a report by a government commission in 1994 stressing the inefficiency of the bureaucratic administration. In 1994, the South African Revenue Service (SARS) was created, but not yet given much administrative autonomy. In 1997, the SARS was given the administrative autonomy to set its own policies and procedures and collect all taxes except for the gaming and property tax (Friedman and Smith 2005). SARS is less privatized than other

[16] For a different perspective on patronage that stresses its positive as well as negative features, see Kasara (2007).

[17] In 1997, the president personally intervened in the appointment of the general commissioner of the URA. The person appointed was not even on the list of candidates to be interviewed, but had close family ties to the president (Therkildsen 2003).

revenue authorities in Africa, but does have some autonomy. SARS is defined as "an organ of state within the public administration, but as an institution outside the public service" funded through legislative appropriations (Taliercio 2004: 48).

During its period of transition, SARS streamlined its administration by reducing fifty staff levels in the old system to thirteen and cutting the number of employees by about 10 percent (from 11,942 in 1999 to 10,847 in 2001; Taliercio 2004: 18). Also, to increase its efficiency, SARS continues to respond proactively to cases of corruption within its staff. Since 1998, SARS has dismissed 173 employees for misconduct, representing about 1.5 percent of the total average staff over the period (Taliercio 2004: 19). They also increased salaries, but were limited by the government from raising them much higher than those for civil service employees, an indication of their lack of autonomy compared to other SARAs. Initially, SARS used a system of individual bonuses based on performance in order to compensate for their inability to raise salaries substantially. Between 1996 and 1999, 46 percent of annual salaries paid to SARS employees came in the form of performance-based bonuses. However, the bonus system was scaled back when salaries were raised (Taliercio 2004: 19). This is unfortunate, because performance-based pay seems to have improved efficiency and decreased corruption in premodern states (Kiser 1994).

Unlike other African cases, SARS's personnel system has not been subject to challenge by the government's civil service commission. The Ministry of Finance reviews SARS's personnel policy to ensure that SARS recruits its staff through a meritocratic evaluation process. Compared to the national (public and private) average turnover rate of 13 percent, SARS's overall turnover rate is low at 6 percent (Taliercio 2004: 18), which is indicative of SARS' relative efficiency.[18] Because of its relative autonomy, SARS has been able to outsource its information technology (IT) staff from eighty-two different private companies. This arrangement allowed SARS to solve the serious obstacle faced by its civil service predecessor of attracting and retaining skilled employees in the IT sector (Taliercio 2004: 19–20).

The SARS reform was successful in several respects. Perhaps most important, and in sharp contrast to the URA, they were able to substantially increase the tax base by increasing registration of both individuals and firms. Registration for the income tax increased by 43 percent between 1989 and 2001, with more than half of the increase coming in the last two years of that period (Smith 2003: 7–8). During the same period, the registration of companies increased by 40 percent (Smith 2003: 7). Because of the increase in taxation registration and compliance, revenue collection has increased each year since 1995/96 (Friedman and Smith 2005: 41–2; Hlophe and Friedman 2003: 71–2). This has primarily been a result of increased efficiency of corporate taxation, but the collection of personal income tax has improved as well. Since 1989–90, revenue from personal income tax has increased overall by $1.25 billion. Rough calculations suggest that in the period 1989–90 to 2000–01, the collection of personal income tax increased by about

[18] SARS is experiencing difficulties retaining highly skilled employees. The Large Taxpayer's Office has experienced almost 100 percent turnover in its audit staff in approximately three years (Taliercio 2004).

7 percent per year (Friedman and Smith 2005: 41–2). Overall, since 1998 the public purse has seen an increase of an estimated $14.1 billion, because, in part, of SARS's efforts (Friedman and Smith 2005: 43–4).

Many factors have been cited as contributing to the increasing efficiency of tax collection: improvements in technology, dealing effectively with officials engaging in bribery and other forms of corruption, recruiting more staff with corporate backgrounds, and using negative publicity to embarrass and deter tax evaders (Hlophe and Friedman 2003: 70; Taliercio 2004: 37). The first of these seems to have been especially important, because an increase in the number of registered taxpayers has led to a substantial increase in tax revenue. However, our argument suggests that further increasing the autonomy of SARS could produce additional improvements in administrative efficiency.

THE KENYA REVENUE AUTHORITY

The Kenya Revenue Authority (KRA) was established in 1995 to decrease civil service corruption and tax evasion that produced a tax gap of 40 percent in Kenya (Cheeseman and Griffiths 2005: 11). Its scope was slightly more limited than the other two cases, covering all taxes but the gaming, property, and social security taxes. However, it is also the most autonomous and privatized of the three cases. In addition to being a separate legal entity and having the ability to own assets, the KRA is funded by a percentage of the tax it collects (1.5 percent of estimated collections and 3 percent of the difference between actual and estimated collections, up to a limit of 2 percent of collections). However, as in the Ugandan case, the partial shift of residual claimancy to the SARA has not been implemented because the government has failed to make the payments it had promised. From 1995 to 2000, the KRA received an average of 1.2 percent of total estimated revenues. By 2000, the treasury owed KRA the equivalent of 1.62 percent of total revenues in 1999–2000, which is greater than its annual budget (Taliercio 2004: 65).

The KRA has been very successful in firing corrupt and ineffective employees (Muriithi and Moyi 2003: 11). The 4,500 employees the KRA inherited from the civil service in 1995 were reduced to 4,002 in 2000 and to 3,140 in 2001 (Taliercio 2004: 17). They also significantly increased salaries in order to attract and retain professional staff. The wage bill in real terms increased by an average of 12.8 percent per year between 1996 and 2000, after declining by an average of 16.7 percent per year in the pre-KRA era (1991–5; Taliercio 2004: 96). The KRA also instituted a merit-based promotion system and performance-based bonuses (however, as in Uganda, the government has not paid the promised performance bonuses).

Of our three cases, the KRA is characterized by the most layered accountability system. The KRA is subjected to monitoring by high-level managers, the Commissioner General, its board, the Ministry of Finance, the Kenyan Anti-Corruption Authority, and the National Assembly (Taliercio 2004: 75). Most international observers agree that the KRA has increased efficiency and lowered levels of corruption in Kenyan tax collection, making international donors less fearful that their money will be wasted (Cheeseman and Griffiths 2005: 12–13). The KRA has increased the number of taxpayers registered for the VAT by 55 percent from

1997 to 2000 (Taliercio 2004: 32). The Large Taxpayer Office, established in 1998, has also been effective. On-time compliance with quarterly payments increased from 85 percent in 1998 to about 99 percent in 1999 (Taliercio 2004: 33). However, there has been little change in tax revenue as a proportion of GDP because of a significant reduction of tax rates across the board (Taliercio 2004: 28).

CONCLUSION

After a period of imitating the centralized bureaucratic administrative systems that remain dominant in the developed world, with, predictably from the perspective of agency theory, very little success, African states in the last few decades have begun to partially decentralize and partially privatize their tax administrations, moving more in the direction of administrative systems used by premodern states. Although the jury is still out, because of their short duration, the limited nature of reforms in some cases, and the lack of detailed data, partial privatization using SARAs seem to be increasing efficiency and decreasing corruption. Although reliable data are not available to evaluate the effectiveness of decentralization efforts across Africa, our theory suggests that it too should increase efficiency and decrease corruption.

Drawing on lessons from premodern tax administration, our main recommendation would be to further decentralize and privatize the tax administrations in African states. The main competing policy prescription for reducing monitoring costs is investing resources to improve monitoring capacity enough to run effective centralized bureaucratic administrations by improving transportation, communications, and record-keeping. Although this may, in fact, be the best solution in the long run, it is not currently feasible. First, African states lack the revenue to pursue such a major set of projects, in large part because their tax administration is so inefficient. Second, even if they did have the revenue to begin this massive endeavor, it would take decades to produce the desired effects. Therefore, their best strategy is to decentralize and privatize administration now, and invest some of the increased revenue into projects that will eventually improve their monitoring capacity enough to make centralized bureaucratic administration effective. It is important to emphasize that we are not advocating decentralization and privatization for ideological reasons or in all instances; only as the best solution given the existing (and only slowly changing) structural conditions present in contemporary Africa.

We acknowledge that under certain circumstances, decentralization can exacerbate intra- and interregional income disparities, corruption (Prud'homme 1995), coercive taxation methods, and can also incite secessionist demands (Hechter 2000). We argue that the potential benefits of decentralization outweigh these costs. In spite of pressure from international organizations and local groups who argue that decentralization could increase both efficiency and democratic accountability, state administration is still highly centralized in Africa. There are several barriers to decentralization, including the French legacy in West Africa, the lack of federal constitutions, and the natural fear of weak states to cede too much power. Further gains in administrative efficiency, especially in the collection of property and gaming taxes, will be contingent on overcoming these obstacles. The trend

is clearly in the direction of greater decentralization, and we expect that trend to continue.

Perhaps the most interesting development in African tax administration has been the increasing use of SARAs. They, too, are in very early stages of development and are at this point only very partially privatized. Agency theory and the history of premodern tax administration suggest that further privatizing SARAs would yield substantial improvements in efficiency. Most important, other SARAs should follow the Kenyan example and fund SARAs by a percentage of tax revenue they collect – this would provide stronger incentives for the commissioners of SARAs to improve efficiency. Along the same lines at the micro level, SARAs should increase their use of performance-based pay, both for individual employees, and, when it is difficult to tie individuals' contributions to outcomes, for subgroups.

Increasing privatization does run the risk of the overzealous collection found in many premodern states (that caused the French revolutionaries to go after the headquarters of the tax farmers even before the Bastille), but there are reasons to believe this would be less of a problem in contemporary African states. First, improved communication technologies would allow taxpayers to more easily report cases of coercive tax collection and the human rights violations that often accompanied tax farming. Second, the power of some taxpayers, like multinational corporations for example, would make them immune to overzealous or coercive collection; thus, these problems would not arise with the increased privatization of Large Taxpayer Offices.[19]

Another important benefit of increasing both decentralization and privatization would be to limit the extent of central government interference in tax collection. Our case studies demonstrate that one of the greatest difficulties confronting African tax administration today is continuing government interference in hiring, firing, setting salary structures, and opposing necessary reforms, and the government's failure to pay SARAs agreed-upon bonuses for good performance. It is necessary to increase the autonomy of both local government organizations and SARAs to limit the extent to which this happens in the future.

Last, patronage is still a major problem in African tax administration. Many tax officers and managers remain embedded in networks of traditional social relations and are expected to fulfill reciprocal obligations to members of their extended kin. The importance of such ties may be growing rather than withering away as countries try to democratize in a context of economic instability and uncertainty (Rose-Ackerman 1998: 317–23). Thus, it is going to be very difficult to eliminate patronage networks within tax administrations without resorting to increased government interference in tax administration. However, premodern states faced with similar problems did come up with some partial solutions. Employees should be prohibited from working in areas in which they grew up, and they should be rotated frequently. Foreign employees should be hired when possible, because they lack local patronage ties. Perhaps most important, SARAs should have the autonomy to fire employees found to be involved in corrupt patronage networks.

[19] Capital flight could be a problem, however, so the government would have to monitor that very closely.

More effective tax administration could have important consequences for state capacity, stability, and democratization in Africa. Without adequate tax revenue, states will not able to provide basic public goods like health care, education, water, and roads to citizens. If states are unable to deliver services, they are unlikely to elicit citizens' quasi-voluntary compliance with extractive demands (Levi 1988). They are also unlikely to achieve cooperation for such voluntary acts as voting, participation in community problem solving, and compliance with health regulations (Lieberman, Chapter 6). One of the greatest challenges facing African states is to realize more efficient tax administration while furthering, rather than inhibiting, human rights, social development, and democracy.

12 Adam Smith and the Search for an Ideal Tax System

BEVERLY MORAN

In this chapter I use Adam Smith's 1776 treatise, *An Inquiry into the Nature and Causes of the Wealth of Nations*, to show how the present U.S. tax system has strayed from capitalist ideals at the same time that we imagine ourselves the model capitalist state. I use Adam Smith (who some call the first sociologist) because of Smith's status as the father of capitalism and modern economics as well as for the interplay in Smith's work between the empirical and the philosophical.

I conclude that Smith's ideal tax system consists of two complementary taxes: a flat rate consumption tax with a refundable credit large enough to support what we now call the living wage, combined with a flat rate wealth tax. By investigating the specific conditions that Smith faced, I conclude that his ideal was impossible during his lifetime because of the structural, institutional, and cultural conditions present in eighteenth-century Britain. Based on his writings, I show that Smith himself understood that his larger concepts were not attainable given the administrative restrictions of his era (Salomon 1945). However, Smith also believed that ideas can speak across time and culture. In this chapter, I explore both Smith's ideal and the ways in which he tempered that ideal because he was aware of, and worked with, the limitations of his own time. The dual tax I derive from Smith's writings is very different from our present experience. In fact, I argue that Smith would conclude that our contemporary tax system is both unfair and antithetical to the capitalist principles he articulated in his writings.

What were those capitalist principles? For libertarians, one of the fundamental tenets derived from Smith is the notion that unregulated self-interest and competition can lead to social benefits through the powers of a seemingly "invisible hand." This preoccupation with private interests overlooks another central aspect of Smith's capitalist principles, namely the need for a historically specific legal and institutional framework that can ensure the harmonization of private and public interests (Blaug 1977).

A pivotal aspect of such a framework for Smith was a tax system that effectively and conveniently raised revenue while encouraging labor productivity. By examining Smith's writings and comparing his ideals to the current U.S. tax system, I conclude that (1) a tax on capital instead of labor meets Smith's requirements for a capitalist tax system, and (2) our present tax system, which unabashedly favors capital over labor, paradoxically goes against capitalist principles. These arguments

might shock those who know Smith only through his conservative acolytes. In the free market world of conservative authors, Adam Smith is the god who discovered the invisible hand that, when left completely unfettered by government, produces a net social good from all the selfish, immoral behavior some people engage in for profit (Rothschild 2001). That caricature of Adam Smith would never want to tax capital or apply a higher rate to the rich than the poor. You will not find that Adam Smith in these pages.

Instead you will find a man who situated his analysis in a concern for the poor and the working classes and who had no problem taxing the rich at higher rates or targeting wealth as an appropriate – in fact, the most appropriate – tax base. There is little written about this Smith and taxation, perhaps because Smith's views on taxation demonstrate Smith's lack of deference to the wealthy, and show that his commitment to capitalism did not imply special treatment for capitalists. Instead, Smith's work on public finance expresses his desires to design tax policies and institutions that could promote economic growth for all classes, while preserving the power of markets and natural liberty (Peacock 1975).

In that our present society purports to strive toward Smith's capitalist ideal, it is interesting to note how our own tax system deviates from the specific role Smith creates for taxation within his overall scheme for universal prosperity and political liberty. Specifically, our own system deviates from Smith's capitalist ideal by how much it privileges material wealth in contrast to Smith's ideal tax system, which privileges labor.

For Adam Smith, the tax system played a vital role in supporting the capitalist state, not only by raising revenue, but also by supporting the capitalist ideal of universal prosperity and political freedom. This second goal was accomplished by protecting the working class from taxation while also taxing the wealthy on their property and their consumption of luxuries. In this regard, Smith's ideal tax base reaching both wealth and consumption is not much different from the Haig-Simons' definition of the ideal income tax base as the sum of consumption and changes in net worth (Simons 1938).

Thus, the exercise of examining Smith's writings allows us to look back at the role that a tax system played within the creation of the utopian Enlightenment ideal of Smith's day called capitalism. It also allows us to reflect on our own society and its claim to the capitalist mantle. What we find when we look at Smith is an interdisciplinary scholar with a broad view of the proper role of government who espoused a tax system meant to achieve social justice ends. What we also find is a pragmatic bureaucrat who tempered his utopian views with a rich understanding of his own culture and its social, political, and technical limits. When we apply Smith's tax ideals to our own tax system, we see a society that purports to be the best example of capitalism but that finances itself with a tax system that works against the social justice role that Smith saw for taxation. If we adopted Smith's tax principles to the contemporary United States, large portions of the population would be dropped from the tax rolls. Smith's concern for promoting universal prosperity would lead to an exemption level that would have far-reaching consequences. This is especially true for female heads of household, Hispanics, and blacks, but the exemption from taxation would reach at least 40 percent of white

households as well. Perhaps surprisingly given Smith's reputation, a tax system founded on the principles of Adam Smith would do more to help the poor than our current tax system does.

EIGHTEENTH-CENTURY BRITISH TAXES AND ADMINISTRATIVE CAPACITY

In addition to his contribution to economics, Smith was both a humanist and an empiricist whose works were grounded in philosophy, history, and empirical observation. Beyond his contribution to the social sciences and humanities, Smith was a proponent of social justice whose entire project, from his exploration of the development of moral responsibility and sympathy in *The Theory of Moral Sentiments* (Smith [1759] 1976) to his examination of the role of law and government in guiding human behavior in *The Lectures on Jurisprudence* (Smith [1766] 1978), to his investigation of the cause of different economic outcomes across nations in *An Inquiry into the Nature and Causes of the Wealth of Nations* (Smith [1776] 1979) is a search for the necessary components of universal material prosperity and natural political liberty. Although Smith is thought of as a conservative economist whose work is available to attack social legislation, Smith was a more sophisticated thinker than his academic reputation suggests (Heilbroner 1999).

Smith's practical familiarity with taxation included his father's work as a customs clerk and his own work as the Commissioner of Customs of Edinburgh, consultant to Lord Townsend, and personal tutor to the Chancellor of the Exchequer's stepson. As a person who both administered taxes and advised others on tax administration, Smith showed a fine sense for the wide array of taxes available both within and outside of Britain, their advantages, faults, and incidence. Although Smith wrote extensively about taxation in *The Wealth of Nations* and, to a lesser extent, in his other works as well, his thinking did not directly reflect the present-day income tax because the income tax was not introduced into Britain until 1799 (Rothschild and Sen 2006). Nevertheless, Smith's analysis of taxes in general and their role in promoting social welfare has great significance for present-day income taxes.

In addition to being on the verge of industrialization, the eighteenth-century Britain that Smith observed was an expanding military power supported by an aggressive system of public finance based on a combination of taxes and debt. Although throughout most of human history governments raised revenues without using either debt or taxes (as, for example, through the sale of natural resources or by conquest through war), the political realities of eighteenth-century Britain limited that government's revenue-raising options. In fact, the aggressive revenue policy needed to fund military expansion, combined with the political need to raise revenues through taxes or debt, meant that early eighteenth-century British taxes were significantly higher than taxes in other European countries. These taxes were commonly raised as stamp, customs, excise, and land taxes (Brewer 1989).

Although the century ended with the excise tax raising 40 percent of Britain's revenues, the land tax was preeminent in the early 1700s and continued to play a significant role throughout the eighteenth century (Brewer 1989). In fact, some scholars assert that the rise of the excise tax in Britain (with that tax's emphasis on

commodities) and the decline of the land tax (with its emphasis on agriculture-related tenant rents) paralleled a similar shift in Britain's economic life from prominent landed gentry to an increasingly influential merchant and manufacturing class.

The eighteenth-century British shifts from land taxes to excise taxes not only reflected changes in the nation's economic structure (away from agriculture and toward manufacturing) but a shift in its administrative and political capacities as well. One reason that the land tax remained robust throughout the century was that it represented the power of the Parliament and local government over the central executive. This emphasis on legislative and local control was built into the British laws governing land taxes (which required that Parliament identify the tax base and set the tax rate each year) and in the administrative structure of land tax collection that was housed in local county boards.

One should not underestimate the lack of administrative infrastructure and its impact on British taxation. For most of the eighteenth century, the central British government left administration of its two major sources of revenue to local county boards and private companies. This is in keeping with the premodern tax systems that Kiser and Sacks describe in Chapter 11. At first, a lack of administrative infrastructure meant that the central government could not absorb the increased cost of collecting customs and excises that were handled by private interests instead. Later, as the central executive's capacity increased, collection moved from private tax farming to state collection agencies (Brewer 1989). In any event, eighteenth-century Britain was in no position to have a comprehensive tax system of any type although the closest it came was the wealth tax on land.

In addition to the material obstacles to tax collection that informed Smith's thinking – from poor administrative capacity to lack of technology and access – he was also aware of social and cultural constraints and their effect on taxation. Smith identifies four major principles of an ideal tax system: rates set in proportion to revenue (Smith [1776] 1979: 825), transparency as to amount ([1776] 1979: 825), convenience as to time and manner of payment ([1776] 1979: 826), and appropriately constrained administrative cost ([1776] 1979: 826). Each of these four principles is meant, in part, to ensure that tax collection works within the social and cultural constraints of the time to minimize disturbance to taxpayers.

For Smith, invasions of privacy in pursuit of tax revenues were particularly disturbing aspects of tax collection. Accordingly, Smith favored limited intrusion into private space in determining tax liability. For example, in constructing a land tax, Smith preferred using the number of windows as a proxy for value rather than the number of hearths because windows are visible from outside a building, whereas hearth taxes require that the collector enter the taxpayer's home (Smith [1776] 1979: 845–6). Smith also opposed any tax that required a merchant to open his books because the public knowledge of the merchant's finances might expose him to public shame (Smith [1766] 1978: 531). On the other hand, Smith believed that land values are public and well known and so a land-based wealth tax did not raise privacy concerns. These examples show that Smith adopted the view that taxation is constrained and shaped by social relationships in addition to the limitations caused by infrastructure and administrative capacity.

SMITH'S IDEAL TAX SYSTEM

If Smith attended to the social and institutional context that constrained the eighteenth-century British tax system, he also made clear in *Wealth of Nations* Book V what his ideal tax system, free of social and administrative constraints, would look like. Book V concerns the role of government in the production of the ideal capitalist society and is broken into three major topics: Public Expenditure, Taxation, and Public Finance. Each topic is meant to convey the duties that should guide government as it administers the public trust. Smith identifies these duties as protection from outside oppression ([1776] 1979: 689), domestic justice ([1776] 1979: 708–9), and the creation and provision of diffuse benefits (primarily public education and the protection of domestic and foreign commerce) ([1776] 1979: 723).

Having identified the major uses of public funds, Smith then articulates the proper tax base – not what had to be taxed in the context of the specific limitations that the eighteenth-century British tax system faced, but the ideal tax base for an ideal capitalist world. For Smith, that ideal tax base was a combination wealth and consumption tax limited in order to virtually exempt the working and middle classes. Smith's works point to this combined tax base to both raise revenue and reflect the capitalist values Smith believed radiated from his system. In fact, as we have seen earlier, Smith's own time and place was incapable of administering the tax system Smith envisioned. Smith never expected to see his ideal implemented. Nevertheless, the eighteenth-century British tax system did at times reflect elements of Smith's overall scheme, for example a wealth tax on land and various consumption taxes on luxury items.

Smith subscribed to the benefit theory of taxation. Benefit theory tries to justify taxation by tying tax payments to government benefits (Murphy and Nagel 2002). However, Smith did not subscribe to a traditionally narrow sense of benefits. Unlike Thomas Hobbes, who believed that the best measure of the benefits provided by government protection was the value of an individual's consumption, Smith was open to a more capacious view of benefits (Brownlee 2006: 3). Smith believed that the primary government benefit was the protection of each individual's wealth. According to Smith, government protects rich people's wealth in a variety of ways including by creating social welfare programs so that the poor do not turn against the rich.

Smith applied his broadened benefit theory when he recommended that local people pay taxes for local benefits such as lights, water, and sewage ([1776] 1979: 815); litigants pay taxes for part of the administration of justice through stamp taxes and filing fees ([1776] 1979: 815); students pay a portion of the cost of education through a direct payment of teachers' salaries ([1776] 1979: 815); transporters pay the cost of highways, bridges, and canals and then pass the cost onto consumers ([1776] 1979: 724); and ground rents should be set at higher rates than other types of taxes because ground rents are unique riches brought on by government services ([1776] 1979: 844).

In part, Smith joined taxes and benefits because he believed that those who both benefit from and pay for government services were more likely to properly

regulate their collection and use ([1776] 1979: 825). In part, Smith bound taxes to benefits as a way of avoiding political unrest because he believed that reasonable people were willing to pay for well-priced government goods and services ([1776] 1979: 844). At base, Smith connected taxes to benefits because of his theory of the relationship of private property to government.

The nature of property and who owned property rights was central to many Enlightenment thinkers. As opposed to some of his Enlightenment comrades, Smith did not believe that property existed before the creation of the state. Nor did Smith contend that property carries responsibilities and rights that exist beyond the state and which free the property owner from obligation to the state (Fleischacker 2004). Instead, Smith believed that property could not exist apart from the state. Thus, for Smith, the protection of the rich against the poor, both in their person and their property, was the primary benefit conferred by the modern state. For Smith, wealth is not a proxy for government benefits. Rather, wealth is exactly the benefit that government produces and protects. "Where there is no property . . . civil government is not so necessary" (Smith [1776] 1979: 710). In fact: "Civil government, so far as it is instituted for the security of property, is in reality instituted for the defence of the rich against the poor, or of those who have some property against those who have none at all" (Smith [1776] 1979: 715). When, for example, Smith identifies the Sovereign's second obligation as the administration of justice, he has definite ideas about what justice means: the creation of wealth and protection of property:

> Wherever there is great property, there is great inequality. For one very rich man, there must be at least five hundred poor, and the affluence of the few supposes the indigence of the many. The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possessions. It is only under the shelter of the civil magistrate that the owner of that valuable property, which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security. He is at all times surrounded by unknown enemies, whom, though he never provoked, he can never appease, and from whose injustice he can be protected only by the powerful arm of the civil magistrate continually held up to chastise it. (Smith [1776] 1979: 709–10)

Thus, Smith makes at least two points that are relevant to wealth as a tax base: first, that wealth is the ultimate government benefit:

> Property and civil government very much depend on one another. The preservation of property and the inequality of possession first formed it, and the state of property must always vary with the form of government [(Smith [1766] 1978: 401, as cited in MacCormick 1981)].

It is this basic thesis of Smith's – that property and civil government, and therefore positive law (which is the creature of civil government), are closely intertwined – which is the greatest interest to us. He put the same point another way: "Till there be property there can be no government, the very end of which is to secure wealth and to defend the rich from the poor." (Smith [1766] 1978: 404, as cited in MacCormick 1981)

Smith's second point is that taxes should match benefits whenever possible. These two points – that government creates wealth and that taxes should be tied to benefits – argue strongly in favor of a comprehensive wealth tax.

Smith's ideal tax system required a tax base, and Smith's use of benefit theory required a wealth tax base. However, a wealth tax alone could not complete Smith's ideal tax system because Adam Smith also believed that taxes should have the smallest possible effect on prices.

Smith's theory of price posits two prices: market price and natural price. Natural price reflects the value embedded in an object by labor. Market price is influenced by other concerns such as supply and demand (Smith [1766] 1978: 72–81, 552–3). Goods become widely available at a fair price when natural price and market price match. Unfortunately, as Smith acknowledged, there are a number of factors that can upset the balance between natural and market price including a poorly designed tax system ([1766] 1978: 555).

According to Smith, a direct tax on labor distorts the match between natural price and market price because the cost of labor is already reflected in natural price so that government actions that increase the cost of labor (for example, a direct tax on wages) increase natural price and adversely affect supply. For Smith, indirect taxes on labor were even worse than direct taxes because of the additional costs associated with the collection of indirect taxes ([1766] 1978: 583). According to Smith, the cost associated with both direct and indirect taxes on wages are eventually borne by the consumer through higher prices ([1776] 1979: 873). Accordingly, either direct or indirect taxes on labor hurt the public good. Thus, Smith tells us: "The middling and superior ranks of people, if they understood their own interest, ought always to oppose all taxes upon the necessaries of life, as well as all direct taxes upon the wages of labour" ([1776] 1979: 873).

On the other hand, for Smith, surplus profit is open to taxation subject to his four tax ideals and several other themes that he developed in Book V. The additional themes already discussed in this chapter include Smith's directions that (1) taxes should be laid so that they have the least effect on prices; (2) taxes are justified by government benefits; and (3) tax systems should specifically identify and tax those whom government benefits. For example, Smith approved of taxes on the weight of wagons that use the public highways because the tax had the least effect on the cost of goods. According to Smith, the tax was actually passed onto the consumer. However, because the roads made it cheaper to bring the goods to market, the decrease in price created by the roads more than offset the increase in price caused by the tax used to support the roads (Smith [1776] 1979: 725). Smith also liked the highway tax because the tax was used to maintain roads that were then used by the people who paid the tax and their payment of the tax by the weight of their wagons was a good proxy for the actual stress that the taxpayer/transporters put on the roads ([1776] 1979: 724). In other words, the tax was tied directly to the use. Thus, the highway tax fit Smith's ideal first by matching the beneficiary to the cost ([1776] 1979: 848–9) and then by also having a positive (lowering) effect on price.

Another consideration for Smith's ideal tax system not yet discussed here concerns exemption amounts. With the flat rates that Smith included in his four tax principles, exemptions allowed Smith to create a mildly progressive tax. Smith

constructed his exemptions around his belief that the minimum compensation needed to take on the risk of capital should be returned to the owner without tax ([1776] 1979: 847). For the working class, Smith provided the same exemption through the concept of "necessaries" (Smith [1776] 1979: 869). Because most of what workers earn goes to necessaries, Smith considered direct taxes on both necessaries and wages as inevitably resulting in either an increase in wages or a decrease in employment ([1776] 1979: 874).

Continuing with necessaries and their role in taxation, Smith devoted a full section of Book V to a discussion of the taxation of consumable commodities ([1776] 1979: 869–906). Smith divided consumable commodities into either necessaries or luxuries ([1776] 1979: 869). Taxes on the consumption of necessaries, according to Smith, performed the same price-raising function as direct taxes on wages because these consumption taxes are an indirect tax on the cost of producing labor. For Smith, however, direct and indirect taxes on wages do more than distort prices to the detriment of society as a whole; they also violate time and culture specific standards of natural justice and human dignity that shift with each society's fortunes, allowing everyone (including the poor) to enjoy a rising standard of living ([1776] 1979: 870). Smith's definition of "necessaries" includes both those things that are needed for life (for example, heating fuel in the winter) and those things that "[t]he poorest creditable person of either sex would be ashamed to appear in publick without them" ([1776] 1979: 870; see also 874). What the poorest person needs for human dignity is highly dependent on historical and cultural conditions ([1776] 1979: 870). Thus, as countries become richer, their populations ought to prosper so that everyone (including the poor) shares in the rising standard of living. In order to include the poor and working classes in the universal prosperity that capitalism promises, a nation must avoid all direct and indirect taxes on wages and necessaries ([1776] 1979: 870–1).

Smith's depiction of the poor and the working classes was in marked contrast to the two prevailing views of his time. One view was based on traditional notions of social hierarchy and was reinforced by common economic theories about labor and motivation. Under that view, poverty was an eternal and deserved state best left undisturbed. The second view was based on Christian ethics. It held that the rich had a duty to treat the poor with kindness and compassion and to aid them in times of stress. Smith rejected both of these traditional notions by disputing that the poor are inherently inferior or lacking in moral judgment and work ethic. Rather, Smith asserted that the poor have the same natural talents as the most exalted and that their problems arise not from laziness but from overwork. In fact, given poor and working peoples' contributions to society, Smith believed that it was only equitable that they have access to the goods that they produced (Fleischacker 2004).

Although Smith was fiercely opposed to taxes on wages and the necessaries that wages purchase, he was favorably inclined toward consumption taxes on luxury items. For example, although Smith opposed all taxes on necessaries, he was more than comfortable with luxury taxes (Smith [1776] 1979: 873). Furthermore, Smith advocated higher taxes on the rich than the working classes even in the face of his own desire for flat rates ([1776] 1979: 842).

If he were freed from the constraints of his own time and its limited administrative capacity, Smith would promote a flat rate wealth tax with a large exemption and a consumption tax with a refundable credit. The flat rates for both taxes reflect Smith's principle of rates in proportion to benefit. The wealth tax base applies Smith's observations regarding benefit theory and taxation to the effect that the primary benefit derived from government is the production and protection of wealth. The refundable credit up to the amount needed to purchase necessaries (what we might now call the living wage) comports with Smith's theory of price and his desire to avoid both direct and indirect taxes on the wages used to purchase necessaries. The fact that the credit is refundable also acts as a welfare system within the tax system (as the Earned Income Tax Credit [EITC] does in our tax system), allowing for the protection and the support of the consumption of necessaries. Finally, the wealth tax and the consumption tax acting together equalize tax liability as between savings and consumption while avoiding the need to differentiate between necessaries and luxuries. Thus, the tax supports such economic goals of the capitalist system as natural price and such social justice goals as the exemption of working-class consumption from taxation.

Smith's writings show a strong belief in both universal principles and in making adjustments to ideals in order to take account of practical constraints that might derive from culture, politics, or administrative capability. In fact, Smith was known for taking into account those limits to action based on either human nature or development (Haakonssen 2006). Because of the interaction of his concerns for both realism and idealism, Smith might applaud a twenty-first-century U.S. wealth and luxury consumption tax base although he did not advocate a similar measure for eighteenth-century Britain.

Indeed, there is specific textual evidence that Smith would have explicitly favored a wealth tax if that tax were administratively feasible. In *Lectures on Jurisprudence*, Smith opines that all taxes are either taxes on possessions (which Smith identifies as land, stock, or money) or taxes on commodities (such as salt, cloth, or alcoholic beverages; Smith [1766] 1978: 581). As between possessions and commodities, Smith is inclined toward a possessions tax because, as explained earlier, Smith believed that taxes on commodities either increase the cost of labor, thereby indirectly increasing prices, or decrease the availability of goods. Yet, although Smith preferred to tax possessions, he was faced with cultural restrictions concerning privacy and political restrictions in the form of a lack of administrative capacity that left land as the only plausible possession for the eighteenth-century British government to tax. In this context, Smith explicitly notes that it is the challenge of taxing either stock or money in the aforementioned administrative environment that left those possessions virtually exempt from taxation ([1766] 1978: 581, 582).

In short, Smith's ideals argue for taxing possessions (i.e., wealth) and the consumption of luxuries. Yet, Smith's ideals were forced to operate within a culture that disapproved of inquiry into personal finances and an administrative system that was generally much better at taxing commodities than possessions. This conflict between idealism and realism is why eighteenth-century Britain relied so heavily on customs, stamp, and excise taxes. It is also one reason why Smith offers examples that favor progressive rates. In general, the taxes that eighteenth-century Britain

was forced to lay – stamp, duties, and customs in particular – are regressive taxes. They become even more regressive if Smith is correct and the ultimate cost of a commodities tax is borne by working people or consumers. In order to balance the regressive nature of the tax system brought about by cultural, political, and administrative factors, Smith introduces progressive tax rates mostly in the form of higher taxes on luxury consumption.

The comprehensive dual wealth and luxury consumption tax system that fits Smith's ideal could not exist in eighteenth-century Britain but pieces of it were part of the overall British tax system. Eighteenth-century Britain was not administratively sophisticated enough to have a comprehensive wealth tax, but it did engage in land taxation, which is a limited form of wealth taxation. There were taxes on luxuries (which Smith approved) but also on necessaries, a major violation of Smith's prohibition of indirect taxes on wages.

APPLYING ADAM SMITH TO THE CONTEMPORARY UNITED STATES

As Kiser and Sacks point out, historical sociology maintains its relevance by its ability to move backward and forward in time trying to match what is similar and to identify what is different as a means of providing relevant information to the present age (Chapter 11). In the context of contemporary American society, the amount needed to purchase what Smith called necessaries are now known as the living wage. There are a number of ways to calculate a minimum material standard-of-living threshold. In the contemporary United States, three frequently proposed standards are the poverty threshold for a family of four ($20,614 in 2006; U.S. Bureau of the Census 2007; see; Fisher 1992, 1997), the salary that two adults working full-time at minimum wage earn after factoring in the EITC and the Social Security wage tax ($23,848 in 2006),[1] or the amount that a married couple filing a joint return with two children can earn before completely losing eligibility for the EITC ($39,783 in 2007; Administration for Children and Families, U.S. Department of Health and Human Services, n.d.; on the living wage, see Waltman 2004).

According to Smith's view of necessaries as culturally specific, the amount needed to sustain a living wage for a two-parent family of four is best left tax-exempt to avoid reaching the wages needed to purchase necessaries. As one would predict in a society that claims to pursue capitalist ideals, the United States' federal income tax system does exempt approximately $45,000 of income for a two-parent family of four assuming the use of the childcare credit. However, this same $45,000 of income is subject to other federal taxes, to say nothing of state and local taxes as well. For example, as of 2008, these wages will pay more than 15 percent in Social Security wage taxes (assuming that the incidence of both the employer and

[1] Calculated as $5.85/hour × 40 hours a week × 52 weeks @ year × 2 workers = $24,336 + $2,950 for the EITC − [$3,438 Social Security] = $23,848. This is the EITC for 2006 assuming no other outside income or deductions. See IRS Form 1040 Schedule EIC and Publication 596 (2006) Earned Income Tax Credit. The amount of the Social Security tax is taken from one-half of the self-employment tax from Form 1040 SS (self-employment U.S. income). School breakfasts and lunches, food stamps, bus passes, and subsidized housing move the family further from the poverty threshold.

the employee tax falls on the laborer) and each gallon of gasoline that this family purchases will pay more than eighteen cents in federal excise taxes.

Although the U.S. income tax does exempt a living wage from taxation, perhaps because our system focuses so much on the income tax, we have forgotten that taxpayers need more than a yearly stream of income from labor for prosperity. Wealth is needed in addition to income as a cushion against hard times. Whether due to illness, plant closing, or the need to take care of a relative, there are times when people are forced to drop out of the labor force. When an unanticipated shock to the income stream occurs, those families with assets are in a better position to sustain themselves during bad times and to recover as the economy recovers (Conley 1999, 2004).

What is the amount of wealth needed to make that difference? Because housing is such an important part of most Americans' wealth portfolio, one simple standard to use is the cost of entry into the housing market. Ginnie Mae estimates that a family with $45,000 of annual income in 2008 could carry a $190,000 house with an 80 percent mortgage. The cost of entry into that housing was approximately $45,500 (Ginnie Mae, n.d.). To arrive at an appropriate amount to exempt from wealth taxation, we should add six months' salary in a cash account for emergencies, for a total of $68,000 in 2008 dollars.

The treatment of wealth in the U.S. tax system highlights its deviation from capitalist ideals. Rather than privileging wages and labor, as Smith's ideal tax system requires, the U.S. tax system husbands most of its benefits for wealth. Furthermore, as McCaffery would predict, "old" wealth is privileged over "new" wealth in ways that make it difficult for those left behind to catch up (Chapter 13). So for example, once a family raises the cash to enter into the housing market, the appreciation in its asset will likely be harvested tax free through borrowing, inheritance, or sale. However, the cash that must be collected over a number of years in order to enter the housing market is generally subject to tax under the U.S. tax system thereby subjecting those with the least amount of financial cushion to the highest levels of taxation on just the amounts that are set aside for wealth enhancement.

The choices reflected in our tax system have race, ethnic, and gender consequences in addition to the class consequences reflected by favoring those with capital over those who labor. For example, average (mean) value of non-Hispanic white households' assets already far exceeds the minimum wealth needed to sustain a living wage. In fact, the non-Hispanic white households' assets' average value of $198,383 (in 2000) was almost three times the minimum amount needed to enter the housing market on a living wage. In contrast, average net worth of black household assets in 2000 was $35,284, or just over halfway toward the amount needed to enter the housing market at the living wage with comfort (Housing and Household Economic Statistics Division, U.S. Census Bureau 2005). There were similar gaps for female heads of household (DeNavas-Walt, Proctor, and Smith, U.S. Census Bureau 2007). In the fiscal sociology tradition, these differences paint clear pictures of who wins and who loses under our current tax system (Moran and Whitford 1996).

Would Smith's benefit principle still imply a wealth tax in the twenty-first-century United States? On the surface it seems that opposing views of the benefits

of government distinguish twenty-first-century America from eighteenth-century Britain. For example, as opposed to the early twenty-first-century United States, eighteenth-century Britain employed virtually no transfer payments (Heilbroner 1999). As those benefit theorists who argue for a flat or regressive tax ask: Don't the poor get more from government, not less, in the twenty-first-century United States?

In answer to the question of whether government benefits are no longer limited to the creation, preservation, and protection of property, consider that Smith ties government and wealth together in ways that modern-day benefit theorists on either side of the spectrum might dispute. For example, although Smith concedes that public education benefits the working classes by providing escape from dull lives of repetition brought on by the division of labor, for Smith the real benefit of public education is enjoyed by the wealthy because they receive a prophylactic against revolution (Smith [1776] 1979: 782):

> The state . . . derives no inconsiderable advantage from . . . instruction [of the working classes]. The more they are instructed the less liable they are to the delusions of enthusiasm and superstition, which, among ignorant nations, frequently occasion the most dreadful disorders. An instructed and intelligent people, besides, are always more decent and orderly than an ignorant and stupid one. They feel themselves, each individually, more respectable and more likely to obtain the respect of their lawful superiors, and they are therefore more disposed to respect those superiors. They are more disposed to examine, and more capable of seeing through, the interested complaints of faction and sedition, and they are, upon that account, less apt to be misled into any wanton or unnecessary opposition to the measures of government. In free countries, where the safety of government depends very much upon the favourable judgment which the people may form of its conduct, it must surely be of the highest importance that they should not be disposed to judge rashly or capriciously concerning it (Smith [1776] 1979: 788).

Thus, free universal public education – what some twenty-first-century benefit theorists see as the premier wealth transfer to the poor – Smith sees as a tremendous government benefit to the rich (Moran 2008). Although public education protects the poor from boredom, it protects the rich from execution and their wealth from confiscation.

THE INSTITUTIONAL POSSIBILITIES FOR SMITH'S IDEAL TAX SYSTEM

Much has changed in the modern world since Smith first purposed his ideal tax system. The cultural and administrative limitations that kept Smith from recommending a comprehensive wealth and luxury consumption tax base in eighteenth-century Britain do not apply in the twenty-first-century United States. For example, Smith's eighteenth-century Britain and the present-day United States differ widely in concerns over privacy. Smith could never have imagined a country where telephone calls, emails, cars, and homes were as open to both public and government inspection as is common today. Nor could he imagine that the population would accept such intrusions into what he saw as private space. In the face of the

greatly reduced expectations of privacy that prevail today, Smith's concerns about a vexatious wealth tax become less compelling. Indeed, in the context of the twenty-first-century United States, a comprehensive wealth tax with a large exemption is actually less vexatious than the present-day income tax because a wealth tax base reduces the size of the taxpaying public, thereby providing immediate relief for a large number of former taxpayers.

The administrative burdens that Smith knew so well are also of less concern in the twenty-first century. Although eighteenth-century Britain raised as much revenues as some twenty-first-century developing countries, Smith had no experience of the tax burden imposed by the United States, the European Union, or other prosperous nations today. What Smith saw was a government that could not sustain any sort of comprehensive tax system and was reduced instead to targeting specific commodities and land as a way of raising revenues. Nevertheless, both a wealth tax and a consumption tax on luxuries were administered in eighteenth-century Britain by a government with much less administrative capacity than our own. And the United States has already demonstrated the capacity to reach income and wages at home and abroad in all sorts of forms. There is no reason to believe that the present U.S. bureaucracy lacks the capacity to tax wealth in lieu of income.

As Smith noted, everyone finds taxation vexatious and capital is no exception. Smith views capital as mobile when possible in search of profit. Because income is similarly mobile, the United States presently imposes its federal income tax on its citizens' and resident aliens' worldwide income. Thus, Americans are not ignorant of or adverse to comprehensive and worldwide tax bases. Of course, declaring that a government is empowered to reach worldwide income or wealth and actually taxing foreign-based revenue are two different matters. The United States has demonstrated an ability to reach a substantial portion of overseas income even in the face of elaborate tax avoidance mechanisms. In this regard, the United States has a greater reach than eighteenth-century Britain even though Britain in Smith's era faced less mobility of capital than we do today.

A comprehensive wealth tax with a large standard deduction would create a prosperous taxpayer population with a higher average ability to engage in elaborate tax avoidance. In turn, this smaller but more sophisticated taxpayer population would force shifts in the regulating administrative agency. One of those shifts would have to include more sophisticated work in identifying both domestic and foreign wealth. Surely incentives exist for capital flight under a wealth tax to the same extent as they now exist for income flight under the income tax. In comparison to income, however, wealth remains less mobile even in our increasingly technological society. For example, as noted earlier, one of the most significant parts of the United States's wealth base is land.

That land remains a significant source of wealth in this country also goes to Smith's questions concerning the instability of valuation. As compared to eighteenth-century Britain, the twenty-first-century United States has ways of tracking wealth in land, stocks, and other types of property both tangible and intangible that was impossible to imagine at the time of the American Revolution.

The greatest challenge to a comprehensive federal wealth tax in the United States is not administrative capacity or modern cultural sensitivities. The main roadblock

to an American wealth tax is a constitutional restriction on direct taxes without apportionment that make a wealth tax impossible without a constitutional amendment. At the same time that the eighteenth-century Adam Smith was analyzing tax systems across space and time, the eighteenth-century U.S. Constitution was written to prohibit wealth taxes. The restriction on wealth taxes was achieved in the U.S. Constitution's Article 1 Section 2, which requires that direct taxes be apportioned by population. In the eighteenth-century United States, the restriction on direct taxes shows that the political dilemma associated with taxing wealth was not equivalent to the eighteenth-century British problem. According to Smith, the administrative problem facing an eighteenth-century British wealth tax was that wealth in Britain was hard to identify and value, which also made wealth difficult to tax. In contrast, the political problem facing a wealth tax in the eighteenth-century United States was that wealth was all too readily identifiable and easy to tax.

In the eighteenth-century United States, most wealth was held either in land or slaves, both easy targets for tax. The wealthiest Americans – those with the largest acreage and slaveholdings – resided in states with the lowest white male populations. Their low white male populations, especially in relation to acreage, put these wealthy planter states at a numerical disadvantage in the House when compared to states with larger white male populations and smaller per capita white male landownership. A tax on land and slaves – the most significant forms of eighteenth-century American wealth – would have shifted the cost of government away from the highly populated small states of the Northeast and toward the slaveholding South with its low white male population. At least two adjustments were placed in the U.S. Constitution in order to avoid this outcome. One was the counting of slaves as three-fifths of a man for purposes of allocating representatives, and the second was the prohibition against direct taxes without apportionment, which effectively made a federal wealth tax unconstitutional (Einhorn 2002).

The constitutional prohibition on direct taxes is not, however, an insurmountable barrier to the kind of wealth tax favored by Smith. The U.S. Constitution was amended to permit the modern American income tax. It could also be amended to permit a federal tax on wealth.

Both the eighteenth-century British and the eighteenth-century American objections to a wealth tax have less appeal today. After the Civil War, the United States developed a more national outlook that is less focused on interstate rivalries. Thus, individual states have less to fear from a federal tax on their citizens' wealth. The present-day income tax is acknowledgment of that political change from seeing oneself as the citizen of a state to becoming a citizen of the United States. In addition, although twenty-first-century American wealth holdings are far more sophisticated than their eighteenth-century British counterparts, the United States' ability to track wealth is more sophisticated as well. Furthermore, like eighteenth-century Britain, the twenty-first-century United States already has sophisticated, albeit local, agencies that annually value one significant source of twenty-first-century American wealth – land and buildings. Thus, neither the constitutional argument against a comprehensive wealth tax nor the administrative argument is compelling in light of present realities.

CONCLUSION

A look back to a different place and time can sometimes shed light on contemporary issues. Looking at how Adam Smith, the father of capitalism, shaped his ideal tax system and at some of the ways that the U.S. tax system deviates from that ideal helps us see how our own tax system privileges wealth over labor in opposition to what we purport to be our foundational principles. At the same time, focusing on how Smith compromised his own ideals in the face of the realities of his time and place allows us to see how he attacked the problem of the creation of a tax system both by presenting an ideal and by modifying that ideal in the service of the revenue arm of a successful empire. The tension between using the tax system as a part of a social justice agenda and the need to raise revenues in the context of limited capacity is felt all over the world today as countries move through various levels of development. Smith reminds us that tax systems can affect their social order consciously and with purpose. Social justice is as much a concern of taxation as it is of any other branch of government, as illustrated by the chapters in this text and the works of Adam Smith.

Capitalism and the free market are often invoked in support of an "anti-state intervention" ideology. The misuse of Smith's "invisible hand" has stoked arguments that self-interest leads to collective betterment and has made Smith a poster child for those advocating laissez faire and its latter-day descendants. (Rothschild 2001). A central element of this reading of Smith is that Smith opposed a wealth tax. Yet, as I show in this chapter, Smith was not fundamentally opposed to a wealth tax and made some positive mention of the British land tax, the central wealth tax of his time. Instead, Smith's failure to advocate a comprehensive wealth tax was driven by his awareness that the cultural and administrative situation in eighteenth-century England was unsuited to any comprehensive tax system. In fact, Smith's embrace of benefit theory and his argument for the role of government in the protection of wealth all support a comprehensive wealth tax for reasons that resonate with contemporary concerns. Thus, in this chapter I argue that a close reading of Adam Smith has contemporary relevance – but not in the way that many would imagine. In contrast to those who invoke Adam Smith to justify absence of intervention into the market, I show that a careful reading of Smith leads to a strong justification for a tax system based on the taxation of consumption and wealth rather than of income.

13 Where's the Sex in Fiscal Sociology?: Taxation and Gender in Comparative Perspective

EDWARD McCAFFERY

INTRODUCTION: BEYOND WAR

In a book on a subject as daunting as fiscal sociology, getting the word sex into the title of a chapter makes obvious marketing sense. Yet, in fact, something important is missing from the other chapters, each valuable and interesting in its own right.

The field of fiscal sociology, born in Schumpeter's stirring invocation of the "thunder of history" (Schumpeter [1918] 1991), has dwelt, as many of the other chapters show, mainly with how government tax (or "extraction," in Charles Tilly's preferred word choice in Chapter 10) schemes interact with large-scale issues of war, crisis, state construction and destruction, and the like. These are important subjects, situated at the macro level of society. A closer and more detailed look at tax systems show that they have deep, persistent consequences on the micro level as well. Fiscal policies affect patterns of marriage, childbearing, work, savings, education, charity, home ownership, and more. *Fiscal sociology* is thus an essential element of cultural sociology. Social norms and biases are reflected in fiscal – tax and transfer – systems, and such systems, in turn, exercise coercive force, tending to entrench patterns of social life in an endless feedback loop, a point also emphasized in Beverly Moran's chapter. This is rich and important subject matter for multidisciplinary scholars to explore.

The taxation of households illustrates the point. Tax codes and other aspects of fiscal systems have often been explicitly sexist (Stotsky 1996; Teck 2004). In Britain, for instance, income taxation was instituted in 1799, with all income attributed to the husband, reflecting the laws of the time whereby all of the wife's property became the husband's at marriage. The Married Women's Property Act in 1882 allowed women for the first time to retain management and control of their separate property and earnings. (For an excellent analysis of the movement for women's

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property rights in the United States, see Siegel 1995). After a delay, the tax code was amended in 1894 to allow the wife's earnings the same tax relief as a single person's if the couple's combined income was less than the then-significant sum of five hundred pounds; above that threshold, an "aggregation" model persisted, whereby the wife's income was added atop the husband's in his taxable income. In 1918, a "married man's allowance" was introduced and was increased to 1.6 times a single man's allowance in 1982 (the 1.6 multiplier clearly deriving from U.S. law, as we shall see later); the extra deduction amount giving a man a tax savings for having a wife, whether she had market earnings or not. Well into the 1970s the Inland Revenue, the United Kingdom's tax agency, refused to correspond with or send tax withholding refunds to married women, dealing only with their husbands. The law had to change to compel bureaucratic sensitivity to modern norms: in 1978, the Finance Act required the Inland Revenue to send married women their refunds. Still, as a matter of substance, households with wives earning more than a minimal amount of market earnings faced a marriage tax created by the aggregation model of joint filing, discussed later. This was eliminated by legislation in 1988 (effective in 1990) requiring individual returns for earnings and investment income. The married man's allowance became an allowance that could be transferred between spouses in 1993 (Briggs 1985; Stotsky 1996). Just about the entire history of this household tax policy was written in explicitly sexist language, of "men" and "women," "wives" and "husbands," and the English system had clear effects throughout the British Empire, such as in Canada (Kesselman 2007), New Zealand (Jones 2005), Australia (Cass and Brennan 2003), and Malaysia and Singapore (Teck 2004). Now it is one thing to note, in honest language, the inevitably sexist and gendered effects of tax laws; it is quite another thing to make as a matter of positive law a rule whereby taxing authorities will not communicate with married women.

Sexist effects run far deeper than expressive and dignitarian harms, however severe these may be. In the United States, to take an important example, tax systems, mainly created in the twentieth century – and hence generally free of the openly sexist language found in England and many commonwealth societies – are not facially gendered. Yet, major features of the American tax system were put in place in the 1930s, 1940s, and 1950s, periods when the one-earner family with a stay-at-home wife was both the descriptive fact and the normative ideal for most Americans. These structural elements persist, unmitigated and indeed often increased in their magnitudes, well into the twenty-first century.

Fiscal policies in the United States now make it difficult to be a household featuring two wage-earners, married with children – although this has long been the dominant model among married couples with children in the United States: In 2005, 65.1 percent of all married couples with children under age 18 fit it (U.S. Census Bureau 2007: Table No. 582). It is important to understand that the burdens on two-earner households are analytically distinct from the "marriage penalties" that have dominated political discussion and rhetoric (Zelenak 2007: 1140); indeed, as marriage penalties for the middle and upper classes have been lessened, the analytically distinct secondary-earner bias has increased (Richards 2008). In any event, the deep bias against two-earner households has different

effects along class lines, and affects patterns of the sexual division of labor and hierarchy throughout the wider society:

1. At lower-income levels, marriage becomes the choice variable, as working for pay is not: tax and other fiscal laws make it hard to be a two-earner married family, hence children are raised by unmarried, single parents. One-third of American children live in households without two parents, most with their mother, and most of these households are poor (U.S. Census Bureau 2007: Tables No. 65 and 676). Women in these settings are trapped by economic needs, social stigma, and the relentless constraints of too little time. And yet, ironically, marriage penalties among the poor persist in full force (Richards 2008, McCaffery 2003).
2. At the upper-income levels, in contrast, the same bias against two-earner households leads to the choice variable being whether the "second" earner works outside the home, for pay, or not: a bias against two-earner households pushes toward "traditional," single-earner households with a stay-at-home spouse, typically the wife, making this model predominate among the economic elite (see for example Tahmincioglu 2006).
3. In the vast middle-income classes, the bias pushes toward stress and instability, as most married couples are forced to swim upstream, as it were, living out a life of work-family "balance" in a socioeconomic structure designed to discourage that very life (Crittenden 2001; McCaffery 1997). Here the issue is not marriage penalties – which ironically have been reduced – but relief for childcare, which has not been increased.

Fiscal policies are both the causes of and the absence of cures for the attendant social stresses and ills. These effects come from choices, consciously and subconsciously made, over nearly a century of comprehensive tax policy. And America's choices meanwhile have had echoes and resonances throughout the developed and even the developing world, just as the British answers have had throughout their empire (see Brownlee, Chapter 14, for another example of American influence – for the worse? – in matters of tax policy).

The American and British stories are just two among many. Although the U.S. tax system provides a strong orientation for a "traditional," two-parent, single-earner family – a model that has had perverse and perhaps unintended consequences on those households who do not or cannot fit it – other countries have addressed the issues differently. After a period of time, in the wake of World War II, in which many developed countries around the world more or less blindly mimicked the American approach (see again Brownlee, Chapter 14, on the Shoup Mission for an interesting parallel), the vast majority of developed and many developing countries are now following a "worldwide trend" toward individual, rather than joint, filing (Pechman and Englehardt 1991; see also OECD 2006a: 54–6). A prime mover for the reforms seems to have been the desire to encourage greater female labor-force participation: in 1984, the European Community (EC) examined the impact of EC tax systems on women's participation in the workforce, a major concern being the high marginal rate secondary earners face under joint filing systems, such as the

current U.S. one, and concluded that a disincentive for women to enter the labor force resulted:

> Indeed, the continuing increase in the number of married women entering the job market, and the consequent rise in the number of two-earner families, coupled with the continued application of tax systems which benefit the traditional family, produces the anomalous situation in some Member States that a growing number of couples will be financially better off remaining unmarried, and this particularly where there are children, owing to benefits granted for one parent families. (European Communities 1985)

The EC analysis takes working women as a social fact and, hence, concludes that a bias against two-earner families will lead to nonmarriage; the United States in its policy, in contrast, has never acknowledged the fact of working wives and is clearly ambivalent about it. In any event, the United Kingdom, France, and the Netherlands, among others, reformed their tax systems after the EC memorandum to mitigate the effects (Stotsky 1997). South Africa did so as well in 1995 (Smith, n.d.). Today, most developed nations have separate or individual filing, although the presence of other features in the tax systems, such as deductions allowed to the earner in a one-earner household, continue to make it difficult to discern just what the net effects in any one country are (Pechman and Englehardt 1991; OECD 2005; Ryrstedt 2006).

Yet again, there is great variation. The Czech Republic, for example, bucked the worldwide trend by opting for joint taxation in 2005, apparently using an optional separate filing model (OECD 2006a: 54). Some societies, like Germany, following a model developed in West Germany and in marked contrast to the incentives prevailing in East Germany prior to unification, continue to use tax and other fiscal policies to encourage stay-at-home mothers (Duggan 2003); Germany is often singled out as an example of tax and fiscal policies using a "male breadwinner model" (Palme 2005). France uses a complex system of family taxation and generous state-sponsored childcare programs, both to encourage large families and to facilitate women staying in the paid workforce after giving birth (Henneck 2003; see also Pechman and Englehardt 1991). The only parallel to the family's being the appropriate taxable unit seems to be the *Hindu joint family*, (HJF) as used in Malaysia and Singapore, where the HJF files and pays taxes as a consolidated unit, provided that the *karta*, or head of the family, typically the eldest male, is resident in the nation (Teck 2004). Japan has a system of individual filing that features an "Allowance for Spouses" (AS) and "Special Allowance for Spouses" (SAS) that appears to have been designed with the express intent of encouraging married women to work outside the home – but only on a part-time or limited basis (Akabayashi 2006). Scandinavian countries boast of employing a "dual-earner model" that "supports female labour force participation and to a large extent also male participation in care of children" (Palme 2005).

Back to America, much of today's law and effects hearken back to a policy implemented in 1948, when a major piece of the "peace dividend" attendant on the end of World War II was spent on a tax law change designed to get women back into the homes that they had left during the war effort (McCaffery 1997).

And so here is another relevance of the macro-scale issue of war to fiscal sociology: the perceived need for the central government to accommodate and even actively shape the demographics of the workforce, during and after wartime. Nations need women workers to fuel war efforts or growth, or they do not want women workers to compete with men during periods of high unemployment (see, e.g., discussion in McCaffery 1997: 76–8); depending on the need, nations change their tax and other fiscal policies. So, too, countries seem to change tax policies in response to natalist concerns about too many or too few children. And so on: in each case, fiscal tools – government tax and transfer policies – have strong effects, often surprisingly actively argued for and supported, on the character of family life, and the division of sexual roles and labor throughout the society.

In all of this, some common and interconnected themes emerge, three of which I comment on in this chapter.

One, causes and effects are often hard to see in the dizzying complexity of tax and fiscal policy: there is a "fog of tax," akin to the "fog of war" (Morris 2004), making it hard to understand what is going on. It can be difficult, for example, to compare general fiscal political regimes across countries because an effect evident in one system, such as the encouragement of married women's paid labor-force participation that comes about under a system of separate filing under a comprehensive income tax, can be undercut by some incentive effect generated by another system, such as the absence of subsidized childcare options, or special tax and other fiscal benefits for traditional one-earner couples (European Communities 1985; Pechman and Englehardt 1991; OECD 2005).

Two, in the complexity and haze, there is much room for rhetorical manipulation and even cognitive error. Terms like penalties and bonuses are often used and abused; competing conceptions of neutrality or horizontal equity vie with one another; abstractions such as imputed income lose out to more tangible realities. Underlying this phenomenon is a simple analytic fact that has dramatic cognitive consequences: What is a subsidy or a bonus viewed from one perspective or baseline is a tax or a penalty viewed from another (Thaler 1980; Schelling 1981; McCaffery and Baron 2004). Child credits are childless surcharges; marriage bonuses are singles penalties; subsidies for stay-at-home spouses are taxes on working ones. Given the many degrees of freedom to characterize equivalent policies, cognitive confusion bred by systematic complexity, and a status quo bias in any event, change is, in general, hard. Thus, tax and other fiscal policies that shape and constrain familial arrangements tend to persist, as in the British and American contexts, well after the underlying norms of family have changed (McCaffery 1997; Ventry 2007).

Three, when change does come, it more often than not favors the elite – as shown by the United States (McCaffery 1997; Ventry 2007), Canadian (Kesselman 2007) and New Zealand (Jones 2005) case studies we shall consider later – or is predicated on macroeconomic concerns, such as the need for more (or less) labor-force participation (European Communities 1985), or more or fewer children (Henneck 2003). Absent from the domain of fiscal politics, by and large, is a thicker substantive conception of rights or fundamental fairness, especially one looking to the dynamic effects of micro-level decisions about work and family on systemic patterns of discrimination and entrenchment (McCaffery 1993b; 1996).

By dynamic I mean a concern with the effects of static rules, such as tax-law structures, over time: in how they affect decisions such as human capital formation, on the supply side, and hiring and promotion decisions, on the demand side, that endure through time. And even where such a concern does seem to be present, as in Scandinavia (Palme 2005), and, perhaps, France (Stotsky 1997), changes in the direction of helping emergent family models do not necessarily obtain that goal, because of the complexity of the whole, and the tendency of competing political groups and ideas to get rewarded elsewhere in the system (European Communities 1985; Pechman and Englehardt 1991). Furthermore, a concern with fiscal consequences or social norms that suggests that working mothers are more appropriate or more needed among the poor has led to many child- and family-oriented policies being means tested, but then the withdrawal of these benefits as households attempt to emerge from the lower-income realms works like a tax, creating various forms of poverty and family structure traps (McCaffery 1999; Palme 2005). Just as scholars concerned with fiscal sociology can fail to see the sexist and other socially constructed biases enmeshed in tax and other fiscal systems, so too can those persons and movements concerned with egalitarian and progressive goals fail to look to fiscal policies for their particular gendered and other social constructions (as opposed to their broad and often crude distributive properties), or fail accurately to integrate the divergent and often conflicting elements of a single system into a coherent whole.

These various themes lead to a strong conclusion that more detailed work, on a country-by-country basis, is needed simply to ascertain what is going on and why, and to a more tentative conclusion that the game may no longer be worth the candle: that there is good reason to be skeptical of complex tax and fiscal systems consciously or unconsciously aimed at social engineering even if we accept the inevitability of some nonneutral effects from any set of rules.

This chapter explores these themes with a historical and comparative focus. Like the other chapters in this volume, the topics raised here are large ones, and the sweep, in both time and space, is wide, so I can do little more than note the prevalence and interest of the themes. The limits of time and space are compounded by the simple fact that the analytics of the sexual aspects of tax policy are highly complex – this is one of the themes, after all. Any meaningful exploration of tax-law biases in any historical or comparative context should proceed from a sound analytic understanding of the facts of the matter. In the next section, therefore, I lay out some of the basic terms and concepts, illustrating both the analytic points and the broader themes with comparative and historical observations. The final section then circles back to discuss briefly how the analytics and certain case studies illustrate the three themes noted earlier.

THE ANALYTICS OF TAXING HOUSEHOLDS

Comprehensive tax systems as found in the United States and other developed countries – and increasingly mimicked in developing countries, for better or, largely, worse (Bird and Zolt 2005) – are complex. Sexist and other socially contingent effects lie hidden beneath the surface – this is part of the story, for only certain

actors go looking for social construction through tax codes, and these actors are often rewarded for the effort. It is important to define terms clearly and understand the analytics well. This section gives an abbreviated but necessary guide to key concepts and vocabulary.

THE FILING UNIT, MARRIAGE PENALTIES, AND BONUSES

We begin with some basics. As we do so, it is important to bear in mind that marriage penalties and bonuses – which easily grab one's attention – are not the main issue of concern to the sexist division of labor at home and in the market. That comes with the *secondary-earner bias*, which comes later.

CHOICES OF FILING UNIT

Any system of comprehensive individuated taxation must answer the question of *attribution*, or the appropriate *filing unit*, that is, in short, the question of who pays taxes. In the first instance, this typically has meant deciding what to do about households with two adults living together. In the United States today, this question still comes down to how to tax married couples, for the federal tax law has refused to consider any accommodation for unmarried couples, including same-sex ones generally denied the legal right to marry under federal law (Ventry 2006). As of 1991, the Netherlands was the only country to allow unmarried couples living together to obtain the same benefits as heterosexual married ones (Pechman and Englehardt 1991).

One answer, the initial default one in America (more or less), is to ignore marriage and to treat all individuals like individuals. This is known as *separate filing*. Most countries around the world, many of which tried the more typically American system of joint filing for a while, have now chosen or reverted to separate filing (Pechman and Englehardt 1991; Stotsky 1997; OECD 2005).

A second answer, which has been the American one since 1948, is to treat spouses as a unit, which is known as *joint filing*.

A compromise or hybrid answer is to countenance both answers, a system of *optional separate filing*, in which couples can choose to file their taxes together or apart. As explained later, this is not the same system as "married, filing separately" under U.S. law. The Czech Republic apparently adopted this solution in 2005 (OECD 2006a).

There are also other possible filing units. One of relevance to the story of taxing households is known in the United States as *Head of Household status* (Pechman and Englehardt 1991), which refers to a single parent or other adult raising children, a common feature across the globe. However, the main options I consider next are separate filing, joint filing, and optional separate filing.

WHY DOES IT MATTER?

Why does any of this matter? Because most developed nations' principal tax systems depend on a pattern of *progressive marginal rates*. This mechanism, commonly misunderstood, works like a step function or a metaphoric ladder. One pays

Table 13.1. *Individual rate schedule*

Income	Marginal rate
$0 to $20,000	0%
Above $20,000	20%

different rates of tax on different levels of income, moving into a higher rate bracket, on the margin, as one's income rises. This new rate does not apply to all of one's income, just the amount that is in the new bracket.

TWO NEUTRALITIES AND ONE IMPOSSIBILITY THEOREM

Under a system of progressive marginal rates, two seemingly attractive ideals, that of *marriage neutrality* and *couples neutrality*, come into tension, posing a certain impossibility theorem. Marriage neutrality holds that a couple's taxes should not be affected by marriage. Couples neutrality holds that "equal-earning couples" should bear equal total tax burdens. The impossibility theorem is that, in a system with progressive marginal rates, there cannot be both types of neutrality at once.

A NUMERICAL EXAMPLE

This all sounds complicated, but fortunately the main ideas can be illustrated with a simple example, using a simplified rate schedule. Suppose that the income tax had just two rate brackets – as proponents of a *flat tax* in fact desire. There is an initial 0 bracket, followed by a 20 percent one (see Table 13.1). We begin with a rate structure for all individuals, as would exist in a world of universal separate filing.

Now imagine two couples, the more traditional Ozzie, who earns $40,000, and Harriet, who earns $0, and the more modern, egalitarian Harry, who earns $20,000, and Sally, who also earns $20,000. Under the individualized, separate filing system, Ozzie pays $4,000 in taxes (0 on his first $20,000 plus 20 percent, or $4,000, on his next $20,000); Harriet pays $0, and Harry and Sally each also pay $0, because all of their income falls within the 0 bracket. As the rate structure applies to both unmarried individuals and married individuals as individuals ("filing separately," that is), there is marriage neutrality: The Ozzie and Harriet couple pay $4,000 in taxes between them, whether they are married or not, and the Harry and Sally couple pay $0 in taxes, whether they are married or not. Marriage is irrelevant. However, this example violates couples neutrality, because the two couples, each earning $40,000 combined, pay different total taxes. In the United States this resolution came to be seen as unacceptable. In essence, couples neutrality has been held to be a higher value than marriage neutrality.

After the war, the United States revisited the issue, and now moved to a system of joint filing with full income splitting, at double the singles' rates, as discussed later. This plan not only rendered moot the incentives for spouses to income split, or pretend to income split, on their own, but it also benefited all married households, especially high-earning, one-earner ones. It was thus widely approved (McCaffery 1997: 51–4). Ever since this fateful moment in 1948, U.S. law has made provision

for joint filing, which means that all married couples are taxed as a unit, and thus, by design, all equal-earning married couples bear the same aggregate tax. And, even though only the Czech Republic, France, Germany, Ireland, Luxembourg, Poland, Portugal, Switzerland, and the United States have some form of joint filing today (OECD 2006a: 54–6), the norm of couples neutrality still seems to haunt worldwide analysis of tax systems, prompting calls for reform or tax and fiscal breaks for one-earner families who, like Ozzie and Harriet in our running example, pay higher taxes than two-earner ones under separate filing (European Communities 1985; Pechman and Englehardt 1991; OECD 2005; Kesselman 2007).

MOVING TO JOINT FILING AND ADDING IN RATES

Once a system has gone to some form of joint filing, the question becomes what to do with the rate schedule. Suppose, in the first instance, that the law maintained exactly the same rate structure for married couples as for individuals. This is often called *aggregation* in the literature (European Communities 1985; Jones 2005; Kesselman 2007) because the two spouses' incomes are simply aggregated together. This was the British way, for most of their taxing history, as noted earlier. New Zealand had this system in place until 1960 (Jones 2005), and it is what was proposed – and widely opposed – in the United States in the midst of World War II.

What would happen to our two hypothetical couples under aggregation? Table 13.1 would still apply, now to married couples as well as to individuals. Ozzie and Harriet, if unmarried, would still pay $4,000 in combined taxes; Harry and Sally would still pay nothing. Now let us marry the two couples. Ozzie and Harriet stay at $4,000 in taxes, but Harry and Sally now must pay this, too – as a couple, their $40,000 bears no tax on the first $20,000, and a 20 percent tax on the second $20,000. Hence, the *marriage penalty:* the taxes of the equal-earning couple increase on marriage. Note that any couple with just about any kind of split in their incomes – even those couples who could split their capital income only, or those who used legal manipulations to appear to split their labor income, or yet again those who could rely on state community property law to do the splitting for them – would see their taxes increased under joint filing with aggregation. This is why the system was so vociferously opposed – by wealthy traditional households – in the United States in 1941. Yet the aggregation answer does have couples neutrality, because the two married couples, each earning a combined $40,000, pay the same total tax.

Suppose, finally (for now) that the law doubles the rate brackets for married persons, allowing, that is, a couple to have a $40,000 zero bracket in the running example. This is often called *income splitting* in the literature, because the effect of doubling the rate brackets is to treat each spouse as if she or he had earned one-half of the total (combined) spousal incomes – the law does the splitting for couples, in effect, so that they do not have to, or pretend to, do so themselves. The rate schedule would now have different rates for unmarried individuals and married couples (see Table 13.2).

If our two couples are unmarried, the analysis continues as earlier: Ozzie pays $4,000, none of the other individuals pays any tax, using the left-hand rate schedules. If and when the couples get married, both couples see their taxes go

Table 13.2. *Rate schedule with individual and joint filing*

Unmarried individuals		Married couples	
Income	Marginal tax rate	Income	Marginal tax rate
$0 to $20,000	0%	$0 to $40,000	0%
Above $20,000	20%	Above $40,000	20%

down to $0; both couples, as couples, now have a $40,000 "0 bracket," using the right-hand side. Hence arose the *marriage bonus*, which comes only to the more traditional, single-earner Ozzie and Harriet household, because their aggregate tax burden falls on marriage; recall that Harry and Sally paid no taxes when they were unmarried. The effects of income splitting are evident here, because the combined, doubled-up rate schedule for married persons has the same effect as treating each spouse – Harriet as well as Ozzie – as if she or he were a single person earning half the combined spousal income; viewed from this perspective, Harriet gets a zero bracket, too, just like Sally has always had by virtue of her own work. Note, too, that we once again have couples neutrality, because all married couples pay the same tax, using the right-hand rate schedule in Table 13.2.

THE MATH OF IT ALL AND A THIRD WAY

All of the math of marriage penalties and bonuses can be understood from this simple example, although the magnitudes get higher as rates and rate brackets increase, and also as we consider other factors, such as tax credits and nontax benefit programs, that also have marriage penalties and bonuses within them (McCaffery 1999; OECD 2005; Palme 2005). The question under joint filing is by how much, if at all, the law multiplies the individual rate brackets to accommodate married couples. In the first example, featuring aggregation, we had no accommodation, which is the same thing as multiplying the singles rate brackets by one. Such an answer yields only penalties and has no bonuses. In the second example, featuring full-income splitting, we doubled the rate brackets, that is multiplied them by two. Such an answer yields only bonuses, no penalties.

This mathematical view of the matter helps to explain additional options, such as those that have prevailed in the United States starting in 1969. The problem at that time was considered the "singles penalty" (Groves 1963; McCaffery 1997: 59–67). A *singles penalty* is simply the absence of a marriage bonus. Consider that, under our running example and the doubled-up rate brackets put in place in 1948, if Ozzie did not marry Harriet, he would be paying $4,000 in taxes; if he got married, this tax would go away. It is simply an analytic fact that "bonuses" can be converted into "penalties" by semantic manipulation of the baseline: one could fairly say that there was a "penalty" on not being married – the absence of a bonus can always be restated as a penalty (Thaler 1980; Schelling 1981; McCaffery and Baron 2004). In 1969, the singles penalty came to be seen as especially unfair, and so the American rate structure changed, by multiplying the individual rate schedule by 1.6 – a value between 1 and 2 (and the same value used for the expansion of the British "married

Table 13.3. *Rate schedule with joint filing but not full income splitting*

Unmarried individuals		Married couples	
Income	Marginal tax rate	Income	Marginal tax rate
$0 to $20,000	0%	$0 to $32,000	0%
Above $20,000	20%	Above $32,000	20%

man's allowance" in 1982, as discussed earlier) – for married couples. This created both marriage penalties and marriage bonuses in the same law.

Consider Table 13.3, with a rate schedule such as has been obtained in the United States since 1969. Notice that now the right-hand rates, for married couples filing jointly, have a 0 bracket of just $32,000, less than double the singles 0 bracket of $20,000: the amount is 1.6 times the singles bracket, or (equivalently) 80 percent of double it.

Consider, for one final time, Ozzie and Harriet, and Harry and Sally. Each couple still earns, as a couple, $40,000, but now they must pay a tax of $1,600, or 20 percent of the amount in excess of $32,000. Ozzie and Harriet still get a marriage bonus, as their taxes are reduced from $4,000 pre-marriage, but this bonus has been reduced, from the full $4,000 to $2,400. Harry and Sally, in contrast, now see their taxes increase on marriage, in a marriage penalty, from $0 to $1,600. Couples neutrality is preserved, but there are both penalties and bonuses on marriage.

It is important to note who pays penalties and who gets bonuses: The more equal-earning a couple is, the higher their marriage penalty; the more one earner earns as a percentage of the household's total earnings, the higher their marriage bonus. Hence Harry and Sally, at a 50–50 split, see a maximal marriage penalty and Ozzie and Harriet, at a 100–0 split, see a maximal bonus. It has been consistently true in America that one-earner families, a distinct minority of households, are the big winners in the story.

As a final wrinkle, since this change in 1969, American married couples have had the option of being married, but filing separately. Yet this is not, however, the same thing as "optional separate filing," as apparently the Czech Republic has now adopted. Consider that there are two effects evident in Tables 13.2 and 13.3, with their joint filing. One is the attributional matter of joint filing. The other is the rate schedule. In Table 13.2, the rate structure is set at a doubling of the individual rate schedules, making for full income splitting. This cannot raise any couple's taxes, and will lower them for all but those couples making the same income. In contrast, in Table 13.3 the rate schedules are set at double 80 percent of the singles rate schedules (1.6 times or 160 percent); both bonuses and penalties result, depending on the pretax split of income between the spouses. Under the "married filing separately" rate schedules, one pays tax under one-half this amount, in other words, 80 percent of the true singles' bracket, for a 0 bracket of $16,000, not $20,000, in our running example, as illustrated in Table 13.4.

If Sally and Harry are married and decide to file separately, they continue to pay $1,600, as a couple: each pays $800, or 20 percent of the $4,000 between their incomes, $20,000, and the 0 bracket of $16,000. Because their incomes are already

Table 13.4. *Prior rate schedule with married, filing separately status*

Unmarried individuals		Married filing jointly		Married filing separately	
Income	Marginal tax rate	Income	Marginal tax rate	Income	Marginal tax rate
$0 to $20,000	0%	$0 to $32,000	0%	$0 to $16,000	0%
Above $20,000	20%	Above $32,000	20%	Above $16,000	20%

split, they do not need joint filing, and the decision to file separately is neutral for them. Ozzie and Harriet, in contrast, would pay higher taxes if they were married and filed separately; Harriet would pay $0, as per usual for her, but Ozzie would pay $4,800, or 20 percent of his $24,000 of income over the 0 bracket: a significant increase over the $1,600 Ozzie and Harriet pay filing jointly. Income splitting by means of joint filing is a large benefit for traditional couples, like Ozzie and Harriet, who have not split their economic incomes on their own.

A system of truly optional separate filing, in contrast, allows married couples to file *as if they were unmarried*, in which case couples who suffer marriage penalties, like Harry and Sally, would file separately, using the left-hand rate schedule, and those who got marriage bonuses, like Ozzie and Harriet, would file jointly, using the middle schedule. America has soundly rejected the option of optional separate filing. Simply to illustrate the confusion in all this – and to make you, dear readers, feel better about working it all through – note that the OECD, in a lengthy published report on "fundamental reform of personal income taxes," showed its misunderstanding, noting without explication that the United States gives couples the option to file jointly or separately (OECD 2006a: 55). However, it is not much of an option in the United States, and it certainly does not remove marriage penalties or the secondary-earner bias.

A LOOK AT THE NORMS

Table 13.5 summarizes the five different filing unit-rate schedule systems we have considered: separate filing; joint filing with the singles rate schedule, 1× (aggregation); joint filing with double the singles rate schedule, 2× (full income splitting); the compromised American-style system with joint filing and 1.6× the singles rate bracket; and optional separate filing. It indicates whether each system meets the norm of "couples neutrality" and "marriage neutrality," and whether it has marriage bonuses, penalties, or both.

I trust it is now more than apparent that this is all a tangled web indeed. The United States, ever since 1948, has only had options that feature couples neutralities and marriage bonuses; further, ever since 1986, no tax law change has benefited two-earner couples without also benefiting one-earner ones (McCaffery 1997; Ventry 2007). Most of the rest of the developed world, in contrast, has chosen or reverted to separate filing, with its marriage neutrality (Stotsky 1997; OECD 2005). Yet, because of the perceived unfairness of more heavily taxing one-earner couples with the same combined income than two-earner couples – because of the

Table 13.5. *Filing unit, rate schedule structures, and norms and effects*

	Filing unit/rate schedule structure				
		Joint filing			
Norm/effect	Separate filing	At 1× singles schedule (aggregation)	At 1.6× singles schedule (U.S. post-1969)	At 2× singles schedule (full (income splitting)	Optional separate filing
Couples neutrality	N	Y	Y	Y	N
Marriage neutrality	Y	N	N	N	N
Marriage bonuses	N	N	Y	Y	Y
Marriage penalties	N	Y	Y	N	N

violation of couples neutrality, that is – most countries that have separate filing give some additional tax benefits to one-earner couples (Pechman and Englehardt 1991; OECD 2005; Kesselman 2007).

The political and psychological complexity of this all is only about to increase, however, as we move on to consider that these very norms of couples and marriage neutrality are not the only effects at work and are almost certainly not the most important ones. I have put them first in the analysis because this is where they have tended to be in the political and intellectual historical development of tax policy. However, now it is time to enrich and complicate the analysis. First let us note that the very measurement of these norms, as reflected in Table 13.5 and political and economic discourse worldwide, misses a very important point.

A (Not Just) Semantic Note

Before leaving the narrow but important subject of taxable units and rate schedules, I want to draw attention to one semantic matter that is far more than semantics. We have seen that in the United States, the ideal of "couples neutrality" has won out over that of "marriage neutrality" – there is strong norm of taxing "equal-earning couples equally." This norm has had influence worldwide, even in countries that reject the American-style male breadwinner model. Canada, for example, is considering a reform even as I write to allow greater income splitting for married couples (Kesselman 2007). Canada has long had a system of separate filing, although its nuances, like most countries' tax systems, are complex.

Yet, there is a sleight of hand in this analysis, which only the most sensitive readers might have caught: it lies in the assumption that Harriet in our running example is not really doing anything valuable at all. In other words, how are we even thinking about earnings or income? Are Ozzie and Harriet, and Harry and Sally, really "equal-earning" couples?

As all married couples with children – and hopefully all people, period – know full well, the stay-at-home spouse and parent is providing tremendously valuable services, including childrearing and home care (Staudt 1996). Tax experts refer to the market value of such services as *imputed income*. This reflects the amount of money that one would have to pay to have a third party do what one does for him or herself. The critical point is that the American, as all other comprehensive income tax systems, simply ignores imputed income. Tax falls on monetary income, in cash or cash-equivalents, and this is the metric by which the "equal-earning couple norm" was measured. This means that "traditional" one-earner households already get a benefit, which a system with marriage bonuses or other special relief for them only compounds.

Looked at another way, consider how easily manipulated conceptions of neutrality are. "Couples neutrality" sounds like an appealing norm and, in fact, in psychological experiments I have conducted with Jonathan Baron, we found that ordinary citizens were very attracted to it (McCaffery and Baron 2004). Yet, the equality in "couples neutrality" is one in observed, monetized income, which is easy to see as an arbitrary variable. Suppose instead that we posited a norm of "childcare neutrality." This would hold that the value of childcare services, whether provided by one's self or by a paid third-party provider, should be taxed the same. I suspect that many readers would recoil at the first intuition as to how to meet this goal: the idea of putting a value on the services of the stay-at-home parent and caregiver, and taxing her for it. There would of course be significant complexities in administering a scheme that taxed nonmarket housework. Yet, consider that imputed income is also the absence of the out-of-pocket costs that come when one does not have self-provided capital or labor. The two-earner couple, Harry and Sally, in other words, have childcare costs, which they must pay in cash, that one-earner households like Ozzie and Harriet typically do not have. Thus, the norm of "childcare neutrality" could (simply) mean a general deduction for paid childcare from the income tax. Neither America nor any other country has such a provision; indeed, many countries give tax breaks for one-earner households (Pechman and Englehardt 1991; OECD 2005). (It is true, however, that many countries, including France and the Scandinavian ones, have very generous state-sponsored childcare provision outside of the tax system, which does have the effect, typically intended, of facilitating dual-earner households. See Duggan 2003; Henneck 2003; Palme 2005). Meanwhile, working parents must earn twice as much as they need to pay for childcare because their distant Uncle Sam (or other sovereign "relative") must get paid first, before the nanny.

In a final irony, scholars (Staudt 1996) and many political movements sometimes point out that the services of stay-at-home spouses are not properly valued, which relates to the fact that they are not cashed out in monetary terms. I do not deny that, in many important expressive and dignitarian ways, not putting a cash value on something means not valuing it fully. Yet, in tax systems that tax monetized transactions, this "nonvaluing" is a benefit. Nonetheless, the psychological perception that one-earner families are suffering under a tax system with separate filing, perhaps aided by conscious or unconscious social engineering and

construction, has led many countries to give benefits to couples with stay-at-home spouses (OECD 2005).

NOT JUST THE MARRIAGE PENALTY: SECONDARY-EARNER BIAS

Alas, the plot must thicken, as anticipated earlier. We have just explored, at some length, the questions of the filing unit and rate schedules, which lead to marriage penalties, bonuses, or both under a system of progressive marginal tax rates. These analytic facts and various rhetorical characterizations of them have played a role in the sexual fiscal politics of many countries worldwide. Yet, the marriage penalty and its cognates, a powerful psychopolitical element in the United States and elsewhere, has almost nothing to do with another effect, which exerts a real coercive force on women worldwide: the *secondary-earner bias.*

Once you have joint filing, the question – an accounting question in the first instance – arises as to whose income to put first in the calculation of household income and taxes. Suppose, for example, that Harriet in the running example considers going to work outside the home. Given that Ozzie is already working and most likely not thinking of taking any significant time off, Harriet's first dollar will be taxed at 20 percent. And here is a place where the simplification of this chapter matters, because many U.S. spouses will see their first dollar taxed at 50 percent or more, and the number can approach 100 percent in some lower-income households, when one considers the costs of the loss of various means-tested benefits, or programs that depend on a putative recipient's other available means of support (McCaffery 1993a, 1999; Shaviro 1999). Contrast that with the "first" or primary earner, who always enters the workforce in the zero bracket – and for whom this zero bracket gets bigger, in the case of joint filing (or, indeed, in the case of most separate filing systems, historically and worldwide, for primary earners with nonwage-earning spouses). Note that this effect does not depend on the precise rate accommodation for married couples, nor does it depend on whether there are marriage penalties, bonuses, or both. The secondary-earner bias comes about simply and strictly because of joint filing. In a system of joint filing with aggregation, there can be only marriage penalties; in one with income splitting, only bonuses; but in both – and indeed in all – cases where husbands and wives are added together by the tax system, the secondary or "marginal" worker will see his or her labor income taxed at a rate bracket dictated by the "primary" worker's income. If Harriet goes to work, given that Ozzie is earning $40,000, her first dollar will be taxed as the couple's 40,001st one. The effects can be dramatic, as we shall see next, and there is plenty of evidence that the discouragement of second workers, in whole or in part, in at least certain countries – the United States, Germany, and Japan foremost among them – is and has been quite deliberate.

Of course, the language and rhetoric of "primary" and "secondary" can be offensive, and it is increasingly common for wives to have higher incomes than husbands. Yet, any attempt to avoid a sexist language – putting the woman "second" – can get in the way of understanding and opposing a sexist reality. "Marriage penalties" and "bonuses" have a great deal of salience, and arguments for valuing stay-at-home spouses have clouded the problems of secondary-earner bias. Yet,

looks abroad and through time indicate that powerful decision-makers have been generally aware of the inducements for second earners within households to enter the paid workforce, or not, and have willingly used fiscal policy as a tool to shape society in their preferred ways.

A NOTE ON THE KIDS: CHILD VERSUS CHILDCARE CREDITS

A key distinction is between tax relief designed to lower the burden of taxation for the presence of children – relief that benefits all households with children, whether or not both parents work outside the home – and provisions for childcare, which benefit just the families with needs for paid third-party care, typically meaning dual-earner households. A large and intensifying theme in the United States has been the tendency to benefit children, as by per-child credits, and thereby to encourage stay-at-home spouses. At the same time there has been a reluctance to do anything distinct or special for households using paid care, thereby not specifically helping paid market working mothers (McCaffery 1997). Where there is childcare relief, it tends to be geared toward lower-income households, introducing an important class dimension into the analysis: a thought that poor wives and mothers ought to work, but rich ones ought not.

Germany has a similar pattern to the American one of benefits for one-earner households, child benefits not tied to dual workers, and means-tested programs (Duggan 2003; Henneck 2003), all earning it a reputation as a strong "male breadwinner model" society (Palme 2005).

France, in contrast, which has a family-based tax system to reward and encourage large families, also has a series of provisions meant to enable dual-earner households, especially working mothers. For example, France offers generous parental leave options and family allowances. These allowances are intended to replace wages and, thus, reward a baseline salary for both spouses (or at least encourage the wage-earning spouse to take time off and care for his or her children), rather than serving as payment for motherhood, per se, as in Germany or the United States. A larger portion of French women are employed full-time than American women, apparently because of the availability of high-quality and affordable childcare: 25 percent of 0–2 year olds and 95 percent of 3–5 year olds are in public childcare (the lower number for younger children related to the generous leave policies), whereas 78.8 percent of women in the peak childbearing years, between ages 25 and 39, are employed. Still, in recent years in France, means testing has increased, which may actually and ironically cause some low-income families to decide to have a stay-at-home parent so as not to forego benefits – once again, the loss of such benefits acting like a tax on the working poor. In addition, France offers either parent paid parental leave until the child is three years old, although women are virtually the only ones to take such leave (Henneck 2003). Thus, from a Scandinavian vantage point, even with the generous state-subsidized childcare and the prevalence of market-working mothers, France gets labeled as a "male breadwinner model," just like Germany (Palme 2005).

Italy has perhaps the strongest approach to keeping mothers at home: parental leave for working women can last up to eight years, but childcare for infants and

toddlers is locally controlled and highly inconsistent, thus incentivizing women to stay home. In addition, maternity leave is mandatory for the first five months after childbirth at 80 percent of prior earnings. Thereafter, there is parental leave of 30 percent of earnings until the child is eight years old (Henneck 2003).

Through slightly different fiscal mechanisms, the United States, France, Italy, and Germany each manifest a goal of facilitating parental care in the home. Many German mothers drop out of the labor force after the leave period expires; for instance, of West German mothers taking leave in 1990 and 1992, about half did not return to work (Henneck 2003). Tax matters.

NOT JUST THE INCOME TAX

As if all of the previous discussions were not enough, one cannot consider the full effects of fiscal policy on childbearing, household formation, and the sexual division of labor by looking at the income tax alone, even supplemented with reference to childcare mechanisms inside and outside the tax system. In the United States, once again, an extremely large and important tax system is the payroll tax that funds Social Security and Medicare. And here, yet again, one-earner families are large winners, whereas two-earner ones are large losers. Non-income-earning spouses receive benefits based on their spouses' paid work efforts, a policy dating back to 1939. Yet, this then means that, in the majority of two-earner households, the "second" earner is paying a pure tax, with no offsetting benefit in his or her benefits profile, because he or she would get these anyway, as a spouse (McCaffery 1997).

The analysis could continue. Employer-provided "noncash" or "fringe" benefits, which now account for a large share of compensation in America (and worldwide), in large part because of favorable tax provisions, typically are built on and reward a traditional, one-earner model, by extending free or low-cost benefits to stay-at-home spouses, while requiring all workers to accept benefits, even if, on account of their having a working spouse, they do not need them. And so on: governmental benefits and burdens of all sorts must be examined with some considerable care to unearth all of the biases and hidden coercive elements involved.

THE SUM TOTAL

Notwithstanding the considerable complexity touched on in the prior sections, this summary only suffices to scratch the surface of the role for sex and other cultural norms and biases in fiscal systems. In sum, in the United States there are severe marriage penalties affecting the working poor, on account of the loss of benefits as one enters the lower middle class. Marriage is very costly among the poor, who can least afford the price. In the middle-income classes, the secondary-earner bias is severe. And among the upper-income classes, the incentives for a traditional male-breadwinner model are clear.

There is plenty of evidence that these biases have been noticed worldwide. In the wake of World War II, the United States was influential in setting global tax policy (see Brownlee, Chapter 14), and, therefore, many countries adopted the American solutions. Yet, after a few decades, other nations discovered that

they could not afford them: the pressure on women to work was great, and this revealed the biases in the American way (European Communities 1985). Hence, countries reverted to separate filing, which mitigated the secondary-earner bias. Still, these nations have tended to feel some remorse over the higher taxes paid by one-earner families – although this is the flip side, and necessary correlate, of eliminating the secondary-earner bias – and so they have instituted one-earner tax relief (Pechman and Englehardt 1991; OECD 2005). Some countries, however, seem to relish the traditional male-breadwinner model, such as Germany and Japan. Others try to back off of it, but with unclear effects, like France and Italy. Still others try to create brave new worlds, like the Scandinavian countries, but, absent a full and deep exploration, there is little reason to have confidence as to the net effects. Everywhere, countries seem haunted by the ghosts of the past, and by norms with superficial appeal but little connection to anything that seems really to matter.

THREE THEMES

In this section, I briefly return to the three themes noted at the outset, each of which has been advanced in the prior analytic section.

THE FOG OF TAX

I take it that there is little reason to expound any more on the "fog of tax;" I suspect that most readers came into this chapter with some sense of the dizzying complexity of the subject matter, and that that attitude has only deepened. And, as noted throughout, we have only scratched the surface. The EC Report in 1984 commented tersely that "[t]here are a bewildering variety of methods for taking a taxpayer's family and personal circumstances into account in the calculation of tax liability" (European Communities 1985). Indeed. No two countries seem to approach the matter in quite the same way, and there is no doubt, in the scholarly and political commentaries on point, that confusion abounds.

RHETORICAL MANIPULATION AND COGNITIVE ERROR

The complexity of the subject matter combined with some difficult abstractions, and strong political motivations, has meant that there has been a great deal of room for rhetorical manipulation as well as flat-out error. The OECD, for example, seems simply to misunderstand separate filing, confusing the U.S.-style "married, filing separately" with "optional separate filing," as detailed earlier. Neutralities and equities are explored using observable, monetary income, consistently missing the facts that traditional households with stay-at-home spouses have a large and important store of invisible, imputed income – often, indeed, encouraged by the tax system – that is not being taxed. Consider three quick case studies.

One comes again from the United States. The conservative *Contract with America* and other events in the early 1990s put the subject matter of "marriage penalties" in the tax system on the front page of many newspapers and high in the public

political consciousness. Yet, the only solutions ever enacted, under both Democrat President Clinton and Republican President George W. Bush, have been in the direction of child, not childcare, relief and a doubling of the rate brackets: solutions that not only eliminate marriage penalties, but also increase marriage bonuses and exacerbate the secondary-earner bias. Child, not childcare, tax credits also help all couples with children, with or without working spouses or the need for paid third-party care. In the wake of *Taxing Women's* publication, I was honored to see that the book led to some consideration of optional separate filing, which, as we have seen, would eliminate marriage penalties without also increasing marriage bonuses. My honor was short-lived: conservative forces, led by Phyllis Schlafly of the Eagle Forum ("Leading the pro-family movement since 1972" is their motto) mounted a fierce counterattack, protesting that to do anything that helped only two-earner families would encourage working mothers and thus harm children. Once again, we see the effects of a baseline: the biases against two-earner families are deep and entrenched, but are now taken for granted. Schlafly was able to isolate a political and rhetorical focus on the change and argue that it was unfair not to help traditional one-earner families. And so the United States has continued to do nothing particular to reverse decades of bias against the most common model of married households today – America is no Scandinavia.

Another interesting example comes from New Zealand in 1960 (Jones 2005). New Zealand had retained the British, overtly sexist "aggregation" model, in which wives' income was simply added atop their husbands', filing together under a singles' rate schedule. In part because this is a harsh model with a severe secondary-earner bias, the tax system evolved long ago to have a generous "working spouse" exemption that meant that only a small percentage of New Zealanders were impacted by aggregation: high-income ones with spouses who also had high incomes. Still, there was a broadly popular movement to repeal aggregation and move to a purer separate filing system. Proponents of change were able to exploit the rhetoric of hurting modern, two-earner families and women, in order to benefit a comparative handful of the wealthiest.

A similar drama seems to be playing out today in Canada (Kesselman 2007). This country has long had a system of separate filing. However, of late the bias against one-earner families has become more noticeable, and there is a movement afoot to move toward a full or partial system of income-splitting – just like the United States has. Although it is easy to see that such a move would create secondary-earner biases, perhaps creating or exacerbating patterns of sexual discrimination in the workplace (McCaffery 1993b), the proposal seems to have attracted a great deal of support north of the border, including from the Green Party. Politics, fiscal sociology, and flat-out confusion make for strange bedfellows.

ELITES AND EFFICIENCY

The three case studies just noted illustrate my third and final theme. In the fog of tax, with confusion swirling about and multiple characterizations possible, change is hard. Reforms responding to salient rhetorical characterizations often work at cross-purposes. Predicting the direction of change or the net effects of any one

element of the system in isolation becomes all but impossible. And in the swirl of confusion and complexity, it is most often the case that one of two types of "winners" prevails.

One is elites, who always have advantages when it comes to manipulating the political process, and who have the time, resources, and incentives to exploit them. For example, changes in America in the family arena, ever since 1948 and arguably before, have helped traditional, high-wealth, one-earner families over all competing models, even though this is a model that fits fewer than 10 percent of American households. The lower classes are left to fend for themselves, on scraps of "workfare," existing in a growing universe of single-parent households altogether outside the vaunted American "dream" (McCaffery 1999). Meanwhile, the middle classes are left to scrape on by, while the wealthy traditional one-earner families continue to prosper. This seems also to be true in Germany and Japan, two wealthy nations. The New Zealand and Canadian examples also illustrate how wealthy actors can use rhetoric of family and fairness simply to reduce their own taxes.

The chief counterweight to elite private actors seems to be the macroeconomic needs of the state. Thus, where it seems important to get women into the workforce, to drive up national income or to maintain wages at times of low unemployment, tax policy wearing a family-friendly face can come to the rescue. So, too, with natalist concerns, which seem to form an explicit backdrop in Germany and France at least.

Absent far more and far deeper exploration into individual countries' stories, it is hard to say much more, or to conclude that the apparent counterexamples of the Scandinavian countries, in fact, reflect richer substantive notions of equality between the sexes and accommodation of different household forms. Yet, it does appear to be the case that, given the complexity, confusion, and relative advantages of the elites in finding ways to further their private ends, that fiscal policy is very often a hodgepodge, with different mechanisms pointing in different directions. Thus, for a large set of examples, although separate filing eliminates the secondary-earner bias and encourages a model in which men and women share time both at home and in the paid workforce, the panoply of benefits to one-earner families in countries with separate filing (Pechman and Englehardt 1991; OECD 2005) – which bonuses to one-earner households are, of course, penalties on two-earner ones – reintroduce some if not all of the biases. Countries worldwide, in embracing fiscal tools to manage and shape households, have woven tangled webs.

CONCLUSION

We are born free, but are everywhere in chains, as Rousseau taught us. The strongest of chains are those emanating from our households, where we were born and raised, as Freud taught us. States and state actors, who have featured so prominently in most of the pages of this volume, have figured all this out. They have taken their power, where they have found it – and a more enduring, frequent source of power than even that of musket and missile has been the power of the fisc, to tax and spend – and used it to shape household and social life, consciously and unconsciously. Once in place, the fiscal choices have been hard to change: indeed, they are

hard even to see or understand. Social choices and constructions linger, shaping lives in ways barely seen. Confusion and complexity form a breeding ground for narrow interest-group politics, continued incremental reform, and the lingering chokehold of the status quo.

Given what nations have done with the tools of fiscal power, it is hard to be sanguine about keeping those tools in their hands. Although there can be no naïve neutrality, perhaps it is time to get the sex out of fiscal policy. However, an indispensable step toward that lofty goal is to get the sex into fiscal sociology, as a legitimate and deeply important tool for understanding where we are now and where we could be tomorrow with a little more thought and enlightenment.

14 The Shoup Mission to Japan: Two Political Economies Intersect[1]

W. ELLIOT BROWNLEE

INTRODUCTION: AN AMBITIOUS MISSION

Between 1945 and 1952, during the military occupation of Japan, the administration of President Harry S. Truman undertook a restructuring of Japan's tax system. The most visible aspect of this effort was the so-called Shoup mission to Japan. On May 10, 1949, General Douglas MacArthur, the Supreme Commander for the Allied Powers (SCAP), brought to Japan a group of American tax experts, under the leadership of Carl S. Shoup, a distinguished professor of economics and public finance at Columbia University. SCAP charged the Shoup mission with the task of studying the Japanese tax system and making recommendations for its comprehensive reform. Three months later, the Shoup mission filed an extensive report that surveyed the Japanese tax system and made numerous recommendations (Shoup Mission 1949a, b). The mission was the most ambitious project ever of American experts to transform a national tax system, either at home or abroad. For both the Truman administration and the Japanese government, the stakes of the mission's work were high. Both assumed that comprehensive tax reform in Japan, just as in the United States, could influence economic stability, shape the course of economic development, reconfigure democratic institutions and practices, and advance the strategic, international interests of liberal democracies. Consequently, the background, recommendations, and effects of the mission provide a window into the political economies of both the United States and Japan.

POLITICAL ECONOMIES IN NATIONAL CRISIS

National crises – crises of war and economic instability – heavily shaped the development of tax systems during much of the twentieth century.[2] In these crises, political leaders faced issues that went far beyond the financial problem of meeting demands to increase government spending. The great crises – which often involved

[1] I am grateful for the assistance of Steven Bank, Andrew DeWit, Laura Hein, Ide Eisaku, Kathryn James, Malik Martin, Edward McCaffery, Iju Morinao, Jinno Naohiko, Sekiguchi Satoshi, Joseph Thorndike, Dennis Ventry, and the editors of this volume. (In this chapter I observe the convention of listing a Japanese surname before the given name.)

[2] On the United States, see Brownlee 2004.

the meaning or survival of the nations involved – prompted discussions and often conflicts over national values and the nature of the social contract. In the process, the great crises at times intensified existing ideological and distributional divisions within societies. This was especially so for the major wars of the twentieth century. They required huge sacrifice of lives as well as treasure, and consequently they had especially great potential for exacerbating social division. In response, in each of the major belligerents in the world wars, powerful architects of wartime regimes introduced tax systems that aimed to do two key things: (1) centralize fiscal power and (2) provide tax relief or expand benefits for those sectors of society whose support was necessary to prosecute the war efforts. Although the major powers took institutional paths of finance that were superficially different, all of them centralized and redistributed tax burdens and benefits in ways designed to advance their war efforts. None of the major powers taxed in a fashion that was exceptional in any fundamental way.

Comparison of the tax histories of the United States and Japan during World War II illustrates the essential similarity of the various national approaches to taxing for total war in the twentieth century. In these two particular nations, initial conditions, in a path-dependent fashion, reinforced the institutional logic of centralization of fiscal power and strategic tax relief to produce striking congruence of both tax function and form.

In both nations, a sharply progressive income tax provided the core of wartime taxation. To some extent, that was a consequence of the fact that both nations had had income taxes in place well before World War II. In Japan, an income tax had been a distinctive feature of its national taxation since the unification of the nation under the Meiji Restoration. The United States enacted its first major income tax slightly earlier, also during an episode of national consolidation and national-state building, the American Civil War. Both nations designed their taxes after a close examination by experts of tax ideas current in Western Europe, particularly in Britain and Germany.[3] During World War I, the United States made a highly progressive income tax, including a steep levy on corporate excess profits, its major source of tax revenue. Japan relied less heavily on income taxation during World War I but closely tracked the American experience and acquired additional administrative and political experience with the tax.

During World War II, both nations expanded progressive income taxation as the primary means of fiscal mobilization. Japan did so in 1940, and the United States followed suit in 1942. Both deepened their income taxes, reaching substantial new populations through collection at the source. While so doing, both nations made their fiscal systems substantially more progressive than before the war. Both nations used progressive income taxation, on the one hand, to assign war costs to the most productive sectors of the economy and, on the other hand, to strengthen popular support for wartime sacrifice of lives and treasure. The wartime income tax in the United States imposed a dramatically progressive rate structure. In Japan, the increase in progressivity was less marked, given the reliance on a proportional

[3] For linkages between Japan and Germany, see Shiomi 1957: 114–15. Ikeda 1957: 161–5, pays attention as well to Japanese study of the British income tax.

rate structure for the regular income tax, but a progressive surtax climbed steeply, reaching a top marginal rate of 65 percent. In addition, an excess-profits tax imposed progressive rates, graduated from 10 to 40 percent. And the Japanese government used a major portion of its income tax revenues in a progressive fashion, subsidizing the least wealthy prefects in the nation to help maintain social order in the areas of the nation that accelerating industrialization had most disrupted. At the same time, however, both nations offset somewhat the progressiveness of their income taxes in order to favor capital formation and retain the support of their business infrastructures. For Japan, Jinno Naohiko has written: "The shift of taxation onto the modernized sector planned in the 1940 tax reform was delicately balanced against the system of incentives" (Jinno 1999: 228). He would have been correct in saying the same thing about the United States. In their combinations of progressive income taxation coupled with capital-favoring tax expenditures, Japan and the United States crafted markedly similar wartime finance systems. In both nations, wartime crises became the occasions for strengthening national states. And, in both nations, architects of war found similar ways to manage the mutual interdependence of the "tax state" and the market economy.

The similarity of the wartime tax systems in the United States and Japan helped account for the similarity of some the economic stresses facing the two nations during the early post-war period. The economic situations of the two nations were, of course, fundamentally different. The victorious, remarkably unscathed, and hugely productive United States emerged from the war as the world's preeminent economic power, whereas the Japanese war economy, as Jerome Cohen wrote, "had been starved, pounded, and beaten virtually to its knees by mid-summer of 1945" and then "came to a standstill upon surrender" (Cohen 1949: 417). But both nations experienced severe post-war inflation, and in both nations the inflation interacted in a stressful fashion with the progressive rate structures of income taxes. In both the United States and Japan, "bracket-creep" — and bracket-leap — created problems for all taxpayers, many of whom would not have been paying income taxes without the inflation, and most of whom already found the inflated prices of goods and services daunting. At the same time, the increases in effective tax rates inhibited investment and the growth of productive capacity that could expand output and help relieve inflationary pressures.

Following World War II, the tax systems of the two nations converged further during two new, intertwined crises: the reconstruction of Japanese society and the prosecution of the Cold War. The early American occupation reformed the Japanese tax system along New Deal lines as an important part of a larger program of social democratization. In 1946, SCAP arranged the enactment of a stiff progressive tax on capital in order to reinforce the early occupation's effort to dissolve the *zaibatsu* groups. In 1947, SCAP replaced what had been the schedular personal income tax with one that consolidated incomes, dividends, and interest in its base and imposed a more steeply graduated rate structure. The marginal rates reached from 20 to 85 percent at the top of the scale. However, later in 1947 and into 1948, the intensification of the Cold War led the administration of President Harry S. Truman to shift its Japanese tax policy to place greater emphasis on fighting inflation and stimulating economic recovery than on democratization. The new

tax emphasis would, the administration hoped, promote higher rates of Japanese savings and capital investment, particularly in Japanese export industries. In 1948, as part of the new fiscal program, the Treasury and SCAP jointly organized a mission of tax experts, with Carl Shoup as its director, to make recommendations for comprehensive, fundamental reform of the Japanese tax system.[4]

THE SHOUP MISSION: THE AMERICAN SETTING

In August 1949, barely more than three months after Carl Shoup stepped off a military transport in Tokyo to launch his mission, the occupation authorities published Shoup's bilingual, four-volume report on the Japanese tax and fiscal system. The scope of the report was huge, covering the complexities of Japanese at all levels of government; its documentation was highly detailed; and its recommendations were intricate.

It is stunning that Shoup and his colleagues were able to accomplish so much, so swiftly, especially because none of the members of the mission had any particular expertise in Japanese taxation. Yet, in effect, American economists had been working on what became the Shoup report for well over a half-century. Shoup and his colleagues based their report on a three-generation-long tradition of mobilizing systematic economic knowledge to reform tax policy in the face of economic crises.

In the late nineteenth and early twentieth centuries, during and after economic crises, the founders of this tradition sought to enhance the relationship between the market economy and what Joseph Schumpeter called the "tax state" by (1) strengthening both government and civil society by redistributing tax burdens according to "ability to pay"; (2) deepening public confidence in taxation and thus promoting voluntary taxpaying by energizing democracy at all levels of government; and (3) increasing the economic efficiency of the tax system by (a) encouraging reliance on income taxation over the existing systems of sales and property taxation and (b) heading off radical alternatives. These founders worked closely with governments, first state and local and then, particularly during World War I, national as well. A need for huge revenues for mobilization, popular enthusiasm for "soak the rich" taxation, and worries both within government and business circles about the impact of wartime taxation on prices, profits, and productivity led to a leap in governmental demand for public finance economists, among them Edwin R. A. Seligman, a professor at Columbia University, and his most accomplished student, Robert Murray Haig, who joined Seligman at Columbia as a faculty colleague in 1912.[5] Haig, who served in the Treasury during the war, focused on repealing the wartime excess profits tax and reforming the income tax in ways that would make the tax more efficient economically (Brownlee 1990: 416, 424–25). Haig concluded that the income tax had created significant economic distortions, particularly in taxing capital gains, through its highly progressive rate structure. Haig also found fault with what he regarded as the excessive and increasing number of deductions

[4] On the "reverse course" shift of tax policy within the Treasury and SCAP, see Brownlee 2007: 159–65.

[5] On Seligman and "ability to pay" doctrine, see Mehrotra 2005a, b. On the history of the "ability to pay" doctrine in the United States, see Brownlee 2006.

and exemptions, and saw them as the results of lobbying by interests seeking to mitigate the impact of highly progressive tax rates. These special privileges within the tax code, he believed, were economically inefficient and unfair, weakening public confidence in the fairness of the new tax system. The solution, Haig believed, was twofold: reduce high marginal rates, and broaden the base by eliminating deductions and exemptions. In thinking about base broadening, Haig developed a novel definition of income to guide the process. From the standpoint of economic efficiency, the income tax ought to reach all income: "the money value of the net accretion of one's economic power between two points in time" (Haig 1921). He hoped this concept would catch hold among economists and policy makers and form the basis for new, comprehensive base for income taxation. Haig's rigorous approach to defining the base of income taxation had no significant, immediate impact on federal taxation, but it did win support as a guiding principle from technocrats within the Department of the Treasury.[6]

During the 1920s, both economists and the Treasury paid increasing attention to international taxation in their efforts at postwar cleanup. The huge and largely successful financial effort of the United States during the war and the growing financial stake of Americans in the world motivated American experts to increase their export of advice. Of concern were nations in debt to the United States – particularly those, like France, that were especially vulnerable as a consequence of the U.S. policies of high tariffs, rapid return to the gold standard, and repayment of World War I debts. As American experts became more involved in international tax reform, they concentrated more on promoting U.S. economic interests and increasing the efficiency of global markets than on promoting social justice. However, an interest in distributional equity did not disappear from the intellectual agenda of American experts. Often, they regarded promotion of an equitable tax system as an effective means of increasing public confidence in government and, thereby, of increasing the fiscal capacity of government.

Robert M. Haig played a major role in this growing interest in the organized export of public finance ideas. During the winter of 1925–6, Haig launched an ambitious study at Columbia: a survey of "social and economic developments in France since 1918." Over a period of about four years, he organized nearly a dozen historians, economists, and political economists, largely faculty from Columbia, and fifty staff members into a project that ultimately produced seven volumes. Haig, with three assistants wrote the first volume, *The Public Finances of Post-War France* (Haig 1929). Like the Shoup mission, the Haig project in France was in large part an effort to help restore the fiscal and economic strength of an important nation and, in the process, to help stabilize a world economic order. An assistant to Haig was one of his Ph.D. students, Carl Shoup. Of the three assistants, Shoup, who spent seven months in France, contributed most heavily to writing the book. Thus, more than twenty years before Shoup traveled to Japan, he went on an expedition to a war-ravaged major power to explore its postwar fiscal trials – but not to criticize the broader context set by American foreign economic policies.

[6] On the post-World War I support in the Treasury for both base-broadening and cutting the highest marginal rates, see Brownlee 1996: 99–101, and Murnane 2004.

PREPARATION FOR THE MISSION

Shoup had been born in San Jose, California, in 1902 and grew up in the affluent family of his father, who became president of Southern Pacific Railroad in 1929. Shoup graduated from Stanford in 1924 with undergraduate and law degrees. He was uncertain about either a business or a legal career, moved to New York, where he worked briefly as a political reporter for *The New York World*, and then entered graduate school in economics at Columbia. Shoup's interest in finance and politics led him to studies in political economy. Haig was at the height of his powers, and Shoup was drawn to his intellect and energy. In intense graduate work with both Haig and Seligman (who did not retire from Columbia until 1930) and then in his faculty career at Columbia, Shoup situated himself squarely in the tradition of analysis and moderate advocacy that Seligman and Haig had helped pioneer.

Within the Haig project on France, Shoup specialized in the study of the French sales tax and went on to write his dissertation on that subject. In 1930, a year after the publication of Haig's volume, the dissertation became a book, *The Sales Tax in France*. Shoup analyzed a 1 to 2 percent turnover tax (a tax on gross receipts from almost all business transactions) that the national government had adopted in 1920. Shoup expressed deep doubts about both the vertical and horizontal equity of the turnover tax. However, Shoup did not second-guess the French government by criticizing its fundamental policy choice. In his view, the sales tax had developed in what later generations might call a path-dependent fashion, shaped heavily by the failure to adopt a significant income tax prior to the war, by the huge demand for new tax revenues during both the war and postwar periods, and by the powerful hostility of French conservatives to income taxation. He abstained from advice on fundamental, structural reform, but he ended his book on almost a wistful note: "Forced on the French people by results of the war, the tax now has a hold on them which they might regret the more could they realize what it would mean to start afresh and build up their tax system free from the urgent pressure for ready money." For the moment, Shoup could only dream about an opportunity to make sweeping changes in tax policy (Shoup 1930: 354).

Shoup joined the faculty of the Columbia School of Business (and then later, the Department of Economics) and stayed with the topics of sales taxation and the financial health of nations in debt to the United States. Almost immediately, he plunged into his second project to export public finance advice. In 1931 and 1932, he and Seligman visited Cuba and reviewed that nation's tax system, which relied heavily on various forms of sales taxation. After Shoup conducted the lion's share of the research, he and Seligman made a series of recommendations to increase the capacity of the Cuban government to meet its payments on debts to American banks and public works contractors. Seligman and Shoup were much less restrained in giving advice than Haig and Shoup had been in France. The Seligman–Shoup recommendations entailed a thoroughgoing and complex reform of the Cuban tax system. "The details of this program are interconnected," Seligman told the press, "and we can take no responsibility for any one of the recommendations unless it is considered in its proper connection with all the others." The goal, he added, was not so much to meet an immediate crisis as "to shape a firm foundation that

would last for years to come" (New York Times 1932). In summary, this complex program entailed a reduction or abolition of numerous sales taxes coupled with "a centralized tax on real estate levied on rental value, from a personal income tax to be assessed on presumptive rather than actual income, from a tax on the net profits of business enterprises, chiefly corporate, and from an inheritance tax" (New York Times 1932; Seligman and Shoup 1932: 10).[7]

During the early 1930s, Shoup turned increasingly to the fiscal problems occasioned by a new national crisis – the Great Depression. At the same time, he built a large, international network of academics and tax practitioners while serving, between 1930 and 1936, as editor of the *Bulletin* of the National Tax Association. In 1933 and 1934, with the support of that network and substantial funding from the Rockefeller Foundation, he produced *The Sales Tax in the American States* with the subtitle: *A Study Made Under the Direction of Robert Murray Haig*. This was a sweeping survey of a hot topic; things were moving fast. Whereas only three states had sales taxes in place before 1933, in that year alone eleven states enacted and implemented them. Shoup rendered harsher judgments regarding the equity of the sales taxes than he had permitted himself when evaluating French sales taxation. He concluded his book with advice that he had been reluctant to give the French: Try much harder to find emergency taxes that were more equitable in their distributional effects. He pointed to the examples of gasoline taxes, motor vehicle registration fees, inheritance and estate taxes, tobacco taxes, and gross receipts and franchise taxation of corporations (Shoup et al. 1934: 9–11).

In 1934, Shoup shifted to the study of national-level taxation under Depression conditions. Roswell Magill, a professor in Columbia's law school and a Treasury advisor, had been impressed by Shoup's research on the sales tax. Magill brought Shoup to Washington as one of seven consultants on a comprehensive study of the federal revenue system, and Shoup played a central role in organizing the project (Blum 1959: 298; New York Times 1934a; Blakey et al. 1934).[8] The recommendations upon which Shoup and his six colleagues could agree included increasing income tax revenues by lowering personal exemptions and thereby deepening the tax. This measure "would have the advantage, from our point of view," they wrote, "of increasing the number of direct taxpayers and thereby the number of persons having a conscious interest in government." At the same time, the group cautioned against expanding the corporate income tax or excess profits taxation, noting that "the word 'excess' is difficult to define both in a philosophical approach to the problem and in the drafting of a law that is equitable in principle and administratively possible."[9]

[7] On the extent of Shoup's contribution to this work, see "Contract between the government of Cuba and Edwin R. A. Seligman," 1931. Shoup Papers. Cuba Series, Box 2, No. 17. Yokohama National University Library, and Statement of Expenses, Cuban Tax Study, January 23, 1932. Shoup Papers. Cuba Series, Box 2, No. 17. Yokohama National University Library. In 1938, Shoup returned to Cuba, this time with Magill, because Cuba was in trouble once again with its U.S. creditors. See Magill and Shoup n.d.

[8] Carl S. Shoup. "Memorandum to Professor Magill on Federal Revenue System," May 5, 1934. Shoup Papers. F-file, Box #51. Yokohama National University Library.

[9] Ibid, "Foreword"; "Memorandum G"; and "Memorandum Q." On Shoup's proposals for coordinating corporate and personal income taxes, see Thorndike 2005: 377–83.

The recommendations of Magill's group had little direct effect on the tax reform program of the New Deal, except perhaps to offset slightly the influence of advocates of anticorporate taxation like Raymond Moley and Adolf Berle, who had little professional expertise in business taxation. Yet, partly because of Shoup's application of Haig's principles, Shoup's reputation soared within the Treasury and among those economists and attorneys who focused on national tax policy. Contributing as well was the skill he demonstrated in organizing a large, complex project involving contentious issues of national import and contentious colleagues. In addition, he had demonstrated his ability to write reports quickly, and in prose that helped produce consensus, satisfied technicians, and reached wider audiences.

Shoup's performance in the Magill study, and the continuing influence of Haig, vaulted Shoup into a leadership role within yet another collaborative project that was high-profile and well-funded: a two-year survey of taxation in the United States that the Twentieth Century Fund sponsored. The study culminated in 1937 with the publication of *Facing the Tax Problem: A Survey of Taxation in the United States and a Program for the Future*. Haig and Magill, who became Undersecretary of the Treasury while the project was underway, served on the Fund's Committee on Taxation, which set the agenda for the study and prepared the formal recommendations based on the survey. However, Shoup, as research director, crafted the recommendations.

Shoup leaned against expanding the most severely redistributional of the New Deal initiatives and even suggested some reversals. For example, he recommended repealing or significantly reforming the radical undistributed profits tax that the New Deal had enacted as an antimonopoly instrument; replacing the progressive corporate tax rates with a single flat rate; and imposing "only very light taxes on corporation net income" (Shoup, Blough, and Newcomer 1937: 419–420; see also 406–7). In analyzing both the corporate and personal income taxes, Shoup applied a normative framework that placed the objectives of "tax justice" and "social control" in secondary positions. It was within this framework that Shoup recommended moving toward Haig's broad-based formulation of income taxation – what Shoup called in the report "the unified type of income tax." (Shoup, Blough, and Newcomer 1937: 412). Increases in income tax revenues ought to come, he said, not from raising rates at the top but instead from raising "the rates in the middle-income brackets" and lowering exemptions. He proposed building on experience with collecting Social Security taxes in order "to include the smallest incomes that administrative considerations allow." Shoup also recommended an experiment in "taxing imputed income from home ownership and farm produce."[10] The result, in his view: a tax system better designed to promote tax consciousness, which Shoup regarded as "in general a force for good government" (Shoup, Blough, and Newcomer 1937: 421–2; see also New York Times 1937; Thorndike 2005: 500–2; and Blum 1959: 439–51).

Throughout the rest of his career, Shoup continued to stress the value of adopting "the unified type of income tax"; it became the key element in his long-run reform strategy. In the early 1930s, Shoup considered writing a book to advance Haig's

[10] Shoup, "Memorandum to Professor Magill," 413–14.

theoretical conception of the tax, but he set this project aside during his intense work for the Treasury and the Twentieth Century Fund. The refinement of Haig's work fell, instead, to a doctoral student at the University of Chicago, Henry Simons (Simons 1938: 50). In 1937, Shoup read Simons' dissertation and wrote to him, suggesting that he take a look at *Facing the Tax Problem*, which was about to appear. "I think you will agree," Shoup wrote, "our thoughts have been running pretty closely along the same paths with respect to many fundamental issues, although, in several of them, you have carried the analysis considerably farther than I have."[11] Simons's book appeared the next year, and increasingly "the unified type of income taxation" became known as Haig–Simons taxation. Yet Shoup felt that there was more to be done, and during the late 1930s he urged a Columbia doctoral student, William Vickrey, who had worked with Shoup on *Facing the Tax Problem*, to use his dissertation as an opportunity to advance further the model that Haig and Simons had pioneered.[12]

From 1934 through 1949, Shoup worked almost continuously in different capacities for the Treasury's Division of Tax Research. After 1937, Shoup's approach to redistributive personal and corporate taxation, coupled with his practical interest in increasing and stabilizing streams of tax revenue, played particularly well within the Treasury and, gradually, the White House. The post-1937 assault by business, supported by Democrats like Bernard Baruch and Joseph P. Kennedy, on anticorporate taxation pushed administration thinking about tax policy toward Shoup's. And the need for new revenues for military preparedness and then war itself enhanced interest in Shoup's analysis of alternatives for increasing taxes. Meanwhile, Shoup turned his attention to a new, looming crisis: World War II. Shoup's goal was to promote wartime finance that avoided the kind of economic problems that World War I had created.

Three important projects resulted: (1) a book, *Federal Finances in the Coming Decade: Some Cumulative Possibilities, 1941–51* (Shoup 1941a); (2) an assessment of the state of knowledge of its fiscal future and economic effects of the new Social Security payroll tax (Shoup 1941b); and (3) a study, financed by the Carnegie Corporation, of how to determine "the amount of taxation needed to avert inflation" (Shoup, Friedman, and Mack 1943). Taken together, these projects advanced some of what became key aspects of wartime finance: the deepening of the personal income tax, reliance on Social Security's administrative infrastructure for taxpayer identification and tax collection at the source, and restraint in adopting excess profits taxation.

Under wartime conditions, however, Shoup did not achieve any significant success in advancing Haig–Simons taxation. Support for reform along these lines could not stand up to the popular attachment to steep and high progression; to interest-group pressure for relief from such progression via tax expenditures (exemptions and deductions); and to the vested political interest of the tax-writing committees of Congress in protecting and expanding those tax expenditures. Nonetheless, by

[11] Carl S. Shoup to Henry Simons, March 20, 1937. Shoup Papers. Box 392–2. Yokohama National University Library.
[12] This dissertation became Vickrey 1947.

the end of World War II, Shoup had won admiration, particularly within the Treasury, for his efforts to make the American mass-based income tax more productive of revenue, more equitable in a horizontal sense, more efficient in terms of its effects on investment, and more effective as a tool to control inflation.

Consequently, in 1947 Undersecretary of the Treasury A. L. M. Wiggins invited Shoup to "draw up a report that would blueprint a permanent peacetime tax system." With the assistance of William Warren, a tax specialist in the Columbia law school, and the benefit of informal advice by Haig, Shoup proposed taking advantage of the postwar "peacetime dividend" to undertake a massive reform of the federal tax system along Haig–Simons lines. The elaborate set of reforms he recommended would have raised a number of key tax rates, but the overall revenue reductions he also proposed would have reduced the potential for political backlash. Key provisions Shoup advocated included income averaging, treatment of capital gains as regular income, taxation of unrealized capital gains at death through an accessions tax, reduction of high progressive rates, and integration of personal and corporate income taxation. However, in early 1948, the Congress, over a veto by President Truman, reduced the peace dividend through across-the-board tax cutting. The Treasury abandoned its project but thanked Shoup for the "valuable groundwork" he had contributed for future comprehensive reform.[13]

Just a few months later, SCAP and the Treasury tapped Shoup for the mission to Japan. The Treasury had been impressed with Shoup's efforts to use taxation to control inflation and expected the same in Japan. More specifically, the Treasury wanted reforms that would enhance Japan's capacity to generate budgetary surpluses while avoiding any significant redistribution of income among major social groups, which the Treasury feared might lead to an increased sense of social entitlement and further inflationary pressure. Within those constraints, the Treasury also wanted Shoup's mission to promote economic recovery. SCAP, meanwhile, hoped that the mission would find ways to continue to advance the goal of social democratization.

THE SHOUP RECOMMENDATIONS

The prospects for reform exhilarated Shoup. He seemed to have a free hand to advance the Haig–Simons model of "unified" income taxation, and he was able to handpick his team for the mission. He included as key members his favorite student, William Vickrey, who was now a faculty colleague at Columbia, and two tax attorneys who had worked closely with him in the Treasury – William Warren and Stanley Surrey, a young professor at the University of California, Berkeley. Given what Shoup and his colleagues believed to be the power of SCAP over the

[13] Carl S. Shoup to A. L. M. Wiggins, April 12, 1949. Shoup Papers. Box 391–3. Yokohama National University Library; A. L. M. Wiggins to Carl S. Shoup, July 28, 1948. Carl S. Shoup Papers. Box 391–3. Yokohama National University Library. See also Shoup, Carl S., and William Warren. December 24, 1947. A Suggested Outline for a Peace-Time Federal Tax System. Shoup Papers, F-file "Federal Tax Reform."

Japanese government, they saw an opportunity to accomplish far more than he and like-minded reformers had ever had in the United States or overseas.

Shoup arrived in Tokyo in early May and within six weeks he wrote to Haig to tell him that "the general nature of the problem we are facing begins to be apparent." On the one hand, "both in the law and as seen through the figures on tax collections, the Japanese tax system is one of the most modern in the world." The income tax, he explained, was "on a pay-as-you-go basis, complete with withholding at source (including interest and dividends) and quarterly estimates of income not subject to withholding." On the other hand, "when we come to how the system works in practice, we find that 'self-assessment' is largely just a name for arbitrary assessment by the tax office." Shoup admitted that no one knew whether or not a more transparent process would produce more income "chiefly because the taxpayers have no accurate accounting records." He was confident, however, that big business evaded taxes through "elaborate systems of books designed to conceal rather than reveal." In looking for solutions, Shoup rejected "moving into extensive indirect taxation" because he believed "evasion of the indirect taxes seems to be at least as extensive and maybe more so." He had decided that at the core of the problem was a vicious circle of excessively high rates and comparable levels of evasion. "How to break this circle is one of our first problems."[14]

In just a few short weeks later, Shoup believed that he and his colleagues had solved this problem, as well as many others. In August, he announced the mission's final recommendations. To help "break the circle" in which he believed income taxation was trapped, Shoup proposed reducing the top marginal rates of personal income taxation from 85 to 55 percent. Shoup criticized the high rates of the wealthiest, maintaining the rates created incentives for evasion, particularly by self-assessed filers, and therefore weakened income tax revenues. In addition, reducing the top rates would be economically more efficient: Lower rates would "leave the individual with a very substantial incentive to increase his income" (Shoup Mission 1949a: 83). At the same time that the Japanese government reduced the top rates of personal income taxation, it should, Shoup urged, broaden the base, not only through improved compliance, but also by taxing realized capital gains as ordinary income, making certain that all interest income was taxed, and severely restricting tax exemptions and deductions. In Shoup's view, a personal income tax with a broader base and greater horizontal equity would win the public's trust. In turn, that trust, by increasing voluntary compliance with tax law and increasing the flow of tax revenue, would enhance the fiscal strength of the nation (Shoup Mission 1949a: 16–19).

A horizontally equitable system would, in the view of the members of the mission, also promote economic efficiency. Shoup and his colleagues did not provide any extended discussion of the possible effects of their tax program on economic growth and development, but throughout the report they mentioned efficiency effects. In 1989, Shoup stressed that the mission had avoided proposing specific incentives to economic growth. "How did we know," Shoup asked, "what kind

[14] Carl S. Shoup to Robert M. Haig, June 16, 1949. Robert M. Haig Papers. Butler Library, Columbia University.

of economic growth was desirable?” Because “we did not know which economic activities were to be preferred,” the mission had sought instead a tax system that was “economically neutral.” The mission had faith in the “marketplace” and the productive capacity of Japan, and “wanted to be careful that the tax system did not impede spontaneous economic rehabilitation.” Shoup and his colleagues recognized, however, that taxation that was economically neutral would conflict sharply with the Japanese preference for using the tax system to create investment incentives (Ramseyer and Shoup 1989: 2–3).

Within the realm of corporate taxation, a key recommendation was to reduce the normal rate of corporate income taxation to 35 percent and take some modest steps toward integrating personal and corporate income taxation. Also, the mission proposed repeal of excess-profits taxation. In language that Shoup adapted from *Facing the Tax Problem*, he wrote of the extreme difficulty of defining “‘excessiveness’ with the precision that is necessary for a workable tax law” (Shoup Mission 1949a: 105). Finally, the mission proposed a revaluation of corporate assets to take account of wartime and postwar inflation. The intent was to allow corporations to build up depreciation reserves and to avoid paying taxes on inflation-swollen capital gains (Shoup Mission 1949b: 128–31, and Appendix C).

Shoup’s program on behalf of horizontal equity extended to the local level. Localities would move away from depending on “equalization” funds from the central government and develop their own revenue sources. The most important new source would be a prefecture-level tax: a “consumption-type” value-added tax (VAT) on a broad range of goods and services.[15]

Shoup’s recommendation of a VAT for Japan was his first endorsement of such a tax, although he had evaluated the revenue potential for a VAT as early as 1941 (Shoup 1941a: 7, 57–8; Shoup, Friedman, and Mack 1943: 90–1). He had come to appreciate the economic efficiency arguments on behalf of a VAT, avoiding the distortions and inequities unique to a cascading retail sales tax. Immediately after he returned from Japan, Shoup told the National Tax Association that a VAT was “the most economically neutral form of business taxation.” He went on to explain that “it does not discriminate against the use of labor-saving devices (as does any tax on profits); it does not favor machinery over labor (as does a payroll tax); it does not favor the large vertically integrated concern (as does the turnover tax or gross-receipts tax)” (Shoup 1950: 412). He concluded not only that the Japanese prefectures, like the American states, needed independent revenue sources, but also that a VAT was the least bad of the available options. The tax would replace both an even more regressive transactions (turnover) tax, which the national government levied, and a local tax on business income that Shoup believed heavily burdened small, unincorporated shops and factories and was sometimes shifted to consumers. Moreover, the VAT revenues would fund local services, including public health, whose benefits would be distributed progressively. Also, Shoup believed the adoption of a prefecture-level tax would stimulate local democracy as well as expand fiscal capacity, and a regressive tax might be especially helpful in that

[15] The proposal was for a “consumption-type,” subtraction-method VAT. The best explanation of the proposal, including some of its political implications, remains Martin Bronfenbrenner 1950.

regard. He had in mind a process very similar to the one that Charles Tilly analyzes in Chapter 10 of this volume. The initiation of the regressive, locally controlled tax would jumpstart a dialogue between Japanese citizens and what had been very weak prefectural governments. The result of intensified bargaining over tax levels and social provision: invigorated social democracy at the local level.

Shoup's recommendation for a VAT placed him on a policy frontier. Public finance economists in the United States, Germany, and Japan had discussed value-added taxation since the 1920s. Yet Shoup's proposal was, as economist Malcolm Gillis has written, "the first concrete, detailed proposal for value-added taxation . . . in the English language" (Gillis 1991: 32). However, in outlining his program for MacArthur, Shoup claimed that he was not proposing turning Japan into a social laboratory to test out new fiscal instruments. "In our recommendations," he told MacArthur, "we have attempted to adhere to the principle expressed during the interview in your office the day after my arrival – a minimum of experimentation, no 'guinea pig' approach."[16] In 1989, Shoup recalled that in proposing the VAT "we remembered that, but we thought that maybe one new thing would be all right" (Ramseyer and Shoup 1989: 4).

Despite Shoup's comments to MacArthur, and his 1989 recollections, other new taxes that he and his colleagues had recommended were also experimental. Most important, no modern nation, including the United States, had explicitly and comprehensively embraced Haig's concept of the proper base for income taxation. Jerome Cohen, a research associate with Shoup's mission, expressed more accurately the disposition of his colleagues when, a few months later, he described Japan as "an economic laboratory unparalleled in financial history" (Cohen 1949: 125).

Shoup believed that he had an opportunity to apply the principles of public finance that had guided his work throughout his career. At the end of his mission in Japan, Shoup sent a summary of his report to Haig with the comment: "I believe you will discern in the recommendations the pervasive influence of the teachings of Professor Robert M. Haig."[17] Shoup believed Haig's teachings and principles had enough intellectual power to reduce the risks of experimentation to a tolerable level. "We have tried," Shoup wrote to the Department of the Army when he completed his report, "to keep a judicious balance between no undue experimentation and no slavish adherence to the past."[18]

The pay-off could be huge for both Japan and the United States. Shoup declared: "We believe that the Japanese people should have the opportunity to be able to say, within five or ten years, that they have the best tax system in the world." He explained that "We have formulated our recommendations with this aim in mind. The rest will be up to them [the Japanese people]."[19] Shoup also hoped the

[16] Radiogram, SCAP to Vorhees, Taxation Progress Report, August 12, 1949. Box 6369, unmarked file folder. SCAP files, Record Group 331, National Archives and Record Administration (NARA), Washington, DC.

[17] Carl S. Shoup to Robert M. Haig, September 1, 1949. Robert M. Haig Papers. Butler Library, Columbia University.

[18] To West from Shoup, August 24, 1949. Box 6836, file folder: "Taxation." SCAP files, Record Group 331 (NARA).

[19] Ibid.

Haig-inspired program, having been successfully tested in Japan, would catch on with the public elsewhere, including the United States, where Shoup's advocacy of it had failed in 1947–48. Less than a month after he returned from Japan, Shoup was installed as President of the National Tax Association. The topic he chose for his Presidential address was "Tax Reform in Japan." In it, he declared that "my aim is only partly that of describing and analyzing the Japanese system." It was "also to consider whether any of the measures recommended for Japan might be applicable to the United States." And, he went on to tout the value-added tax, among other of his recommendations to the Japanese people (Shoup 1950).

The expert missionaries from America believed they had presented Japan with the means for fiscal salvation.[20] To be saved, however, they had to accept the message without qualification. Shoup declared, just as Seligman had in Cuba in 1939: "All of the major recommendations, and many of the minor ones, are interconnected." He warned that "If any of the major recommendations are eliminated, some of the others will thereby become of less value, or even harmful." The mission, Shoup warned, would "disclaim responsibility for the results that may follow the adoption of only part of our recommendations" (Shoup Mission 1949a: ii).

THE AFTERMATH AND LEGACY OF THE MISSION

The Japanese government, under Prime Minister Yoshida Shigeru, the leader of the Liberal Party, reluctantly agreed to put on the books most of the Shoup recommendations.[21] Yet Yoshida stalled in implementing them, particularly the proposed changes in local finance, and then, after the end of the occupation in 1952, Yoshida's government repealed all of the reforms it disliked. Virtually nothing remained of the Shoup recommendations at the local level, although some important ones survived at the national level. Those that did, such as the revaluation of assets to take account of inflation and the repeal of the early occupation's New Deal-style reforms, were measures that may have a much greater impact on promoting Japan's "economic miracle" than is commonly realized – an impact even greater than the "strategic" tax breaks for corporations adopted by the Japanese government after the end of the occupation. However, the Yoshida government, with its desire to promote capital formation, might well have adopted the broad-based benefits for capital formation as well as the tax breaks had there been no Shoup mission.

What had gone wrong with the project of comprehensive tax reform by some of the best and the brightest of American public finance economists? One might be tempted to leap to the conclusion that the problem was that Shoup and his colleagues, in their enthusiasm for Haig's principles, had departed too far from historically informed analysis. Another distinguished public-finance economist, Harold Groves, who had been trained under John R. Commons in a more

[20] To West from Shoup, August 24, 1949. Box 6836, file folder: "Taxation." SCAP files, Record Group 331 (NARA).

[21] On the negotiations involving SCAP, the Truman administration, and the Japanese government, see Brownlee 2007: 169–72.

sociological strain of public finance analysis, had warned that this might happen. In 1948, the Treasury had interviewed Groves as well as Shoup when selecting a leader for the tax mission to Japan. According to economist Martin Bronfenbrenner, who was a colleague of Groves at the University of Wisconsin at the time, Groves "doubted that any outsider, ignorant of 'things Japanese,' could ever reform the Japanese tax system in any satisfactory or enduring way." Because of such "scruples," Bronfenbrenner recalled, Groves withdrew "his name from consideration."[22]

To be sure, Shoup had a more universalist approach to tax reform than Groves, believing in the applicability of Haig's tax principles to all modern societies. However, Shoup also believed that applying them properly required close attention to social context. In contrast with all of the occupation's other financial missions, Shoup's intensively investigated the historical development as well as the contemporary nature of Japanese fiscal institutions, Shoup and his colleagues consulted extensively with both Ministry of Finance (MoF) officials and the leading Japanese economists of public finance, whose training and experience provided them with a deep understanding of the history of tax institutions. The latter included Tsuru Shigeto and Ito Hanya of Hitotsubashi University, and Shiomi Saburo of Kyoto University.

Shoup relied most heavily on Tsuru, who had received a Ph.D. in economics at Harvard University in 1940, worked in the economics section of the Ministry of Foreign Affairs during World War II, and served as a key economic advisor in the Socialist government of Prime Minister Katayama Tetsu that held power between April 1947 and March 1948. Tsuru was particularly enthusiastic about Shoup's proposals to revitalize local democracy, which Japanese Socialists had traditionally favored. In 1993, Tsuru recollected that "of all the missions sent by the United States to Japan during the Occupation period the Shoup Mission was the most conscientious in the sense that all of the Mission members took great pain in trying to learn complexities, traditional and contemporaneous, of the local conditions before applying modern principles of taxation of which they were at the frontier." He also praised the Shoup report "as a most readable summary of the tax systems in Japan, far superior to, and more enlightening than, the bureaucratic or textbook summaries that had been available in Japanese." He went on: "It is a testimony to the far-sighted wisdom of the Mission that even after forty years the Shoup Report of 1949 is still studied as a reference and guide for tax reforms in Japan" (Tsuru 1993: 16–18, 52–4).[23]

The MoF officials who worked most closely with the mission admired the professionalism of Shoup and his colleagues and were impressed by the extent of their investigations. They appreciated the fact that Shoup and his colleagues, using

[22] Bronfenbrenner, Martin. n.d. *Marginal Economist* (unpublished autobiography). Martin Bronfenbrenner Papers, Rare Book, Manuscript, and Special Collections Library, Duke University, Chapter 14, 17.

[23] On Tsuru's career, see Hein 2004: 88, 251. In 1985, in recognition of the continuing relevance of the Shoup report to understanding Japanese taxation, a team of fourteen present and former officers for the Ministry of Finance published a new translation of the Shoup report. See Shoup 1989: 181–2 and Fukuda 1985.

Japanese interpreters, seized every opportunity to interview both local tax officials and taxpayers, including shopkeepers, fishermen, farmers, factory workers, and miners, with regard to what they understood about the tax system, and how taxes affected their behavior.[24]

Finally, in the Shoup report, the mission struggled to avoid negative cultural stereotyping. However, when Jerome Cohen later wrote about Japanese tax administration, he referred to an "oriental penchant for negotiation, compromise, and bribery in tax matters" and added that "the thought that one should accurately reveal his real income to tax authorities was wholly alien to the oriental mind" (Cohen 1950: 119, 122).[25] No such language appeared in the report. In contrast with Cohen, Shoup was, as the historian John Perry Curtis reported, "struck by similarities between Americans and Japanese." Shoup had confidence that "diligence and civic pride could be tapped" in both the United States and Japan. At the outset of the taxpaying process "the citizen" in both "could be trusted to compute and pay his own tax."[26] Stanley Surrey held the same view. He wrote that "the Japanese already possess the one factor without which all else is meaningless. They are basically an honest people. On this solid foundation they can with patient effort build a proper income tax administration"[27]

Shoup and his colleagues, however, did have to take shortcuts in discussing some important institutional problems. Under pressure of time, they had to gloss over, in particular, administrative and accounting difficulites involved in implementing their most innovative reforms, most notably the VAT. Yet Shoup and his colleagues acknowledged this and took steps to supplement the report. They continued the work of the mission by rendering extensive advice to SCAP staff after they returned home; by making a follow-up visit to Japan in 1950; and by then issuing a second report. In addition, Shoup augmented the SCAP staff with both economic expertise and a passion for understanding Japanese financial institutions. He did so by arranged for SCAP to hire Martin Bronfenbrenner, a promising young economist at the University of Wisconsin, on a two-year appointment to represent the mission, after its departure, in a liaison role between SCAP and MoF. Bronfenbrenner had excellent Japanese language skills, a passion for learning about Japanese society and culture, and excellent rapport with Tsuru and other Japanese tax experts, including officers of MoF. In time, Bronfenbrenner would become the leading American expert on Japanese economic development.[28]

[24] Shoup 1989: 225; Fukuda 1985: 454; and interview with Hara Sumio, Study Group on the Financial Situation, 1955: 13–14. I am grateful for the translation assistance of Dr. Iju Morinao.

[25] Cohen had been a Naval Intelligence Officer who interrogated Japanese citizens for the Strategic Bombing Survey. Cohen also differed from Shoup in his approach to interviewing Japanese tax experts and taxpayers. Cohen regarded the process as interrogation, requiring a style that he described as "firm and at times sharp." Jerome Cohen to Carl S. Shoup, August 9, 1949. Shoup Papers, Cohen Series 1, No. 1, Yokohama National University Library.

[26] Shoup to John Curtis Perry (February 22, 1979), quoted by Perry 1980: 154.

[27] Surrey, Stanley. 1949. Administration of the Individual and Corporate Income Taxes. Box 27, file folder: "Tax Mission-1949 (1)." Stanley Surrey Papers, Harvard University Law School Library, Harvard University.

[28] Carl S. Shoup to Martin Bronfenbrenner, March 10, 1949. Shoup Papers. Bronfenbrenner Series, 1 No. 1. Yokohama National University Library.

The intellect, sensitivity, and energy of the mission, however, were not sufficient to stem the counter-reform movement of the Yoshida government. At the end of the day, the problem was that Shoup and his colleagues had neither fully understood nor had the power to resist the strength of the forces that stood in opposition to much of the Shoup program. SCAP's apparent power, coupled with an unrivalled and unfamiliar opportunity to transform the tax system of a modern nation, had held Shoup and his colleagues spellbound. In that state of mind, they ignored central issues – issues of power and its distribution – that political economy must confront.

At one level, the problem for the mission was that public opinion in Japan never backed Shoup's reforms, despite the mission's direct appeals to the Japanese people and an American-sponsored publicity campaign modeled on the pay-your-taxes campaigns that the Bureau of Internal Revenue implemented within the United States during World War II. The Japanese public tarred the Shoup mission with the broad brush it applied to all occupation policies associated with the severe deflation (and unemployment), which ensued in mid-1949. Although the Japanese people were not inclined to explore patiently the obscure intricacies of the complex Shoup proposals, they clearly perceived two key points. The mission, by accepting the Treasury's anti-inflationary constraints, had not sought to provide significant relief from high taxes either for taxpayers at large or for any important class of taxpayers. And, in proposing the VAT, the mission had flown in the face of powerful hostility to another regressive consumption tax (the transactions tax) that Japanese voters had already demonstrated at the polls. The mission had failed to address the contradiction in embracing both the top-down, paternalistic reforms of the occupation and the primacy of Japanese democracy.

In fairness to Shoup, however, there is evidence that he held out hope for the election of a coalition government, one including Socialists, that would have supported the mission's more innovative reforms, even though they initially became law as a consequence of the uneven power relationship between SCAP and the Japanese government (see e.g. Bronfenbrenner and Kogiku 1957: 346–7). If so, Shoup pinned his hopes on a highly contingent, rather unlikely chain of events, including the interest or success of that coalition government in explaining and selling the VAT as part of a larger program of expanding the power of local government in the realm of social welfare provision. In addition, Shoup failed to recognize that, whatever intelligence chatter there may have been in Tokyo and Washington about the possibility of a new government, such talk probably served mainly to strengthen Yoshida and his Liberal Party, which was in any case growing in popular support. Most crucially, the formation of the People's Republic of China in 1949 and the outbreak of the Korean War a year later led the Truman administration to strengthen its support for the Yoshida government. In turn, Yoshida and MoF acquired greater flexibility in doing what both they and the constituencies of the Liberal Party wanted – delaying and weakening the Shoup recommendations, especially in the realm of local finance. The intensification of the Cold War in East Asia also led SCAP to launch a "Red Scare," purging suspected Communists and further alienating the Japanese Left. Bronfenbrenner became an innocent casualty, based on an earlier, trumped-up accusation and then his team-teaching of a

graduate seminar with Tsuru at Hitsubashi University. His loss to the Shoup team helped to derail the already fragile process of negotiating an effective VAT and a more general transformation of local finance.[29]

The growing power and popularity of the Yoshida government also meant a strengthening of the same kind of alignment – business groups and entrenched political interests within the national government with a powerful, mutual interest in tax expenditures – that had proved fatal to reform along Haig–Simons lines in the United States. Within the American government, the tax-writing committees of Congress were primarily responsible for carving loopholes within the progressive income tax. Within the Japanese government, the responsibility rested with Prime Minister Yoshida and MoF. Yoshida and his finance minister, Ikeda Hayato, displayed what Ito Hanyo, one of the economic advisors to the mission, described as "a growing tendency to reduce the tax burden of enterprise, especially that of big business, in the name of rehabilitation of national economy and the furtherance of capital accumulation, at the expense of other social classes" (Ito 1953: 382–3). With regard to the taxation of big business, the Yoshida government wanted to provide more general benefits than Shoup had recommended. Chalmers Johnson has characterized this post-occupation shift as a matter of intentional industrial policy – "preferential treatment of strategic industries" and Tsuru similarly emphasized the benefits of the shift to large, export-oriented companies (Johnson 1982: 232–6; Tsuru 1993: 104–8). However, although it is possible that the substantive "strategic" choices of Liberal leaders and MoF bureaucrats were more coherent than those of the House Ways and Means and the Senate Finance committees, they were no less the result of the distribution of political and economic power. If there had been a failure of democracy in the making of tax policy in Japan, it only paralleled a similar failure within the United States.

In sum, after all of the high-stakes turmoil over tax reform during the American occupation, its net effect was to reinforce the tax and expenditure regime that the Japanese government had established during World War II. The reinforcement was very long term in its effects. As Jinno Naohiko has explained, the "centralized-deconcentrated" fiscal system created in 1940 still remains largely in place today (Jinno 1999). And, when Shoup wrote a preface to the 1985 retranslation of his mission's report, he reminded his Japanese audience that their government commonly adopted "economic growth measures" that departed from the Shoup mission's recommendations because "they often take the form of tax preferences for particular groups of taxpayers, and this in turn leads to charges of favoritism and unfairness; the equity of the tax system is impaired" (Shoup in Fukuda 1985: 5).

The results of the rollback of the Shoup program extended beyond Japan, producing a flow of ideas that was exactly the reverse, in content and direction, of what Shoup and his colleagues had in mind. During the 1970s and early 1980s in the United States, anxiety over "the Japanese miracle," and the example of Japan's

[29] Martin Bronfenbrenner to Carl S. Shoup, May 5, 1950. Shoup Papers. Bronfenbrenner Series, 1 No. 1, Yokohama National University Library; Bronfenbrenner, Martin. n.d. *Marginal Economist* (unpublished autobiography). Martin Bronfenbrenner Papers, Rare Book, Manuscript, and Special Collections Library, Duke University, Chapter 14, 6–7 and Chapter 15, 6.

capital-favoring incentives and tax cuts, contributed to the enthusiasm of the "Reagan revolution" for expanding tax expenditures that favored capital investment. That approach to using the tax system to enhance productivity was a key element in the Economic Recovery Act of 1981. The approach that the Shoup mission had favored – reducing high marginal rates but closing loopholes – soon enjoyed a subsequent victory in the United States: the passage of the Tax Reform Act of 1986 (Brownlee and Steuerle 2003). However, like the members of the Shoup mission, the experts in the Treasury who crafted the framework for the 1986 legislation ran against the grain of one of the fundamental elements of the "tax state" in the United States and Japan. The victory in 1986 over business tax expenditures proved incomplete, and vulnerable to the tax cutting of the administration of George W. Bush.[30] In the United States and Japan, the tax regimes created during World War II and, more generally, the underlying political economies, had important elements in common, demonstrated great resilience, and found reinforcement from the American and Japanese efforts to prosecute the Cold War. And, over time, in each country, the major departures from horizontal equity that characterized the national tax system may well have significantly weakened public trust in both the tax system and government in general.

[30] The expansion of tax expenditures has contributed significantly to tax cutting in the United States since 1981. Since that time, the share of Gross Domestic Product (GDP) taken by taxes has been roughly comparable, roughly between 26 and 28 percent, in Japan and the United States. By this measure, Japan and the United States have made the lowest tax effort among the wealthy democratic nations. Common fiscal elements (in addition to high levels of tax expenditures) that contribute to relatively low levels of tax effort in Japan and the United States are low levels of consumption taxation, high levels of deficit finance, and modest commitments to the welfare state. See Dewit and Steinmo 2002, especially 159–62 and Chapter 8, by Ide and Steinmo, in this volume. On the connections among the relatively heavy taxation of capital, the relatively light taxation of labor income, and the relatively small scale of the welfare state in both Japan and the United States, see Lindert 2004: 235–45 and Ide and Steinmo, Chapter 7.

Epilogue: A Renaissance for Fiscal Sociology?

JOHN L. CAMPBELL

As the editors of this volume remind us in their introduction, the comparative and historical study of taxation should be a field of considerable importance because taxes – and revenues in general – provide the means with which states implement a host of policy initiatives. Indeed, tax revenues are the "life-blood" of the modern state (Braun 1975: 243). Without them it is hard to imagine how states could sustain welfare or defense programs; maintain infrastructures like roads, airports, schools, and public transportation systems; regulate business and markets; enforce property rights and the law; or support commerce. To be blunt, without revenues it is inconceivable how states could provide the support necessary for capitalism itself.

Nevertheless, and despite the fact that influential theorists, such as Max Weber and Joseph Schumpeter, called for and did research on the subject, the field of fiscal sociology, as Schumpeter called it, has experienced somewhat of a hiatus. There are, of course, significant streams of research that investigate taxation and other means by which states generate revenue. Most obvious is the field of public finance in economics. Historians, sociologists, and political scientists have also made some contributions over the years (Campbell 1993). Yet, observers argue that the field has not yet developed into a coherent research area, by which they mean presumably that it has not yet established a unifying theoretical perspective or identified essential debates (Swedberg 2003: 178–9). To be sure, fiscal sociology remains overshadowed relative to many other areas of research in the social sciences. Still, there are signs that this may be changing and that fiscal sociology may be on the verge of a renaissance. In their introduction to this volume, the editors briefly raise this possibility, but I want to examine it in more detail here.

There are several reasons for this possible renaissance. Some of them involve the nature of discourse about fiscal sociology within the social sciences. Some of them stem from changes in politics and in national and international political economic environments. Some of them are reflected in the contributions to this volume. And some of them are to be found in the broader literatures of the social sciences.

DIALOGUE ACROSS DISCIPLINARY AND SUBDISCIPLINARY BOUNDARIES

First, as this volume demonstrates, scholars from different social science disciplines are beginning to talk to one another across disciplinary boundaries and recognize each other's work in the area of fiscal sociology. Where such interdisciplinary discourse arises, intellectual cross-fertilization and, in turn, important breakthroughs sometimes follow. This has been the case historically in areas including science, music, and art.

For example, major intellectual breakthroughs in science have often resulted from scientists being located in places where several different disciplinary currents converged, thereby affording them an opportunity to blend their seemingly disparate ideas in new and profound ways that changed the course of science. A case in point is the famous Pasteur Institute in France. During its early days, it was one of the most successful and productive research centers of its kind in the world. This was because it was among the first to recruit scientists from diverse fields, such as biology and chemistry, to work and teach together. This resulted not only in the development of new medicines and vaccines, which led to national and international accolades, including Nobel Prizes, but also – and this is the important point – new and influential subfields of science, such as biochemistry (Hage and Mote 2008). Similarly, in music, as is well known, young artists gave birth to rock 'n' roll by combining elements of blues, gospel, and even a bit of jazz. In principle, there is no reason why fiscal sociology cannot grow as a strong and coherent subfield of research in the social sciences – at least so long as this sort of expansive interdisciplinary discourse continues to develop. Certainly the editors of this volume are to be commended for encouraging such a dialogue.

However, the development of broader and more inclusive dialogues about fiscal issues can also occur across subfields within social science disciplines. For instance, one of the more encouraging signs that this is happening is in political science. Scholars are beginning to examine the relationships between welfare and tax policy and recognize that we cannot really understand changes in one without understanding changes in the other. In other words, welfare and tax policy are mutually constitutive (e.g., Kato 2003; Pierson 1994). For instance, as Christopher Howard's chapter shows, in the United States a significant amount – as much as 40 percent – of the nation's total welfare spending is, in effect, provided to the middle and upper-middle classes through tax expenditures for things like childcare, housing, health care, and private pension accounts. Other political scientists who have traditionally studied the political and economic determinants of welfare policy in different types of welfare states are now exploring whether the same models can also explain variation in tax policy (Swank 2002).

Subfield dialogues are also possible in sociology and ought to be pursued. As in political science, there has long been great interest among political sociologists in identifying the determinants of different types of policy. Furthermore, among economic sociologists there is much interest in identifying the institutional determinants of change in corporate and industrial structure. Property rights are one of

these determinants. And tax policy is one of the most important forms of property rights. It determines the degree to which states take profits from firms and earnings from individuals, thus impinging directly on rights of private property ownership and appropriation. It also affects the investment strategies of firms and individuals and, as a result, how they use their property. Hence, fiscal sociology has much to offer both political and economic sociology. The same is true for the sociology of law.

Although the intellectual dialogue around taxation is expanding and can be expanded further both across and within social science disciplines, I do not mean to be naïve. This will not necessarily be easy. As the editors note in their introduction, the professional disciplines in the social sciences have grown more specialized, compartmentalized, and insulated during much of the twentieth century. So the degree to which they will accommodate such a discourse is an open question. Yet, the fact that many universities have started to recognize the benefits of and encourage interdisciplinary dialogue suggests that these disciplinary barriers can be breached. So does the fact that a volume like this can find a good publisher!

Similarly, within disciplines different intellectual traditions have become partitioned over the years. In economics, for example, formidable professional barriers were built in the United States separating institutionally and historically oriented work from ahistorical formal modeling, particularly of the neoclassical and rational choice varieties, which came to dominate the field (Yonay 1998). Similar divides have developed in political science and to a lesser extent in sociology where rational choice theory was on one side of the fence and other approaches were on the other side. Few people were willing to engage in constructive conversations across the fence. The potential for this sort of problem exists in fiscal sociology. After all, some scholars in fiscal sociology attend to the institutional, historical, and symbolic elements of taxation, as the chapters in this volume by W. Elliot Brownlee, Robin L. Einhorn, Charles Tilly, and Joseph J. Thorndike, among others, aptly demonstrate. But others, including Naomi Feldman and Joel Slemrod in this volume, are concerned with more formal rational choice theorizing. However, this sort of intellectual divide is neither inevitable nor insurmountable. Edgar Kiser and Audrey Sacks's chapter is a case in point insofar as it effectively blends rational choice theory with historical analysis.

TAXATION AND THE RISE OF NEOLIBERALISM

The second reason why fiscal sociology may experience a renaissance is that the issue of taxation has moved up the political agenda in many countries to a point where it is now one of the most important issues being debated publicly. This is due to the rise of the neoliberal policy paradigm that prescribes significant reductions in taxes and government spending. Neoliberalism emerged in response to the failure of Keynesian economic policies to resolve stagflation during the 1970s. This was perhaps most obvious in the Anglo-Saxon countries, where calls for neoliberal policy began to be heard in the mid-1970s and eventually culminated in major tax reforms. Especially in Britain and the United States, where tax issues helped

Margaret Thatcher and Ronald Reagan rise to power, cutting taxes and reducing government expenditures were central parts of their new conservative agendas. Some of the authors in this volume, notably Fred Block and Andrea Campbell, discuss this explicitly and explain some of the politics that caused this to happen. Whether neoliberalism will continue to dominate policy making in the wake of the 2008 financial crisis remains to be seen. But the fact that the massive government bailout and stimulus packages in the United States, currently expected to be in excess of $1.4 trillion, will send fiscal deficits skyrocketing ensures that the issue of lowering or raising tax rates will remain at the center of policy making debates for years to come as policy makers struggle with deficit problems.

However, the issue of taxation has become increasingly politicized elsewhere as well. In Scandinavia, where taxes have long been among the highest in the capitalist world, governments have recently risen and fallen on the issue. In Sweden, after decades of nearly uninterrupted rule by the social democrats, a newly elected conservative government came to power promising neoliberal tax reform. Soon thereafter, in 1991, they cut marginal tax rates on personal and capital income and closed many tax loopholes. A few years later, the social democrats returned to power and raised these rates again, in part because there was public outcry that the effect of the conservative tax reforms had shifted the tax burden regressively from higher to lower income groups (Blyth 2002; Campbell 2004, Chap. 5). Neoliberal tax policy also played a prominent role in Danish politics. One of the key issues that helped the conservatives form a coalition government there in 2000 was their promise to reduce the general tax burden.

Taxation has also risen on the political agenda in other parts of the world as neoliberalism has spread. The chapter by Eisaku Ide and Sven Steinmo shows how this happened in Japan as policy makers pursued supply-side tax cuts after the 1970s oil shocks in the hope of bolstering state finances – a move by which Japan began to resemble the United States from a fiscal point of view. And as Kiser and Sacks point out, developing countries, such as Uganda, South Africa, and Kenya, have also been affected in varying degree by the neoliberal movement insofar as they have embraced the so-called New Public Management program, which seeks to improve the efficiency of public administration, including the efficiency with which states collect taxes.

Finally, issues of fiscal reform have been of the utmost importance in postcommunist Europe and Russia since 1989. This is especially clear in Tilly's chapter about the Russian case. Public sentiment and the politics surrounding these reforms have been formidable and quite variable across countries. As a result, the timing and depth of these reforms as well as the extent to which they have stuck has also varied across the region. The influence of neoliberalism has been unmistakable there, particularly insofar as governments embraced the shock therapy approach, advocated by the International Monetary Fund and other international organizations and advisors, which encouraged steep reductions in state revenue extraction and spending. And, again, some governments have risen and fallen because of how they handled these issues (Bönker 2006; Campbell 2001).

In sum, as Keynesianism fell into disrepute, as communism collapsed in the Soviet Union and Eastern Europe, and as other countries around the world moved

to develop themselves economically during the late twentieth century, neoliberalism rose to prominence politically. And with it so did increasing public and political concern over tax reform. It does not seem likely that this issue will soon drop off the political agenda or recede from public discourse. To the extent that public issues fuel academic research and theorizing, the political situation in the world today provides a window of opportunity for fiscal sociology – particularly as calls for, and reactions against, neoliberal tax reform continue to influence policy making agendas in high-profile ways.

TAXATION AND GLOBALIZATION

The third reason why fiscal sociology may experience a renaissance is closely related to the last one. Politicians, the business community, and increasingly, the public are aware that the world has become much more interconnected through the process of globalization. By globalization I mean rising levels of international economic activity, such as trade, foreign direct investment, transnational corporate activity, and capital mobility more generally. It is virtually impossible nowadays to open a major newspaper without seeing something about globalization. This is even more obvious in a quick scan of the financial pages and the business press. And within the social sciences, globalization has become an increasingly hot topic judging from the exponentially rising number of citations on the subject in recent years (Guillén 2001; Ó Riain 2000). One of the most pressing issues in all of this concerns the relationship between globalization and taxation. Debate revolves around the following question: Does globalization necessarily lead to a convergence across countries in tax rates and tax burdens, especially on business and capital, such that national governments must "race to the bottom" toward some minimal level of taxation (e.g., Dehejia and Genschel 1999; Genschel 2002)?

According to the conventional wisdom, the pressures of globalization are forcing advanced capitalist states to do exactly this in order to reduce the costs to firms of doing business. Why? Competition for capital is the key. Dramatic advances during the late twentieth century in transportation and telecommunications, such as overnight air delivery, fiber optics, microwave and satellite communications, and computer microprocessing, have vastly improved firms' knowledge of profitable economic opportunities around the world and have increased the speed and effectiveness with which they can pursue them. International capital mobility has increased accordingly. Capital mobility was facilitated further by the breakdown in 1971 of the Bretton Woods system of fixed exchange rates; by the deregulation of international capital flows after that; and by trade liberalization both unilaterally and through international agreements, such as the General Agreement on Tariffs and Trade (GATT) and subsequently the World Trade Organization (WTO). All of this increased the threat of capital flight – that is, the tendency for capital to move from one country to another in search of the most profitable business environment. In turn, it is argued, states must compete more aggressively to attract and retain capital investment within their borders. To do so successfully they must cut taxes. Otherwise they will suffer rising interest rates, sluggish economic growth, higher unemployment, and other economic maladies that will eventually force

them to adopt these measures anyway (Cerny 1997; Giddens 2000; Greider 1997; McKenzie and Lee 1991; Ohmae 1990, 1995; Strange 1997; Tanzi 1995: xvii).

This perspective is ubiquitous in public discourse (Block 1996; Bourdieu 1998). It also enjoys a place in academic debate (e.g., Genschel 2002; Swank 2002, Chap. 7). Furthermore, politicians frequently invoke the argument to justify a variety of policy moves (e.g., Schmidt 2002, Part III). And international agencies continue to lament the threat of capital flight and urge countries to collectively address it. For instance, the Organisation for Economic Co-operation and Development (OECD) is so concerned about this that it warned that tax competition will undermine the ability of national governments to maintain their tax bases and, therefore, urged international cooperation to eliminate such harmful tax practices (OECD 2000).

However, a number of scholars have raised serious doubts about this argument. For instance, John Hobson (2003) showed that the real direct and indirect tax burdens in OECD countries have actually risen on average since the 1960s, albeit at slower rates since the mid-1980s. He argued that this was because while tax rates at the top were trimmed, the tax base was broadened by closing various tax loopholes – a move designed to defend the public treasury and avoid exorbitant deficits. Indeed, the tax burdens on capital in particular, including corporate income taxes, have risen, not declined, during this period (Swank 2002, Chap. 7). Others have made similar arguments even when examining different types of political economies within the OECD group, such as those with different types of welfare-state regimes and, thus, different revenue requirements (Campbell 2005, 2004, Chap. 5). So, despite the conventional wisdom, research thus far has found little support for either the convergence or race-to-the-bottom arguments. At least one major study suggests why: tax regimes per se – and government fiscal policy more generally – do not have much effect on the investment decisions of multinational corporations. Foreign direct investment is affected far more by the quality of a country's political institutions and the political risks that multinationals believe are associated with these institutions (Jensen 2006).

Because debates such as this are relevant both for academic and public discussion, they can provide another platform for elevating the coherence and profile of fiscal sociology if scholars take advantage of it. This possibility is enhanced, as I suggested earlier, by the fact that these debates involve researchers from several social science disciplines. Indeed, sociologists, political scientists, and economists (not to mention journalists) have all weighed in on the issue of globalization and tax convergence.

TAXATION AS A SOURCE OF INSTITUTIONAL COMPETITIVENESS

The fourth reason for optimism that fiscal sociology may blossom is that scholars, politicians, and business leaders are beginning to understand that the fortunes of business firms and, in turn, industries and national economies depend significantly on the institutions within which firms operate. Put differently, firms can compete successfully not only by cutting costs, as is well known, but also by taking advantage of the benefits afforded them by the surrounding institutions within which they operate – including the institutions of taxation and revenue extraction.

A large literature in comparative political economy now recognizes that the routes by which firms compete successfully in today's world may vary tremendously depending on national institutional conditions. Success can be achieved in more than one way (e.g., Hall and Soskice 2001). For instance, where taxes are low, firms can compete on the basis of low cost. However, where taxes are high, firms can compete on the basis of high-quality production, innovations in products and production processes, and other things that depend on a well-trained labor force, state-of-the-art technological infrastructure, and more. In this case, high taxes are often necessary in order to support education, continuous vocational training, technological development, and the like. In other words, contrary to neoliberalism and the conventional globalization thesis, high taxes may actually be an important and beneficial source of institutional competitiveness in some situations rather than an obstacle to it (Campbell and Pedersen 2007a).

Some members of the business community understand this. Consider two very different national economies: Denmark and the United States. In the United States, total government revenues amounted to about 26 percent of Gross Domestic Product (GDP) in 2001. This was among the lowest tax burdens among the advanced capitalist countries. In Denmark, they were nearly twice that amount at 48 percent. Furthermore, in 2003 taxes on income and profits in the United States were 11 percent of GDP, whereas in Denmark they were nearly three times that amount at 29 percent (OECD 2006b). Given the conventional wisdom about the need for low taxes in order to avoid capital flight and economic trouble, we should expect that the Danish economy would be in the doldrums, but it is not. According to the World Economic Forum (2006), despite its very high taxes Denmark ranks among the most competitive economies in the world and one of the most attractive places for business investment.[1] This is because the Danes spend tax revenue on things that boost national economic competitiveness like publicly funded education all the way through college and an excellent national apprenticeship program for students not going to college. The result is one of the world's most skilled labor forces. Danes also enjoy a publicly financed universal health care system that is less expensive and more effective than the U.S. health care system in terms of many national health indicators. In turn, firms operating in Denmark benefit from smart, innovative, and healthy workers and are not saddled with the exorbitant costs of health insurance as are firms in the United States. The competitiveness of Danish firms in the global economy has benefited as a result (Campbell and Pedersen 2007b).

Not only have these sorts of tax-based benefits enhanced the competitiveness of Danish employers, they have also proven attractive to foreign firms – including many based in low-tax countries, such as the United States. The director of European operations for one of the largest U.S. software-manufacturing companies recently told one of my Danish colleagues that these institutional benefits were the sorts of things that led his firm to put its European headquarters in Copenhagen,

[1] In 2006, Denmark ranked fourth in the world following only Switzerland, Finland, and Sweden. The Danes managed this while minimizing income inequality and poverty. The poverty rate in the United States is about twice as high as it is in Denmark, and the level of income inequality is much higher in the United States too (Campbell and Hall 2006).

adding quickly that Denmark's high taxes were not even a consideration. The fact that some – but certainly not all – business leaders recognize that high taxes may yield important benefits is probably another reason why OECD states have not moved more aggressively to cut taxes (e.g., Kiser and Laing 2001; Swank 2002, Chap. 7). This is certainly consistent with Evan Lieberman's premise in this volume that taxpayers are more likely to accept tax policies if they believe that they will enjoy benefits from these policies. According to public opinion polls, this story holds true for Denmark as well (Goul Andersen 2005).

Politicians in some countries are also beginning to recognize the benefits of high taxes for national competitiveness. I recently addressed the Danish Prime Minister's Globalization Council, which invited me to speak about the institutional basis for Denmark's recent competitive success. I talked about some of the benefits of high taxes as outlined earlier. Members of the audience, including a former head of the central bank, agreed. After I finished, one high-ranking government official told me privately that the government understood this and assured me that they had no intention of pursuing draconian tax cuts. This, of course, was the same government that had come to power only a few years earlier calling for significant tax cuts. They never followed through, in part because they realized apparently that although promising tax cuts might be good political rhetoric during an election campaign, steep tax cuts could undermine the institutional basis of Denmark's impressive success. Indeed, the Globalization Council's final report emphasized the importance of maintaining and improving tax-based institutional supports for the Danish economy (Globalization Council 2006).

Recognition by business leaders and politicians as well as academics that the relationship among taxation, government spending, and national economic performance is more complex than previously understood by many people provides another window of opportunity for fiscal sociology. Because little is known about this relationship, particularly how it varies cross-nationally and historically, fiscal sociology can provide insights that are interesting for business, politicians, and academics alike. Of course, how tax regimes should be configured and administered are difficult questions. And the answers are likely to be both historically and nationally specific with important normative implications. Indeed, Beverly Moran's chapter shows that debates over taxation stretching all the way back to Adam Smith revolved around normative questions regarding the best way to tax people in order to ensure equality and justice.

CONCLUSION

In sum, there are several good reasons to be optimistic that fiscal sociology may soon enjoy a renaissance. Particularly encouraging is the fact that important debates are emerging upon which scholars from different disciplines can focus collectively – debates that are not just about arcane intellectual matters, but that bear directly on fundamentally important matters of business and politics. There are hurdles to overcome, but these are not impassable.

What is perhaps the most promising aspect of the new fiscal sociology represented by this volume is the framing of taxation as a relational concept. That is,

tax systems affect and reflect social relations of various sorts. The editors argue in their introduction that tax systems are forms of a social contract that influence and specify relationships between individuals and their government and society. Many of the chapters in this volume illustrate this point by discussing how tax systems are the result of struggles, conflicts, negotiations, and compromises among citizens and rulers, different social classes, and the like. And although many of these chapters demonstrate this from a historical perspective, we can do the same by thinking about the future. For instance, because of its low tax burden relative to spending, the United States is passing a significant portion of the costs of today's federal programs, notably entitlements like Social Security and health care, along to future generations in the form of skyrocketing national debt. In other words, today's tax system forges an implicit social contract with future generations who will have to compensate for our lack of fiscal discipline through innovative fiscal policies of their own. The point is that by recognizing that taxation is necessarily about social relations, it becomes virtually impossible to ignore its sociological character. For this reason alone the study of taxation ought to spawn increasing interest among sociologists as well as social scientists more generally – not just among public finance economists.

That said, additional steps can be taken to broaden the audience to which fiscal sociology speaks. For example, although many of the chapters in this volume are qualitative, the increasing availability of good quantitative data lends itself to statistical analysis. Some work has been done along these lines. Indeed, some researchers have tried to identify the conditions under which tax reforms are more or less likely to occur. In some cases, they have drawn lessons from this about how states and the policy-making process operate more generally (e.g., Allen and Campbell 1994; Campbell and Allen 1994; Steinmo and Tolbert 1998; Swank 2002, Chap. 7). Central here has been an interest in whether public opinion and interest groups of various sorts drive tax policy, or whether elites sitting behind closed doors do so. This issue is either implied or discussed explicitly by several contributors to this volume, but especially by Fred Block and Andrea Campbell. Of course, this should concern anyone wondering about the nature of democracy. A case in point is Lieberman's chapter, which shows that the study of taxation provides excellent subject matter for constructing theories about how states operate and about the conditions under which they treat different groups within them equally or not.

Similarly, economists and others have studied how taxation affects income distributions across the general population of countries. Work has also been done examining the degree to which taxation may affect racial or gender groups differently. This is a theme that appears in the chapters by Lieberman, Einhorn, and Moran, and that is well worth exploring further insofar as issues of race and gender attract much attention in general among the social sciences as well as the public. In particular, Edward McCaffery's chapter, which builds on previous work by legal scholars, shows how taxation affects the family. Yet, this sort of work could probably benefit from a tighter integration with sociology and other social sciences.

There is also much interest among social scientists these days about how policies in one country affect those in another. As suggested by Brownlee's chapter on Japanese tax reform after World War II, and by Ide and Steinmo's discussion of

more recent Japanese reforms, international effects can be profound yet complex. That is, fiscal reform ideas can travel from one country to another with significant effect, depending on the situation. This is an idea that should have broad resonance, at least in light of the extensive interdisciplinary literature on how policy ideas diffuse internationally through interpersonal networks of policy makers and experts, international nongovernmental organizations, transnational social movement activists, and the like (e.g., Boli and Thomas 1999; Dolowitz and Marsh 1996; Keck and Sikkink 1998).

These ideas, obviously, just begin to scratch the surface of some of the broadly appealing questions and issues that fiscal sociology can address. Indeed, given the opportunities I have outlined and the evidence provided by contributors to this volume, I am optimistic that the field can come to enjoy a long and healthy future, and that a renaissance for fiscal sociology is fast approaching.

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