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How the New Deal Soaked the Rich, Middle Class, and Poor

by Jim Powell

The New Deal was paid for mainly by the middle class and the poor. This was because excise taxes were the biggest revenue generators for the federal government. They applied to beer, liquor, cigarettes, chewing gum and other cheap pleasures enjoyed disproportionately by the middle class and the poor. Until 1936, excise taxes generated more revenue than the federal personal income tax and the federal corporate income tax combined. Not until 1942 — in the middle of World War II — did the federal personal income tax become the biggest revenue generator for the federal government.

FDR pushed for higher excise taxes during his hallowed first Hundred Days. First came liquor excise taxes. Congress had already (February 20, 1933) passed a bill to repeal federal prohibition of alcohol in 19 states without Prohibition laws, and when this bill was ratified by the states, Washington would immediately begin to collect liquor excise taxes — those taxes had never been eliminated.

To raise even more money from the sale of alcoholic beverages, FDR secured passage of the Beer-Wine Revenue Act on March 22, 1933. The following year, on January 11, 1934, Congress passed the Liquor Taxing Act which nearly doubled the excise tax on distilled liquor from \$1.10 per gallon to \$2, and the wine excise tax was substantially increased as well. In addition, there was a \$5 per gallon tariff on imported alcoholic beverages, and FDR wasn't about to eliminate that. Besides liquor excise taxes, FDR raised excise taxes on tobacco and gasoline.

There were more taxes during the Hundred Days. The National Industrial Recovery Act imposed a 5 percent tax on corporate dividends, and it reduced deductions for business and capital losses. The Agricultural Adjustment Act added a tax on food processors like millers which ground wheat into flour, and there were special punitive taxes on farmers who produced more than the government permitted; for instance, 33-1/2 percent of the value of tobacco above quota and 50 percent of the value of cotton above quota was taxed. Finally for 1933, there was a 5 percent tax on corporate net income above 12 percent of a corporation's capital stock.

All this was just for openers. The Revenue Act of 1934 raised taxes on people making more than \$9,000. In addition, there wasn't any provision for carrying forward net losses to future years — while FDR wanted to share in everybody's capital gains, he didn't want to share their losses. FDR increased the estate tax to 60 percent. And as if FDR hadn't learned anything from Hoover's disastrous experience with the Smoot-Hawley tariff, the Revenue Act of 1934 introduced tariffs on coconut and other oils imported from the Philippines (a goody for farm lobbyists).

In his January 1935 budget message, FDR had promised that there wouldn't be any new taxes, but on July 19, 1935, he suddenly demanded new taxes. He expressed his view that the Great Depression was somehow caused by private wealth:

The disturbing effects upon our national life that come from great inheritances of wealth and power can in the future be reduced, not only through the method I have just described, but through a definite increase in the taxes now levied upon very great individual net incomes.

Accordingly, FDR proposed raising the top rate to 75 percent, compared with Hoover's top rate of 63 percent. In addition, FDR declared, "Great accumulations of wealth cannot be justified.... I recommend, therefore, that in addition to the present estate taxes, there should be levied an inheritance, succession, and legacy tax."

The Revenue Act of 1935 didn't prove to be very effective at raising federal revenue or redistributing the wealth. But it did send a clear signal to employers and investors that they were under attack. Such taxes encouraged them to conclude that they would be foolish to put their money at risk.

Then in 1936 FDR signed into law a graduated undistributed profits tax that penalized companies for building up savings essential for investment. Companies that retained 1 percent of their net income would see 10 percent of it taxed away. Companies that retained 70 percent of their net income would see 73.91 percent of it go to the government. Internal Revenue Service Commissioner Guy Helvering described the purpose of undistributed profits tax rather delicately: "the Federal government shall not be unreasonably and inequitably deprived of necessary revenues."

In his study *The Undistributed Profits Tax*, economist Alfred G. Buehler warned that the new levy would discourage businesses from making investments. "To the extent that the undistributed profits tax deprived business of funds needed for expansion," he wrote, "it will slow up business improvement, dampen the spirits of businessmen, and tend to reduce the long-run profits of business."

FDR demonized investors and employers as "economic royalists" and "privileged princes." Opinion surveys of private sector employers suggested widespread fear of the federal government because of FDR's policies. An American Institute of Public Opinion poll reported that

a majority of employers anticipated more government control of the economy in the future. In a November 1941 *Fortune* poll, 93 percent of employers said they expected their property rights to be undermined, and there could be a dictatorship.

It was no wonder that as Robert Higgs has pointed out, investment was at historic lows during the 1930s. Without investment, it was virtually impossible to create new jobs. Economist Lester Chandler observed, “The failure of the New Deal to bring about an adequate revival of private investment is the key to its failure to achieve a complete and self-sustaining recovery of output and employment.”

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This article was originally published in March 2009.