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# The Forgotten Henry Simons

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# THE FORGOTTEN HENRY SIMONS

Daniel Shaviro\*

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## I. INTRODUCTION

Surely just about everyone in the U.S. federal income tax field has heard of Henry Simons, although mainly for just one thing: his famous definition of “personal income” as the market value of one’s consumption plus change in net worth during the relevant period,<sup>1</sup> in his classic 1938 work, *Personal Income Taxation*. Simons’ formulation of what became known as the Haig-Simons income definition provided a central orientation point for U.S. tax policy thinking for many decades thereafter. Even today, it remains extremely important.

The man behind the definition is, in some respects, considerably less well-known. For example, while most tax aficionados probably would identify him as a strong advocate of the federal income tax and of using a broadly defined base, fewer may know how comfortable he was with retaining the realization principle as a practical accommodation.<sup>2</sup> Fewer still may be aware that he advocated eliminating the corporate income tax, conditioned only on a rule change providing for shareholder-level gain realization when appreciated stock (or other property) was transferred by gift or bequest, and accompanied by the suggestion that dividends not be taxed until the shareholder had fully recovered her basis in the underlying stock.<sup>3</sup>

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<sup>1</sup> More precisely, Simons states: “Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption, and (2) the change in the value of the store of property rights between the beginning and end of the period in question.” Henry C. Simons, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938) (henceforth, Simons, PERSONAL INCOME TAXATION).

<sup>2</sup> Cite to Federal Tax Reform or Personal Income Taxation.

<sup>3</sup> Cite to Federal Tax Reform or Personal Income Taxation.

Perhaps fewest of all realize that today, in active intellectual memory, there are actually two Henry Simons – albeit each the same person, not just biologically but also intellectually – remembered in two mostly distinct communities. First, of course, there is the income tax community’s Henry Simons, who, in the course of advocating a broad tax base and “drastic progression”<sup>4</sup> memorably demolished several intellectual opponents,<sup>5</sup> vehemently denounced support for his own bottom-line positions that was based on reasoning about utility or sacrifice,<sup>6</sup> and lucidly addressed how a workable income definition could actually be implemented.<sup>7</sup>

Simons was not just an income tax writer, however. At the time of his death, most of his published work discussed other issues – for example, the case for a competitive free-market economy,<sup>8</sup> the problems caused by labor unions,<sup>9</sup> and his approach to monetary policy.<sup>10</sup> The nontax writings included not only Simons’ best-known work at the time of his death<sup>11</sup> –which *Personal Income Taxation* cites as its underlying policy guide<sup>12</sup> – but also the work that he considered his best.<sup>13</sup> Moreover, while these writings are little known today in tax circles, there is a community interested in free enterprise, Chicago-school economic analysis, and libertarianism, to which they remain at least historically important, but are highly controversial.

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<sup>4</sup> Simons, *PERSONAL INCOME TAXATION*, *supra*, at 18.

<sup>5</sup> *Id.* at \_

<sup>6</sup> *Id.* at \_

<sup>7</sup> *Id.* at \_

<sup>8</sup> Cite. \_

<sup>9</sup> Cite. \_

<sup>10</sup> Cite. Simons’ previously published nontax writings were collected and posthumously published in Henry C. Simons, *ECONOMIC POLICY FOR A FREE SOCIETY* (1948). The book includes twelve previously published essays that together are more than 300 pages long. This admittedly is slightly shorter than the combined page count for *PERSONAL INCOME TAXATION* plus his only other significant tax policy work, *FEDERAL TAX REFORM* (1950), but the latter was only posthumously published.

<sup>11</sup> The prefatory note to *ECONOMIC POLICY FOR A FREE SOCIETY*, by Simons’ close friend Aaron Director (at vi) states that his “best-known essay” (which I discuss in detail below) was “A Positive Program for Laissez Faire,” initially published in 1934.

<sup>12</sup> See Simons, *Personal Income Taxation*, at 2 n. 1.

<sup>13</sup> See Stigler, Henry Calvert Simons, *supra*, at 5 (stating that Simons once said that his article on monetary policy, “Rules Versus Authorities in Monetary Policy,” was “the best piece of writing he had produced.”).

George Stigler called Simons the “Crown Prince of ... the Chicago school of economics,”<sup>14</sup> and others have agreed that he was its “prime architect.”<sup>15</sup> What is more, Simons labeled and regarded himself, not merely as a free market supporter, but more specifically as a libertarian. However, some aspects of Simons’ work – including, but not limited to, his advocacy of progressive income taxation – have caused this characterization to rankle in some quarters. Indeed, the wounds are sufficiently fresh that the title of one recent entry, published in the *Journal of Libertarian Studies*, used the present tense in proclaiming: “Henry Simons is Not a Supporter of Free Enterprise.”<sup>16</sup>

I first encountered the second Henry Simons at a lecture given by Ronald Coase at the University of Chicago Law School, about twenty years ago. As I recall it, Coase devoted a large portion of his remarks to denouncing Simons for what Coase considered an inappropriate willingness to rely on governmental regulatory solutions to market failure, rather than asking how markets could themselves handle the problems.<sup>17</sup> My then-Chicago colleague, the late Walter Blum, a Simons protégé who kindly acted as a mentor to me when I first entered law teaching, told me the next day that Coase had expressed surprise when Walter told him after the lecture of Simons’ continuing prominence as an intellectual architect of the income tax.

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<sup>14</sup> George J. Stigler, Henry Calvert Simons, 17 *J. L. Econ* 1 (1974).

<sup>15</sup> See Van Horn and Murowski, *supra*, at 5 (calling Simons the “prime architect” of the Chicago school); Caldwell at 6 (accepting the “prime architect” claim although disagreeing in other respects with Van Horn’s and Murowski’s analysis of the Chicago school’s early history). See also Edmund W. Kitch, *The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932-1970* 26 *J. Law. & Econ.* 163, 179 (1983) (discussing Simons’ strong intellectual influence on the development of the Chicago School).

<sup>16</sup> Walter Block, *Henry Simons Is Not a Supporter of Free Enterprise*, 16 *J. Libertarian Studies* 3 (2002).

<sup>17</sup> Coase relatedly, but as I recall less prominently at this particular lecture, criticized Arthur Pigou, who famously proposed what are now called “Pigovian” taxes to address negative externalities such as pollution, rather than asking how markets, through the assignment of property rights, could do the job. I would guess that Coase’s reason for emphasizing Simons more than Pigou was that he recalled Simons’ close connection with the University of Chicago Law School, the site and sponsor of the talk, as its first economist faculty member and an important early leader in the Chicago law and economics movement.

It may seem most improbable that Simons, at least in his own self-assessment, was “at the same time an extreme libertarian and a believer in massive wealth redistribution.”<sup>18</sup> As Herbert Kiesling notes, however, while “[o]ne can wonder how such a strange mixture could be internally consistent ... in Simons’ hands the combination was logical.”<sup>19</sup> I will argue that he is best viewed as an egalitarian of a particular kind. He hated wealth inequality and concentrated economic power as people on the left often do, and centralized political power as anti-state people on the right often do, but for exactly the same reasons and in exactly the same way. He thus explained that he would have liked what he called decentralized socialism, just as much as he liked what he called libertarianism, if not for his conclusion that it was self-contradictory and/or turned into the same thing anyway.<sup>20</sup>

By itself, this tale of the two (but actually one) Henry Simons would provide ample motivation for looking back at his work, in the context of a conference commemorating one hundred years of the U.S. federal income tax. In particular, it helps to show why he viewed comprehensive income taxation as such a good solution to a large piece of the dilemma that he faced by reason of hating both wealth inequality and government intervention in the economy.

However, there is also an interesting story to review regarding Simons’ perspective on the design of the federal income tax. Although his reasons for favoring comprehensive income taxation were quite distinctive, other underlying motivations can lead to the same place. Thus, it is of interest today, for its own sake, to see how his views, as an undeniably smart commentator early in the intellectual history of the U.S. income tax, look more than seventy years later. I

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<sup>18</sup> Herbert Kiesling, *TAXATION AND PUBLIC GOODS: A WELFARE-ECONOMIC CRITIQUE OF TAX POLICY ANALYSIS* 67 (1993).

<sup>19</sup> *Id.*

<sup>20</sup> Henry C. Simons, Introduction: A Political Credo, in Simons, *ECONOMIC POLICY FOR A FREE SOCIETY* 29-31 (1948). George Stigler, while offering a strong statement of Simons’ libertarian credentials that I quote below, also said of Simons that “[m]uch of his program was almost as harmonious with socialism as with private-enterprise capitalism.” George J. Stigler, *MEMOIRS OF AN UNREGULATED ECONOMIST* 149 (1988).

therefore will review Simons' views on the choice between income and consumption taxation, with an eye both to what has changed since the 1930s, and to how these changes might matter to one who shared his normative framework. In effect, I will ask what Simons might think today – but with due understanding that it would be both silly and presumptuous to draw overly confident bottom-line conclusions.<sup>21</sup>

The rest of this paper will proceed as follows. Section II offers a brief overview of Simons' career. Section III discusses the issues raised by his self-proclaimed libertarianism, in light of its underlying philosophical motivations, his support for strong economic regulation in certain respects, and his support for a progressive income tax. Section IV discusses his views on the income versus consumption tax debate. Section V offers a brief conclusion.

## II. SIMONS' METEORIC CAREER

Henry Simons was born in 1899 in the small town of Virden, Illinois, the second child in an ambitious, upper middle class family.<sup>22</sup> Second in his high school class, he was forced by family economic reverses to enroll at the University of Michigan, rather than following his older sister's route to an elite eastern private college.<sup>23</sup> Here, he initially planned to be a lawyer like his father, but became interested in neoclassical economics. He started teaching economics at the University of Iowa in 1922. In 1927, he followed his mentor, the economist Frank Knight, to the University of Chicago Economics Department.<sup>24</sup>

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<sup>21</sup> I am not the first to ask this sort of question. See Charlene Luke, What Would Henry Simons Do? Using an Ideal to Shape and Explain the Economic Substance Doctrine, 11 *Houston Bus. & Tax Law J.* 108 (2011).

<sup>22</sup> See Stigler, Henry Calvert Simons, *supra*, at 1; Sherryl Davis Kasper, THE REVIVAL OF LAISSEZ-FAIRE IN AMERICAN MACROECONOMIC THEORY 30 (2002) (noting that he “grew up comfortably as a member of the middle class, the son of a moderately successful lawyer and an extremely ambitious homemaker”).

<sup>23</sup> See Sherryl Davis Kasper, Why Was Henry Simons Interventionist: The Curious Legacy of a Chicago Economist (2011) at 4.

<sup>24</sup> *Id.* Stigler, Henry Calvert Simons, *supra*, at 1, describes Simons as Knight's “premier student.” After starting at Iowa, Simons also did a summer of graduate study at Columbia University, and spent a half-year in Germany studying the work of leading German economists. See Edmund W. Kitch, “Henry Calvert Simons,” in Peter Newman (ed.), THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW, 3” 465 (1998). George Stigler later

Here things initially did not go well. Many years later, Simons' close friend Aaron Director reported that "Henry Simons was not liked in the economics department."<sup>25</sup> Economics students found him a rude and aggressively indifferent teacher,<sup>26</sup> quite in contrast to his subsequent very positive reception at the University of Chicago Law School. Simons' scholarly record was also considered weak, as it consisted of "two book reviews in ... twelve years"<sup>27</sup> until finally, in 1934, he published a self-described "propagandist tract" in support of traditional liberalism called "A Positive Program for Laissez-Faire: Some Proposals for a Liberal Economic Policy."

Simons' long pre-1934 period of academic torpor presumably reflects that, as George Stigler put it, not just "brilliance" but also a "capacity for boredom ... marked his entire life."<sup>28</sup> However, both the Great Depression and the Roosevelt Administration's whirlwind "One Hundred Days" response to it upon taking office in 1933 – which Simons detested, but considered no worse than what the Hoover Administration had already been doing<sup>29</sup> – galvanized him into activity. In June 1933, he gave a public speech in which he declared: "I must talk, I believe for the first time in my life, as an extreme conservative, as an exponent of that much ridiculed political philosophy nineteenth century liberalism."<sup>30</sup> The *Positive Program* was then

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noted a view among the University of Chicago economics faculty that Simons "had been sent to Europe for six months so that he would learn German so he could get a Ph.D." See Kitch, *Fire of Truth*, supra, at 176.

<sup>25</sup> Kitch, supra, at 176.

<sup>26</sup> According to Paul Douglas, Simons' colleague in the Chicago Economics Department, "Simons was almost openly insolent to those who ask questions and generally tells them that the questions they are asking are either too elementary for him to pay attention or that they are not questions which any sensible person should propound or to which any sensible person reply. " See George J. Stigler, *MEMOIRS OF AN UNREGULATED ECONOMIST*, supra, at 187 (quoting a letter by Douglas).

<sup>27</sup> Kitch, *Fire of Truth*, supra, at 177.

<sup>28</sup> Stigler, *Henry Calvert Simons*, supra, at 1.

<sup>29</sup> See Simons, *Positive Program*, supra, at 34-35 ("One cannot criticize the policies of the present administration without seeming to approve those of its predecessors. In fact, one must condemn the Democrats mainly for their wholesale extension of the worst policies of the past. The NRA is merely Mr Hoover's trust policy and wage policy writ large. The agricultural measures and many other planning proposals are the logical counterpart and the natural extensions of Republican protectionism.").

<sup>30</sup> From the Simons papers, as cited in Kasper, *Why Was Henry Simons Interventionist*, supra, at 15-16.

his follow-up, explaining, not only why he favored what he called a laissez-faire economic policy but also why departures from that approach were, in his view, responsible for the Great Depression. He subsequently called *Personal Income Taxation* merely “part of a scheme of policy outlined” in *Positive Program*,<sup>31</sup> and the latter includes a section on tax policy that extensively anticipates the now more famous follow-up work.

I will further discuss the *Positive Program* in section III below. In terms of his career, however, while the tract attracted a large audience to its dissent from the overwhelming New Deal-era consensus against laissez faire economics,<sup>32</sup> skeptics on the Chicago faculty viewed it as merely “skillful propaganda” that “isn’t basic scholarship and we shouldn’t be giving our few jobs on that basis.”<sup>33</sup> What is more, while “[n]obody had any doubts about how smart Henry Simons was ... there were great doubts about ... whether that book on personal income taxation would ever be finished.”<sup>34</sup> He had been working on it since the late 1920s,<sup>35</sup> initially as his never-completed Ph.D. dissertation.<sup>36</sup>

There was a clear political and ideological element to the tenure fight over Simons. His mentor, Frank Knight, is “widely remembered as ... one of the most prominent advocates of free markets during the Roosevelt years,” and as a man whose lectures “were credited ... with transforming incoming socialists into nascent libertarians,” leaving behind ardent disciples such as George Stigler and Milton Friedman.<sup>37</sup> Knight’s and Simons’ arch-foe in the University of

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<sup>31</sup> Simons, *PERSONAL INCOME TAXATION*, *supra*, at 2 n. 1.

<sup>32</sup> See Ellis Hawley, *THE NEW DEAL AND THE PROBLEM OF MONOPOLY* 292 (1966, republished 1995).

<sup>33</sup> Kitch, *supra*, at 177 (statement by George Stigler, paraphrasing the views at the time of Paul Douglas).

<sup>34</sup> *Id.* at 177.

<sup>35</sup> Aaron Director, *Simons on Taxation*, 14 *U. Chi. L. Rev.* 15 (1946).

<sup>36</sup> Stigler, *Henry Calvert Simons*, *supra*, at 1; Kasper, *Why Was Henry Simons Interventionist*, *supra*, at 10-11. Reportedly, the reason Simons never finished obtaining his Ph.D. is that he “did not want to be examined by inferior minds” in oral examinations. *Id.* at 11 n. 7.

<sup>37</sup> Angus Burgin, *The Radical Conservatism of Frank H. Knight*, 6 *Modern Intellectual History* 513, 514 (2009). Knight did, however, to the perennial puzzlement of his followers, give a lecture at the University of Chicago in 1932 with the title “The Case for Communism, from the Standpoint of an Ex-Liberal.” See *id.* He may have later

Chicago Economics Department, Paul Douglas – who spent several years trying to get Simons’ faculty appointment terminated<sup>38</sup> – was a New Deal progressive, highly typical of an era in which institutionalist economists and legal realist law professors strongly favored extensive government in the economy, and viewed laissez-faire as a doctrine that had utterly failed. As Milton Friedman later noted, Simons was “opposed to almost everything that the institutionalists and legal realists stood for.”<sup>39</sup>

Ordinarily, Simons’ limited scholarly output, halfhearted teaching efforts, and stance outside the intellectual mainstream might have been expected to lead to his dismissal. However, in the face of Knight’s extremely emphatic support for Simons, and accompanying insistence that Simons’ opponents were engaged in a “personal attack on me,”<sup>40</sup> the easier course for the Economics Department was simply to put off any final decision.<sup>41</sup>

Robert Maynard Hutchens, the energetic president of the University of Chicago, then resolved the impasse by (in Walter Blum’s later words) “thrusting” Simons onto the law school faculty<sup>42</sup> in 1939, or one year after *Personal Income Taxation* had finally appeared in print. Simons had friends in the law school, but the majority there was “either opposed to having an economist or indifferent.”<sup>43</sup> Hutchens’ main motive, apart from resolving the impasse at the

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regretted giving this talk, which was not widely published and which his libertarian supporters insisted was meant ironically or as a joke. See *id.* at 517-518. Others argue that it reflected his genuine ambivalence about free market capitalism, especially during the Great Depression, albeit reflecting feelings of “ex-liberalism” more than of actual communism or socialism. See *id.*

<sup>38</sup> See Stigler, Henry Calvert Simons, *supra*, at 1-2; Stigler, MEMOIRS OF AN UNREGULATED ECONOMIST, *supra*, at 187-189.

<sup>39</sup> Kitch, *The Fire of Truth*, *supra*, at 176.

<sup>40</sup> *Id.* at 177 (statement by George Stigler, apparently paraphrasing what he learned from reading Knight’s correspondence). In his autobiography, Stigler quotes a letter from Knight saying: “I ‘feel’ as if eliminating [Simons] is eliminating me, and that when it is done I would simply be ‘through’ with the group, morally and sentimentally. Stigler, MEMOIRS OF AN UNREGULATED ECONOMIST, *supra*, at 188-189.

<sup>41</sup> George Stigler reports that the “controversy was resolved, Solomon-wise, by retaining Simons and releasing another Knight disciple.” *Id.* at 189,

<sup>42</sup> See *id.* at 176.

<sup>43</sup> *Id.* (quoting Walter Blum).

Economics Department, was to fill “the practical need to teach economics in the law school,”<sup>44</sup> an aim he valued given his view that “law schools as then in existence were mere trade schools anyway.”<sup>45</sup>

Things immediately started to go much better for Simons, who became a far more enthusiastic and effective teacher in his new setting. He not only intrigued and bemused law students who (in George Stigler’s words) had never before met an “intelligent conservative,”<sup>46</sup> but rapidly emerged as an intellectual leader. As Milton Friedman later noted, “Henry was a very gregarious fellow,” and exerted a “great deal of influence through these social interactions.”<sup>47</sup> Walter Blum, for example, “got to know him as a result of drinking beer with him in Hanley’s tavern about once a week over a period of about six to eight months.”<sup>48</sup>

By the early 1940s, according to Aaron Director, Simons “was slowly establishing himself as the head of a ‘school.’”<sup>49</sup> Friedrich Hayek, the pro-free market economist whose 1944 work, *The Road to Serfdom*, became a central libertarian tract, agreed, calling Simons the “intellectual centre” of a group of like-minded economists.<sup>50</sup> Simons’ influence and teachings centered on using economic analysis to question the basic premises behind interventionist

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<sup>44</sup> Id. at 167.

<sup>45</sup> Id. at 167 (quoting Aaron Director).

<sup>46</sup> Id. at 177.

<sup>47</sup> Id. at 179. Aaron Director and Allen Wallis also testified to Simons’ influence. See id.

<sup>48</sup> Id. Simons’ intellectual influence is clear (although its limits can also be discerned) in Blum’s classic coauthored work (with Harry Kalven, Jr.), *THE UNEASY CASE FOR PROGRESSIVE TAXATION* (1953). For example, this work shares Simons’ skepticism about theories “constructed on notions of benefit, sacrifice, [or] ability to pay.” Blum and Kalven, *UNEASY CASE* at 104. It agrees with Simons that the main reason for tax progressivity is to reduce inequality (a much more obvious conclusion today than when *UNEASY CASE* was written). In addition, while it notes of Simons’ critique of inequality as “unlovely” that “[t]his approach . . . forecloses any further discussion,” id. at 72, and while it specifically critiques the “contention [arguably assumed by Simons] that money represents economic power which permits its owners to make economic decisions affecting the lives of others” (id. at 78), its guarded ultimate endorsement of progressivity appears to rest on similarly intuitive grounds.

<sup>49</sup> Aaron Director, Foreword, in Henry Simons, *ECONOMIC POLICY FOR A FREE SOCIETY* v (1948).

<sup>50</sup> See Van Horn and Mirowski, *supra*, at 11 n. 7.

economic programs, such as minimum wage laws, securities regulations, price controls, and pro-union labor laws.<sup>51</sup>

Simons was in touch with Hayek as early as 1934, when Hayek contacted him to express admiration for “A Positive Program for Laissez-Faire,” and they soon became close friends.<sup>52</sup> In April 1945, after a *Reader’s Digest* condensation of *The Road to Serfdom* had become a national best-seller, things reached a new stage. A speech by Hayek at the Detroit Economics Club, on a U.S. tour promoting the book, led a politically activist conservative businessman in the audience (Harold Luhnnow, president of the Volker Fund) to propose funding a specifically American version of *The Road to Serfdom*.<sup>53</sup>

While Luhnnow wanted Hayek (or someone designated by him) to write an almost comic-book version of *Road*, suitable for a barely literate mass audience,<sup>54</sup> Hayek urged that the funding go instead to support the creation of a pro-free market intellectual center in the U.S. To this end, he promptly contacted Simons, who responded enthusiastically. Simons proposed the establishment, at the University of Chicago, of an independent Institute to be headed by a serious pro-free market intellectual – he had in mind his close friend Aaron Director, whom he hoped to lure back from Washington to Chicago – and to have a largely academic bent.<sup>55</sup> While this was not quite what Luhnnow wanted, further negotiations (also involving Robert Maynard Hutchins

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<sup>51</sup> Kitch, *Fire of Truth*, supra at 179. (quoting Walter Blum). Blum states that Simons’ intellectual contributions “had a great deal to do with the tone at the University of Chicago law school at that time and later.” Id.

<sup>52</sup> Van Horn and Mirowski, supra, at 7.

<sup>53</sup> See Bruce Caldwell, *The Chicago School, Hayek, and Neoliberalism* 3 (2009); Van Horn and Mirowski, supra, at 4-6.

<sup>54</sup> Luhnnow apparently “suggested the book *How We Live* by Fred G. Clark (1944) as stylistic model for the *American Road to Serfdom*. One doubts if Hayek had ever seen a copy, for if he had, he would have immediately soured on Luhnnow. *How We Live* was a large print book, with didactic pictures facing each page of ‘text’, which itself consisted of single sentence paragraphs written for people who still moved their lips as they read. The quality of argument resembled a fourth-grade civics textbook.” Van Horn and Mirowski, supra, at 21.

<sup>55</sup> See Caldwell, supra, at 14-16.

on behalf of the University of Chicago) led to a more modest plan to create a Free Market Study at Chicago, headed by Director, whose salary the Volker Fund would pay for five years.<sup>56</sup>

There was one catch, however. The plan stipulated that Director would be granted tenure at the University of Chicago Law School, and this required approval, not just from the law school (which agreed), but also from a university committee. On June 18, 1946, the committee rejected the proposal – to Simons’ great disappointment, in part due to his eagerness to persuade Director to move to Chicago. On June 19, 1946, Simons died from an overdose of sleeping pills, possibly or even probably a suicide.<sup>57</sup>

Shortly thereafter, Director agreed to come to Chicago even without an up-front promise of tenure. There, in addition to playing a key foundational role in establishing the law and economics program and movement at the University of Chicago Law School, Director oversaw the posthumous publication of two additional Simons books: *Federal Tax Reform*, collecting a linked set of essays that Simons had written in 1943 and 1944 to guide post-World War II U.S. tax policy; and *Economic Policy for a Free Society*, collecting a number of Simons’ non-tax works, including “A Positive Program for Laissez-Faire.”

### **III. HENRY SIMONS: A DIFFERENT TYPE OF LIBERTARIAN?**

Biographically speaking, Henry Simons’ credentials as a libertarian and free-market conservative could scarcely be stronger. He called himself “severely libertarian or, in the English-Continental sense, liberal”<sup>58</sup> and had what one can only call the audacity to write a spirited defense of laissez-faire economic principles in 1934, at the very moment when they were at their all-time U.S. low-water mark due to the Great Depression. He was closely associated

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<sup>56</sup> See Van Horn and Mirowski, *supra*, at 21-26.

<sup>57</sup> For a full discussion of the question whether Simons committed suicide, see Robert Van Horn, A Note on Henry Simons’ Death (forthcoming 2012 in *History of Political Economy*).

<sup>58</sup> Simons, Introduction: A Political Credo, *supra*, at 1.

both with Friedrich Hayek, whom contemporary libertarians still revere, and with such foundational conservative economists as Milton Friedman, George Stigler, and Aaron Director.<sup>59</sup> Indeed, if one had to name a single “architect” of the pro-free market law and economics movement at the University of Chicago, Simons’ credentials are as good as anyone’s.<sup>60</sup>

Yet there are three at least apparent contradictions in thus classifying Simons. The first is that he was not a philosophical libertarian, at least as the term has often subsequently been defined in the literature. The second is that his version of laissez-faire economic policy, as set forth in his 1934 pamphlet, soon came to be seen by pro-free market conservatives, and quite undeniably, as, in Ronald Coase’s later words, “highly interventionist.”<sup>61</sup> The third is that Simons is rightly known for supporting progressive redistribution, and to this end championing a comprehensive income tax. Needless to say, progressivity and redistribution, not to mention the income tax, are anathema today among libertarians and many conservatives. Yet Simons himself evidently saw no contradiction, lauding progressivity in the 1934 pamphlet<sup>62</sup> and then describing *Personal Income Taxation* as merely an elaboration of his 1934 ideas.<sup>63</sup> The rest of this section discusses these at least apparent contradictions.

#### A. Philosophical Libertarianism

In contemporary usage, libertarianism often is defined as a rights-based or process-based approach to justice that rejects consequentialism. Thus, Robert Nozick in *Anarchy, State, and Utopia*, rejects “end-result principles” that assess distributive justice in society based on how

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<sup>59</sup> See, e.g., Robert Van Horn, Chicago’s Shifting Attitude Towards Concentrations of Business Power (1934-1962), 34 Seattle U. L. Rev. 1527, 1528 (“From the mid-1930s through the mid-1940s, among economists (and economists in training) at the University of Chicago, there was a cohort of young economists – which included Henry Simons, Aaron Director, Milton Friedman, and George Stigler – who opposed concentrations of market power on the basis of classical liberal doctrine. Simons was the public face of this group.”).

<sup>60</sup> See, Stigler, Henry Calvert Simons, *supra*, at 1; Van Horn and Murowski, *supra*, at 5); and Caldwell, *supra*, at 6; as well as Kitch, *Fire of Truth*, *supra*, at 179.

<sup>61</sup> Kitch, *Fire of Truth*, *supra*, at 177.

<sup>62</sup> See Simons, *A Positive Program for Laissez Faire*, *supra*, at 25-27 and 39.

<sup>63</sup> Simons, *PERSONAL INCOME TAXATION*, *supra*, 2 n. 1.

things have come out, in favor of the “historical” view that “whether a distribution is just depends on how it came about.”<sup>64</sup> Thus, one can defend a state of affairs merely by showing that it had arisen via voluntary transactions from a just starting point.

As Nozick recognized, this logic can support the enforceability of voluntary self-enslavement contracts, and thus the essential justice of a society in which nearly everyone is observed to be a slave.<sup>65</sup> While most libertarians reject this position by positing that certain basic human rights are inalienable,<sup>66</sup> libertarianism today is often construed as requiring acceptance, at least in most cases, of a rights-based, non-consequentialist approach to distributional and other issues. Thus, consider the claim that taking money from billionaires and giving it to poor people would be desirable if this would greatly increase aggregate human happiness – taking account both of the relative marginal utility of a dollar to people in the two groups, and to the transfer’s incentive and political economy effects. To a modern deontological or rights-based libertarian, this claim need not be empirically false in order for it to be rejected. Its being a rights violation rules it out from the start.

This plainly is not Simons’ philosophical position. Consider the following statement from the second paragraph of his *Positive Program for Laissez Faire*: “There is in America no important disagreement as to the proper objectives of economic policy – larger real income, greater regularity of production and employment, reduction of inequality, preservation of

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<sup>64</sup> Robert Nozick, *ANARCHY, STATE, AND UTOPIA* 153 (1974).

<sup>65</sup> See *id.* at 331 (“Will it be possible to shift to a nonvoluntary framework permitting the forced exclusion of various styles of life? .... The comparable question about an individual is whether a free system will allow him to sell himself into slavery. I believe that it would.”).

<sup>66</sup> See, e.g., Walter Block, *Toward a Libertarian Theory of Inalienability: A Critique of Rothbard, Barnett, Smith, Kinsella, Gordon, and Epstein*, 17 *J. Libertarian Studies* 39, 41 (2003) (noting that few libertarians agree with his and Nozick’s view that support for the proposition that voluntary self-enslavement contracts should be enforceable, and then proceeding to rebut prominent “middle ground” libertarians who have argued to the contrary).

democratic institutions. The real issues have to do merely with means, not with ends (or intentions).<sup>67</sup>

To show how this plays today in deontologically libertarian circles, consider the libertarian economist Walter Block's aforementioned tract, "Henry Simons Is Not a Supporter of Free Enterprise." Block, while himself an "anarcho-capitalist" libertarian who deems all government illegitimate, is willing to extend the label to "limited-government libertarians ... who take the position that a proper government exists only to protect people's rights to personal safety and to the security of their legitimately held possessions."<sup>68</sup> Hence, these libertarians, unlike Block himself, accept the potential legitimacy of armies, the police, and the courts. Alas, however, even thus given "at least a sporting chance of attaining the honorific 'libertarian,'"<sup>69</sup> Simons falls so far short that Block convicts him of intellectual "fraud and false advertising,"<sup>70</sup> and closes by asking "how such a leftist could attain a reputation as a rightist ... and why he felt the need to hide his views ... under the banner of laissez faire. But these are questions for another day."<sup>71</sup>

Block is surely right that today's libertarians – even though, in his view, they are for the most part lamentably heterodox – generally would be inclined to break Simons' staff and expel him from the Libertarian Order. As we will see shortly, Simons most definitely did not view the government's role as limited to providing an army, police, and the courts to protect people's safety and "legitimately held possessions." However, Block's reading of the term "libertarian" is both ahistorical and too narrow – at least, if we are trying to classify Simons as a matter of good

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<sup>67</sup> Simons, A Positive Program for Laissez-Faire, *supra*.

<sup>68</sup> Block, *supra*, at 4-5.

<sup>69</sup> *Id.* at 5.

<sup>70</sup> *Id.* at 4 n. 3.

<sup>71</sup> *Id.* at 31.

intellectual history, rather than simply to apply one's own preferred definition (which Block, of course, has every right to do).

Consider Hayek's *The Road to Serfdom* - surely, in intellectual history, a canonical and foundational libertarian work. Rather than emphasizing the importance of rights irrespective of consequences, Hayek emphasizes the empirical claim that movement towards greater centralized economic planning, even when it has as yet gone no further than it had in England and the United States as of the book's 1944 publication date, will lead inexorably to Nazi- or Soviet-style totalitarianism.<sup>72</sup> This is precisely the concern that Simons was expressing a decade earlier in *Positive Program*.<sup>73</sup> Simons, just like Hayek, despised the "mongrel system of 'national planning'" not only as a mere way station on the march towards totalitarianism, but as something that itself "implies and requires extreme concentration of political power, under essentially undemocratic institutions."<sup>74</sup> The New Deal did not have to turn into Nazism in order for Simons to view it as containing odious qualities of the same type, even if in vastly lesser degree.

Even in today's intellectual climate, purporting to out Simons as a "leftist" and as "not a supporter of free enterprise," merely because he cared about consequences, rather than about innate and inviolable rights, and thus was conditionally willing to contemplate rights violations, is too restrictive. It rules out including any classical liberal / contemporary political conservative who relies on the consequentialist view that free markets, strong private property rights, and limited government are generally the best prescription for increasing human welfare. This view would require classifying the likes of Adam Smith, Milton Friedman, and Richard Epstein, among others, as likewise "leftists" who oppose capitalism and freedom.

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<sup>72</sup> See, e.g., Hayek, *supra*, at 3-4. Hayek accepts that wartime calls for centralization of powers (see *id.* at 225), but views the current English and U.S. course as clearly towards totalitarianism even in the aftermath of Hitler's then-impending defeat.

<sup>73</sup> Simons, *A Positive Program for Laissez-Faire*, *supra* at 1-2 and 36.

<sup>74</sup> *Id.* at 11.

In this regard, consider what Milton Friedman says about graduated income taxation in his classic 1962 book, *Capitalism and Freedom*. To be sure, Friedman does “find it hard, as a liberal” to see the justification for graduated rates when they are merely being used to redistribute income, rather than to finance the costs of government.<sup>75</sup> He considers this “a clear case of using coercion to take from some in order to give to others and thus to conflict head-on with individual freedom.”<sup>76</sup> Yet Friedman defines the costs of government, which everyone must help to pay for, as “including perhaps measures to eliminate poverty,”<sup>77</sup> even though this is redistribution (coercively funded) plain and simple.

Moreover, Friedman accepts that, in principle, paying for the costs of government “might well call for some measure of graduation, both on grounds of assessing costs in accordance with benefits and *on grounds of social standards of equity*.”<sup>78</sup> The only problem he sees is that the “present high nominal rates [then reaching 92 percent, under the federal income tax] . . . can hardly be justified on this ground – if only because their yield is so low.”<sup>79</sup> In short, under Block’s standard, not only is Milton Friedman no libertarian (a point that is uncontroversial),<sup>80</sup> but only as a matter of degree can he fall short of being a “leftist” who opposes capitalism and freedom, despite having used those two words in the title of his most famous book. So perhaps the next question should be why Friedman, like Simons, won’t own up to being a secret “leftist.”

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<sup>75</sup> Milton Friedman, *CAPITALISM AND FREEDOM* 174 (1962).

<sup>76</sup> *Id.*,

<sup>77</sup> *Id.*,

<sup>78</sup> *Id.* (emphasis added).

<sup>79</sup> *Id.* A few pages earlier, in response to the view that progressive income taxation could be viewed as an insurance device that effectively pools people’s income and ability risk, thereby addressing the market failure that arises if the market fails to supply a suitable insurance vehicle, Friedman objects only that “the taxes are imposed *after*” market outcomes are known, with “taxes being voted mostly by those who have drawn the blanks.” He states that he would have no objection if one generation voted the tax schedules that were to apply on this ground to as yet unborn generations, although he posits that the resulting rate structure would be much less graduated. *Id.* at 163.

<sup>80</sup> Block has noted a long set of issues on which Friedman and libertarians disagree. See Walter Block, Milton Friedman RIP, *Mises Daily*, November 16, 2006 (available on-line at <http://mises.org/daily/2393> ). He also has published correspondence in which Friedman good-humoredly called him “a fanatic, not . . . a reasonable man.” Walter Block, *Fanatical Not Reasonable: A Short Correspondence Between Walter Block and Milton Friedman*, 20 *J. Libertarian Studies* 61 (2006).

Returning to Simons, he certainly did not claim to be a libertarian in today's deontological sense – unsurprisingly, since any such claim would have been anachronistic. Rather, Simons placed himself squarely in an intellectual tradition whose “distinctive feature ... is emphasis upon liberty as both a requisite and a measure of progress.”<sup>81</sup> While consequentialist and thus “largely pragmatic” in his view of social ethics, he described his views as “giv[ing] special place to liberty ... as a ‘relatively absolute absolute.’”<sup>82</sup>

George Stigler helped make the case for the accuracy of Simons' self-characterization in a 1974 retrospective: “The central philosophy of the *Positive Program* was highly individual. Simons believed that it was essential to the preservation of personal freedom that a large sector of economic life be organized privately and competitively – this was a fundamental element of the liberal position that many, perhaps even an increasing share of us, still believe .... Simons' central goal is as vital and as irresistible today as it was forty years ago: to devise a decentralized, unpoliticized world in which personal freedom and economic efficiency find wide scope and strong defense.”<sup>83</sup>

Stigler had good reason for saying this. For example, Simons was, as Stigler notes, a “violent critic” of New Deal industrial policy legislation such as the National Recovery Act (NRA).<sup>84</sup> Nor was he kinder to specific NRA and industrial policy proponents, calling Henry Wallace, the Secretary of Agriculture and then Vice President in the Roosevelt Administration,

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<sup>81</sup> Simons, Introduction: A Political Credo,” supra, at 1. In naming his precursors within the liberal tradition, Simons did not restrict himself to people we would call libertarians. The people he cited included, for example, Adam Smith, John Stuart Mill, John Locke, David Hume, Jeremy Bentham, Alexis de Tocqueville, and his friend (as discussed above) Friedrich Hayek. Id.

<sup>82</sup> Id. at 2. As I discuss below, the full quotation that I excerpted in the text above states that Simons “gives special place to liberty (*and nearly coordinate place to equality*) as a ‘relatively absolute absolute’” (emphasis added).

<sup>83</sup> Stigler, Henry Calvert Simons, supra, at 3, 5. In section III.B. below, I discuss certain crucial qualifications to Stigler's view that Simons favored free markets and laissez faire.

<sup>84</sup> See Kitch, Fire and Truth, supra, at 178. Simons stated, for example, that “[n]o diabolical ingenuity could have devised a more effective agency for retarding or preventing recovery (or for leading us away from democracy) than the National Recovery Act and its codes.

“our leading advocate of the totalitarian or pre-totalitarian economy of negotiation among tightly organized, monopolizing functioning groups.”<sup>85</sup> Simons also hated labor unions, saying that “our [most] serious and ominous monopoly problem lies in the labor market and in the power of unions to behave monopolistically.”<sup>86</sup>

Simons argued that the greatest social and economic ill that the U.S. faced was monopolistic price-fixing, along with “excessive political interference with relative prices,”<sup>87</sup> such as through tariffs and industry subsidies. He viewed such interference with market prices not just as allocatively inefficient, and not even just as also a prime cause of the Great Depression, but also as fundamentally violating principles of economic and political freedom and equality, and as leading inexorably to the need for dictatorship to mediate the conflicts between organized groups.<sup>88</sup>

One might almost say here, “case closed” regarding Simons’ classical liberal and generally pro-free market credentials, except for one further consideration. Simons did indeed support a set of policies that involved significant government intervention in the economy. My next topic, therefore, is what to make of what he called his “positive program for laissez faire.”

#### B. Assessing and Explaining Simons’ “Interventionism”

As noted above, one generally might expect that a libertarian, or even a generally pro-free market classical liberal, would support keeping the government’s economic and regulatory role quite limited. What about Henry Simons? In the *Positive Program* and elsewhere, he called for the “outright dismantling of our gigantic corporations .... with a [l]imitation upon the total amount of property which any single corporation may own.” In addition, he favored regulating

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<sup>85</sup> Henry C. Simons, For a Free-Market Liberalism, 8 U. Chi. L. Rev. 202,203 (1940-1941).

<sup>86</sup> Id. at 205. Simons further discussed his negative view of unions in Henry C. Simons, Some Reflections on Syndicalism, 52 J. Pol. Econ. 1 (1944).

<sup>87</sup> Simons, Positive Program, supra, at 3.

<sup>88</sup> See id. at 4-5.

companies' financial structure by providing that they could issue only two or three types of securities, centered on a single class of common stock and what we might call plain-vanilla debt.<sup>89</sup> Likewise, almost startlingly (or, as Block says, “eerily”<sup>90</sup>) anticipating the classic 1958 book, *The Affluent Society*, by the decidedly progressive and anti-laissez faire economist John Kenneth Galbraith, Simons condemned advertising for its capacity to manipulate, rather than actually satisfying, consumer demand, and, for this among other reasons, urged that it face heavy taxation.<sup>91</sup>

Given such features of Simons' thought, it is unsurprising that Ronald Coase, at a 1983 retrospective session among founders of the Chicago law and economics movement, should find it “hard to understand” characterizations of the “highly interventionist” *Positive Program* as pro-free market,<sup>92</sup> adding that he “would be interested if someone could explain this pro-free market view of Henry Simons.”<sup>93</sup> As Brad DeLong, in telling this story, recounts, “Simons' former Chicago pupils, his successors as upholders of classical liberalism in economics, did not [respond by] ris[ing] to his defense.”<sup>94</sup> Instead, they admitted that “You can paint him with different colors,” and that “It's quite a mixed picture,” to be defended on the ground that, when he wrote in the 1930s, almost everyone else, both at the University of Chicago and around the country, was even further to the left.<sup>94</sup> Aaron Director, his closest friend in the group attending

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<sup>89</sup> Simons, *Positive Program*, supra, at 17-18.

<sup>90</sup> Block, supra, at 28.

<sup>91</sup> See Simons, *Positive Program*, supra, at 31-33. Simons complains that “[p]rofits may be obtained either by producing what consumers want or by making consumers want what one is actually producing. The possibility of profitably utilizing resources to manipulate demand is, perhaps, the greatest source of diseconomy under the existing system.” Id. at 31.

<sup>92</sup> Kitch, *Fire of Truth*, supra, at 178. Not long after this session, Stigler wrote in his autobiography that “Simons had preached a form of laissez-faire in ... [*Positive Program*], but what a form! He proposed nationalization of basic industries such as telephones and railroads because regulation had worked poorly. (I am reminded of the king who was asked to award a prize to the better of two minstrels. After hearing the first, he said ‘Give the prize to the second.’). Stigler, *MEMOIRS OF AN UNREGULATED ECONOMIST*, supra, at 148-149.

<sup>93</sup> J. Bradford DeLong, In Defense of Henry Simons' Standing as a Classical Liberal, 9:1 *Cato Journal* 105 (1990).

<sup>94</sup> See id. at 105-106; Kitch, *Fire of Truth*, supra, at 178-179. Thus, Milton Friedman pointed out that, “in 1934, when [*Positive Program*] appeared, I would say that close to a majority of the social scientists and the students in

the retrospective, even offered the suggestion that one of Simons' reasons for expressing support for "interventionist programs was to make the private system of production palatable to his colleagues,"<sup>95</sup> as opposed to actually favoring such programs – as it happens, a suggestion that finds some support in Simons' private correspondence.<sup>96</sup>

Simons' old friends may not entirely have remembered, however, the extent to which their own views had changed since the 1930s. Thus, consider Milton Friedman, who recalled viewing the *Positive Program* as "strongly pro free market in its orientation" when he first read it in the 1930s – only, upon later rereading, to be "astounded by what I read."<sup>97</sup> Part of the reason for this change in perspective may have been that Friedman himself had changed in the interim. Friedman, not just in the 1930s but as late as 1947, had been sufficiently worried about the corporate monopoly problem to resemble Simons in favoring regulatory restrictions (albeit milder ones) that he hoped would discourage corporate mergers and the existence of large companies.<sup>98</sup>

Private monopoly, as a potential consequence of corporate size and thus perhaps even its cause, was a major concern to Chicago school economists until empirical work in the 1950s persuaded them of two things. The first was that competition in private markets pervasively undermines monopoly even if it is briefly established.<sup>99</sup> Thus, regulatory intervention is not needed to combat it. Second, they now concluded that the main danger of monopoly "come[s]

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the social sciences at the University of Chicago were either members of the Communist party or very close to it," and in which "the general intellectual atmosphere was strongly prosocialist." *Id.*

<sup>95</sup> Kitch, *Fire of Truth*, *supra*, at 179.

<sup>96</sup> As Sheryl Davis Kasper recounts, in response to a letter from Hayek questioning Simons' proposal for direct government ownership (in lieu of regulation) of natural monopolies, Simons wrote: "I confess privately to having used a low, debating trick.... I am willing to prostitute my judgment somewhat, in advocating government ownership, in order to vent my spleen fully as to the merits of a grand system of private monopoly with government regulation of prices and wages." Kasper, *Why Was Henry Simons Interventionist*, *supra* at 28.

<sup>97</sup> Kitch, *Fire of Truth*, *supra*, at 178.

<sup>98</sup> See Van Horn, *Chicago's Shifting Attitude*, *supra*, at 1540.

<sup>99</sup> See, e.g., Van Horn, *supra*, at 1540-1543.

not from large corporations that exploit purely private economies of scale ... but from interest groups that enter into a symbiotic relationship with a government that purports to ‘regulate’ them.”<sup>100</sup> Hence, concern about the private exercise of monopoly power should make one all the more eager to restrict the scope of regulation, since “[w]henver the government does something, it probably acts in the interest of some powerful and monopolistic interest group.”<sup>101</sup>

Given this change in empirical knowledge (or at least belief), Brad DeLong argues that Coase and others were mistaken, in later years, to classify Simons as an interventionist rather than as truly one of them. He merely differed from them empirically, based on the Chicago school’s state of knowledge about monopoly problems when he was writing, as compared to later. Thus, “Simons was a consistent classical liberal of his times, even if, in retrospect, he may now appear to have been [empirically] wrong in his judgment on specific issues.”<sup>102</sup>

DeLong concludes that, under Simons’ empirical beliefs concerning the monopoly problem (which, again, were standard in Chicago at the time), restricting corporate size so that markets will remain competitive is merely “a completion of the idea of the night watchman state. The night watchman state enforces contracts and guards against explicit theft. A monopolist is also an implicit thief because his possession of market power leads to the exchange of commodities at prices that do not reflect underlying social scarcities.”<sup>103</sup>

Simons makes very much the same point in the *Positive Program*. Responding to laissez faire’s reputation as “a merely do-nothing policy,” he calls this characterization “unfortunate and misleading. It is an obvious responsibility of the state under [laissez faire] to maintain the kind of

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<sup>100</sup> DeLong, *supra*, at 119.

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at 111. Consistently with this view, Simons defines “commutative justice,” which he distinguishes from “distributive justice” while regarding both as important, as connoting “exchange of equal values, as measured objectively by organized [but competitive] markets.” Simons, *Political Credo*, *supra*, at 4. Monopoly is indeed theft under Simons’ view. Further supporting this view, Simons in the *Positive Program* argues that laissez

legal and institutional framework within which competition can function effectively.”<sup>104</sup> In short, breaking up large companies is no more a violation of *laissez faire* than enforcing contracts and protecting private property against thieves.

The same line of argument could also, perhaps, apply to Simons’ support for heavily taxing advertising. A key complaint he makes about advertising is that, because it is so costly, it “[e]ntrenches monopoly by setting up a financial barrier to the competition of new and small firms.”<sup>105</sup> Relatedly, it creates wasteful arms races among firms, which “must spend enormous sums ... if only to counteract the expenditures of competitors.”<sup>106</sup> Thus, even if he adds the Galbraith-style complaint that advertisers manipulate consumers into “want[ing] what one is actually producing,” which seems to raise broader issues about the welfare effects of market outcomes, one could argue that he is mainly just seeking to advance his anti-monopoly program, while also addressing a collective action problem as between business rivals that leads to waste.

As George Stigler later noted, Simons’ hostile view of advertising was widely held among economists before the 1960s, when Stigler’s own work on the economics of information made the case for viewing advertising much more benignly, as “an extremely efficient way of conveying information ... [that] is as essential for competitive firms as for monopolies.”<sup>107</sup> Thus, in defense of Simons’ standing as a pro-free market classical liberal notwithstanding his view of advertising, one could again argue that the dispute is merely empirical, concerning means rather than ends, and that it is anachronistic to judge Simons based on whether he had accepted, in advance, arguments that the Chicago school only made decades later. Nonetheless, his view of advertising does indeed suggest a more capacious sense of market failure, and of the

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<sup>104</sup> Simons, *Positive Program*, *supra*, at 3.

<sup>105</sup> *Id.* at 32.

<sup>106</sup> *Id.* at 31.

<sup>107</sup> Stigler, *Memoirs of an Unregulated Economist*, *supra*, at 163-164.

need for government intervention, than one might expect from a “laissez-faire” economist. The metaphor of the mere night watchman grows increasingly strained as the list of market failures that the state must address keeps growing.

Suppose one nonetheless accepts Simons’ classical liberal and generally pro-free market credentials. How does one square them with his favoring significant redistribution through an income tax that features “drastic progression”<sup>108</sup> in its rates? One possibility is to separate the two Henry Simons, as if they were different people. Thus, Brad DeLong “place[s] to one side” Simons’ tax policy views when assessing his classical liberal credentials,<sup>109</sup> and George Stigler – sounding less certain than one might have expected – describes these views as “surely independent” of Simons’ other beliefs.<sup>110</sup>

Simons himself evidently did not thus classify his tax views, however. Indeed, the *Positive Program* treats a set of tax policy recommendations that are largely identical to those in *Personal Income Taxation* – mainly written by this time, although not yet published – as part and parcel of his libertarian and laissez-faire program. As we will see next, this reflects a commonality of motivation that has powerful internal logic, even if it is not at all how people typically parse the issues today.

### C. Simons’ Support for Progressive Income Taxation

In determining why Simons favored “drastic progression,” a natural first stop is *Personal Income Taxation*, and in particular the first half of its forty-page first chapter. Here Simons evaluates at length various grounds for favoring progressivity, while the second half of the chapter considers tradeoffs to pursuing redistribution (such as effects on efficiency) and the question of what tax and other fiscal instruments might be deployed in its behalf. Unfortunately,

<sup>108</sup> Simons, *PERSONAL INCOME TAXATION*, *supra*, at 18.

<sup>109</sup> DeLong, *supra*, at 107 n. 3.

<sup>110</sup> See Stigler, Henry Calvert Simons, *supra*, at 4.

the result of this inquiry – unless supplemented by looking at other writings by Simons – is disappointing and even perplexing, potentially creating the false impression that his endorsement of progressivity is so whimsical and seemingly unmotivated that the question of how it might relate to his other economic views is destined to remain mysterious. Only when one supplements it, in particular by looking at the *Positive Program* and at *A Political Credo*, which offers a broader account of his political views,<sup>111</sup> does the mystery lift to a degree.

Simons opens the first chapter of *Personal Income Taxation* with a harsh attack on tax policy writers who “dissemble” their true underlying beliefs by “maintain[ing] a pretense of rigorous, objective analysis untingered by mere ethical considerations.” These aspiring, but fake, scientists “religiously eschew a few proscribed phrases, clutter up title pages and introductory chapters with pious references to the science of public finance, and then write monumental discourses upon their own prejudices and preconceptions.”<sup>112</sup>

Who exactly might Simons mean by this? The answer appears to be: virtually everyone in the then-existing academic literature on tax policy. He starts by mentioning the “doctrine of taxation according to benefit,” under which “[e]ach person may be called upon, as in his dealings with private enterprise, to pay according as he receives.”<sup>113</sup> But given the impossibility of measuring different people’s benefit from the provision of public goods, such as national defense and internal security, this “slogan, of course, has little more than emotive content,” and “leads nowhere at all.”<sup>114</sup>

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<sup>111</sup> Simons wrote the Political Credo in 1945, although it was only published posthumously, “in an endeavor to formulate specifically the political predispositions implicit in his work,” Simons, *ECONOMIC POLICY FOR A FREE SOCIETY*, *supra*, at 1, editors’ note \*.

<sup>112</sup> Simons, *PERSONAL INCOME TAXATION*, *supra*, at 1-2.

<sup>113</sup> *Id.* at 3.

<sup>114</sup> *Id.* at 4.

Next he addresses “[t]he greater part of what has been written about justice in taxation ... couched in terms of sacrifice. This concept, along with ‘ability’ and ‘faculty,’” rests ultimately on the concept of utility.<sup>115</sup> Unfortunately, however, each version of these doctrines (in Simons’ view) is utter nonsense – unsurprisingly, given how “absurd” and “naïve” he finds all “hedonistic” ethics and welfare economics (i.e., anything relying on the concept of utility).<sup>116</sup> So what if “[m]any professors of economic dialectic still find comfort and intellectual satisfaction (and ‘filler’ for courses and textbooks in the ‘explanations’ of hedonism,” and if they “continue to practice a kind of utility therapy and to write their prescriptions for the economist’s millennium in the hedonistic code.”<sup>117</sup>

Thus, John Stuart Mill’s doctrine of “equal sacrifice – that tax burdens should so be distributed that the same total sacrifice is imposed upon every individual” – has received “devastating criticism,” in particular from Francis Edgeworth, who “demonstrates conclusively – so far as possible with such dialectical tools – that equal individual sacrifice by no means minimizes the total burden” in utility terms, which definitionally is the proper utilitarian aim.<sup>118</sup>

Yet Edgeworth’s “minimum sacrifice” theory fares no better in Simons’ hands. This theory ostensibly supports complete leveling of income, on the ground that everyone has the same utility function, characterized by declining marginal utility of income. Thus, so long as A has even a dollar more than B, equalizing their after-tax incomes will increase B’s welfare more than it reduces A’s welfare. Simons raises numerous objections, however. What about people’s attachment to their current levels of income?<sup>119</sup> And what about the unproved “assumption that

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<sup>115</sup> Id. at 5.

<sup>116</sup> Id. at 12.

<sup>117</sup> Id. at 14-15.

<sup>118</sup> Id. at 6.

<sup>119</sup> Id. at 8-10.

all individuals are, or must be treated as, equally efficient as pleasure machines”?<sup>120</sup> Given these absurdities (in Simons’ view), “[w]hat really commends the Edgeworth doctrine to liberal students, of course, is its conclusion – its pseudoscientific statement of the case against inequality.”<sup>121</sup>

Having thus disposed, at least to his own satisfaction, of what remains today the most widely followed ground in the public economics literature for favoring progressive redistribution,<sup>122</sup> Simons concludes his scathing survey of the existing literature by dismissing the work of writers who assert that tax burdens should vary based on “ability” or “faculty.”<sup>123</sup> This standard is “totally ambiguous,” and thus not even to be described as a “principle” except in scare quotes. Given that “ability or faculty ... cannot be conceived quantitatively or defined in any terms of any procedure of measurement,” their use “indicates that the writer prefers the kind of taxation which he prefers; that he is unwilling to reveal his tastes or examine them critically; and that he finds useful in his profession a basic ‘principle’ from which, as from a conjuror’s hat, anything may be drawn at will.”<sup>124</sup>

This brings us near the end of Simons’ almost wholly destructive survey in *Personal Income Taxation* of why one might favor a progressive tax system. What does he propose to do instead? In a word, simply to be forthright about his own priors and prejudices. Then comes what is probably the most famous sentence in *Personal Income Taxation*, other than the income

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<sup>120</sup> Id. at 11.

<sup>121</sup> Id. at 12.

<sup>122</sup> I refer here to the claim that people have, or should generally be treated as having, identical utility functions characterized by declining marginal utility. Edgeworth’s claim that this leads to favoring a 100 percent tax rate, and full equalization of everyone’s after-tax income, is generally rejected today due to concern about incentive effects. The literature on optimal income taxation building on James Mirrlees’ work, generally treats the question of tax rate design as turning on the tradeoff between Edgeworth’s logic and concern about the incentive effects of positive marginal tax rates.

<sup>123</sup> Simons finds a kind word for the “so-called sociopolitical theory of [the German writer] Adolph Wagner. Wagner is praised, however, for saying that one needs a prior view as to the proper distribution of income in order to support any particular theory. Thus, “[h]is views (if we pursue them no farther) seem eminently sensible and represent sound criticism of other writers.” Simons, *PERSONAL INCOME TAXATION*, *supra*, at 15.

<sup>124</sup> Id. at 17.

definition: “The case for drastic progression in taxation must be rested on the case against inequality – on the ethical or aesthetic judgment that the prevailing distribution of wealth and income reveals a degree (and/or kind) of inequality which is distinctly evil or unlovely.”<sup>125</sup> And with that said, Simons moves on to discussing tradeoffs and methods of implementation.

Reading *Personal Income Taxation* all by itself can make it seem natural to conclude that Simons’ aversion to inequality, and his consequent support for “drastic progression,” is a mere isolated prejudice or sentiment that he sees no need to explain. We have the biases we have, he suggests, so all we can do is acknowledge them and move on, as distinct from reasoning or arguing about them. And if that is so, then there might perhaps also be no point to seeking to relate this particular sentiment to anything else that Simons believes, given the lack of any broader discussion of his views in *Personal Income Taxation*. And while careful readers may have observed that Chapter One has a footnote, at the start, stating that one’s tax policy views are “properly a derivative, or subordinate part, of a broader position on economic policy,” as to which readers are encouraged to consult the *Positive Program*,<sup>126</sup> this precedes the famous “unlovely” statement by a full sixteen pages, and thus is easy to miss.

As it happens, the words “evil” and “unlovely” are in fact derived from the *Positive Program*, where Simons states the following:

Turning now to questions of justice, of equitable distribution, we may suggest that equitable distribution is at least as important with respect to power, as with reference to economic goods or income.... Surely there is something *unlovely*, to modern as against medieval minds, about marked inequality of either kind. A substantial measure of inequality may be unavoidable or

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<sup>125</sup> Id. at 18-19.

<sup>126</sup> Id. at 2 n. 1.

essential for motivation; but it should be recognized as *evil* and tolerated only so far as the dictates of expediency are clear.<sup>127</sup>

This still does not offer an underlying rationale for Simons' dislike of inequality. It does, however, reveal the core of what his support for laissez faire has in common with his tax policy views. Both political power and economic wealth, in his view, should be distributed more equally, rather than less equally, albeit subject to "dictates of expediency" to the contrary. With respect to political power, this means having a limited government that leaves alone relative prices and the allocation of capital between industries. With respect to economic power, it calls for redistribution through the income tax.

The *Positive Program*'s reference to "unloveliness" comes right after a sustained denunciation, first of centralized economic planning as leading inexorably to dictatorship, and then of private monopoly power as equally odious and dangerous.<sup>128</sup> Simons has the same revulsion for state actors wielding centralized power to tell us what to do – the case of unequal power – as he does for princes living it up in their castles while paupers starve.

Elsewhere in the *Positive Program* and the *Political Credo*, Simons expresses the same vision. Thus, to offer a full quote that I selectively edited above, he says that classical liberalism "gives special place to liberty (*and nearly coordinate place to equality*) as a 'relatively absolute absolute.'"<sup>129</sup> These two values are linked, however, by the difficulty of having either one without the other. "Freedom without power, like power without freedom, has no substance or meaning."<sup>130</sup> And this presumably applies to economic freedom, no less than to political freedom, given Simons' habit of linking the two. In Simons' view, therefore, an economically

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<sup>127</sup> Simons, *Positive Program*, supra, at 11 (emphasis added).

<sup>128</sup> See generally id. at 1-10.

<sup>129</sup> Simons, *A Political Credo*, supra, at 2 (emphasis added).

<sup>130</sup> Id. at 6.

unequal society, even if reflecting free market outcomes rather than the exercise of government or private monopoly power, is one in which the worst-off people not only are not equal to the rest, but really are not entirely free.

This is a horizontal, or even a leveling, vision of both economic and political power. Simons does not like plutocrats rising far above the peasants (even if the latter, as a formal legal matter, are entirely free), any more than he likes Washington bureaucrats telling private economic actors what to do. Is this “liberal” in the classical sense? That depends on how one defines the tradition. In any event, however, emotionally no less than intellectually, it is certainly no Ayn Rand or Paul Ryan version of the laissez-faire creed. Simons does not yearn for a world in which the great are permitted to thrive, but for one in which the small do not have anyone too far above them, either politically or economically.<sup>131</sup>

In this regard, Sherry Davis Kasper makes an important point about the difference between Simons’ intellectual background and that of his successors in the Chicago school. She notes that he, like other economists who received their training between the two World Wars, was influenced by the immediately preceding era’s Gilded Age economists, for whom “the primary problem ... [was] the concentration of economic wealth and power and the accompanying inequality it engendered.”<sup>132</sup> She later adds that he “worked in the climate of interwar pluralism. As a result, he looked through the world with a different set of lenses, colored primarily by elements of progressive social science that the pluralism of interwar economics allowed to linger.”<sup>133</sup> Only, Simons amalgamated these classic Gilded Age and

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<sup>131</sup> See also, Simons, *A Political Credo*, supra, at 23: “A cardinal tenet of libertarians is that no one may be trusted with much power – no leader, no faction, no party, no ‘class,’ no majority, no government, no church, no corporation, no trade association, no labor union, no grange, no professional association, no university, no large organization of any kind.”

<sup>132</sup> Kasper, *Why Was Henry Simons Interventionist*, supra, at 5.

<sup>133</sup> *Id.* at 28.

interwar concerns of economic power with a commonly motivated dislike of centralized political power that his successors would hold without retaining the Gilded Age element.

One last point worth noting here concerns how Simons' views about economic and political power cohered to make a comprehensive income tax so attractive to him. One of its greatest virtues, in his view, was that, insofar as it treated all different types of income neutrally, it avoided engaging in selective economic regulation – the great vice, along with regressivity, that he ascribed to the tariffs and excise duties that were still the main U.S. federal revenue sources when he wrote and published *Personal Income Taxation*. Taxing all income as alike as possible keeps the government out of the price-fixing and resource allocation business, thus preserving free market conditions and limiting centralized political power, even if people face very high tax rates.

#### IV. SIMONS ON THE INCOME TAX

With Simons' general philosophical commitments and motivations better in focus, I turn now to his work on income taxation, and will focus on why, and to what extent, he preferred income taxation to consumption taxation. After discussing his main arguments and conclusions, along with the separate question of how definitely he actually favored an income tax in practice, I will ask what has changed since he wrote, and how that might affect the views that one who shared his intellectual commitments would hold today.

##### A. Income Taxation Versus Consumption Taxation

###### 1. Why Did Simons Prefer the Income Tax?

For a number of decades, the leading big-picture issue in U.S. academic debate about tax policy has been whether the federal income tax should be replaced by an individual-level consumption tax that, like the income tax, has graduated rates. Experts' awareness that one can

levy a consumption tax at the individual level – as distinct from, say, a retail sales tax or value-added tax model, in which businesses’ role in collecting the tax impedes applying varying individual rates – often is thought to date from no earlier than 1956, when the British economist Nicholas Kaldor published a book advocating cash-flow taxation of individuals,<sup>134</sup> or perhaps even 1974, when Harvard law professor William Andrews published a classic article on the subject.<sup>135</sup>

It thus may come as a surprise to see Simons addressing this very topic at length, in both *Personal Income Taxation* and *Federal Tax Reform*. This, however, turns out to reflect two antecedents. The first is economist Irving Fisher’s advocacy of a progressive consumption tax, to which Simons responded at some length – and, by his acerbic standards, quite respectfully – in *Personal Income Taxation*. The second, less well-known today although cited by both Simons and Fisher, is an actual legislative proposal for a cash flow tax, which Congressman Ogden Mills introduced in 1921 and wrote about in the *National Tax Journal*. This was essentially a Kaldor or Andrews-style cash flow consumption tax *avant la lettre*. It involved replacing the existing income tax with a tax on people’s consumer expenditures during the year, which it would have computed by requiring taxpayers to report on the following information:

- “(1) Cash or equivalent assets on hand at the beginning of the taxable year;
- (2) Total receipts including amounts borrowed;
- (3) The amounts of the items exempt from taxation [i.e., deductible], including investments;
- (4) Cash or equivalent assets at the end of the taxable year.”<sup>136</sup>

<sup>134</sup> Nicholas Kaldor, *AN EXPENDITURE TAX* (1956).

<sup>135</sup> William D. Andrews, *A Consumption-Type or Cash-Flow Personal Income Tax*, 87 *Harv. R. Rev.* 1113 (1974).

<sup>136</sup> Ogden L. Mills, *The Spendings Tax*, 7 *Nat’l Tax Ass’n Bulletin* 18, 19-20 (1921). Items that were effectively deductible included not only most investment outlays, but also ordinary and necessary business expenses, other

With Ogden Mills' proposal retaining, as of the late 1930s, its status as a known though untested alternative, debate concerning its merits took on an odd form. Based on an argument that went back at least to John Stuart Mill,<sup>137</sup> Fisher asserted that such a tax not only was both feasible and desirable, but was actually the true form of an "income tax." In Fisher's view, an income tax as conventionally defined to include both consumption and returns to saving involves the "fallacy of double counting" because it applies twice to assets' capitalized value – first when they are received, and then again when they generate annual consumption or cash returns. "[S]avings may be invested in land or in confectionery. The only true income is the use of the land or the use of the confectionery. To include also the value of the land or the value of the confectionery is to count as income the capitalization of the income"<sup>138</sup> Thus, taxing returns to saving was not merely a bad policy idea (although it might be that as well, if it reduced saving), but was actively fallacious, reflecting the "confusions"<sup>139</sup> promulgated by sloppy writers and hence not logically defensible.

Simons' response to Fisher is partly semantic, reflecting the character of Fisher's own argument. He calls his disagreement with Fisher "essentially one of terminology rather than logic."<sup>140</sup> While the question of how to define a given term is "only that of choice among verbal symbols .... it seems a hardly debatable proposition that usage is already too firmly established to permit our accepting Fisher's proposal"<sup>141</sup> regarding what "income" actually means. "His proposal comes all too tardily in the history of our language, and his pleas have been, and must

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taxes paid, charitable gifts, amounts paid for medical and dental services, and funeral expenses. *Id.* at 19. For mentions of the Mills bill, see, e.g., Irving Fisher, *The Double Taxation of Savings*, 29 *Am. Econ. Rev.* 16, '7-'8 (1939); and Simons, *PERSONAL INCOME TAXATION*, *supra*, at 226.

<sup>137</sup> See John Stuart Mill, *PRINCIPLES OF POLITICAL ECONOMY*, Book V, chapter 1, sec. 4 (1984), as quoted in Fisher, *The Double Taxation of Savings*, *supra*, at 16 (arguing that, "unless savings are exempted from income-tax, the contributors are twice taxed on what they save.")

<sup>138</sup> Irving Fisher, *THE NATURE OF CAPITAL AND INCOME* 107-109 (1906).

<sup>139</sup> *Id.* at 107.

<sup>140</sup> Simons, *PERSONAL INCOME TAXATION*, *supra*, at 89.

<sup>141</sup> *Id.* at 98.

be, without effect upon our courts, legislatures, accountants, and men of affairs – not to mention economists.”<sup>142</sup>

The disagreement was not just semantic, however. Simons was fundamentally unsympathetic to the line of thought that had led Fisher down his semantic blind alley. As Simons notes, the real intellectual value of Fisher’s work on income and capital lay in his development of time-preference theory, which treats saving as merely deferred consumption.<sup>143</sup> Once one accepts this view of saving, it becomes clear that taxing returns to saving means that future consumption is being taxed at a higher rate than current consumption (all else equal), which may appear unmotivated. And if it is unmotivated, one may conclude that consumption is a better tax base than income, resulting not just in less economic distortion but also in better measurement of people’s relative “ability” or “ability to pay.”<sup>144</sup>

Simons, however, believed that “there is something sadly inadequate about the idea of saving as [merely] postponed consumption.”<sup>145</sup> “Many people save mainly because it is the thing to do, because it is expected of them.”<sup>146</sup> And – echoing his denunciation of utility-based theories in other contexts – “[t]o assert that considerations of utility determine the allocation of consumption ... [over time] explains nothing at all, but merely says, with egregious extravagance of language, that people consume what they consume.”<sup>147</sup> Accordingly, in his view, two people

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<sup>142</sup> Id.

<sup>143</sup> See id. at 95.

<sup>144</sup> See, e.g., David F. Bradford and the U.S. Treasury Tax Policy Staff, BLUEPRINTS FOR BASIC TAX REFORM 2 and 37 (1984); Joseph Bankman and David A. Weisbach, The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax, 60 Stan. L. Rev. 789 (2007).

<sup>145</sup> Simons, PERSONAL INCOME TAXATION, supra, at 97.

<sup>146</sup> Id. at 96-97.

<sup>147</sup> Id. at 95. Although perhaps not germane here, I have explained elsewhere why I regard Simons’ position on this issue, which is commonly expressed to this day, as itself fallacious. The value of wealth lies in the fact that it can be used to buy things. Accordingly, under a perpetual flat rate consumption tax, one has already borne the full burden of the tax with respect to one’s unconsumed wealth. The fact that it can be spent is what gives it value. “Wealth is worth only what it can buy; otherwise, it might as well be play money from the board games Monopoly or Life.” Daniel Shaviro, Replacing the Income Tax With a Progressive Consumption Tax, 103 Tax Notes 91, 105 (2004). Treating saving as deferred consumption therefore correctly reflects the fact that we have no particular reason to

with the same income make a better horizontal comparison than two people with the same consumption, and the former pair is thus the one whose members should presumptively be equated through the choice of tax base.<sup>148</sup>

As a matter of logic, then, Simons preferred income taxation to consumption taxation. Perhaps the most important motivation, however, lay in his underlying distributional concerns. Because economic income includes, not just current year consumption, but also the amount of any increase in the market value of one's assets during the year, it offers a "more inclusive measure of economic power"<sup>149</sup> than does consumption. And economic power was the very thing that he wanted the tax system to equalize. So what, he argued, if – as he expressly agreed – to save the preponderance of a large income was "morally superior[]" to engaging in "vulgar and tasteless ostentation in private consumption."<sup>150</sup> While "our private sentiments may properly distinguish between better and worse uses of great economic power,"<sup>151</sup> tax policy should not take heed of the difference. "[T]here is an urgent social and political problem of preventing excessive and persistent inequality of power.... [and] these distinctions should not blind us to the need for mitigating inequality or to the danger that our efforts in this direction will miscarry if we attempt to differentiate greatly among persons according to the way in which they use their power."<sup>152</sup>

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think savers are better-off on a lifetime basis than sooner consumers, unless we mean to rely on specific empirical theories regarding people's behavior and welfare.

<sup>148</sup> Under a view of saving as deferred consumption, if A and B earn the same wage this year and the tax base is consumption (with a perpetual flat rate), they pay the same taxes, in present value over the long run, even if, this year, one of them consumes less and saves more. Thus, support for consumption taxation does not rely on the claim that two people who consume the same amount this year should bear the same tax burden, even if one of them has greater savings.

<sup>149</sup> Simons, *PERSONAL INCOME TAXATION*, *supra*, at 229.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

A last reason for Simons' preferring the income tax to Fisher's and Ogden Mills' spendings (i.e., progressive consumption) tax was administrative. The income tax was in current use, and working reasonably well, albeit susceptible to significant improvement. "Fisher is urging us to abandon the best part of an established revenue system and to start anew with an untried form of personal tax."<sup>153</sup> Departing radically from existing (and income-based) business accounting, and creating a need, among other challenges, to measure taxpayers' dissaving (such as from borrowing) was asking for trouble and might prove unworkable.<sup>154</sup> What is more, while Simons understood that the spendings tax could achieve "the same degree of progression that we now have, or the same amount of taxes on persons of great wealth," this might require imposing high-end marginal tax rates as high as 1,000 percent.<sup>155</sup> This seemed likely to be politically unfeasible, and would in any event increase compliance problems.<sup>156</sup>

In sum, the picture so far appears clear. Simons was on the income tax side of the longstanding debate, and seemingly considered it important to tax wealth-holders on their returns to saving. The case is apparently closed, and with a conclusion as unsurprising as that in the banal headline "Dog Bites Man." Surely everyone in the tax community who has heard of Simons already knew that he was a strong income tax proponent.

A surprise emerges, however, when one turns to the details of his tax reform views. Simons was actually quite comfortable with letting savers defer their income tax liabilities without penalty, so long as the deferral was not potentially permanent, and in this sense appears to have been very comfortable in practice with an end result that looks very similar to that under consumption taxation, so long as one specifies (as he did) that making gifts and bequests is itself

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<sup>153</sup> Id. at 226.

<sup>154</sup> See id. at 227-228.

<sup>155</sup> Id. at 230.

<sup>156</sup> Id.

a form of consumption. I show this next by examining how he dealt with the realization requirement, under which gain and loss are not taxed prior to the occurrence of a realization event, such as an asset sale.

## 2. Simons' View of Realization and Deferral

As Simons well understood, an income tax in name may not function much like one in practice if taxpayers can take sufficient advantage of a realization-based system. Current law, for example, might permit a “very wealthy diversifying ‘operator’ ... [to] show very little taxable income at all, while living like a king and steadily increasing his net worth.”<sup>157</sup> All this required was selectively realizing losses and not gains, while borrowing as needed to fund current consumption. The deferred tax liability would then disappear at death, given the allowance at that point of a tax-free step-up in basis.<sup>158</sup>

While realization turns the income tax into an effective consumption tax if one must realize gain in order to finance consumption outlays, in the above scenario we do not even have a consumption tax. Blocking it may therefore be crucial to the effectiveness of the income tax (in name) as either a true income tax or an effective consumption tax, so far as high-end progressivity is concerned. And if one prefers the income tax approach, as Simons emphasized that he did, one might be expected to emphasize as well the importance of limiting the deferral, not just the permanent elimination, of the tax on unrealized gain. Our priors here might therefore lead us to predict that Simons would want to address and limit taxpayers' use of realization for deferral, and not just for permanent elimination of gain. This, however, is not at all what we find when we look closely at *Personal Income Taxation* and *Federal Tax Reform*.

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<sup>157</sup> Simons, FEDERAL TAX REFORM, *supra*, at 62.

<sup>158</sup> *Id.*

Simons is remembered as a foe of realization doctrine for several reasons. One is that the Haig-Simons income definition gives realization absolutely no place. Changes in the market value of one's assets are economic income, as the definition makes clear, whether one sells the assets or not. Simons also notably called financial accounting's reliance on realization a "professional conspiracy against truth," albeit one that might be expedient "in a world of corruptible accountants and optimistic directors."<sup>159</sup> And he famously executed a brutally effective intellectual takedown<sup>160</sup> of Edwin R. A. Seligman of Columbia University for incoherently arguing that realization is a conceptually necessary component of income.<sup>161</sup> Seligman was Simons' elder by thirty-eight years, and arguably had been the preeminent U.S. tax economist since before Simons was born.<sup>162</sup>

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<sup>159</sup> Simons, PERSONAL INCOME TAXATION, *supra*, at 81.

<sup>160</sup> See *id.* at 85-88. Simons' critique of Seligman is remarkably sarcastic and dismissive. Seligman assumes what he needs to in order to supply the end result he wants, "then moves merrily to his conclusion." *Id.* at 85. "[H]e has evidently no misgivings as to the finality of his [in Simons' view, ad hoc and incoherent] contribution." *Id.* He starts by defining income as consumption, but "[b]efore long ... income becomes something more familiar – savings being slipped in quite unceremoniously." *Id.* At one point in Seligman's argument, "income" depends on value, but soon enough this "ceases to be true." *Id.* at 86. A periodicity requirement for income is "essential" at two points in Seligman's argument, but at another point "is excluded utterly." *Id.* "Seligman's differentiation between the growth of a herd and the growth of a forest is one of the less obscure features of his argument." *Id.* Later on, "[i]ncome depends on the number of trees cut – but only provided they do not cut too many!" *Id.* at 87. "After an extended parade of dogmatic assertions – put forward as necessities of logic – the author [adds yet another extraneous argument] ... rather casually." *Id.* "Professor Seligman's insistence both upon 'realization' and upon depreciation deductions seems to involve serious logical difficulties." *Id.* at 88. "Of course, it goes without saying that, after dragging in an amazing variety of income concepts and choosing useful attributes from different ones at will, Seligman finds little difficulty in throwing out an item like stock dividends, which was almost defenseless from the start." *Id.*

<sup>161</sup> The Seligman article to which Simons gave this harsh treatment was *Are Stock Dividends Income?*, 9 *Am. Econ. Rev.* 517 (1919), from which the opinion of the Supreme Court in *Eisner v. Macomber*, 252 U.S. 189 (1921), holding that stock dividends cannot constitutionally be taxed because they fail a realization prerequisite for finding taxable income, had largely been cribbed. Simons was not the only tax academic to be unimpressed by Seligman's analysis. See, e.g., Robert M. Haig, "The Concept of Income – Economic and Legal Aspects", in Haig, *THE CONCEPT OF INCOME* 1 (1921) (describing cases such as *Eisner v. Macomber* as "leading toward a definition of income so narrow and artificial as to bring about results which from the economic point of view are certainly eccentric and in certain cases little less than absurd"); Paul H. Wueller, *Concepts of Taxable Income* II, 53 *Pol. Sci. Q.* 557, 564 (1938) (Seligman's "concepts of income are, in the last analysis, but philological derivatives – without acknowledged social purpose").

<sup>162</sup> Seligman was born in 1861, started at Columbia in 1885, published two major books on taxation in the 1890s, was the president of the American Economic Association from 1902 through 1904, and became a chaired Professor of Political Economy at Columbia in 1904. He then had continued publish regularly through 1932. See [http://en.wikipedia.org/wiki/Edwin\\_Robert\\_Anderson\\_Seligman](http://en.wikipedia.org/wiki/Edwin_Robert_Anderson_Seligman). Simons clearly saw no need to pull punches with an eminent senior member of his field, whose influence he obviously thought had lasted long enough.

In practice, however, Simons was comfortable with taxpayers' use of realization accounting to defer gain. It is not just that he considered realization "indispensable to a feasible income tax system,"<sup>163</sup> and opposed departing from it selectively even where this was most feasible, such as under an early proposal to require annual mark-to-market accounting for publicly traded securities.<sup>164</sup> What is more, he considered realization "relatively unobjectionable in principle where it results only in postponement of assessment" rather than its permanent elimination.<sup>165</sup> Annual accrual of gain, while "implied by the underlying definition of income ... is quite unnecessary to effective application of the definition."<sup>166</sup> He even called the argument that income must be allocated to the right period, in order to eliminate the "interest saving" from deferral, "this mosquito argument," at which he had "several times swatted ... [and] must now swat once more, [albeit] not to kill the pest."<sup>167</sup>

Part of the reason for Simons' impatience with arguments that income must be allocated to the right period, rather than being deferred under the realization rule, was simply his general conviction that the best should not be the enemy of the good. A reasonably well-functioning system should be considered entirely acceptable, even if along the way it posed insoluble (or, in his words, "hopeless") dilemmas that could only be given "arbitrary" solutions.<sup>168</sup> However, he did not consider the time value of deferral – in an era when interest rates were low, by the standards of more recent decades – as merely something that one would like to eliminate, but that in practice was too small to worry about. Instead, in many circumstances he was actually affirmatively reluctant to deny it to taxpayers.

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<sup>163</sup> Id. at 162.

<sup>164</sup> Simons, FEDERAL TAX REFORM, *supra*, at 74.

<sup>165</sup> Simons, PERSONAL INCOME TAXATION, *supra*, at 162.

<sup>166</sup> Id. at 208.

<sup>167</sup> Simons, FEDERAL TAX REFORM, *supra*, at 127.

<sup>168</sup> Simons, PERSONAL INCOME TAXATION, *supra*, at 53-54 (discussing problems of imputed income and of drawing a firm boundary between business expenses and personal consumption).

Simons recognized, for example, that “long postponement of tax payment” can have a significant “interest cost to the Treasury.”<sup>169</sup> Nonetheless, allowing such postponement to businesses would yield “some gains, even to the Treasury, in allowing capital so to ‘fructify.’” The interest loss seems a moderate price to pay, not only for simple tax procedure but also for stimulation of new enterprise and venturesome investment.<sup>170</sup> Indeed, there was “very much to be said for *not* forcing unproved enterprises to deplete their reinvestable earnings or reserves by forcing them to pay taxes,” even indirectly via a shareholder-level tax that would lead to increased dividend payouts.<sup>171</sup> Simons argued that this “scheme really does derive sound support from much the same argument which Professor Fisher has used, persuasively but (I think) improperly, to condemn the income tax.”<sup>172</sup>

This perspective, under which the mere deferral of gain was unobjectionable so long as it did not turn into permanent exclusion, pervasively influences Simons’ actual reform proposals. As Aaron Director noted in his introduction to the posthumously published *Federal Tax Reform*, Simons’ “great contribution” to income tax thinking was to propose what he called “constructive realization.”<sup>173</sup> Under this approach, “[e]very transfer of property by gift, inheritance, or bequest [w]ould be treated as a realization, at the estimated fair market value, by the donor or by the deceased owner’s estate.”<sup>174</sup>

So long as constructive realization guaranteed a final accounting when the taxpayer ceased to own appreciated property, Simons not only could tolerate, but affirmatively supported, eliminating the corporate tax.<sup>175</sup> The fact that corporate shareholders could thereby earn income

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<sup>169</sup> Simons, *FEDERAL TAX REFORM*, *supra*, at 127.

<sup>170</sup> *Id.*

<sup>171</sup> *Id.* at 128.

<sup>172</sup> *Id.*

<sup>173</sup> *Id.* at vii.

<sup>174</sup> Simons, *PERSONAL INCOME TAXATION*, *supra*, at 167.

<sup>175</sup> See, e.g., Simons, *FEDERAL TAX REFORM*, *supra*, at 16, 23, and 40.

that was free of any current tax was not a problem, so long as there was corporate-level dividend withholding plus a guarantee that any transfer of the underlying stock, including by gift or bequest, would be treated as a realization by the shareholder, with the gain being taxed at the ordinary income rate (and preferably subject to averaging, so taxpayers would not be adversely affected by the “bunching” problem if annual rates were steeply graduated).<sup>176</sup>

Under this approach, a taxpayer might pay less tax in present value terms, not only than under a pure Haig-Simons income tax, but even than under a true consumption. Thus, suppose that one financed a lifetime of consumption by borrowing against appreciated corporate stock (with no tax applying at the entity level), and that only at death was the appreciation taxed.

How could Simons be so casual, ambivalent, and even self-contradictory regarding whether income’s broader tax base than consumption (as he saw it) was actually reached in practice? The answer probably goes back to his underlying motivation for viewing tax reform as a vital part of his “laissez-faire program.” At the time when he wrote, the U.S. income tax contributed less than 10 percent of all federal revenues,<sup>177</sup> with the rest coming from tariffs and excise taxes that he abhorred as both anti-free market and regressive. Replacing them with a broad-based and relatively neutral levy that reflected individuals’ overall personal circumstances was the big thing, with the exact details being considerably less important. What is more, Simons’ broader macroeconomic interests (and his experience of the Great Depression) appear to have encouraged him to focus more on savings and growth, as opposed to just internal tax policy analysis, than if he had been purely a tax scholar, and one who lived in less interesting times.

### 3. What Might Simons Think Today About the Choice Between Income and Consumption Taxation?

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<sup>176</sup> Id. at 40 and 44.

<sup>177</sup> Simons, PERSONAL INCOME TAXATION, *supra*, at 39.

Given Simons' surprising degree of comfort with employing an income tax by name that, in practice, often followed timing rules that were at least as favorable to taxpayers as those under a consumption tax, it is natural to ask, if only out of curiosity or as a kind of parlor game, what he might think about the choice of tax base today. Or more precisely, without speculating about such imponderable questions as whether he would have been swayed by intellectual developments and fashions in the field that he never lived to see, one can ask what, given his views, he might have made of our many subsequent decades of practical experience. Overall, I see two reasons why he might have been more fervently pro-income tax in practice today than he was back then, and two reasons why he might have shifted to favoring a progressive consumption tax.

#### More Pro-Income Tax?

(1) Importance of timing – The first reason why Simons might have become more eager to impose a true income tax, in the sense of limiting interest-free deferral, is that the decades since he published *Personal Income Taxation* and *Federal Tax Reform* have taught us how much timing matters. Perhaps this is simply because we have frequently lived with higher interest rates than those of his era, and thus have gotten to observe how pervasively timing issues can dominate income tax practice and lead to economic distortions. As William Andrews put it, we have learned that realization is often the “Achilles heel” of the income tax,<sup>178</sup> and not just because Simons' constructive realization approach has never been adopted. Today, income tax proponents generally recognize that it is quite important to their goals that deferral issues be addressed more aggressively than he thought was necessary. Thus, for example, few would argue today that we can simply eliminate the corporate income tax, while still imposing such a

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<sup>178</sup> See William D. Andrews, *The Achilles' Heel of the Comprehensive Income Tax*, in Charles E. Walker & Mark A. Bloomfield (eds.), *NEW DIRECTIONS IN FEDERAL TAX POLICY FOR THE 1980S* (1983).

tax at the individual level, serene in the knowledge that a given shareholder's slice of corporate income might often fail to be taxed before that shareholder died.

(2) Greatly increased high-end inequality – Over the last thirty years, high-end income inequality in the U.S. has vastly increased. Between 1986 and 2008, for example, under one relevant measure the share of national income earned by the top 1 percent of the income distribution almost doubled, while the income share of the top 0.01 percent more than tripled.<sup>179</sup>

Unsurprisingly, and as Simons would have predicted, increased economic inequality has affected the distribution of political power. In the last few years, we have seen the greatest and most sustained collapse of employment levels since the Great Depression prompt startlingly little concern from Washington policymakers. Instead, the concern of people in business and finance about forestalling even the remotest threat of modest inflation appears to matter a lot more politically. Likewise, consider the spectacle, in the 2012 presidential campaign, of billionaire donors, set free of campaign finance restrictions by the Supreme Court's *Citizens United* decision,<sup>180</sup> giving millions of dollars to support their favored candidates and causes, in apparent exchange for access and at least hoped-for influence.

It is not just anachronistic projection to posit that all this would have disgusted, and even enraged, the Henry Simons who wrote in the 1930s and 1940s. He viewed concentrated economic and political power as ugly and offensive, and thought no group, profession, or class should be allowed too much superiority or sway in either realm. Thus, he presumably would have wanted to take strong measures to address high-end inequality. At least when he wrote, the income tax, along with the estate and gift tax, was the main policy tool that he considered suitable for this purpose. His concern that, in practice, a spendings tax would not be progressive

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<sup>179</sup> See Daniel N. Shaviro, 1986-Style Tax Reform: A Good Idea Whose Time Has Passed, 131 Tax Notes 817, 834 (2011) (summarizing research by Facundo Alvaredo, Tony Atkinson, Thomas Piketty, and Emmanuel Saez).

<sup>180</sup> *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010).

enough even if in principle it could be, would surely have remained relevant to his analysis of the choice of policy tool.

Potentially Pro-Consumption Tax?

(1) Political difficulty of addressing inter-asset distortions – I posited above that the clearly demonstrated importance of timing issues, over the last few decades, might have motivated Simons to support fuller implementation of a true Haig-Simons income tax. It also is possible, however, that it would move him in the opposite direction, by demonstrating that the income tax could not be as politically pure and economically neutral as he had fondly hoped. Even by the early 1940s, he was worrying that the federal income tax “reads less and less like a prescription of taxes on persons according to their incomes, and more like an inventory of miscellaneous dispensations” to well-connected interest groups.<sup>181</sup> This introduction of “ad rem elements” like those in excise taxes was an instance of “concealed democratic corruption,” exemplified at the time by the oil depletion allowance.<sup>182</sup>

Simons favored tax policy transparency,<sup>183</sup> and might reasonably have concluded (as others have) that an income tax inherently lacks this virtue with respect to cost recovery methods that are neutral between assets or industries. By contrast, in a cash flow tax that applies to businesses (whether incorporated or not) as well as directly to individuals, expensing achieves inter-asset neutrality by relatively simple and transparent means. He thus might reasonably have asked himself the question of whether shifting to a cash-flow consumption tax might lead to greater neutrality and transparency, and thus reduce industry groups’ capacity to hijack economic

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<sup>181</sup> Simons, FEDERAL TAX REFORM, *supra*, at 96.

<sup>182</sup> *Id.*

<sup>183</sup> See *id.* at 4.

and regulatory policy. As I have argued elsewhere,<sup>184</sup> it is far from certain that shifting to a cash-flow consumption tax would actually improve political outcomes, but the possibility that it would (by reason of uniform expensing's simplicity) would certainly have merited Simons' consideration.

(2) Administrative complexity of the income tax – A second reason why Simons might consider giving up on the income tax, if he saw where we are today, concerns its tax planning, compliance, and administrative costs. The baroque complexities of modern practice, founded in large part on realization problems that matter much more than he had anticipated given the frequent existence of higher interest rates (along with the continuing non-adoption of his constructive realization idea) might conceivably move him to consider progressive consumption tax prototypes, even though they remain largely untested.

One set of issues that Simons did not and could not have fully anticipated in the 1930s concerns the extraordinary growth, since that era, of aggressive tax sheltering transactions and legal responses, in the form both of expansive judicial doctrines<sup>185</sup> and detailed statutory responses.<sup>186</sup> A second set of issues that he did anticipate, but that arguably has grown worse, concerns entity-level corporate income taxation, which most analysts now agree (contrary to his view) is necessary if one taxes income, rather than consumption, at the individual level. Simons detested the impact of income tax considerations on companies' business planning, and also on

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<sup>184</sup> See Daniel Shaviro, *Simplifying Assumptions: How Might the Politics of Consumption Tax Reform Affect (Impair) the End Product?* In John W. Diamond and George R. Zodrow (eds.), *FUNDAMENTAL TAX REFORM: ISSUES, CHOICES, AND IMPLICATIONS* (2008).

<sup>185</sup> The economic substance doctrine that lies at the core of judicial responses to aggressive tax planning predates the publication of Simons' *PERSONAL INCOME TAXATION*. See *Gregory v. Helvering*, 69 F.2d 809 (2<sup>nd</sup> Cir. 1934), aff'd, 293 U.S. 465 (1935). However, *Gregory* concerned, not the creation of artificial tax losses, but the use of a tax-free reorganization rule to reduce greatly the tax imposed on a corporate distribution. Simons noted the "awful complexity" of the corporate reorganization rules, and attributed it to what he considered the mistake of taxing corporations as if they were natural persons. Simons, *FEDERAL TAX REFORM*, supra, at 89-90.

<sup>186</sup> Detailed statutory responses to tax sheltering in the current tax code include, for example, Code sections 163(d) (the investment interest limitation), 465 (the at-risk rules), and 469 (the passive loss rules). The economic substance doctrine was also recently codified. See Code section 7701(o).

their financial structure. His *Federal Tax Reform* emphasizes the undesirability of the corporate income tax system's bias in favor of debt over equity.<sup>187</sup> And while debt bias is not inevitable under a corporate income tax, as decades of diverse "corporate integration" proposals have shown,<sup>188</sup> the very fact that none has been enacted may add to the appeal of a "Gordian knot" solution, in the form of eliminating the need to tax income at the entity level.

International tax considerations arguably weigh in this direction as well. The rise of international business transactions, along with capital flows that facilitate income-shifting for tax purposes, in the decades since Simons wrote, may cause longstanding problems with the international tax rules to be ever more damaging to the cause of taxing individuals on the income they earn through corporate entities. With a corporate income tax, in which residence determinations must be made at the entity rather than the individual level, these problems inevitably lack good solutions.<sup>189</sup>

While income taxation surely looks worse administratively than it did when Simons was writing, progressive consumption taxation looks somewhat better. Ogden Mills' spendings tax was fairly rudimentary in design and in its degree of specification. Its lineal descendant, the "Blueprints" cash flow that David Bradford and the U.S. Treasury Tax Policy staff developed in the 1980s,<sup>190</sup> goes considerably further in showing how such an approach might work. It also contains a tax rate-smoothing or income averaging feature<sup>191</sup> that Simons might conceivably have liked, given his belief that this is important.<sup>192</sup> The decades since Simons wrote have also seen the promulgation of an alternative approach to progressive consumption taxation: David

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<sup>187</sup> See Simons, *FEDERAL TAX REFORM*, supra, at 4, 19, and 26.

<sup>188</sup> On the variety of leading corporate integration proposals, see, e.g., Daniel Shaviro, *DECODING THE U.S. CORPORATE TAX* 151-165 (2009).

<sup>189</sup> See Daniel Shaviro, *FIXING THE U.S. INTERNATIONAL TAX RULES* (forthcoming).

<sup>190</sup> See David F. Bradford and the U.S. Treasury Tax Policy Staff, *BLUEPRINTS FOR BASIC TAX REFORM*, supra.

<sup>191</sup> See id. at 44.

<sup>192</sup> See Simons, *FEDERAL TAX REFORM*, supra, at 40 and 127.

Bradford's X-tax, which builds administratively on the rise (since the 1950s) of value-added taxes (VATs) that tax consumption relatively simply and efficiently through broad-based taxes that are collected at the company level.<sup>193</sup> While these progressive consumption tax models remain largely untested, clearly the consumption tax side of the administrability debate has gained ground today, relative to when Simons was writing.

Obviously, one cannot in the end really say what Simons would think today about the choice of tax base if he were miraculously revived and apprised of the last few decades' main developments. He surely would, however, be disappointed by the trajectory of the income tax in recent decades. It thus is plausible that he would be open to considering whether a progressive consumption tax could both do a lot better administratively and sufficiently match the actual progressivity of the existing income tax. If one had a definite answer to these questions, not only Simons' choice but ours would likely be a lot easier and clearer.

## V. CONCLUSION

The Henry Simons who called himself an "extreme conservative" and foe of economic regulation, and the Henry Simons who favored "drastic progression" in the income tax, were one and the same intellectually, rather than just biologically. They shared a dislike for concentrated economic and political power, and a view of liberty and equality as not just comparably important, but also highly interdependent in practice. In his view, unlike that of many of today's libertarians and free market advocates, a plutocratic society would be unappealing even if everyone's legal rights were formally inviolate. It is an interesting question – grist for a number of recent studies<sup>194</sup> – why his concern about economic as well as political power, and his view

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<sup>193</sup> The X-tax combines a VAT with allowing businesses to deduct wages, which are taxed to workers under a progressive rate structure. See David F. Bradford, *The X-Tax in the World Economy* (2003); Alan Viard and Robert Carroll, *PROGRESSIVE CONSUMPTION TAXATION: THE X-TAX REVISITED* (2012).

<sup>194</sup> DeLong, Kasper? Van Horn, etc.

that “freedom without power ... has no substance or meaning,”<sup>195</sup> have faded as much as they have among his successors in the classical liberal tradition.

Intellectual history moves inexorably forward, reflecting not just fashion but new information and improved understanding. Thus, to my mind (although others may disagree), neither Simons’ scorn for theories based on utility and/or ability, nor his analysis of the choice between income and consumption taxation, is persuasive today. His hatred of all hierarchies, while appealing to me emotionally, needs a fuller intellectual foundation than he offers. And his broader economic analysis, such as that concerning the dangers of monopoly power, may in some respects be more dated still.

Even seventy years down the road, however, much of Simons’ work remains compelling, lucid, and persuasive. This is no small accomplishment. His brilliance, vehemence, and urgent commitment to improving the world he lived in helped motivate him to produce, not just a few instances of inspired advocacy, but substantial contributions both to income tax scholarship and to the intellectual and institutional foundations of modern law and economics. I only wish that, in some imaginary place, I could adequately praise and thank him to his face – perhaps over a beer at Hanley’s tavern in the twilight zone, as Walter Blum looks on with a benign half-smile and even Ronald Coase, persuaded at last to accept the value of Simons’ contributions, nods approvingly.

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<sup>195</sup> Simons, *A Political Credo*, *supra*, at 6