

# The Forgotten Henry Simons

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FSU Law School Tax Conference, March 1, 2013

# Why Henry Simons?

Why discuss him at a “100 years of the income tax” conference?

- 1) He's important,
- 2) He's interesting,
- 3) We broaden our minds by looking at “then versus now.”

Of particular interest to me in this paper:

- 1) How could he have been both “severely libertarian” and in favor of “drastic progression”?
- 2) Income tax vs. consumption tax: Where did he stand and why; how have the considerations that he relied on changed since the early 1940s?

# Simons' early career

Born 1899, ambitious upper middle class family, economic reverses sent him to U. Michigan instead of elite Eastern private college.

Planned to be a lawyer, got interested in economics, followed Frank Knight from Iowa to the U of Chicago Economics Dep't in 1927.

Disastrous early career: “2 book reviews in 12 years,” “openly insolent” to students who asked questions. George Stigler: “brilliance” and a “capacity for boredom ... marked his entire life.”

June 1933: hatred of the New Deal (though also of the Hoover Admin) drove him to speak out “for the first time in my life, as an extreme conservative” and “exponent of ... nineteenth century liberalism.”

In short, this knight-errant came out to do battle on behalf of “laissez-faire” at the precise moment of its all-time U.S. low-water mark.

# The “two Henry Simons” (??)

His best-known work during his life was *A Positive Program for Laissez-Faire* (1934), the follow-up to his 1933 speeches.

Its theme: the great evil in our society is monopolistic price-fixing, along with “excessive political interference with relative prices.”

Centralized price controls were oppressive, created political warfare between powerful groups that would set the stage for totalitarianism (cf. Hayek, *Road to Serfdom* (1946)), and had caused the Great Depression.

A far cry from the Simons who, in *Personal Income Taxation* (1938) calls for “drastic progression” because inequality is “evil or unlovely”??

Not according to Simons, who discusses income taxation (to similar effect) in the *Positive Program*, which he then cites in *Personal Income Taxation* as the best account of his broader program.

# Finishing the biography

Un-fireable yet un-tenurable in the Econ Dep't, Simons was “thrust” on the U of Chicago Law School by President Hutchins. A huge success there, gregarious, many disciples, became the “prime architect” or “Crown Prince” of Chicago-school law and economics (according to many of those whom we today regard as the founders).

Pioneered & encouraged the use of economic analysis to question the basic premises behind interventionist programs (e.g., minimum wage, securities regulation, pro-union labor laws).

Teamed up with Hayek to convert proposed donor funding for a cartoon version of *Road to Serfdom* into \$\$ for a 5-year Free Market Study at U Chicago, to be headed up by his close friend Aaron Director.

University approval required, as Director wanted a promise of tenure.

In June 1946, such approval was denied; Simons died the next day from an overdose of sleeping pills.

# Was Simons actually a libertarian?

Not in the modern philosophical sense (Nozick, etc.) of rejecting consequentialism &/or viewing certain rights as absolute.

But that would have been anachronistic. Was Milton Friedman also a “closet leftist” (as anarcho-libertarian Walter Block calls Simons)?

But there are also 2 further grounds for challenging Simons’ libertarian or pro-free market credentials (however sincerely claimed):

(1) As Ronald Coase complained in the early 1980s, his economic views were way too “interventionist” for today’s free marketeers.

(2) His support in tax policy for “drastic progression” – often treated as wholly separate from his economic program, but this contradicts Simons’ own view.

# Simons' "interventionism"

His "sins," by later Chicago school / pro free market lights, include his supporting:

- (1) "outright dismantling of our gigantic corporations," to be enforced by rules setting gross asset limits.
- (2) strict limits on corporate capital structure – e.g., perhaps just plain vanilla debt & equity, along with a ban on pyramid structures.
- (3) a punitively high tax on advertising – to discourage unproductive arms races between firms, reduce barriers to entry, and also on proto-Galbraithian grounds (to prevent producers from "manipulating demand").

# Explaining the interventionism

Not until the 1950s did Chicago economists conclude either (a) that markets could autonomously resist monopolistic concentration, or (b) that regulatory intervention was more likely the problem than the solution.

By Simons' empirical lights, combating monopoly was a key responsibility of the "night watchman state" – no less important (or directed at "theft") than providing police protection & the courts.

His view of advertising is admittedly harder to square with classical (as distinct from modern) liberalism.

The more pervasive the assumed market failures, the less apt the "night watchman" metaphor.

But we're still in the neighborhood if we can explain his support for "drastic progression."

# Simons the redistributionist

His demanding that the tax system address inequality, because it is “evil or unlovely,” may initially seem at odds with modern classical liberalism.

But not so fast ...

He harshly denounced all tax policy approaches based on utility or sacrifice or welfare economics – the prime foundations of modern economic theory re. redistribution (optimal income taxation or OIT).

*Personal Income Taxation* notably refuses to offer any alternative foundation other than Simons’ own unexplained personal sentiment or aesthetics.

But *A Positive Program for Laissez-Faire* fills in the gap.

# More on the aesthetics of egalitarianism

A fuller version of Simons' famous statement that inequality is “evil” or “unlovely” appears in the *Positive Program*:

“Surely there is something unlovely, to modern as against medieval minds, about marked inequality of either [wealth or political power]. A substantial measure of inequality may be unavoidable or essential for motivation; but it should be recognized as evil and tolerated only so far as the dictates of expediency are clear.”

The *Positive Program* explains how the fuller motivation for this view relates to the classical liberal tradition that underlies libertarianism.

# Why was inequality “evil or unlovely”?

Simons considers liberty or personal freedom a “relatively absolute absolute.” But “[f]reedom without power, like power without freedom, has no substance or meaning.”

This applies just as strongly to economic power as to political power. If you are poor or someone else is rich, that makes you less free.

Hence he gives “nearly coordinate place to equality” (alongside liberty) as a “relatively absolute absolute.”

In short, he takes a horizontal or even a leveling vision of both economic and political power.

Simons detests plutocrats rising far above the peasants, no less than Washington bureaucrats telling private economic actors what to do.

# Is this still libertarian or laissez-faire?

Certainly it's not the Ayn Rand / Paul Ryan version.

Simons does not yearn for a world in which the great are permitted to thrive, but for one in which no-one rises too high above others, either politically or economically.

Whether or not “laissez-faire,” this is an open, pluralistic, competitive vision of society, with vibrant markets and decentralized power.

Simons' views have a consistent internal thread, even if remote from what appears to drive today's libertarians and free marketeers.

But (per Sherry Davis Kasper), his views also reflect the influence of Gilded Age economists, who were preoccupied with concentrated economic wealth & power, and whose views still lingered during Simons' formative years.

# Simons on the income tax

Simons knew that a tax w/ progressive rates, collected from individuals, could use either income or consumption as the base. (Kaldor 1956 / Andrews 1974 avant la lettre?)

Like progressive consumption tax advocate Irving Fisher, he was familiar with Ogden Mills' 1921 proposal for a cash flow or consumed income tax (actual proposed legislation, written up in NTJ).

Simons' main line of argument against Fisher in *Personal Income Taxation* is semantic. In effect: "That ain't income. And if you don't like it, talk to Funk & Wagnalls."

But 2 further facts, the first better-known than the second: (1) Simons actually preferred income taxation, but ...

(2) in a way, not so much – e.g., he had no objection to extensive deferral, and proposed repealing the corporate tax (along with a basis-first rule for taxation of dividends) to promote saving & reinvestment.

# Why tax income, not consumption?

Simons considered income a “more inclusive measure of economic power,” since it included not just  $C$  but also  $\Delta W$ .

Thus, he thought it came closer to targeting the very thing he wanted to equalize.

And “there is something sadly inadequate about the idea of saving as [merely] postponed consumption.” People save because it’s expected of them, not based on inter-temporal utility maximization (which he mocked as emptily demonstrating that people consume when they consume).

Plus, the income tax had been tested & worked reasonably well; Mills’ scheme was dangerously untested.

Hence, tax policy should generally ignore the fact that (in his view) saving most of a large income was “morally superior[]” to engaging in “vulgar and tasteless ostentation in private consumption.”

## But on the other hand ...

Objecting to tax deferral under the realization requirement was “this mosquito argument” – a “pest” that he must “swat” repeatedly.

Indeed, deferral might actually be a good thing if it allowed capital to “fructify,” such as by “not forcing unproved enterprises to deplete their reinvestable earnings” by paying tax sooner.

He thought his main contribution to income tax thinking was “constructive realization” – treating gifts & bequests as realizations.

With that in place, he saw no need to tax corporate income before the shareholder transferred the stock (including by gift or bequest).

Interest rates were lower in the 1930s than today – but he understood that deferral could significantly reduce the present value of one’s tax liability. Nonetheless, “tax later” was OK, so long as the taxpayer’s death was the outside limit.

# Which tax base might Simons prefer today?

More pro-income tax: (1) With frequently higher interest rates, perhaps he'd find deferral more important & objectionable.

(2) Greatly increased high-end inequality – it is NOT anachronistic to say that he would detest the rise of the “Masters of the Universe.”

More pro-consumption tax: (1) Simons HATED inter-asset distortions that reflected bureaucratic meddling or interest group politics. A consumption tax with expensing is much better in this dimension, *if* one believes it will lead to less economic intervention by Congress.

(2) Administrative complexity: the income tax looks far worse today than back then (although he was expressing dismay by the early 1940s). While cash flow taxes on individuals remain untested, at least we have seen that VATs can work pretty well.

# A final word

The two Henry Simons were one and the same.

I find his detestation of concentrated power & social/political hierarchy emotionally appealing, if lacking in a full intellectual foundation.

He was both an inspired advocate with great rhetorical gifts, and a clear-minded analyst who, in evaluating tax design, never let the best be the enemy of the good.

At once a traditionalist & a hater of orthodoxies, one wonders what he would make today of the canonization of “Haig-Simons income” ...

... or of OIT’s preeminence, contradicting everything he said about using welfare or utility concepts in tax analysis.

One can almost hear the trumpets, summoning Simons to some wholly unpredictable yet characteristically fierce new field of battle.