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NEW YORK UNIVERSITY
SCHOOL OF LAW

"T.S. Adams and the Beginning of the Value-Added Tax"

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and
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April 3, 2018
Vanderbilt Hall – 208
Time: 4:00 – 5:50 p.m.
Week 10

SCHEDULE FOR 2018 NYU TAX POLICY COLLOQUIUM

(All sessions meet from 4:00-5:50 pm in Vanderbilt 208, NYU Law School)

1. Tuesday, January 16 – Greg Leiserson. Washington Center for Equitable Growth. "Removing the Free Lunch from Dynamic Scores: Reconciling the Scoring Perspective with the Optimal Tax Perspective."

2. Tuesday, January 23 – Peter Dietsch, University of Montreal Philosophy Department. "Tax Competition and Global Background Justice."

3. Tuesday, January 30 – Andrew Hayashi, University of Virginia Law School. "Countercyclical Tax Bases."

4. Tuesday, February 6 – Gerald Auten, U.S. Treasury Department. "Income Inequality in the United States: Using Tax Data to Measure Long-Term Trends."

5. Tuesday, February 13 – Vanessa Williamson, Brookings Institution. "How the Taxpaying Experience Obscures Low-Income Taxpayers and Shapes Attitudes about Progressivity"

6. Tuesday, February 27 – Jacob Goldin, Stanford Law School. "Tax Benefit Complexity and Take-up: Lessons from the Earned Income Tax Credit"

7. Tuesday, March 6 – Lisa Philipps, Osgoode Hall Law School. "Gendering the Analysis of Tax Expenditures."

8. Tuesday, March 20 – Lisa De Simone, Stanford Graduate School of Business. "Repatriation Taxes and Foreign Cash Holdings: The Impact of Anticipated Tax Reform"

9. Tuesday, March 27 – Damon Jones, University of Chicago Harris School of Public Policy. "How Do Distributions from Retirement Accounts Respond to Early Withdrawal Penalties? Evidence from Administrative Tax Returns."

10. Tuesday, April 3 – Ajay Mehrotra, American Bar Foundation and Northwestern University School of Law. "T.S. Adams and the Beginning of the Value-Added Tax."

11. Tuesday, April 10 – Jason Furman, Harvard Kennedy School. "Should Policymakers Care Whether Inequality Is Helpful or Harmful For Growth?"

12. Tuesday, April 17 – Emily Satterthwaite, University of Toronto Law School. "Electing into a Value-Added Tax: Survey Evidence from Ontario Micro-Entrepreneurs."

13. Tuesday, April 24 – Wolfgang Schon, Max Planck Institute. "Taxation and Democracy."

14. Tuesday, May 1 – Mitchell Kane, NYU Law School. "Collecting the Rent: The Global Battle to Capture MNE Profits"

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TO: Participants in NYU Tax Policy Colloquium

FROM: Ajay K. Mehrotra, American Bar Foundation & Northwestern Law

DATE: March 25, 2018

RE: Colloquium Paper and Presentation

Thank you for the opportunity to present some of my research at your tax policy colloquium. I have recently embarked upon a new long-term research project ("The VAT Laggard: A Comparative History of U.S. Resistance to the Value-added Tax"), which explores why the United States remains the only advanced, industrialized nation that continues to resist the global spread of the value-added tax (VAT). The first part of this comparative-history project examines the 1920s intellectual beginnings of the VAT in the United States.

To give you a sense of the larger project, I have attached a brief essay ("The Myth of the 'Overtaxed' American and the VAT That Never Was"), which is forthcoming in the journal *Modern American History*. This essay provides some background for the larger project and discusses the other historical periods I plan to cover in later papers. In the future, this brief essay is likely to be the foundation for an introduction to a larger book project.

I have also attached the draft, and still incomplete, paper for this colloquium, titled "Economic Expertise, Democratic Constraints, and the Historical Irony of U.S. Tax Policy: Thomas S. Adams and the Beginnings of the Value-Added Tax." This paper focuses on the important role of Thomas S. Adams as the intellectual godfather of the VAT. Thus far, I have only drafted the paper's introduction and the first section on Adams's background. At this stage, I plan to write this paper as a standalone article, but eventually I imagine that it will be an early chapter in the broader book project. I hope that this draft paper together with the brief essay will provide enough material for our discussions.

While I welcome questions and comments about the larger research project, I am most interested in getting your assistance with the way I have framed the Adams paper, especially whether it appeals to an interdisciplinary audience of tax law scholars and political and policy historians. Thanks in advance for all your help.

The Myth of the "Overtaxed" American and the VAT That Never Was
Forthcoming 2018, *Modern American History*

Ajay K. Mehrotra

Taxation is the lifeblood of a modern liberal democracy. It is the one policy area without which nearly all of the other functions and aspects of the state would not be possible. Yet in the face of this reality, many Americans continue to believe that they can receive the goods and services provided by a modern regulatory, administrative, social-welfare state with low taxes and limited government. Many politicians and everyday Americans have even perpetuated the myth that they are "overtaxed" compared to the citizens of other advanced, industrialized nations.[1]

Unsurprisingly, political leaders opposed to increased government spending frequently perpetuate the myth of the "overtaxed" American. "I oppose any new spending programs which will increase the tax burden," Richard Nixon proclaimed in 1972 as he accepted the Republican Party's presidential nomination.[2] "The truth is that Americans are overtaxed, not undertaxed," Newt Gingrich claimed in 1993. "Besides, it's not the people who need to sacrifice, it's the bloated Government."[3] More recently, false claims about high American taxes have also provided political cover for tax cuts. "We're the highest taxed nation in the world," President Donald Trump has repeatedly asserted. "People want to see massive tax cuts."[4]

Despite these claims, there is little comparative empirical evidence to support the fable of the "overtaxed American." Even a cursory examination of well-known statistics shows that the United States is a stark outlier in how *little* it taxes its citizens. Not only is the United States well behind other advanced countries in the total amount of taxes raised as a portion of national income; more conspicuously, the United States is one of the few industrialized nations without a national consumption tax such as a value-added tax (VAT). Indeed, according to the Organization of Economic Cooperation and Democracy (OECD), the United States is among the least taxed industrialized nations in the world, with a total taxes/GDP ratio of roughly 26%, well below the OECD average of 34% for 2014 (See Table 1 and Chart 1) This fact has been historically consistent since the post-World War II period. [5]

[insert Table 1 and Chart I about here]

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[1] See, e.g., Kenneth Rapoza, "Are Americans Overtaxed?" *Forbes*, March 14, 2013, available at: https://www.forbes.com/sites/kenrapoza/2013/03/14/are-americans-over-taxed/#384388025518; William G. Gale, "Are Americans Really Overtaxed?" Brookings, available at: https://www.brookings.edu/opinions/are-americans-really-overtaxed/

[2] Richard M. Nixon, *Public Papers of the Presidents of the United States: Richard M. Nixon, 1973* (Best Books, 1975), 62.

[3] Jack Kemp, "Taxes vs. Growth" *New York Times*, 19 February 1999.

[4] Rebecca Savransky, "Trump Repeats False Claim that U.S. is the Highest Taxed Nation in the World," *The Hill*, October 10, 2017, available at: http://thehill.com/homenews/administration/354729-trump-repeats-false-claim-that-us-is-the-highest-taxed-nation-in-the

[5] Organization for Economic Cooperation and Development (OECD). 2016. *Revenue Statistics—OECD Countries: Comparative Table*. Paris: OECD.

Table 1. International Comparison of Total Taxes as a % of GDP, 2014									
	Mexico	**Korea**	**USA**	**Canada**	**Japan**	**OECD Average**	**Germany**	**Sweden**	**France**
Total Taxes/ % GDP	15.2	24.6	25.9	31.2	32	34.2	36.6	42.8	45.5
Income, Profits Taxes*	5.7	7.2	12.3	15	10.2	11.5	11.4	14.9	10.8
Personal Income Taxes	3	4	10.2	11.3	6.1	8.4	9.6	12.2	8.5
Corporate Income Taxes	2.6	3.2	2.2	3.3	4.1	2.8	1.7	2.7	2.3
Consumption Taxes	5.4	7.4	4.5	7.2	6.3	11	10.1	12.1	11
Value Added Taxes	3.9	4.2	0	4.2	3.9	6.8	7	9	6.9
Sales Taxes	0	0	2	0.1	0	0.1	0	0	0
Other^	1.5	3.2	2.5	2.9	2.4	4.1	3.1	3.1	4.1
Payroll and Workforce Taxes	0.4	0.1	0	0.6	0	0.4	0	4.5	1.6
Property Taxes	0.3	2.7	2.8	3.7	2.7	1.9	1	1.1	3.9
Social Security Contributions	3.1	6.6	6.2	4.7	12.7	9.1	13.9	9.9	17
Unallocable Taxes#	0.2	0.7	0	0	0.1	0.2	0	0	1.1

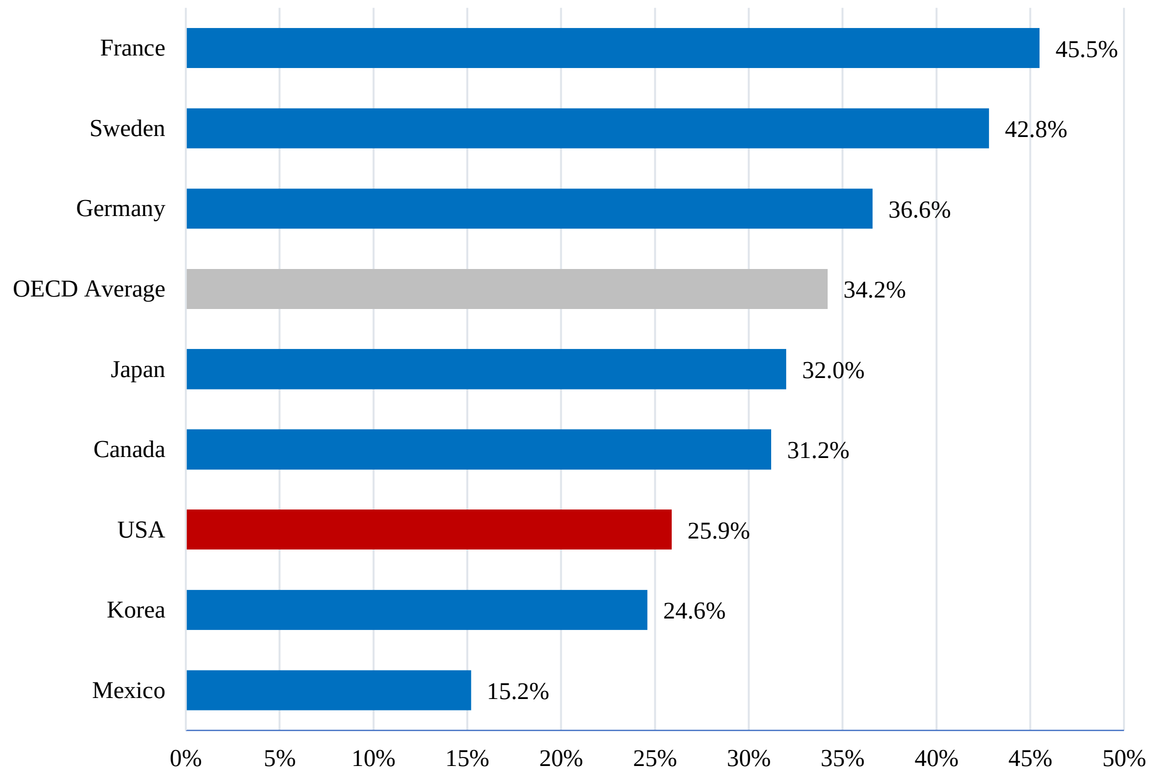
* Income, Profits Taxes: comprised of income, profits and capital gains of individuals and corporates

^ Other includes the OECD subcategories: "other" general taxes on goods and services, taxes on specific goods and services, and unallocable taxes on production, sales, transfer, etc.

Unallocable Taxes: the OECD database does not specify the contents of this category, but does distinguish between those paid exclusively by business, and those not.

Source: Organization for Economic Cooperation and Development (OECD). 2016. *Revenue Statistics — OECD Countries: Comparative Table*. Paris: OECD. Last modified November 30, 2016. Available at: https://stats.oecd.org/Index.aspx?DataSetCode=REV

Chart 1. International Comparison of Total Taxes as a Percentage of GDP, 2014



Source: Organization for Economic Cooperation and Development (OECD). 2016. *Revenue Statistics — OECD Countries: Comparative Table*. Paris: OECD. Last modified November 30, 2016. Available at: https://stats.oecd.org/Index.aspx?DataSetCode=REV

One reason for this stark difference is the U.S. resistance to a national consumption tax. Whereas all other OECD countries have a national consumption tax, usually in the form of a VAT, the United States has throughout its modern fiscal history rejected any type of federal consumption tax. Since the VAT accounts, on average, for about 8% of total taxes/GDP among OECD countries, the U.S. rejection of a VAT explains much of the American shortfall in total taxation as a percentage of GDP.[6]

Although the notion of "American exceptionalism" has in recent years come under increasing scholarly scrutiny,[7] there appears to be something genuinely unique about American fiscal policy. Why is the United States such an outlier when it comes to national taxes? Why have Americans historically resisted national consumption taxes?

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[6] Id.

[7] Thomas Bender, ed., *Rethinking American History in a Global Age* (2002); Godfrey Hodgson, *The Myth of American Exceptionalism* (2009).

Part of the answer may have something to do with the relationship between taxes and spending. There is considerable empirical evidence indicating that regressive consumption taxes, such as a VAT, are highly correlated with robust public sector, social-welfare spending.[8] This correlation may help explain the U.S. resistance to a VAT. In fact, there is an old Washington, D.C. saying, frequently attributed – apocryphally perhaps – to Harvard University economist and former U.S. Treasury Secretary Lawrence Summers which states that the VAT has not been adopted in the United States because liberals fear that it will have a regressive impact on low-income Americans, and conservatives fear that it will be a "money machine" for big government.[9]

There may be a great deal of truth to this adage. But determining precisely why American liberals and conservatives have consistently rejected national consumption taxes requires a long historical view. Complex and changing historical conditions, seminal events, and contingent forces have shaped contemporary American tax law and political economy. In the language of the historical social sciences, the U.S. resistance to the VAT has been a "path-dependent process." During past "critical junctures" American lawmakers "locked-in" U.S. tax policy with particular political decisions, and they have subsequently created "feedback mechanisms" that have ossified the U.S. resistance to national consumption taxes.[10]

Rejecting national consumption taxes was not, however, the only path that was historically available to Americans. Throughout the twentieth century, there were several moments of plasticity when U.S. policymakers could have adopted a crude form of federal consumption taxes, but choose not to. Exploring those historically contingent moments of contestation may help explain why the United States has continued to reject national consumption taxes.

The first of these critical junctures came in the early 1920s, during the aftermath of the First World War. At the height of the war, the U.S. national tax system had been transformed in response to the national emergency. A mildly progressive income tax, enacted in 1913 on the heels of the ratification of the Sixteenth Amendment, was turned into a fiscal workhorse during the international conflict. Income tax rates skyrocketed from 7% in 1913 to a top rate of 77% in 1919. During the same period, exemption levels declined, bringing nearly 20% of American wage-earners onto federal tax rolls. Innovative "excess-profits" taxes on businesses were also adopted. Led by President Woodrow Wilson, the federal government actively transformed American state, economy, and society during the war.[11]

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[8] Junko Kato, *Regressive Taxation and the Welfare State: Path Dependence and Policy Diffusion* (2010). In this sense, the central question "Why no VAT in the U.S.?" may be a subset of the classic Werner Sombart question, "Why no socialism in the U.S.?" Werner Sombart, *Why is There No Socialism in the United States?* (1906).

[9] Jan Rose, "Tax Watch; The Likely Forms of New Taxes." *New York Times*, December 19, 1988. Available at: http://www.nytimes.com/1988/12/19/business/tax-watch-the-likely-forms-of-new-taxes.html; Robert J. Barro, "The Coming Crises of Government," *Financial Times*, August 3, 2011; Summers is purported to have said that a U.S. VAT will be possible only when these two political opponents swap views – that is only when liberals realize that a VAT can be a money machine and conservatives realize its economic incidence is regressive. Rose, "Tax Watch."

[10] Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis* (2004); Kathryn James, *The Rise of the Value-added Tax* (2015).

[11] David M. Kennedy, *Over Here: The First World War and American Society* (1980); Christopher Capozzola, *Uncle Sam Wants You: World War I and the Making of the Modern American Citizen* (2010).

After the Great War, when Republicans swept into office and took control of national policymaking, economic and political retrenchment soon became an integral part of the "return to normalcy." Among the first targets was the robust wartime fiscal state. While some progressive and populist lawmakers sought to retain high income tax rates and innovative business levies to pay off war debts and to regulate large corporations, conservative business leaders and politicians sought to dismantle the steeply progressive wartime tax system. A mild postwar economic recession brought increased attention to tax policy. Prevailing economic and political conditions thus provided lawmakers with a unique opportunity to reconsider the future trajectory of American tax law and policy.[12]

A national consumption tax was among the ideas in circulation at the time. Although a number of business leaders called for a national sales tax to replace the income tax, it was U.S. Treasury Department and Yale University political economist Thomas S. Adams who articulated the most sophisticated version of a national consumption tax, as a complement to the existing income tax. Adams had a long and distinguished career as a "scholar in politics," and his ideas and theories had a significant impact on fiscal policymaking, both at the state level when he was at the University of Wisconsin and at the federal level during his World War I tenure at the Treasury Department.[13]

In a seminal 1921 journal article, Adams made the case for the administrative simplicity and economic efficiency of a national business sales tax. As an academic who spent a great deal of time working as a tax administrator, Adams was well versed in the theoretical as well as the practical aspects of tax law and administration. His central goal was not to replace the fledgling progressive income tax with a regressive sales tax, as some conservative politicians had hoped. Rather, Adams had a sophisticated "scientific" vision of combining high-end progressive income taxes with a unique business tax on manufacturers and retailers and a series of smaller excise levies or commodity taxes "capable of clear definition and successful administration." His ultimate objective was to ease the administrative burden on the existing tax system as a way to save the income tax. "The simple truth is that we are overburdening the income tax," Adams argued. "Nothing is more common in the history of taxation than the demoralization of what has been a good tax, as taxes go, by increasing its rates until the breaking point is reached."[14]

A key component in Adams's broad-minded reform vision was a special kind of business sales tax. "In the case of producers and sellers of 'goods, wares and merchandise' further simplicity could be achieved," he wrote, "by giving the tax the form of a sales tax with a credit or refund for taxes paid by the producer or dealer (as purchaser) on goods bought for resale or for necessary use in the production of goods for sale." This specific proposal was arguably one of the first conceptual articulations of what tax experts today would call a "credit invoice" method

[12] Ajay K. Mehrotra, *Making the Modern American Fiscal State: Law, Politics, and the Rise of Progressive Taxation, 1879-1929* (2013).
[13] W. Elliot Brownlee, *Progressivism and Economic Growth: The Wisconsin Income Tax, 1911-1929* (1974); Michael Graetz and Michael M. O'Hear, "The 'Original Intent' of U.S. International Taxation" *Duke Law Journal* 46:5 (1997), 1020-1109.
[14] Thomas S. Adams, "Fundamental Problems of Federal Income Taxation," *Quarterly Journal of Economics*, 35:4, 527-56 (1921).

of value-added taxation. Adams can, thus, be seen as one of the intellectual godfathers of the VAT.[15]

Despite his innovative economic ideas, Adams understood the political challenges of his time. After more than two decades of public service at the state and national level, he had come to realize that economic ideas did not exist in a vacuum, and that broader social and political factors frequently determined the development of fiscal policies. "The plan has little chance of adoption," Adams presciently observed about his proposal toward the end of his 1921 essay. But that did not mean that one could not learn from this potential failure. In words that would resonate for decades, as future U.S. policymakers and analysts considered other forms of consumption taxes, Adams eloquently explained how and why the democratic desire for fairness and equity always seemed to trump the economic logic of simplicity and administrative ease. The failure to adopt a consumption tax serves "the useful purpose of illustrating the futility of basing one's principles on one's personal experience," Adams conceded. "It demonstrates the supreme necessity of subordinating administrative logic and personal predilections to the great political and social forces which control the evolution of tax systems. These forces must be accepted as facts. The historical fact is that modern states prefer equity and complexity to simplicity and inequality. The cry for equality and justice is louder and more unanswerable than the demand for certainty and convenience. You may think it sentimental and stupid, but that does not alter the fact."[16]

Adams prediction soon came true. Although no lawmaker in 1921 endorsed the nuanced, proto-VAT that Adams had recommended, several crude forms of national sales taxes were proposed in Congress. Like other European countries experimenting with sales taxes at the time, the United State in 1921 could have adopted a national sales tax; doing so may have led subsequently to the creation of a U.S. VAT. Indeed, some of the most effective VATs in existence today trace their roots to earlier more rudimentary forms of consumption taxes. None of the U.S. sales tax proposals, however, was enacted in 1921. A fragmented business community, uncertain about how a new sales tax would affect their bottom-line, refrained from supporting the new levy. Progressive activists exploited the business community's ambivalence and galvanized democratic support for equality and justice to retain the progressive income tax – just as Adams had anticipated. The democratic desire for fairness and complexity trumped the economic calls for efficiency and administrative simplicity. Eventually the early 1920s promise of radical and comprehensive tax reform dissipated into simple tax cuts for the wealthiest Americans.

If the 1920s were a critical juncture for American fiscal policy, the decision to reject Adams's recommendation and the other sales tax proposals seemed to lock-in U.S. tax policy on a particular path. In the early 1940s, at the start of World War II and another moment of historical contingency, national lawmakers seriously reconsidered the idea of adopting a federal sales tax. But by then many U.S. states were already using sales taxes to fund their governments,

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[15] Id., 553. It is one of the interesting ironies of history that an American political economist was one of the intellectual originators of a levy that the United States continues to reject.
[16] Id., 554.

thus creating tension between the states and the federal government over a consumption tax base.[17]

During the 1970s, national lawmakers once again flirted with federal consumption taxes. The Nixon administration considered a VAT as a way to reform educational financing in the United States.[18] In 1979, House Ways & Means Chairman Al Ullman went so far as to propose a 10% national VAT. Both proposals quickly failed. Ullman lost his re-election bid in 1980, and many politicians thereafter became reluctant to recommend any kind of national consumption tax.[19]

Today, the notion of the United States joining the rest of the advanced, industrialized world by adopting a VAT seems highly unlikely. Although a recent tax reform proposal floated by Congressmen Paul Ryan and Kevin Brady in the fall 2017 included a pseudo-VAT, the plan was eventually rejected by the Trump administration. Past moments of historical contingency, when the United States may have taken an alternative fiscal path seem to be closed off – at least for now – and as a result everyday Americans and politicians, like Donald Trump, can continue to falsely assert that the United Sates is "the highest taxed nation in the world."[20]

[17] Joseph J. Thorndike, *Their Fair Share: Taxing the Rich in the Age of FDR* (2013); Lawrence Zelenak, *Learning to Love Form 1040: Two Cheers for the Return-Based Mass Income Tax* (2013).
[18] Isaac William Martin, *The Permanent Tax Revolt: How the Property Tax Transformed American Politics* (2008); Junko Kato, *Regressive Taxation and the Welfare State: Path Dependence and Policy* (2003).
[19] Michael J. Graetz, *100 Million Unnecessary Returns: A Simple, Fair, and Competitive Tax Plan for the United States* (2008), 72.
[20] Savransky, "Trump Repeats False Claim that U.S. is the Highest Taxed Nation in the World."

Economic Expertise, Democratic Constraints, and the Historical Irony of U.S. Tax Policy: Thomas S. Adams and the Beginnings of the Value-Added Tax

Ajay K. Mehrotra

In the spring of 1921, legal and economic experts in the U.S. Treasury Department were faced with a serious challenge. Just weeks earlier, a newly-elected Republican President and Congress rode into power with a perceived political mandate to reduce World War I public debt, rationalize the post-war tax regime, and restore order to a global economy still racked by the dislocations of the Great War. The Treasury experts, many of whom were holdovers from the previous Democratic administration, were asked to help return the country to what President Warren G. Harding referred to as "normalcy." Harding appointed Andrew W. Mellon, the Pittsburg banker and businessman, to lead the U.S. Treasury Department. Mellon's main charge was to dismantle the robust wartime tax regime. The expert administrators and bureaucrats in Mellon's Treasury Department were, thus, called upon to do what they could to bring back the good old days. It was no easy task.[21]

Among the leading economic experts working in the Treasury Department at the time was Thomas S. Adams, a Yale University professor of political economy and former Wisconsin tax administrator, who had been one of the key architects of the national wartime fiscal regime. Adams was initially appointed in 1917 by President Woodrow Wilson as a temporary advisor to the Treasury Department and the Bureau of Internal Revenue, the forerunner of today's Internal Revenue Service. But he soon became a fixture in Treasury. Adams was a frequent spokesman for the department before several congressional committees. He helped draft many of the wartime revenue acts that financed the global war. And he conducted rigorous and systematic studies of the economic and social effects of new tax and spending laws and policies. Along with his legal counterparts, such as the former Wall Street lawyers Russell C. Leffingwell and S. Parker Gilbert, Adams not only helped build the administrative infrastructure that underwrote the successful U.S. war effort, he was also among the few Wilson administration Treasury officials who remained in Washington after the Armistice to ensure a smooth post-war transition.[22]

During and immediately after WWI, the United States was heavily indebted to economic experts like Adams. The modern nation-state, as numerous scholars have documented, has had a tremendous interest in economic knowledge – both as producer and consumer – especially

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[21] Ellis Hawley, *The Great War and the Search for a Modern Order: A History of the American People and their Institutions, 1917-1933* (New York: St. Martin's Press, 1979); David Cannadine, *Mellon: An American Life* (New York: Knopf, 2006); David J. Goldberg, *Discontented America: The United States in the 1920s* (Baltimore: Johns Hopkins University Press, 1999).

[22] "Tommy Adams," *Saturday Evening Post*, June 3, 1933, 20; "Thomas Sewall Adams (1873-1933)" *Bulletin of the National Tax Association*, 18 (April 1933), 194-201; Michael J. Graetz and Michael M. O'Hear, "The 'Original Intent' of U.S. International Taxation," *Duke Law Journal* 46:5 (March 1997), 1020-1109; Lawrence L. Murray, "Bureaucracy and Bipartisanship in Taxation: The Mellon Plan Revisited," *Business History Review* 52:2 (Summer 1978), 200-25. For more on Adams's direct influence on the drafting of wartime tax laws, see generally, "Folder, Amendments to the Revenue Bill of 1918 (amendments pertaining to the income tax, arranged by sections)," in Box 1: Amendments to Revenue Bill of 1918, Thomas Sewall Adams Papers, Manuscripts and Archives, Sterling Memorial Library, Yale University, New Haven, Connecticut [hereinafter TSAP].

during periods of national crisis or emergencies.[23] Treasury department experts like Adams collected, analyzed, and disseminated economic data, and conducted studies that helped guide American fiscal policy during and after the war emergency. In the process, such government administrators also helped create the political and economic institutions that could process and distill the economic ideas and data brought before policy analysts and federal lawmakers. Public officials like Adams were thus pivotal players in what historian Brian Balogh has identified as "one of the most fundamental relationships in twentieth-century politics: the co-evolution of Federal institutions and the experts who eventually staffed them."[24]

The rise of professional experts and the emergence of a national regulatory, administrative, social-welfare state may well have gone hand-in-hand, as part of the development of Western bureaucratic rationality. But the relationship was hardly simple or linear. Beyond Weberian "ideal-types," the real world, historical symbiosis was often complicated and uneven. Trained economic specialists, such as Adams, certainly facilitated American political and economic development, and these experts in turn benefited from the growth of national political institutions. An increasingly rationalized legal and economic system valued these experts, and therefore bestowed upon them greater resources, power, and prestige.[25]

Yet there were frequently other forces, such as democratic politics, which intruded upon the co-evolution of professional expertise and national state-building. The popular preferences and desires of everyday Americans, who exercised their authority through the ballot box and other forms of political participation, often challenged and frustrated the aims and objectives of professional experts attempting to build a rational and coherent national administrative polity. Indeed, political thinkers and social critics have long observed the tension between American democracy and expert policymaking. While some have sided historically with journalist Walter Lippmann, who urged elected officials to rely on scientific experts to help run the government, others have been more skeptical of the alleged disinterested "objectivity" of experts. John Dewey, in response to Lippmann, famously noted that experts had their own private interests, and that democracy could devolve into an oligarchy of experts if "the masses do not have the chance to inform the experts as to their needs."[26]

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[23] Michael Bernstein, *Perilous Progress: Economists and Public Purpose in Twentieth-Century America* (2001); see also, e.g., the essays contained in the volumes: Mary O. Furner and Barry Supple, eds. *The State and Economic Knowledge: the American and British Experiences* (New York: Cambridge University Press, 2002); Michael J. Lacey and Mary O. Furner, eds. *The State and Social Investigation in Britain and the United States* (New York: Cambridge University Press, 1993). For a comparative perspective on the relationship between the modern state and the economics profession, see Marion Fourcade, *Economists and Societies: Discipline and Profession in the United States, Britain, and France, 1890s to 1990s* (2009).

[24] Brian Balogh, "Reorganizing the Organizational Synthesis: Federal-Professional Relations in Modern America," *Studies in American Political Development* 5:1 (1991): 119-172; Michael Schudson, "The Trouble with Experts - and Why Democracies Need Them," *Theory and Society*, 35:5/6, 2006, pp. 491–506; W. Elliot Brownlee, "Economists and the Formation of the Modern Tax System in the United States: The World War I Crisis," in *The State and Economic Knowledge: The American and British experiences*, eds. M. Furner, and B. Supple (1990): 401-34.

[25] Max Weber, *Economy and Society* (1968 [1922]); Roger Brubaker, *The Limits of Rationality* (2013); George Ritzer, "Professionalization, Bureaucratization and Rationalization: The Views of Max Weber," *Social Forces* 53:4 (1975): 627-634.

[26] Walter Lippmann, *Public Opinion* (1922); John Dewey, *The Public and Its Problems* (1927). For more on this tension during the Progressive Era, see generally, Leon Fink, *Progressive Intellectuals and the Dilemmas of Democratic Commitment* (1999).

Nowhere perhaps was the tension between democracy and expertise more evident than in the realm of fiscal policy, where historically-determined political and economic interests constrained the development of purely rational tax laws and policies. "Modern taxation or tax-making, in its most characteristic aspect," Adams famously noted toward the end of his career, "is a group contest in which powerful interests vigorously endeavor to rid themselves of present or proposed tax burdens. It is, first of all, a hard game in which he who trusts wholly to economics, reason, and justice, will in the end retire beaten and disillusioned. Class politics is the essence of taxation."[27]

The democratic constraints of raw political power were particularly salient during the 1920s, when U.S. fiscal policy was facing dramatic challenges. Indeed, there is now a growing scholarly literature on the historical importance of the 1920s as a critical juncture in the path-dependent development of U.S. tax policy. Much of this scholarship also focuses on the role of experts like Adams in steering economic policy and lawmaking down a particular path. In contrast to an earlier depiction of the 1920s as a reactionary rollback of previous progressive commitments to direct and graduated taxation, recent revisionist accounts have uncovered the institutional connections that existed between the Wilson administration's robust WWI tax regime and the 1920s.[28]

More recently, scholars have identified a number of factors to explain why continuity, rather than rupture, existed during this highly contested time period. Some have noted how the structural floor created by heavy WWI public debts prevented the complete retrenchment of the hearty wartime fiscal state. Others have argued that the tremendous administrative burden of novel and complex wartime taxes and bipartisan faith in existing bureaucratic officials required stability in fiscal policy, despite the changing political winds. Still others have pointed to the mounting political and social pressures to pay a post-war veterans bonus to show that lawmakers were constrained in their ability to slash tax rates. The recent revisionist scholarship has, in short, helped us re-evaluate 1920s fiscal policymaking.[29]

Although the new literature challenges long held historical assumptions about the meaning of post-WWI fiscal policy, we still know very little about the other possible alternatives that existed during this pivotal time period. In other words, while we understand the paths that were taken during this critical juncture, we know much less about those available paths that were

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[27] Thomas Sewall Adams, "Ideals and Idealism in Taxation," *The American Economic Review* 18.1 (1928): 1-8.
[28] Examples of the earlier conventional account include Arthur M. Schlesinger, *The Age of Roosevelt: The Crisis of the Old Order, 1919-1933* (Boston, 1957), 61; William E. Leuchtenburg, *The Perils of Prosperity, 1914-1932* (Chicago, 1958), 98; Randolph E. Paul, *Taxation in the United States* (Boston, 1954), 125.
[29] Examples of the revisionist accounts include Benjamin G. Rader, "Federal Taxation in the 1920s: A Re-examination," *Historian* 33, no. 3 (1971): 415-435; Lawrence L. Murray, "Bureaucracy and Bi-partisanship in Taxation: The Mellon Plan Revisited," *Business History Review* 52, no. 2 (1978); Anne L. Alstott and Ben Novick. "War, Taxes, and Income Redistribution in the Twenties: The 1924 Veterans' Bonus and the Defeat of the Mellon Plan," *Tax L. Rev.* 59 (2005): 374; M. Susan Murnane, "Selling Scientific Taxation: The Treasury Department's Campaign for Tax Reform in the 1920s," *Law & Social Inquiry* 29.4 (2004): 819; George K. Yin "James Couzens, Andrew Mellon, the Greatest Tax Suit in the History of the World, and the Creation of the Joint Committee on Taxation and Its Staff," *Tax L. Rev.* 66 (2012): 787; Ajay K. Mehrotra, *Making the Modern American Fiscal State: Law, Politics, and the Rise of Progressive Taxation, 1877-1929* (2013), Ch. 6.

not. We know much less about the failed fiscal policies of the early 1920s. One of the aims of this paper is to investigate one of the alternative policy options that American policy analysts and lawmakers faced, but foreclosed during this critical juncture: the adoption of a national consumption tax.

Toward the end of the war, Adams proposed a highly innovative business levy that could have been the first U.S. federal consumption tax. At the same time, several national lawmakers also recommended a variety of spending taxes, but for reasons dramatically different from Adams.[30] Meanwhile, other countries in post-war Europe, notably Germany and France, began to experiment with national expenditure taxes. Although none of the 1920s U.S. consumption tax proposals gained traction in Congress, Adams's creative recommendation would, in time, become the conceptual foundation for a new tax regime – one that by the end of the twentieth century would sweep across much of the global. Indeed, decades later, scholars would credit Adams for being one of the intellectual fountainheads of the modern value-added tax (VAT) – a business-based consumption tax that has been adopted in every developed country in the world, except for the United States. In fact, today the VAT, which imposes a levy on the value added by a business in the production of goods and services, exists in over 150 countries and accounts for roughly 20 percent of worldwide tax revenue.[31]

This paper explores the historical irony of how a tax that began with an American economist has failed to take hold in the United States. More specifically, this paper examines the intellectual beginnings of the VAT and the early American resistance to this particular consumption tax. Where did the idea of imposing taxes on businesses for the value they add to the production of goods and services come from? And why was Adams's innovative 1921 business tax proposal rejected in the United States? Many secondary sources credit Adams and the German businessman Wilhelm Von Siemens as the two individuals who independently devised the concept of a modern VAT in the early 1920s. What these two thinkers shared, as we shall see, is a desire to reform the then existing taxation of businesses. But we know little about the genealogy of their ideas, and even less about the origins of Adams's specific U.S. proposal and why it was rejected. This paper seeks to address these important historical questions.

These seemingly narrow questions about the historical irony of U.S. tax law and policy may inform wider investigations about comparative law, society, and political economy. Given that there is a high degree of historical-comparative correlation between regressive national consumption taxes like the VAT and robust social welfare spending, understanding why there is no value-added tax in the United States may shed light on broader questions about American political preferences and social values.[32] Why no VAT in the U.S. may, thus, be a fiscal

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[30] T.S. Adams, "Fundamental Problems of Federal Income Taxation," *Quarterly Journal of Economics* 35:4 (1921), 527; Steven A. Bank, "The Progressive Consumption Tax Revisited," *Michigan L. Rev*. 1001:6 (2003): 2238-2260; Steve C. Wells and Tonya K. Flesher, "Lessons for Policy Makers from the History of Consumption Taxes," *Accounting Historians Journal* 26.1 (1999): 103-126.

[31] Kathryn James, *The Rise of the Value-Added Tax* (2015); Organization of Economic Cooperation and Development, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (2012); Clara K. Sullivan, *The Tax on Value Added* (1965); Alan Schenk and Oliver Oldham, *Value Added Tax: A Comparative Approach* (2007).

[32] Junko Kato, *Regressive Taxation and the Welfare State: Path Dependence and Policy Diffusion* (2003). Kato's research indicates that countries with regressive consumption taxes frequently use progressive social-welfare

historian's version of the classic Werner Sombart query: why is there no socialism in the United States? Or the more pragmatic contemporary question: why so little social-welfare spending in the United States?[33]

[A comparative-historical study of the beginnings of the VAT and the early U.S. resistance to the levy may be particularly timely given the increasing pressures of globalization and the looming fiscal crisis of American entitlement spending – both of which are exerting greater demand for increased U.S. tax revenue. In recent years, international competition for corporate capital has led many advanced, industrialized countries to slash their statutory corporate income tax rates. After many decades of resistance, the United States has recently joined this global trend. One reason other countries were able to reduce their corporate tax rates was because they could rely on VAT receipts to make up the revenue shortfall from decreased corporate taxes. By contrast, the United States has recently cut its corporate income tax rate without adopting a VAT. The impending budget shortfall may, thus, lead American lawmakers one day to consider new revenue sources such as a VAT.[34]

Long-term demographic trends in the United States are also likely to compel lawmakers to explore new revenue sources. Because of demographic forces, namely the aging of the baby boom generation, federal entitlement spending in the form of Social Security, Medicare, and Medicaid is projected to account for a growing share of federal spending. As a result, there is a tremendous mismatch between the promises that have been made to future recipients of these social-welfare programs and the taxes that exist to fund them.[35] Although there is a great deal of uncertainty about the long-term budgetary outlook, public finance experts generally agree that the U.S. is on an "unsustainable fiscal path."[36] As American policymakers confront this fiscal reality, they will have little choice but to increase revenue, reduce benefits, or both. Adopting a national consumption tax such as a VAT may one day become a necessity. Thus, the imminent question may not be whether the U.S. adopts a VAT, but rather when. Understanding why the United States has historically resisted a VAT may help facilitate a seemingly necessary transition.

Numerous scholars and policy analysts have, in fact, made the normative case for why the United States ought to have a VAT. Many have done so on revenue grounds to avoid the

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spending to overcome regressive tax incidence, and those countries that have had more long-standing commitments to the combination of regressive consumption taxes and progressive social-welfare spending have been able to withstand recent attacks on the social-welfare state. Id.

[33] Werner Sombart, *Why Is There No Socialism in the United States?* (1976 [1906]). In this sense, this paper is part of a larger comparative-historical research project exploring the question: why no VAT in the U.S.?

[34] A recent Congressional tax reform proposal, led by House Speaker Paul Ryan and Ways & Means Chair Kevin Brady, contemplated a reduction in corporate income taxes and a quasi-VAT in the form of a border-adjustment tax. Paul Ryan and Kevin Brady, "A Better Way: A Pro-Growth Tax Plan for All Americans" (2016); Alex Brill, "Tax Reform: Ryan-Brady Plan is a Better Way," *AEI Economic Perspectives* (2016). But the proposed border-adjustment tax was rejected and replaced by the recently enacted Tax Cuts and Jobs Act of 2017. Pub. L. No. 115-97 (2017).

[35] The United States currently has a debt-to-GDP ratio (roughly 72%) that is surpassed historically only by the years surrounding WWII; this ratio is projected rise to 100 percent in 2032 and 200 percent by 2054 and then continue to increase thereafter. Alan J. Auerbach and William G. Gale, "Forgotten but Not Gone: The Long-Term Fiscal Imbalance," *Tax Notes* 144.13 (2014): 1555-70.

[36] Ibid.

looming “fiscal abyss” mentioned above. Others have supported an American VAT as part of a broader tax reform plan to reduce corporate tax rates, to simplify the existing income tax, and to facilitate international coordination of current tax and trade agreements. Still others have focused on the VAT’s potential to raise significant revenue for increased social welfare spending, especially to fund rising health care costs. Few scholars or policy analysts, however, have investigated how and why the United States has historically resisted a VAT, while the rest of the world has embraced this levy.[37]]

This paper proceeds in three parts. Part I begins with a brief intellectual history of Thomas S. Adams and his experiences as a scholar and tax administrator. It examines Adams’s personal background, educational training, and his lived experiences and places them into a broader historical and comparative context to plumb the conceptual origins of his tax reform ideas. [This section also compares Adams’s ideas with other tax reform proposals at the time, including the VAT proposed by von Siemens.] Part II then takes a closer look at the specifics of Adams’s 1921 tax proposal and his political realism about the viability of his recommendation. This section explains why his background led him to recommend an innovative business tax reform that even he conceded was doomed to failure and hence ahead of its times. Part III traces the political and legislative history of the several consumption tax proposals that were considered by Congress in the early 1920s, but ultimately rejected. It shows how during this pivotal period in American fiscal history, U.S. lawmakers elected to follow a path that may have foreclosed the possibility of an American VAT. In the process, legislators may have hindered a more robust co-evolution of expertise and state-building.

I. Thomas S. Adams – “A Scholar in Politics”

Adams was not a typical early twentieth-century academic expert. Although he shared with many of his mentor’s a religiously-infused sense of social reform, Adams seemed to be most comfortable traversing between the academic world of ideas and the rough-and-tumble arena of politics and lawmaking – something he did regularly throughout his career. Educated at the Johns Hopkins University, Adams spent the early part of his academic career immersed in gathering empirical data and assisting policymakers. He began teaching in 1901 at the University of Wisconsin – Madison, where he was imbued with the “Wisconsin Idea” – the principle that a research university be committed to serving the broader public. He moved to Yale University in 1916, and in the following year President Wilson called him into service to be a Treasury Department expert. He returned to Yale after his government service, but he remained a frequent special advisor to the Treasury Department, as well as a sought after private consultant. By the end of his career, Adams came to be known by his contemporaries as a

[37] For a survey of the works for and against a U.S. VAT, see the essays contained in *The VAT Reader: What A Federal Consumption Tax Would Mean for America* (Tax Analysts, 2011). See also, Michael J. Graetz, *100 Million Unnecessary Returns: A Simple, Fair and Competitive Tax System for the United States* (New Haven: Yale University Press, 2010); Reuven S. Avi-Yonah, “Summary and Recommendation,” *Tax Law Review* 63(2) (2010); Avi-Yonah, “Taxation and Inequality: A Case for the VAT,” *Challenge* (Dec. 2014), 97-104; Leonard E. Burman, “A Blueprint for Tax Reform and Health Reform,” 28 *Virginia Tax Review* 287 (2008). The few studies that have examined the history of U.S. resistance to the VAT have focused exclusively on the post-1960s, eliding earlier periods of potential tax reform. James, *Rise of the Value-added Tax*, Chapter 7; Alan Schenk, “Prior U.S. Flirtations with VAT,” in *The VAT Reader*, 52-63.

"shining example" of a "scholar in politics," and as "a liaison officer between the world of thought and the world of action."[38]

Thomas Sewell Adams was born and raised in Baltimore, Maryland, the third son of a native, Congregationalist family with deep roots in the area. As a student at the prestigious Baltimore City College, one of the oldest public high schools in the nation, Adams distinguished himself at an early age, and gained admission to the newly created Johns Hopkins University, where he received his undergraduate and graduate training. Although there are few surviving records of Adams's early years, we know that he was reared in a supportive family environment, one that not only produced Tommy's scholarly interests, but also promoted the journalistic endeavors of his older brother, John Haslup Adams, who would go on to become editor-in-chief of *The Baltimore Sun*.[39]

Adams attended Hopkins at a seminal moment in the university's history. By the time he began college in 1893, Hopkins had distinguished itself as an intellectual leader of higher education, especially in the field of political economy. The university's first president, Daniel Coit Gilman, sought to establish Hopkins as a pioneer in American graduate education. Before arriving in Baltimore, Gilman had helped create the Sheffield Scientific School at Yale College and was president of the University of California. In his early years at Hopkins, Gilman hired the historian Henry Baxter Adams (no relation to Thomas) and the labor economist Richard T. Ely, and together these European-trained scholars imported the German "seminary" style of education to Hopkins's Department of Historical and Political Science. While at Hopkins, Ely also launched the first salvo against the traditional "old school" of political economy, calling for a "new school" of politics and economics that embraced empirical and inductive methods and sought to inform policymaking. Ely's bold and ambitious claims about the methodological and normative aims of political economy set off an intramural war within the nascent discipline, and likely precipitated his departure from Hopkins. But Ely's call to arms also attracted many young graduate students in the emerging social sciences to the university. Indeed, during Gilman's tenure, Hopkins produced far more Ph.Ds. than any other university, and it established itself as an incubator of reform-minded academics.[40]

After his undergraduate training, Adams remained at Hopkins to pursue his doctorate in political economy. Although Ely had left Hopkins for the University of Wisconsin by the time Adams began his education, the university remained a magnet of activity for established and aspiring economists, including many who were active in policymaking. Ely helped recruit a

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[38] "Tommy Adams," *The Saturday Evening Post*, June 3, 1933, 20; "Thomas Sewall Adams (1873-1933)" *Bulletin of the National Tax Association*, 18:194-201 (April 1933); Graetz and O'Hear, "The 'Original Intent' of U.S. International Taxation." For more on Adams's private consulting practice, see the materials contained in "Folder, American Gas Associates Survey," Box 1, and "Folder, Cement Survey," Box 6, TSAP.
[39] Roy G. Elliot, "Dean of Tax Experts," *The Credit Monthly*, (March 1921), 21; Thomas Earl Geu, "Professor T.S. Adams (1873-1933) on Federal Taxation: Déjà vu All Over Again," *Akron Tax Journal* 10 (1993), 29-46.
[40] William J. Barber "Political Economy in the Flagship of Postgraduate Studies: The Johns Hopkins University" in William J. Barber ed. *Economists & Higher Learning in the Nineteenth Century* (1993), pp. 203-224; John C. French, *A History of the University Founded by Johns Hopkins* (Baltimore: Johns Hopkins Press, 1946); Hugh Hawkins, *Pioneer: A History of the Johns Hopkins University, 1874-1889* (Ithaca, N. Y.: Cornell University Press, 1960). Hopkins produced nearly 600 Ph.Ds. during Gilman's 25 years as president, twice as many as its closest rival in graduate education, Harvard. Barber, "Political Economy in the Flagship of Postgraduate Studies: The Johns Hopkins University," 224.

number of faculty members to the department and Gilman appointed, as visiting lecturers, some of the country's leading economic and legal thinkers such as Columbia economist John Bates Clark, Michigan Supreme Court Justice Thomas M. Cooley, and Hopkins alumnus Henry Carter Adams (Ph.D. 1878), an outspoken economic reformer who divided his time between teaching at the University of Michigan and working as the chief statistician for the Interstate Commerce Commission. Thus, throughout his formal education Thomas Adams was part of a vibrant intellectual community. He received his Ph.D. in 1899 when he completed a thesis on "Index Numbers and the Standard of Value," written under the supervision of Sidney Sherwood, a mathematically inclined economist who had been one of Ely's students.[41]

Unlike many of his mentors, Adams did not travel to Germany after receiving his formal American education. Instead, he opted for practical experience. Adams began his career by immersing himself in the data of the U.S. Census. Working as a statistician at the Census Bureau, Adams confronted the challenges of collecting, standardizing, and analyzing a wealth of information about the U.S. population, mortality rates, and changes in the agricultural and manufacturing sectors. While at the Census Bureau Adams met Allyn A. Young and Wesley C. Mitchell, two other junior institutionalist economists, with whom Adams would develop lifelong friendships. The time spent collecting and analyzing census data no doubt taught Adams the importance of inductive and empirical research methods. At the same time, Adams began his research in labor relations and taxation. In 1900, he translated the French economist Emile Levasseur's *American Workman* and published a study on Maryland taxation, both under the auspices of Johns Hopkins University Press.[42]

The Maryland investigation was part of a larger study contrasting the economic conditions and tax capacity of various states. From it, Adams learned two important lessons that would remain with him throughout his career as a scholar and policymaker. First, the detailed analysis of differing social and economic conditions taught him that systematic statistical studies were a prerequisite for scientific understanding and practical reform. And, second, he learned that there was no universal blueprint for state-level tax reform; that each community had particular economic, historical, and cultural differences that needed to be respected. This early interest in state-level taxation was followed by a year of practical experience in public finance when Adams became the assistant to the Treasurer of Puerto Rico.[43]

After his brief experiences with the practical aspects of economic investigation, Adams returned to the academy in 1901when he began teaching economics and statistics at the University of Wisconsin, Madison. Hired by Richard Ely as one of Ely's first external appointees, Adams was attracted to the emerging connections between the university and the state's progressive politics. His Congregationalist upbringing and his practical experience at the

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[41] Adams's doctoral thesis was a historically based, inductive analysis of the benefits and limitations of various measures of price indexes. T.S. Adams, "Index Numbers and the Standard Value," 10 *Journal of Political Economy* (December 1901): 1-31.

[42] Emile Levasseur *American Workman* (translated by Thomas S. Adams) (Baltimore: Johns Hopkins University Press, 1900); Adams "Taxation in Maryland," *Johns Hopkins University Studies in Historical and Political Science* 18: 13-75 (1900).

[43] "Thomas Sewall Adams (1873-1933)" *Bulletin of the National Tax Association*, 18:194-201 (April 1933); Adams "Taxation in Maryland;" Thomas Sewall Adams, "The Financial Problems of Porto Rico," *The ANNALS of the American Academy of Political and Social Science* 17.3 (1901): 48-57.

U.S. Census and in Puerto Rico suggest that Adams was looking forward to using his formal education and practical training to do much more than conduct research and teach. Like many of the other economists hired at Wisconsin around this time, such as John Commons, Adams was intrigued by the notion of joining a group of scholars who sought to engage actively in the making of public policies. This was, of course, the historical period when the "Wisconsin Idea" was first taking hold, and the notion of producing research to serve the public was surely attractive to Adams and many other scholars. Though Adams may not have realized it at the time, his first teaching position at Wisconsin gave him an exceptional opportunity to pursue the path of a scholar in politics.[44]

Adams's career as a scholar and policymaker unfolded at a time when the economics profession was still grappling with its identity. Although the neoclassical, marginal utility analysis advanced in the United States by John Bates Clark became the dominant paradigm of the early decades of the twentieth century, the ascendancy of a competing school of institutionalism – as embodied in the works of Thorstein Veblen, Wesley C. Mitchell and others – would soon pose a formidable challenge to American marginalism. Adams, however, did not fit neatly into either of these intellectual camps. By becoming an expert in public finance whose work traversed the academy and policymaking, Adams was able to tread a middle ground between the orthodox theories of neo-classicism and the heterodoxy of institutionalism. Unlike many of his academic colleagues, Adams's dual role as a scholar and policymaker provided him with a unique type of intellectual autonomy: His allegiance was to developing sound and coherent theories that could be translated into practical laws; thus, he was not beholden to either of the two camps that were competing for control of the academic discipline.[45]

The Wisconsin economics department in the early 1900s itself was a hotbed of early institutionalism. With Ely's encouragement, many colleagues straddled the worlds of the academy and policymaking. During his time in Madison, Adams further developed his scholarly and practical interests in public finance and labor relations. He published several articles on taxation and industrial relations. Ely soon became an important mentor for Adams, recruiting him to be a co-author on the 1910 edition of Ely's popular textbook, *Outlines of Economics*. With Ely's assistance, Adams also co-authored, with Helen L. Sumner, a second textbook in 1920 on *The Labor Problem* aimed at undergraduate students. This text demonstrated Ely's importance influence on Adams's thinking, especially his support for organized labor. While he was in Madison, Adams also served for many years as a member of the Wisconsin Tax Commission, where he helped lead the enactment of the first effective state-level progressive income tax in 1911.[46]

[44] Fred R. Fairchild "Thomas Sewall Adams" *Dictionary of American Biography Volume XXI, Supplement One* ed. Harris E. Starr (New York: Charles Scribner's Sons, 1944), 9-10.
[45] Yuval P. Yonay, *The Struggle over the Soul of Economics: Institutionalist and Neoclassical Economists in America between the Wars* (Princeton University Press, 1998); Dorothy Ross, *Origins of American Social Science* (New York: Cambridge University Press, 1991); Mary O. Furner, *Advocacy and Objectivity: A Crisis in the Professionalization of American Social Science, 1865-1905* (1975); Mary S. Morgan and Malcolm Rutherford, eds. *From Interwar Pluralism to Postwar Neoclassicism* (London: Duke University Press, 1998); Malcolm Rutherford, *The Institutionalist Movement in American Economics, 1918–1947: Science and Social Control* (Cambridge University Press, 2011).
[46] Rutherford, *Institutionalist Movement in American Economics*, Ch. 7; Thomas S. Adams, "Mortgage Taxation in Wisconsin," *The Quarterly Journal of Economics* 22.1 (1907): 1-27; Richard Theodore Ely and Thomas Sewall

Adams's service on the Wisconsin Tax Commission was a formative experience. There he worked closely with other economic and legal experts in improving the ailing state and local tax system. Collaborating with lawyers such as Neil Haugen, Adams came to understand the importance of administrative capacity for a well-functioning system of public finance. Although Adams was not himself a lawyer, he gained an appreciation for how laws operated on the ground. His many years with the Wisconsin Tax Commission taught him that amending state constitutions and reforming laws were only the first steps in improving the formal tax system; lasting reform also required a change in the administrative infrastructure – to enforce new laws and constitutional provisions – and perhaps even more importantly a change in legal culture or consciousness. This was particularly evident during Wisconsin's movement to enact a graduated income tax. While other tax experts were skeptical that Wisconsin could effectively collect a personal income tax, Adams boldly predicted that the Badger State's experiment would gradually become a success. He was confident that Wisconsin lawmakers had established the key administrative innovation of creating a crude form of "information withholding," which required banks and other financial intermediaries to report the payment of interest, dividends, and other forms of income. This new method of information sharing would, in turn, help educate Wisconsin's citizens about their fiscal responsibilities to the state.[47]

Adams boldly shared his confidence in the Wisconsin income tax experiment and his faith in administration with other leading tax experts. Writing to Edwin R.A. Seligman, the Columbia University economist who was then the dean of American tax experts, Adams professed his views on tax reform and criticized others, such as Seligman, who focused on the substance of tax laws while neglecting the administrative infrastructure. "I believe that reform can only be achieved by changing the administration and that with proper administration the kind of tax law is comparatively (but only comparatively) unimportant," he wrote. "In short, the way to approach personal taxation is to develop the administrative machinery necessary to sustain person taxation, and not to rush off in the diametrically opposite direction." Seligman did not take kindly to this rebuke from a junior colleague, and he continued to insist that the Wisconsin experiment was doomed to failure. Just three years later, however, income tax revenues were flowing into the Wisconsin treasury and economic experts like Seligman had no choice but to concede that Adams had been correct – Wisconsin had created the administrative regime to collect the first effective state-level income tax.[48]

Just two years after Wisconsin adopted its income tax, the federal government followed suit. Coming on the heels of the ratification of the Sixteenth Amendment, the 1913 national income tax was a modest levy aimed principally at the country's wealthiest citizens. Adams,

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Adams, *Outlines of Economics* (1910); Thomas Sewall Adams, Helen Laura Sumner, and Richard Theodore Ely, *Labor Problems* Macmillan (1920).

[47] T. S. Adams, "The Significance of the Wisconsin Income Tax," *Political Science Quarterly* 28.4 (1913): 569-585; W. Elliot Brownlee, *Progressivism and Economic Growth* (1974); Ajay K. Mehrotra, "Forging Fiscal Reform: Constitutional Change, Public Policy, and the Creation of Administrative Capacity in Wisconsin, 1880–1920," *Journal of Policy History* 20.1 (2008): 94-112.

[48] T.S Adams to Edwin R.A. Seligman, August 9, 1911, "Folder – Miscellaneous Papers on Taxation," Box 25, Miscellaneous Papers on Taxation, 1911-1915, TSAP. Edwin R.A. Seligman, *The Income Tax: A Study in the History, Theory, and Practice of Income Taxation at Home and Abroad* (1914), 111.

once again, was among the economic experts backing the new income tax law. His experiences with the Wisconsin income tax proved useful. He used empirical evidence from Wisconsin to counter those economists who opposed the progressive income tax. Presenting a paper before the American Economic Association in 1915, Adams took on the charge that an income tax was a penalty on savings and a disincentive to work. "Carefully formulated and efficiently administered income and inheritance taxes do equalize the distribution of wealth and do not, in any appreciable degree, set into motion any subtle, subterranean or remote economic forces of an objectionable kind, such as the professional economists do dearly and so properly loves to analyze and evaluate," he announced to an audience of fellow economists. Even at this relatively early career stage, Adams was not afraid to challenge the discipline's conventional wisdom.[49]

At the same time, Adams was also a steadfast political realist. His experience with the Wisconsin Tax Commission had taught him to respect the democratic limits on fiscal policymaking. Neither an income tax nor an inheritance tax, in his opinion, was a useful tool to combat "swollen fortunes." They were both "feeble instruments" to redistribute wealth in any radical sense. "If swollen fortunes are bad, they should be attacked directly and the cause removed," he argued. "To let them accumulate and then tax them … smacks of hypocrisy and the attempt to make the income tax do the work of social reform is apt to spoil the income tax." Ultimately, Adams rested his support for the income and inheritance taxes on a more holistic view of fiscal policy, on the administrative machinery that would extract such revenue and on the uses of the revenue generated by these levies. Whether these taxes "could be wisely extended as additional taxes depends altogether upon the efficiency of government and the use to be made of the new revenues which they would yield" he contended. "Here, in the field of public expenditure, is the crucial test of each proposed new tax. For a wasteful and inefficient government no new tax is a good tax." Direct and progressive taxes were, for Adams, neither a panacea nor something to be avoided at all costs. They were, instead, a means to a higher end.[50]

Five years after he helped enact the Wisconsin income tax, Adams moved to Yale University via Cornell, and even before he was settled in New Haven, President Wilson tapped him to be an expert consultant to the Treasury Department in 1917. Adams quickly became a pivotal figure in the department. Not only did he work closely with other Treasury officials and legislators in drafting crucial wartime revenue acts, he also conducted several important studies of the impact of recently enacted tax laws. Adams, for example, led a Treasury study of the incidence of the controversial 1918 "excess profits" tax – a levy aimed at large corporations that were allegedly exploiting wartime economic conditions. Initially, Adams was one of the few mainstream economists who supported the excess profits tax as a regulatory tool to combat war profiteering. But after he conducted his Treasury study, Adams was convinced that the excess profits tax was leading to the unintended consequences of taxing smaller businesses more than the large corporations it was designed to attack. Adams's empirical study helped convince even some of the most recalcitrant lawmakers to reconsider their support for the excess profits tax.[51]

[49] Thomas Sewall Adams, "Effect of Income and Inheritance Taxes on the Distribution of Wealth," *The American Economic Review* 5.1 (1915): 234-244, 243.
[50] Ibid.
[51] Brownlee, "Economists and the Modern Tax System," 415-17; Mehrotra, *Making the Modern American Fiscal State*, 334-7.

Adams's tenure in the Treasury Department, like his experiences with the Wisconsin Tax Commission, influenced his views of tax reform. Unlike other policy analysts who stubbornly held on to their normative positions, especially during the wartime crisis, Adams was more committed to empirical evidence than he was his a priori views. He was not blindly wedded to his support for the excess-profits tax. When the evidence indicated that the levy was not operating as it was designed, Adams did not hesitate in changing his position. His willingness to remain flexible in the face of contradictory evidence illustrated his commitment to the disinterested and objective expert in the service of the state. Towards the end of his career, Adams would reflect back on his years of public service, as he encouraged other scholars to think beyond the cloistered world of scholarship. Writing to his friend Allyn Young, Adams counseled that "a big scientific career" meant much more than publishing. "You can do your work through your students, occasional articles, [and] public service."[52]

[remainder of section and paper to be written]

II. A New Way to Tax Business

A. Context of TSA's 1921 Proposal
B. The Specifics of TSA's Proposal
C. TSA's Political Realism – Once Again

III. The Political Rejection of the 1920s Consumption Tax Proposals

A. The Other Spending Tax Proposals
B. Political Support and Opposition
C. Reasons for Eventual Rejection

Conclusion

[52] T.S. Adams to Allyn A. Young January 4, 1923, Allyn A. Young Papers, Archives of Harvard University, Pusey Library quoted in Perry G. Mehrling, *The Money Interest and the Public Interest* (Cambridge, MA: Harvard University Press, 1997), 18.