

The Impact of Trade on Direct Taxation, 1870-1914

Lucy Barnes *

August 2, 2011

Word count: total (excl. abstract, figures and tables): 12671

Text (excl. notes and references): 10450

Abstract

Between 1870 and 1914, reforms of direct taxation increased its importance as a share of revenue, and introduced progressivity. This article explores these origins of modern tax structures to understand why countries varied in the tax reforms they pursued. I argue that international trade had an important effect on tax structures. First, free-trade countries were constrained in the use of tariffs as an alternate source of revenues, thus direct tax expansions were greater. Second, the politics of trade opened up opportunities for emerging representatives of lower income groups to offer support on the trade question to existing elite parties. In so doing, they gained political power and the ability to shape tax reforms along more progressive lines. The paper compares the the United Kingdom, Sweden, France and Australia– cases varying on both of these trade dimensions– to trace out the implications for their tax reforms.

*Email lucy.c.barnes@post.harvard.edu. I gratefully acknowledge comments on earlier drafts of this paper from James Alt, Pablo Beramendi, Peter A. Hall, Timothy Hicks, Torben Iversen, Alexander Kuo, Iain McLean, David Rueda, David Soskice and Anne Wren. All remaining errors are my own.

Taxation in the industrialized capitalist democracies is highly varied. Even with convergence in terms of top marginal tax rates in the years of globalization since the mid-1970s, differences remain in the reliance of different countries on different tax sources, and the amount of redistribution effected by the tax system. Surprisingly, anglophone welfare states' tax systems tend to be the most progressive.¹ Notwithstanding this variation, and despite the centrality of taxation to the legitimacy and functioning of modern states, the political economy of taxation has received much less attention than that of welfare spending policies.²

This article explores the origins of modern tax structures around the turn of the twentieth century to understand why some countries adopted more progressive taxation even before the advent of mass popular participation and left power following World War I. Between 1870 and 1914, reforms of direct taxation increased its importance as a share of revenue, and introduced progressivity. These changes provided the framework in which wartime governments operated to meet the extreme revenue demands of war. I argue that trade policy created varying incentives for the reform of direct taxation, both in limiting governments' alternative revenue from tariffs and in shaping the electoral rewards available to elite groups making common cause with the emerging left.

The need to find new revenues from direct taxation depended on the availability of alternative sources. One major stream of government revenue in the nineteenth century came from duties on imported goods. The capacity of these tariffs to raise increasing revenues was limited by governments' commitment to free trade, as they inevitably had a protective effect.³ This revenue substitutability tied direct tax reforms to trade politics. Countries more strongly oriented toward trade openness had more reason to adopt revenue-generating direct tax expansions including (but not limited to) income tax modernization.

Second, trade politics shaped the political landscape in which demands for progressive direct

¹Ganghof, 2006; Kato, 2003; Lindert, 2004; Prasad and Deng, 2009.

²Martin, Mehrotra, and Prasad, 2009; Morgan and Prasad, 2009.

³Bohlin, 2005; Nye, 1991.

taxation emerged. Where elite parties were divided over trade, one or more of them had an incentive to collaborate with low income groups to construct trade policy coalitions. This cooperation, particularly if accomplished through electoral non-competition agreements or parliamentary partnerships, resulted in stronger political platforms for groups advocating redistributive reforms of the tax system. This (relative) privileging of the interests of poorer segments of society could occur through trade-policy alliances with either free trade or protectionist elite groups. The strongest spur to direct tax expansions, however, came with the concurrence of coalition and revenue motives for reform- that is, where free trade interests collaborated with labor groups. In these cases both the revenue needs of the government and the interests of emerging left interests were served by expansions of progressive direct taxation.

I explore these theoretical arguments in a comparison of four country cases between 1870 and 1914. The United Kingdom (UK), Australia, France and Sweden provide examples of each potential trade-policy influences on taxation: revenue pressures and coalition dynamics could each provide impetus toward direct tax reforms, or not. Despite sharing a need for new revenues, each of these countries reacted with different tax policy reforms. In France, immobilism in the tax system reigned, and little changed before the advent of war. In the UK, Liberal governments expanded direct taxation piecemeal until the incorporation of Labour into a push for progressive direct tax expansions between 1906 and 1914. Sweden introduced high-yield direct taxes with little distributive conflict, while Australia saw battles over redistribution even in the presence of high tariff revenues.

Thus this article contributes to the literature on the long run factors involved in the political economy of redistribution.⁴ It also joins Scheve and Stasavage in arguing for the importance of international factors in the determination of domestic distributive outcomes.⁵ However, the international economy may have a more powerful influence on domestic policy via its political rather than its economic implications. This is in contrast to the emphasis of what I term the ‘globalization hypothesis’ that underpins most of the political economy scholarship on taxation in the

⁴Iversen and Soskice, 2009a; Martin, Mehrotra, and Prasad, 2009; Scheve and Stasavage, 2009, 2010.

⁵Scheve and Stasavage, 2009.

contemporary era of economic integration, which take as a starting premise the constraints that the international economy puts on direct, progressive, tax structures.⁶

1 The Impact of Trade Politics on Direct Taxation

The key intuition underpinning the role that trade politics had on tax policy is, first, that tariffs and other sources of taxation (direct and income taxation in particular) are substitutes from the perspective of providing government revenues. Secondly, protection has distributive consequences that cut across the income distribution.⁷ Non-poor groups are differentially affected by the levying of tariffs, and they may seek lower income groups as allies in pursuit of their trade policy goals.

Both of these elements of trade politics, the *revenue* pathway and the *coalitional* pathway will influence reforms and expansions of direct taxation. The two paths of trade influence will have slightly different effects on the shape of reform: a strong revenue impetus for direct tax expansions need not imply a particularly progressive or redistributive tax structure. Conversely, coalitions incorporating the left are more likely to lead to progressive taxation, possibly even in the absence of strong revenue needs.

1.1 Tariffs and Revenues

The role of both tariffs and taxes in raising revenues for the state means that as trade policy affects tariffs, so it affects tax policy. As a result, the politics of trade set the stage for questions of tax reform. Where revenues were more easily raised via tariffs, the (re-)distributional impact of direct taxation was isolated as its defining characteristic. Where tariff revenues were more difficult to raise- either economically or politically- the revenue raising features of direct tax reform would recommend it to those outside its distributive beneficiaries. This is what I refer to as the *revenue*

⁶Beramendi and Rueda, 2007; Cusack and Beramendi, 2006; Ganghof, 2006, 2007; Hays, 2003; Swank, 1998; Swank and Steinmo, 2002.

⁷Adserà and Boix, 2002; Rodrik, 1998.

pathway by which trade policy affects the tax structure.

There are a number of potential constraints on a country's use of tariffs as a revenue raising device. In theory, protectionism could lead to prohibitive tariffs, eliminating imports and raising no revenue. However, for the countries considered here, tariff rates were not this high. American tariffs at the time were below their revenue maximizing levels,⁸ and in France and Germany in the 1880s and 1890s, tariff rates and revenues were positively related, implying the same was true there.⁹ Higher tariffs meant higher protection and revenues in the period in question.

The practicability of tariffs as a source of revenue also depends on national economic characteristics. In particular, export-oriented producers are more sensitive to price conditions than their domestically oriented counterparts. To remain competitive, exporters cannot afford high tariffs on their inputs. While tariffs can be specific, or structured so as to limit their impact on exporters, any such exemptions will undermine the revenue yield. If labor markets are tight, this effect can undermine support even for tariffs on consumer goods, as price increases will lead to demands for higher wages. At the level of policy, governments choosing to pursue export-oriented growth must attend to these producers' concerns: small, export oriented countries are less able to raise large revenues via tariffs.

It is beyond the scope of this paper to consider the determinants of trade policy positions, and the role of ideas versus economic interests in this outcome. But between 1870 and 1914, countries also had differing 'ideological' orientations to free trade and the use of tariffs.¹⁰ Aversion to the use of tariffs for protection influences debates on the utility of tariffs for revenue purposes, given the impossibility of 'pure' revenue tariffs or purely protective levies.¹¹ Such ideas operate on two levels: the national and the particular. At the national level there may be variation in the center of gravity of attitudes toward trade openness. At the partisan level, a commitment to free trade

⁸Irwin, 1997.

⁹Meadwell, 2002.

¹⁰Trentmann, 1998.

¹¹Nye, 1991; Verdier, 1994.

principles among distinct groups leads them to oppose tariffs, constraining their revenue impact.

1.2 Trade and Political Coalitions

The second way that trade issues can have on taxation is via a *coalitional pathway*. When the tariff question divides traditional political elites, each side may try to form alliances with other groups to win the trade issue. Where these incentives exist, mechanisms for sustaining the trade-policy alliance- parliamentary support for reformist governments and electoral non-compete pacts- lead to the expanding influence those other groups. For trade policy battles at the turn of the twentieth century, the primary ‘other group’ was labor, who also favored progressive expansions of direct taxation.

Trade policy-based alliances translate into the domain of direct taxation via two main channels. The first is via concrete agreements on the exchange of political support. For the trade coalition to affect other policy areas, some power over these policies must be ceded to the new groups. The key mechanisms for cementing trade alliances were electoral non-competition or parliamentary support, both of which entail some such release of power. The former translates trade policy coalitions to other policy areas by changing the identity of representatives and thus their position on other dimensions. The latter translates to support for government bills, although is likely to be less secure across policy dimensions as parliamentary factions nominally in support of the government have room for maneuver on bills that are not confidence motions, or if they have little to fear from a change in government.

Less tangible but nonetheless important, trade alliances may alter the attitude of elites towards non-elite participation in politics, and legitimate lower-income demands made through the political system. Cross-class cooperation on trade issues limited the ability of elite parties to coalesce around anti-socialist platforms and to discredit lower income groups’ demands in other areas. In reaction to accommodating elite policies, emerging labor politicians were also be better able to secure support

for incremental and democratic concessions on social policy, as opposed to revolutionary action.¹²

Thus the political logic by which trade influences direct tax outcomes is analogous to the logic of elite transitions to democracy,¹³ but in the realm of political cooperation with lower income groups rather than the extension of formal rights. In some cases this logic was reinforced by the linkage of tax and tariff issues as a result of their shared capacity to generate revenue (see above, Section ??), whereby free trade elites would benefit from low-income collaboration not only for support on trade policy but also because they were sympathetic to the revenue possibilities of direct tax reforms.

1.3 Two Pathways of Trade Influence on Taxation

Trade thus can influence the shape of direct taxation in two ways distinct from the constraining influence of internationalization on the taxation of mobile factors. The two pathways are summarized in Figure 1. The trade interests of elite groups dictate incentives for cross-class coalitions to form over trade policy (on the left side of the figure), with an effect on direct taxation as the result of political concessions. On the right side of the figure is the revenue pathway, whereby trade policy affects direct tax outcomes as the result of the constraints or opportunities it generates to raise funds for the state.

FIGURE 1 ABOUT HERE

However, the two pathways need not be entirely distinct, and political coalitions formed around trade policy may be more important to the politics of taxation than other cross-class alliances precisely because of the revenue linkage. Where the search for alternative sources of revenues coincides with opportunities for political gain there is the greatest pressure for direct tax expansions. Thus alliances between labor and free trade interests are more strongly cemented by economic interest than those between labor and protectionists.

¹²Berman, 2006; Luebbert, 1991.

¹³Collier, 1999; Iversen and Soskice, 2009b.

Finally, although both political- and revenue-based mechanisms affect direct taxation, their impact is not entirely the same. Where lower income interests are incorporated through political bargains, more weight will be given to progressivity rather than revenues. Trade policy induced revenue pressures, when not combined with political alliances, are more likely to result in direct tax reforms structured to raise funds. The most efficient way to raise revenue may dictate some progressivity (depending on the distribution of assets and income), but the reforms will reflect the revenue motive. They will be technocratic, and conflicts between redistribution and revenue yield will be resolved in favor of revenues. This interplay of forces in the way trade affects direct tax policy is summarized in Table 1.

TABLE 1 ABOUT HERE

The table also includes the position of the four cases to be considered here. As argued below, the UK was characterized by both revenue and political pressures for direct tax reforms, while both were absent in France. In Sweden, limited tariff revenues but little coalitional pressure led to revenue-oriented direct tax expansions, while in Australia low-income political power in the presence of high tariff revenues led to highly progressive tax structures with less revenue impact.

2 Comparative Histories: Direct Taxation in the Pre-War Era

The role of trade policy in determining the shape of taxation in the late nineteenth and early twentieth centuries is important given the formative nature of these years for modern states. The liberal era was a period of great change in the structure of taxation as governments struggled to meet the revenue demands of the modern state. The period before 1914 is widely regarded as the era in which the ‘origins’ of modern tax systems can be found.¹⁴ While there was a trend toward direct taxation, it varied across countries. Table 2 shows changes in tax structures between 1881

¹⁴Morgan and Prasad, 2009; Steinmo, 1993.

and 1913 for the cases considered here, as well as the United States and some other European countries. There significant variation in tax structures in 1913, but despite similar revenue pressures, the changes over the period vary across countries: where countries like the UK and United States extend direct taxation, in France and Italy the preponderance of direct taxation in total revenues actually declines.

TABLE 2 ABOUT HERE

The second characteristic of the pre-war era that recommends it to the study of tax policy is that the distributional implications of tax politics in this era were better separated from the impact of government activity. That is, with the development of the welfare state, and different revenue-side structures to finance them, cross-national variation in the politics of taxation became complicated by variation in the benefits they pay for.¹⁵ The major spending categories for which turn-of-the-century tax finances were needed (defense, public health and education) did have distributional implications, but politically it was tax policy itself that was the (re-)distributive issue of the day.¹⁶ Finally, the period was characterized by high, but varied levels of economic integration across national borders,¹⁷ yet there remained political conflict over trade policy.

The empirical work presented here draws heavily on secondary evidence. The contribution of this paper lies in the “careful juxtaposition of findings that the historians themselves have usually presented without awareness of cross-national patterns,”¹⁸ and the theoretically informed comparison across cases. The four cases- the UK, Australia, France and Sweden- selected for comparative study here were chosen based on their different profiles in terms trade politics- the independent variable in question. The trade policy impetus for direct tax reforms based in revenue needs can be high or low, and similarly the coalition dynamics can yield high or low favorability for reform. Each case thus represents one of the four potential combinations of trade policy characteristics.

¹⁵Beramendi and Rueda, 2007; Cusack and Beramendi, 2006; Kato, 2003; Timmons, 2010.

¹⁶Daunton, 2002.

¹⁷Bordo, Eichengreen, and Kim, 1998.

¹⁸Orloff and Skocpol, 1984, p. 732.

In the UK, trade politics weighed toward increased revenue reliance on direct taxes and progressive structures, as deep political cleavages over trade coincided with a limited capacity (albeit ideological more than economic) for tariff revenue generation. In Sweden, limited democratic institutions and technocratic government meant that the political pathway for trade policy influence on taxation was limited, but the economic strategies of the government (and business) made high reliance on tariffs impossible, implying a revenue-based impetus for technocratic direct taxes.

Australia provides the opposite configuration: politics was strongly divided along fiscal-party lines, but revenue needs muted by a protectionist tariff. Finally, France typifies the absence of strong impetus for reform on either of the dimensions. Revenue needs were largely met by indirect taxes, and trade politics did not play a critical role in generating political allies for low income groups. Rather, elites were united in adherence to protection in the form of the Méline tariff. The relationship of these characteristics to the theory is summarized in Table 1.

While varying in their trade politics, the cases were chosen in order to minimize their variation on other characteristics which might plausibly be thought to affect trade policy. However, given the finite historical record it is not possible to match other country characteristics exactly, thus I address other possible explanations of tax politics in Section ??.

2.1 United Kingdom

Revenue motives, and after 1903, the politics of trade worked in favor of direct tax expansions in the UK. On the revenue side, an ideological predisposition toward free trade, particularly within the Liberal party limited the possibility of raising indirect taxes in general and customs revenues in particular. In terms of political coalitions, the free trade orientation of labor and its organized representatives made it an attractive source of support for Liberal governments once trade and tariff reform became a polarizing political cleavage, empowering advocates of progressive reform.

Trade politics in Britain was dominated by a commitment to free trade throughout the late nineteenth century.¹⁹ But in 1903 Joseph Chamberlain launched a campaign to increase tariffs, and restructure them along the lines of imperial preference, to provide the revenues for the Treasury, and to protect British production. Chamberlain claimed that tariff reform alone could provide a viable financial base for modern government.²⁰ This polarized political debate between free traders and Tariff Reformers, and the 1906 election was fought between these positions.²¹

In terms of tax outcomes, reforms in 1894 introduced a graduated structure and extended the same treatment to land as to other forms of property. These reforms were a strategy for the “containment” of radical demands as well as responding to revenue needs.²² Progressivity was constrained by technocratic resistance to graduation and expansion of the income tax. Official opinion from the Treasury was wedded to the Gladstonian ideal of raising taxes from direct and indirect sources in equal proportion, and the Inland Revenue opposed graduation in income tax rates. Nevertheless, the 1898 budget, needing revenues to pay for greater wartime expenditure, saw the increase of the standard rate from 8d to 14d in the pound (3 to 6%) under a Conservative government. This direct tax hike was mirrored by indirect tax increases (excises on beer, spirits, tobacco and tea as well as a sugar duty).

The polarization of the tariff debate changed the politics of taxation, convincing Liberals of the need for direct tax expansions as a way to finance a free trade state, and bringing labor representation into parliament. This cemented reliance on income taxation, and the system of free trade. Following the 1906 election, expansions of the income tax and greater progressivity (introduced via differentiating income sources and graduating rates) passed in 1907 and 1909. It was the land tax provisions of the ‘People’s Budget’ rather than other direct tax expansions that were controversial, leading to the constitutional crisis in 1910. The ‘People’s Budget’ of 1909, and Liberal governments

¹⁹Gourevitch, 1978; Trentmann, 1998.

²⁰Murray, 1973.

²¹Irwin, 1994; Russell, 1973.

²²Daunton, 2001.

after the 1910 elections, relied on Labour support. This was secured by an electoral pact under which these free trade parties avoided three-cornered election battles, but the cost of this support, from a Liberal perspective, was the redistributive concessions which had to be made to keep this support from the left.²³

The revenue implications of Britain's free trade policy pushed towards the expansion of direct taxes much as the theory implies. Tariff revenues were constrained throughout the period, although commitment to unilateral free trade weakened in the 1890s. Revenue pressures and an increasingly protectionist international environment created a constituency within the Liberal party that advocated tariffs for the purposes of revenue and retaliation- for example a 10 per cent tariff advocated by the free trader Bernard Samuelson in 1901. Harcourt, the Liberal Chancellor of the Exchequer between 1892 and 1895 was particularly concerned that a "McKinley tariff which raises immense revenue... may have become inevitable."²⁴ In comparative context, however, support for higher tariffs remained low, and the response to this revenue challenge was to increase the yield of death duties by graduating rates. Increases in government spending under the Tories between 1899 and 1902 were met by further Liberal expansions of direct taxation in 1902, "less as a device for redistribution and social reform than as a means of securing revenue for expenditure on efficiency."²⁵ By the mid-1900s, increasing revenues were once again required; and the Liberal landslide in 1906 meant that "having rejected tariffs as a source of revenue, direct taxes were the only solution."²⁶

By 1906, electoral threats to free trade had helped cement a left-free trade alliance between the Liberals and Labour, and trade also affected taxation via the coalition mechanism. From 1903, both Tariff Reformers and free traders sought to appeal to working class voters. Chamberlain claimed that protection could guarantee wages and employment, alleviating poverty, while tariff revenues could finance old age pensions. The Liberals' appeal focused on the impact of protection on food

²³Daunton, 2001, p. 358.

²⁴Harcourt to Acland, Jan 1893. In Daunton, 2001, p. 304.

²⁵Daunton, 2001, p.342.

²⁶Daunton, 2001, p.342.

prices,²⁷ and won the day: the Labour party formally rejected protectionism. A secret electoral non-competition pact between Labour and the Liberals was agreed in 1903, and the 1906 election saw 24 of 30 Labour representatives returned to parliament, running unopposed by Liberals. Where earlier reforms were solely focused on free trade finance, the tax reforms of the late 1900s had two goals: to create a more buoyant fiscal regime, and to cement the political alliance of the more prosperous working class and middle class producers.²⁸

To what extent did trade politics motivate Liberal-Labour cooperation, and what effect did this cooperation have on these tax outcomes? From the Labour side, the Liberal position on trade was less important than electoral strategy: Labour had struggled in three-way contests. Winning where Liberals stood aside in by-elections in 1901 and 1902,²⁹ Labour thought could advance working class interests through cooperation. The Liberals were also penalized by three-way elections, but why was the fear of Tory victory strong enough to recommend an alliance which was problematic in the short term, and arguably fatal to the party in the long run?

Since the 1903 agreement was a secret one, unearthing the motives of the Liberal leadership is difficult. Aside from its timing, there is another piece of evidence that implicates trade politics as a Liberal motivation: the alliance held only at the national level. In municipal elections Liberal candidates continued to compete with labor representatives. The issues salient at the local level divided the Liberals from Labour more than from the Conservatives.³⁰ The key national-level policy at issue from 1903 until the 1906 election was that of free trade, and ensuring victory over the Conservatives on this issue was more important to the Liberals than disagreements with Labour in other areas.³¹

Labor representation in parliament as a result of the pact had an important impact outside the

²⁷Russell, 1973.

²⁸Daunton, 2001, p. 370.

²⁹Bealey, 1956.

³⁰Bernstein, 1983.

³¹Powell, 1986; Russell, 1973.

sphere of trade politics, including in tax policy outcomes. Despite their agreement on trade, the two parties differed on other issues. For example, Labour representation shaped the Trade Disputes Act (in 1906)– a Private Members’ Bill introduced by the Labour MP Keir Hardie. This passed after the government’s retreat from its own bill, which was much less generous to the unions.³² In terms of tax policy, too, Labour representation had an important impact on government policy, as “the need for support from Labour members meant that the government had to meet demands for social reform”.³³ The inclusion of the graduated super-tax in the 1909 budget was an example of this influence, pushing toward direct taxation. The electoral pact ensured a free trade victory in 1906, but shifted other policies left by empowering Labour MPs.

The case of Britain therefore highlights both of the mechanisms by which trade politics acted to push towards direct tax expansions. Before 1900, the revenue mechanism predominated, and expansions were revenue-seeking, technocratic, and of limited progressivity. The need to preserve free trade in the period of the Tariff Reform campaign helped create a political coalition between Labour and the Liberals, entailing the expansion of direct taxes on social policy grounds.

2.2 Australia

In Australia, a wide franchise combined with the politics of trade helped incorporate labor representation early, and the coalition structure led us to progressive tax reforms. However, Australia’s protectionism led to tariffs that generated enough revenue that financial motives for increasing direct taxes were limited. In Victoria, and later in the Commonwealth, labor was largely protectionist, undermining its capacity for collaboration on direct tax expansions with the Free Trade party who also sought such reforms on revenue grounds. Table 2 indicates that while direct taxation did increase in the thirty years leading up to the first world war, the increase was much less pronounced than in the UK or the USA. There was no federal income tax in Australia before the outbreak of war. However, Australia was able to tax land, a progressive reform never achieved in the UK. Tax

³²Kidner, 1982.

³³Daunton, 2001, p. 365-6.

reforms that were introduced by Labour, Protectionist, or their combined governments reflected the political power of the poor in their structure, and the relative absence of revenue needs in their level.

Before federation in 1901, each of the colonies operated independent policies in the spheres of both trade and taxation, and there was variation across the six colonies. Federal politics after 1901 closely followed the model of Victoria, thus I most closely examine tax policy in Victoria and the Australian Commonwealth. Different trade politics in New South Wales prior to federation led to tax policy outcomes more similar to those in the UK, and this contrasting case is considered briefly at the end of this section.

The trade policy of Victoria from the 1890s onward, and Australia after federation, was much more protectionist than the other countries considered here. Until 1890 average tariff rates in Australia were comparable to those of Sweden, and higher than those in the UK and France. The broad contours of economic interest pitted urban protection leagues against rural free trade leagues.³⁴ In the 1890s, particularly in Victoria, increasing revenue needs were met by increasing tariffs.³⁵ Federation and the customs union that followed changed the parameters of tax and tariff policies in the colonies, as the national government set a uniform tariff, rebating three quarters of the revenue raised back to the state governments for the first ten years of the federation.

National policy followed Victorian preferences in enacting a ‘compromise tariff’ that confirmed the protectionist orientation of the new federation. This “especially failed to please the Free Traders, either on the Liberal or Labour side.”³⁶ Overall, the level of the tariff increased,³⁷ and the compromise was “was not between free trade and existing protection, but between existing protection and further protection”³⁸. In the years after federation protection continued to rise, culminating in the Lyne tariff in 1907, raising duties on a broad range of goods. As trade in Australia was affected less

³⁴Hiscox, 2001.

³⁵Patterson, 1968.

³⁶Mills, 1925, p. 210.

³⁷Forster, 1975.

³⁸Irwin, 2006, p. 9.

severely by the First World War, the federal government was also able to continue its tariff finance approach, enacting wartime revenue tariffs that were repealed after 1918.³⁹ As a consequence of the revenues generated by protective tariffs, revenue motives for direct tax expansions were limited.

The political context of trade policy in Australia created more pressure for tax reform. Trade policy was a major, salient policy issue and the emergence of programmatic parties in the colonies was largely along ‘fiscal’ (tariff policy) lines.⁴⁰ In Victoria, all men over 21 had the right to vote by 1857, and labor interests were incorporated by protectionists who sought support in contentious battles with agricultural land-owners.⁴¹ These battles were fought over protection, and the distribution of land (in the 1860s), and political reforms, particularly plural voting (in the 1870s). By the 1890s the Protectionist platform allied protection and pro-poor policies in opposition to the “hide-bound conservatism” of free trade.⁴² Lower income groups both within and allied with the Protectionists sought tax reforms on redistributive grounds.

In the early federal elections, political competition was balanced between three near-equally sized blocs of Protectionists, Free Traders, and Labor. The 1903 elections led to a near exact balance of power with the three parties winning 26, 25 and 23 seats respectively. Until 1906, the tariff question dominated politics, and a ‘Victorian’ alliance with Labor sustained Protectionist minority governments until 1904. The final Protectionist ‘concession’ to labor was the ‘new protection’ designed to enable manufacturers to pay high wages. Thus the politics of trade in Australia had helped Labor secure its influence: as the ‘king-maker’ in a system divided between two elite fiscal parties. Protectionists in power relied on Labor support, and despite anti-Labor ‘fusion’ of the elite parties in 1909, Labor was the first party to win a majority in 1910. By this time, though, the defeat of the free trade cause had led to the re-orientation of traditional conservative forces away from the tariff question and towards an opposition to labor influence. Federal politics in Australia proceeded after the ‘fusion’ with both Labor and anti-Labor parties agreed on a protectionist stance, with

³⁹Lloyd, 2007.

⁴⁰Loveday, Martin, and Parker, 1977.

⁴¹Rickard, 1976.

⁴²Rickard, 1976, p.48.

conflict over issues of redistribution and industrial relations. With trade politics settled, its impact on tax policy via political coalitions diminished.

How then did these trade policy dynamics- the absence of a strong revenue motive for direct taxation, but incentives for protectionists to incorporate labor interests for political gain- translate to tax policy outcomes? In Victoria, incremental reform of property and land taxation was ongoing. The government passed a bill to introduce income taxation in 1893; it was implemented in 1895 under Turner, a protectionist.⁴³ Compared to the other colonies, as well as other countries in consideration here, this was relatively early adoption, but the income tax raised only half the revenue of its New South Wales counterpart. As a share of revenues, too, overall direct taxation in Victoria was falling before federation.⁴⁴

The political impetus from poorer interests led to land taxation explicitly designed to break up large estates. The income tax in 1890s Victoria was progressively structured with rates of 4d on incomes up to £1200, 6d to £2200, and 8d above that level (whereas New South Wales levied a uniform 6d rate).⁴⁵ Thus pre-federation Victorian politics, matched with smaller need for revenue from direct taxes, yielded progressive direct tax reforms, but a less expansive direct tax yield.

In the early years of the commonwealth government, revenues from the tariff more than covered federal outlays. Without a revenue motive, there was less scope for labor to pursue social goals via tax policy. Early Protectionist governments advocated a land tax to secure Labor support, but stopped shy of enacting it when the issue came up in Deakin's second government.⁴⁶ By this time, the tariff issue was becoming less important, and could no longer cement the Labor-Protectionist alliance. In 1908, the Labor government attempted to introduce a progressive land tax, designed primarily to encourage subdivision of large estates.⁴⁷ Recognizing it as such, the Protectionists

⁴³Mills, 1925.

⁴⁴Coghlan, 1904.

⁴⁵Coghlan, 1904.

⁴⁶Rickard, 1976, p. 209.

⁴⁷Mills, 1925, p. 233.

withdrew their support for the Labor government.

Only after the general election in 1910, and the rout of the anti-Labor parties, could the new Labor government claim a mandate for its land taxation. It was quickly passed, with a progressive structure: a starting rate of 1d in the pound above a £5000 exemption level, up to a top rate of 6d. However, in the presence of the tariff instrument for raising revenues, even the Labor government did not enact income taxation until after the outbreak of war in 1915. At the federal level, the tariff operated as a substitute policy in terms of revenue. The elimination of conflict over tariffs meant that Labor tax reforms were pursued without cross-class support, but Australian Labor's relatively early emergence as a political force owed some debt to its support for protection and the Protectionists in the early Commonwealth.

Thus in Australia trade politics had a significant impact on tax policy. Despite a stronger parliamentary left than in any other country before the war, Australia had no income tax and remained much more reliant on customs revenues as a source of government finance than either the UK or United States. This was in large part attributable to the trade interests of labor: their demands for protection in trade policy allowed the revenue needs of the government to be served by the tariff. However, the structure of those direct taxes that did exist was highly progressive, due in large part to alliances that incorporated labor interests into policy.

It is worth taking a moment to highlight one colony in pre-federation Australia with very different trade-tax outcomes to Victoria, since although national policy later reflected Victorian dynamics, there was variation in the independent colonies' policies. New South Wales maintained a strong commitment to free trade throughout the 1890s,⁴⁸ and its politics of trade and taxation more closely resembled the British case. Free Traders, under Reid, enacted progressive expansions of land and income taxation in 1895, to secure both the working class vote and a viable means of financing free trade.⁴⁹ At federation, these free trade interests were sidelined in the construction of

⁴⁸Boix, 2006.

⁴⁹Rickard, 1976.

national policy;⁵⁰ however, at the state level they were largely victorious, as federation removed all barriers to intra-continental trade. With the tariff instrument reserved to the national level all the states had enacted and greatly expanded income taxation by 1907.

2.2.1 Sweden

In contrast to Australia, in Sweden trade policy gave impetus to the reform of direct taxation thanks to its effect on revenues, but there was little scope for progressively oriented reform coalitions. Sweden stands out among the cases considered here for its lack of democratic institutions in the period in question. The King was not unconstrained, but electoral participation was much more limited than in the other cases until the extension of the franchise between 1907 and 1909. Parliamentary government was not established until 1917.⁵¹ The political power of the left was therefore limited.

As a small country reliant on export-led development, however, there was little scope for extensive use of tariffs.⁵² As a consequence, Swedish direct tax reforms were enacted fairly early (mildly progressive inheritance taxation in 1894, income taxation in 1902) but technocratically. The redistributive impact of direct tax reforms was less important in Swedish tax reform than its capacity to raise revenues in a small, open state. In this section I first outline trade policy in Sweden, and then its major tax reforms, which highlight the importance of free trade revenues. Direct tax reform in Sweden reveals a conspicuous absence of strong redistributive motives- unsurprising given the absence of strong labor and lower-income political representation in the processes of reform.

Interpretations of trade policy in Sweden around the turn of the twentieth century are contested. Swedish trade policy has been described both as part of the “free-trading old world”, along with Britain and Denmark.⁵³ Other scholars point to increasing protectionism in Sweden after 1888,

⁵⁰Loveday, Martin, and Parker, 1977.

⁵¹Verney, 1972.

⁵²Lindbeck, 1974.

⁵³O'Rourke and Williamson, 1999, p. 61.

comparing the evolution of Swedish tariff policy to that in Germany.⁵⁴ Measured by average tariff levels, protection in Sweden appears not to rise in the period of interest, supporting the view that protectionism there was less pronounced; but considering protective duties (those on domestically produced goods) somewhat undermines this picture.⁵⁵

Nevertheless, those in support of free trade included the dynamic, export oriented segment of manufacturing that was beginning to emerge in this period- particularly in high-technology engineering; bankers, and commercial interests such as shippers in port cities, as well as workers. Small scale farmers, especially in northern and central Sweden, also tended to support free trade.⁵⁶ In terms of their electoral influence, protectionist and free trade interests were closely balanced: the two elections of 1887, fought under conditions so as to almost be referenda on free trade, were both won by the free traders, but narrowly.⁵⁷ In addition, the export-driven nature of Swedish economic growth⁵⁸ and its small population limited the scope for broad protection via tariffs,⁵⁹ and its revenue potential had been largely exhausted by the mid-1890s.

Three major changes to direct taxation in 1894, 1902, and 1910 highlight the revenue mechanism by which free trade shaped policy. Each of these reforms was introduced in the context of pressing revenue needs and the impossibility of raising revenues from tariff expansions in a small economy. Tellingly, there was little difference between liberals and conservatives on the issues of taxation. Further, while the income tax was expanded in 1910 with the support of the left, similar reforms were passed before the extension of the franchise created any such political pressure.

The first of these was the reform of the inheritance tax in 1894, under Boström. Progressive inheritance duties were enacted to abolish traditional land taxes, and to finance defense expen-

⁵⁴Lehmann and Volckhart, 2010.

⁵⁵Bohlin, 2005.

⁵⁶Gourevitch, 1986; Lehmann and Volckhart, 2010.

⁵⁷In the autumn election, so narrowly that the disqualification of Stockholm's free trade delegation on tax-fraud grounds resulted in a protectionist government.

⁵⁸Lindbeck, 1974.

⁵⁹Gourevitch, 1986.

diture and military reforms. Even this protectionist Agrarian prime minister did not raise tariffs to pay for these changes. Instead he introduced a tax on large agricultural holdings (effectively introducing progression into property taxation) and introduced progressivity into the inheritance tax. This raised the top rate to 1.5%, where previously there had been a flat rate of 0.5% in the presence of legal heirs.⁶⁰ It increased the share of revenues raised by these assessed direct taxes from nine to 12 per cent of central taxation.⁶¹

Agrarian opposition to further land taxation, coupled with industrialists' need for imports, meant that traditional sources of revenue were effectively deadlocked by the turn of the century.⁶² In this context, it was under the premiership of Frederik von Otter- a political independent, but a naval officer from a wealthy aristocratic family- that the income tax was introduced in 1902, again accompanying military reforms. This tax was mildly progressive with a top rate of 4%,⁶³ and would raise nearly ten percent of central government revenues by 1906.⁶⁴

The final major peacetime reform in Sweden was implemented in 1910 by Finance Minister Carl Swartz, and had two principal objectives. First, revenue needs were outpacing existing taxes, so new sources of finance were sought. Second, dynamic industrial (and largely export-oriented) sectors sought the modernization of the economy as a whole, including reforms to the tax structure that could consolidate the position of Swedish industry. Nominally conservative, the Lindeman government in which Swartz served had ties to industrial interests who sought the modernization of the tax system, and Swartz himself was more a technocratic servant of the state than a partisan.⁶⁵ The 1910 reform hewed closely to export-oriented industrial preferences, incorporating a wealth tax, and expanding the income tax, including the introduction of corporate taxation as a tool to manage the economy.

⁶⁰Steinmo, 1993.

⁶¹Flora and Alber, 1983.

⁶²Steinmo, 1993, p.63.

⁶³Steinmo, 1993, p.64, n.23.

⁶⁴Flora and Alber, 1983.

⁶⁵Steinmo, 1993, p.65, n.25.

While its instigators were perhaps surprising, opposition to the 1910 tax reform came from predictable sources. In particular, the landed aristocratic classes denounced the reforms as socialistic (despite opposition to the corporate taxes included in the bill from the socialists themselves). Agricultural interests opposed to direct tax reform were also strongly protectionist in orientation. In general, since the 1880s the tendency in Sweden had been for the free traders to be “inclined to the left, whereas protectionists more often included conservatives;”⁶⁶ specifically, the most vocal opposition to the 1910 reforms came from Count Ludvig Douglas, a staunch protectionist. However, bureaucratic and business interests in direct taxes as rational revenue tools for a small and open economy outweighed these objections.

The Swedish case is thus one where free trade finance precipitated the expansion of direct taxation. Technocratic economic policy-making and an export-oriented growth strategy translated into the expansion of direct taxation as a means to raise revenue. Progressivity was incorporated into both inheritance and income taxation, but as a means to raise revenues rather than as a tool of social policy. The obsolescence of land taxation over this same period highlights the absence of a redistributive motive. Sweden differs from the UK in that tariff policy was more the result of the structure of economic growth than partisan preference. This meant that trade helped shape taxation outcomes even in a much less open political system. Relatively insulated bureaucrats (and ministers) thus introduced revenue-oriented direct tax reforms even in the absence of political power of the left, particularly before the extension of the franchise for the lower house between 1907 and 1909.

2.3 France

Trade politics in France led to neither a redistributive political coalition, nor pressing revenue needs. Despite a broad franchise, parliamentary dominance, and an extended period of left-liberal political power, the taxation of income was not introduced until 1914, and it never became the mainstay of public finances as in the UK. Indeed, there was no change to the system of direct

⁶⁶ Åberg, 2011, p. 100.

taxation until 1901, and direct tax revenues declined in the period from 1870, as a share of revenue and of national income.⁶⁷ This was not for lack of salience: 200 propositions for the introduction of an income tax were introduced into the chamber of deputies between 1871 and 1909, yet all failed,⁶⁸ When France did finally enact changes to its system of direct taxation, they were pushed through by similar groups as elsewhere: redistributive interests from the left, and revenue-oriented modernizers. But limited common cause on a trade policy basis limited the scope of these reforms.

In France, in contrast to Australia or Britain, inter-industry factor mobility in the period between 1870 and 1914 was low. Hiscox has argued that this led to industry-centered, interest group lobbying on trade policy, as opposed to class based coalitions.⁶⁹ The dominant coalition of trade interests in the legislature was a protectionist grouping of textile manufacturers, cattlemen, colliers, iron masters, and the charcoal and iron industry and its suppliers.⁷⁰ Free trade support came from much of the agricultural sector, woolen and worsted manufacturing, and wine exporting regions, as well as the internationally oriented financial, commercial, and transport sectors in Paris and in large sea and river ports such as Marseilles, Bordeaux and Lyon.⁷¹ While each industrial grouping held a shared tariff policy position, cross-cutting interests on redistributive issues, as well as the lack of institutionalization of the trade blocs in formal parties or pacts,⁷² limited the impetus for direct tax reform.

On the basis of these divisions, the free trade policies of the Second Empire were largely continued through the 1870s and in tariff legislation in 1881 and 1882. During this time that revenue-oriented proposals for direct tax reforms were commonly proposed, but defeated. In 1871 an income tax was proposed by free traders. The advocates of this early proposal included Henri Germain, Jules Siegfried, and free trade economists who saw direct taxation- in contrast to tariffs- as the fiscal system better suited to business prosperity. During this period, those reforms which received

⁶⁷Flora and Alber, 1983.

⁶⁸Smith, 1980, p. 240.

⁶⁹Hiscox, 2002.

⁷⁰Verdier, 1994.

⁷¹Smith, 1977.

⁷²Barnes, 2010.

the most serious attention were “designed mainly to raise revenues as efficiently as possible,” rather than strongly redistributive.⁷³ Resistance from small- and medium-sized business and industry, and prime minister Thiers’ protectionism and opposition to the income tax, meant that the only element of this reform to pass was a tax on income from securities.

Over the course of the 1880s support for protection increased further,⁷⁴ while retrenchment of ‘extraordinary’ government expenditures brought revenue pressures under control. In the 1881-2 tariff revisions, but more importantly in 1892, tariffs were revised in a sectoral log-roll.⁷⁵ The Mèline tariff (1892) was a broad tariff including specific protections for large segments of agriculture and industry that stood in conflict over non-tariff issues.⁷⁶ Industrial protection addressed the erosion of support for the Republic among the anti-radical and bourgeois elite following labor unrest. Agricultural protection served to perpetuate peasant support for an essentially bourgeois regime.⁷⁷ The revenue function of the tariff was certainly a factor in the discussion of the Méline tariff in 1892; indeed an income tax was discussed during the debates as an alternative way to raise revenues,⁷⁸ but the distributive impact of the tariff recommended it to the fragmented legislature: in the context of specific interests in trade, the complex tariff could also accommodate free trade interests with generous loopholes.

This effectively removed the tariff question from political debate after 1892⁷⁹, and thus,

“[t]he tariff issue played virtually no role in the discussions about income taxation in the 1890s, as there was no push to replace tariffs as a source of revenues.”⁸⁰

By co-opting elites on both sides of the trade issue, as well as radically-oriented peasants who benefited from protection, the Méline compromise helped solidify a bourgeois, Republican centralism

⁷³Owen, 1982, p. 92.

⁷⁴Smith, 1980; Verdier, 1994.

⁷⁵Verdier, 1994.

⁷⁶Gourevitch, 1978.

⁷⁷Smith, 1980.

⁷⁸Meadwell, 2002; Owen, 1982.

⁷⁹Smith, 1977.

⁸⁰Morgan and Prasad, 2009, p. 1370.

leaving urban workers (who would particularly stand to benefit from tax reforms) on the outside of the parliamentary consensus.⁸¹

Radical electoral platforms kept direct tax reform on the agenda through the 1880s and 1890s, but without allies supporting direct tax expansions for revenue purposes, those interested in redistribution via the tax system were too weak to pass their proposals. Both general property taxation and graduated inheritance taxes were proposed in the assembly, and met with little support. There was little urgency to the parliamentary discussions- the post-war financial crisis had passed, and bills were routinely submitted, reported on in committee with little enthusiasm, and left untouched for some period of time before being resubmitted to exactly the same fate.⁸² The Socialists and Radicals kept the issue of income taxation alive, but the left was not strong enough to win a purely redistributive debate, particularly as the Radicals were moving more toward the ideological right at this time.⁸³

Trade politics also provided little incentive for elites on either side of the trade debate to enter into political alliances with those supporting redistributive goals via direct tax reforms. In contrast to both the UK and Australia, trade divided the major elite political parties internally, rather than providing a line of partisan cleavage.⁸⁴ While the Socialists (who were committed to free trade) might seek alliances with free traders in elite parties, trade policy was nowhere a priority for socialists. Its absence as an elite priority in France meant that such alliances had little appeal to either side. To some degree, the defense of the Republic and anti-clericalism did help to cement alliances on the left, as evidenced by the increasing difficulty of maintaining left coalitions after the clerical issue was 'solved' by the separation of church and state in 1905,⁸⁵ but translating this alliance across areas not linked by the revenue motive proved impossible given the shifting, non-programmatic nature of Third Republic parties.⁸⁶

⁸¹Owen, 1982; Smith, 1977.

⁸²Seligman, 1913.

⁸³Wright, 2005.

⁸⁴Verdier, 1994, p.129.

⁸⁵Wright, 2005, p. 267.

⁸⁶Barnes, 2010; Wright, 2005.

The importance of alliances with revenue-oriented modernizers for the success of direct tax reform is illustrated by the fact that it was the ‘grand bourgeois’ Joseph Caillaux who was responsible for both the implementation of graduated inheritance taxes (passed by the Assembly in 1895 but delayed in the Senate until Caillaux’s Finance Ministry in the Waldeck-Rousseau government), and for moving income tax legislation through the Chamber between 1906 and 1909. Although nominally a Radical after the Dreyfus affair, Caillaux was little interested in redistributive policies. His father had served in conservative governments in the 1870s and Caillaux himself had entered the Chamber as a Moderate. In discussion of his income tax bill in 1907, while the Chamber as a whole had majority support in favor of large exemptions for small- and medium incomes, Caillaux was the obstacle to these more progressive amendments.⁸⁷

Caillaux was interested in securing revenue for the state. He had been a finance inspector and sought to strengthen the state by modernizing its tax systems. Indeed his objection to exemptions for lower incomes was based on the fact that this would reduce the yield of the tax.⁸⁸ In the absence of any pressure to reduce tariffs via the new direct taxes, or any other pressing financial crisis, Caillaux’s proposal spent two years in the Chamber of Deputies before being sent to the Senate in 1909. Delaying tactics such as line-item discussions, as well as motions only to delay the tax question were available to opponents in the Chamber only in the absence of a strong revenue incentive for the reforms, just as the Senate was able to delay consideration of the income tax between 1910 and 1912.

The eventual passage of the income tax in France came about only in the context of a renewed need for revenues for rearmament in 1913. As in the UK, the impetus for greater spending came from conservative proposals for military expenditure (in the case of France, the extension of military service to three years). Thus when Radicals and Socialists again proposed income taxation,

⁸⁷Owen, 1982.

⁸⁸Owen, 1982, p. 178.

the issue could not be delayed.⁸⁹ Nevertheless, the distributional impact the 1914 income tax was deliberately offset by the introduction of sales taxation at the same time. This is in stark contrast to the UK where polarization on the issue of trade had also polarized the debate between direct and indirect taxation, such that any increases in indirect taxes were seen as the thin end of the protectionist wedge.⁹⁰ Until this point, the absence of strong divisions on trade limited the supporters of direct tax reform almost exclusively to those who would benefit from its distributive effects; technocratic, modernizing supporters of direct tax reform were few and far between. Trade policy in France provided revenues to the state and few potential political allies to leftist tax reformers. As a result, direct taxation in France lagged behind reforms even in countries that were less democratic, such as Sweden.

2.4 Discussion

The individual cases considered above outline the ways in which the political and revenue effects of trade in four countries. In the UK, a national free trade commitment extended to precluding high tariff revenues, and strong Liberal-Conservative divisions over trade lead the Liberals to cede parliamentary seats and power to the Labour party, yielding progressive and high-revenue direct tax reforms. Australia had a more protectionist orientation (except in New South Wales), but strong political cleavages along trade lines until 1906. Direct tax reforms did not need to respond to revenue pressures to the same extent as in free trading countries, but the Protectionists incorporated Labor politically, leading to progressive changes to taxation. Neither Sweden nor France had such political coalitions based on trade, but whereas in Sweden the economic development strategy ruled out high tariffs, France from 1892 was characterized by consensus on high tariffs. The revenue pressures in the former case led to revenue-oriented tax reforms, while in the latter any reform of direct taxation was stilted until the eve of war.

⁸⁹Owen, 1982.

⁹⁰Daunton, 2001.

2.4.1 Alternative Explanations

While the four cases were selected to maximize variation in terms of trade politics, while minimizing other differences, it is worth considering other differences between the four cases that might lead to divergent direct tax outcomes. As a central economic lever, tax policy has been an important subject of study for economists, and until recently the revenue side of government budgets has received more attention from public economics than political science or sociology.⁹¹ The theoretical findings of the optimal tax literature, however, tend to highlight behavioral parameters for which there is little expectation of variation across countries. Positive and empirical approaches tend to highlight the degree to which policy does or does not conform to the prescriptions of theory,⁹² rather than investigating how tax policy is actually made, with the priority of understanding cross-national variation. The economies considered here did vary somewhat in their economic structure, but there seems little reason to think the parameters relevant to tax policy varied systematically across the cases.

More political explanations of tax structures also exist within the literature, and do tend to emphasize the explanation of differences between countries. In particular, the importance of the electoral franchise, other political institutions, the timing of state development and the role of war have been hypothesized to be important to tax outcomes. In this subsection I outline these alternative explanations and how they relate to variation in tax policy in the period and cases in question.

Given the timing of the extension of the franchise and growth in the size of government, along with an intuitive account of political representation, it is unsurprising that the redistributive impact of democratization has attracted a good deal of scholarly attention.⁹³ The decreasing relative income of voters, as political rights extended down the income distribution, leads to demands for redistributive policies from the government.⁹⁴ Empirically, too, there is evidence that as long as the administrative costs of an income tax are not prohibitive, franchise extensions which enlarge

⁹¹Martin, Mehrotra, and Prasad, 2009, Introduction.

⁹²Mankiw, Weinzierl, and Yagan, 2009.

⁹³Acemoglu and Robinson, 2005; Boix, 2003; Lindert, 2004.

⁹⁴Meltzer and Richard, 1981.

the constituency for redistributive spending also increase the demand for redistributive tax structures.⁹⁵ However, the importance of the extension of the franchise for redistributive outcomes has been disputed. Ansell and Samuels provide evidence- particularly from the period between 1880 and 1930- that democracy had little impact on redistribution by government.⁹⁶

In terms of the cases in question here, too, the level of democratization does not seem to be what differentiates tax policy outcomes. Most importantly, there is little to choose in terms of democratization between the UK and France in this period, yet there is a great deal of difference in their direct tax reforms. Non-democratic Sweden passed reforms that were more important in terms of revenues than Australia, which was one of few countries at the time with universal male suffrage. Equally, direct tax reform in many countries was an elite project. While democratic institutions in general, and franchise extension in particular, may have helped create the conditions for direct tax extensions, they cannot readily explain variation within the democratic UK, French and Australian cases (as well as other countries not considered here) which were highly similar in this regard.

Political institutions other than suffrage rules have also been examined in the determination of tax policy. Hays highlights the difference between consensus and majoritarian democracies in responding to global economic pressures since the 1970s.⁹⁷ However, in the pre-war period, there was only little variation in this regard: only three countries have proportional electoral rules (Belgium from 1899, Finland from 1907, and Sweden from 1909). As we saw above, the only tax change plausibly affected was Sweden's 1910 reform, which was still passed by conservatives and technocratic, not progressive, in orientation. Similarly, while variation in the levels of economic coordination may be traced to features of the turn-of-the-century political economy, corporatist and consensus institutions had not been well-institutionalized (at least not at the national level) before the 1920s.⁹⁸

Morgan and Prasad claim that differences in the timing of the development of business power

⁹⁵ Aidt and Jensen, 2009.

⁹⁶ Ansell and Samuels, 2010.

⁹⁷ Hays, 2003.

⁹⁸ Crouch, 1993; Cusack, Iversen, and Soskice, 2007; Martin and Swank, 2011.

versus state power led to different public reactions to income taxation.⁹⁹ In terms of the cases in question here, Australia seems most comparable to the United States in terms of the relative power of the state versus business (land, rather than industry), yet while such tax reform in Australia was more progressive than that in France, it was more limited than that in the UK, where the central state was more powerful. The case of Sweden, or other less democratic countries, is similarly problematic for Morgan and Prasad's argument, since the technocratic expansion of direct taxes represented an expansion of state power in a much less developed economy with a strong state. However, the idea that public suspicion of the state versus economic interests is in some ways complementary to that presented here, in that the public reaction is in large part a response to the framing of tax policy (for example, as an anti-trust tool), and will be influenced by the nature of political coalitions.¹⁰⁰

Distinct from explanations based on cross-country institutional and partisan variation, Scheve and Stasavage have argued that in considering long run political economy puzzles it is necessary to pay more attention to international processes, and long run economic trends.¹⁰¹ In the study of taxation, they argue that mass mobilization for warfare contributed to the willingness of the public to accept high and progressive income taxation, by instilling norms of 'equal sacrifice' that supported redistribution.¹⁰² The limitation of their focus on top rates of income taxation are clear in considering the structure of taxation more broadly: while top rates may have increased significantly among combatants during World War I, the dynamics of the tax structure were quite different: increased reliance on income taxation was more pronounced in non-combatants than belligerent countries during the war.¹⁰³ The dynamics during the war were also such that governments met their needs for revenue by building on their pre-existing tax structures: even in wartime, France could not quickly pass income tax legislation, while in the UK it was far more straightforward to raise the rates of a pre-existing tax.

⁹⁹Morgan and Prasad, 2009.

¹⁰⁰Martin, 2010.

¹⁰¹Scheve and Stasavage, 2009.

¹⁰²Scheve and Stasavage, 2010.

¹⁰³Flora and Alber, 1983.

2.4.2 Scope of the Argument

Free trade orientation leads to higher direct taxation; and political divisions over trade at the elite level empower redistributive tax demands in the UK, France, Australia and Sweden before World War One. These findings potentially apply to a broader set of cases as well. While it is beyond the scope of this paper to examine the coalition pathway in other countries, I look briefly at changes in revenue sources across a number of western European countries, and then look at some well known trade-policy conflicts in other countries to see how well the theory travels to explain variation in the origins of modern direct taxation. Finally, I consider the limits to the importance of this theory in the temporal dimension.

Figure 2 plots changes in revenues from direct taxation as a share of domestic taxes between 1870 and 1913 against changes in customs revenues. To prevent an ‘automatic’ negative relationship between direct and customs revenues as a share of total revenues, direct tax receipts are measured as a share of taxes from domestic sources only. While the linear relationship is not overwhelming, countries with increasing customs revenues tended to decrease their share of direct taxation.

FIGURE 2 ABOUT HERE

The political dynamics, where cross-class alliances on trade facilitated greater low-income representation do have parallels in some other countries’ tax histories. In the United States Wilson’s 1912 election victory and subsequent introduction of income taxation was based on an alliance between the free-trading south and redistributive demands from northeastern workers, and western progressives in favor of both elements of reform. The first income tax provision after the repeal of the Sixteenth Amendment was incorporated into a tariff bill- the Underwood Tariff of 1913.¹⁰⁴ Trade politics in Germany aligned the interests of upper income groups in favor of protection,¹⁰⁵

¹⁰⁴Brownlee, 2004.

¹⁰⁵Gourevitch, 1978.

and left little scope for fiscal coalitions with the social democrats: Germany did not introduce a national income tax until 1924. Given the complexity of incentives for political coalitions, this evidence is merely suggestive, but it does imply that the four cases considered here are not completely idiosyncratic.

The theoretical argument whereby revenues are more constrained under free trade than when tariffs can be used would also seem to apply well beyond the time period in question. Similarly, where cross-class coalitions incorporate lower-income interests into the political system, the same effect in terms of redistributive outcomes should be expected. However, the political pathway is in fact relatively constrained by this mechanism. That is, trade coalitions will have this effect only in cases where these low income groups are strong enough to be viable coalition partners, yet weak enough to need coalition agreements to secure greater power. This would seem to limit the political mechanism in western Europe and the (now) advanced democracies to a fairly narrow historical window- albeit one with important ramifications precisely because it represented the start of formal labor representation in politics.

3 Conclusions

In this article I have argued that trade politics in the liberal era before World War I affected the emergence of direct taxation as a mainstay of government finance. Theoretically informed comparative histories show the ways that variation in trade politics affected the extent to which governments sought to reform direct taxation at the turn-of-the-century. Tariff revenues weakened incentives for direct tax expansions to raise revenue. Differences in party-political competition over trade policy led to different actors being available for alliances with the emerging redistributive left, resulting for a stronger or weaker platform for the incorporation of progressive demands into tax reform. The in-depth comparison of four cases helps us better to understand the origins of modern systems of taxation.

Further, though tax reform is rarely far from the political agenda, the “introduction of a major

new tax is a rarity.”¹⁰⁶ Thus battles over the reform of direct taxation in the late-nineteenth and early twentieth century, (and in particular the origins of modern, mass income taxation) have cast a long shadow over tax structures even until the present day. France continues to raise only a small share of its revenues from income taxation (24.1% of total taxes in 2008), while in the UK, Sweden and the United States nearly four-fifths of total revenue (including sub-national taxes) are raised from income.¹⁰⁷

The broader implications of this study for political science are twofold. First, I join Morgan and Prasad in calling for a greater attention to taxes.¹⁰⁸ In questions about the size of government and its redistributive impact— the questions which most directly affect ‘who gets what’ in political economy— the paucity of research on tax systems compared to that on spending policies remains remarkable. A recent proliferation of tax policy scholars is beginning to remedy the imbalance, but there remain important elements in the political economy of taxation that are yet to be discovered. Taxes, just as much as the spending programs, have huge implications for important outcomes: inequality,¹⁰⁹ partisan politics, and the welfare state itself.¹¹⁰

Second, theories of political economy that focus on domestic (re-)distribution need to be attentive to the international context in which those policies are determined, not only for reasons of economic constraint, but also because political alliances may straddle the ‘disciplinary’ divide between international and domestic policy areas. Scheve and Stasavage emphasize an important gap in the comparative political economy literature to which this paper contributes— specifically, an understanding of how domestic policy choices are taken in the context of international political and economic situations.¹¹¹ Further, while some international characteristics imply economic constraints (as in the case of Sweden here, and the globalization literature more generally), the political effects of international developments may act in a different direction. I conclude that the

¹⁰⁶Daunton, 2001, p. 15.

¹⁰⁷<http://stats.oecd.org/Index.aspx?DataSetCode=REV>

¹⁰⁸Morgan and Prasad, 2009, p.1386.

¹⁰⁹Atkinson and Piketty, 2007.

¹¹⁰Kato, 2003; Wilensky, 2002.

¹¹¹Scheve and Stasavage, 2010.

origins of modern direct taxation cannot be well understood without attention to the politics of free trade and protection, as well as their economic implications.

References

- Acemoglu, Daron and James Robinson (2005). *Economic Origins of Dictatorship and Democracy*. New York: Cambridge University Press, 2005.
- Adserà, Alícia and Carles Boix (2002). “Trade, Democracy and the Size of the Public Sector: the Political Underpinnings of Openness”. In: *International Organization* 56.2 (2002), pp. 229–262.
- Aidt, Toke S. and Peter S. Jensen (2009). “Tax Structure, Size of Government and the Extension of the Voting Franchise in Western Europe, 1860-1938”. In: *International Tax and Public Finance* 16 (2009), pp. 362–394.
- Ansell, Ben W. and David J. Samuels (2010). “Democracy and Redistribution, 1880-1930: Re-assessing the Evidence”. In: Annual conference of the American Political Science Association. Washington DC, 2010.
- Atkinson, Anthony Barnes and Thomas Piketty (2007). *Top Incomes over the Twentieth Century: A Contrast between Continental European and English-speaking Countries*. New York: Oxford University Press, 2007.
- Barnes, Lucy (2010). “The Political Economy of Progressive Taxation and Redistribution: The Role of Political Fragmentation”. In: *Council for European Studies Seventeenth International Conference of Europeanists*. Montreal, Apr. 2010.
- Bealey, Frank (1956). “The Electoral Arrangement between the Labour Representation Committee and the Liberal Party”. In: *Journal of Modern History* 28.4 (Dec. 1956), pp. 353–373.
- Beramendi, Pablo and David Rueda (2007). “Social Democracy Constrained: Indirect Taxation in Industrialized Democracies”. In: *British Journal of Political Science* 37.04 (2007), pp. 619–641.
- Berman, Sheri (2006). *The Primacy of Politics: Social Democracy and the Making of Europe’s Twentieth Century*. New York: Cambridge University Press, 2006.
- Bernstein, George L. (1983). “Liberalism and the Progressive Alliance in the Constituencies, 1900-1914: Three Case Studies”. In: *The Historical Journal* 26.3 (Sept. 1983), pp. 617–640.
- Bohlin, Jan (2005). “Tariff protection in Sweden 1885-1914”. In: *Scandinavian Economic History Review* 53 (2005), pp. 7–26.
- Boix, Carles (2003). *Democracy and Redistribution*. New York: Cambridge University Press, 2003.

- Boix, Carles (2006). "Between Redistribution and Trade: The Political Economy of Protectionism and Domestic Compensation". In: *Globalization and Egalitarian Redistribution*. 2006.
- Bordo, Michael D., Barry Eichengreen, and Jongwoo Kim (1998). *Was There Really an Earlier Period of International Financial Integration Comparable to Today?* NBER Working Papers 6738. National Bureau of Economic Research, Inc, Sept. 1998.
- Brownlee, W. Elliot (2004). *Federal Taxation in America: A Short History*. Second. New York: Cambridge University Press, 2004.
- Coghlan, T. A. (1904). *A Statistical account of Australia and New Zealand, Volume 10, Parts 1902-1903*. Sydney: Government of the State of New South Wales and the Commonwealth of Australia, 1904.
- Collier, Ruth Berins (1999). *Paths Toward Democracy: the Working Class and Elites in Western Europe and South America*. New York: Cambridge University Press, 1999.
- Crouch, Colin (1993). *Industrial Relations and European State Traditions*. Oxford: Oxford University Press, 1993.
- Cusack, Thomas and Pablo Beramendi (2006). "Taxing Work". In: *European Journal of Political Research* 45.1 (2006).
- Cusack, Thomas R., Torben Iversen, and David Soskice (2007). "Economic Interests and the Origins of Electoral Systems". In: *American Political Science Review* 101.3 (2007).
- Daunton, Martin (2001). *Trusting Leviathan: The Politics of Taxation in Britain, 1799-1914*. New York: Cambridge University Press, 2001.
- (2002). *Just Taxes: The Politics of Taxation in Britain, 1914-1979*. New York: Cambridge University Press, 2002.
- Flora, Peter and Jens Alber (1983). *State, economy, and society in Western Europe 1815 - 1975. a data handbook in 2 volumes- 1*. Frankfurt am Main: Campus Verlag [u.a.], 1983.
- Forster, Clive (1975). "Federation and the Tariff". In: *Australian Economic History Review* 17 (1975), pp. 95–116.
- Ganghof, Steffen (2006). "Tax mixes and the size of the welfare state: causal mechanisms and policy implications". In: *Journal of European Social Policy* 15.4 (2006).

- Ganghof, Steffen (2007). “The Political Economy of High Income Taxation: Capital Taxation, Path Dependence and Political Institutions in Denmark”. In: *Comparative Political Studies* 40.9 (Sept. 2007).
- Gourevitch, Peter (1978). “The second image reversed: the international sources of domestic politics”. In: *International Organization* 32 (1978), pp. 881–912.
- (1986). *Politics in Hard Times: Comparative Responses to International Economic Crises*. Ithaca: Cornell University Press, 1986.
- Hays, Jude C. (2003). “Globalization and Capital Taxation in Consensus and Majoritarian Democracies”. In: *World Politics* 56.1 (Oct. 2003), pp. 79–113.
- Hiscox, Michael J. (2001). “Class versus industry cleavages: Inter-industry factor mobility and the politics of trade”. In: *International Organization* 55.1 (2001).
- (2002). *International Trade and Political Conflict: Commerce, Coalitions, and Mobility*. Princeton: Princeton University Press, 2002.
- Irwin, Douglas A (1994). “The Political Economy of Free Trade: Voting in the British General Election of 1906”. In: *Journal of Law & Economics* 37.1 (Apr. 1994), pp. 75–108.
- Irwin, Douglas A. (1997). *Higher Tariffs, Lower Revenues? Analyzing the Fiscal Aspects of the “Great Tariff Debate of 1888”*. NBER Working Papers 6239. National Bureau of Economic Research, Inc, 1997.
- Irwin, Douglas A. (2006). *The Impact of Federation on Australia’s Trade Flows*. NBER Working Papers 12160. National Bureau of Economic Research, Inc, 2006.
- Iversen, Torben and David Soskice (2009a). “Distribution and Redistribution: The Shadow of the Nineteenth Century”. In: *World Politics* 61.3 (2009).
- (2009b). “Two Paths to Democracy”. In: (2009).
- Kato, Junko (2003). *Regressive Taxation and the Welfare State: Path Dependence and Policy Diffusion*. Cambridge: Cambridge University Press, 2003.
- Kidner, Richard (1982). “Lessons in trade union law reform: the origins and passage of the Trade Disputes Act 1906”. In: *Legal Studies* 2 (1 Mar. 1982).

- Knibbs, G. H. (1915). *Year Book Australia*. Melbourne: Australian Bureau of Statistics, 1915.
URL: <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/1301.0Main+Features11915?OpenDocument>.
- Lehmann, Sybille and Oliver Volckhart (2010). “The Political Economy of Agricultural Protection: Sweden 1887”. In: *European Review of Economic History* 15 (2010), pp. 29–59.
- Lindbeck, Assar (1974). *Swedish Economic Policy*. Berkeley: University of California Press, 1974.
- Lindert, Peter H. (2004). *Growing Public: Social Spending and Economic Growth Since the Eighteenth Century*. Cambridge: Cambridge University Press, 2004.
- Lloyd, Peter (2007). “100 Years of Tariff Protection in Australia”. In: 1023 (Dec. 2007).
- Loveday, P., A. W. Martin, and R. S. Parker (1977). *The Emergence of the Australian party system*. Sydney: Hale and Iremonger, 1977.
- Luebbert, Gregory M. (1991). *Liberalism, Fascism and Social Democracy*. New York: Oxford University Press, 1991.
- Mankiw, N. Gregory, Matthew Weinzierl, and Danny Yagan (2009). “Optimal Taxation in Theory and Practice”. In: *Journal of Economic Perspectives* 23.4 (2009), pp. 147–74.
- Martin, Cathie Jo and Duane Swank (2011). “Gonna Party Like it’s 1899: Party Systems and the Origins of Varieties of Coordination”. In: *World Politics* 62.1 (Apr. 2011), pp. 78–114.
- Martin, Isaac W. (2010). “Redistributing toward the Rich: Strategic Policy Crafting in the Campaign to Repeal the Sixteenth Amendment, 1938-1958”. In: *American Journal of Sociology* 116.1 (July 2010), pp. 1–52. DOI: 10.1086/653597. URL: <http://dx.doi.org/10.1086/653597>.
- Martin, Isaac William, Ajay K. Mehrotra, and Monica Prasad (2009). *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective*. New York: Cambridge University Press, 2009.
- Meadwell, Hudson (2002). “The Political Economy of Tariffs in Late Nineteenth Century Europe: Reconsidering Republican France”. In: *Theory and Society* 31.5 (Oct. 2002), pp. 623–652.
- Meltzer, Allan and Scott F. Richard (1981). “A Rational Theory of the Size of Government”. In: *Journal of Political Economy* 89.5 (1981).
- Mills, Stephen (1925). *Taxation in Australia*. London: Macmillan, 1925.

- Morgan, Kimberly and Monica Prasad (2009). “The Origins of Tax Systems: A French-American Comparison”. In: *American Journal of Sociology* 114.5 (2009).
- Murray, Bruce K. (1973). “The Politics of the People’s Budget”. In: *The Historical Journal* XVI.3 (1973).
- Nye, John Vincent (1991). “The myth of free-trade Britain and fortress France”. In: *Journal of Economic History* 51.1 (1991), pp. 23–46.
- Orloff, Ann Shola and Theda Skocpol (1984). “Why Not Equal Protection? Explaining the Politics of Public Social Spending in Britain, 1900-1911, and the United States, 1880s-1920”. In: *American Sociological Review* 49 (1984), pp. 726–750.
- O’Rourke, Kevin H. and Jeffrey G. Williamson (1999). *Globalization and history: the evolution of a nineteenth century Atlantic economy*. Cambridge: MIT Press, 1999.
- Owen, Stephen Walker Jr (1982). “The Politics of Tax Reform in France, 1906-1926.” PhD thesis. University of California, Berkeley, 1982.
- Patterson, Gordon D. (1968). *The tariff in the Australian colonies 1856-1900*. Melbourne: F. W. Cheshire, 1968.
- Powell, David (1986). “New Liberalism and the Rise of Labour, 1886-1906”. In: *The Historical Journal* 29.2 (June 1986), pp. 369–393.
- Prasad, Monica and YingYing Deng (2009). “Taxation and Worlds of Welfare”. In: *Socio-Economic Review* 7 (2009).
- Åberg, Martin (2011). *Swedish and German Liberalism: From Factions to Parties 1860-1920*. Lund: Nordic Academic Press, 2011.
- Rickard, John (1976). *Class and politics : New South Wales, Victoria and the early Commonwealth, 1890-1910*. Canberra: Australia National University Press, 1976.
- Rodrik, Dani (1998). “Why Do More Open Economies Have Bigger Governments?” In: *Journal of Political Economy* 106.5 (1998), pp. 997–1032.
- Russell, Alan K. (1973). *Liberal landslide: the general election of 1906*. Newton Abbot: David and Charles, 1973.

- Sawyer, Charles (1949). *Historical Statistics of the United States, 1789-1945. A Supplement to the Statistical Abstract of the United States*. Department of Commerce: Bureau of the Census, 1949.
- Scheve, Kenneth and David Stasavage (2009). "Institutions, Partisanship and Inequality in the Long Run". In: *World Politics* 61.2 (2009).
- (2010). "The Conscription of Wealth: Mass Warfare and the Demand for Progressive Taxation". In: *International Organization* 64 (2010), pp. 529–561.
- Seligman, Edwin R. A. (1913). *The Income Tax. A study of the history, theory and practice of income taxation at home and abroad*. New York: Macmillan, 1913.
- Smith, Michael Stephen (1977). "Free Trade Versus Protection in the Early Third Republic: Economic Interests, Tariff Policy, and the Making of Republican Synthesis". In: *French Historical Studies* 10.2 (1977), pp. 293–314.
- (1980). *Tariff Reform in France, 1860-1900: The Politics of Economic Interest*. Ithaca: Cornell University Press, 1980.
- Steinmo, Sven (1993). *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State*. New Haven: Yale University Press, 1993.
- Swank, Duane (1998). "Funding the Welfare State: Globalization and the Taxation of Business in Advanced Market Economies". In: *Political Studies* XLVI (1998), pp. 671–692.
- Swank, Duane and Sven Steinmo (2002). "The New Political Economy of Taxation in Advanced Capitalist Democracies". In: *American Journal of Political Science* 46.3 (July 2002), pp. 642–655.
- Timmons, Jeffrey (2010). "Taxation and Credible Commitment: Left, Right and Partisan Turnover". In: *Comparative Politics* 42.2 (2010), pp. 207–227.
- Trentmann, Frank (1998). "Political culture and political economy: interest, ideology and free trade". In: *Review of International Political Economy* 5.2 (1998), pp. 217–251.
- Verdier, Daniel (1994). *Democracy and International Trade: Britain, France and the United States, 1860-1990*. Princeton: Princeton University Press, 1994.
- Verney, Douglas (1972). "The Foundations of Modern Freedom: The Swift Rise and Fall of Swedish Liberalism". In: *Political Studies* 20.1 (1972), pp. 42–59.

Wilensky, Harold (2002). *Rich Democracies: Political Economy, Public Policy, and Performance*.

Los Angeles: University of California Press, 2002.

Wright, Julian (2005). "Social Reform, State Reform and Aristide Briand's Moment of Hope in France, 1909-1910". In: *French Historical Studies* 28.1 (2005), pp. 31-67.

Tables and Figures

Table 1: The impact of trade on taxation: revenue and political mechanisms

		Revenue impetus towards direct taxation	
		Strong	Weak
Political opportunities for direct tax advocates	Strong	Strong movement towards direct taxation: structure likely progressive, revenue yield likely high <i>UK</i>	Some movement towards direct taxation: structure likely progressive, but revenue yield likely low <i>Australia</i>
	Weak	Some movement towards direct taxation: high yield likely, but structure not highly progressive <i>Sweden</i>	Little impetus towards direct taxation <i>France</i>

Table 2: Direct taxation as a share of total revenues. Source: Coghlan (1904); Flora and Alber (1983); Knibbs (1915); Sawyer (1949).

	1881	1897	1902-3	1913-14
France	0.22	0.25	0.26	0.17
Sweden	0.21	0.11	0.21	0.22
Australian Commonwealth ^a	0.22	0.15	0.14	0.28
New South Wales ^b	0.22	0.31	0.11	0.51
Victoria ^b	0.25	0.22	0.18	0.48
United Kingdom	0.29	0.37	0.44	0.46
United States ^b			0.46	0.49
Netherlands	0.37	0.42	0.41	0.41
Italy	0.38	0.39	0.37	0.29
Denmark	0.25	0.20	0.18	0.26
Belgium	0.29	0.25	0.31	0.25
Germany ^c	0.00	0.00	0.00	0.03
Switzerland ^c	0.06	0.04	0.04	0.02

a. Total federal, state and local taxation. Given the relative size of the subnational governments this figure mainly reflects the dominance of property taxation in the state and local tax bases.

b. Figures for Australian colonies are direct tax revenues divided by state tax revenues plus the commonwealth subsidy

c. Central government revenues only

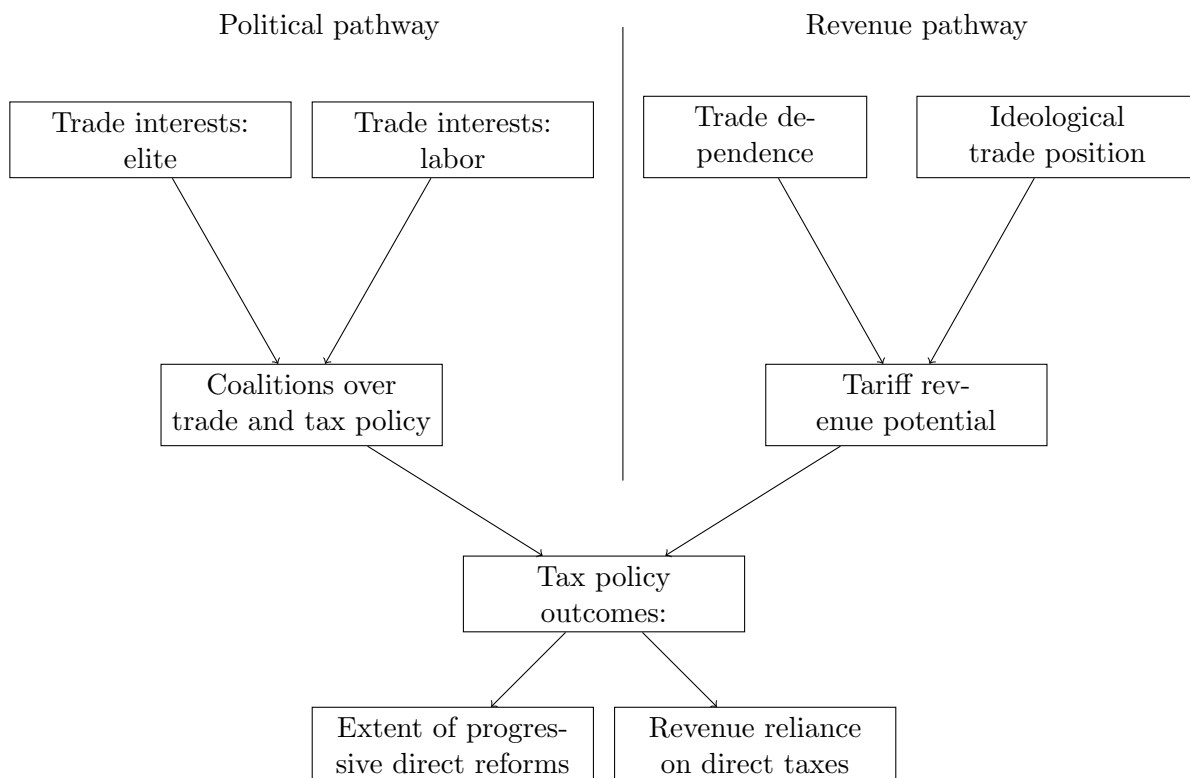


Figure 1: The impact of trade on tax policy outcomes: two paths of influence

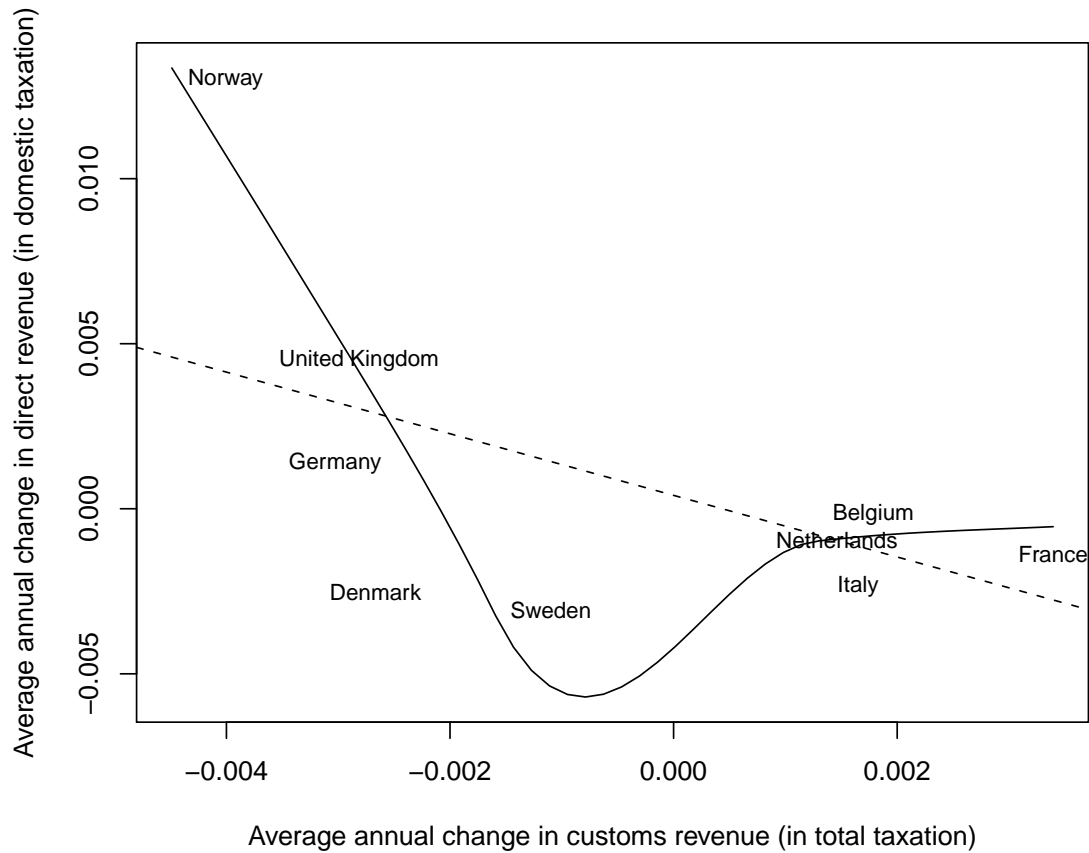


Figure 2: Direct taxation and customs revenues. Direct taxation is measured as a share of central government revenues from domestic sources, customs revenues as a share of central tax revenues. The dashed regression line has a slope of -0.9 (standard error = 0.5, p -value = 0.14). Source: Author's calculations, Flora and Alber et al., 1983.