

HAPPY ANNIVERSARY?

100 YEARS WITH PERSONAL INCOME TAXES AND CENTRAL BANKING

Even after the contentious political campaigns last fall, still hardly a day goes by without some mention of a proposed change in taxes or government spending, a warning about looming deficits and debt, or the efficacy of Federal Reserve (Fed) interventions to revive our sluggish economy. These front-page headlines and evening-news accounts, like clutching our Starbucks beverage or cell-phone, would have been totally foreign to life in this country 100 years ago.

1913. With Delaware's ratification on February 3, 1913, we added the 16th amendment to the U.S. Constitution: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." Thus after some 19th century fits and starts, the nation now had a personal income tax.

Subsequent emendations have included adding the payroll (FICA) tax in the 1930s to fund Social Security, tax withholding in the 1940s, establishing April 15 as "tax day" in 1955, indexation for inflation in the 1980s, and periodic changes in the tax base and marginal rates.

On December 23, 1913, President Woodrow Wilson signed into law the Federal Reserve Act: "To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." Thus, also after some prior missteps, we now had a central bank with uniform paper money – Federal Reserve Notes ("legal tender for all debts public and private").

Subsequent changes on the monetary side have included deposit insurance and some controversies with the Bank Act (including Glass-Steagall) in the 1930s, cutting ties between the dollar and gold in the early '70s, bank deregulation in the early '80s, and the

BY ALLEN R. SANDERSON Dodd-Frank Act plus various "QE" (quantitative easing) rounds to address 21st-century economic crises.

With these two 1913 legislative initiatives, the basic framework for taxation, the financial sector and the conduct of fiscal and monetary policy was set.

1776-1912. In the 19th century, tariffs, land sales, and excise taxes provided the bulk of revenue for the federal government. Courts ruled unconstitutional attempts to create a tax on incomes. As late as 1912 the average American paid under 10 percent of his/her income to the federal government; today, depending upon one's definition, we send about a quarter of our earnings to Washington, and the personal income tax is the largest source of revenue, followed by the payroll tax and, more recently, issuing debt (aka borrowing).

Two years into our new nation, we created The First Bank of the United States, with a 20-year charter (1791-1811); in 1816 we tried



central banking again and established The Second Bank of the United States; it became an election casualty in 1836. So from 1836 to 1913, the economy operated—"the free-banking era"—without a central bank.

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1913-2012. Although the 16th amendment was added in 1913, Americans became starkly aware of it about 30 years later with the revenue needs to finance World War II commitments. And except for four years (1997-2001), the federal government has run

budget deficits from 1970 to ...

Central banking has received its share of knocks over time. Milton Friedman and Anna Schwartz, in *A Monetary History of the United States*, blamed the Fed for the severity of the Great Depression of the 1930s. They and other scholars also put the onus for the 1970s' stagflation at the Fed's doorstep.

President Kennedy once remarked that the only way he could remember what the Fed did was because "money" and "Martin" (William McChesney Martin, his Fed chair) both started with "M." Today, immediate past chairmen, Paul Volcker and Alan Greenspan, and current incumbent Ben Bernanke, are almost household names, and the Fed chair is considered by many (though not by Grover Norquist nor the heads of SEIU or AARP) to be the second most powerful person in Washington.

2113. Other than for one constant—the Cubs will still be chasing that elusive World Series championship—predicting 100 years out is a parlor game at best, though for sure there will be no paper money, but perhaps one worldwide central bank and a common currency—the DEY (dollar, euro, yen/yuan)—with periodic yearnings to return to a gold standard.

On the fiscal side, there will be the occasional push to require a balanced budget, perhaps a less complicated tax code, and, of course, learning how to say "Thank You" in Mandarin Chinese. □