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Communications

R. M. Haig: Pioneer Advocate of Expenditure Taxation?

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I. *Introduction*

For more than a decade, there has been a great debate in the profession concerning the proper base for personal and business taxation. This debate has focused on the choice of the "income" base versus the "expenditure" (or consumption) base. The concept of "income" used in these debates is a comprehensive accretion measure often referred to as "Haig-Simons" income, after the work of Robert M. Haig (1921) and Henry C. Simons (1938). This is the standard concept of income that has been used (with several variations) in tax policy analysis in the postwar period. However, it appears not to be widely recognized that, although Haig did ultimately settle on accretion income as the best feasible tax base, he definitely saw this as a second-best measure of "true" income. As will become clear, reexamination of Haig's famous article reveals that Haig actually felt that *consumption* expenditure would be a better measure of "true" income than accretion income, and he would have preferred a tax on this base—that is, he preferred what today would be called a *consumption tax*. He felt that the consumption tax would be *infeasible*, but not *undesirable*. Thus, I shall argue that it is basically inaccurate to include Haig among those who favor "Haig-Simons" income as an *ideal* tax base, or to refer to accretion income as "Haig-Simons" income. In this note, I review in some detail the crucial opening pages of the original paper by Haig (1921) in order to verify this interpretation of Haig's work. In the light of current controversies and the long association of Haig's name with the accretion income approach, it is quite startling to find him making explicit statements favoring the use of consumption as the proper base for taxation.

To put Haig into proper context and to provide a framework for the following discussion, a capsule summary of the debate over income and consumption taxation is helpful. As anyone who has read an undergraduate public finance text in the past 30 or so years will know, a traditional concept of income measurement for income tax purposes is "comprehensive income," a.k.a. "Haig-Simons income," "Schanz-Haig-Simons income," or "accretion income."[1]

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[1] The references on this income concept are practically innumerable. For a few examples, see Alan Auerbach (1987), George Break and Joseph Pechman (1975), Richard Goode (1976, 1977), Richard Musgrave (1959), Pechman (1977), Carl Shoup (1969), Stanley Surrey (1973), and William Vickrey (1947). As Musgrave (1989, p. 6) has recently noted, the concept of accretion income "became the bible of income tax reformers, extending through the decades of the 1950s, 1960s, and 1970s, on into the recent U.S. tax reform of 1986." Shoup (1984) discusses the 1896 article by Georg Schanz and assesses its impact

This is usually defined to be the total accretion of property rights from all sources to an individual over a period of time, regardless of whether these rights are exercised to support current consumption (C) or whether they are used instead to augment the taxpayer's stock of wealth (ΔNW). Thus, "accretion income" (the term that will be used for this concept for the remainder of this essay) Y is defined to be

$$Y = C + \Delta NW.$$

A long line of very influential public finance economists have advocated using accretion income as the base for personal income taxation, and it can be regarded as the "textbook" standard at least for the period up to the mid-1970s. However, advocates of "consumption" or "expenditure" taxation have argued instead that C would be a preferable tax base. The choice between the two, as both sides would acknowledge, depends on a host of considerations, including primarily the equitability of each, their implications for efficiency of resource allocation, and their ease of administration and enforcement.

A consideration of the actual merits of each of these viewpoints need not detain us here. For our purposes, the problem is simply to determine where Haig stands on the issue. We shall see that Haig felt (like Irving Fisher, and in contrast to Simons) that C is a better measure of "true income" than Y, and that an "income" tax would ideally tax C.

II. *Haig on "Income" Measurement*

Let us turn now to the text of Haig's famous article. To begin with, it must be conceded that Haig, on page 7 of his essay, did indeed articulate a concept that all today would recognize as accretion income. In a passage that has been repeatedly quoted, he wrote:

> Income is the *money value of the net accretion to one's economic power between two points of time.* (1921, p. 7. Emphasis in original)

In the notation introduced above, this statement can be rephrased as "income = Y." However, for Haig (and in contrast to Simons, writing in 1938), this is not an ideal tax base that has been derived from first principles. Quite the contrary, it is the result of a series of compromises that Haig felt obliged to make on practical grounds, and that he seems to have made with some reluctance. Indeed, the first part of his article, leading up to this celebrated passage, is devoted to the conceptual foundations of income measurement, and throughout this discussion Haig is generally unsympathetic to the accretion income concept. He writes:[3]

> Modern economic analysis recognizes that fundamentally income is a flow of satisfactions, of intangible psychological experiences. If one receives a dollar he receives something which he ordinarily can and does spend—perhaps for a dinner. Is his income the dollar, or is it the dinner [itself], or is it . . . the satisfaction of his wants which he derives from eating the dinner? If one spends his dollar for something more durable than a dinner—say a book or a pipe—is his true income the book or the pipe, or the series of satisfactions or "usances" arising from reading the book or smoking the pipe? *There is no doubt as to the answer to these questions. A man strives for the satisfaction of his wants and desires and not for objects for their own sake.* (1921, p. 2. Emphasis added)

on thought in the U.S.; Musgrave (1989) also comments on Schanz and the currents of German nineteenth century thought leading up to his work. Robert Eisner (1989) has recently discussed "Hicks-Haig-Simons income" in connection with the general problem of income measurement for economic analysis (as opposed to the narrower problem of measuring income for tax purposes).

[2] The advantages and disadvantages of the income and expenditure tax bases have been discussed for many years. However, interest in this issue intensified markedly in the mid-1970s, beginning, say, with the publication of the U.S. Treasury's *Blueprints for Basic Tax Reform* in 1977 (reprinted in David Bradford 1984). However, the debate has hardly been confined to the U.S. Another landmark contribution, for example, was the Meade report in the U.K. in 1978 (Institute for Fiscal Studies 1978), and a government-sponsored study supporting consumption taxation appeared in Sweden in 1976. (The study appears in an English version in Sven-Olaf Lodin 1978.) The subsequent discussion has been voluminous. See, for just a few examples, Henry Aaron and Harvey Galper (1985), Aaron, Galper, and Pechman (1988), Robin Boadway, Neil Bruce, and Jack M. Mintz (1987), Bradford (1986), Robert Hall and Alvin Rabushka (1985), Pechman (1980), and Charls Walker and Mark Bloomfield (1987). Most of these publications present comparisons of the accretion income base with the consumption tax base.

[3] The opening pages of Haig's essay will be quoted extensively in what follows.

In modern terminology, then, income is the flow of utility from current consumption. Haig is quick to buttress this view of income with citations and references (pp. 2–3 of his essay) to what he regards as the economic authorities of the day: Taussig, Ely, Seligman, Marshall,[4] and, perhaps most notably in view of subsequent controversy, Irving Fisher.[5]

Practical considerations intrude, however:

> [T]he economist, while recognizing all this, realizes that before he can proceed far with his analysis . . . he must arrive at something more definite and more homogeneous—less diaphanous and elusive than these psychic satisfactions. . . . The usances and satisfactions and the goods and services which are of significance to the economist in his analysis are those which are susceptible of evaluation in terms of money. (1921, pp. 3–4)

Nonetheless, compromises on the fundamental principles of income measurement are to taken only with caution:

> It should be carefully noted . . . that, first, when one abandons "usances" and satisfactions and substitutes the goods and services yielding these satisfactions, he is taking a step away from the fundamentals . . . ; and second, *if one takes the next step, as most income tax laws do . . . , and substitutes money received during a period in place of goods of services used, as the content of the term income, he has really moved a very appreciable distance from the fundamental conception, for . . . everyone is, in effect, considered to be in receipt of his income when he gets the money with which to buy the goods and services which will yield the usances and satisfactions which go to make up his true income. Indeed, the purchase of the goods and services may, of course, be postponed indefinitely.* (1921, pp. 4–5. Emphasis added)

Haig (1921, p. 5) now quotes Ely to eliminate any possible ambiguity:

> Money income should, perhaps, refer to the value of the goods consumed and the services enjoyed, although in popular speech and by many economists the word is used in the literal sense of the net amount of money that comes in, whether it is spent for enjoyable things or is saved.

On the basis of these comments, there is no doubt about what Haig regards as the most meaningful economic definition of income. To put the above discussion into more modern language, Haig assumes that each taxpayer is endowed with a utility function $U(\cdot)$ that is an increasing function of the flow of current consumption services from food, books, pipes, and so on. It is the flow of utility that constitutes true income. It is necessary to resort to a monetary measure of income for practical purposes, however, and this would ideally be the value of the flow of current consumption services C. Haig notes with regret that C does not correspond to income as it is typically measured in practice: "[W]hen taxable income is identified with money received in a given period two approximations have been introduced, each of which involves anomalies and inequalities as between members of the same class ostensibly on equal terms" (p. 5). As we would now say, income when measured ("as most income tax laws do") as something like Y rather than C—or, ideally, $U(C)$—involves *horizontal inequities!*

A puzzle now presents itself. Haig ranks utility as the best possible tax base, and consumption expenditures as the next best. How is it then that he ends up with the concept of accretion income that was presented in the first quotation above, and that has ever since been associated with his name? The answer is that Haig simply felt that a tax on utility or on consumption expenditures was impractical. To begin with, he recognizes (p. 5) that utility is not a suitable metric for a tax base:

> Who, for instance, would seriously defend the proposition that taxes should be apportioned according to the capacity for appreciation rather than according to the capacity to command the goods and services which are appreciated?

No modern reader would dispute this point, at least in the broad sense that everyone would agree that a workable tax base must be ex-

[4] According to Haig, "[e]ven in England . . . modern economists recognize the validity of the analysis set forth above." Haig appears to have thought it remarkable that there should be transatlantic agreement about the concept of income.

[5] It is well known, of course, that Fisher defined *income* to be what we would today call *consumption* (i.e., C). Irving and Herbert Fisher (1942) argue for what we now call *consumption taxation*, and, interestingly, cite Haig as a supporter of accretion income taxation. See Footnote 9 below.

pressed in monetary units rather than utils.[6] Haig now makes a crucial further leap. He assumes not only that it is impossible to measure the flow of utility $U(C)$, but also that the flow of consumption services C cannot be measured. Because of this, he argues that one must in practice fall back on the accretion income tax base Y. Haig does not actually address the question of measurement of consumption expenditures, but simply takes it for granted that this is administratively impracticable. In this, he precedes many commentators who, down until relatively recent times, felt that direct measurement of C was impossible and that this would render a consumption tax infeasible. Haig now attempts to downplay the damage that this compromise does to the tax system. He writes:

> [T]wo persons who receive precisely equal amounts of money-income may receive very unequal amounts of goods and services . . . [if] one has postponed spending a larger portion of his money than the other. . . . *No great harm is done if the person who postpones spending his money is taxed upon it when he receives it rather than when he spends it.* (1921, p. 5. Emphasis added)

In short, while the C base is closer to the theoretical ideal, it is a matter of comparatively small consequence if one instead falls back on the Y base for practical purposes! This part of Haig's argument, which is offered in a rather apologetic fashion, is unacceptable to all modern commentators on taxation, because it amounts to the assertion that the distinction between the consumption and accretion income tax bases is not a very important one. Both accretion income tax advocates and supporters of consumption taxation would at least agree that it really does make a difference which base one chooses.

Thus, on the practical grounds of feasibility, Haig has now decided to sacrifice his preferred consumption base for the accretion income base. A few more paragraphs bring us to the famous definition of accretion income quoted at the outset. Even after stating the accretion definition, however, Haig is reluctant to let the reader go without a cautionary reminder of the nature of the compromise that has just been made:[7]

> It will be observed that this definition departs in only one important respect from the fundamental economic conception of income. . . . It has the effect of taxing the recipient of income when he receives the power to attain satisfactions rather than when he elects to exercise that power. . . . It will be readily agreed that this definition . . . constitutes, then, the closest practicable approximation of true income. It coincides very closely indeed with the flow of economic "usances" and satisfactions expressed in terms of money, *which all economists agree constitutes the thing after all we are trying to measure.* (1921, p. 7. Emphasis added)

It should be clear from this quotation, and from the other quotations already given, that Haig is *not* fully satisfied with the accretion concept of income that he has just defined in his famous and widely quoted passage. On the contrary, he is explaining that while accretion income may be the best that one can do as a practical matter, it does differ in one—and *"only one"*—important respect from the ideal tax base: that is, to put it in modern terms, it departs from a pure consumption tax base in the direction of accretion income!

On the basis of this evidence, there seems

[6] Concern about "capacity for appreciation" is still reflected in the structure of deductions and exemptions, however. There seems to be substantial support for deductions or exemptions based on family size, blindness, old age, medical expenses, and so on. These can be interpreted as adjustments for the ability of different taxpaying units to enjoy income.

[7] Contrast this quotation with Richard Goode (1977, p. 8) who writes that Haig "emphasized that the definition [of income] is in terms of the power to satisfy economic wants rather than the satisfactions themselves and pointed out that this means that income is received when the power is obtained and not when it is exercised. This is to say, income includes savings as well as consumption." Goode's comments accurately characterize the accretion concept that Haig finally settled on, and are a good example of the prevailing interpretion of Haig. However, it is clear from the quotation here that Haig did *not* wish to include savings in income, and *did* want to tax the power to satisfy wants *only* when it was exercised. In connection with this quotation, it should be noted that some writers have argued that the accumulation of wealth brings pleasure in its own right and should therefore be taxable as a flow of consumption services. Whatever the merits of this view, it seems clear from the present excerpt that Haig is unsympathetic to it.

to be no doubt that Haig prefers the consumption base C to the accretion income base Y. He is convinced that the C base is impracticable, however, and believes that it is reasonable to fall back on the Y base because it is not a bad approximation—about the best that one could do—to the C base. It is rather ironic that Haig felt compelled to move toward accretion income taxation and away from consumption taxation because of "practical" administrative concerns. As modern discussions (e.g., William Andrews 1974 and Bradford 1986) have made clear, one of the attractive features of a consumption tax is precisely the simplifications that it would allow in its practical implementation.[8]

The above quotations have shown that Haig should not be included among those who, as a matter of principle, advocate accretion income taxation as against consumption taxation. Just as Keynes may not have been a Keynesian, so, on the evidence of his most celebrated publication, Haig should not be classified as a supporter of "Haig-Simons" accretion income taxation, except on the second-best ground of administrative feasibility: Haig would appear not to be a "Haigian."[9]

[8] Economists who favor accretion income taxation would not necessarily agree that a consumption tax dominates the income tax on administrative grounds. Nonetheless, as Andrews, Bradford, and others have shown, there are serious administrative complications for income taxation even in the best of circumstances, most of them arising from the inherent difficulty of keeping track of *comprehensive* net capital income on an accrual basis. The consumption tax base is at least free of some of these very formidable and *inherent* problems.

[9] It appears that the Haig of later years, as opposed to the Haig of 1921, may indeed have been a Haigian. In a personal communication, Professor Carl Shoup shares the following memories:

> Irving Fisher invited Haig and me to lunch in downtown New York a couple of times in the 'thirties, trying to persuade Haig that the income base was unneutral (between saving and consumption). Haig seemed unimpressed; at least, he showed no sign of abandoning the accretion concept in favor of consumption.

Apparently, Haig became increasingly committed in later years to the accretion income concept despite Fisher's efforts to win him over, or back, to consumption taxation. As we have seen, however, it appears that Haig's preference for accretion income (at least as of 1921) was based entirely on administrative considerations, not fundamental principles.

III. *Conclusion*

There is obviously considerable confusion in the literature about what Haig thought the ideal tax base should be. As nearly as I have been able to determine, all writers in public finance who have mentioned Haig have described him as a supporter of the accretion income concept or at least have associated him with this doctrine. Haig is mentioned as such in the leading textbooks on the subject and in a wide range of other writings.[10] This reflects a tradition which seems to go back as far as Simons (1938), who cites Haig as a supporter of the accretion income concept. Even writers on the history of income taxation, such as Harold Groves (1974), inevitably cite Haig as one of the original developers of the concept of accretion income. The fact that Haig viewed the income tax base as fundamentally inferior to the consumption tax base seems not to have been recognized in any previous writings on the subject.

The term *Haig-Simons income* may by now be a permanent part of the professional lexicon. Whether it is or not may be a matter of indifference to most economists. Operationally speaking, it may matter little for the way that public finance discourse and research is conducted whether or not Haig's article really argued in favor of accretion income as the tax base. Nonetheless, it comes as quite a shock for a modern reader of Haig to discover his obvious preference for the consumption tax base over accretion income. Furthermore, the record of thought in the 1920s should be of particular interest today. The income tax system that has evolved since 1913 has become a topic of constant controversy among policy makers, the public, and the profession. How did we come to think of income taxation in the way that we do? When scholars and policy makers laid the foundations of our current tax regime, what fundamental principles guided their actions? They had to come to grips with the problem of income measurement in a way that had not previously been necessary, and the decisions that they made and the views that they expounded have had a profound impact on the theory and practice of taxation in this century. It is impor-

[10] Most of the references in Footnotes 1 and 2 above refer to Haig in this way, for example. It would not be difficult to find dozens of specific citations.

tant to disentangle the extent to which these views and policies were based on compelling economic principles, administrative convenience, error, insight, or inertia.

Considering the published record of Haig's thought, it is strange that his name should be continually associated with the concept of accretion income taxation. Above all, it is richly ironic that Haig's preferred tax, the consumption tax (or close relatives thereof), should today be the main rival, in policy debates, to "Haig-Simons" income taxation. A revision of the customary terminology appears to be in order.

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