TAX AND SPEND

The Welfare State, Tax Politics, and the Limits of American Liberalism

Molly C. Michelmore

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Politics and Culture in Modern America

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Volumes in the series narrate and analyze political and social change in the broadest dimensions from 1865 to the present, including ideas about the ways people have sought and wielded power in the public sphere and the language and institutions of politics at all levels—local, national, and transnational. The series is motivated by a desire to reverse the fragmentation of modern U.S. history and to encourage synthetic perspectives on social movements and the state, on gender, race, and labor, and on intellectual history and popular culture.

For Mammus and Pappas

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INTRODUCTION

TAX MATTERS

Taxes matter. They matter to every American worker whose paycheck is cut in half by state, local, and federal taxes. They matter to the millions of Americans who file income tax returns each year. They matter to the state, local, and national governments that depend on tax revenue to provide necessary public services. Taxes matter to economists and policymakers who seek to manage the national economy, to control inflation, and to combat unemployment. They matter to the millions of older Americans who rely on Social Security and Medicare, and to the workers whose payroll taxes fund those entitlement programs. Taxes matter to political office seekers—liberal Democrats and conservative Republicans alike—who must balance promises to protect the rights and interests of ordinary taxpayers with other policy priorities. Indeed, taxes and tax talk now dominate domestic policymaking. In 1960, the Democratic Party platform devoted 9 sentences to taxes, and the GOP platform only two. By 2008, the Democrats dedicated 33 sentences and the GOP almost 80 to tax policy.[1] Today's politicians are as likely to speak to Americans as *taxpayers* as they are to address them as citizens or voters.

America's obsession with taxes paralleled the growth of the modern welfare state. Broadly defined to include the myriad ways the federal government protects citizens from what President Franklin D. Roosevelt once described as the "hazards and vicissitudes" of life, the welfare state has grown by leaps and bounds over the last eighty years.[2] At the turn of the twenty-first century, government-sponsored social programs accounted for more than a third of the federal budget; more than 90 percent of Americans relied to some greater or lesser degree on public monies for their social and economic security.[3] Today, as in the past, most of the recipients of federal aid are not the suspect "welfare queens" of the popular imagination, but rather middle-class homeowners, salaried professionals, and retirees. To an extent rarely recognized, much less openly acknowledged, the American middle class is, in fact, the product of almost a century of targeted social and economic policies. Yet, most Americans are far more likely to see themselves as the overburdened victims of the tax code than as the beneficiaries of government programs that have helped to secure economic security and mobility for the vast middle-class majority.

Americans' hostility toward taxes in general, and toward the federal income tax in particular, has marked and fueled the political right turn of the last four decades, as conservative leaders have successfully translated popular frustration over taxes into a broader rejection of the activist state.[4] By the middle of the 1970s, the GOP had developed and popularized a political and policy agenda that attacked federal efforts to redress social and economic inequality as ineffective, counterproductive, and even immoral. "Preoccupied with expanding eligibility and . . . benefits," the Republican National Committee declared in 1978, Democratic liberals had succeeded only in "creating a new caste of Americans . . . free from basic wants, but almost totally dependent on the state, with little or no hope or prospect of breaking free."[5] President Ronald Reagan put it even more succinctly in his First Inaugural Address, insisting that government was "not the solution" to the nation's problems. Government itself *was* the problem.[6]

Yet, the GOP has singularly failed in its efforts to roll back the welfare state. The largest and most expensive parts of the American social safety net—Medicare and Social Security—survived Reagan-era budget cuts. Only two major welfare programs—public service jobs and general revenue sharing—disappeared entirely.[7] What is more, the GOP has not only failed to shrink the state but has actively encouraged its growth. In 2003, for example, President George W. Bush and the Republican Congress added a new, hugely expensive and unpaid-for prescription drug benefit to the existing Medicare program.[8] All told, the U.S. government today spends more money than ever on programs to ensure the economic security and well-being of its citizens.[9] Perhaps even more surprising, the American public continues to support the most basic goals of the welfare state, even as faith in government institutions has been in free fall since the mid-1960s.[10] According to a 2011 Harris Poll, the vast majority of Americans oppose cutting spending on retirement security programs, education, and health care. Indeed, support for specific government programs has actually *increased* in the decades since Reagan took office.[11]

This is the basic paradox of contemporary American politics. Americans hate government, but demand and expect, almost as a matter of right, the privileges, security, and mobility that government offers.[12] *Tax and Spend* aims to unravel this apparent contradiction by analyzing the development of tax and spending policy from the New Deal of the 1930s through the Reagan revolution of the 1980s. Neither taxes nor spending alone can explain the rightward drift of American politics in the late twentieth and early twenty-first centuries. Only in the context of a politicized struggle between the rights of taxpayers and the claims of what one official in President Lyndon Johnson's White House once called "tax eaters" on the welfare rolls, does this transformation start to make sense.[13] Focusing on two key instruments of economic and social policy—the federal income tax and Aid to Families with Dependent Children (AFDC)—this study provides a new interpretation not only of postwar liberalism—its well-known failures, contradictions, and limitations, as well as its often forgotten successes—but also of the conservative reaction that has both replaced and depended on it.

AFDC—most commonly referred to simply as "welfare"—has played a critical role in Americans' understanding of the state. Created as part of the landmark Social Security Act of 1935, Aid to Dependent Children, AFDC's original name, allowed the federal government to supplement state-run programs providing a bare subsistence income to poor women raising children alone.[14] The program was never large or particularly costly. By 1994, two years before Congress finally abolished it, spending for AFDC amounted to less than 2 percent of the country's entire social welfare budget.[15] Yet, welfare has long held political implications disproportionate to its size or its cost to the average taxpayer. As early as 1949, the national press had raised alarms about "welfare chiselers" stealing the "taxpayer blind" by using public funds to purchase "whiskey, marijuana and tropical fish."[16] By the mid-1950s, lawmakers, the press, and the public had embraced a narrowed definition of the term "welfare," using it almost exclusively to refer to need-based cash assistance to the very poor.[17] The visibility and political vulnerability of welfare stands in stark contrast to the invisibility and relative security of much of what might be called the middle-class welfare state of social insurance entitlements and various forms of tax spending. Indeed, the visibility of AFDC, combined with the suspect racial and moral character of its recipients—by the early 1960s, nonwhite, unmarried mothers made up a disproportionate share of the welfare rolls—have played a critical role not only in obscuring the extent to which government policies have underwritten middle-class prosperity and mobility, but also in diminishing support for the liberal state itself. Conservatives in particular have benefited politically from Americans' truncated definition of welfare. As the economy faltered in the 1970s, the GOP successfully exploited public hostility toward AFDC and AFDC recipients to capture the votes of middle-class homeowners and taxpayers who saw themselves as the casualties of the "tax and spend" liberal state.

That the American right has capitalized on popular antipathy toward taxes and welfare to rebrand itself as the populist defender of taxpayers' rights, of course, is not news. What is more surprising, perhaps, is that in doing so the Republican Party has borrowed a page out of the Democratic Party's playbook. Throughout the postwar period, liberal state builders repeatedly defended low tax rates on ordinary Americans as an essential element of the economic security promised by the liberal state. Liberal antitax logic, apparent even at the birth of the welfare state in the 1930s, at first reflected state builders' assessment of the challenges posed by popular resistance to new taxes, but soon became an essential element of the liberal social compact itself. Even during the supposed Big Bang periods of postwar state building in the 1930s and 1960s, liberal presidents with unprecedented Democratic majorities in both houses of Congress refused to tie new social benefits directly to tax increases on the majority of Americans. President Roosevelt rejected any effort to expand the federal income tax base to pay for the New Deal; Lyndon Johnson likewise simultaneously launched the Great Society and championed a sweeping income tax *cut*. From Roosevelt's pledge to "quit this business of relief," to President Bill Clinton's promise to bring the "era of Big Government" to an end by "ending welfare as we know it," liberal policymakers have combined a marked ambivalence toward welfare with a spirited defense of individual taxpayers' rights.[18] American liberals may have promised to give citizens a Fair Deal, to create a Great Society on the New Frontier, to remedy the poverty of the Other America, and to remove the barriers that have for too long walled some Americans within a "gate-less poverty," but these same liberals consistently coupled these commitments to a policy agenda that promised to protect taxpayers' "rights" to economic security, individual mobility, *and* low taxes.[19] Focusing on the politics of taxation—rather than on the politics of spending alone—illuminates the continuity between the so-called right turn of the late twentieth century and the liberal consensus that preceded it. The supposed conservative backlash of the late twentieth and early twenty-first centuries has deep roots. Reagan's revolution and his promise to slash welfare spending for the poor in the name of ordinary taxpayers did not break radically with the past. Rather it built on and fully realized the antitax logic first articulated by liberal state builders in the New Deal and World War II eras.

Building the Tax and Welfare State

The Great Depression marked a watershed in American state building. As social worker Josephine Brown noted, between 1929 and 1939 more was done in the area of "public welfare than in the [previous] three hundred years."[20] Yet, even at the height of the Depression, liberals' commitment to public welfare was ambivalent at best. The federal government did not provide any direct assistance to individuals until 1933, when President Roosevelt made good on his campaign promise to strike a New Deal with the American people by setting up the Federal Emergency Relief Administration (FERA), which, together with other early New Deal programs, including the Civil Works Administration and the Civilian Conservation Corps, provided much-needed cash and jobs to nearly 28 million people.[21] But, the FERA and other forms of direct relief sat uneasily with some members of the Roosevelt administration and with the president himself. In 1934, worried that "continued dependence on relief" would induce a "spiritual and moral disintegration fundamentally destructive to the national fibre," Roosevelt offered Americans not relief but rather "security of a livelihood," "security against the hazards and vicissitudes of life," and "security of decent homes."[22]

The Social Security Act of 1935, the "cornerstone" of the American welfare state, aimed to realize this commitment to the economic security of the "men, women, and children of the nation."[23] Comprising five major programs—contributory Old Age and Unemployment Insurance (OAI and UI) and federally subsidized but state-run Old Age Assistance (OAA), Aid to Dependent Children (ADC), and Aid to the Blind (AB)—the Social Security Act promised to "promote recovery . . . develop a more stable economic system" and assure "assistance to the victims of insecurity and maladjustment."[24] Contributory social insurance lay at the heart of this new economic security system; most New Dealers saw categorical assistance as a temporary expedient necessary to meet the extreme need created by the Depression itself.[25]

The shape of the New Deal welfare state—and in particular its reliance on regressive, but hidden, payroll taxes to fund its most significant policy innovations—reflected the importance of tax politics to liberal policymaking. New Dealers recognized the need to manage popular opposition to new federal income taxes and to insulate the administration from the kind of taxpayer hostility that had produced a vibrant and powerful grassroots antitax movement in the early 1930s. Rejecting proposals to expand the income tax base to raise new revenues, liberal state builders instead relied on indirect or hidden taxes—including regressive consumption and payroll levies—to offset the costs of New Deal spending programs. Social Security financing, and the administration's insistence that OAI and UI be financed out of dedicated payroll taxes, also reflected Roosevelt's own preference—shared by many of his key advisors—for a fiscally conservative welfare state.[26] As historian Julian Zelizer has pointed out, the president believed that fiscal conservatism would not only answer the demands of the financial and investment communities, but would also appeal to an electorate who "still saw balanced budgets as a symbol of stable governments" and "shared the traditional American aversion to taxation."[27] Indeed, New Deal fiscal conservatives, including Treasury Secretary Henry Morgenthau and Budget Director Lewis Douglas, as well as many members of the new Social Security Board (SSB), argued that contributory social insurance alone could provide a secure basis for the kind of economic security promised by the president in his 1935 State of the Union address. Hoping to protect these key economic security policies against antitax politics, some of the Social Security program's supporters even went so far as to argue that OAI and UI would ultimately relieve the average taxpayer, not to mention state and local governments, of the "burden of relief."[28]

Of course, the new unemployment and old age insurance programs *did* rely on federal taxes and *did* require a vast expansion of federal responsibility for the well-being of large groups of American citizens. But liberal state builders carefully distinguished between social insurance and the welfare and relief programs most hoped would disappear once the crisis of the Great Depression had passed. The administration and members of the new SSB usually cast payroll taxes as a kind of insurance premium that entitled contributors to a certain annuity as a matter of right. According to one SSB member, for example, the requirement that "workers and their employers. . . contribute a small portion of their earnings" to cover the "natural risks of life" might best be compared to taking out "insurance against fire and theft."[29] Defended, sold, and understood as more like private insurance than public welfare, OAI—and to a slightly lesser extent UI—have not only escaped the hostility heaped on other forms of public provision, but have often fallen outside the public's understanding of welfare altogether.

The administration's commitment to this annuity fiction stemmed in part from its need to shore up public support for the Social Security bill and to protect the programs from popular resistance to new or higher taxes. The widespread demand for old age pensions—made most apparent in the groundswell of support for the Townsend Movement's proposal to provide all Americans over age sixty with a $200 monthly pension—did not necessarily translate into public support for new taxes.[30] Indeed, tax revolts and strikes were common throughout the early 1930s, as farmers, real estate agents, and property owners came together to form grassroots taxpayers' leagues to resist state and local property tax laws. These groups wreaked havoc on municipal budgets. By 1932, for example, Chicago taxpayers' refusal to meet their property tax obligations had cost the city $500 million in uncollected tax revenues and forced local policemen, firefighters, and teachers to go without pay.[31] Described by one reporter as the "nearest thing to a political revolution in this country," these tax protests not only inspired local and state officials to sponsor tax limitation laws but also profoundly shaped welfare and social security policy at the national level.[32]

The White House was not alone in designing its economic security programs to minimize taxpayer resistance. The Townsend plan, for example, would have paid for old age pensions with a new federal sales tax—a hugely regressive form of taxation far less visible than either income or property taxes. Even the more radical alternatives to the administration's economic security bill, including Senator Huey P. Long's populist Share Our Wealth scheme and the Workers' Bill sponsored by Minnesota Representative Ernest Lundeen, would have paid for new programs only by taxing the incomes of the wealthy.[33] The administration's reliance on the payroll tax to finance its most significant welfare policy initiatives—and its commitment to the annuity fiction—successfully muted taxpayer resistance to these programs and to the tax dollars used to fund them by distinguishing between social insurance *premiums* and the *taxes* that financed other forms of public welfare.[34]

Other elements of the 1930s taxing state reflect New Dealers' willingness to tailor revenue and spending proposals to meet perceived popular hostility to new and direct federal taxes. The processing, excise, luxury, and other consumer taxes that undergirded the 1930s tax regime, for example, often escaped public notice. Although these hidden taxes generated a considerable amount of revenue, and cost even the poorest taxpayers upward of $100 per year, they did not often register as taxes, nor did they generate any significant degree of tax consciousness.[35] According to one 1939 survey, for example, almost a quarter of those polled believed that they "didn't happen to pay any taxes." Not surprisingly, lower-income taxpayers—who did not pay any federal income tax thanks to high income exemption levels—were least likely to see themselves as taxpayers. While 93 percent of upper-income voters and 81 percent of middle-income voters identified themselves as taxpayers, only 40 percent of lower-income voters did so.[36]

New Dealers' reluctance to risk a taxpayer revolt alone does not explain their commitment to a fiscally conservative welfare state grounded in wage-based social insurance. Equally important were liberals' own understandings of the sources of economic instability and their commitment to an economic security model grounded in the experience of white male industrial workers.[37] The architects of the New Deal welfare state believed that the social insurance programs put in place in 1935 would eventually expand to provide a meaningful degree of economic security for *all* Americans. Most New Dealers, from the president on down, viewed the categorical assistance programs created by the 1935 law as temporary and residual, and predicted that they, like other forms of direct relief, would disappear as the economy recovered and the social insurance system grew. This conviction that a "comprehensive, contributory social insurance system covering all of those economic hazards to which people are exposed" would reduce, if not eliminate the "residual load of public assistance" survived the Great Depression.[38] Even those liberal policymakers most invested in the public assistance programs, including members of the American Public Welfare Association (APWA), favored an insurance-based model. According to the APWA's legislative consultant, Elizabeth Wickenden, the organization always lent its "strongest support to Social Security as a means of preventing the need for assistance."[39] More an article of faith than an empirically tested proposition, the idea that the need for public assistance would soon "wither away" in the face of economic growth and a vibrant, wage-based social safety net only grew stronger in the 1940s as the World War II and postwar economic booms gave lie to Depression-era concerns that the United States had reached a point of "secular stagnation," "sick recoveries," "depressions which feed on themselves," and a "seemingly immovable core of unemployment."[40] By the early 1950s, labor representatives and business groups agreed that a more comprehensive system of social insurances would allow the federal government to "begin an orderly withdrawal from the field of providing assistance to the needy."[41] President Harry Truman gave this idea the presidential seal of approval in 1951, when he announced that the "basic purpose of public assistance" had "always been to supplement our social insurance system."[42]

Although it initially left large numbers of Americans unprotected against economic insecurity, contributory social insurance anchored liberal state builders' plans for the eventual expansion of the social safety net. Social Security advocates in the SSB, and later the Social Security Administration, wary of possible taxpayer resistance to new income taxes, argued that any alternative to contributory financing—whether endorsed by liberal friends of the welfare state or by its conservative opponents—would weaken political incentives to expand this basic economic security system. As SSB Chairman Arthur Altmeyer later admitted, like many Social Security experts he believed that any proposal to supplement contributory social insurance benefits with flat-rate pensions paid for out of general revenues would "weaken the incentive for uncovered groups to be covered under a contributory social insurance system."[43] Altmeyer was, at least in part, prescient in his predictions. Once it began to pay out benefits, this contributory arrangement created new political constituencies interested in not only preserving but improving current benefits. Lawmakers' desire to meet the public demand for higher benefits and their eagerness to keep payroll taxes relatively low created an almost irresistible pressure to expand social insurance coverage to groups—including agricultural and domestic workers—excluded under the original legislation.[44] Indeed, the eventual expansion of OAI did allow OAA—once the largest and most expensive of the programs created by the Social Security Act—to more or less wither away.

This commitment to wage-based social insurance and the widespread acceptance in policymaking circles of the "withering away fallacy" reflected liberal state builders' unacknowledged racial and gendered assumptions and biases.[45] Committed to an economic and family model that viewed women's work as secondary or even deviant, the architects of the Social Security system presumed that the expansion of wage-based social insurance would provide economic security to vulnerable women and children by virtue of their connection to a wage-earning man. Because they understood economic insecurity largely in terms of the Depression-era crisis in male employment, social insurance experts like Abraham Epstein designed both OAI and UI specifically to secure "the worker and his family against the economic emergencies resulting from the temporary or permanent loss of a job through unemployment, sickness, invalidity or old age."[46] That this male-breadwinner model was already becoming obsolete for much of the working class, and had never applied to nonwhite families, did little to dislodge these gendered assumptions from the center of New Deal social policy. As Altmeyer later told the American Federation of Labor—itself deeply committed to the male-breadwinner model and the family-wage system—the expansion of Social Security would "protect *everybody* in the United States who is dependent on his earnings—everybody and *his* family."[47]

Nor did liberal state builders fully consider how the new economic security systems might affect African Americans. Understanding the problem of racial inequality largely in terms of class politics, leading liberals like Harold Ickes insisted that the "Negro problem" be seen primarily in terms of the "greater problem of American citizens generally who are at or below the line in decency or comfort."[48] While many leading black organizations endorsed this color-blind approach to Depression-era policymaking, the strategy failed to open up new economic opportunities to the black community as a whole. White workers determinedly and sometimes violently policed the color line, even laying claim to work previously reviled as "Negro jobs." Unchecked by New Deal labor laws, and in combination with the race-laden occupational exclusions written into the 1935 Social Security Act, persistent labor-market discrimination undermined nonwhite workers' claims to any form of wage-based economic security even as it relegated them to more debased forms of public assistance and set the stage for the racially charged "welfare crisis" of the 1960s and 1970s.[49]

Perhaps even more significantly, the architects of the New Deal welfare state, aware of popular resistance to new taxes on any but the richest Americans, deliberately obscured the relationship between the obligations and the rights of citizenship and never asked ordinary taxpayers to *pay* for the economic security many soon came to expect as a matter of right. In 1932, President Herbert Hoover's treasury secretary Ogden Mills had noted that Americans were "accustomed to high exemptions and very low rates on smaller taxable incomes."[50] The New Deal did little to change this. Despite the unprecedented demand placed on federal coffers by the explosion of New Deal spending programs, and in spite of his own fiscally conservative inclinations, Roosevelt resisted any attempt to include the middle classes in the federal income tax system. Base-broadening tax reform did gain ground among some progressive reformers and liberal economists in the mid-1930s. Championed in Congress by Senator Robert La Follette, a Wisconsin Republican with impeccable progressive credentials, base broadening offered another way to attack the problem of "the maldistribution of wealth and income" and to "rebuild society."[51] Disappointed that the administration lacked the "guts to tax the people," reformers pointed out that higher income taxes on the very