THE FISCAL REVOLUTION AND TAXATION: THE RISE OF COMPENSATORY TAXATION, 1929–1938

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I

INTRODUCTION

In his classic study of federal economic policy, *The Fiscal Revolution in America*,[1] Herbert Stein offered a telling comparison. In 1931, faced with rising unemployment and a growing budget deficit, President Herbert Hoover proposed a tax increase. In 1962, faced with similar (if less acute) conditions, President John F. Kennedy proposed a tax reduction.

This contrast reveals a sea change in American political economy. Between the late 1920s and the early 1960s, economists and political leaders changed the way they thought about taxes, spending, and the impact of each on the national economy. As a group, they embraced "domesticated Keynesianism," a particular type of compensatory fiscal policy designed to regulate the business cycle.[2]

As the name implies, domesticated Keynesianism drew its inspiration from the work of John Maynard Keynes, especially his 1936 treatise, *The General Theory of Employment, Interest and Money*.[3] But it represented a distinctly American interpretation of the Keynesian canon. Domesticated Keynesianism emphasized the use of automatic stabilizers (like a relatively stable tax system), rather than active manipulation of revenue and spending decisions. In addition, domesticated Keynesianism paid homage (more symbolic than substantive) to the political shibboleth of a "balanced budget," albeit one balanced at a

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1. HERBERT STEIN, THE FISCAL REVOLUTION IN AMERICA (2d rev. ed. 1996).

2. Fiscal policy has been variously defined by different authors, but this article adopts Stein's definition: "policy about the large aggregates in the budget—total expenditures and total receipts and the difference between them—as directed toward affecting certain overall characteristics of the economy, such as employment and unemployment, price levels, and the total share of government activity in the economy." *Id.* at 4.

3. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY (1936).

theoretical level of "full" or "high" employment rather than one balanced in the actual economic conditions prevailing each fiscal year.[4]

The history of Keynesianism, in all its variants, has been told many times. But most studies—especially those focused on the early years of the fiscal revolution—have emphasized the spending side of the fiscal equation, giving short shrift to the important role of taxation.[5] The reasons for this relative neglect are both obvious and puzzling. They were obvious because early champions of compensatory fiscal policy were themselves inclined to downplay the role of taxation. Federal taxes in the 1930s were either too narrow (income taxes that burdened only the rich) or too unwieldy (myriad excise taxes paid by millions of consumers) to play an effective role in compensatory policy. Expansionary tax cuts—an element of countercyclical policy that we now take for granted—were hard, if not impossible, to engineer before the advent of a broad-based, flexible revenue instrument like the modern income tax that emerged during World War II.

But the neglect is puzzling given the political salience of taxation during the Great Depression. No issue did more to estrange Franklin Roosevelt from wealthy Americans and leaders of the U.S. business community. And no issue was more responsible for the New Deal's political problems in the late 1930s, when a tax-driven backlash put an end to Roosevelt's ambitions for structural economic reform and gave a boost to less contentious Keynesian schemes for managing the economy.[6] Even more important, the particular version of countercyclical fiscal policy that proved ascendant in American politics—Stein's domesticated Keynesianism—relied principally on taxation, rather than spending, to manage the vicissitudes of the business cycle.

To understand the rise of *domesticated* Keynesianism, we need a better history of *revenue* Keynesianism: the distinctive role of taxation within a larger program of compensatory fiscal policy. This article explores the early history of compensatory taxation, focusing not on the era of its intellectual and political maturity after World War II, but on its relative infancy during the 1930s.[7] It

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4. STEIN, *supra* note 1, at 518.

5. Stein's book is an exception to the rule of revenue neglect: he gives substantial attention to tax policy through his story, even arguing that the growing acceptance of taxation as an instrument of countercyclical fiscal policy was a key part of the fiscal revolution. But even Stein gives the subject less attention than it deserves, especially as tax policy developed during the early years of the fiscal revolution.

6. Literature on the post-1937 embrace of Keynesian fiscal policy is abundant. For two of the most useful and relatively recent contributions, see WILLIAM J. BARBER, DESIGNS WITHIN DISORDER: FRANKLIN D. ROOSEVELT, THE ECONOMISTS, AND THE SHAPING OF AMERICAN ECONOMIC POLICY, 1933–1945, at 80–115 (1996); ALAN BRINKLEY, THE END OF REFORM: NEW DEAL LIBERALISM IN RECESSION AND WAR 65–105 (1995).

7. On the overall history of New Deal taxes, see MARK HUGH LEFF, THE LIMITS OF SYMBOLIC REFORM: THE NEW DEAL AND TAXATION, 1933–1939 (1984); Walter Lambert, New Deal Revenue Acts (1970) (Ph.D. dissertation, University of Texas).

gives special attention to debates within the tax-policy community, a loose grouping of fiscal experts whose influence on the fiscal revolution was pivotal.[8]

As it turns out, compensatory taxation found a receptive audience in the tax community of the 1930s. Though it took more than thirty years for domesticated Keynesianism to win the hearts and minds of politicians, revenue Keynesianism swept the tax community in less than a decade. The conversion of the experts was most obvious within the Treasury Department, where tax economists moved from skepticism to enthusiasm in just three years. This shift—prompted by a confluence of intellectual theory and economic reality—was more or less complete by 1938. And by the early 1940s, it had found concrete expression in the wartime tax regime—a distinctive system of taxation that remains largely intact even today.[9]

II
THE PROMISE OF COMPENSATORY FISCAL POLICY

Compensatory fiscal policy—tax hikes during booms followed by tax cuts during busts—had champions long before John Maynard Keynes laid claim to the idea in the mid-1930s. While balanced budgets remained an article of faith for most elected officials, economists were more flexible in their definition of "sound" fiscal policy. Between 1929 and 1932, a number of leading scholars endorsed expansionary fiscal policy, including the deliberate use of federal deficits to encourage recovery. Ultimately, however, such arguments failed to persuade President Hoover and congressional leaders, who cooperated to pass the deflationary Revenue Act of 1932 at the very nadir of the Depression.

A. Public Spending to Combat Recession

Many political and business leaders of the 1920s believed that government had a useful role to play in fighting recessions and curbing unemployment.[10] They placed particular faith in the efficacy of increased spending on public works.[11] New dams, roads, and tunnels might prove to be long-term public

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8. On the notion of a tax-policy community and its importance to the policy process, see JULIAN E. ZELIZER, TAXING AMERICA 8–11 (1998).

9. On the notion of tax regimes, see W. ELLIOT BROWNLEE, FEDERAL TAXATION IN AMERICA: A SHORT HISTORY 2 (2d ed. 2004).

10. STEIN, *supra* note 1, at 10. Political leaders sometimes distinguished between these two goals, since the latter often implied a range of humanitarian concerns not necessarily included in worries about cyclical downturns.

11. *See generally* NAT'L BUREAU OF ECON. RESEARCH, BUSINESS CYCLES AND UNEMPLOYMENT xxvii–xxix, passim (1st ed. 1923) (committee report of President Harding's 1921 conference on unemployment, supervised by Secretary of Commerce Herbert Hoover), *available at* http://www.nber.org/books/comm23-1; Georg Bielschowsky, *Business Fluctuations and Public Works*, 44 Q.J. ECON. 286 (1930); F.G. Dickinson, *Public Construction and Cyclical Unemployment*, 139 ANNALS AM. ACAD. POL. & SOC. SCI. i (1928); Leo Wolman et al., *Public Works and Unemployment*, 20 AM. ECON. REV. 15 (1930). For skeptical assessments of the countercyclical utility of public-works spending (emphasizing problems of timing and scale), see ALVIN H. HANSEN, ECONOMIC

assets, but in the short run, they also promoted recovery by supporting wage levels, which in turn increased consumption and encouraged growth. As President Hoover explained while urging business leaders to continue their own, private-sector construction during the early years of the Depression, "These measures will provide employment, enlarge buying power, increase the circulation of money, create markets for farms and factories, and assure prosperity and contented homes."[12]

As the United States plunged into the economic abyss in late 1929, President Hoover focused initially on state and local building projects, as well as on private-sector construction by utilities, railroads, and other businesses. The federal government, he believed, should promote and coordinate these efforts to maximize economic benefits.[13] This approach reflected Hoover's conception of the associational state: a vision of modern, scientific governance that emphasized public–private cooperation, rather than purely governmental solutions.[14] Under pressure from rival politicians and interest groups, however, Hoover also agreed to increase and accelerate public-works spending. He won approval from Congress for roughly $200 million in additional spending during 1930 and 1931—a significant increase, but well short of the mammoth programs urged by some true believers in the efficacy of public-works spending, who urged programs in the range of $1 billion to $6 billion.[15] Moreover, the increase was dwarfed by the decline in private-sector construction spending, which dropped by $2.7 billion between 1929 and 1930.[16]

B. Politicians and the Importance of Balanced Budgets

Even given the modest size of Hoover's spending program, budget watchers worried about how to pay for it. Economists generally agreed that debt finance was the only plausible answer: expenditures were too large and revenues too

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STABILIZATION IN AN UNBALANCED WORLD 186–89 (1932); Sumner H. Slichter, *The Economics of Public Works*, 24 AM. ECON. REV. 177 (1934).

12. *Quoted in* STEIN, *supra* note 1, at 9. Hoover hoped that private-sector construction, when combined with an expanded federal public-works program, would stem job losses and turn the economy around. Stein observed that while Hoover's understanding of public-works spending did not reflect any sort of sophisticated proto-Keynesian theory of income determination, it was probably good enough for government work. *Id.*

13. *Id.* at 20. As Hoover declared in his 1929 State of the Union address,

> I have, therefore, instituted systematic, voluntary measures of cooperation with the business institutions and with State and municipal authorities to make certain that fundamental businesses of the country shall continue as usual, that wages and therefore consuming power shall not be reduced, and that a special effort shall be made to expand construction work in order to assist in equalizing other deficits in employment.

President Herbert Hoover, State of the Union (Dec. 3, 1929), *available at* http://www.presidency.ucsb.edu/ws/?pid=22021.

14. For the seminal exploration of Hoover's associational ideology, see Ellis W. Hawley, *Herbert Hoover, the Commerce Secretariat, and the Vision of an "Associative State," 1921–1928*, 61 J. AM. HIST. 116 (1974).

15. STEIN, *supra* note 1, at 23–24.

16. *Id.* at 21–22.

small to pay for emergency spending on a current basis.[17] But this academic recognition hardly conferred a license to borrow on Hoover and the Congress. Economic theory competed with political reality as lawmakers tried to reconcile expansionary spending with traditional notions of fiscal responsibility.

For politicians in both parties—not to mention businessmen, journalists, and the general public—balanced budgets were an article of faith.[18] From 1920 to 1930, receipts had exceeded expenditures every year, sometimes by a large margin.[19] That fiscal record was held in high esteem by almost everyone. "That policy of a balanced budget—expenditures within receipts—must not be molested," intoned President Calvin Coolidge as he prepared to leave office in early 1928. "It must not be endangered. The great good which has come to this country from a balanced budget is too measureless, too far-reaching, even to suggest any other course."[20]

President Hoover agreed. "I am confident that the sentiment of the people is in favor of a balanced Budget," he said in December 1930. "I am equally confident that the influence on business of having the financial affairs of the Federal Government on a sound basis is of the utmost importance."[21] Even John Nance Garner, Democratic Speaker of the House, lent his support to the traditional notions of sound budget policy. "It has come to a point now where the worst kind of taxes are better than no taxes at all," he declared in March 1932. "The budget must be balanced."[22]

In general, the guardians of fiscal probity insisted that balanced budgets were essential to "business confidence," another elusive but powerful notion. Confidence, in turn, was widely considered the wellspring of economic growth and the guarantor of prosperity. "Business confidence may, in fact, be considered the hub on which all the factors in the trade cycle turn," declared one economist in 1923. "The community acts according to its expectations of the future, and the action taken is almost invariably such as to bring about the effect anticipated."[23]

Such broad, bipartisan fealty to the notion of a balanced budget masked considerable flexibility in practice. When it came to real-world politics, balanced budgets were not an iron law. Accounting standards allowed for

17. *Id.* at 11.

18. On the history and political importance of balanced-budget ideologies, see DENNIS S. IPPOLITO, WHY BUDGETS MATTER: BUDGET POLICY AND AMERICAN POLITICS (2003); JAMES D. SAVAGE, BALANCED BUDGETS AND AMERICAN POLITICS (1988).

19. OFFICE OF MGMT. & BUDGET, HISTORICAL TABLES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2010, at 21 (2009).

20. President Calvin Coolidge, Address at the Fourteenth Regular Meeting of the Business Organization of the Government, Washington, D.C. (Jan. 30, 1928), *available at* http://www.presidency.ucsb.edu/ws/?pid=444.

21. President Herbert Hoover, Annual Budget Message to the Congress, Fiscal Year 1932 (Dec. 3, 1930), *available at* http://www.presidency.ucsb.edu/ws/?pid=22459.

22. *Garner Will Take Floor Today to Lead Fights for Tax Bill*, N.Y. TIMES, Mar. 29, 1932, at 1.

23. J.R. Bellerby, *The Controlling Factor in Trade Cycles*, 33 ECON. J. 305, 319 n.1 (1923).

considerable flexibility in the treatment of certain expenditures (including public-works spending), as well as the treatment of debt repayment. Even more important, many political leaders, including Hoover, recognized that sound finance did not require that budgets be balanced *every year*. Rather, deficits incurred during a dip in the business cycle were unobjectionable if they were offset (in fairly short order) by surpluses during prosperous years.[24]

Still, policymakers felt compelled to seek budget balance and to explain deviations from the ideal. In 1931, a substantial deficit prompted much handwringing in Washington, and with an even larger shortfall looming for the following year, policymakers in both parties agreed to raise taxes.[25]

C. Economists and the Utility of Deficit Finance

Many economists endorsed the drive for a tax hike, insisting that it was necessary to preserve fiscal soundness. Indeed, most of the discipline's established leaders were committed to the importance of balanced budgets and attuned to the dangers of deficit finance.[26] But these fiscal traditionalists faced a growing number of skeptical colleagues, who argued that unbalanced budgets could be a useful tonic for an ailing economy. A preference for expansionary fiscal policy—especially on the spending side of the ledger—was relatively common among academic economists of the late 1920s and early 1930s.[27] As one economist later recalled of the early Depression years, "the idea [of countercyclical fiscal policy] was then a commonplace in my academic surroundings of the time."[28]

Expansionary fiscal policy was particularly popular among members of the "Chicago School"—a group of like-minded economists that emerged at the University of Chicago during the 1920s and 1930s. Best known during the latter half of the twentieth century for its free-market sensibility and monetarist proclivity, the Chicago School was originally less doctrinaire. Indeed, several of its founders were receptive to government interventionism, at least when it came to fiscal policy in a depression. While they still generally agreed that budgets should be balanced over the length of the business cycle, they insisted

24. STEIN, *supra* note 1, at 26–29.

25. On the Revenue Act of 1932, see ROY G. BLAKEY & GLADYS C. BLAKEY, THE FEDERAL INCOME TAX 301–34 (1940); RANDOLPH E. PAUL, TAXATION IN THE UNITED STATES 149–62 (1954); Jordan A. Schwarz, *John Nance Garner and the Sales Tax Rebellion of 1932*, 30 J. S. HIST. 162 (1964); Lambert, *supra* note 7.

26. Robert W. Dimand, *The New Economics and American Economists in the 1930s Reconsidered*, 18 ATLANTIC ECON. J. 42, 42 (1990); *Economists Advise Credit 'Expansion*,' N.Y. TIMES, Jan. 16, 1932, at 30. For a particularly influential critique of expansionary spending, see R.G. Hawtrey, *Public Expenditure and Trade Depression*, 96 J. ROYAL STAT. SOC'Y 438, 438 (1933).

27. STEIN, *supra* note 1, at 9–10. Even some early monetarists, like Irving Fisher, made room for deficits in their prescriptions for recovery, since they viewed debt-financed spending as a method of monetary expansion. *See* BARBER, *supra* note 6, at 84.

28. Jacob Viner, *Comment on My 1936 Review of Keynes' General Theory*, *in* KEYNES' GENERAL THEORY: REPORTS OF THREE DECADES 263 (Robert Lekachman ed., 1964).

that debt-financed public spending could stimulate aggregate demand and encourage recovery.[29]

No less an authority than Milton Friedman acknowledged as much. In an article exploring the early work of Henry Simons—the leading light of 1930s economics and cofounder of the Chicago School—Friedman remarked on the "great similarity between the views expressed by Simons and by Keynes—as to the causes of the Great Depression, the impotence of monetary policy, and the need to rely extensively on fiscal policy."[30] As early as 1933, Simons had recognized the need for expansionary fiscal policy—including new spending and targeted tax cuts—to help raise prices and reverse the downturn.[31]

Simons, moreover, was not alone. In May 1932, his Chicago colleague Frank H. Knight assured Senator Robert Wagner that deficits were appropriate in the midst of a depression. "As far as I know, economists are completely agreed that the Government should spend as much and tax as little as possible, at a time such as this," he wrote, "using the expenditure in the way to do the most good in itself and also to point toward relieving the depression."[32]

Perhaps most important, Chicago economist Jacob Viner emerged as a vocal champion of expansionary fiscal policy in the early 1930s.[33] Viner's opinion merits attention not simply because he was a leading figure of his discipline, but also because he played a vital role in the early New Deal, advising Treasury Secretary Henry Morgenthau on a range of issues, including fiscal policy. In 1931, Viner complained to his colleagues that Hoover's Treasury Department was pursuing "traditional policy, based on so-called sound principles of finance, of taxing heavily, spending lightly, and redeeming debts."[34] Such an approach was steeped in tradition but ultimately misguided. Better, Viner said, to follow an opposite policy: taxing lightly, spending heavily, and borrowing the money to finance both.[35] "When business activity is declining, or is stagnant and at a low level," he contended, "increased expenditures, reduced taxation, and budget deficits are, from the point of view of the national economy as a whole, sound policy rather than unsound."[36]

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29. For arguments challenging the notion of a unitary "Chicago School"—and seeking to replace it with a pair of intellectual traditions located at the University—see M. Bronfenbrenner, *Observations on The "Chicago School(s),"* 70 J. POL. ECON. 72 (1962); H. Laurence Miller, Jr., *On the "Chicago School of Economics*," 70 J. POL. ECON. 64 (1962); Eugene Rotwein, *Jacob Viner and the Chicago Tradition*, 15 HIST. POL. ECON. 265 (1983).

30. Milton Friedman, *The Monetary Theory and Policy of Henry Simons*, 10 J.L. & ECON. 1, 7 (1967).

31. *Id.* at 8.

32. 75 CONG. REC. 10323 (1932).

33. Rotwein, *supra* note 29, at 272.

34. REPORT OF THE ROUND TABLES AND GENERAL CONFERENCES AT THE ELEVENTH SESSION 182 (Arthur Howland Buffington ed., 1931) (hereinafter REPORT OF THE ROUND TABLES).

35. *Id.*

36. *Id.*; *see also* JACOB VINER, BALANCED DEFLATION, INFLATION, OR MORE DEPRESSION 24 (1933).

Indeed, Viner urged policymakers to simply embrace the need for price inflation. Higher prices would restore profits and encourage business activity, he insisted. And the easiest way to inflate prices was through deliberate deficits. "[T]he simplest and least objectionable procedure would be for the federal government to increase its expenditures or to decrease its taxes," he wrote in 1933, "and to finance the resultant excess of expenditures over tax issues either by the issue of legal tender greenbacks or by borrowing from the banks."[37]

In 1932 and 1933, Viner joined his Chicago colleagues in urging policymakers to adopt a more expansionary fiscal policy, including additional debt-financed spending. "[I]nflationary expenditures would be handsomely rewarded in greater production, larger employment and higher tax revenues," they declared in a 1932 letter to congressional leaders. "These expenditures would be financed by large-scale sale of Government bonds to the Federal Reserve Banks or by issuance of greenbacks."[38] Viner and his colleagues took special care to argue against timidity in price policy: "parsimonious inflation," they advised, "is an illusory economy."[39]

Such thinking was not universal among American economists in the late 1920s and early 1930s. But neither was it heretical. Compensatory fiscal policy, including a preference for deficit finance, had developed a strong following as the nation approached the worst years of the Depression.

D. Triumph of the Traditionalists

President Hoover's initial response to the stock-market crash included a tax cut, but it was not conceived as an expansionary or deliberately inflationary measure. Rather, the 1929 tax reduction was intended to bolster *confidence*, that watchword of politicians fighting downturns in every era. Hoover and his advisers hoped that a tax cut would signal their own confidence that Wall Street's crash was immaterial to the nation's broader economic health—including its tax revenues. Money would continue to flow into the Treasury, and budgets would remain balanced.

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37. VINER, *supra* note 36, at 24–28. Viner understood that deficits provoked fear in many circles. But he believed such worries were misplaced. He reassured one colleague by recalling the words of Adam Smith:

> When, during the American Revolutionary War, a young friend, Sir John Sinclair, lamented to [Smith] the misfortunes, presumably financial, in which the war was involving Britain, and exclaimed, "If we go on at this rate, the nation must be ruined!", Adam Smith replied, "Be assured, my young friend, that there is a great deal of ruin in a nation."

JACOB VINER, THE LONG VIEW AND THE SHORT: STUDIES IN ECONOMIC THEORY AND POLICY 114 (1958). Viner believed that American public finance could tolerate an episode of "ruinous" deficit spending. Indeed, he believed it was necessary. But he *did* worry about the potential for political misuse of countercyclical fiscal policy. Many politicians, he observed, were inclined to replace the old dogma of budget balance with a new one of spendthrift fiscalism. "[T]he long view tells me that while this may not be the road to ruin," Viner warned, "it at least blazes a trail to it." *Id.* at 115.

38. *Economists Offer Plan to Aid Nation*, WASH. POST, May 24, 1932, at 5.

39. *Id.*

In other words, Hoover cut taxes not because the country needed it, but to signal that it *didn't*. "The action of the government today," wrote one reporter commenting on the tax cut, "was taken as still another means of assuring the nation that the government was satisfied that business was on such a firm basis that revenues will continue to assure a comfortable surplus."[40]

The 1929 tax cut, of course, did nothing to slow the economy's death spiral. The budget *did* remain balanced for 1930, but it slipped into deficit the next year. And with that deficit came a resurgence of fiscal traditionalism. Economists had failed to convince Hoover or almost anyone else in Washington that deficits could be a useful tonic. Instead, political leaders coalesced around the idea of a tax hike—and not the sort of tax hike counseled by the economists.

Debate over the Revenue Act of 1932 was vigorous. Republicans, who controlled the Senate, sparred with Democrats, who controlled the House of Representatives. Leaders of both parties fought with President Hoover, who was mired in his losing campaign for re-election. Perhaps most striking, Democrats found themselves torn apart by a rebellion in their own ranks. Eager to claim the mantle of fiscal responsibility, party leaders had been gulled into supporting a new federal sales tax (long a favorite of Republicans). But rank and file party members, led by North Carolina Representative Robert "Muley" Doughton from the Ways and Means Committee, had defeated the plan on the House floor.[41]

Even sales-tax foes, however, were generally resigned to the need for a tax hike. On its face, the impulse seems puzzling, since policymakers understood what the economists were telling them: tax hikes might very well *slow* the process of economic recovery, not speed it up. But officials had to balance that knowledge against other concerns. Large and persistent deficits, they feared, might cause long-term interest rates to rise, hampering recovery. Also, deficits might frighten business leaders, who would react by hoarding cash rather than investing it. Perhaps most important, deficits might undermine international confidence in the dollar and exacerbate the outflow of gold from government coffers—a process already underway and contributing to the Federal Reserve's new tight-money policy.[42]

When judged in context, then, the bipartisan decision to raise taxes was not unreasonable, even if it quickly proved unwise. The resulting legislation, the Revenue Act of 1932, imposed the single largest peacetime tax hike in

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40. *Mellon Outlines Plan*, N.Y. TIMES, Nov. 14, 1929, at 1. For more on the 1929 tax cut, see Joseph J. Thorndike, *Tax Cuts, Confidence, and Presidential Leadership*, 120 TAX NOTES 1205 (2008). Many observers were not buying what Hoover was selling. The tax cut, the *Nation* magazine declared, was a transparent ploy to bolster confidence, and an unconvincing one at that. "[N]otwithstanding the supporting figures given out," the magazine said, "the change in the Treasury's tax plans at this time cannot be defended on fiscal grounds." *Business to the Rescue*, 129 NATION 651, 651–52 (1929).

41. Schwarz, *supra* note 25, at 166–69.

42. W. Elliot Brownlee, *Tax Regimes, National Crisis, and State-Building in America*, *in* FUNDING THE MODERN AMERICAN STATE, 1941–1995: THE RISE AND FALL OF THE ERA OF EASY FINANCE 72–73 (W. Elliot Brownlee ed., 1996); STEIN, *supra* note 1, at 34–38.

American history to that point.[43] At the time of its passage, it was predicted to raise $1.1 billion in new revenue, including $457 million from a broad array of new, and generally regressive, excise taxes on consumer goods—exactly the taxes that most economists urged lawmakers to avoid.[44] To be sure, the law raised progressive taxes, too, including the personal income tax. But with the sharp economic downturn—and the extremely narrow base of the income tax—such levies alone could not raise enough money to close the yawning budget gap.

After its passage, commentators in the press hailed the Revenue Act of 1932 as a milestone in fiscal probity. Lawmakers, not surprisingly, were quick to pat themselves on the back. But as some observers warned—and later analysts confirmed[45]—the law promised to slow recovery, not speed it. Indeed, if the 1932 tax act was any sort of milestone, it was a marker on the long detour from depression to prosperity by way of misplaced austerity.[46]

III

THE CASE FOR COMPENSATORY TAXATION AND ITS NEW DEAL SKEPTICS

Over the course of the early 1930s, economists built a case for compensatory fiscal policy. Expansionary spending had plenty of adherents,[47] and it found a prominent place in the early New Deal when the National Industrial Recovery Act authorized $3.3 billion in new-construction spending. Numerous observers endorsed the effort, if not the implementation. Most notably, sympathetic criticism came from John Maynard Keynes, who chastised President Roosevelt in an open letter in late 1933 for moving too slowly to expand government spending.[48]

Over the course of the 1920s, Keynes had emerged as a supporter of compensatory fiscal policy, including the use of public works to stimulate economic growth. In general, he preferred private to public investment, arguing that monetary and credit policy were the first line of defense when trying to cope with a slump. But when business confidence reached a nadir, these traditional tools of economic stabilization could prove inadequate.[49] At that point, Keynes argued, expansionary fiscal policy had a key role to play. "Government investment will break the vicious circle," he said. "If you can do

43. Brownlee, *supra* note 42, at 73.

44. *Id.*

45. E. Cary Brown, *Fiscal Policy in the 'Thirties: A Reappraisal*, 46 AM. ECON. REV. 857, 863–66 (1956).

46. *See id.* at 868–69 (discussing the deflationary impact of the 1932 revenue law).

47. See COLUM. UNIV. COMM'N, ECONOMIC RECONSTRUCTION 35–37 (1934) for a particularly influential example of professional economic opinion.

48. John Maynard Keynes, *From Keynes to Roosevelt: Our Recovery Plan Assayed*, N.Y. TIMES, Dec. 31, 1933, *available at* http://www.naomiklein.org/files/resources/pdfs/keynes-roosevelt-1933.pdf. Much of Keynes' more scholarly work carried the same policy implications. *See, e.g.*, QUINCY WRIGHT ET AL., UNEMPLOYMENT AS A WORLD-PROBLEM 25 (1931).

49. STEIN, *supra* note 1, at 133–41.

that for a couple of years, it will have the effect, if my diagnosis is right, of restoring business profits more nearly to normal, and if that can be achieved, then private enterprise will be revived."[50] By 1933, Keynes was firmly convinced that government spending was vital to recovery.[51]

Meanwhile, expansionary taxation also won a following, as a handful of economists and public intellectuals suggested that tax cuts could promote recovery just as effectively as spending increases. After all, it was the deficit that mattered, not the means to it. A few champions of compensatory taxation even developed an argument for expansionary tax *hikes*. Building on economic insights about the marginal propensity to consume, they contended that heavy taxes on the rich could liberate purchasing power locked away in private hoards.

Nonetheless, skeptics of compensatory taxation remained legion, especially in the corridors of power. In particular, the New Deal Treasury proved to be a bastion of traditional thinking on fiscal policy, more or less impervious to charms of the "new economics." While inclined to support progressive taxation on fairness grounds, the department's tax experts found little to like in broader arguments for compensatory taxation.

A. The Rise of Compensatory Taxation

While advocates of compensatory fiscal policy still emphasized government spending, they gradually made room in their models for countercyclical tax policy. Economists pointed out that tax cuts would expand the nation's purchasing power in much the way that spending hikes would. "[T]he administration has given perhaps too little attention to temporary tax reduction as a means toward the desired deficit," observed members of the Commission of Inquiry into National Policy in International Economic Relations, a blue-ribbon panel convened by the Social Science Research Council (SSRC) in late 1933. "In general, a deficit achieved by tax reduction is as reflationary as one obtained by extraordinary outlays."[52]

Keynes himself made this point the same year. In *The Means to Prosperity*, he stressed the desirability of new, loan-financed, government spending. But in the next breath, he also endorsed tax cuts. "For the increased spending power of the taxpayer will have precisely the same favourable repercussions as increased spending power due to loan-expenditure," he wrote, "and in some ways this method of increasing expenditure is healthier and better spread throughout the community."[53]

50. *Id.* at 145.

51. *See, e.g.*, JOHN MAYNARD KEYNES, THE MEANS TO PROSPERITY 9–16 (1933).

52. COMM'N OF INQUIRY INTO NAT'L POLICY IN INT'L ECON. RELATIONS, INTERNATIONAL ECONOMIC RELATIONS 92–93 (1934). Notably, the commission included Beardsley Ruml among its members and Alvin Hansen among its staff—both soon to become outspoken champions of Keynesian theory.

53. KEYNES, *supra* note 51, at 16.

The SSRC commission offered specific tax cuts for consideration. A cut in excise taxes would expand mass purchasing power and reduce costs for affected industries, the members declared. "The consequent price reductions, in the case of goods of wide consumption, would either markedly increase consumption and production directly, or leave people with larger amounts to be spent on other consumption goods." Either development, they maintained, would promote recovery.[54]

The commission anticipated that a comprehensive system of compensatory fiscal policy—tax hikes during booms, tax cuts during busts—might be useful on a continuing basis, not simply as a remedy for the current crisis. But its members understood the inherent difficulty of trying to manage a fast-moving business cycle with slow-moving fiscal tools. Whereas depression created an immediate need for expansionary policy, recovery would demand equally swift measures to prevent inflation. "The fiscal position must be kept highly flexible," the panel observed, "and the administration must be prepared, legislatively and administratively, both for rapid scaling down of expenditures and, in an extremity, for the prompt imposition of new and higher taxes."[55]

A few years later, economist Joseph Schumpeter made a similar point, suggesting that tax policy could be used not simply as a treatment for economic depression, but more generally as a tool for business-cycle regulation. "[T]axation itself may be made a useful instrument of remedial policy if taxes which are in any way proportional to business success are systematically lowered in depression and increased in prosperity," he wrote in January 1934, "in which case they would act in a way similar to that of the variations of the rate of interest."[56]

Such arguments were persuasive to many economists, at least in theoretical terms. But they elided some of the technical and administrative difficulties involved in "highly flexible" fiscal policy. Tax experts were more attuned to such concerns, yet they, too, were beginning to embrace the notion of compensatory taxation. In a 1935 article for *The Tax Magazine*, an influential trade journal for tax practitioners, Chicago tax lawyer and accountant George Altman suggested that income taxes could be used to fine countercyclical effect.

> The method, in general, would be to step up the income tax as investment, [as] its counterpart, prosperity, increased and to let it down as investment dropped off. In this way the income tax would be a counteracting force, preventing, by its increase, the

54. COMM'N OF INQUIRY, *supra* note 52, at 93.

55. *Id.* at 96.

56. COLUM. UNIV. COMM'N, *supra* note 47, at 239. Part of Schumpeter's interest in using taxes, rather than spending, to stimulate the economy stemmed from his suspicion of the political system. While "whole-heartedly agreeing" that new spending on public works and relief was important, he was

> disposed to lay greater stress on the necessity of not letting budgets go entirely to pieces, and of upholding the principles of careful and conscientious administration of public finances, to which it may be practically impossible to return when once the spirit of reckless expenditure has been allowed to grow up.

Id.

> excesses of saving and investment which break off and thereby bring on depressions; and permitting, by its decrease, a source and incentive for saving and investment if these should fall below the proper level.[57]

Clearly, Altman had absorbed some lessons from the economists. But unlike most academic writers, he was attuned to the practical pitfalls of fiscal activism. He recognized, for instance, that this sort of sophisticated compensatory role would require careful management—more careful than lawmakers were likely to provide. The income tax, he counseled, should not be left to the vagaries of the political system. Rather, its cyclical manipulation should be entrusted to experts, who would adjust rates as economic circumstances changed. "If the rates are definitely hitched to measurable economic factors, such as employment and production, the task of shifting the rates may be placed in the hands of a purely fact-finding body," he explained.[58]

Altman's faith in technocratic taxation was naïve: lawmakers had never been willing to delegate the making of tax policy, not even to the Bureau of Internal Revenue, which could lay claim to quite a store of tax expertise. But Altman thought lawmakers might jump at the chance to regulate the business cycle without resort to "a maze of strangling regulations."[59] Compensatory fiscal policy promised macroeconomic regulation with a light touch. As Altman observed, "The tax would allow free reign to enterprise, except that if enterprise became too exuberant, it would administer the necessary admonition."[60]

B. Progressive Taxation for Recovery

Advocates of compensatory taxation believed lawmakers should cut taxes during a recession to help increase aggregate demand. But which ones? In 1934, more than forty-five percent of federal revenue came from an eclectic array of excise taxes.[61] The enthusiasm of the SSRC commission notwithstanding, constant revision of these myriad taxes was impractical, especially since their incidence was uncertain and their opponents well-organized.[62]

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57. George T. Altman, *Control of the Business Cycle by Means of the Income Tax*, 13 TAX MAG. 9, 12, 54 (1935).

58. *Id.* at 54.

59. *Id.* at 55.

60. *Id.* Keynes made a similar claim to conservatism in *The General Theory of Employment, Interest and Money*: "In some other respects the foregoing theory is moderately conservative in its implications. For whilst it indicates the vital importance of establishing certain central controls in matters which are now left in the main to individual initiative, there are wide fields of activity which are unaffected." KEYNES, *supra* note 3, at 377–78.

61. OFFICE OF MGMT. & BUDGET, *supra* note 19, at 32.

62. *See* LEFF, *supra* note 7, at 19–30 (discussing the politics of excise taxation in the 1930s, including the influence of industry groups). On the uncertain incidence of administrative difficulty of manipulating excise-tax rates, see GEORGE HAAS, TAX REVISION STUDIES: GENERAL STATEMENT, REVENUE ESTIMATES, SUMMARIES, AND RECOMMENDATIONS (1937), *available at* http://www.taxhistory.org/Civilization/Documents/Surveys/hst23729/23729-1.htm.

> In the case of excise taxes and customs duties, every increase or decrease in rates or coverage introduces an extraneous disruptive influence upon the relative competitive positions of different commodities and of those dealing in them. The extent to which a given increase or

The income tax, by contrast, was theoretically a fine tool for compensatory taxation—flexible and easy to manipulate through rate changes. But in the 1930s, it was paid only by the rich, who were already inclined to oversave and underspend. Cutting income taxes on the rich "would serve largely to pour public funds into private hoards," observed the SSRC commission.[63] Worse, it would provide a major tax benefit to the nation's most fortunate few, even as millions were plagued by privation.

As the depression worsened, economists and tax experts expanded on the notion of "private hoards" to make the case for a different sort of compensatory tax policy: expansionary tax *hikes.* Basing their argument on economic theories about the relative propensity to consume, they suggested that higher taxes on the rich were not simply innocuous in the face of depression. They might, when properly designed, actually encourage recovery.

When compared with their less-fortunate neighbors, rich people were less likely to spend their money and more likely to save it. "[W]e have to reckon with a tendency toward saving a progressively increasing proportion of our income as our income itself gets larger," economist John M. Clark noted in the Columbia University report on economic reconstruction.[64] If money were shifted from people with a low propensity to those with a high propensity to spend, then overall purchasing power would rise in the process.[65] This concept was not new in the 1930s; writers like J.A. Hobson had advanced it for some years.[66] But it took on new salience as economists tried to make sense of the depression and received a major boost in 1936 when Keynes gave it prominence in the *The General Theory of Employment, Interest and Money.*

Keynes's insight on consumption propensities had profound implications for tax policy, even if Keynes left them largely unexplored in his own work. At several points, he acknowledged, somewhat vaguely, that a redistribution of wealth by means of taxation might help boost aggregate demand. "If fiscal policy is used as a deliberate instrument for the more equal distribution of incomes," he wrote, "its effect in increasing the propensity to consume is, of course, all the greater."[67] More specifically, though he generally avoided most specific discussion of tax policy, Keynes seemed to suggest that higher income and estate taxes might be a good vehicle for redistribution.

Other economists were more inclined to tackle the issue head-on. In the early 1930s, for instance, Jacob Viner had pointed out that lawmakers could

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> decrease in rates will be borne by suppliers, middle-men, or ultimate consumers, will vary greatly according to the relative elasticities of demand and production for the various products and the associated service involved.

Id.

63. COMM'N OF INQUIRY, *supra* note 52, at 93 (discussing reductions in income taxes or estate taxes).

64. COLUM. UNIV. COMM'N, *supra* note 47, at 109.

65. *Id.* at 113.

66. David Hamilton, *Hobson with a Keynesian Twist*, 13 AM. J. ECON. & SOC. 273, 278–79 (1954).

67. KEYNES, *supra* note 3, at 95.

raise taxes on the rich without endangering recovery. The money collected from progressive levies like the income tax, Viner noted, "otherwise would be hoarded and saved."[68] And hoarded money wasn't helping anyone but the hoarder. If it was used to finance new spending, then the net effect was expansionary.

In 1932, William Trufant Foster argued strongly for higher taxes on the rich as a recovery device. "[W]e must increase the incomes of those who desire to consume, and reduce the incomes of the very wealthy," he advised. "We can do that through higher taxes upon incomes in the upper brackets, through higher taxes upon profits, through very much higher taxes upon inheritances."[69] Raising taxes on the poor (as Congress actually did in the Revenue Act of 1932) was utterly counterproductive, even in the service of balancing the budget. "We thereby *reduce* consumption precisely when the supreme need of business is *increased* consumption."[70] Raising taxes on the rich, by contrast, would compensate for their propensity to oversave, thereby increasing aggregate demand.

Viner's Chicago colleague, Paul H. Douglas, made a similar point in 1935. Most taxes amounted to a simple transfer of purchasing power from one person to another, with no net change in total demand. But when lawmakers used progressive taxes, they could actually create new purchasing power by taking money from those who would not spend it and giving it to those who would.[71] "Since it is the well-to-do who have the largest hoards," Douglas concluded, "it follows that while taxation as a whole is inferior during a depression to the other two methods of financing [borrowing or the printing of new Treasury notes], highly progressive income taxes are the least, and sales taxes the most objectionable forms of taxation which could be used."[72]

Some tax experts were inclined to agree with these arguments. "The income tax is like the human heart," observed New York lawyer Charles A. Roberts in 1931. "Business depression represents a stoppage or sluggishness of the two streams which are the lifeblood of commerce. The tax draws in the moneys which have become stagnant, and pumps them into forcible circulation in the stream of general buying power, restoring the vigor of our commercial life."[73]

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68. REPORT OF THE ROUND TABLES, *supra* note 34, at 183.

69. William Trufant Foster, *Planning in a Free Country: Managed Money and Unmanaged Men*, 162 ANNALS OF THE AM. ACAD. OF POL. & SOC. SCI. 49, 51 (1932).

70. *Id.*

71. PAUL HOWARD DOUGLAS, CONTROLLING DEPRESSIONS 136 (1935).

72. *Id.* at 136–37.

73. Charles A. Roberts, *The Income Tax and Business Recovery*, 9 TAX MAG. 427, 428 (1931). "Whether this be just or unjust," Roberts explained, "it is apparent that the tax moneys are taken from those who would have used them for expansion of productive facilities, facilities for which we have no immediate need. It is equally apparent that most of these moneys, when paid out by the Government, find their way quite promptly to men of moderate means, resulting in an expansion of the public's purchasing power, for which we have the utmost need."

Roberts further suggested that exemptions for the income tax should be raised, further narrowing its scope and making it the exclusive burden of America's economic elite. *Id.* at 427, 431.

Roberts worried that lawmakers would shrink from the task at hand, delaying necessary tax hikes on wealthy Americans.

> On every hand we see a plethora of idle money and a plethora of unsalable goods today. This heart of trade, this money-pump, should be set to work at once. It is not enough to have money available at low rates. *Someone must spend the money*, if business is to revive. Armed with the power of the income tax, the Government can set the pace in this necessary resumption of spending.[74]

Such ideas were gaining popular currency in the early 1930s. David Cushman Coyle—a journalist-*cum*-public intellectual, described as an "engineer, eccentric, economist"[75]—contended in 1933 that "[l]arge personal incomes are not, in fact, circulated back into the market entirely through the personal consumption of goods and through distribution by means of capital investment." Some came back through contributions to cultural and philanthropic organizations. Still more was spent on personal services. And perhaps most important, a good deal came back by way of government spending.[76] "What the public has failed to discern is the fact that the Federal Government, by its spending and fiscal policy, can distribute incomes and cause a large and effective increase in total buying power," he wrote.[77]

C. New Deal Skeptics of Compensatory Taxation

Not everyone thought taxation could function effectively as a countercyclical device, at least not in the real world. Some insisted that politics would get in the way, especially if lawmakers tried to raise taxes too quickly on the rich as part of a redistributive program.[78] Others questioned whether tax changes of any sort—cuts as well as increases—could be implemented quickly enough to make a difference, especially given the size of the overall economy.

Among those voicing such doubts were tax experts in Franklin Roosevelt's Treasury Department. In the summer of 1934, Treasury Secretary Henry Morgenthau had commissioned a series of studies on tax reform. He brought Jacob Viner to Washington to assist with the project and arranged for Roswell Magill, a prominent New York City tax lawyer, to supervise it in his new role as Undersecretary of the Treasury.

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74. *Id.* at 453.

75. *ECONOMICS: According to Coyle*, TIME, Oct. 24, 1938, at 59, *available at* http://www.time.com/time/magazine/article/0,9171,883826,00.html.

76. David Cushman Coyle, *New Aspects of the Distribution Problem*, 165 ANNALS AM. ACAD. POL. & SOC. SCI. 109, 111 (1933). "The solution must lie in a public policy that will encourage or require those who might invest to refrain and to divert a large part of the savings into the market for services," Cushman continued. "Obviously, the backbone of such a policy for some years to come must be a large program of public and semi-public projects, supported by income taxes or by large contributions stimulated by the tax laws." *Id.* at 112.

77. *Id.* at 114–15.

78. *See, e.g.*, Alvin H. Hansen, *Mr. Keynes on Underemployment Equilibrium*, 44 J. POL. ECON. 667, 682 (1936) (suggesting that a program of redistribution of income through taxation "would only serve to make a 'flat situation still flatter,' thereby leaving no alternative except complete socialization . . . .").

The resulting reports, known collectively as the Viner Studies, outlined a comprehensive program for progressive tax reform.[79] It was not a radical program. Indeed, in many respects it was conservative, driven by a commitment to revenue adequacy. The first and most important task of the tax system was to raise revenue. All other concerns—fairness, efficiency, or administrative convenience—were secondary.

The Viner Studies argued for a broad expansion of the individual income tax.[80] As then structured, the income tax was still a rich man's burden, paid by a relative handful of Americans. That narrow focus satisfied certain definitions of social justice (especially among Democrats), but it made for a volatile revenue stream. By broadening the tax to include some of the middle class, the authors hoped (among other things) to make its revenues less susceptible to swings of the business cycle.

This recommendation, and the rationale behind it, imply a distinctly old-school view of fiscal policy. Treasury officials still considered revenue stability a cardinal virtue, since they were chiefly concerned with securing adequate revenue, even in the face of the depression. Champions of compensatory taxation might argue that lower revenues (and higher deficits) were a useful stimulant to economic activity, but Treasury tax experts weren't buying it. Indeed, they remained suspicious of any effort to use the tax system as countercyclical device.

> The tax system, so the argument runs, may be employed to eliminate business cycles or at least to lessen their severity, by penalizing "over-saving" and encouraging consumption, by checking speculation, by favoring certain geographical or social classes at the [expense] of others, by encouraging business initiative, by discouraging "unwise" business expansion, and so on. Finally, there is always the plea for "redistribution of wealth" through the tax system.[81]

While the use of federal tax policy for such purposes, the Treasury staffers concluded, was "not necessarily an evil," it was still dangerous. Given the limited state of economic knowledge, policymakers were ill-equipped to pursue such ambitious designs. "We believe that at present not enough is known about the economic mechanism to warrant a conclusion as to whether, if saving is checked, certain advantages with respect to the business cycle will or will not follow," they wrote. "Then there is always the troublesome problem of degree, and here even the primary effect of certain tax changes cannot be predicted."[82] For instance, a discriminatory tax of twenty-five percent on income from

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79. For a summary of the reports' conclusions, see CARL SHOUP, THE FEDERAL REVENUE SYSTEM: FORWARD AND SUMMARY OF RECOMMENDATIONS (1934), *available at* http://www.taxhistory.org/Civilization/Documents/Surveys/hst23735/23735-1.htm.

80. ROY G. BLAKEY, FEDERAL REVENUE SYSTEM: FEDERAL INCOME TAX (CERTAIN PHASES) (1934), *available at* http://www.taxhistory.org/Civilization/Documents/Surveys/hst23737/23737-1.htm.

81. SHOUP, *supra* note 79.

82. *Id.*

savings might, in fact discourage savings. But by how much? And how would that affect the business cycle? Economists could not provide an answer.[83]

In other words, compensatory taxation made sense, in theory. But for those charged with crafting policy for real-world use, it was dangerous and untrod ground. Ultimately, the Treasury concluded, "[T]here is a heavy burden of proof to be borne by those who would attempt to use the tax system to influence decidedly the major economic currents of the country . . . ."[84] And that proof was not yet forthcoming.

Such comments reflected a very traditional view of taxation. And more generally, the Treasury experts (most of them economists but with a sprinkling of legal experts in the mix) took a similarly traditional line on expansionary fiscal policy more generally. They discouraged heavy reliance on borrowing and urged a program of heavy taxation to support emergency expenditures. "Too heavy and, especially, ill-advised taxes may be deflationary, may check recovery, and may [defeat] the purpose of all economic effort, including that of the Government," they acknowledged.[85] But too much borrowing would be inflationary, raising doubts about the government's commitment to sound finance. Lawmakers were simply compelled to raise taxes. "[P]ublic credit must be maintained at all hazards," the Treasury staff concluded. "Such taxes as these are not popular and never will be popular, but real [statesmen] must face realities and, if necessary leave popular acclaim to history."[86]

Such traditional views notwithstanding, the Treasury experts did show some awareness of newer trends in public finance. In their discussion of the income tax, for instance, they reeled off a list of its virtues:

> In normal times it can yield an abundance of revenues; if properly handled in prosperous times it can yield enough more to build up reserves for the future or to pay off debts of depression periods. Those large income taxes, contributed by industry in boom times to pay off debts and build up reserves, may serve at the same time to stabilize business in several ways; they may lessen taxes for debt service in future depression periods. They may check the overextension of plant and unbalanced production that would follow unduly large profits and surpluses, and they may help to build up industrial and government insurance reserves that [may] steady purchasing power and decrease tax drains for relief purposes in bad times.[87]

"Check the overextension of plant"? "Steady purchasing power"? Such terminology reveals a more than passing acquaintance with theories of compensatory taxation. But for Treasury tax officials, these were still distinctly secondary concerns—and not yet ready for real-world use, in any case. The

83. *Id.*

84. *Id.*

85. BLAKEY, *supra* note 80. To some extent, Treasury experts may simply have been toeing the party line. President Roosevelt was committed, at least symbolically, to the goal of a balanced budget, and Morgenthau was, if anything, even more of a fiscal conservative. *See generally* Julian E. Zelizer, *The Forgotten Legacy of the New Deal: Fiscal Conservatism and the Roosevelt Administration, 1933–1938*, 30 PRESIDENTIAL STUD. Q. 331 (2000) (discussing the fiscal conservatism of the early New Deal).

86. BLAKEY, *supra* note 80.

87. *Id.*

signal virtue of the income tax was its ability to raise ample revenue without violating norms of distributive justice. If the levy could also help the economy function more smoothly, then all the better. But taxes, they believed, should not be designed with such ancillary effects moved to the fore.

IV
THE NEW-DEAL EMBRACE OF COMPENSATORY TAXATION

New Deal tax experts may have been skeptical of compensatory fiscal policy in 1934, but just three years later, they were unabashed enthusiasts. Their conversion was prompted by a change in economic circumstance, coupled with continuing intellectual ferment following the publication of Keynes's *The General Theory of Employment, Interest and Money*. Meanwhile, political and revenue imperatives prompted Roosevelt to champion yet another sweeping tax law, this time focusing on the taxation of corporate profits. The undistributed-profits tax (UPT)—introduced in 1936 despite the vigorous complaints of business leaders—drew its root inspiration from theories of compensatory fiscal policy. But its political rise in 1935—and subsequent fall in 1937—turned principally on fairness concerns, not business-cycle regulation.[88]

Nonetheless, the UPT proved pivotal in shaping attitudes toward compensatory fiscal policy—and countercyclical taxation in particular—within the Treasury Department. As the economy nosedived into a resurgent depression in 1937, and the New Deal lost its forward momentum, leaders of the Roosevelt Administration embraced compensatory fiscal policy. Treasury experts were no exception, and by 1937, they were quick to defend the UPT on countercyclical grounds, while also making the case for a broader compensatory system of taxation.

A. The Early New Deal and Compensatory Taxation

As he approached the 1936 election, Franklin Roosevelt made room for tax reform on the crowded New Deal agenda. The Revenue Act of 1935, which the President championed vigorously, imposed heavy new taxes on the rich, raising rates for both income and estate levies. In general, he defended the measure as a blow for social justice, insisting that concentrations of wealth and economic power were inconsistent with modern American democracy.

Such arguments carried the day, but in the flush of victory, Roosevelt appended an economic justification for his soak-the-rich tax reform. The purpose of the law, he told one correspondent, "is not to destroy wealth, but to create [a] broader range of opportunity, to restrain the growth of unwholesome and sterile accumulations and to lay the burdens of Government where they can best be carried."[89] This language echoed arguments for compensatory taxation,

88. LEFF, *supra* note 7, at 175–77.

89. President Franklin D. Roosevelt, Reply to Letter from Roy W. Howard (Sept. 6, 1935), *available at* http://www.presidency.ucsb.edu/ws/?pid=14932.

especially of the progressive variety. But compensatory arguments for the 1935 law were an afterthought; Roosevelt sought higher taxes on the rich for a variety of political and moral reasons, but regulating the business cycle was not a leading motive for the President or any of his chief advisers.[90] The New Deal's first real experiment in countercyclical taxation came the following year, when Roosevelt unveiled his proposal for a controversial tax on undistributed corporate profits.

The UPT was not a new idea, having been championed by tax economists for more than a decade. But it made its New Deal debut during the 1932 campaign, when several of Roosevelt's key advisers—including Raymond Moley and Adolf Berle—suggested that a tax on undistributed corporate profits could help regulate the business cycle.[91] Companies, they argued in a pivotal memo, had traditionally distributed profits by paying dividends to shareholders. Increasingly, however, many were choosing to retain their profits, "hoarding" cash in company coffers, where it sat unproductively. According to Moley and Berle, these retained profits had contributed to the depression by disrupting the natural flow of supply and demand, encouraging companies to overinvest in productive capacity and limiting the circulation of money among consumers.[92]

To correct this tendency, Moley and Berle suggested that companies be taxed on some share of their undistributed earnings.[93] An undistributed-profits tax could be levied on companies that failed to distribute a reasonable percentage of their annual profits. If made steep enough, the rates would force companies to disgorge their annual profits (though not their existing surpluses).

This was a dramatic but not entirely novel proposal.[94] An early version of the UPT had been implicit in the Civil War income tax, which taxed shareholders not only on dividends, but on their share of a corporation's undivided profits.[95] In the early twentieth century, lawmakers had revived this idea, adapting it to reflect the advent of a corporate income tax. During World War I, Treasury adviser Thomas S. Adams had recommended the UPT as a

90. *See* Joseph J. Thorndike, *"The Unfair Advantage of the Few": The New Deal Origins of "Soak the Rich" Taxation*, *in* THE NEW FISCAL SOCIOLOGY: TAXATION IN COMPARATIVE AND HISTORICAL PERSPECTIVE 29 (Isaac William Martin et al. eds., 2009).

91. Memorandum from Raymond Moley and others, to Franklin Delano Roosevelt (May 19, 1932) (in Box 282, Folder 3, Raymond Moley Papers, Hoover Institution Library and Archives, Stanford University) [hereinafter Memorandum of May 19, 1932]. Other Roosevelt advisers contributed to this memo, especially Rexford Tugwell. Elliot Rosen argues that Moley took the lead in crafting the proposal for an undistributed-profits tax. *See* ELLIOT A. ROSEN, HOOVER, ROOSEVELT, AND THE BRAINS TRUST: FROM DEPRESSION TO NEW DEAL 114–50 (1977). By contrast, legal historian Steven Bank has maintained that Berle was the principal advocate for the UPT. *See* Steven A. Bank, *Corporate Managers, Agency Costs, and the Rise of Double Taxation*, 44 WM. & MARY L. REV. 167, 188 (2002).

92. Memorandum of May 19, 1932, *supra* note 91, at 2–3; *see also* Bank *supra* note 91, at 184–85.

93. Memorandum of May 19, 1932, *supra* note 91, at 2–3; *see also* Bank *supra* note 91, at 188.

94. LEFF, *supra* note 7, at 171.

95. Steven A. Bank, *Is Double Taxation a Scapegoat for Declining Dividends? Evidence from History*, 56 N.Y.U. TAX L. REV. 463, 474 (2003).

matter of fairness. "[T]he undivided profits of a corporation should be taxed at the rates which would apply if such profits were distributed to the shareholders," he wrote in 1918.[96] In 1920, Woodrow Wilson's Secretary of the Treasury had also proposed a new tax on undivided profits, and the Joint Committee on Internal Revenue Taxation, while eschewing a decisive stand, supported some version of the tax in the late 1920s. Meanwhile, the tax system already included a weak version of the UPT, although exemptions and exceptions had rendered it a dead letter.[97]

Advocates of large-scale economic planning, like Rexford Tugwell, were among the most vocal proponents of taxing corporate reserves. Properly designed, Tugwell maintained, a tax on retained earnings would prevent corporate managers from investing too heavily in productive capacity. Like many of his contemporaries, Tugwell believed that overinvestment was a principal cause of the Great Depression. With easy access to investment capital—in the form of retained earnings—managers had made foolish investments. A tax on undistributed profits would prevent companies from expanding recklessly during prosperous years. If designed with a steep, almost punitive rate structure, it would force companies to part with their precious cash. Managers still intent on expansion would then be forced to seek funds in the open, and presumably more rational, capital market.[98]

Many of Tugwell's colleagues in the academy and liberal intelligentsia believed that companies were sitting on huge piles of cash. The Treasury Department estimated that from 1923 to 1929, corporations had retained more than forty-five percent of their total earnings.[99] Some observers believed this propensity to retain earnings reflected the growing divide between ownership and management.[100] In a 1932 study of corporate structure, Adolf Berle and Gardiner Means had stressed the size and importance of this gap. By 1930, they pointed out, most of the nation's largest companies were controlled by managers, not owners or their direct representatives.[101] And these managers had

96. Thomas S. Adams, *Federal Taxes upon Income and Excess Profits*, 8 AM. ECON. REV. 18, 26 (1918).

97. *Id.* at 24–26. Lawmakers heeded Adams's advice, enacting an undistributed-profits tax as part of their wartime revenue reforms. But the UPT of World War I proved ineffective. By granting generous exemptions for reserves used to finance productive enterprise, lawmakers rendered it more or less useless. *See, e.g.*, Benjamin Graham, *The Undistributed Profits Tax and the Investor*, 46 YALE L.J. 1 (1936); U.S. DEP'T OF THE TREASURY, 4 TAX REVISION STUDIES: UNDISTRIBUTED PROFITS TAX (1937), *available at* http://www.taxhistory.org/civilization/Documents/Surveys/hst23732/23732.htm.

98. REXFORD G. TUGWELL, THE INDUSTRIAL DISCIPLINE AND THE GOVERNMENTAL ARTS 203–07 (1933); Gerhard Colm, *Conflicting Theories of Corporate Income Taxation*, 7 LAW & CONTEMP. PROBS. 281, 289–90 (Spring 1940).

99. GEORGE HAAS, RATIONALE OF THE UNDISTRIBUTED PROFITS TAX (1937), *available at* http://www.taxhistory.org/Civilization/Documents/UPT/HST8668/hst8668-1.html.

100. This discussion of the "agency costs" associated with independent management of publicly traded corporations draws on Bank, *supra* note 91, at 203; *see also* Bank, *supra* note 98, at 463–64.

101. ADOLF AUGUSTUS BERLE & GARDINER COLT MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 94–117 (1932); *see also* W. L. Crum, *Concentration of Corporate Control*, 8 J. BUS.

their own interests and imperatives. Many were inclined to invest corporate income, even when prudence dictated otherwise. "Officers of a billion dollar corporation certainly enjoy higher incomes and greater social prestige, even if the rate of return on the invested capital is lower, than officers of smaller corporations that are very prosperous," observed one economist.[102]

Moley and Berle embraced Tugwell's theory of excess investment. At the same time, they offered a proto-Keynesian case for the UPT. By forcing money out of corporate coffers and into the economy at large, they predicted, a tax on undivided profits would "liberate a tremendous amount of purchasing power." Excess saving was a drag on the economy, and steep taxation on corporate reserves would turn sterile accumulations to more-productive use. Since inadequate demand had conspired with excessive supply to create the depression, the distribution of corporate profits might help turn the economy around.[103]

The UPT quickly disappeared into the volatile policy process of the early New Deal. But some of the reformist arguments offered by Moley and Berle would reappear in the mid-1930s, as another group of policymakers adopted the UPT as its pet project.

B. An Experiment in Countercyclical Taxation

For senior officials in the Treasury Department, revenue needs were a constant worry. In 1936, they became especially acute when the Supreme Court invalidated the processing tax associated with the Agricultural Adjustment Act. Tax experts working for Treasury Secretary Henry Morgenthau immediately cast about for ways to close the resulting budget gap.[104] What, they wondered, should replace this highly productive consumption tax? They quickly settled on the undistributed-profits tax—thanks largely to the efforts of one person: Herman Oliphant, Treasury general counsel and one of the Roosevelt Administration's leading champions of progressive tax reform.

Oliphant had long favored a tax on undistributed corporate income. He worried incessantly about the power of big business, and his tax proposals were often designed to humble large companies. He was something of an "anti-

U. CHI. 269 (1935); Gardiner Means, *The Growth in the Relative Importance of the Large Corporation in American Life*, 21 AM. ECON. REV. 10 (1931).

102. Robert Weidenhammer, *Causes and Repercussions of the Faulty Investment of Corporate Savings*, 23 AM. ECON. REV. 35, 40 (1933).

103. ROSEN, *supra* note 91, at 142; *see also* Memorandum of May 19, 1932, *supra* note 91. While the propensity of corporations to oversave was widely asserted, the empirical foundation for such claims was weak. Beginning in the latter half of the 1930s, economists would bolster this case, offering data on the relationship between income and the propensity to save, both for companies and individuals. For discussion of this phenomenon, see generally Mordecai Ezekiel, *An Annual Estimate of Savings by Individuals*, 19 REV. ECON. & STAT. 178 (1937); Donald W. Gilbert, *Taxation and Economic Stability*, 56 Q. J. ECON. 406 (1942); Joshua C. Hubbard, *Income Creation by Means of Income Taxation*, 58 Q. J. ECON. 265 (1944).

104. RANDOLPH E. PAUL, TAXATION IN THE UNITED STATES 190 (1954); LEFF, *supra* note 7, at 170–71.

truster," sympathetic to the ideas of Justice Louis Brandeis and eager to disperse concentrations of economic power. He was not among the first rank of New Deal Brandeisians, which included Felix Frankfurter, Tommy Corcoran, and others, but Oliphant believed tax policy could be used to discourage monopoly and stem the concentration of wealth.[105] Artfully employed, he contended, taxes could remake American society.

Oliphant's suspicion of concentrated economic power extended to individuals as well as to organizations. He worried that a handful of wealthy, well-connected oligarchs were dominating the economy. This concern had led him to champion steep new taxes on wealth and income; the progressive emphasis of the 1935 Revenue Act bore the hallmark of Oliphant's soak-the-rich ideology. In 1936, he built on this success by arguing that the UPT would tame not just large companies, but the men who ran them as well. By forcing the corporate elite to cede control over profits, the UPT would promote economic democracy.

In 1935, Raymond Moley had convinced Roosevelt to table Oliphant's plan for a UPT. Since writing his 1932 campaign memo recommending the tax, Moley had soured on the idea. By early 1935, he was warning Roosevelt that such a tax would penalize thrift, hamper recovery, and destroy business confidence. Roosevelt agreed to sideline the proposal, but his revenue message retained an oblique warning about the danger of retained profits.[106]

In 1936, Oliphant revived his plan, and this time he had a revenue crunch to aid his cause. Moley had since parted ways with Roosevelt, and Oliphant quickly lined up support from several other presidential advisers, including Jacob Viner and Roswell Magill.[107] One key Roosevelt adviser, however, was not enthusiastic: Henry Morgenthau. The Treasury Secretary was inclined to oppose the new tax, worried that its introduction—especially when coupled with repeal of existing corporate taxes—would threaten the stability of federal revenue. He also seemed to understand that the tax would prove highly controversial. And on this point, even Oliphant agreed. "If we have to fight," Oliphant told his boss, "we might as well fight the people who are our enemies anyway."[108]

Oliphant's pugnacity presaged a looming battle. While he supported the UPT for its potential to reform the economy, Oliphant now cast the tax principally in terms of fairness. The levy, he argued both publicly and privately, was a means to prevent wholesale tax avoidance among the nation's very rich. His argument depended on the presumption that all taxes were ultimately borne by people, not companies. "When all is said, taxes come out of the

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105. LEFF, *supra* note 7, at 173.

106. RAYMOND MOLEY, AFTER SEVEN YEARS 310–12 (1939).

107. ELLIS WAYNE HAWLEY, THE NEW DEAL AND THE PROBLEM OF MONOPOLY: A STUDY IN ECONOMIC AMBIVALENCE 350–51 (1995); *see also* ARTHUR MEIER SCHLESINGER, THE POLITICS OF UPHEAVAL 507 (1960).

108. 18 HENRY MORGENTHAU, MORGENTHAU DIARIES, 114–19 (1936).

pockets of individuals," he declared.[109] And some of these individuals were not paying their fair share. The moral case for taxing retained profits was overwhelming, Oliphant later told the Senate Finance Committee. The injustice of the current tax structure "makes no other form of taxation at this juncture possible of defense."[110]

As lawmakers sat down to consider the UPT, New Deal officials consistently offered fairness arguments for its passage. Issues of structural economic reform and compensatory relation of the business cycle were largely absent. Opponents of the UPT also left these issues largely unexplored, although they argued strenuously that the attempt to bolster fairness (an attempt they rejected on its own merits) was almost certain to cause widespread economic disruption.

Ultimately, lawmakers passed a watered-down but still-important version of the UPT. And almost as quickly, they began to reconsider their decision. In mid-1937, the economy began a steep decline into a resurgent depression. The downturn was prompted, at least in part, by Roosevelt's renewed commitment to fiscal austerity. The President had succumbed to Morgenthau's persistent arguments for "sound" finance, calling for budget stringency throughout the government. The nation watched as expenditures declined and tax receipts rose. At the same time, the Federal Reserve tightened the supply of credit, and, soon enough, a resurgent depression had appeared.[111]

In the face of the "Roosevelt Recession," Morgenthau continued to argue to budget discipline. He believed that business required a demonstration of fiscal responsibility, especially after years of deficit finance. Outside the Administration, meanwhile, critics were having a field day, many blaming the President's tax policies—and the UPT in particular—for the recent downturn. Business leaders were solidly arrayed against the UPT, and lawmakers on Capitol Hill were giving serious thought to repeal. A few Administration figures urged reform, including Agriculture Secretary Henry Wallace, Reconstruction Finance Corporation chairman Jesse Jones, and even Federal Reserve chairman Marriner Eccles.[112] Soon enough, Congress agreed. The Revenue Act of 1938 gutted the UPT, leaving little more than a vestige. The Revenue Act of 1939 finished the job, ending Roosevelt's grand experiment in corporate (and compensatory) taxation.

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109. *Revenue Act, 1936: Hearing on H.R. 12395 Before the S. Comm. on Finance*, 74th Cong. 889 (1936) (statement of Herman Oliphant, General Counsel for the Treasury Department).

110. *Id.* at 890.

111. Herbert Stein points out that the changing fiscal picture resulted principally from introduction of the new Social Security taxes coupled with an end to the accelerated soldiers' bonus. Roosevelt's newfound commitment to spending restraint played a relatively minor role. *See* STEIN, *supra* note 1, at 99–100.

112. Not surprisingly, Morgenthau was reported to be "extremely dubious" of the UPT. For Treasury plans to reform the tax, see CARL SHOUP, UNDISTRIBUTED PROFITS TAX RELIEF FOR SMALL CORPORATIONS (1937), *available at* http://www.tax.org/THP/Civilization/Documents/UPT/HST8667/hst8667-1.html; U.S. DEP'T OF THE TREASURY, *supra* note 97.

C. Tax Experts and the Embrace of Compensatory Taxation

The same recession that helped defeat the UPT also catalyzed support for it within the Treasury Department. More important, the downturn changed the way tax experts thought about compensatory taxation more generally. Armed with fresh economic theory, including the ideas Keynes had put forward the year before, these experts were now eager to make taxation an instrument of business-cycle regulation.

In 1937, the Treasury Department's tax staff took a hard look at tax reform, much as they had in 1934 under the direction of Jacob Viner and Roswell Magill. Again, they produced a series of major reports, collectively dubbed the Tax Revision Studies, that laid out of program of fundamental tax reform.[113] But while the Viner Studies had been permeated by a sense of immediate crisis, the 1937 reports took a broader, more contemplative view of the tax system.

In some important respects, the conclusions of 1937 looked much like those offered three years earlier. The Treasury economists once again declared revenue adequacy the overriding goal of federal taxation. They repeated their recommendation that income taxes be given a bigger role in the overall revenue system, with lower exemptions bringing middle-class taxpayers within the grasp of this erstwhile rich-man's tax.[114]

But the Treasury economists of 1937—many of whom had also worked on the 1934 reports—broke with the Viner recommendations when it came to broad issues of compensatory taxation. Once leery of plans to make taxes a tool for macroeconomic regulation, they now urged lawmakers to do just that. Taxes, they argued, could help bring stability to an inherently unstable economy.[115]

In general, Treasury staff argued, policymakers should not try to maintain a steady flow of revenue into the Treasury during economic downturns. "The tendency exhibited during the depression years to introduce a great variety of new excise taxes, and to raise the rates on old ones, to make up for the diminished receipts from direct taxes is not a wholesome one," they wrote.[116] Instead, policymakers should devise a flexible revenue system whose receipts were expressly designed to vary over the length of the business cycle.[117]

Annual variation in federal revenues was desirable, according to research director George Haas, as long as it derived from "a basically adequate and stable tax structure which relies heavily upon progressive direct taxes."[118] This statement represented a dramatic reversal from Treasury's earlier position, which had emphasized the need for "sound" finance in the face of depression

113. For a summary of the studies, see HAAS, *supra* note 62.
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*

deficits. And Haas justified it in distinctly Keynesian terms. During recessions, he explained, a stable tax system would produce a sharp decline in revenue, even as spending needs were likely on the rise. But the resulting deficit was no cause for alarm. Indeed, he assured his superiors that it would be "stimulating to the national economy."[119]

"In the opinion of an important body of present-day economists, a business depression is characterized by a lack of balance between saving and investment," he explained.[120] Worried about prospects for the future, people saved too much and invested too little. This left large stores of capital and labor unemployed. In such a situation, government should borrow the nation's unused savings and increase spending immediately, thereby increasing national income and promoting recovery. "In this way," Haas wrote, "during a period of abnormal unemployment, an unbalance of the Federal budget may be said to help to redress the unbalance of the entire economy."[121]

Policymakers should definitely avoid raising taxes in a depression, Haas wrote, at least for everyone except the rich. A tax increase on the poor and middle class (like the excise hikes of 1932) might raise revenue, but it would harm the nation's economic well-being. Indeed, Haas contended, such an increase "only adds to the deflationary forces already operating upon private business."[122]

An increase in progressive taxes, however, might actually encourage recovery by freeing idle money from the hoards of wealthy taxpayers, who were naturally inclined to oversave. "Therefore, as the wealth of the community increases," Haas wrote, "it may be increasingly necessary to reduce the potential savings of the wealthier members, among whom the propensity to save is greatest, and to direct such income to the poorer members."[123]

Income taxes, in conjunction with government spending, could accomplish this redistribution. But so, too, could certain taxes on corporate profits, including the UPT, that also reach idle savings. "There are good grounds for believing that there exists in this country a considerable stream of uninvested savings which prevent a full absorption of the potential products of industry," Haas wrote.[124] A tax on undistributed profits would discourage shareholders (who tended to be rich) from saving too much within corporate coffers.

In broad terms, the compensatory role of federal taxation was designed to help establish a healthy balance among consumption, savings, and investment, Haas concluded. Left unchanged, the existing tax system placed too heavy a burden on consumption through its numerous regressive elements. The prospect of social-insurance payroll taxes only made the situation more urgent.

119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.*
123. U.S. DEP'T OF THE TREASURY, *supra* note 97.
124. *Id.*

> A vast and involuntary increase in the savings to be made by members of the lower income groups under the Social Security Act might well have decidedly unfavorable and profound, economic repercussions if this volume of income withdrawn from current consumption were not offset in considerable measure by a reduction, through taxes levied to defray ordinary Government operating expenditures, in those segments of the income of wealthy individuals which would otherwise be saved by them.[125]

One of the more-notable aspects of the Treasury program was its emphasis on tax-system stability, even within the context of compensatory taxation. All too aware of the inequities and administrative difficulties associated with frequent changes to the tax system, they stressed "the great desirability, on both economic and equitable grounds, of a stable tax structure."[126] This preference was a key element of the domesticated Keynesianism that later came to dominate fiscal policymaking.

Taken as a whole, the Tax Revision Studies offered a powerful Keynesian case for compensatory taxation. They accepted the notion that taxes should be used to regulate the business cycle, and as justification they presented a more or less doctrinaire Keynesian interpretation of the depression. The studies even embraced (somewhat gingerly) arguments for redistributive taxation as a recovery measure—and possibly as a condition of continued economic stability. All this was quite a change from the relatively conservative policy recommendations formulated by the same tax staff just three years earlier in the Viner Studies. The fiscal revolution was moving quickly, at least among fiscal experts.

V

CONCLUSION: THE IMPLICATIONS FOR THE FISCAL REVOLUTION

The New Deal's legislative experiment with compensatory taxation was ephemeral, but its intellectual embrace of the idea proved durable. Indeed, by 1938, the fiscal revolution was largely complete within the tax-policy community. To be sure, some members of this policy community remained to be convinced; elected lawmakers were particularly slow to embrace the desirability of deliberately unbalanced budgets, among other elements of revenue Keynesianism. But for key tax experts, the fiscal revolution ended at roughly the same time that the 1937 recession sent the New Deal itself into general retreat.

In general, historians have minimized the influence of explicitly Keynesian ideas in the 1930s. Even after the "Struggle for the Soul of FDR"—Stein's phrase for the concerted effort in 1937 to convert the President to Keynesian thinking—the New Deal's embrace of countercyclical fiscal policy was a modest affair, constrained by economic and political realities, including Roosevelt's waning influence over Congress in the late 1930s. Compensatory taxation, in particular, remained.

125. HAAS, *supra* note 62.
126. *Id.*

But if practitioners of high politics were still resistant to the Keynesian prescription for macroeconomic management, fiscal experts were not. Revenue Keynesianism had established a beachhead in various parts of the Roosevelt Administration by the late 1930s, but none more secure than its position in the Treasury Department's tax division.[127]

To be sure, the version of revenue Keynesianism adopted by New Deal tax experts relied heavily on the redistributive role of progressive taxation. In the late 1930s, the notion of countercyclical tax cuts—a fiscal tool that would emerge in postwar politics as a key element of domesticated Keynesianism—remained in the land of economic theory, not political reality. As economist Robert Musgrave later recalled, expansionary tax cuts remained "unthinkable" in the late 1930s, not least because they would have delivered disproportionate benefits to wealthy taxpayers.[128]

True revenue Keynesianism emerged only after the fiscal watershed of World War II. The vaunted transformation of the income tax from a "class tax" to a "mass tax"[129] gave policymakers a crucial weapon in their countercyclical arsenal. Indeed, without a broad-based flexible revenue instrument like the income tax, compensatory taxation would have remained an intellectual curiosity, not a serious tool for economic policymaking.

But the conversion of the tax experts was a crucial first step. Treasury experts played a vital role in shaping the wartime tax regime. Congressional leaders were intent on reclaiming their primacy in the tax-policy process, a role that Roosevelt had co-opted in the mid-1930s but relinquished in the latter years of the decade. But Treasury officials, with strong support from Roosevelt, still managed to make their plans for mass income taxation the bedrock of wartime taxation—and the durable regime it spawned.

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127. The triumph of revenue Keynesianism was not confined to the Treasury Department. The late 1930s saw a flurry of research on compensatory taxation, with numerous economists and tax lawyers offering intellectual comfort to the official champions of the idea. *See generally* Roy Blough, *Will Revenues Be Adequate to Balance the Present Scale of Expenditures and to Keep It Balanced?*, 17 PROC. OF THE ACAD. OF POL. SCI. 89 (1938); Gilbert, *supra* note 103; R.A. Gordon, *Fiscal Policy as a Factor in Stability*, 206 ANNALS AM. ACAD. OF POL. & SOC. SCI. 106 (1939); Clarence Heer, *The Place of Personal Income Taxes in a Modern Fiscal System*, 183 ANNALS AM. ACAD. OF POL. & SOC. SCI. 78 (1936); Gunnar Myrdal, *Fiscal Policy in the Business Cycle*, 29 AM. ECON. REV. 183 (1939).

128. Richard A. Musgrave, *U.S. Fiscal Policy, Keynes, and Keynesian Economics*, 10 J. POST KEYNESIAN ECON. 171, 174 (1987–1988).

129. C. EUGENE STEUERLE, CONTEMPORARY U.S. TAX POLICY 33 (2d ed. 2008).