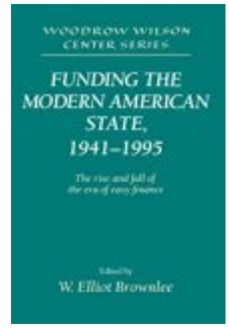
W. Elliot Brownlee, ed.. *Funding the Modern American State, 1941-1995: The Rise and Fall of the Era of Easy Finance.* Cambridge: Cambridge University Press, 1996. ix + 467 pp. $59.95, cloth, ISBN 978-0-521-55240-0.



Reviewed by Richard Vedder

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The good news is that seven scholars from a variety of disciplines (economics, history, political science, law) have given us an engaging narrative on various aspects of the contemporary history of American federal taxation in a volume that should be oft-cited. The bad news is, as is typically the case in edited volumes, the quality of the analysis is uneven and in a few places even historically inaccurate.

The book was probably largely written in 1994 or at the beginning of 1995. I was a little turned off by the very first sentence of text in the book, in a promotional blurb preceding the title page: "The fiscal crisis faced by the American federal government represents the end of a fiscal regime that began with the financing of World War II." My reaction was: What fiscal crisis? At the time I read the book, President Clinton had just announced that the 1997 fiscal year budget deficit was about $22 billion, the smallest deficit in relation to total output in a generation. Moreover, the tax changes implemented in the 1997 budget deal merely extended the fiscal regime arising out of World War II.

Yet the claim is probably not so wrong after all. Americans are extremely unhappy with the administration of the tax system, and with its complexity. The public mood is ripe for reform, perhaps radical change that involves the replacement or profound modification of the progressive marginal rate income tax. The booming economy has given some temporary respite in dealing with the entitlement problem, but in the long run the existing fiscal equilibrium is clearly untenable given what C. Eugene Steuerle appropriately calls (p. 428) "the yoke of prior commitments." It looks increasingly likely that major fiscal changes will occur at some time in the next decade.

Two of the essays (totaling more than one hundred pages) are by Elliot Brownlee. One summarizes the volume and the second provides a historical overview of the tax system since the beginning of the Republic. Brownlee correctly notes that new tax regimes implemented during four national emergencies (Civil War, World War I, the Great Depression, and World War II) facilitated the enormous growth of the federal government. High wartime taxes were only modestly lowered after those conflicts, which, combined with reduced defense spending, allowed for expanded social programs without incurring large political costs.

Brownlee emphasizes the tensions between the Republican emphasis on consumption and tariff taxation and the Democratic yearning for progressive income taxation in the late nineteenth century. Indeed, one can argue that the entire fiscal history of the country since 1860 is one of the changing political importance of two impulses: the progressive impulse to use the tax system to bring about income redistribution, and the conservative impulse to reduce the inefficiencies, resource distortions, and growth drag associated with high rates, particularly with regards to income.

A point that gets occasional mention but little emphasis in the book (possibly excepting Steuerle) is that progressive taxation gave political incentives to encourage price inflation, as bracket creep provided a politically clever way to raise taxes in a stealth fashion to finance social programs. I do not think it is entirely an accident that inflation in the United States was low or non-existent in the era before sharply progressive taxation, was high in the era of high progressive rates, and has moderated since tax indexation reduced (although not eliminated) the bracket creep dimensions of the progressive income tax. Did fiscal policy drive monetary policy?

Brownlee makes its abundantly clear that progressives in both the Wilson and Roosevelt administrations used war emergencies as an opportunity to impose their redistributionist ideas. As he hints, a case can be made that the notion of progressive income taxation was saved, by all people, Secretary of the Treasury Andrew Mellon, who in the 1920s defused Republican efforts to replace the progressive income tax with a national sales tax, an effort that has had a renaissance of sorts today.

Brownlee's account of tax history emphasizes the progressive impulses at redistribution, and pays little attention to the efficiency difficulties that extremely high marginal rates pose. Few economists today would claim that sharply raising marginal tax rates in 1932 was an intelligent move from either a demand or supply side perspective, yet Brownlee does not discuss whether this viewpoint was articulated at the time. Had equity concerns completely silenced the traditional efficiency arguments that arise in tax debates? The emphasis throughout the Brownlee article is on tax changes that provided fiscal support for an increased state: he gives very little attention to the important Kennedy and Reagan tax cuts, and completely ignores several moderately important changes in the tax system, such as in 1954, 1990, and 1993.

Turning from the general to the specific, Carolyn C. Jones competently explores how the government used public relations techniques to convince Americans to comply with high income taxation in the 1940s, when most Americans first became payers of the tax. Edward D. Berkowitz nicely summarizes the history of social security taxation, showing how liberals associated with the administration of the program (such as Wilbur Cohen) played an influential role in crafting Social Security expansion. They convinced legislators that large increases in benefits were possible with only moderate tax increases. In time, of course, political leaders learned this lesson too well, increasing benefits in the 1970s in an actuarially untenable fashion. The modern troubles of Social Security are less extensively explored than the program expansion, although Berkowitz perceptively notes that "Americans have historically tolerated taxes reflecting shared social purpose but that even these taxes can reach a threshold that threatens to undermine the enterprise the tax supports" (p. 183).

In a long and important essay, Herbert Stein updates his *Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969). The era before the 1960s was dominated by tensions between three alternative budget philosophies (old-fashioned Keynesian "functional finance," a more conservative or "domesticated" Keynesianism advocated by Stein, and a traditional Republican balanced budget rule). By contrast, Stein correctly tells us that fiscal policy in the post-1964 era was not governed by any specific budget philosophy. The problem was "the unwillingness of policymakers to subordinate their desires for specific tax and expenditure programs to any aggregate goal" (p. 200).

Stein then goes into a long discussion of the specifics of fiscal policy, emphasizing the era when he was a player, namely the Nixon Administration. The fact is that, for all the policy angst and debate, federal taxation absorbed about twenty percent of the national output throughout the period. Whenever taxes started to rise above that amount from bracket creep, a tax revolt would ensue, culminating in what Stein (p. 266) terms the "Big Budget Bang" of 1981. Whenever taxes fell much lower than one-fifth of the nation's output, tax increases ensued (1982, 1990 and 1993 come especially to mind). The increasing contempt for aggregate fiscal rules of any kind reflected growing tensions posed by the growth of entitlement programs and, on occasion, other spending needs. The marginal political benefits to politicians of spending money exceeded the marginal political costs. The "automatic" nature of entitlement spending increases was aggravated by new programs in the 1960s and 1970s. Deficits were a politically less painful way to finance government constrained by a tax threshold imposed by popular sentiment. Like inflation-induced tax increases, deficits are a stealth form of taxation. As Stein concludes, in the early 1960s it was true that "economic science had provided commands that politics would and should obey. That belief has now disappeared" (p. 286).

Julian E. Zelizer's account of Wilbur Mill's role in the fiscal policy changes is well crafted. Mills shrewdly used experts to help him make important changes in the fiscal system, and to stand up to Administration and congressional pressures. At the same time, he was a creature of Congress and knew how to win votes and maintain power. In a less successful essay, Cathie Jo Martin looks at the role that business played in the tax changes of the postwar era. The paper is marred with significant factual errors. Speaking of the Reagan era, we learn (p. 382) that "neoclassical economists concentrated in the CEA under Murray Weidenbaum and then Alan Greenspan." Alan Greenspan did serve as Chairman of the Council of Economic Advisers--but in the Ford administration several years earlier. I read (p. 394) that administration official Richard Darman was a "supply-side economist." First of all, Darman was (and is) not an economist (his most recent Who's Who in America bio refers to him as a "former investment banker" and "former educator" and earlier biographies as "business consultant"). Secondly, most of the prominent supply siders I know from that era viewed Darman as their enemy, the very antithesis of a "supply side economist." The essay makes several assertions based on interviews with anonymous committee staffers. As a congressional staffer myself in this era, I would suggest that staff interpretations of major congressional events varied widely, and too many assertions are made that at the very least should be qualified.

The book ends on a more solid scholarly note. Steuerle nicely uses fact and logic to suggest that the era of "easy finance" ended in 1981. Up to that date, economic growth, defense cuts, social security tax increases and the impact of inflation in raising taxes and lowering the real burden of the debt made it possible to expand social programs without dire budgetary consequences. After 1981, "the yoke of prior commitments", the productivity growth slowdown, tax indexation and other factors brought about "the fiscal straitjacket era." On the spending side, the growth in entitlements set the stage for a future fiscal crisis that will force some change in the nation's fiscal (and probably tax) regime.

Taken as a whole, this volume advances our understanding of the historical trends in tax policy in important ways. While not pretending to be a balanced or comprehensive survey of history of modern taxation, it is a nonetheless a welcomed addition to the literature that scholars will utilize for years to come.