THE HISTORICAL ORIGINS OF PROGRESSIVE TAXATION

Richard A. Westin[1]

Thus, in practice, we usually find some economists testify before legislators in the morning that wealth should be distributed to make the dicta of welfare economics ethically acceptable. At the same time, other economists in the afternoon will testify before the same legislators that such wealth distributions beget inefficiencies - the little deadweight loss triangles we had studied – and these should be avoided.

Uwe Reinhardt [2]

BACKGROUND

American federal income tax rates run in cycles, generally rising during wars, and then declining. Over the span of America's history, the top wartime rates peaked at 94% during World War Two,[3] then 90%, after which they declined in steps to a nadir of 28% in the early years of Ronald Reagan. Since then they have risen slightly to the present modest 39.6% rate, buttressed by some intricate phase-outs,[4] a fairly toothless alternative minimum tax[5] designed to assure that even the sharpest tax-avoider will contribute at least something to the federal government's coffers and a small tax on investment income of wealthy taxpayers[6]. There is also a significant federal estate tax that affects a

[1] Professor of law, University of Kentucky College of Law. My thanks to William T. Loomis, Franklin Runge, Stephen Salant, Stephen Vasek, Roger Tolbert, and tip of the hat to Joseph Bankman.

[2] From what appears to be a class handout at Princeton University, prepared for a course in microeconmics, captioned How Microeconomists Bastardized Benthamite Utilitarianism, available at http://www.princeton.edu/~reinhard/pdfs/100-NEXT_HOW_ECONOMISTS_BASTARDIZED_BENTHAMITE_UTILITARIANISM.pdf

[3] Individual Income Tax Act of 1944, Pub. L. No. 315, 58 Stat. 231. However, §12(g) provided that the effective rate could not exceed 90 percent. Id. § 12(g). As with all comparisons of differing tax rates over time, the tax base seems always to vary as the tax law evolves, making comparisons invariably imperfect. Hereinafter, references to sections are to the Internal Revenue Code of 1986, as amended, unless otherwise indicated ("IRC").

[4] E.g., IRC's § 67 (2% floor on certain itemized deductions) and IRC § 151(d)(3)(A) (phase-out of personal exemptions).

[5] IRC § 55. It is somewhat toothless because the tax is largely creditable against regular income taxes in years when the taxpayer owes only regular taxes.

[6] The investment income tax rate is 3.8 % and applies only to individuals with large incomes.

small percentage of taxpayers and is easily gamed.[7] However, these transfer taxes do add progressivity to the tax system.[8]

The normal cycle has recently changed in that Congress has declined to pay for America's recent undeclared wars with tax increases, while favoring high income taxpayers in the form of relatively low top rate of taxation on ordinary income and a modest 20 percent top rate of taxation on long-term capital gains and many dividends.[9] At the scandalous edge of this new picture, wily hedge fund managers have learned how to convert income from services into long-term capital gains via the "carried interest."[10]

The recent popular calls for increasing top rates rely on notions of fairness, which calls are commonly denounced as "class warfare" and foolish diversions of the flow of capital that would otherwise support business activity. The claim of "fairness" is often pooh-poohed as merely intuitive and is countered with proposals for flat taxes, value-added taxes and technical criticisms of progressive taxation.[11] The debate is unsophisticated to put it mildly. Laymen and the press seem unable to get past simplistic debates, and as a result, conversations about appropriate rates seem bankrupt.

It seems we suffer from amnesia about Western history. The concept of imposing taxes at increasing rates as income or wealth rises has a history that spans over two thousand years, and a large literature. The most interesting feature is that if one looks at the point of origin, at least in the West, theorizing about taxes begins in Classical Greece, with a focus on societal virtue in a collective moral sense, then moves to Eighteenth Century mathematicians who turned to what are now called microeconomic (or Utilitarian) theories of maximizing societal welfare, and ends today with materialistic, insipid debates that fall far short of the profundity of thinking that evolved in the distant past. In fact, the theories bandied about today are largely rhetorical.

The principles underlying progressive taxation have been with us at least since Aristotle's time. Progressive taxation has an impressive pedigree and yet its history never creeps into the debate. Perhaps that failure is in part because American casebooks on Federal

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7 IRC § 2001; it is buttressed by a complementary gift tax for inter vivos transfers (IRC §2501) and a generation-skipping transfer tax (IRC § 2601). The top rate is 40% for 2013-2014. The seminal article on the weakness of the transfer taxes is George Cooper, A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance, 77 Colum. L. Rev. 161 (1977).

8 See Graetz, To Praise the Estate Tax, Not to Bury It, 93 Yale LJ 259 (1983).

9 IRC §1(h). The computations are extremely complicated and capital gains rates in fact range from 0% to 20%, as income rises.

10 See, e.g., David Weisbach, The Taxation of Carried Interests in Private Equity, 94 Va. L. Rev. 715 (2008).

11 The best known of the criticisms is a short book by Walter Blum and Harry Kalven, The Uneasy Case for Progressive Taxation (The University of Chicago Press, 1963).

income taxation always seem to begin in 1913 with the passage of the Sixteenth Amendment.

The purpose of this article is to trace the history of progressive taxation from Greece to today's contentious battles in Washington, with a main stop at the Enlightenment. A clear inference of this writing is that the furious debates in Congress and the press over progressive taxation go on in a vacuum, bereft of historical context or any recognition of the great contributions of sincere thinkers in the past and how those deep thinkers preferred progressive taxation in some form or other.

Some caveats are in order. First, progressive taxation nowadays usually refers to increasing marginal tax rates as taxpayers' taxable incomes rise, but there are also progressive taxes on wealth or transfers of wealth. When I refer to progressive taxes the meaning will vary with the times. For example, ancient Greece had surrogates for wealth taxes in the form of liturgies. Eighteenth Century Britain had a hodge-podge of taxes, but only briefly was there an income tax and there was no inheritance tax. Perhaps the simplest way to define the term is "rising levels of taxation as the ability to pay rises." Another caveat is that thinking about progressive taxation is often blended with notions of how to distribute tax revenues. As will be seen, a number of leading thinkers consider the combination the important topic, not just the revenues.

Classical Athens

Today's dialogues about progressive taxation sometimes suggest the very idea is novel and possibly even shocking. In fact, the progressive taxation has a visible genesis in ancient Greece, where it was actually practiced, but in forms that are so different from today's practices that one has to dig deep to find it. Most importantly from the point of view tracing the history of progressive taxation as a principle, Aristotle's deep thoughts on the matter presage the thinking of Adam Smith and Jeremy Bentham during the Enlightenment where formal notions of progressive taxation first took hold and considered both revenues and their distribution.

It appears that in general, Athenian citizens historically considered paying taxes something a citizen did as a matter of civic pride. According to one scholar, who found the lack of coherent information on Greek taxes dismaying, there was one constant over time:

> "Until the establishment of democracies, political activity made few financial demands, and they were usually met by the very aristocracy of birth and wealth which monopolized all governmental functions. Timocratic systems, like the one introduced by Solon in Athens . . . defined which property classes (tele) had

> access to magistracies. They nonetheless maintained the principle that possession of wealth and public duty were inseparable. Thus, the age-old Greek creed, that performance of public functions bears a resemblance to the liturgies of the post-Classical period, when these were increasingly absorbed by regular magistracies."[12]

During Greece's Classical period (480 BC and 323 BC), or Athenian Empire, Athens was justly famous for new ideas and a fresh spirit of inquiry, with thought emanating from first principles, honestly sought and developed. The focus was largely on moral and ethical issues, but there was also an opposing forensic side provided by the Sophists. In college classrooms Classical Greece is the usual starting point for the study of Western civilization, so this article starts there. Although many of the accepted norms are offensive to modern values – such as acceptance of slavery and the subordination of women – there is no doubt that education flourished in the form of colonies of private academies and that literacy rapidly increased.[13] Perhaps a good measure of the power of education was that Socrates' open-minded thinking became so provocative that the authorities felt it necessary to execute him allegedly on the grounds of impiety and corrupting youth, but really for his provocative philosophical inquiries.

Not everyone complied. One can detect this in the following famous passage from *The Republic* in which Socrates (469 BC to 399 BC) debates the Sophist, Thrasymachus, who exposes what most people consider a horrible truth:

> "The just man is always a loser, my naïve Socrates. He always loses out to the unjust. Consider private business. If a just man takes an unjust man for a partner and the partnership is later dissolved, it is invariably the unjust man who walks away with the lion's share of the assets. Consider their dealings with government. When taxes fall due, the just man will pay more and the unjust less on the same amount of property. Or, if the government is letting out contracts or disbursing money for some other purpose, those who are unjust will get it all and the just will get nothing. The just man in public office will reap no rewards. In the first place, as he conscientiously attends to the affairs of the state, he must necessarily have little time left to attend to his own affairs. His principles forbid him to embezzle on his own account. They will also prevent him from handing out unlawful favors from the public treasury to others. In consequence, he will earn

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12 A Companion to Ancient Greek Government (Beck Ed., Blackwell 2013) p. 333 (chapter by Vincent Gabrielson).

13 *Classical Athens,* The Oxford Encyclopedia of Ancient Greece and Rome (Oxford Univ. Press 2012, Michael Gagarin, editor), available at http://www.oxfordreference.com.ezproxy.uky.edu/view/10.1093/acref/9780195170726.001.0001/acref-9780195170726-e-408?rskey=cYPPW9&result=407.

> the enmity of his disappointed friends and acquaintances."[14]

There was no formal study of economics as we know it, but Aristotle (384 BC – 322 BC) made major inroads into the subject[15] especially in *The Topics*, and Chapter 1 of Book 7 of his *Politics,* which contain an early rationale for progressive taxation and a starting point for the study of Utilitarianism. Here are the famous words:

> "[E]xternal goods have a limit, like any other instrument, and all things useful are of such a nature that where there is too much of them they must either do harm, or at any rate be of no use"[16]

He disliked greed, associating it with a lack of virtue.

> "Since the unjust person is greedy, he will be concerned with goods -- not all goods, but with those with which good and bad fortune are concerned; these are always good without qualification, but not always for a particular individual. (People pray for and pursue these things, but they should not; rather, they should pray that those goods that are good without qualification may also be good for them, and they should choose things that are good for them.)"[17]

In modern economic parlance, the marginal utility (incremental value) of anything, including money, declines as its quantity increases in the hands of a human being. The implication is that at the outer reaches of wealth or income, not receiving more of it does not hurt, and might well be a blessing. As applied to income taxation, it implies that as income rises the personal suffering from any given level of tax declines, and implicitly argues in favor of a progressive tax rate rather than a proportionate (flat) rate.

Aristotle drew on his teacher, Plato (roughly 428 BC to 347 BC). Plato's *Laws*[18] include a foray into distributive taxation that many readers may find alarming. Essentially, he asserted through a literary persona, the Athenian stranger, that in an ideal circumstance no citizen should have more than four times the wealth of the least of the citizenry.[19]

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[14] Plato, Republic Book I, Richard Sterling, (William Scott eds. 1958), p 343 *d,e* (1985) (original pagination).

[15] See generally, Scott Meikle, Aristotle's' Economic Thought (Clarendon Paperbacks 1995).

[16] Aristotle, Politics, Book VII Chapter 1. Aristotle's scrupulous scientific thought and careful reasoning still influence the social sciences and humanities; he apparently invented the syllogism.

[17] Book 5, Nicomachean Ethics, Roger Crisp, (Cambridge University Press, 2000), p. 1129 (original pagination).

[18] Plato's teacher was Socrates; his student was Aristotle. Aristotle's most famous pupil was Alexander the Greek who burst out of Macedonia as a teenager and went on to conquer the bulk of the then known world.

[19] Plato, Laws, in Dialogues, 348 BC, Translated by Benjamin Jowett (4th ed., Oxford, Clarendon Press,

The concept is that in the new Utopian Cretan city of Magnesia, each citizen would receive an initial allotment of nontransferable, non-mortgageable land, good in perpetuity. Four times the value of the lot would be the limit of anyone else's wealth.[20] The overly prosperous could give away their surplus to the local government or to the gods, but if not, then the excess would be expropriated. The underlying reason for this would be to prevent "distraction" that arises from civil conflict and disconcerting differences in wealth between rich and poor. For Plato good life is one of virtue through which human beings attain happiness, which seems a pleasant mixture of hedonism and morality. The format of the essay is a discussion among three astute men, Cleinias, from the Cretan city of Cnossos, Megillus, from Sparta, and a nameless stranger from Athens who will collectively found Magnesia, a city designed to nurture the human soul.

It is the stranger – concerned with revenues and redistribution -- who recommends that there be a limit on the amount of wealth a household may accumulate. Special magistrates would assess the value of the land, buildings, and equipment needed to cultivate the land — the basic allotment. Curiously, outsiders such as artisans and merchants excluded from citizenship would be exempt, apparently as a necessary nuisance. On the other hand, aliens could generally reside in Magnesia for no more than 20 years and unlike the citizens would not qualify for Magnesia's generous social safety net. Here are the words of the Athenian stranger –- Plato in disguise one imagines:

> "The form of law which I should propose as the natural sequel would be as follows: In a state which is desirous of being saved from the greatest of all plagues — not faction, but rather distraction; — there should exist among the citizens neither extreme poverty, nor, again, excess of wealth, for both are productive of both these evils. Now the legislator should determine what is to be the limit of poverty or wealth.
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> Let the limit of poverty be the value of the lot; this ought to be preserved, and no ruler, nor anyone else who aspires after a reputation for virtue, will allow the lot to be impaired in any case. This the legislator gives as a measure, and he will permit a man to acquire double or triple, or as much as four times the amount of this.
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> But if a person have yet greater riches, whether he has found them, or they have been given to him, or he has made them in business, or has acquired by any stroke of fortune that which is in excess of the measure, if he give back the surplus to the state, and to the Gods who are the patrons of the state, he shall

1953), Book IV

[20] There seems to be some ambiguity as to how the 400% amount is valued and exactly what its base is.

> suffer no penalty or loss of reputation; but if he disobeys this our law anyone who likes may inform against him and receive half the value of the excess, and the delinquent shall pay a sum equal to the excess out of his own property, and the other half of the excess shall belong to the Gods. And let every possession of every man, with the exception of the lot, be publicly registered before the magistrates whom the law appoints, so that all suits about money may be easy and quite simple."[21]

The Sophists were a diametrically opposite force. They operated during the 5th century BC, for about the same period as that spanned by the lives of Socrates and Aristotle. By trade the Sophists were itinerant debaters, proto-lawyers and teachers who frequented Greek cities, offering young wealthy Greek males an education, always for a fee, especially in rhetorical persuasion. Plato and Aristotle, among others, found them offensive because they placed so much emphasis on argumentation and so little on morality and religion, and reviled them for demanding payment for education.[22] Nowadays, the term *sophistry* has come to mean the unscrupulous use of fallacious reasoning and intellectual charlatanism. Like the modern "spin doctors" of Washington, DC, they were especially skilled at selecting words that would most move their audience.

> "Sophists did, however, have one important thing in common: whatever else they did or did not claim to know, they characteristically had a great understanding of what words would entertain or impress or persuade an audience." [23]

Many scholars consider them a natural outgrowth of the modernization of Greece of the day into a more democratic and litigious society which required people who could argue well, and credit them with having open minds. The most famous of the Sophists, Protagoros, exemplifies this honest side; he was found guilty of impiety for saying he knew nothing of the gods because of his limitations as a human and the complexity of the question. He soon thereafter died in a shipwreck.[24]

Taxes in Ancient Greece

21 Plato's student, Aristotle, staked out a similar position in Politics, where he discussed the issue of excess property, considering that the right to property is limited to what is enough to maintain the households and life that the polis produces. See fn 19, above at pg 313-14.

22 See *The Sophist,* a dialogue likely penned in 360 B.C.

23 Introduction To Protagoras, (Plato), (Nicholas Denyer ed.) (Cambridge University Press, 2008) p.1. A recent example of effective rhetorical use of language includes "junk science" to attack the scientific underpinnings of global warming and "job killer" to describe a change in the tax law that could adversely affect employment and "death panels" to describe risk of socialized medicine.

24 The Cambridge Dictionary of Philosophy, (Audi, Ed. 1995) p.752.

To summarize what is about to come, the tax system was progressive in that the burden of government fell heavily on the wealthy, but there were a variety of other levies that primarily fell on commercial activities. The taxes varied city-by-city. The following discussion only covers Athens. The extent to which the philosophers' thoughts on progressive taxation might have influenced lawmakers seems unknown.

The earliest records of the tax system appear in Solon's reforms, around 594 BC, during the time of the tyrants, meaning one-man rule, but not necessarily a harsh rule.[25] Solon's reforms separated the Athenian people into four categories based on agricultural production. This was one of the early graded flat tax systems, as each class paid a tax that correlated with the amount of agricultural production.[26]

> "Solon made four classes, a number afterwards adopted by Plato in his Work on Laws . . . The first class was the Pentacosiomedimini; that is to say, those who received 500 measures, either dry or liquid, from their lands, medimini of dry, and metretae of liquid measure. For the second class he took those who received 300 measures, and could afford to keep a horse, viz. a war-horse, to which was assessed another for a servant, and they must also necessarily have required a yoke of animals; this class was called Knights. The third class are the Zeugitae, and their valuation is called the valuation of the Zeugiate . . . Their income is stated in general at 200 measures of dry and liquid measure. The last class is the Thetes, whose valuation was less than Zeugitae. 'The Pentacosiomedimini', says Pollux, 'expended upon the public weal one talent, the second 30 minas, the third 10 minas, and the Thetes nothing.'"[27]

During the time of the tyrants wealth was determined on the basis of visible agricultural production, which often represented the taxpayer's wealth unfairly.[28] Kleisthene's reforms of the tax system began in 508-507 BC.[29] Under his system, the citizenry chose a council of 500 citizens called the Boule whose job it was to identify rich citizens who would be singled out for taxation.

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25 It fell within the Archaic ("old fashioned") period in Greece, which spanned the period 800 BC to 480 BC).

26 Lyttkens, Carl Hampus, Rational-Actor Prospective on the Origin of Liturgies in Ancient Greece, *Journal of Institutional and Theoretical Economics*, Vol. 153, No. 3 (Sept. 1997) pp. 462

27 Boeckh, August, The Public Economy of Athens, in four books; to which is added, A dissertation on the silver-mines of Laurion, Volume II, John Murray pp.259-61 (London, 1828). The primary source of historical information about Solon is likely Plutarch's Lives. A famous version is The Lives of the Noble Grecians, by Plutarch, translated by John Dryden et. al. (1683).

28 Kaiser, Brooks A., The Athenian Trierarchy: Mechanism Design for the Private Provision of Public Goods, The Journal of Economic History, Vol. 67 No. 2 (Jun., 2007), p. 448

29 Id. At 448-49

One might think of it as an early whistle-blower system in which the reward was the absence of taxation. It also has the flavor of a "shotgun buy sell agreement."[30] Aside from of a variety of miscellaneous taxes on such things as commerce and professions, a major sources of Athens' revenue came from "liturgies," whose purpose was to induce wealthy private citizens pay for public services, [31] in which the contributors generally took civic pride. The obligations came in two basic forms; festival liturgies and trierarchies. The assignment of liturgies was administered by magistrates, who initially solicited volunteers for the liturgies. After the supply of volunteers ran out, the remaining liturgies were assigned to whomever the magistrates considered wealthy enough to bear their costs. An interesting aspect of the law was that the citizens who were assigned liturgies were empowered to use the antidosis system to shift the burden onto a citizen that was found wealthier.[32]

The process of antidosis was as follows:

> "[V]isible wealth determined whether or not an individual actually carried out the service or attempted the antidosis challenge to avoid it instead. This challenge allowed an individual charged with performing a [tax] the opportunity to prove another individual more fit (wealthier) to carry it out. The mechanism was clever; if an individual challenged another in the antidosis, the challenged citizen had three choices. He might agree he was indeed wealthier . . . and perform the [tax] himself. If the challenged citizen did not agree, two choices remained. He might simply have offered to swap his visible wealth for that of his challenger's, and the challenger would have to perform the [tax] with this new level of wealth. Alternatively, he might rather have the court decide, based on an investigation of wealth. In that case, the court would designate either the challenger or the challenged citizen (each one facing the probability of being selected); the selected one would have to keep his own wealth and perform the [tax]."[33]

Festival liturgies were used to stage festivals for the citizens of Athens, the best known of which were the Choreiga (dramatic productions).[34] Initially the wealthy volunteered as

30 Such agreements are common in small businesses. They permit one owner to come forward with a formal offer. The offeree can then decide if he wants to accept or instead exercise his right to buy the co-owner's share at the same price.

31 Christ, Matthew, Liturgy Avoidance and Antidosis in Classical Athens. Transactions of the American Philological Association (1974-), Vol. 120 (1990), pp. 148 published by Johns Hopkins university press.

32 Christ, Liturgy Avoidance and Antidosis, at 149-50. It is not clear which statesman first enacted this system. According to Financing the Athenian Fleet: Public Taxation and Social Relations p. 94 (Vincent Gabrielsen,, Johns Hopkins University Press, 2010), it was attributed to Solon when it was liked and to Isocrates when disliked.

33 Id. At 449-50

34 Lyttkens at 462.

a great honor was conferred on whoever took on liturgies and often those who put on the liturgies were given high positions in the government.[35] The amount of the liturgy depended on the cost of the event itself, (as high as 3,000 drachmae).[36] After completing a festival liturgy the "donors" were exempt for the next year.[37]

The Trierarchy was an expensive military public contribution, amounting to taxation and highly visible distribution. Each citizen who performed a Trierarchy paid for the commissioning and command of a state warship, as well as its crew for a year. These were more expensive than the festival liturgies, generally costing anywhere from 4,000 to 6,000 drachmae.[38] A person who performed a Trierarchy was exempt from performance for the following two years.[39] Those who defaulted on these obligations were not treated like public debtors; rather the obligation to repay was controlled entirely by private citizens. The next person selected to perform was responsible for recovering the naval equipment from the defaulting debtor. The collection process began with persuasion, but the courts were called in if persuasion failed.[40]

The tax system later became more advanced and broader-based with the development of the Eisphora. This was a direct tax on the wealthy used to finance military campaigns. The first known Eisphora was in 428 to sustain military operations at Mytilene.[41] Prior to 378-9 BC, the amounts and taxpayers were determined by the ecclesia (citizens assembly) with each taxpayer paying the same rate as their peers.[42] Thereafter, the tax was administered by military generals. There were taxes upon two different groups, the Metics (non-citizens) and the citizens. The Metics were placed into groups with registrars assigned to them to administer the tax. Each member of the group provided the registrar with an assessment of his wealth. This assessment was scrutinized and sometimes challenged. Once the assessment of wealth was approved, each person had to pay an amount based on his wealth,[43] with different citizens taxed differently:

> "wealthy citizens liable to the [E]isphora were divided into 100 tax-paying groups known as symmories, each with some fifteen members (*symmoritai*). Each of these

35 Id. at 463.
36 Christ, Liturgy Avoidance at 148.
37 Christ, Matthew R., The Evolution of Eisphora in Classical Athens, *The Classical Quarterly*, Vol. 57, No. 1 (May 2007) pg. 57
38 Kaiser at 449.
39 Christ, Evolution of Eisphora at 57
40 Hunter, Virginia, Policing Public Debtors in Classical Athens, *Phoenix*, Vol. 54, No. ½ (Spring-Summer, 2000) p. 31.
41 Christ, Evolution of Esiphora at 53-54
42 Id. at 59.
43 Thomsen, Rudi, Eisphora: A study of direct taxation in Ancient Athens pp. 11 (Gylendalske Boghandel, 1964); Christ, Evolution of Eisphora at 62.

> groups was probably responsible for one-hundredth of the total sum levied on citizens by the Assembly on any particular occasion; within each group, individuals paid shares of the group's liability in proportion to their level of wealth, as determined on the basis of their current declarations of their assets."

In order to collect the taxes at a faster rate, Athens, soon thereafter, developed the system of Proeisphora, under which the three wealthiest members of each symmoria were responsible for paying the tax of the entire group consisting of the 300 wealthiest citizens identified by the citizens of Athens from which the citizen could only escape through antidosis.[44] Each of the three wealthiest men then turn towards their 100 members to exact contributions. This process was used both for Trierarchies, which were for extraordinary needs, and for regular property taxes, which taxes were apparently unpopular even though apparently progressive, because they could lead to private financial ruin.[45]

Over time the taxation system became more complex and matured in a way that allowed the determination of wealth to be more accurate. The structure of the system allowed for self-regulation by the people. If a wealthy man hid his wealth, his deception would likely be brought out thorough the antidosis system by another citizen who felt he was being unfairly required to pay or perform a liturgy. The collection efforts were done by those who had already paid the debt to the state and thus were almost entirely a private matter outside of courts.

To sum up their practices, Ancient Greece forced exactions from the rich to support military and civic activities and did so in a systematic and apparently transparent manner. Beyond that simple statement lies a confusing landscape of property taxes as well as a mass of other sources of revenues, including tribute, court fees, confiscations, harbor taxes, and customs and excise duties. [46]

In contrast to ancient Greece, industrialized countries rely primarily on income taxes, in large measure because annual taxes on wealth – whether extracted in cash or service – invite enormous administrative difficulties because of the need to generate honest period appraisals of taxpayers' worth. It seems that Ancient Greece overcame those difficulties by means of several factors: the clever system of antidosis that made lying dangerous; a small population that was aware of each other's economic situations; and, the pride taken

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44 Thomsen at 210-12

45 See (Sept. 1997) pp. 462

45 Boeckh, August, The Public Economy of Athens, in four books; to which is added, A dissertation on the silver-mines of Laurion, Volume II, John Murray, principally at pp.285-316 (London, 1828). Boeckh considers that historians' understandings of the facts differ widely on this subject.

46 Id. Pages 3-4 contain a brief summary of the sources of revenue.

in being known for putting on a drama or funding a trireme as well, perhaps, as general civic pride. Income taxes generally have the inequitable feature of taxing people when they have very good years, but not crediting them for bad years.[47] In contrast, wealth taxes apply with an equal hand every year.[48]

Continental Europe Many Years Later

The first tax on income in Continental Europe reportedly appeared in Renaissance Italy[49] and later in Seventeenth and Eighteenth Century France and Holland, but the modern genesis of progressive income taxation is thought to begin in late eighteenth century Britain.[50] Because the topic of Continental taxes never seems to work its way into the American tax dialogue, it is passed over here, except to point out the contributions of a few Continental mathematicians to early Utility Theory.

Bethamite Utilitarianism and the Enlightenment in England

Modestly progressive income taxes have a surprisingly long history in England, perhaps the first of which was Henry II's "Saladin tithe" in 1188 to help fund the unfortunate Third Crusade. It applied at a rate of a tenth of the personal income and moveable property of English laypersons.[51] Crusaders were exempt from the tax. The need arose from the capture of Jerusalem by Saladin at the Battle of Hattin the year before. In 1435 and 1450, in the midst of the Hundred Years War, there was a graduated income tax on propertied individuals, with a minimum rate of 2½%, on incomes under £100 (under £20 in the 1450 tax) rising to 10% on larger incomes.[52] It appears there was another income tax at rate of 10% on people with incomes over £100 to fund wars with Holland and France,[53] as well as a punitive 10% income tax around 1665 on people who bore

[47] Business losses may be carried forwards and backwards to level income under U.S. federal tax law (IRC § 172), but there is no analog for investment loses.

[48] The topic of annual wealth taxes has had a sudden revival, thanks to French economics professor Thomas Piketty. His most recent work is Capital in the Twenty-First Century (Cambridge, MA: Belknap Press, 2014).

[49] Roughly the 14th through 17th Centuries, generally spreading northward from Italy.

[50] See Assaf Likhovski, "A Map of Society: Defining Income in British, British-Colonial and American Tax Legislation" British Tax Review,158-179,(2005), citing inter alia E.R.A. Seligman, The Income Tax (Macmillan, 1911), M. J. Braddick, The Nerves of the State (Manchester University Press, Manchester, 1996); M. Touzery, "Les origines de l'impôt sur le revenu en France: de la monarchie aux républicains radicaux (XVIIIe — XIXe siècles)" (1997).

[51] Peter Harris (2006). *Income tax in common law jurisdictions: from the origins to 1820, Volume 1*. p. 34.

[52] John Lubbbock, THE INCOME TAX IN ENGLAND p. 152. John Lubbock (he North American Review, February 1894).

[53] England, 1642-1791 (Henry Smith Williams editor, 1908). P. 159. Peter Harris. INCOME TAX IN COMMON LAW JURISDICTIONS, VOL. 1 (CAMBRIDGE UNIN. PRESS 2006) p.139.

arms as Royalists.[54] There may have been others as well, but it was not until the Enlightenment that the foundation for progressive taxation was formalized.

The Enlightenment, another of the great eras of open inquiry into seemingly every aspect of science and philosophy, fundamentally revised the underlying principles on which social and political order were founded, and included formalizing the notion of the declining marginal utility of money, but it only tangentially dealt with the theory with respect to taxes, although it did so with force. (The Enlightenment period roughly spanning the 150 years between Hobbes' *Leviathan* in 1651 and the French Revolution in 1798). It was in this period that the modern concepts of the social contract and modern democracy got its start. It is America's political taproot, and remains an intellectual wonder of the world.

The main taxes during the late Enlightenment, when Utility theory was born in England, were those on revenues from the ownership of property, customs duties, stamp taxes and various excises, with excises gradually replacing taxes on the ownership of property. All of these taxes had the potential for being imposed on a progressive basis, but they were not. However, unlike the inflammatory taxes imposed and brutally "farmed" by rapacious agents of the King in France, and to a much lesser degree on the American Colonies, they were imposed so expediently that they avoided general public objection.[55] The excise taxes were particularly attractive because they were assessed on a small number of large producers:

> "There was again, an administrative rationale, for the excise was collected by efficient bureaucrats rather than lay commissioners (as with the assessed and land taxes) or sinecurists (as with the customs). Excise officers were paid salaries rather than fees, promoted on merit with a pension on retirement, and controlled and inspected by a hierarchy of gaugers and surveyors under the general supervision of a central Board of Commissioners."[56]

There was not what we would recognize as a graduated tax on income until 1798 (modified in 1799) when Great Britain enacted an income tax to pay for weapons and equipment in preparation for the Napoleonic Wars.[57] This graduated income tax began at a rate of 2 old pence per pound (.0083 %) on incomes over £60, rising rapidly to a maximum of 2 shillings (10%) per Pound on incomes over £200. The British income tax

54 Id at 159.

55 Martin Daunton, TRUSTING LEVIATHAN, Chapter 1(Cambridge University Press 2001) ("TRUSTING LEVIATHAN"). The book is an excellent resource for studying the evolution of British taxes over the period 1799 to 1914, but provides context in discussions of other periods.

56 Trusting Leviathan, p.36.

57 Id. at p. 44. It provided 28% of the additional revenue needed to finance the conflict with revolutionary France and the Napoleonic Wars. Id. at p.45.

was reinstated during the years 1811-1815 to again finance the Napoleonic Wars.[58] It was explicitly a war tax and was repealed when the war ended.[59] It was reinstated in 1842.[60] England's first inheritance tax was not enacted until 1871.[61] In contrast to taxes in the days of the Enlightenment, current American federal taxes fall primarily on income and employment.

Back to Aristotle and his observation about the declining value of goods as their quantities rise ("declining marginal utility of money" in the language of microeconomists). It seems that his observation was not picked up during the Renaissance, but instead emerged under its own steam from the minds of extraordinary mathematicians of a later era who turned their attention to economics. The first hint appears to be from the pen of a Swiss mathematician by the name of Gabriel Cramer[62] in a private letter written in 1728. However, the theory of diminishing marginal utility of money was not formally written up publicly until 1738, when it appeared in "Specimen Theoriae Novae de Mensura Sortis" (Exposition of a New Theory on the Measurement of Risk)[63] by the Swiss scientist and mathematician Daniel Bernoulli, in 1738.[64] Curiously, both Bernoulli and Cramer derived their insight from studying an obscure paradox involving gambling that still interests economists.[65] The study led them to draw

58 Id atp.p. 26-42. A chart on p.35 indicates that the income tax became a permanent feature of the tax system in 1851.

59 HM Revenue & Customs, "A tax to beat Napoleon". HM Revenue & Customs. Retrieved 2007-01-24. http://archive.is/gAGX

60 Trusting Leviathan p. 26

61 Id. at p. 35.

62 1704 – 1752. His life is chronicled in W. W. Rouse Ball, A Short Account Of The History of Mathematics, 2d ed. p. 338 (Macmillan, 1893). His wide-ranging interests included a study of why planetary motions are elliptical. In addition to being a mathematician he is credited with being a physicist. His principal academic appointment was in Geneva. His writings clearly show him to believe in the declining marginal utility of money. Cramer's life is chronicled by Walter William Rouse Ball, *A Short Account of the History of Mathematics*, 2d ed. p. 338 (Macmillan, 1893).

63 This work appeared in 1738, based on a draft apparently written six or seven years prior to that. Bernoulli, Nicolas; letter of 5 April 1732, acknowledging that he received "Specimen theoriae novae metiendi sortem pecuniariam."

64 Bernoulli, Daniel; "Specimen theoriae novae de mensura sortis" in Commentarii Academiae Scientiarum Imperialis Petropolitanae 5 (1738); reprinted in translation as "Exposition of a new theory on the measurement of risk" in Econometrica 22 (1954). (Bernoulli's lasting claim to fame is that his study of fluid dynamics led to the "Bernoulli effect" which in turn explains how airplanes get their lift and sails their force.)

65 See http://en.wikipedia.org/wiki/St._Petersburg_paradox. This fascinated Bernoulli and Cramer. The paradox involves a theoretical lottery that leads to a random variable that at once offers an infinite expected payoff and at the same time would be worth only trivial money. Footnote 22: the article that you cite in 20 includes Bernoulli's logarithm and briefly discusses Cramer on page 33. The cite for the Econometrica reprint is. Bernoulli, Daniel, Exposition of a New Theory on the Measurement of Risk, Econometrica, Vol. 22, No. 1)Jan., 1954), pp. 23, 36. The logarithm starts on page 26. Preinreich, Gabriel A.D., Progressive Taxation and Proportionate Sacrifice, The American Economic Review, Vol. 38, No. 1

conclusions as to the mathematical rate of decline in the value of money.[66] Unfortunately, their thinking had only a brief moment in the sun.

The next participant of note is Adam Smith (1723-1790) who in 1776 made a famous remark about taxation that reflected the concept of the declining marginal utility of money. It appears in Book IV of the *Wealth of Nations*:[67]

> "The necessaries of life occasion the great expense of the poor. They find it difficult to get food, and the greater part of their little revenue is spent in getting it. The luxuries and vanities of life occasion the principal expense of the rich, and a magnificent house embellishes and sets off to the best advantage all the other luxuries and vanities which they possess. A tax upon house-rents, therefore, would in general fall heaviest upon the rich; and in this sort of inequality there would not, perhaps, be anything very unreasonable. It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion."[68]

Smith considered that as a practical matter taxes on income would create distortions in behavior and preferred taxes on wealth in the form of land because such were administrable and because if wealth taxes were extended to commodities, they would lead to inflation and collusion.[69] He saw property rights as a necessity for any government and believed that successful economies would be characterized by governments that protect the rich from the envious poor. His proposal was for a wealth

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(Mar., 1948), pp. 103-117. Footnote 9 on Page 111 states, "Cramer's thought was that pleasure afforded by wealth increases as the square root of its amount. This means u = ½." The footnote also discusses Bernoulli, whose logarithm is discussed in the paper on pg. 111.

Shoemaker, Paul J. H., The Expected Utility Model; Its Variants, Purposes, Evidence and Limitations, Journal of Economic Literature, Vol. 20, No. 2 (Jun., 1982) pp. 529-63. This work briefly discusses Cramer and Bernoulli on pp. 530-31 and discusses the fact that Bernoulli used a logarithm. Friedman, Milton and Savage, L.J., The Utility Analysis of Choices Involving Risk, Journal of Political Economy, Vol. 56, No. 4 (Aug., 1948) pp. 279-304. Footnote 5 on pg. 281 of this work discusses Bernoulli and Cramer, and the fact that Bernoulli is generally given credit for this idea because he came up with the logarithm, but it does not mention exactly the formula Cramer used.

66 Cramer selected a square root. Preinreich, Gabriel A.D., Progressive Taxation and Proportionate Sacrifice, The American Economic Review, Vol. 38, No. 1 (Mar., 1948), pp. 111 (footnote 9).

67 Adam Smith, An Inquiry into the Nature And Causes of the Wealth of Nations (1776). Book Five: Of the Revenue of the Sovereign or Commonwealth. CHAPTER II: Of the Sources of the General or Public Revenue of the Society. ARTICLE I: Taxes upon the Rent of House.

68 Id. Book IV, Of the Revenue of the Sovereign or Commonwealth.

69 Adam Smith, 5 LECTURES ON JURISPRUDENCE (R. L. Meek, D. D. Raphael & P. G. Stein eds., Glasgow Edition of the Works And Correspondence of Adam Smith, Oxford: Clarendon Press 1976)

tax with a large exemption and a flat rate was in part in order to achieve progressivity of rates.[70]

Jeremy Bentham made by far the greater contribution. He was a rare genius who graduated from Oxford at 15 and became a lawyer, dedicating his life to numerous reforms, including animal rights. He echoed Aristotle's observation about the declining utility of money and applied a great deal of effort to formalizing the subject. The following famous passage offers his thoughts on the taxation of wealth, but it is equally applicable to the taxation of income:

> "Of two people having unequal fortunes, he who has most wealth must by a legislator be regarded as having most happiness. But the quantity of happiness will not go on increasing in anything near the same proportion as the quantity of wealth: ten thousand times the quantity of wealth will not bring with it ten thousand times the quantity of happiness. It will even be matter of doubt, whether ten thousand times the wealth will in general bring with it twice the happiness. Thus it is, that, the effect of wealth in the production of happiness goes on diminishing, as the quantity by which the wealth of one man exceeds that of another goes on increasing: In other words, the quantity of happiness produced by a particle of wealth (each particle being of the same magnitude) will be less and less at every particle; the second will produce less than the first, the third than the second, and so on."[71]

Bentham and John Stuart Mill – who are often referred to in the same breath -- are considered to have founded the school of economic philosophy known as Consequentialism, a forerunner of Utilitarianism, which is itself the foundation for modern microeconomics and is in turn the basis for much serious Congressional testimony by economists. The heart of their doctrine is that the merits or flaws of human actions ought to be judged by the pleasure or pain that they imply for the population and not by abstract normative measures.[72]

Bentham's thoughts are profound because they call for considering not only dryly logical matters of consumption and production, but also the distributive effects of policy choices in the realm of taxation and economics. His search might be called the quest for maximizing aggregate national happiness (or "utility") considering all the participants,

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70 Id., *See also* Beverly I. Moran, *Capitalism and the Tax System: A Search For Social Justice,* 61 SMU L. Rev. 337, 343-47 (2008).

71 Bentham, Jeremy, and Browring, Sir John, The Works Of Jeremy Bentham, Volume 3, pp. 228-29 (W. Tait, 1843)

72 For an excellent, short discussion of this subject and much more, see Uwe Reinhart, *How Economists Bastardized Benthamite Utilitarianism*, which can be found at ^http://www.princeton.edu/~reinhard/pdfs/100-Next_How_Economists_Bastardized_Benthamite_Utilitarianism.pdf

which in its modern form is often described inaccurately as the search for "the greatest good for the greatest number." He referred to the effort to value the results of an act, whether positive or negative, as the *felicific calculus*. The theory is spectacularly powerful, but its applications can be exasperating. Not only is it hard to assign values to acts, but there is also the formal problem that not every similarly situated person assigns the same value to anything. The modern evolution of this effort is the study of welfare economics, which searches for aggregate gains known as "social surplus" via changes in public policy. An important related principle states that if a new policy results in a net financial gain to society then the losers ought to be rewarded with a lump sum payment.[73] For example, if one were to impose a tax on a very useful toxin in order to discourage its production and consumption, one might make compensatory payments to poor consumers, who would then be free to decide whether to use the money to buy the same toxic product or put the money to better uses. This is taken up again later in the article.

Bentham is viewed as favoring taxes on wealth over taxes on labor. He famously said, "Most taxes are, as all taxes ought to be, taxes upon affluence."[74]

John Stuart Mill's thoughts were at once more conservative and more radical. His preference was for proportional taxes on earned income in order to encourage personal exertion, provided that poorer people's necessities were not threatened. He considered designing progressive income taxes an impossible task for the legislature. As to gratuitous transfers, however, graduated rates were desirable and his views would likely be considered surprisingly ruthless today:

> "With respect to the large fortunes acquired by gift or inheritance, the power of bequeathing is one of those privileges of property which are fit subjects for regulation on grounds of general expediency; and I have already suggested, as a possible mode of restraining the accumulation of large fortunes in the hands of those who have not earned them by exertion, a limitation of the amount which any one person should be permitted to acquire by gift, bequest, or inheritance. Apart from this, and from the proposal of Bentham (also discussed in a former chapter) that collateral inheritance in case of intestacy should cease, and the property escheat to the state, I conceive that inheritances and legacies, exceeding a certain amount, are highly proper subjects for taxation: and that the revenue from them should be as great as it can be made without giving rise to evasions,

73 See, e.g., S.Jain & S. Makunda, Economic Policy Reform under Political Constraints: Labor Reallocation and Compensatory Redistribution, draft of presentation at 2003 NEUDC conference, Yale University (September 2003), available at http://aida.econ.yale.edu/conference/neudc03/papers/8e-jain.pdf.

74 Jeremy Bentham, the Works of Jeremy Bentham, The Online Library of Liberty, .p. 1033, a project of Liberty Fund, Inc. available at:
http://files.libertyfund.org/pll/pdf/Bentham_0872-02_EBk_v6.0.pdf.

> by donation during life or concealment of property, such as it would be impossible adequately to check. The principle of graduation (as it is called,) that is, of levying a larger percentage on a larger sum, though its application to general taxation would be in my opinion objectionable, seems to me both just and expedient as applied to legacy and inheritance duties.[75]

Mill at least initially opposed progressive income taxation on the ground that it violated "equality of sacrifice" and penalized people who work hard and save and therefore constituted "a mild form of robbery," but as we have seen did not feel the same way about taking unearned income or inherited wealth.

There are occasional examples of this thinking in American tax law. During the Nixon Administration top federal income tax rates on unearned income were 70 percent, but 50 percent on earned income and the legislative history of the estate tax contained an explicit intention to break up great wealth.[76]

Marginal utility theory – the heart of microeconomics -- took strong hold in the early Nineteenth Century in the hands of such people as William Lloyd (1795/1852)**,** who propounded a form of general utility theory[77] as did Hermann Gossen (1810/1858)**.**[78] Marginal utility refers to the gain from adding an extra unit of a good or service or loss from a decrease in the consumption of the good or service. Its common application is the "law of diminishing returns" under which as a consumer acquires each further unit of the good or service, his or her enjoyment (utility) declines in comparison to the prior unit.

James Madison, the American Revolution and the Importance of Civic Virtue

There is a strain in the early history of the United States that is rarely appreciated or taken seriously, namely the notion of civic virtue. It t stands as a forgotten counterpoint to our modern combative political environment and this country's frequent

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75 J. S, Mill, Principles Of Political Economy With Some Of Their Applications To Social Philosophy (Longman, Greens &Co. 1878)., p. 487.

76 Recently restated in S. REP. NO. 144, 97th Cong., 1st Sess. 124, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 105, 226 ("Historically, one of the principal reasons for estate and gift taxes was to break up large concentrations of wealth") This claim has been repudiated as mere myth. See Michael Graetz, To Praise the Estate Tax, Not to Bury It, 93 Yale L.J. 259 (1983) (estate tax a s supplement to progressivity).

77 A Lecture on the Notion of Value as Distinguished Not Only from Utility, but also from Value in Exchange, forming part of his Lectures on Population, Value, Poor Laws and Rent (1837).[34]

78 Die Entwicklung der Gesetze des menschlichen Verkehrs und der daraus fließenden Regeln für menschliches Handeln (1854). The book is heavily mathematical. The book has been translated into English under the title The Laws of Human Relations and the Rules of Human Action Derived Therefrom (MIT Press 1983).

subordination of moral philosophy by materialistic political rhetoric. Utilitarianism was not part of the American thread of virtuous citizenship, but at the same time, Utilitarianism drew much of its strength from ancient concepts of virtue.[79]

The intellectual history of the founding of the United States found inspiration in England's "Country Party" whose ideology referred back to visions of the Greek *polis* and Roman republic, both of which were seen as free of greed and corruption, run by a virtuous populace.[80] Indeed, there was evidently a widespread belief that America was a fresh blessing from God, which buttressed the social importance of banishing corruption.[81] At the same time there was an inevitable paradox; the Constitution secured property rights and created freedom of commerce, which could lead to the ascendancy of greed and venality. John Quincy Adams once summarized the dilemma this way in a private letter:

> "Public Virtue cannot exist without private, and public Virtue is the only Foundation of Republics. There must be a positive Passion for the public good, the public Interest, Honor, Power, and Glory, established in the Minds of the People, or there can be no Republican Government, nor any real Liberty. And this public Passion must be Superior to all private Passions. Men must be ready, they must pride themselves, and be happy to sacrifice their private Pleasures, Passions, and Interests, nay their private Friendships and dearest connections, when they Stand in Competition with the Rights of society."[82]

He feared "a great Danger that a Republican Government would be very factious and turbulent . . ."[83] After the Revolution, faith in civic virtue as sufficient had declined, there was a general recognition that people are not always virtuous, and that there was a risk of tyrannical government, to which Madison (who drew on Artistotle's *Politics*[84]*)* recommended modified a Constitution based on gridlock ("divided powers") whereby an internally restricted government would expend much its energy fighting itself, thereby

79 For a general discussion see G. Edward White, The Political Economy of The Original Constitution, 35 Harv. J.L. & Pub. Pol'y 61
(Winter, 2012). The subject is Capitalism, Markets, and the Constitution The Thirtieth Annual Federalist Society National Student Symposium on Law and Public Policy--2011 II. Economic Theory, Civic Virtue, and the Meaning of the Constitution G. Edward White

80 H. T. Dickinson, ed., A companion to eighteenth-century Britain (2002) p. 30. See also J.G.A. Pocock, The Machiavellian Moment p 507.

81 Bernard Bailyn, The Ideological Origins of the American Revolution p 525.

82 Letter to Mercy Otis Warren (1776), from Paul Rahe, Republics Ancient and Modern: Classical Republicanism and the American Revolution. Volume: II, p. 23. (North Carolina Press 1994).

83 Id. .

84 Colleen A. Sheehan, James Madison and the Spirit of Republican Self-Government, (Cambridge University Press, 2009) pp.161-163. (especially with respect to stability of regimes).

posing less of a threat to liberty.[85] Madison also foresaw the risk that private interests that might come to dominate government and subvert the public good and the risk of "faction," meaning self-interested groups such as landowners and merchants, debtors and creditors and hence saw the need for public education in civics.[86] In Federalist No. 10, he argued that it was impossible to control factions without unduly infringing on personal liberty and recommended ways to design government to minimize their mischief. In the end, his model prevailed.

Things are never as simple as they may seem. Madison's mechanical design of government still presupposed civic virtue, which nowadays seems almost quaint. Here is his presupposition:

> "But I go on this great republican principle, that the people will have virtue and intelligence to select men of virtue and wisdom. Is there no virtue among us? If there be not, we are in a wretched situation. No theoretical checks, no form of government, can render us secure . . ."[87]

Madison considered we were safe as long as a virtuous citizenry selected its leaders:

> "If there be sufficient virtue and intelligence in the community, it will be exercised in the selection of these men [representatives of the people]; so that we do not depend on their virtue, or put confidence in our rulers, but in the people who are to choose them. "[88]

If one agrees with Madison, this raises the disturbing question of whether serious discussions of progressive taxation can occur in an environment in which the citizenry has lost faith in its politicians and lobbyists and Washington insiders who can provide desperately needed campaign funds to influence the agenda.

The American Civil War

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85 See generally Gordon S. Wood, The Radicalism of the American Revolution ____ (1992). Hamilton feared business forces and landowner forces with excessive representation in legislatures. The Federalist No. 35, at 214-16 (Alexander Hamilton) (Clinton Rossiter ed., 1961).
Hamilton also believed the public would select wise, disinterested legislators. Id. at 214-16

86 So did Thomas Jefferson, among others. Akhil R. Amar, The Bill of Rights: Creation and Reconstruction 131-33 (Yale U. Press 1998).

87 James Madison, Remarks to the Virginia Convention, in Vol. 3, The Debates in the Several State Conventions on the Adoption of the Federal Constitution, 536-537 (Jonathan Elliot, Ed. 2d Ed. 1836).

88 Madison, James, and Ketcham, Ralph Louis, Selected Writings of James Madison 157-58 (Hackett Publishing Company, Inc. 2006) and originally from Virginia Convention Speech, June 20, 1788.

Prior the Civil War the nation depended mainly on import duties to fund the federal government. In addition, there were occasional excise taxes that the government imposed temporarily when customs revenues were inadequate (e.g., to fund the War of 1812), along with revenues from the sale of public lands.[89] The first American progressive income tax was enacted by the Union in the Revenue Act of 1862, long after the formulation of utility theory in economics, but with no evidence visible to this writer that utility theory ever crept into the debate. The tax was levied on individuals; if income exceeded $600 but not $10,000, individuals were taxed at 3%; if income exceeded $10,000, individuals were taxed at 5%.[90] So it was a progressive income tax, presumably founded on simple notions of fairness and political expediency.

The legislative history is dissatisfying. Congressional floor debates are typically useful when examining the policies Congress takes into account before enacting tax legislation, however, the *Congressional Record*, which now collects and sanitizes Congressional floor debates, did not exist until 1873, long after the tax was enacted.[91] As a result, to obtain insight into Congressional considerations regarding the Revenue Act of 1862, one has to examine the *Congressional Globe*, a newspaper-like collation of pre-1873 Congressional deliberations.[92] Because the *Globe* did not provide verbatim accounts, as does the *Record*,[93] but instead provided rough outlines of the debates, and because the *Globe* was thought to be partisan, with certain members misrepresented or not represented at all, the information regarding Congress' reasoning for instituting a progressive tax is lacking.[94]

Nonetheless, the *Congressional Globe* does provide a snapshot of the post-Civil War era in America that helps understand what Congressmen took into consideration before enacting a progressive tax system. The Revenue Act of 1862 was seen largely as a wartime emergency measure, enacted to meet the Union's increased financial demands arising from the conflict with the Confederacy.[95] Aside from the exigencies of war expenditures, the Union had relied on various tax revenues from the southern States before enacting the new progressive tax. Congressmen considered the tax as a means to recoup such losses as import taxes[96] or taxes on slavery.[97] Be that as it may, there is no

89 B. Bittker & L. Lokken, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS, ¶1.1.2. (WG&L, supplemented through 2012).

90 Revenue Act of 1862, Sec. 90, 12 Stat. 432, at 473 (July 1, 1862).

91 Richard J. McKinney, An overview of the Congressional Record and Its Predecessor Publications: A Research Guide, LAW LIBRARIAN'S SOCIETY OF WASHINGTON, D.C., October 2011. Available at http://www.llsdc.org/cong-record/

92 Id.

93 Nowadays the language is in fact sanitized before the Congressional Record is printed.

94 Elizabeth G. McPherson, Reporting the Debates of Congress, 28 QUAR. J. SPEECH 145-146 (1942).

95 Report of the Secretary of Treasury on the Sate of Finances, WASHINGTON: GOVERNMENT PRINTING OFFICE, 6, 126-7, (1863)

96 THE CONGRESSIONAL GLOBE, JANUARY 18, 450-459, (1862)

97 THE CONGRESSIONAL GLOBE, MAY 29, 442-443 (1862)

evidence of philosophical reasoning behind the progressivity of the tax rates. There is certainly no reference to Utilitarian thought.

The 16th Amendment and Revenue Act of 1913

The Revenue Act of 1913 was America's first modern, durable progressive tax.[98] It went into force following the ratification of the Sixteenth Amendment to the United States Constitution, which made Constitutional the collection of taxes from "whatever source derived."[99] By today's standards the rates were modest.

> "In addition to the income tax provided under this section (herein referred to as the normal income tax) there shall be levied, assessed, and collected upon the net income of every individual an additional income tax (herein referred to as the additional tax) 1 per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $50,000, and 2 per centum per annum upon the amount by which the total net income exceeds $50,000 and does not exceed $75,000, 3 per centum per annum upon the amount by which the total net income exceeds $75,000 and does not exceed $100,000, 4 per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $250,000, 5 per centum per annum upon the amount by which the total net income exceeds $250,000 and does not exceed $500,000, and 6 per centum per annum upon the amount by which the total net income exceeds $500,000."[100]

In order to shift some of the financial burden from those least able to bear it onto the shoulders of the wealthy, the Revenue Act offset high tariffs with a progressive income

98 Both the North and the South briefly enacted income taxes during the Civil War. The South imposed multiple taxes which included an 8% tax on naval stores and agricultural products, a 1% tax on the value of securities and invested capital in businesses and a series of licenses on trades, businesses and occupations, some of which were based on gross receipts. Additionally, a tax on salaries and a tax on income and profits were levied.
See William D. Samson, *The Nineteenth Century Income Tax in the South,* 12 Accounting Historians J., S No.1, (Spring 1985). The North's was "progressive" in that it initially levied a tax of 3 percent on annual incomes over $600 but less than $10,000 and a tax of 5 percent above that level. Cynthia G. Fox, *Income Tax Records of the Civil War Years*, 18 Prologue, No. 4 (1986).

99 The Amendment was necessary to bypass the Supreme Court's invalidation of a prior tax on Constitutional grounds, primarily that as applied to dividends, interest, and other income from personal property, it was a "direct" tax which requiring the burden to be apportioned among the States in proportion to their populations, a Herculean requirement. Pollock v. Farmers' Loan & Trust Co., 157 US 429, 158 US 601 (1895).

100 REVENUE ACT OF 1913, Section II, A.2., 38 Stat. 114, 166

tax that effectively largely exempted the poorest Americans. Again, a look at the Congressional debates from the period leading up to the 1913 Act provides an insight into the reasoning behind implementing a progressive income tax scheme. Congressmen of the day considered both social fairness and, implicitly, Utilitarianism.

> "It is a shame and a disgrace, Mr. Speaker, that under our system of taxation the poor laboring man who has a wife and four or five children to support contributes more toward the expenses of the Government than does the millionaire who is too proud to raise a family and has no one to clothe and feed except a wife and a poodle dog… [Polarization of wealth] affects injuriously every citizen, unless it be the few who fatten at the expense of the many."[101]

> "Any Tariff measure which would mean the greatest good for the greatest number would receive my support [shades of Bentham here]. I would endeavor in every measure to ascertain whether it [the Act] would promote the public welfare, weaken special privilege, and help to give every man a fair and square chance before supporting it… I believe that this bill is more just than the present law to the people of the Nation, that as a whole it will improve conditions and bring more of justice and less of oppression to the common man."[102]

Congressmen also considered the argument that taxes on individuals with higher incomes tend to fall much more on economic rent[103] than taxes on those with low incomes:

> "Under the indirect taxes which people have been paying heretofore, which have been largely consumption taxes – because the poor consume out of all proportion to their income of what the rich consume as to their income – the men of small means and small incomes have been paying an extraordinarily large share of the taxes to support the government."[104]

The striking omission in these early revenue acts is the absence of a discussion of why the rates were set at progressive levels and why the particular breakpoints between rates

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101 Congressional Record Bound, CR-1909-0712, 4434 (1909)
102 Congressional Record Bound, CR-1913-0506, 1251 (1913)
103 Rent is an economic term referring to the difference between what a factor of production (i.e., capital, land, or labor) earns and what it could earn in the next best-paid employment. It is generally thought of pejoratively in the sense that a competitive, efficient market would squeeze out rent and offer only "normal" returns. Rent is often considered a fair target of taxation because it can be appropriated without negative effects on consumption and production. See, e.g., Tollison, "Rent Seeking: A Survey" Kyklos, vol. 35, issue 4, pp. 575-602 (1982).
104 Id., at 1250.

were selected. Instead, we see *faits accomplis* which we can only attribute to political compromise and private intuitions of legislators.

America in the Twenty-First Century

Americans pride themselves on their energy, optimism and entrepreneurship and tend to look at increases in the Gross Domestic Product as the measure of national economic success. As a result of this context, arguments about appropriate levels of taxation are generally couched in terms of economic outcomes, with "fairness" generally conceived as an ideological preference. The guiding principle of maximizing production and consumption has tilted the discussion into materialistic realms characterized by bitter forensics and deep questions about whether the debate itself is tainted by an undue influence of money in politics and rigid ideologies on all sides.

The "Right" Level of Progressivity

This subject could not be more controversial and incapable of a precise conclusion. The debate largely turns on intuitive notions of fairness and what is best for the overall economy rather than on morality or the coherent approach of Utilitarianism.[105] What follows are a few of the common arguments and considerations concerning changes in top federal income tax rates.

The "Substitution" and "Income Effects"

Perhaps the most common argument is that progressive taxes are inherently imprudent because they cause productive people to withdraw their labor (the "substitution effect").[106] A completely contradictory and offsetting theory proposes that progression does no harm because heavily taxed individuals will work harder in order to maintain their prior standard of living (the "income effect"). As always in the American tax realm, the empirical evidence is not satisfying because it is sparse and dated, but at least there is some. Unfortunately, this line of honest inquiry died out decades ago. Although it generally favors the income effect over the substitution effect, ideologues seems blissfully unaware of its existence.

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105 The legal and economic literature in this field is exceptionally voluminous. Perhaps the most comprehensive survey is by Bankman and Griffith, *Social Welfare and the Rate Structure: A new Look at Progressive Taxation*, 75 Cal. L. Rev. 1095 (1984).

106 See B. Bittker & L. Lokken, Federal Taxation of Income Estates & Gifts ¶ 3.2 (Warren, Gorham & Lamont 2011).

The first empirical study appeared during the Great Depression and was authored by Professor Paul Douglas, who later became Senator Douglas of Illinois.[107] The upshot of his study was that reducing wages generally makes people work longer.[108] This implies that rising tax rates would be met with more work, not less, and supports the income effect, especially in the case of the young, the old and females. This study and its implications are summarized neatly as follows:

> "These results comport with a common sense analysis: Since most middle-aged men already work full-time, they could not readily increase their earnings to offset higher taxes. On the other hand, when the primary breadwinner's take-home pay is reduced by taxation, one would expect high school students, retired persons, and housewives to give up their unpaid activities and seek gainful employment in order to restore the status quo ante."[109]

Later studies validated Douglas' conclusions, showing that a reduction in the wages of middle-aged wives drove them to leave the work force, and a variety of other results, all of which were dependent on the socio-cultural patterns of those earlier times, especially the greater prevalence of the husband as the primary breadwinner.[110]

> "Efforts have been made to measure the impact of income taxes on the choice between work and leisure not only by statistical studies but also by questionnaires. When asked about the effect of taxes on their work habits, an overwhelming majority of wage earners, salaried employees, and self-employed professionals deny that the impact is substantial."[111]

To make it even more complicated, one can take into account how taxes are spent; if the

107 Douglas had a remarkable career. He taught at the University of Chicago, served on the Chicago City Council and was a marine in WWII, leaving as lieutenant colonel and war hero.

108 Douglas, The Theory of Wages 313 (Kelley & Millman, Inc. 1934); see Break, The Incidence and Economic Effects of Taxation, in Economics of Public Finance 187 (Blinder & Solow eds., Brookings 1984).

109 B. Bittker & L.Lokken, Federal Taxation of Income, Estates and Gifts, ¶ 3.2 (WG&L supplemented through 2012).

110 Id,, citing inter alia Boskin, The Economics of Labor Supply, in Income Maintenance and Labor Supply 163–181 (Cain & Watts eds., Academic Press 1973) and Kosters, Effects of an Income Tax on Labor Supply, in The Taxation of Income From Capital (Harberger & Bailey eds., Brookings 1969).

111 Id., citing inter alia Barlow, Brazer & Morgan, Economic Behavior of the Affluent 129–150 (Brookings 1966); Brown & Levin, The Effects of Income Taxation on Overtime: The Results of a National Survey, 84 Econ. J. 833 (1974); Fields & Stanbury, Income Taxes and Incentives to Work, 61 Am. Econ. Rev. 435 (1971); Holland, The Effect of Taxation on Effort: Some Results for Business Executives, 62 Proc. Nat'l Tax Ass'n 428 (1969).

spending favors the poor and middle class, then the degree of progressivity increases.[112] Plato did not do so in *Laws*, presumably because he felt the moral imperative behind the system of taxation and distribution of taxes regulated both components and viewed the sum of the two as the correct measure. Our debates are far more raucous, and we seem unable to agree on what is fair on either the tax or spending side and depend on intuition rather than scrupulous analysis of the seemingly ideological claims. That is not to say that the government's failure to study the impact of changes in tax rates is abnormal. In reality, such studies are all but nonexistent in all areas of income taxation where matters are settled by forensics and lobbying and then often left for the next administration to grapple with.

The belittling of Utilitarian thought

Bentham and Mill's[113] Utilitarian views are potentially revolutionary if one combines the utilities to be gained from income taxation plus redistribution of that income. The obvious implication is a reduction of economic inequalities, and, if pushed far enough, socialism and ultimately even equality. Microeconomics dominates the academic debate over progressive income taxation, but game theory and behavioral economics seem to be rapidly displacing the study of microeconomics.[114] Although microeconomics itself was born from Utilitarian principles and freely uses "utility" as a crucial tool of analysis, in this author's view it has been largely sterilized because of economists' dread of making "normative" statements. To frame the question, one can consider the following example.[115]

> **To Illustrate:** Islandia has 2 citizens, R (rich) and P (poor). R has 100 pies of income this year and P has three. The pies are necessary to the operation of the government and have no redistributive implications. The economists in Islandia and elsewhere agree there is a declining marginal utility of money. A flat wealth tax rate tax of 10% would cause P to suffer but would be emotionally trivial to R. Intuitively (viewed from abroad) it would be fairer to not tax P and to present R

[112] R. Musgrave & P. Musgrave, Public Finance in Theory and Practice 261-65 (4th ed. 1984).

[113] Mills was leery about progressive income taxation of the fruits of labor. Interestingly, in the US tax rates declined in stages in which income from labor was preferred over income from capital, sharing Mills' preference. Specifically, The top individual rate was 90 percent at the end of WWII, then 70 percent in 1964, then 50 percent for earned income in 1969, then 50 percent for all income in 1981.

[114] John Von Neumann & Oskar Morgenstern, Theory of Games and Economic Behavior (1944) is the starting point, and the application of game theory to economics began in earnest with the work of John C. Harsanyi, *Games with Incomplete Information Played by "Bayesian" Players,* 14 Mgmt. Sci. 159-182, 320-334, 486-502 (1967-1968), Modern treatments of industrial organization commonly include game theory. See, e.g., Dennis Carlton & Jeffrey Perloff, Modern Industrial Organization (2000).

[115] This example can be faulted for incompleteness. Are the taxes somehow avoidable? Are they one shot or do they run into the indefinite future, etc.? These issues are not trivial, but are dismissed for purposes of framing the question in a stark light.

> with a tax bill of three pies.

Microeconomists have various objections to the intuitive solution.

There is no proper definition of utility. This is a legitimate complaint. Bentham defined utility modestly in terms of a:

> " . . . hedonistic calculus: in comparing two actions under consideration, we count up the pleasures or pains each will produce . . . then sum them up for all persons who will be affected. Evidently these directions can at best produce only approximate results."[116]

Exactly how to measure individual utility has become a confused subject.[117] Not even Bentham and Mill agreed on how to define utility. In terms of P and R, how do we measure the impact of the proposed tax?

Mill's method has been called "Rule Utilitarian" because he considered utility had to be confined by morality. For example, one taxpayer's not paying her taxes would bring greater utility to her, but would be catastrophic if no one paid any tax.

> "Mill therefore seems to appeal to a second type of rule-utilitarian theory, one that does not evaluate moral rules in comparative isolation, as in utilitarian generalization, but rather considers them as component parts of a more complex *ideal moral code*, a set of rules that together *would* maximize utility if it was adopted and followed by the overwhelming majority of the members of a society."[118]

This harks back to the Ancients in that it is concerned with moral virtue as the first principle. So much for the idea that hedonism reigns supreme in Utilitarian thought.

In the next stage, Victorian economists adopted Bentham's ideas of presumed pleasure and pain as the measure of utility, but not for long:

> "[O]nce economists discovered (in the "marginalist revolution" of the early part of the twentieth century) that they did not need to attribute utility functions to economic agents in order to prove most of the propositions that seemed

116 The Cambridge Dictionary of Philosophy, p. 69 (Audi, Ed., Cambridge Univ. Press 1995).

117 I have relied heavily on a paper by Ken Binmore entitled "Interpersonal Comparison of Utility" for this topic. He is a member of the Economics Department University of London. Ken Binmore, Interpersonal Comparison of Utility, in Kincaid & Ross (eds.) *Oxford Handbook of Philosophy of Economic Science*, (Oxford University Press 2009)

118 Henry R. West, Blackwell's Guide to Mill's Utilitarianism, pp. 144-145 (Blackwell Pub. Ltd.2006)

> important at the time, all of the baggage on utility theory inherited from the Victorian era was swept away."[119]

Modern theory moved away from explaining people's behavior in favor of observing their behavior objectively; this observed behavior is known as "revealed preferences.[120] Leading thinkers in this sphere are Von Neumann and Morgenstern who came up with an imaginative way to determine people's utility scale for money by reference to lotteries, but it does not solve the matter of interpersonal comparisons.[121] This is the next topic.

Each person's utility varies. This raises the matter of "interpersonal comparisons." It might be that R enjoys giving away his money and that P finds living near the starvation level to be exciting. There is an illuminating example of differing preferences from the Enlightenment philosopher David Hume:[122]

"Were I Alexander," said Parmenio, "I would accept these offers made by Darius."

"So would I too," replied Alexander, "were I Parmenio."

The topic of how to isolate, rank and value individual preferences brings one into extremely deep and uncertain waters. Whatever those preferences are, they are shaped by societal factors that are themselves in motion. It seems possible to identify a best method,[123] but actually applying it to concrete proposals for tax legislation is impossible.

There was a time when there was a view that because one cannot accurately determine people's specific utilities, the defect was so severe that it presented a serious case for discarding utility theory.[124] This theory lives on as a bugaboo in the literature of microeconomics and raises exasperating questions that are ultimately all but impossible to apply scientifically in connection with the making of tax policy. A good example of

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119 Binmore, p. 3.

120 Binmore p.4.

121 See Ken Binmore, Rational Decisions 58-59 (2009) for a critique.

122 David Hume, *An enquiry concerning the principles of morals*, pg. 146, (London, 1751).

123 Bimore's erudiate article proposes that Harsanyi's is the best. See J. Harsanyi, Normative Validity and Meaning of Von Neumann and Morgensern Utilities, in B. Skyrms, ed., Studies in Logic and the Foundations of Game Theory: Proceedings of the Ninth International Congress Of Logic, Methodology And The Philosophy Of Science (Kluwer 1992); Binmore at pp. 15-17.

124 The best known example of this attitude appears in Blum & Klaven, *The Uneasy Case for Progressive Taxation.*, 19 U. Chi. L. Rev. 417 (1952). Blum and Kalvin's analysis is schizophrenic in that it rejects the utilitarian approach overall, but confesses that welfare considerations are legitimate when one compares the tax burden on two individuals, one of whose income is below subsistence and the other has an income above the subsistence level. Id. at 473. Common sense suggests this is merely the most compelling case, not the only case.

impossible quests in the field of economics is the "right tax" to impose on petroleum in order to account for the implicit damage each unit of petroleum does. A great deal of ink has been spent on the subject, and there is simply no single correct answer because the necessary information is lacking.[125]

Despite the impossibility of achieving perfection, and the arguable uselessness of microeconomics to solve the problem of just how to calibrate a set of income tax rates, utilitarian thought is so stubbornly embedded in economic theory that it will stubbornly remain with us, primarily as a basis for looking at proposals for changed tax rates. At the same time, economists decline to opine on the collective social utility of taxes because they consider it is not their charge, although they have formalized the subject of maximizing overall utility in a narrow way, and although various mathematically inclined economists have presented their theorems under the rubric of the "social welfare function," often with intricate graphs and symbolic logic.[126]

Modern Economists and Testimony on Inefficiency

In a country much taken with free-market ideology such as ours, economists' testimony that a proposed change in the tax laws will be "inefficient" sounds grave, but what are they saying exactly in their language? Efficiency means an adjustment in the allocation of resources within society results in at least one person feeling better off and none feeling worse off[127], an idea within the sphere of welfare economics which is a descendant of Utilitarianism. If they are scrupulous they will stop at identifying the winners and losers and quantify the impacts if possible, and leave the policy decision concerning the social merit of proposed legislation to the legislators; this is known as "strict constructionism" among economists. [128]

The trouble is, there are apt to be losers and the data presented by economists frequently depend on the economists' claims as to what the correct inputs are. Proposals for taxes on environmental "bads," such as CO2 emissions offer an excellent example of vast

[125] For one point of entry on this impossible topic see M. Walls, Welfare Costs On An Oil Import Fee, 8-2 Contemporary Economic Policy, pp. 176-189 (1990) (opposing view of desirability of oil tax).
[126] See, e.g., Anthony Atkinson & Joseph Stieligtz, Lectures on Public Economics (McGraw Hill 1980) pp. 339- 340 and Samuel Bowles, Microeconomics: Behavior, Institutions, and Evolutions, p.p. 221-227 (2004). See also, Bankman & Griffith, Social Welfare and the Rate Structure: A New Look at Progressive Taxation, 75 Calif. L. Rev. 1905 (1987); Byrne, Locke, Property, and Progressive Taxes, 78 Neb. L. Rev. 700 (1999).
[127] This is known as a "Pareto optimum" after the Italian economist Vilfredo Pareto (1848–1923) and is commonly used as a guide for fashioning economic policies.
[128] See William J. Baumol, Welfare Economics and the Theory of the State, (Harvard U. Press 1965)

disagreements.[129] It is naïve to think that personal preferences (and sometimes funding from private parties) do not creep into the analyses.

In addition, assuming a policy proposal is not "efficient" in the highly restricted sense that at least one person is worse off as a result of a change, economists will commonly propose that the winners compensate the losers with lump-sum taxes (a one-shot tax of set amount of money per victim). [130] If after the new tax plus the compensation the winners are all better off, then under this analysis overall social welfare increases and the policy is a good one. This approach allows an escape from the rigor of strict constructionism. The trouble is that while this is fine in theory compensation is extremely difficult to implement, yet the policy is apt to be approved anyway.[131] Putting that aside, economists will testify that there will be inefficiencies, commonly expressed as "deadweight losses." However, it is much easier to testify that there is an inefficiency than to calculate it. One remedy is to expand the economists' mandate to include quantifying the inefficiency, after which the policy makers can better evaluate the choices the proposal represents,[132] but scrupulous economists are apt to decline the invitation, considering it an offer of a fool's errand.

The modern rhetorical objections to progressive taxation

Opponents of progressive taxation have busied themselves with economic criticisms. What follows is a description of the principal objections and the common proposal for an alternative system. What they have in common is that they are all based on materialistic considerations.

Inefficiency and deadweight loss . The discussion of economic efficiency in the formal sense as used in welfare analysis has been discussed above, but there are numerous other objections that rely on "inefficiency" to repudiate proposed increases in tax rates on the high end of the economic income ladder. In this contention sphere there are at least four different variations of "inefficiency," namely (1) resources wasted in adjusting to transitions in the tax laws, (2) tax laws that unintentionally distort behavior compared to a situation, free of taxes (3) unduly intricate laws, and (4) high tax rates that lead to

[129] For example, there is large literature on how much of a tax should be imposed on petroleum to account for its implicit costs. See, e.g., Westin, *The Case For a Crude Oil Price Stabilization Tax,* 40 Env. Law Reporter 10328 (2010) for numerous references.

[130] Cite Kaldor and Hicks here are the early proponents.

[131] Professor Uwe Reinhardt discusses this anomaly incisively at Economix, When Value Judgments Masquerade as Science, August 27, 2010, http://economix.blogs.nytimes.com/2010/08/27/when-value-judgments-masquerade-as-science/?_r=0.

[132] See Westin, When One-Eyed Accountants Are Kings: A Primer on Microeconomics, Income Taxes, and the Shibboleth of Efficiency, 69 Minn. L. Rev. 1099 (1985).

excessive tax planning.

Resources wasted in adjusting to transitions in the tax laws The principal objection is that a legislative fiscal change—including an increase or decrease in tax rates -- itself will force wasteful adaptation to the tax in the transition to the tax and thereafter. For example, having heard of the proposed tax increase that starts next year, the well-heeled taxpayer may accelerate his income to avoid having it fall into next year and may defer his deductions, even though all this may be to the detriment of his overall business planning.

Tax laws that unintentionally distort behavior compared to a tax-neutral situation. Here, dead-weight losses are forfeited utilities as a result of a legislative change. A common example involves tax-exempt fringe benefits in employment that not all employees assign full value to. For example, after the tax change, R may deploy his capital into investments that offer tax shelter in the form of depreciation deductions on property R borrowed to buy. If enough people do this, the price of real estate will rise solely because of the tax.

Even benign distortions can lead to deadweight losses. For example, when some "compensation" or economic benefits provided to employees can be excluded from gross income, but cash wages cannot be excluded, the difference in tax treatment can change the preferences of individuals as to the kind of compensation they seek. The result may be that workers get a form of tax-free benefit when they really would rather have cash or some other taxable benefit if it were not for the difference in tax treatment. The tax exemption for employer-provided means under IRC § 119 is an example. If the employer's costs for the two forms (cash paid to employees or meals furnished to employees) are the same and if both are deductible (or not) by the employer, the employees may be worse off than if they could have chosen among various benefits all of which were taxable or all of which were tax-free. Indeed, they may be worse off by more than just the amount of revenue collected by the government or the amount of revenue lost by the government in granting the tax exclusion.

> **Example:** Suppose an employer can offer either a $100 per month pay raise in cash or $100 (cost to the employer) of a tax-exempt meals on the premises. One employee might be indifferent between the two in a world with no income tax, or prefer the cash somewhat, and yet be influenced to choose the free meals costing $100, even if they are only worth $80 to the employee, if there is a 30% income tax in effect. (After a 30% tax, the $100 of cash wages yield only $70 to the employees, whereas the $80 worth of meals aren't taxed and yield an $80 after-tax benefit; it is only the after-tax return that the employee compares in making her choice.) An employee whose union chooses the meals over the cash

> does not like the food offered, but who has no individual choice in the matter, will be badly affected. She would have preferred the cash and the choice of using the cash for other purposes. Assuming she thinks the meals are worth only $75 (even though costing the employer $100) she will probably choose the meals rather than the $70 of after-tax cash. So the employer is spending $100 but the employee is getting only $75 in value, a $25 "deadweight loss" to the economy. The result is sub-optimal, since it causes a misallocation of resources in the economy in the form of excessive production and consumption of meals on the premises, compared to what the allocation would have been in the absence of this element of the tax law. [133]

Unduly complicated tax laws. Economists overlook this issue. A good example is IRC § 263A, an inexcusable provision that imposes monumentally complicated rules to force capitalization of a long list of items, replete with exceptions and limitations, all in order to make a up a revenue loss from other aspects of the Tax Reform Act of 1986. To many it is a lawyers' and accountants' relief act.

High tax rates and excessive tax planning. Another set of questionable claims runs as follows. High tax rates induce taxpayers to engage in the sterile activity of tax planning and employ small armies of tax specialists who dedicate their labor to tax avoidance. [134] That is true, but it is also true that lately legal reforms, including promptly-issued regulation, have largely shut down such activities[135] and that experts are subjected to disclosure requirements[136] and possible penalties[137] that make their more nefarious work too risky to undertake. It seems clear that it is the recent enactment of the passive loss rules[138] and IRS regulation of practice before the IRS[139] along with some prominent criminal prosecutions[140] that shut down the tax shelter industry, not the gentle persuasion of slightly lower rates. This objection boils down to a form of "inefficiency" which is discussed below in connection with macroeconomics. In addition, some

133 A less technical way to think of the subject is that the revenue leakage that resulted from allowing the meals exclusion was poorly managed in that it added unjustifiably little to the national welfare.

134 See Martin Feldstein, Tax Avoidance and the Deadweight Loss of the Income Tax, 81 Rev. Econ. & Stat. 674, 679 (1999) (demonstration and implications of avoidance as deadweight loss);Doernberg, A Workable Flat Rate Consumption Tax, 70 Iowa L. Rev. 425 (1985).

135 *See, e.g.,* Martha Neil, IRS Tightens Tax Shelter Rules, 4 No. 2 ABA J. E-Report 5 (2005); Governmental Attempts to Stem the Rising Tide of Corporate Tax Shelters, 117 Harv. L. Rev. 2249 (2004).

136 See, e.g., 31 CFR § 10.35(e)(1) (disclosure of certain compensation arrangements).

137 See, e.g., IRC §§ 6700 and 6701.

138 IRC § 469.

139 See Circular 230, embodied in 31 C.F. R § 10.3.

140 See J. Scott, *Tax Shelters: Risky Business,* Forbes Magazine Nov. 8, 2013 (criminal convictions and large penalties extracted from lawyers and law firms).

planning is socially useful, such as making larger charitable contributions because of their reduced after-tax cost.[141]

A haunting consideration is that as long as tax planning costs less than tax savings, shrewd taxpayers will pay for the planning, which suggests that rates should be flattened. Conversely, the argument that only high rates invite planning would seem suspect. If human greed is infinite, as microeconomics generally presumes, then any tax that can be neutralized for less than the cost of doing so will fall under attack.

The primary competing tax proposals

There are periodic calls for a consumption tax[142], including a progressive one,[143] but no matter what the exact design or its wisdom, it has the serious practical political disadvantage of exempting income from investments and exacting a disproportionate share of revenues from low-income workers who spent virtually all that they earn on necessities.[144] It is a proposal that never goes away and appears regularly as a Congressional tax policy consideration.[145] The other common proposal is for lower rates and a broader and more coherent tax base.[146]

The Decline of Content and the Rise of Lobbyists and Financed Ideology

Today's Sophistry goes vastly beyond anything seen in the seemingly naïve days of Classical Greece. It is mechanized. Congress is bedeviled by a ground force of well-paid

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141 See Peter Diamond, Optimal Tax Treatment of Private Contributions for Public Goods with and Without Warm Glow Preferences, 90 J. Pub. Econ. 897, 901-03 (2006).

142 Similarly, there are proposals for a national value added tax, a topic with a large literature. There are important benefits, including the opportunity to improve exports by virtue of a manufacturer's ability to receive rebates of the tax and to impose such taxes on incoming goods. One author claims a broad VAT set at about 12.5% on the entire population plus an exemption from income taxation for people earning under $100,000 per year could be a substitute for the income tax for the bulk of the population. M. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 Yale L.J. 261, 282 (2002) (arguing for a tax system that combines a 25% income tax on incomes over $100,000 plus a VAT). An enormous amount of ink has been spilled on this topic and there is no need to spill further ink here. Once again, it is a materialistic consideration.

143 See, M. Graetz, *Implementing a Progressive Consumption Tax*, 92 Harv. L. Rev. 1575, 1601 (1979)

144 See, e.g., J. Repetti, *Democracy and Opportunity: A New Paradigm in Tax Equity*, 61 Vand. L. Rev. 1129 (2008) (lack of national consensus on best tax system and lack of consensus on goals of government; case for progressive income tax with few deductions as preferable to consumption tax).

145 See, e.g., *Present Law and Background Relating to the Tax Treatment of Retirement Savings* (April 13, 2012 JCX-32-12).

146 See *See* Jane G. Gravelle, *Practical Tax Reform For a More Efficient Income Tax,* 30 Va. Tax Rev. 389 (Fall 2010).

lobbyists numbering over 10,000[147]representing a vast array of special interest groups, and each is hired for its ability to deliver Congressional help and votes. Honest open debate is not on their minds, and with good economic reason; their success at overcoming popular demands can be legendary, as in the case of the power of the NRA to prevent any serious effort at gun control.

There is also an air force of well-financed ideologues, drumming their messages to shape public opinion. Policymakers and politicians are not the only targets of their propagandizing; the media and the public itself are also in their sights. These organized interest groups generally direct their political message to the citizenry,[148] largely on the theory that such targeting not only sways the public but also in turn attracts the attention and fear of members of Congress.[149] The most sinister practical effect is that it limits the discretion of the politicians which, in turn, affects the direction of public policy.[150] This indirect form of lobbying can be effective for ideologically minded groups, even including exempt organizations[151] and churches.[152]

Another concern is how ideological interest groups spend money on political action committees (PACs) to influence elections and how citizens view and vote for candidates.

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147 Lobbyists are required to file a registration for each client on whose behalf a contact is made is a certain dollar threshold is met. See William P. Browne, Groups, Interests, and U.S. Public Policy, 84-85 (1998). This means one lobbyist suffers multiple filings with the Clerk of the Senate, such that the total number of filings cannot accurately reflect the number of lobbyists. The Center for Responsive Politics used data from the Senate Office of Public Records, however, to calculate 11,344 individual registered lobbyists who have actually lobbied in 2013. Reuters reported that there was a record of 15,137 registered lobbyists in Washington in 2007, also relying on data from the Center for Responsive Politics. United States Government Accountability Office, Lobbying Disclosure/Observations on Lobbyists' Compliance with Disclosure Requirements GAO-09-487 p. 5, (2009).The Washington Post also uses similar figures, but again they are based off of data from the Center for Responsive Politics. Lobbying Database, available at http://www.opensecrets.org/lobby/ The Post blames the decline in the number of lobbyists on a change to the lobbying rule made in 2007. Id. Robert Repetto, states that "the number of registered lobbyists in Washington grew from approximately 10,000 to 25,000" between the years 1996-2005. Robert Repetto, The Need for Better Internal Oversight of Corporate Lobbying, 50 Challenge, no.1 pg. 76 (2007). Repetto, however, provides no source or citation for his numbers.

148 Id. at 85.

149 Id. One aspect of this coercion is the "scoring" of politicians to identify cases where their votes do not hew the ideological line they claim they will follow. An example appears in Steven M. Graves and Christopher Peterson, , *Usury Law and the Christian Right: Faith-Based Political Power and the Geography of American Payday Loan Regulation,* 57 Cath. U. L. R. 637, 685 (2008) concerning Christian organizations scoring politicians with respect to the issue of usury and payday loans.

150 Id. at 86.

151 David M. Anderson, Political Silence at Church: The Empty Threat of Removing Tax-Exempt Status for Insubstantial Attempts to Influence Legislation; 2006 BYU L. Rev. 115, at 115-6 (2006); see also Chase Manderino, Understanding the Lobbying Efforts of a Church: How Far Is Too Far; 2009 BYU L. Rev. 1049, at 1049-50 (2009).

152 Manderino at 1050.

The concern is over groups spending money to elect particular candidates.[153] McKay conducted a study to determine what types of interest groups spend more money on electing certain candidates, or advancing certain ideological goals, instead of traditional lobbying expenses.[154] Analysis of the results of this study "shows that more ideologically extreme groups do seem to favor PAC contributions over lobbying expenditures."[155] McKay draws from this study the conclusion that the main purpose of campaign contributions among ideology-driven groups (at least, those in the sample), appears to be to help certain candidates win office, rather than to secure access to or influence politicians after the elections.[156] This is consistent with interest groups striving to advance ideological goals.

While there are many groups that present secondary issues, such as tax-exempt organizations; as a whole, ideological-based interest groups are free to advertise their cause to the public through mass media or "propaganda." Aside from the rules governing the use of PACs, there do not appear to any rules governing the use of such forensic efforts, nor is there any distinction in the rules regarding lobbying between ideological interest groups and more traditional lobbying groups. While the marketing of a group's message to the general public may be extremely similar in nature to propaganda, scholars appear to have little interest in the distinction. The following three headings illustrate the kind of word craft that is pitched to the public as part of the privately paid propaganda campaign.

Class warfare versus fairness and "ability to pay"

The words "class warfare" conjure up imagery of massive labor unrest and terrifying Stalinist purges and simply ignores the great discourses of Classical Greece and the patient labors of the Utilitarians. Thrasymachus the Sophist would be proud of this invention.

Conversely, the demand for "fairness" resonates intuitively and is popular with liberal politicians, but provides no framework for defining fairness or calibrating it, and as a result seems like a desperate last resort. The Tax Legislative Committee Reports are devoid of references to Utilitarian theories of taxation[157] and the Congressional Record

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153 Amy McKay, "The Effects of Interest Groups' Ideology on Their PAC and Lobbying Expenditures," Business and Politics: Vol. 12: Issue 2, Article 4 pg. 1 (2010) Available at: http://www.bepress.com/bap/vol12/iss2/art4.

154 Id. at 1-3.

155 Id. at 9.

156 Id.

157 Performed Westlaw search of Federal Taxation Legislative History database using search term "Utilitarian." Performed on December 1, 2013. Resulted in one hit which was not relevant and which re: H.R. 4333 and the utilitarian value of artists' work.

has no apt references.[158] On the other hand, "ability to pay" rears its head everywhere in both the Congressional Record[159] and Committee Reports.[160] The problem is that the term lacks a foundation; it could be a clumsy reference to Utilitarian theory or even to some moral precept, but to those who do not care for taxes, it also sounds just as much like a weak rationalization for the expropriation of private property, which makes it an easy target for its opponents and a poor surrogate for thoughtful Utilitarianism.

Income taxes as destroyers of capital and employment

The arguments about taxing the wealthy can be worthy of Vaudeville comedy. It is a regular claim that reduction in top tax rates will profoundly stimulate investments in productive undertakings.[161] However, when legislative proposals suggest that taxes should be raised on the top strata the immediate objection is that increasing taxes on the rich will result in only modest revenue increases. It is heard whenever such increases are proposed, [162]but when proposals to cut tax rates are in the wind, lobbyists insist that the rich will save a great deal of money, which they will invest in productive activities.[163] Both statements cannot be true, but in the realm of sophistry over fiscal issues it does not matter.

The surprising dissonance between popular preferences and current income tax rates

Although one might think the present structure of income tax rates sits well with the public, a recent study suggests that the American citizenry would flock to a Swedish model of how to distribute wealth and are unaware of how extreme the distribution of

158 Westlaw search of Federal Taxation Congressional Record database on December 1, 2013, using search term "Utilitarian." It generated 35 hits, none of which were relevant.

159 Id. 329 hits about 33% apt.

160 Performed Westlaw search of Federal Taxation Legislative History database using search terms "ability to pay." The search was performed on December 1, 2013, and generated 80 hits, 30 of which appeared to be relevant, basing relevance on hits that discussed a taxpayer's ability to pay a tax (regardless of whether "ability to pay" was a factor in the tax or not; if a taxpayer's ability to pay a tax was mentioned, I treated it as relevant.)

162 See, e.g., John Stossel: Tax The Rich? The Rich Don't Have Enough. Really. (tax –based expropriations from billionaire as insufficient source of revenue). Available at thttp://www.forbes.com/sites/danbigman/2012/04/03/john-stossel-tax-the-rich-the-rich-dont-have-enough-really/.

163 See, e.g., Want Economic Prosperity for Everyone? Cut the top tax rates, not the bottom. http://www.redstate.com/cmndr45/2012/07/10/want-economic-prosperity-for-all-cut-the-top-tax-rates-not-the-bottom/

wealth in America really is.[164] The authors performed a nationally representative online poll the upshot of which was that (1) the participants greatly underestimated the degree of the disparity of wealth in America (not very surprising), and (2) by constructing an ideal distribution that was far more equitable than their erroneously low estimates of the true distribution. Above all, there was a remarkable level of agreement. Even Republicans preferred a more equal distribution of wealth than the status quo, although they also preferred to maintain some disparity. The authors could only speculate as to why poorer people did not press for greater equality:

> "First, our results demonstrate that Americans appear to drastically underestimate the current level of wealth inequality, suggesting they may simply be unaware of the gap. Second, just as people have erroneous beliefs about the actual level of wealth inequality, they may also hold overly optimistic beliefs about opportunities for social mobility in the United States . . . , beliefs which in turn may drive support for unequal distributions of wealth. Third, despite the fact that conservatives and liberals in our sample agree that the current level of inequality is far from ideal, public disagreements about the causes of that inequality may drown out this consensus . . . Finally, and more broadly, Americans exhibit a general disconnect between their attitudes toward economic inequality and their self-interest and public policy preferences . . . , suggesting that even given increased awareness of the gap between ideal and actual wealth distributions, Americans may remain unlikely to advocate for policies that would narrow this gap. "[165]

The participants were subject to the so-called "Rawls constraint" for determining a just society namely ' that they were required to imagine that if they joined this country, they would be randomly assigned to a place in the distribution such that they could wind up anywhere in that distribution. This powerful philosophical construct is the product of John Rawls as part of his study of distributive justice laid out in *A Theory of Justice*, in

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164 Michael I. Norton and Dan Ariely, Building a Better America—One Wealth Quintile at a Time, 6 Perspectives on Psychological Science 9 (2011). The former author is with the Harvard Business School and the latter is with the Psychology Department at Duke University.. Some estimates suggesting that the top 1% of Americans hold nearly 50% of the wealth, topping even the levels seen just before the Great Depression in the 1920s." p. 9.

165 Id. at p. 12 (citing Benabou, R., & Ok, E.A., Social Mobility and the Demand for Redistribution: The POUM Hypothesis. 116 Quarterly Journal of Economics, 447-487 (2001); Charles, K.K., & Hurst, E., The Correlations of Wealth Across Generations, 111 Journal of Political Economy, 1155-1182, (2003); Keister, L.A., Getting Rich: America's New Rich and How They Got That Way (2005); Alesina, A., & Angeletos, G.M., Fairness and Redistribution, 95 American Economic Review 960-980 (2005); Piketty, T., Social Mobility and Redistributive Politics, 110 Quarterly Journal of Economics 551-584 (1995); Bartels, L.M., Homer Gets a Tax Cut: Inequality and Public Policy in the American Mind, 3 Perspectives on Politics 15-31 (2005); Fong, C., Social Preferences, Self-Interest, and the Demand for Redistribution, 82 Journal of Public Economics 225-246, (2001)).

which this influential American philosopher advances a model of justice derived from a hypothetical situation in which the parties assume they do not know whether they are rich or poor, intelligent or simple and so forth (commonly referred to as operating behind a "veil of ignorance"). Rawls proposes that parties would hypothetically choose commonly acceptable principles of justice, including as to matters of the distribution of wealth. Importantly, he asserts that the participants would all prefer to assure that the prospects of the least prosperous were accommodated. His ideas have influenced the thinking of serious modern economists.[166] The outcomes of the experimentations by Norton and Arieley square neatly with Rawls' propositions, and despite the actual outcome of highly skewed distribution of income and wealth and historically low taxes on income, there is strong reason to believe the US public favors greater progressivity of tax rates.

Interestingly, animal studies show that monkeys have a strong sense of fairness and in the opinion of a leading author that sense is likely innate and a function of evolution, and is impliedly significant for humans.[167] Another aside is theological; in the New Testament at Mark 12:41-44 Jesus observes that the poor widow who gave her last coin (a mite) gave more than all the rest, insinuating the compatibility of utility theory and Christianity. It is possible that this Christian thread is subconsciously woven into the fabric of modern progressive taxation.[168]

CONCLUSION

The trajectory of progressive taxation is discomforting, at least if one selects the period from early Greece to early Twenty-First Century America. We begin with principled thinking about how to form a comfortable society living with moral scruples during Classical Greece to the Enlightenment's (or at least Jeremy Bentham's) sincere mathematical inquiry into how to adjust relationships within society in order to maximize collective enjoyment to something more demoralizing than mere Sophistry.

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166 See Anthony Atkinson & Joseph E. Stiglitz, Lectures on Public Economics (McGraw Hill 1980) pp. 339- 340 comparing social welfare functions of Bethamitie objectives versus Rawlseian objectives. A perusal of the subject index at the back makes it clear that Bentham and Rawls remain of great importance in fashioning economic policies. Stieglitz won the Nobel Memorial Prize in Economic Sciences in 2001.

167 Sarah F. Brosnan, Nonhuman Species' Reactions to Inequity and their Implications for Fairness, Social Justice Research, Vol. 19, No. 2, June 2006 (Ó 2006) DOI: 10.1007/s11211-006-0002-z. This is part of rich literature. See footnotes at end of Brosnan's article.

168 This is a growing literature exploring the relationship of taxation to religion See especially, Susan P. Hammill, An Argument for Tax Reform Based on Judeo-Christian Etics, 54 Ala. L. Rewv. 1 (2002) and (Ajay K. Mehrotra, "Render Unto Caesar . . .": Religion/Ethics, Expertise, and the Historical Underpinnings of the Modern American Tax System, 40 Loy. U. Chi. L.J. 321, (2009) (insights include that later 19th and early 20th Century populist pressure for progressivity in taxation was subordinated in public dialogue to economists theories in belief that the latters' justifications for progressivity were the more compelling in public debate).

The obvious problem is that while the concept of fairness is a stubborn one and may even be a part of human evolution, it reduces to little more than a word and a sensation when opposed to the pseudo-science of economics and the unthinking collective urge to maximize Gross Domestic Product. Unless and until the concept of fairness is given a more formal character, it is likely to remain too elusive to inject itself into public debate with the force it is entitled to.

The stakes are high. Societies with vastly disparate distributions of wealth and power breed cynicism and have the potential to become unstable or at least dysfunctional.[169] while failure to tax adequately exacerbates the problem by unfairly casting the burden of public debt onto younger generations. [1] Nobel Prize winner, economist Joseph E. Stiglitz put it this way in The Price of Inequality: "inequality may be at once cause and consequence of a breakdown in social cohesion over the past four decades."[170] He clarified his proposition with this chilling observation:

> "The more divided a society becomes in terms of wealth, the more reluctant the wealthy are to spend money on common needs because they can simply purchase such things as security, clean environment, etc. I would add that the poor are also less likely to cooperate with the wealthy in highly unequal societies. Which is how inequality contributes to the breakdown of the fragile cooperative equilibrium."[171]

Aristotle would surely agree.

Adding these concerns to the usual dry list of policy considerations that normally apply to shaping tax laws would be a healthy improvement, and the job of getting it included would be a worthy task for tax scholars and policymakers. A robust public debate would also surely help, but the political context makes it unlikely. It is surely an understatement to say that what Madison saw as the indispensable ingredient of civic virtue is lost in Washington, D.C. and it is disturbing.

[170] Joseph E. Stiglitz, The Price of Inequality, How Today's Divided Society Endangers our Future xi, p. 62 (2012). Stiglitz is a Nobel Prize winner and, among other achievements, was appointed Chairman of the Council of Economic Advisers in 1995.
[171] Id. at p. 93.