

SOAK-THE-RICH REPUBLICANS?
THE PUZZLING PERSISTENCE OF HIGH TAX RATES IN THE 1950S

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I. Introduction

The 1950s are a puzzle, at least for students of American political economy. We remember the decade for its robust economic growth and resurgent conservative politics. Yet federal tax rates remained stubbornly high throughout the period, reaching more than 90 percent for individuals and 50 percent for corporations. How can we reconcile such high rates with a fast growing economy?

To some degree, the puzzle is more apparent than real. To begin with, growth was good but not great during much of the 1950s. Viewed as a whole, growth averaged just over 4 percent from 1950 to 1959. But it was not consistent, and the average was boosted by unusually quick growth during the Korean War.¹ The 1950s also featured two recessions, including back-to-back slumps in 1953-1954 and 1957-1958.² In other words, the robust growth of the 1950s was perhaps not quite so robust and therefore easier to reconcile with high tax rates.

Moreover, rates were not as high as they might first appear. To be sure, statutory rates reached the nosebleed level, especially for individuals.³ But effective rates – taxes paid as a percentage of total income – were much lower, thanks to various tax incentives, including a preferential rate

¹ Alan Reynolds, “Note to Charles Krauthammer: Economic Growth Averaged 2.9% (not 5%) under Ike’s Military-Industrial Complex,” Cato@Liberty, September 9, 2011, available at <http://www.cato-at-liberty.org/note-to-charles-krauthammer-economic-growth-averaged-2-9-not-5-under-ikes-military-industrial-complex/>. For a similar point with slightly different numbers, James Pethokoukis, “Why we can’t go back to sky-high, 1950s tax rates,” AEI Ideas, April 18, 2012, available at <http://www.aei-ideas.org/2012/04/why-we-cant-go-back-to-sky-high-1950s-tax-rates/>.

² GDP data from Bureau of Economic Analysis, available at <http://www.bea.gov/iTable/iTableHtml.cfm?reqid=9&step=3&isuri=1&910=X&911=0&903=1&904=1950&905=1960&906=A>

³ The top bracket rate never dropping below 91 percent throughout the 1950s. See Tax Policy Center, Historical Top Tax Rate, April 13, 2012, available at <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=213>

for capital gains.⁴ For the nation's wealthiest taxpayers, effective rates declined steadily over the course of the decade, from 49.3 percent in 1953 to 30.6 percent in 1959.⁵

Perhaps most important, the relationship between taxes and growth is far from clear. While it seems safe to say that most economists believe tax rates *do* matter to growth, there is less consensus on *when* they matter. Some new research, for instance, suggests that high rates and robust growth are not incompatible. "In the postwar U.S., higher top tax rates tend to go with higher economic growth—not lower," observed Peter Diamond and Emmanuel Saez in a recent article for the *Wall Street Journal*.⁶ So viewed strictly through an economic lens, perhaps the 1950s aren't so puzzling after all.

Indeed, the real puzzle of the 1950s is political, not economic. High tax rates may not have slowed growth very much in the Eisenhower era (although we obviously can't be sure of such a counterfactual assertion), but many contemporaries certainly believed they did. Moreover, even if effective rates on capital and labor income were relatively moderate, political leaders insisted that statutory rates were much too high. So how did those rates survive, especially after Republicans captured both the White House and the Congress in the 1952 election? The party was broadly and loudly committed to tax reduction. But even when handed the keys to the kingdom, they declined to cut rates.

The conventional explanation centers on President Dwight Eisenhower and his commitment to balanced budgets. Deeply afraid of inflation, he refused to consider rate cuts while spending remained high. Yet politics and national security conspired to make spending control difficult.

⁴ For a classic discussion of effective tax rates, as well as the political issues involved in their calculation, see Boris I. Bittker, "Effective Tax Rates: Fact or Fancy?" (1974). Faculty Scholarship Series. Paper 2290, available at http://digitalcommons.law.yale.edu/fss_papers/2290. For discussion of contemporary effective rates, see Rachel Johnson, Joseph Rosenberg, and Robertson Williams, *Measuring Effective Tax Rates* (Washington, DC: Urban-Brookings Tax Policy Center, 2012). On capital gains rates during the era, see Tax Policy Center, Historical Capital Gains and Taxes, April 11, 2011, available at <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=161>.

⁵ On these effective rates during the period, see Marc Linder, "Eisenhower-Era Marxist-Confiscatory Taxation: Requiem for the Rhetoric of Rate Reduction for the Rich," *Tulane Law Review* 70, no. 4 (1996): 927-933.

⁶ Peter Diamond and Emmanuel Saez, "High Tax Rates Won't Slow Growth," *Wall Street Journal*, April 23, 2012, available at <http://online.wsj.com/article/SB10001424052702303425504577353843997820160.html>. In more specific terms, Diamond and Saez have made the case for markedly higher rates in Peter Diamond and Emmanuel Saez, "The Case for a Progressive Tax: From Basic Research to Policy Recommendations," *Journal of Economic Perspectives*, Fall 2011, 165–190.

In terms of historical analysis, the Congressional Research Service has reached similar conclusions; see Jane G. Gravelle and Donald J. Marples, "Tax Rates and Economic Growth," R42111, Congressional Research Service, December 5, 2011, 5; Thomas L. Hungerford, "Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945," R42729, September 14, 2012, 16.

On the domestic front, Eisenhower proved unwilling to seriously challenge the expanded federal state that he inherited from Roosevelt and Truman.⁷ And with the Cold War ensuring that defense spending would remain elevated for the foreseeable future (despite Eisenhower's concerted efforts to contain it), there wasn't much room for the sort of spending cuts that would make tax reduction possible.⁸

Eisenhower's old-school fiscal conservatism is certainly part of the explanation for 1950s tax policy. But to adequately explain the era's fiscal history, we have to go further. The tax policies of the Eisenhower era were not simply an exercise in misguided but anomalous policymaking, or even a form of policy inertia in the wake of World War II. Rather, they were part of a longer political process described by the economist Herbert Stein as America's "fiscal revolution."⁹ Between the mid 1930s and the early 1960s, U.S. policymakers changed the way they thought about government's role in managing the economy. Among other things, this change involved a protracted argument over the relative importance of fairness and growth in the making of federal tax policy.

Often, growth and fairness are often framed as mutually exclusive goals for federal tax policy.¹⁰ But not everyone accepts the zero-sum nature of this debate. Pro-growth partisans, in particular, generally see it as a non-issue, with growth dissolving questions of distributional equity. Rising tides, expanding pies – pick your metaphor, but the essential point remains: growth makes everyone better off. Some fans of fairness also reject the notion of a tradeoff. Progressive redistribution of wealth and income, they maintain, is actually the key to long-term growth. Prosperity broadly shared is the only prosperity that lasts.

But most fairness champions view tax policy as a zero-sum game, where pro-growth tax cuts for a lucky few necessarily require higher taxes for the rest of us.¹¹ In its most pessimistic form, this argument rests on the assumption that growth will be too modest to resolve distributional concerns. Rather than hoping for a new and bigger pie, we need to focus on how we're going to slice the one we already have.

More upbeat iterations of this fairness argument leave open the possibility of meaningful growth, but they reject the notion that growth – however spectacular – can ever make equity irrelevant. No amount of shared prosperity can paper over the essential injustice of rampant inequality.

⁷ Iwan W. Morgan, *Deficit Government: Taxing and Spending in Modern America*, The American Ways Series (Chicago: Ivan R. Dee, 1995), 72-76.

⁸ On Eisenhower and defense spending, see *ibid.*, 67-71.

⁹ Herbert Stein, *The Fiscal Revolution in America*, Rev. ed. (Washington, D.C.: AEI Press, 1996).

¹⁰ For a stimulating exploration of the tradeoff between fairness and growth, see Robert M. Collins, *More : The Politics of Economic Growth in Postwar America* (Oxford ; New York: Oxford University Press, 2000), preface, prologue, and *passim*.

¹¹ For a useful discussion of zero-sum thinking on taxation, see Ronald Frederick King, *Money, Time, & Politics : Investment Tax Subsidies & American Democracy* (New Haven, Conn.: Yale University Press, 1993), ch. 1.

Contemporary debates over tax policy reflect all these disparate views. But arguments over fairness and growth were especially evident during the middle decades of the 20th century, including the 1950s. Indeed, between 1930 and 1960, champions of equity and growth struggled with one another over which goal should be the focus of federal tax policy.

And both sides won, at least initially. The high tax rates of the 1950s represented a compromise, of sorts, between those who wanted to “soak the rich” in the name of fairness and those who sought to “float all boats” with a rising tide of economic growth. When we recall the era’s sky-high statutory rates, we are remembering only half the story. Fiscal policy in the 1950s also featured notable efforts at pro-growth tax reform. Some of these pro-growth provisions – like the tax preference for capital gains – were well established by the 1950s, having been a part of the federal revenue system for decades. But others – including a preference for dividend income and a more generous depreciation regime, both enacted in 1954 – were new additions to the tax system. As a group, these pro-growth incentives served to reign in the era’s famously high tax rates. Effective rates, especially for the nation’s wealthiest taxpayers, were nowhere near the statutory rates we usually recall.

The Eisenhower-era compromise between fairness and growth explains why Republicans of the 1950s, including both the president and his congressional allies, were willing to tolerate high statutory rates. To be sure, party leaders called frequently for tax reduction, including not simply cuts in marginal rates but also a general reduction in tax levels. But they were able to make peace with the existing tax structure by focusing – at least over the short-term – by adding investment incentives to the tax code.

This paper explores the mid-century debate over growth, fairness and federal taxation. Section II describes the zero-sum thinking about tax fairness that dominated New Deal tax policy, while also highlighting pro-growth ideas advanced by tax experts in the Roosevelt Treasury Department. Part III explains how World War II further revived interest in using the tax system to manage growth. For most of the war, that management involved efforts to contain growth through high taxation. But by 1943, policymakers were already looking for ways to make the tax system – now laden with very high statutory rates on both individual and corporate income – more conducive to growth. Part IV explores the political compromise of the 1950s that allowed for a blend – however dysfunctional – of fairness and growth imperatives in the making of federal tax policy.

II. Promoting Fairness in the 1930s

The 1930s are accurately remembered as an era of “soak the rich” taxation.¹² As historian Mark Leff has pointed out, there was plenty of soak-the-poor taxation, too; the New Deal relied on regressive excise taxes for a large share of total revenue.¹³ But Franklin Roosevelt’s marquee tax

¹² For a general study of New Deal taxation, with an emphasis on its most progressive elements, see Joseph J. Thorndike, *Their Fair Share: Taxing the Rich in the Age of FDR*, Washington, DC: Urban Institute Press, forthcoming 2012.

¹³ Mark Hugh Leff, *The Limits of Symbolic Reform: The New Deal and Taxation, 1933-1939* (New York and Cambridge [UK]: Cambridge University Press, 1984).

reforms focused on raising burdens for the nation's wealthiest taxpayers in the name of social justice. As the nation struggled through the Great Depression, fairness was the touchstone of federal tax reform.

For most of the 1930s, federal tax policy reflected a dismal set of assumptions about the nation's economic future. While most political leaders and policy experts believed the Great Depression was a temporary phenomenon, a substantial cohort of "stagnationist" economists were less hopeful about the future. Often associated with Harvard economist and early Keynesian Alvin Hansen, the stagnationists believed that the American economy was "maturing."¹⁴ The high growth years of our national adolescence were over, done in by the closing of the frontier, a steady decline in birth rates, and the limited prospects for technological innovation. In such an economy, downturns might prove permanent. Self-correcting mechanisms that had previously served to revive a sick economy would cease to function. "This is the essence of secular stagnation," declared Hansen in December 1938. "Sick recoveries which die in their infancy and depressions which feed on themselves and leave a hard and seemingly immovable core of unemployment."¹⁵

The stagnationist diagnosis implied a political cure. If private investment wouldn't save the economy, then public spending had to. Stagnationists believed that mature economies would necessarily provide inadequate investment incentives, leading to persistently slow growth and tenaciously high unemployment.¹⁶ Only activist government could sustain prosperity in such an economy. Initially, stagnationists focused on vital role of deficit spending, arguing that government spending, especially on public works, would break what Keynes called a "vicious cycle" of declining confidence and sagging private investment.¹⁷

But the stagnationists also believed that income redistribution was vital to long-term prosperity in a mature economy. Only by redistributing money from the rich (with their high propensity to save) to the non-rich (with their high propensity to spend) could the forces of supply and demand find balance. "If fiscal policy is used as a deliberate instrument for the more equal distribution of incomes," explained John Maynard Keynes, "its effect in increasing the propensity to consume is, of course, all the greater."¹⁸

¹⁴ On Hansen and his role in defining certain strains of American Keynesianism, see W. Robert Brazelton, "Alvin Harvey Hansen: Economic Growth and a More Perfect Society: The Economist's Role in Defining the Stagnation Thesis and in Popularizing Keynesianism," *American Journal of Economics and Sociology* 48, no. 4 (1989).

¹⁵ Alvin H. Hansen, "Economic Progress and Declining Population Growth," *The American Economic Review* 29, no. 1 (1939).

¹⁶ Michael A. Bernstein, *The Great Depression : Delayed Recovery and Economic Change in America, 1929-1939*, Studies in Economic History and Policy (Cambridge Cambridgeshire ; New York: Cambridge University Press, 1987), 13.

¹⁷ Stein, *The Fiscal Revolution in America*, 145.

¹⁸ John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York,: Harcourt, Brace, 1936), 95.

For tax policy, then, the stagnationist diagnosis implied substantial changes to the revenue side of the budget, as well as the spending side. Heavy progressive taxation would actually encourage recovery, not retard it.¹⁹

Stagnationist theories proved popular with many New Dealers, if only because they seemed to validate their fairness arguments for progressive tax reform. By the late 1930s, Roosevelt and his champions were struggling to explain the economy depressed (and why it took a particularly steep nose dive in 1937, shortly after Congress had enacted the New Deal's most sweeping progressive tax reforms). Stagnationism gave them the answer. "The trouble was not something the New Deal had done but was the fatal flaw in capitalism," as economist Herbert Stein later summarized the argument. "The flaw was the inexorable tendency of private investment to fall behind full-employment saving in a technically advanced economy."²⁰

On some level, New Dealers had been singing this tune for years. In 1932, during his first campaign for the White House, Franklin D. Roosevelt had seemed to anticipate the stagnationist diagnosis that Hansen made popular in the mid 1930s. "It seems to me probable that our physical economic plant will not expand in the future at the same rate at which it has expanded in the past," he said. "We may build more factories, but the fact remains that we have enough now to supply all of our domestic needs, and more, if they are used."²¹

In a mature economy, Roosevelt counseled, Americans had to focus on making the most of what they already had, not seeking endlessly (and fruitlessly) for more. Rather than fighting the inexorable reality of slowing growth, in other words, political leaders should try to cope with it.

Our task now is not discovery or exploitation of natural resources, or necessarily producing more goods. It is the soberer, less dramatic business of administering resources and plants already in hand, of seeking to reestablish foreign markets for our surplus production, of meeting the problem of underconsumption, of adjusting production to consumption, of distributing wealth and products more equitably, of adapting existing economic organizations to the service of the people. The day of enlightened administration has come.²²

As historian Robert Collins has pointed out, this sort of stagnationist thinking was central to the early New Deal. Ambitious legislation like the Agricultural Adjustment Act and the National

¹⁹ On the use of tax hikes to encourage recovery, see Joseph J. Thorndike, "The Fiscal Revolution and Taxation: The Rise of Compensatory Taxation, 1929-1938," *Law and Contemporary Problems* (Winter 2010): 95-122; Joseph J. Thorndike, "FDR's Unlikely Prescription: Tax Hikes for Recovery," *Tax Notes*, December 4, 2008.

²⁰ Stein, *The Fiscal Revolution in America*, 167.

²¹ Franklin D. Roosevelt, Address at Oglethorpe University, May 22, 1932, in *The Public Papers and Addresses of Franklin D. Roosevelt*, Vol. 1, 1928-32, (New York City: Random House, 1938), p. 639.

²² Franklin D. Roosevelt: "Campaign Address on Progressive Government at the Commonwealth Club in San Francisco, California," September 23, 1932, available from Gerhard Peters and John T. Woolley, The American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=88391>.

Recovery Act were premised on the notion that forces of supply and demand should be realistically balanced through active governmental management. Permanently and substantially expanding either was a vain hope.²³

Similarly, New Deal deficits – while not exactly intentional forms of demand stimulation, at least in full-blown Keynesian form – were broadly consistent with stagnationist theory. If higher relief spending was a humanitarian necessity, it was also a powerful shot in the arm for the economy. By increasing aggregate demand, additional spending might jumpstart recovery.

Not all New Dealers were convinced by such thinking, especially when it came to the management of production. “Rationalize it any way we have to,” said Rexford Tugwell, “we can’t make a religion out of growing or making fewer goods with this whole country and the whole world in bitter need.” Similarly, other New Deal officials were determined to craft policies that would encourage growth, not just manage stagnation. “The only way each of us can enjoy bigger income slices,” wrote economist Mordecai Ezekiel from his perch in the Department of Agriculture, “is by making the whole pie of production and income bigger.”²⁴

Indeed, over time, the scarcity theories undergirding the NRA and AAA gave way to more growth-oriented policies in the New Deal, albeit ones that still assigned a central role to government activism. Tax policy figured prominently in this new focus on growth.

By and large, New Deal revenue laws were heavily progressive. The revenue acts of 1935, 1936, and 1937 all raised tax burdens on wealthy individuals and corporations. These tax hikes often took the form of statutory rate increases, but they also involved the elimination of tax avoidance techniques (loophole closing, in popular parlance). The overall effect of such efforts was a steady and dramatic increase in effective rates paid by the nation’s wealthiest taxpayers. Between 1931 and 1936, the effective rate paid by the top 1 percent of taxpayers rose from 3.4 percent to 16.4 percent.²⁵

Roosevelt and his aides justified progressive tax reform as a blow for social justice. “Our revenue laws have operated in many ways to the unfair advantage of the few,” he declared in a message to Congress. “And they have done little to prevent an unjust concentration of wealth and economic power.”²⁶

²³ Collins, *More*, 6.

²⁴ Tugwell and Ezekiel quoted in *ibid.*, 7.

²⁵ Effective tax rates are drawn from W. Elliot Brownlee, “Historical Perspective on U.S. Tax Policy toward the Rich,” in *Does Atlas Shrug?*, ed. Joel B. Slemrod (New York and Cambridge: Russell Sage Foundation and Harvard University Press, 2000).

²⁶ Franklin D. Roosevelt: “Message to Congress on Tax Revision,” Jun 19, 1935. For details on the 1935 legislation, see Joseph J. Thorndike, “The Unfair Advantage of the Few”: The New Deal Origins of “Soak the Rich” Taxation” in Isaac William Martin, Ajay K. Mehrotra, and Monica Prasad, *The New Fiscal Sociology : Taxation in Comparative and Historical Perspective* (Cambridge ; New York: Cambridge University Press, 2009), 29-47.

But New Dealers also stressed the growth potential of progressive taxation. Higher taxes on the rich were good because they took money from people inclined to save and gave it to a government inclined to spend. Similarly, taxes on business income, including a new levy on undistributed corporate profits, would force companies to disgorge idle capital and get it to shareholders, who would presumably be more inclined to spend it.²⁷

In defending higher tax rates, FDR gave a nod to growth concerns. Taxes, he said while outlining his 1935 reform proposal, “must produce ample revenues without discouraging enterprise.” But he dispensed with such worries immediately, instead focusing on the overriding need for greater fairness in the tax system (with fairness defined in terms of greater rate progressivity, both statutory and effective).

But if Roosevelt wasn't particularly worried about growth, some New Deal economists were. Even assuming that oversaving (and excess investment) was a problem, they suggested, undersaving (and under investment) could still slow recovery from the Depression. “The federal personal income tax rates are very low at the bottom and very high at the top,” wrote two Treasury economists in 1937. “They are probably higher at the top than they should be, in view of the incentives to avoidance and evasion that they create, and the consequent administrative troubles, and in view, also, of the danger of stifling the willingness to take risks.”²⁸ Coming from New Deal loyalists, such worries might seem surprising. After all, neither these economists nor most others working on New Deal tax policy doubted that some amount of income redistribution was likely to bolster a sluggish economy.

But by the late 1930s, redistribution through taxation seemed to be approaching its practical and theoretical limit. Encouraging consumer demand was important, but so was encouraging investment. “The stimulation of investment by changes in the tax system requires much bolder moves and more patience than the stimulation of consumption,” argued Carl Shoup, on loan to the department from Columbia University, “but the rewards are probably much greater”²⁹

Moreover, Keynesian theories of demand management, while plausibly enlisted in support of redistributive taxes, could also be turned against any sort of tax hike. As many subsequent commentators have observed, Roosevelt could have pursued expansionary fiscal policy through a series of tax cuts, rather than just spending increases. The stimulus came from the deficit itself, not from the means of creating that deficit. Moreover, tax hikes of any sort necessarily curbed

²⁷ On stimulus hopes for the undistributed profits tax, see Stein, *The Fiscal Revolution in America*, 86-87.

²⁸ Carl Shoup and Roy Blough, "A Report on the Federal Revenue System Submitted to Undersecretary of the Treasury Roswell Magill, 20 September 1937" <http://taxhistory.org/thp/readings.nsf/cf7c9c870b600b9585256df80075b9dd/7555c9d686d69ae785256e430078dbfe?OpenDocument> (accessed 12 February 2005).

²⁹ Carl Shoup, "Effects of Taxation on National Income, 1940," Box 34; Economy in General; 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.

any stimulus pursued through other means. In fact, several of Roosevelt's most prominent supporters – including Keynes – told the president as much.³⁰

Ultimately, however, such worries left Roosevelt unmoved, and New Deal tax policy retained its emphasis on fairness and progressive reform. FDR's electoral reverses in the late 1930s (when conservative Democrats joined with Republicans to stymie further progressive tax revision) forced the Roosevelt Administration to backtrack on some of its most ambitious achievements, including the undistributed profits tax. But incipient growth concerns, like those at the Treasury, nonetheless reflected a diversity of opinion, even among liberals, about the proper focus of federal tax policy. Growth might yet find a place in the making of federal taxation.

III. Fighting Inflation in the 1940s

World War II brought an end to stagnationist thinking about the American economy. "The coming of World War II resolved the ambivalence of the Depression era," writes historian Robert Collins, "tipping the balance decisively away from the economics of scarcity and toward economic expansion."³¹ Fairness, in other words, started to give way to growth in the formulation of tax policy.

But if the war demonstrated the nation's enormous potential for growth, it also underscored the dangers of unchecked inflation. In the late 1930s, economists had speculated on the use of activist fiscal policy to manage aggregate demand, with a keen eye on tax reforms that would increase it. In particular, they pondered the utility of deliberate deficits. "[D]uring a period of abnormal unemployment, an unbalance of the Federal budget may be said to help to redress the unbalance of the entire economy," concluded one key Treasury department study.³²

But the war made budget "unbalance" unavoidable, and almost immediately, policymakers shifted their attention to *limiting* demand, at least on the consumer side of the economy. Inflation, not stagnation, was the wartime bogeyman. "[N]othing in the economic field can interfere with the war effort as much as an uncontrolled rise in prices," Treasury Secretary Henry Morgenthau told the House Ways and Means Committee in early 1942. "An inflationary price rise is a source of grave social injustice. It undermines morale and impedes war production. It strikes at random without consideration of equity or ability to bear the hardships which it imposes. Once it has acquired momentum, inflation is extremely difficult to control, and leaves a heritage of post-war stresses and strains that will haunt us for decades."³³

³⁰ On the utility of tax cuts as a form of fiscal stimulus, and the dangers of tax hikes, see Stein, *The Fiscal Revolution in America*, 88-89.

³¹ Collins, *More*, 10.

³² See, for example, United States Department of the Treasury, "Tax Revision Studies: General Statement, Revenue Estimates, Summaries, and Recommendations" <http://www.taxhistory.org/Civilization/Documents/Surveys/hst23729/23729-1.htm> (accessed June 1 2009).

³³ Henry Morgenthau, "Statement of Secretary Morgenthau Before the Ways and Means Committee of the House of Representatives," March 3, 1942, Box 34; Defense and War; Records

In response to such worries, lawmakers expanded the income tax dramatically, seeking to drain purchasing power out of the economy and slow the upward spiral of rising prices. In response to Administration requests for new revenue, Congress asked millions of middle class Americans to pay income taxes for the first time. Long confined to the nation's economic elite, the income tax was transformed rapidly from a class tax to a mass tax. Or as two legal scholars later described the tax, "[a]lmost overnight it changed its morning coat for overalls."³⁴

Over the course of the war, the number of Americans paying income taxes increased sevenfold, and by 1945, about 90 percent of American workers were subject to the levy.³⁵ Policymakers justified this expansion as an economic necessity; only a mass tax, they argued, could effectively reduce aggregate demand and slow inflation. "In waging fiscal war on inflation, additional taxes can and must play a prominent part," declared Randolph Paul, the Treasury lead tax official during the war.³⁶

As policymakers shifted the focus of their fears from stagnation to inflation, they were effectively embracing a growth argument in reverse. No longer were they looking for tax policies that would bolster demand. Instead, they were seeking to constrain growth by limiting personal consumption. Still, their emphasis on fiscal policy as a tool for managing the economy marked a conceptual shift. The use of tax *hikes* to curb prices implied the use of tax *cuts* (or targeted tax incentives) to encourage growth. Anti-inflation tax policy, in other words, was simply pro-growth tax policy flipped upside down.

Fairness, however, remained a central concern of policymakers, and the wartime tax regime included a healthy dose of New Deal-style progressivity. Lawmakers might have chosen to regulate demand with regressive levies, like a national sales tax. But Franklin Roosevelt's continuing commitment to progressive reform led them to abandon that option. Moreover, Roosevelt also insisted on a dramatic increase in tax rates for the rich, since he was determined to ensure that the overall tax system appeared fair to all its new taxpayers.

Roosevelt's commitment to progressive notions of tax fairness was especially clear in late 1942 when he suggested a cap on personal incomes. "In time of this great national danger," he declared, "when all excess income should go to win the war, no American citizen ought to have a net income, after he has paid his taxes, of more than \$25,000 a year."³⁷ The proposal went

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.

³⁴ Stanley S. Surrey and William Clements Warren, *Federal Income Taxation, Cases and Materials*, 1953 ed. ed. (Brooklyn, : Foundation Press, 1953), 15.

³⁵ Steven A. Bank, Kirk J. Stark, and Joseph J. Thorndike, *War and Taxes* (Washington, D.C.: Urban Institute Press, 2008), 84.

³⁶ Randolph E. Paul, "Fiscal Policy and Inflation: Address to the American Academy of Political and Social Science," November 30, 1942, Box 34; Inflation, Depression, Recovery; 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.

³⁷ Franklin D. Roosevelt, "Message to Congress on an Economic Stabilization Program,"

nowhere, but it demonstrated the continuing influence of fairness arguments in the shaping of federal tax policy. And the tax rates that Congress *did* enact clearly demonstrate the political efficacy of such arguments. With statutory rates pushed as high as 94 percent (and effective rates on the rich soaring to almost 60 percent near the end of the war), the wartime tax regime was clearly imbued with a Rooseveltian understanding of tax fairness.³⁸

Tax Fatigue

Through the early years of the war, Congress remained reasonably willing to enact major tax hikes in the name of fiscal soundness, inflation control, and patriotic responsibility. But as the fighting wore on – and lawmakers began to contemplate the return of a peacetime economy – that willingness began to fade. The 1942 tax bill – regarded by contemporaries as the greatest tax bill of all time – raised enormous revenue and established the foundation for a durable tax regime that would long outlast the war. But when Roosevelt asked for still more money in early 1943, Congress was distinctly cool to the idea. When the president finally offered a specific plan, asking for \$10.5 billion in new revenue, he got a hostile reception. As one observer put it, lawmakers fell on the proposal "like Caesar's assassins."³⁹ Loudly proclaiming their solicitude for the middle class and their worries about business solvency, both democrats and Republicans rejected the president's request out of hand.

In asking for the tax hike, Roosevelt had underscored the continuing danger of inflation. But congressional leaders, including most Democrats, were unmoved. "In my opinion, such a crushing burden of taxation would be far worse than any real or fancied danger of inflation now facing our country," insisted House Ways and Means Committee Chair Robert L. Doughton, D-N.C.⁴⁰

Similarly, Republicans attacked the administration proposal as a threat to the nation's future. "It is short-sighted and dangerous to 'kill the goose' to get a few more 'tax eggs' now, and thereby destroy its future productivity, but this would be the practical effect of putting the administration's tax proposals into operation," insisted GOP members of the Ways and Means Committee. "[I]f enacted, [the administration plan] would become a prime factor in the destruction of all that our armed forces are now battling throughout the world to preserve and maintain."⁴¹

April 27, 1942, available from the American Presidency project at <http://www.presidency.ucsb.edu/ws/index.php?pid=16251>

³⁸ On effective rates during the war, see Brownlee, "Historical Perspective on U.S. Tax Policy toward the Rich," 60-61.

³⁹ Randolph E. Paul, *Taxation in the United States* (Boston: Little Brown, 1954), 356.

⁴⁰ "Deficit tax bill passed by house," Palm Beach Post, November 25, 1943, 1.

⁴¹ Committee on Ways and Means, "The Revenue Bill of 1943: Supplemental Views," H. Rpt. 78-871, pt. 2., November 18, 1943, 2-3.

Congress eventually agreed to raise something over \$2 billion in new revenue – a measly sum, in FDR’s estimation.⁴² But not before packing the bill with numerous “relief” provisions intended to protect various industries and corporate taxpayers. Democrats and Republicans had cooperated in crafting these provisions, ostensibly to protect the future prosperity of the American people. In and of themselves, they did not constitute a coherent, pro-growth agenda for tax reform. But they did reflect a growing interest in protecting American business from the ostensible ravages of a pro-fairness tax regime.

When the bill reached his desk, Roosevelt took special aim at the numerous tax breaks buried within it. The Revenue Act of 1943, he declared, was “not a tax bill but a tax relief bill providing relief not for the needy but for the greedy.”⁴³ In explaining why he was going to veto the bill, Roosevelt cited the “special privileges” it contained. The legislation, he noted, included relief provisions for corporations reorganized under bankruptcy protection, businesses involved in mining and other forms of resource extraction, pipeline operators, and other lucky supplicants.⁴⁴ Each of these relief provisions, of course, had its defenders, both in Congress and in the private sector. More broadly, lawmakers defended their friendly approach to the business community by insisting that companies would need help to navigate the postwar conversion from military to civilian protection.

But such sentiments did not sway Roosevelt, who only stopped fighting the legislation when Congress overrode his veto with large bipartisan majorities. The struggle was important not simply because it was the first time any president had vetoed a tax bill. Rather, the 1943 revenue act also represented a turning point in federal tax policy, as lawmakers began to shake off their war-borne willingness to raise taxes on almost everyone and every business. From this point forward, lawmakers in both parties would give increasing attention to requests for tax assistance, both for companies and individuals. And while equity concerns would continue to shape policy, growth imperatives would gain increasing prominence in the fiscal debate.⁴⁵

IV. Reconciling Fairness and Growth in the 1950s

As lawmakers crafted the tax policies of the late 1940s and 1950s, they tried to strike a balance between fairness and growth. The war had banished most worries about long-term economic stagnation, but many policymakers believed tax policy would still play a vital role in regulating

⁴² For a general survey of the bill, see Roy G. Blakey and Gladys Blakey, "Federal Revenue Legislation, 1943-1944," *American Political Science Review* 38, no. 2 (1944). On procedural issues surrounding enactment of the bill, see Mabel Newcomer, "Congressional Tax Policies in 1943," *The American Economic Review* 34, no. 4 (1944).

⁴³ Franklin D. Roosevelt, "Veto of a Revenue Bill," February 22, 1944, available from the American Presidency Project at <http://www.presidency.ucsb.edu/ws/?pid=16490>

⁴⁴ On these so-called “relief provisions,” see James E. Fahey, "'Relief' Provisions in the Revenue Act of 1943," *The Yale Law Journal* 53, no. 3 (1944).

⁴⁵ On the tension between fairness and growth, and how it was manifest in the 1943 veto showdown, see King, *Money, Time, & Politics : Investment Tax Subsidies & American Democracy*, 121-122.

the economy.⁴⁶ In particular, they thought tax reductions (including both broad rate cuts and narrow tax incentives for investment) might be used to jumpstart a sluggish economy during cyclical downturns.

At the same time, however, many lawmakers (including some of the same ones worried about growth) insisted that high tax rates on the rich were an important element of social justice. The distinctive tax structure of the 1950s – marked by high statutory rates and relatively low effective ones – represented an effort to reconcile these twin, and often conflicting, imperatives.

Postwar Tax Cuts

As World War II drew to a close, policymakers spent a lot of time pondering the economic aftermath. Broadly speaking, they worried about two dangers: inflation and recession. On the one hand, they suggested, pent-up consumer demand might send prices soaring once lawmakers dismantled civilian production controls. In such a scenario, heavy taxation might still be necessary for price stability. On the other hand, a quick drop in military spending might plunge the economy into recession as aggregate demand took a nosedive. In that case, tax cuts might be necessary to prevent – or at least ameliorate – a dangerous downturn.

Ultimately, recession fears won out. Politicians and policy experts coalesced around a bipartisan consensus for fiscal stimulus – or at least some sort of relief from heavy wartime tax rates. As historian Dennis J. Ventry has observed, “Postwar tax programs – conservative and liberal, Republican and Democratic – emphasized economic growth through tax reduction.”⁴⁷

In 1945, Congress gave substance to this consensus by enacting a \$6 billion tax cut (roughly 13 percent of total revenue).⁴⁸ The measure, which had strong support from the White House, eliminated the corporate excess profits tax and rolled back regular income taxes on both

⁴⁶ Collins, *More*, 10.

⁴⁷ Dennis J. Ventry Jr., "Equity Versus Efficiency and the U.S. Tax System in Historical Perspective," in *Tax Justice: The Ongoing Debate*, ed. Joseph J. Thorndike and Dennis J. Ventry Jr. (Washington, DC: Urban Institute Press, 2003), 36. For a survey of several important plans, see Carl Shoup, "Three Plans for Post-War Taxation," *The American Economic Review* 34, no. 4 (1944). Other notable studies on the topic include: Committee on Federal Tax Policy., *A Tax Program for a Solvent America* (New York, : Ronald press, 1945); Harold M. Groves, "Revising the Postwar Federal Tax System," *The American Economic Review* 34, no. 2 (1944); Randolph Evernghim Paul, *Taxation for Prosperity* (Indianapolis, New York, : The Bobbs-Merrill company, 1947).

⁴⁸ This section on postwar tax reform draws on Joseph J. Thorndike, “Tax History: The Fifties: From War to Peace,” Tax Notes, “March 21, 2011, available at <http://www.taxhistory.org/thp/readings.nsf/ArtWeb/FE35B2AF92BE72718525785A004C98F6?OpenDocument>; and Joseph J. Thorndike, “Tax History: The Fifties: From Peace to War,” Tax Notes, March 31, 2011, available at <http://www.taxhistory.org/thp/readings.nsf/ArtWeb/5096E87F9B0111E6852578A8003CF49E?OpenDocument>

corporations and individuals.⁴⁹ Taken as a whole, it was the largest tax cut to be enacted between 1940 and 1967.⁵⁰ But for many lawmakers in both parties, the legislation nonetheless represented only a down payment on tax reduction.

President Harry Truman, however, resisted the drive for further cuts, insisting on the need for debt reduction and inflation control. He even floated the idea of a tax hike. Truman was never wholly, or even largely, a convert to the gospel of growthmanship. In the face of a continuing drive for lower taxes, insisted that tax cuts threatened price stability, as well as vital notions of economic fairness.⁵¹

In the 1946 elections, Republicans capitalized on Truman's unpopular stance to win majorities in both houses of Congress. As Truman's daughter later recalled that unhappy election night: "My father awoke aboard his special train, en route to Washington and discovered that he had a bad cold and a Republican Congress." A leading member of Truman's own party, Sen. J. William Fulbright, D-Ark., urged the president to resign.⁵²

Republicans immediately set about crafting a major tax cut (as they had promised during the campaign). GOP leaders defended the need for tax reduction in striking terms. Progressive taxation in the New Deal mode posed a threat to American society, insisted the new chair of the Ways and Means Committee: "For years, we Republicans have been warning that short-haired women and long-haired men of alien minds in the administrative branch of government were trying to wreck the American way of life and install a hybrid oligarchy at Washington through confiscatory taxation."⁵³

Truman stood firm against the Republican drive for tax reduction, but after a long struggle – including three presidential vetoes – the GOP eventually got its way in the Revenue Act of 1948, which cut taxes by another \$6.5 billion.⁵⁴ Taken together, the tax cuts of 1946 and 1948 reduced marginal rates significantly, but they remained high compared to the pre-war period. The top rate – an imperfect but common marker for gauging tax progressivity – got as low as 82 percent after the 1948 act. But that was the last rate cut that high-income Americans were going to see for a while.

The outbreak of the Korean War put tax hikes back on the agenda in Washington. Within six months of the North Korean invasion of South Korea, Congress had enacted two major revenue bills raising income taxes (individual and corporate), while also imposing a new excess profit tax

⁴⁹ For a general survey of the act, see Carl Shoup, "The Revenue Act of 1945," *Political Science Quarterly* 60, no. 4 (1945).

⁵⁰ Jerry Tempalski, *Revenue Effects of Major Tax Bills* (Washington, DC: U.S. Department of the Treasury, 2006), OTA Working Paper 81.

⁵¹ Collins, *More*, 37.

⁵² William E. Leuchtenburg, "New Faces of 1946," *Smithsonian* magazine, November 2006, available at <http://www.smithsonianmag.com/history-archaeology/newfaces.html>.

⁵³ Quoted in John F. Witte, *The Politics and Development of the Federal Income Tax* (Madison, Wis.: University of Wisconsin Press, 1985), 132.

⁵⁴ On the struggle over the 1948 bill, see *ibid.*, 131-136.

on business income. The next year, lawmakers approved yet another increase in the Revenue Act of 1951. By the end of the war, individual tax rates had returned almost to the highpoint reached during World War II. For corporations, rates actually reached a new peak, topping out at 52 percent.⁵⁵

A Reluctant Tax Cutter

In 1952, Republicans won a sweep in national elections. With Dwight Eisenhower in the White House and GOP majorities in both houses of Congress, tax cuts seemed a near certainty. Eisenhower himself had made tax reduction a prominent theme in his campaign. “Long-continued taxes that are only a little below the confiscatory level will destroy free government,” he declared in one well-publicized speech.⁵⁶

Once in office, Eisenhower continued his call for tax reform, and he made a notable effort to frame the issue in terms of both fairness and growth. “Revision of the tax system is needed to make tax burdens fairer for millions of individual taxpayers,” he said in his 1954 budget address. “It is needed to restore normal incentives for sustained production and economic growth.”⁵⁷

Invocations of fairness notwithstanding, Republicans generally – and Eisenhower in particular – were more interested in the second of his paired goals. As he continued: “We must restore conditions which will permit traditional American initiative and production genius to push on to ever higher standards of living and employment. Among these conditions, a fair tax system with minimum restraints on small and growing businesses is especially important.”⁵⁸

Such statements gave champions of pro-growth tax reduction reason for hope. But in practice, Eisenhower was proving to be a reluctant tax cutter. Instead of charging ahead with rapid tax relief in the early years of his presidency, he had instead emphasized the dangers of inflation. Talk of a tax cut first arose in early 1953, when Republican leaders sought to accelerate scheduled rate cuts for the personal income tax. (The Excess Profits Tax of 1950 and the Revenue Act of 1951 had both provided for automatic, scheduled rate reductions.) But Eisenhower resisted the campaign to move up these cuts, even suggesting that reductions in the excess profits tax be postponed for six months. After weak resistance from his party colleagues, the president got his way.⁵⁹

Still, Eisenhower was widely believed to favor some sort of substantial tax reduction. “On the way out is a New Deal theory that industry growth can be promoted best by a system of income-

⁵⁵ For a survey of Korean war tax legislation, see Bank, Stark, and Thorndike, *War and Taxes*, 110-126.

⁵⁶ “Text of Eisenhower's Speech at Abilene, Opening His Political Campaign,” *New York Times*, June 05, 1952, 16.

⁵⁷ Dwight D. Eisenhower, “Annual Budget Message to the Congress: Fiscal Year 1955,” January 21, 1954, available from the American Presidency Project at <http://www.presidency.ucsb.edu/ws/index.php?pid=9919>

⁵⁸ Ibid.

⁵⁹ Witte, *The Politics and Development of the Federal Income Tax*, 144-145.

leveling taxes,” reported *U.S. News and World Report*, “designed to underwrite a boost in mass buying power. In its place comes a new theory that the same purpose can be achieved more effectively by a system of profit-preserving taxes, designed to encourage investment.”⁶⁰

As Congress set to work on the Revenue Act of 1954, such predictions proved wrong; the Eisenhower approach to tax reform would leave key elements of the New Deal revenue regime essentially intact. In particular, it preserved the high marginal rates that gave this tax regime its distinctive quality. Thanks to a looming deficit, Eisenhower was reluctant to consider any sort of major cut in these rates, and Congress eventually agreed to leave them virtually unchanged.⁶¹

Targeted Growthmanship

Still, the 1954 tax law was not without its consolations for champions of growth-friendly tax policy.⁶² In particular, it featured a variety of incentives designed to jumpstart investment. Ever since the end of World War II, business leaders and many economists had been emphasizing the need for such incentives, often warning of an crisis in capital formation. Tax policy, according to many business representatives, was making it hard for companies to raise investment capital. The double taxation of dividends was a chief culprit in the eyes of many. By taxing corporate profits twice – first at the corporate level, when earned by a business entity, and second at the individual level when distributed as dividends – the existing system reduced the return to capital and made investment less attractive.⁶³

The campaign to do something about double taxation faded during the early postwar years as business groups focused on other, more pressing reforms (like repeal of the excess profit tax). And later, the Korean War further delayed effort to address the issue.⁶⁴ But by 1954, business groups had revived their campaign to eliminate or at least reduce the burden of double taxation, and this time Congress responded.

As during the early postwar years, concerns about an equity crisis helped drive the campaign for pro-growth reform. Stock purchases had fallen sharply during the recession of 1953-1954, and while this decline could not be attributed solely to the tax treatment of dividends, many observers believed that taxes played an key role. As one Wall Street leader insisted, “taxation of capital gains and double taxation of dividends are Federally-erected twin dams holding back the free flow of life-giving venture capital into American industry.”⁶⁵

⁶⁰ Quoted in Linder, “Eisenhower-Era Marxist-Confiscatory Taxation: Requiem for the Rhetoric of Rate Reduction for the Rich,” 915-916.

⁶¹ *Ibid.*, 917-918.

⁶² Stein, *The Fiscal Revolution in America*, 300. On the various pro-growth elements of the act, including ones discussed below, see Witte, *The Politics and Development of the Federal Income Tax*, 147.

⁶³ Steven A. Bank, *From Sword to Shield: The Transformation of the Corporate Income Tax, 1861 to Present* (Oxford University Press, 2010), 194-195.

⁶⁴ *Ibid.*, 192-193.

⁶⁵ Quoted in *ibid.*, 219.

In calling for tax reform in early 1954, Eisenhower had singled out the need for ameliorating the double taxation of dividend income, suggesting that Congress grant a credit to stockholders against their personal taxes as an offset to the corporate tax that had already been paid at the entity level. “This will promote investment which in turn means business expansion and more production and jobs,” he said.⁶⁶

Republican lawmakers embraced Eisenhower’s plan for dividend relief, even as Democrats complained that it was a giveaway to the rich. As one congressional critic put it, the provision “was an attempt to make the man who earns his bread by the sweat of his brow pay more and more of the \$50 billion cold war with Russia ... while at the same time letting the investor, the corporation and the large stockholder pay less and less.”⁶⁷ Such comments exemplified the tension between pro-growth tax reforms and traditional Democratic commitments to tax fairness. As historian Steven Bank has observed, debate over the 1954 revenue act embodied a zero-sum mentality (bolstered by Eisenhower’s commitment to keeping the law nearly revenue neutral). In a zero-sum world, a tax break for investors necessarily implied a tax hike for non-investors.⁶⁸

Republicans managed to keep dividend tax relief in the legislation, if only barely. As finally passed, the Revenue Act of 1954 featured a distinctly modest form of relief: individuals were allowed to exclude from income up to \$50 in dividends paid by a domestic corporation. In addition, stockholders were granted a credit equal to 4 percent of any dividend income above \$50. Clearly, such a small credit didn’t provide much relief from the high statutory rates still on the books in the 1950s. Indeed, the \$50 exclusion tended to focus the benefits of this relief on small investors, who were probably not subject to the highest rates anyway.

The 1954 legislation also included new depreciation provisions designed to encourage business investment. Depreciation had been a nettlesome problem for income tax since its inception. In the early decades of the new tax regime, when lawmakers allowed business considerable in calculating “reasonable” depreciation, deductions had run amok. In 1931, thanks largely to the precipitous decline in corporate profits brought on by the Great Depression, depreciation deductions actually exceeded the total taxable net income for all U.S. corporations.⁶⁹ In response to congressional requests, the Treasury responded with regulations for “straight-line” depreciation, and these remained in place for two decades.⁷⁰

In 1954, however, Congress liberalized depreciation provisions to encourage capital investment, especially in machinery and processing facilities used for manufacturing, but also for real estate. (Indeed, Stanley Surrey later described the extension of accelerated depreciation to real estate as

⁶⁶ Eisenhower, “Annual Budget Message to the Congress: Fiscal Year 1955.”

⁶⁷ Quoted in Bank, *From Sword to Shield*, 223.

⁶⁸ *Ibid.*

⁶⁹ William T. Hogan, *Depreciation Policies and Resultant Problems* (New York: Fordham University Press, 1967), 6.

⁷⁰ For a quick summary of depreciation before 1954, see Thomas W. Hanchett, “U.S. Tax Policy and the Shopping-Center Boom of the 1950s and 1960s,” *The American Historical Review* 101, no. 4 (1996): 1093-1094.

a legislative “happenstance,” enacted as an “inadvertent appendage” to the machinery and equipment provisions.)⁷¹

Effective Rates

The depreciation reform proved to be among the most powerful “pro-growth” element of the 1954 bill. Numerous analysts have cited the change as an explanation for moderating effective corporate tax rates and declining corporate tax revenue (at least relative to the income tax).⁷² In conjunction with other investment incentives, the depreciation reform helped make effective rates notably low when compared to the marquee statutory rates that loomed so large in 1950s political debate and still color our memory of the era.⁷³

Over the course of the decade, effective rates dropped steadily for most income groups, but especially at the top of the income distribution.⁷⁴ The decline was partly attributable to several factors, including the growing popularity of joint returns (a relatively new addition to the tax system in the 1950s). But according to one leading scholar, a key factor was “erosion of the tax base” in the form of deductions, which were especially popular in higher income groups. In 1961, deductions in the highest income group (taxpayers with an adjusted AGI of more than \$1 million) totaled 20.4 percent of AGI; in 1954, the figure had been 12.9 percent. Charitable contributions accounted for much of this increase.⁷⁵

⁷¹ Ibid.

⁷² See, for example, Jane Gravelle, *Historical Effective Marginal Tax Rates on Capital Income* (Washington, DC: Congressional Research Service, 2004), 3; Harold G. Vatter, *The U.S. Economy in the 1950's; an Economic History*, [1st ed. (New York, : Norton, 1963), 144.

⁷³ Measuring effective tax rates is straightforward in concept but complex in practice. In general, effective rates represent the amount paid in taxes as a percentage of pretax income. But rates for any given taxpayer (or group of taxpayers) can vary dramatically, depending on how you measure payments and income. For brief discussions of this issue, see Thomas L. Hungerford, *An Analysis of the "Buffett Rule"* (Washington, DC: Congressional Research Service, 2011), 3; Johnson, Rosenberg, and Williams, *Measuring Effective Tax Rates*, 1. In general, rates calculated relative to “taxable income” tend to be relatively high compared to statutory rates, since taxable income allows for numerous deductions, exemptions, and other tax preferences. Broader definitions of income (such as Adjusted Gross Income, which is the most common definition used for calculating effective rates) yield higher rates.

For a general historical survey of effective tax rates on the nation’s richest taxpayers, see Brownlee, “Historical Perspective on U.S. Tax Policy toward the Rich.”

⁷⁴ This analysis uses effective rates in William V. Williams, “The Changing Progressivity of the Federal Income Tax,” *National Tax Journal* 17, no. 4 (1964). In calculating these rates, Williams used a broader measure of income than standard IRS estimates of effective tax rates, which rely on AGI. In particular, the Williams version of “Amended AGI” included income from all capital gains. For a discussion of various income measures and their effect on effective tax rates during this period, see Linder, “Eisenhower-Era Marxist-Confiscatory Taxation: Requiem for the Rhetoric of Rate Reduction for the Rich,” 927-933.

⁷⁵ Williams, “The Changing Progressivity of the Federal Income Tax,” 427.

Also central to the decline in effective rates, however, was an increase in the percentage of income derived from capital gains. During the Eisenhower years, as in most other periods of American tax history, capital gains were taxed at a much lower rate than other forms of personal income. The maximum rate on capital gains during the 1950s was 25 percent, and effective rates on capital gains were in the range of 13 percent to 15 percent.⁷⁶

Between 1954 and 1961, this tax-favored source of income increased for every income group, but especially for the top cohort, where it accounted almost 75 percent of total income in 1961 (up from 40 in 1953). Other income groups also enjoyed the benefit of lower capital gains rates, but faced with lower statutory rates on their income in the first place, their tax benefit was commensurately smaller. The rising tide of capital gains no doubt derived from a variety of economic factors, but the decade-long Wall Street boom of the Eisenhower era almost certainly played a central role.⁷⁷

Effective Tax Rates by Amended AGI

	Income (in 1000s of dollars)											
	All classes	<5,000	5 to <10	10 to <15	15 to <20	20 to <50	50- <100	100- <150	150- <200	200- <500	500- <1000	>1000
1953	12.8	8.2	12.7	16.9	20.1	27.1	39.1	44.6	44.6	45.9	46.2	49.3
1954	11.5	7.1	11.2	14.9	17.5	23.4	33.9	39.0	39.6	39.3	38.7	38.8
1955	11.7	7.2	11.0	14.7	17.3	22.9	32.4	36.0	37.0	36.8	35.6	35.8
1956	12.0	7.4	11.1	14.7	17.2	23.0	33.0	35.9	37.4	37.4	36.7	36.1
1957	12.1	7.4	11.0	14.6	17.2	23.0	33.3	38.1	38.5	38.6	36.6	40.0
1958	12.0	7.1	11.0	14.5	17.0	22.5	32.1	36.8	37.0	36.9	36.0	33.1
1959	12.4	7.3	11.0	14.3	16.8	22.1	31.6	34.5	34.3	33.8	32.1	30.6
1960	12.3	7.3	10.9	14.2	16.7	21.9	31.3	34.5	34.6	33.1	30.8	31.3
1961	12.5	7.2	10.9	14.1	16.5	21.6	30.5	33.0	33.1	31.5	29.1	27.2

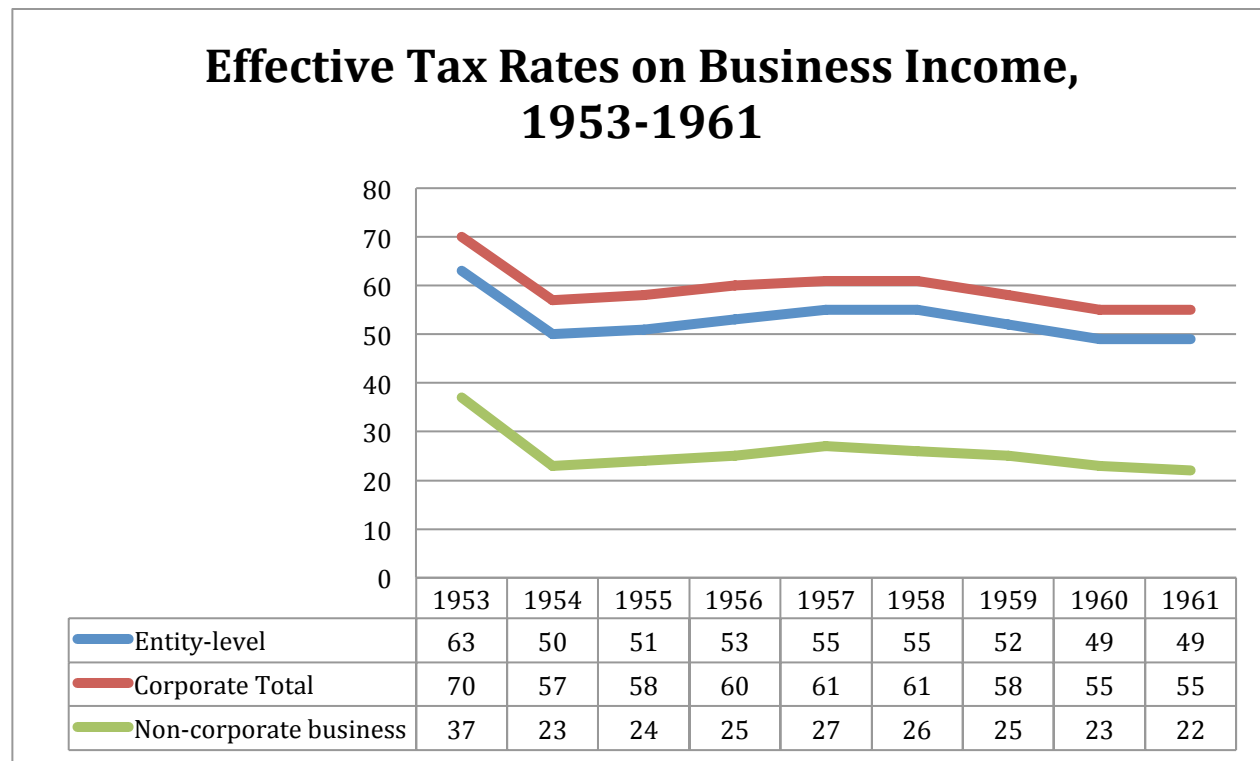
Source: Williams, William V. . "The Changing Progressivity of the Federal Income Tax." *National Tax Journal* 17, no. 4 (1964): 425-429.

Individual effective rates weren't the only ones headed down in the 1950s; business taxes were also in decline. Between 1953 and 1966, effective rates on corporate income paid at the entity level dropped by 14 points, from 63 percent to 49 percent. This reduction stemmed, in large part, from pro-growth tax reforms, according to an analysis by the Congressional Research Service, especially in the form of generous depreciation provisions and investment credits. Effective rates on corporate income that included both entity and shareholder taxes also declined, from 70

⁷⁶ Tax Policy Center, "Historical Capital Gains and Taxes", Urban-Brookings Tax Policy Center <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=161>.

⁷⁷ Williams, "The Changing Progressivity of the Federal Income Tax." On the role of rising stock prices, see Linder, "Eisenhower-Era Marxist-Confiscatory Taxation: Requiem for the Rhetoric of Rate Reduction for the Rich," 932.

percent in 1953 to 55 percent in 1961. And rates on non-corporate business income similarly fell, from 37 percent in 1953 to 22 percent in 1961.⁷⁸



Source: Gravelle, Jane. *Historical Effective Marginal Tax Rates on Capital Income*. Washington, DC: Congressional Research Service, 2004.

Policymakers were well aware of the gap between statutory and effective tax rates in this period. Indeed, when it came to investment incentives, the gap was entirely deliberate. “[T]he key stimulus is to come from specific tax rewards for engaging in the highly preferred activity of investing in plant and equipment,” explained one of the era’s leading tax experts. “[R]ewards through more favorable tax treatment of depreciation, research and development expenses, loss carryovers, retained earnings, and the like.”⁷⁹

Spokesmen for the Eisenhower administration were at pains to emphasize the broadly-shared benefits that would flow from these sorts of investment incentives. Rejecting claims that the 1954 law showered its largesse disproportionately on corporations and wealthy individuals, Treasury Secretary George M. Humphrey insisted that investments would benefit anyone who worked for a living. Investments boosted not simply supply, but demand as well, thereby promoting growth. “The goose that lays the golden egg is production,” he said in congressional

⁷⁸ Gravelle, *Historical Effective Marginal Tax Rates on Capital Income*, 3.

⁷⁹ Economist Walter Heller, quoted in Linder, “Eisenhower-Era Marxist-Confiscatory Taxation: Requiem for the Rhetoric of Rate Reduction for the Rich,” 920. For an interesting historical study of the effect that investment incentives like accelerated depreciation had on the economy, see Hanchett, “U.S. Tax Policy and the Shopping-Center Boom of the 1950s and 1960s.”

testimony. “Payrolls make consumption; stop payrolls and you stop consumption automatically.”⁸⁰

Democrats were unconvinced by Republican arguments about the shared benefits flowing from investment incentives. Throughout the Eisenhower years, they continued to emphasize fairness arguments for progressive taxation, and complained repeatedly that Republicans were catering to their rich constituents. John W. McCormack, a Massachusetts Democrat who later was to become speaker of the House, offered a typical objection. “The Republican tax bill is indefensible in that portion which gives great benefits to corporations and constitutes a bonanza to stockholders, the larger ones in particular,” he said in 1954. “It is unjust and in my opinion morally wrong to make a person with earned income pay considerably more in taxes than persons with unearned income from dividends.”⁸¹

Ultimately, the tax structure of the 1950s made room for these sort of progressive sentiments, principally through the retention of high statutory rates. But at the same time, the Eisenhower-era tax system provided investment incentives to ease the growth burden imposed by these rates. It was a compromise, and one that made reasonable sense in the context of the time, even if it appears paradoxical today.

V. Conclusion

In recent years, the apparent paradox of 1950s taxation – high rates coupled with high growth – has received a lot of attention from contemporary analysts. The era seems to demonstrate that high tax rates are not, in fact, a danger to prosperity. “Growth was actually fastest in years with relatively high top marginal tax rates,” observed Michael Linden of the Center for American Progress in 2011. “Back in the 1950s, when the top marginal tax rate was more than 90 percent, real annual growth averaged more than 4 percent. During the last eight years, when the top marginal rate was just 35 percent, real growth was less than half that.”⁸²

In broad strokes, Linden is correct; while high tax rates probably didn’t encourage growth in the fifties, they didn’t make it impossible, either. But is there a contemporary policy lesson embedded in this observation? Probably not. Mining the past for policy guidance is a tricky business; as they say on Wall Street, past performance is not an indicator of future results. Every historical period is unique, with countless moving parts that together produce a particular result. Change a few of these variables, and the policy lessons become less clear.

⁸⁰ Edward F Ryan, “More Jobs, Better Living Declared Aim of Tax Plans,” *Washington Post*, February 3, 1954, 1. See also King, *Money, Time, & Politics : Investment Tax Subsidies & American Democracy*, 138.

⁸¹ Floyd Norris, “Unearned, and Taxed Unequally,” *New York Times*, January 19, 2012, available at <http://www.nytimes.com/2012/01/20/business/investment-income-hasnt-always-had-tax-advantages.html?pagewanted=all>

⁸² Michael Linden, “The Myth of the Lower Marginal Tax Rates,” Center for American Progress, June 20, 2011, available at http://www.americanprogress.org/issues/2011/06/marginal_tax_charticle.html.

In the case of the 1950s, for instance, we can't make ultimately sense of the period without first accounting for the United States' overwhelming dominance of the world economy in the years after World War II. At the beginning of the decade, U.S. production accounted for about 60 percent of the world's total manufacturing output.⁸³ In such a situation, robust growth seems less surprising, even in the face of high tax rates. Absent that global dominance, would high tax rates still be inconsequential? Hard to say.

But more broadly, Eisenhower era tax policy is not as paradoxical or difficult to explain as it might first appear. The period makes sense – at least in terms of political economy – when viewed in the broader context of Herbert Stein's fiscal revolution. The gradual and contested rise of growthmanship – especially when coupled with the continuing influence of zero-sum thinking about fairness – explains why rates could remain high on individual and corporate income but growth could still be respectable throughout the period (at least when viewed as a whole).

Likewise, the political curiosity of high rates in a Republican era is not especially hard to explain. Eisenhower's vaunted fiscal conservatism is certainly part of the story. But so are the growth incentives added to the Code in 1954. In the view of many tax experts, some of these incentives were not especially potent. The dividend relief, in particular, was arguably more cosmetic than meaningful. But favorable depreciation provisions were probably much more powerful – and more likely to have promoted real economic growth. Moreover, the continued favorable treatment of capital gains income went a long way toward softening the rough redistributive edges of the era's rate structure. The capital gains preference was not new, of course. But it helps explain why Republicans opposed to high taxation could tolerate (however grudgingly) the rates they inherited from the Truman administration.

Taken as a whole, pro-growth provisions of the 1950s tax system served as an economic and political counterweight to the era's high statutory rates. "The nominal rate schedule would be scaled sharply upward as a matter of conscious policy, yet its progressive impact would be tempered via a number of categorical exemptions and dispensations," explains political scientist Ronald King. "The tax system would continue to give the appearance of egalitarianism while actually reducing effective burdens for those engaged in specified practices, notably owner expenditures for new productive facilities."⁸⁴

The wide gap between statutory and effective rates has always been a feature of American taxation, thanks largely to the favorable treatment of capital gains. But it has also long struck observers as a fraud of sorts. "The whole procedure involves a subtle kind of moral and political dishonesty," complained economist Henry Simons way back in 1938. "One senses here a grand scheme of deception whereby enormous surtaxes are voted in exchange for promises that they will not be made effective. Thus the politicians may point with pride to the rates, while quietly

⁸³ See William H. Branson, Herbert Giersch, Peter G. Peterson, "Trends in United States International Trade and Investment since World War II," in Martin Feldstein, ed., *The American Economy in Transition*, National Bureau of Economic Research, University of Chicago Press, 1980, 183-274 at 185; available at <http://www.nber.org/chapters/c11297.pdf>

⁸⁴ King, *Money, Time, & Politics : Investment Tax Subsidies & American Democracy*, 138.

reminding their wealthy constituents of the loopholes.” The result, Simons concluded, was “a decorative sort of progression.”⁸⁵

That sort of muted outrage has been the driving force behind modern tax reform, defined as an effort to broaden the tax base and lower the tax rates in a revenue neutral sort of trade. Not only does that sort of reform improve incentives and remove distortions, it also reflects a more honest approach to issues of fairness and economic growth.

⁸⁵ Quoted in Carl Campbell, *Economic growth, capital gains, and income distribution, 1897-1956*, Arno Press, 1977: 376.

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