REVIEWS

AN EXPENDITURE TAX. By Nicholas Kaldor. London: George Allen and Unwin, 1956. New York: The Macmillan Company, 1957. Pp. 249. $2.75.

IN this short and meaty book, an eminent British economist argues powerfully in favor of replacing the progressive tax on personal income with a progressive tax on personal expenditures, thus excluding from the tax base that part of income which is saved. Although its central thesis is old, the book commands the attention of students of public policy because of the author's authority and the cogency with which the concept of a spendings tax is applied to the contemporary British economy. Professor Kaldor describes his book as an offshoot of his work as a member of the 1950 Royal Commission on the Taxation of Profits and Income. The book is organized in two parts, the first dealing with expenditure taxation in principle, the second considering the practical application of the principle.

The book provides new evidence of a profound change in the values and attitudes of academic economists in the United Kingdom. The strong preference for income equality, which marked British thinking about fiscal policy during the thirties and forties, is disappearing. A deeper concern may now be seen for the larger savings and capital formation which are essential to more rapid economic growth. Many Americans will agree that such a shift in the objectives of tax policy is salutary—in the United States as well as in the United Kingdom. Yet the reader is entitled to ask whether the radical change in the tax base proposed by Professor Kaldor is as well-calculated to produce the desired result as would be reforms in the income tax.

An incidental word of caution may be directed to those radicals of the Right, who would drastically reduce or abolish federal income taxes and replace them with a heavy federal sales tax on consumer goods and services. Professor Kaldor offers them no comfort. He espouses the principle of progressive expenditure taxation, not because it will lighten the tax load of the rich, but because he believes that it will diminish their consumption expenditures, made either from capital or from income now escaping tax—capital gains are not taxed at all in the United Kingdom. Because of heavily progressive rates, "a changeover to an expenditure tax would undoubtedly have the most severe effect on the wealthy and not on the people who are only moderately well-off."[1] Kaldor visualizes top-bracket tax rates on expenditures of several hundred percent. Significantly, he credits Mr. Hugh Gaitskill—head of that traditional stronghold of British egalitarianism, the Labour Party—with the idea that the expenditure tax principle was worth exploring. Kaldor proposes to shift the balance between spending and saving. Adoption of his proposal would relieve

1. P. 50.

the wealthy miser, not the wealthy spendthrift. The change is urged primarily on the ground that the contemporary public interest in the United Kingdom is to foster saving rather than consumption.

Kaldor effectively develops the major arguments against personal income taxation. No statutory definition of "taxable income" can truly measure a man's "spending power," because there is no rational means of reducing to a common denominator the three elements of monetary receipts: receipts from ownership of property—interest, rents, dividends; receipts from personal services—wages, salaries, professional fees; and casual receipts—gifts, bequests, capital gains. The proposal, made by Haig, Simons and others, that "income" be defined as the algebraic sum of (1) the market's value of rights exercised in consumption and (2) the change in the value of the store of market rights between the beginning and the end of the taxable period is rejected on two grounds. It treats all three types of receipts as equal and is administratively impossible to apply because it requires a satisfactory revaluation of all elements of a taxpayer's capital each year.

An income tax, writes Kaldor, involves double taxation of savings: first, in the year in which they are made and again, as their fruits are realized. "That the wealthy classes in Britain have ceased to save, and dis-save on a considerable scale—at least in relation to their taxed incomes—is not, I think, seriously contested by anybody . . . ."[2] The sensible way to deal with the problems of large fortunes and concentration of economic power which an exemption of savings will foster is to limit the rights of inheritance, not to tax the process of accumulation.

Income vis-a-vis expenditure taxation discriminates against risk-taking enterprise. This is so even if the tax rate is a constant proportion of income; and the discrimination rises with the degree of progression in the tax rate. Elimination of capital gains from taxation, or their preferential treatment, may, of course, reduce the discrimination, but cannot altogether eliminate it. The implications for innovation and economic growth are obvious.

Finally, income vis-a-vis expenditure taxation adversely affects the incentive to work. Under identical rates of taxation, a man can convert leisure into real income on more favorable terms under an expenditure tax than under an income tax. A progressive expenditure tax would be less of a disincentive to work than a progressive income tax yielding the same revenue. Its advantages over the latter would rise with the degree of fluctuation in a person's earnings and with the height of the marginal rate of income tax at which his peak earnings are taxed.

Kaldor recognizes the necessity of relating the taxation of company or corporation income to his expenditure tax, because the prevailing forms of business taxation are an essential complement to the system of personal income taxation. Until recently, company profits in Britain have not been taxed per se; the payments made by companies were of taxes presumptively "withheld" and

2. P. 93.

due from their shareholders to the government. The rapid postwar rise in the rates of company income taxation have, according to Kaldor's sound analysis, been borne mainly by the stockholders of business corporations, although in the very long run a good part of the tax may be shifted. In a perceptive passage, Professor Kaldor notes that an important offset to this burden has been the capital appreciation of investment enjoyed by the shareholder under a generally inflationary monetary and fiscal policy of government. "The ordinary shareholder is thus the true residuary legatee of the full-employment, full-prosperity policies of the modern State."[3] In other words, the dampening effect of heavy corporate income taxation on enterprise and economic progress can be mitigated by an inflationary policy. However, if the aim of public policy is a stable price level as well as full employment, and government pursues a noninflationary policy, excessive taxes on corporate profits will surely retard economic growth.[4] Current anti-inflationary monetary and fiscal policies in Britain and the United States therefore carry with them an urgent need for sharp reductions in company income taxation.

Perusal of Professor Kaldor's book brings to mind the controversy during the thirties between Professor Irving Fisher of Yale and Professor Henry C. Simons of the University of Chicago. Fisher encumbered his proposal for the elimination of savings from income taxation by redefining "income" to mean, in effect, consumption, the stream of benefits acquired by a person during a taxable period. Professor Kaldor sidesteps this semantic difficulty, which involves a complete recasting of well-understood concepts. Although he uses familiar language and proposes to tax "consumption" instead of "income" redefined, the essence of the proposal remains the same. The critical drawbacks of the proposal were spelled out in Henry Simons's classic title, *Personal Income Taxation*.[5] The reader who is attracted to Kaldor's proposals could do no better than to turn to this generation-old indictment of the then-current, and still substantially continuing, federal personal income tax and its thoroughgoing proposals for reform.

Simons pointed out the grave difficulties of a spendings tax. First, the base of the tax will probably have to be determined as income minus savings, with negative saving—consumption spending in excess of income—counting as a positive item. Hence, the administration of the tax would involve all the present problems of estimating annual income, plus those of measuring annual net saving or "dis-saving." Secondly, the tax base would be greatly narrowed, and this effect would aggravate the problems surrounding taxation of income in kind. Thirdly, difficult problems arise in co-ordinating a spendings tax with the taxation of inheritances. Finally, to obtain under a spendings tax anything like the present degree of progression in income taxation would require a maximum surtax rate of many hundred percent. Political support of such tax

3. P. 146.
4. JACOBY, CAN PROSPERITY BE SUSTAINED c. 11 (1956).
5. SIMONS, PERSONAL INCOME TAXATION (1938).

rates is extremely doubtful; and, even if they were imposed, the rewards to evasion would be inordinately large.

Notwithstanding the impressive logic of Professor Kaldor's reasoning, the Simons arguments seem more compelling. All things considered, to build upon existing public knowledge and morale in respect to income taxation by reforming the present system in desirable directions is better than to introduce an unfamiliar concept, shot through with administrative difficulties and enticements to evasion and avoidance. Most of Kaldor's arguments for replacing an income with a spendings tax are equally valid for reforming the American income tax. Current progressive rates are inordinately high on the upper brackets of income. Were it not for the fact that few wealthy persons really pay them, they would so patently penalize productive effort, savings and economic progress as to be intolerable. The rich avoid them, of course, by going into the oil-producing business, transforming ordinary income into capital gains in a hundred devious ways, buying state and municipal securities or transferring assets to trusts of various sorts. The appropriation, through federal taxation, of more than half the net incomes of business corporations imposes an absurd degree of discrimination against assuming the risks of corporate business enterprise. Corporate income taxes in the United States should be radically reduced and ultimately integrated completely into the personal income tax system. Kaldor logically proposes this for his system of expenditure taxation. We need to integrate income and estate taxation as well.

A short review cannot accord adequate treatment to the many interesting and important ideas advanced by Professor Kaldor. Whether or not the reader emerges from a study of the book's pages convinced of the feasibility and desirability of a personal expenditure tax, he cannot fail to gain the satisfaction of knowing he has come to grips with the fundamental issues of direct taxation. This is undoubtedly one of the most challenging and closely reasoned works on taxation to appear in the postwar period. It demands the reader's close attention but repays him many times. It is reassuring to know that fundamental tax reform is once again engaging the attention of able economists. Recognition is widening that the current British and American tax systems need substantial changes before they will help to advance us toward our common economic goal of steady growth without price inflation.

NEIL H. JACOBY†

MR. BARUCH. By Margaret L. Coit. Boston: Houghton Mifflin Co., 1957. Pp. 784. $7.50.

MISS Margaret L. Coit, author of a rather well-received study of John C. Calhoun, came to write a biography of Bernard M. Baruch because Mr. Baruch asked her to. When she accepted his invitation, Mr. Baruch opened his exten-

†Dean, Graduate School of Business Administration, University of California, Los Angeles.