ARTICLES DE FOND

Problems of General Income Theory

By

F. NEUMARK

Professor of Economics and Public Finance in the University of Istanbul.

1. — Among the economic problems which have of late been attracting increasing attention are those relating to the concept, nature, and significance of income. It is true that problems pertaining to distribution have always played an important rôle in economic theory and have occupied a prominent place in the systems elaborated by the physiocrats and classical authors. But these early writers had not made clear enough the distinction between income on the one hand, returns (yields), receipts, property (capital), etc. on the other, a distinction to which modern theory justly attributes such great importance. Besides, economic literature up to the end of the last century did not distinguish between the various categories of income in a manner to suit the theoretical and practical needs of our time; the same might be said about the attempts to clarify the specific nature of interest, entrepreneur's profit, and even wages. This omission was largely due to the fact that the classical theorists and many of their successors were interested in functional rather than in personal distribution.

Even today we find that most economic *textbooks* attribute little or no importance to the *general* problems of income. Although such books inevitably make wide use of the concept of income they fail to examine the basic problems related to it. This fact, in my opinion, demonstrates a regrettable lack in this type of literature, which, in this respect, falls behind the evolution of economic practice; the fact that the number and importance of *monographic studies* about certain *special* problems related to income have increased lately does not wholly make up for this lack.

2. — I have alluded to practical needs that provided a stimulus to research work in the field of income problems. What are these needs?

First, there are *fiscal* needs — or the necessity of evolving and elaborating the concepts and theories that are indispensable for the creation and application of modern income taxes. To this we must add the desire to express by a short formula and in the most exact quantitative manner the economic result of the productive activity of a nation, or of the degree in which the needs of its population are satisfied; for this purpose it still seems that *national income* is by far the most adequate means, in spite of many well-known and largely justified doubts and objections. Research on national income undertaken during the last thirty years was the primary cause of critical analyses of income problems, while during the last century and in the early 1900's investigation of these problems primarily followed fiscal lines of inquiry. Finally we must add that the modern science of business management has also made a serious study of some problems of income, especially those related to cost and profit accounting. This is easily explained by the fact that the closest possible calculation of profits «becomes a business necessity with the expansion of the market and a corresponding increase in uncertainty» [1]. Useful and interesting as all these studies may be, they cannot, however, take the place of a thorough theoretical inquiry into the economic problems of individual income. For, notwithstanding the necessity of a close cooperation between economics on the one hand and business management, public finance and statistics on the other [2], one must not neglect the differences between these branches of knowledge with regard to aims and methods of research.

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[1]) **A. Bornemann:** Accounting profits: an institution, «Journal of Political Economy», vol. LI, p. 166.

[2]) The usefulness as well as the limitations of exchanges of view between economic theory and accountancy have recently been stressed by **H. Norris:** Notes on the relationship between economists and accountants, «Economic Journal», vol. LIV, 1944, pp. 375-383.

3. — If we accept, as most theorists are inclined to do, as the date of the beginning of income theory in the modern sense the year of the publication of the well-known book by *F. B. W. von Hermann* «Staatswirtschaftliche Untersuchungen» (first edition, München 1832), we can say that this theory is little more than a century old. This fact is easily explained by the evolution of economic life. To clarify and understand property, yields, profit, wage, etc. was theoretically and practically important even before the 19th century. But «*income*» in general—although the term was in use long before[2*]) — *is a phenomenon attributable only to the capitalist era;* it is conditional upon the prevalence of the rationalistic and calculatory «capitalist spirit», the development of monetary and banking institutions and transactions, and a degree of perfection in the accounting of costs, prices and profits that was, as a rule, unknown before the last century. This makes it easy to understand why even today an exact calculation of income is usually not attained — and in most cases practically not attainable — in enterprises belonging to the «non-capitalist» sector of our economy, such as rural enterprises of the «family farm» type and those of artisans and small retailers. Furthermore, the fact that the first modern income tax was created in Great Britain which was also the first country in the world to build up a capitalist industry, was no mere accident; nor that France, which was the last industrial country of Western Europe to adopt the principles of income taxation, was also the country where the science of business management showed slow progress in comparison with the United States, Great Britain, or Germany. Until very lately, indeed, the problems of general income theory received so little attention in France that most textbooks and treatises on economics did not bother whith them at all; while the French financial theorists and statisticians — apart from a small minority — attributed little or no importance to the examination of national income and the fiscal income concept. Thus the French contributions — at least the original

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[2*]) The word «income» goes back to the 16 th century; it was used in a sense near to the modern one as early as 1601. (Cf. the quotations in «The Oxford Dictionary», ed. **J. A. H. Murray**, vol. V, part II, Oxford 1901, p. 162). The term «revenue» — then having a very broad meaning — exists even since the 15 th century, whereas the French «revenu» — which, in the beginning, was apparently employed in the sense of public income — appears in the 16 th century, (See «Oxford Dictionary», op. cit., vol. VIII, part I, 1910, and **E. Littré**: Dictionnaire de la langue française, Paris 1877, p. 1707, as well as «Revenu», in **A. Furetière**: Dictionnaire Universel, La Haye 1727, t. IV.)

ones — to the solution of modern income problems may be said to be rather small [3]).

Perhaps our previous characterisation of income as a phenomenon solely characteristic of the capitalist era will be questioned as the extravagantly dogmatic formula of a theorist. Were there no incomes during the mercantile era or the middle ages, or even in ancient times? Should not income be recognized as one of the constant phenomena of any economic order? What did the slave-owning land-proprietor in ancient Rome, or the craftsman of the feudal system, or the merchant of the early capitalist era use to pay his living expenses from, if not his income? And were there not already in pre-capitalist times income taxes and even attempts to calculate national income such as that by *G. King* (1696)?

Although these questions seem quite legitimate at first sight, in fact they imply a failure to grasp the very nature of the issue we are concerned with, which is that certain returns of a particular enterprise cannot be considered elements of «income» in the modern sense of the word, at least not fully, and that the use of monies or goods not coming within the theoretical concept of income to meet the expenses of everyday life results in unsoundness in private and national economy. A clear distinction thus assumes great theoretical and practical importance. Indeed, it will be seen from the ensuing argument that it is impossible to define income in the strict sense of the word without a clear understanding of the concepts of property, or capital, and yields.

Income is an *abstract quantity*, the «result of certain arithmetical operations» *(H. C. Simons)*; its existence, as *A. Schäffle* puts it, «is confined to accounting books» [4]). Just as capital, money, etc.,

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[3]) For the French literature, see the remarks of **P. H. Wueller:** Concepts of taxable income, «Political Science Quarterly», vol. LIII, 1938, p. 84, and **Allix:** L'impôt sur le revenu, t. I, Paris 1926, pp. 164 ff. — Recent contributions of French writers to the theory of income are found in the following books: **Allix:** op. cit.—**Ch.-A. Colin:** La notion du revenu en matière de législation fiscale, Thèse, Paris 1924. — **L. Bocquet:** L'impôt sur le le revenu, 3. éd., Paris 1926, pp. 763 ff. — **B. Nogaro:** Principes de théorie économique, Paris 1943, chap. VII. — **H. Laufenburger:** Précis d'économie et de législation financières, t. 1, Paris 1941, pp. 35 ff.

[4]) Cf. **H. C. Simons:** Personal Income Taxation, Chicago 1938, pp. 78-80. — **Schäffle:** Mensch und Gut in der Volkswirtschaft, «Gesammelte Aufsätze», Bd. I, Tübingen 1885, p. 173. — Also for **C. Heer** (Personal Income Taxes, «The Annals of the American Academy of Political and Social Science», January 1936, p. 80) income is «not an objective fact» but «a theoretical concept concerning the exact

income can be correctly understood and appreciated only through its function[5]). If one is disposed to accept the concept of «gross income», one may say with *Schäffle* that this income is a «real» quantity. But there can be no doubt that *net* income is an abstract concept discovered by modern economic theory, not as an idle intellectual speculation but as an indispensable instrument for the theoretical penetration of contemporary economic processes, and for the accomplishment of very practical tasks by private enterprise and public finance. Moreover, the increased importance of the dynamic income concept as against the static concept of property is a logical corollary to the ever-growing «dynamification» of economic processes that is so characteristic a feature of the development of capitalism.

4. — What is true of income in general is particularly true of *entrepreneur's profit*, which is the most dynamic category of income. We shall have to treat this subject here in a very short space [6]).

If we examine the history of the doctrines and theories relating to entrepreneur's profit we find that also this history is closely conditioned by, and tied up with, the practical evolution of the phenomena and institutions of modern capitalism. Classical theory, as formulated by *Smith, Ricardo* and *Malthus* in the early days of economic science, and even later in the form *Marx* [6*]) gave it, considered as «profit» the total earnings of the entrepreneur-capitalist; clear distinctions such as that between interest and profit were not made. This is largely explained by the fact that during the first half of the 19th century the entrepreneur was still in most cases

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content of wich even theorists are not entirely agreed». — Reference is further made to **B. Moll:** Probleme der Finanzwirtschaft, Leipzig 1924, p. 132, **E. Lederer:** Aufriß der ökonomischen Theorie, 3. Aufl., Tübingen 1931, p. 80, and **A. Garelli:** Il concetto di reddito nella scienza finanziaria, «Il Filangieri», 1917, p. 337.

[5]) **F. Neumark:** General theory of economics (in Turkish), vol. I, second edition, Istanbul 1944, §§ 16, 21 and 22.

[6]) Cf. **Neumark:** op. cit., vol. II, Istanbul 1942, pp. 419-444, and the studies cited there and pp. 542-543, especially those of **J. B. Clark, Marshall, Taussig, Schumpeter, F. Perroux, U. Ricci, Diehl, Eckert** and **Amonn.** — As is well-known, entrepreneur's profit in the strict sense is according to **Schumpeter** — whose theory we think in the main correct — exclusively a phenomenon of «economic development» (see his «Theory of Economic Development», Cambridge 1934).

[6*]) **Marx,** although he recognises that «profit, interest, commercial gainings, rent, etc.» are different and independent forms of what he calls «surplus» (Mehrwert) and that these «fragments of the surplus» fall to different categories of persons, does not sufficiently clarify the issue in question. Cf. **K. Marx:** Das Kapital, Volksausgabe **(Kautsky)**, 2. ed., Stuttgart 1919, vol. I, pp. 501, 523.

his own financier, and therefore the separation between the two functions was far less clear-cut than the economic and social separation between entrepreneurs and wage-earners. Yet the classical English theory of profit was little suited to the economic conditions which existed, for example, in Germany and France at the beginning of the last century. Therefore it is not astonishing that in the latter countries, partly owing to differences in the prevailing economic and social ideologies, greater importance was attributed to factors like the share of the entrepreneur in the production activity taking place in his own enterprise, his assumption of risk, etc.; accordingly, elements such as the «wage of management» or the «risk premium» were separated, for accounting and calculating purposes, from total profits, and contrasted with «profit» in the strict sense — imputable to the specific directing entrepreneur activity — and interest — the share imputable to capital investment —. This conception of profit was based largely upon the «wage theory» of business profits presented by *J. B. Say* («Traité», Livre II, chap. VII, § III) which had been developed in Germany ever since the beginning of the 19th century *(G. Hufeland, L. H. von Jacob;* later, in a more systematic and comprehensive manner, by *H. K. E. von Mangoldt);* it was better fitted to the craftsman-and-peasant economies still existing in continental European countries than the English doctrine of profit. The further development of economic life showed that it was the German theory (later adopted and perfected by the science of business management) that proved more serviceable in economic practice.

5. — Although I do not intend to enter here into a detailed discussion of the problems pertaining to the general income concept — for this I refer to the studies mentioned previously by *P. Wueller*, *H. C. Simons* and the present author — I wish to emphasize the fact that the formulation of this concept is decisively conditioned by a desire to exclude from it receipts, the treatment of which as elements of income would impair the capital stock of the individual or corporation in question; and to make sure of including those receipts which, on account of certain peculiarities, are usually not regarded by the recipients as elements of their income, although they have income character. As I have pointed out before, the older economic theory and practice knew of no such clear classification of receipt items [7]).

[7]) In medieval finance, too, we find levies the object of which was a mixture of income and property. See **K. Bücher**: Zwei mittelalterliche Steuerordnun-

But as, with the evolution of capitalist economy, the relative importance of capital borrowed from outside investors in enterprises increased apace and personal net profit taxation became more wide-spread and rigorous, clear distinctions became more and more essential.

For a long time the recurrence or *periodicity* of receipts was considered a criterion determining income character; this view led many to the so-called «*source theory*» which postulates that the existence of an enduring source of receipts is essential for the income concept [8]). To this doctrine *G. von Schanz* opposed his famous «*theory of net influx of wealth*» [9]) which considers as income every receipt that increases the economic disposing power of the recipient. This definition abolishes, first, the criterion of periodicity which is indeed becoming increasingly inapplicable to modern economies with their cyclical business fluctuations, mass unemployment, etc.; secondly, it rejects the view, often found among the older theorists, that income is all that is available for the purpose of consumption, provided the consumer acts in what is called a «rational way», a formula which would exclude from income non-recurrent receipts such as inheritances, sweepstake gains, etc. On the other hand, the principle — emphasized already by *Malthus* — of «preserving the source of income» or, as *Pigou* [10]) terms it, the principle of «maintaining capital intact», is naturally given due consideration in the income concept established by *Schanz*. According to this concept «income» is *net* income and excludes not only interest payments as well as capital losses, but also expenditure undertaken to maintain capital stock (repairs, wear and tear, obsolescence, etc.).

6. — *Schanz's* income concept has been critized ever since it was

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gen, «Festschrift zum Leipziger Historikertage», 1894. — **B. Moll:** Zur Geschichte der Vermögenssteuern, Leipzig 1911. — The logical structure of the modern concept of property is, by the way, much the same as that of the income concept; as **Bastable** rightly points out («Public Finance», third edition, London 1922, p. 470) property is in many cases «only an abstraction obtained by capitalising revenue», and capital value, according to **Bücher** (op. cit., p. 139), is «an artificial abstraction in accordance with the capitalistic conception of developed credit affairs».

[8]) Apart from some minor differences the same idea is urged by **Plehn, Hermann, Fuisting, Allix** and **Papi.**

[9]) Cf. **Schanz:** Der Einkommensbegriff und die Einkommensteuergesetze, «Finanz-Archiv», Bd. XIII, 1896, p. 1 ff.

[10]) **A. C. Pigou:** Economics of Welfare, 4. ed., London 1932, p. 43.

established for being «too broad» [11]). A great deal of that criticism was inspired by considerations of economic and fiscal *policy*. Now it may become desirable for reasons inherent in economic and social policy or fiscal technique to exempt from income tax certain receipts which, considered from the angle of pure economic theory, would undoubtedly form a component of income; on the other hand, the opposite situation might occur, i. e. certain other receipts which do not fall within the economic concept of income might be subjected to income tax. But this circumstance does not constitute a valid objection to that concept, provided it has been correctly defined in the first place. For one thing, the fiscal income concept must not necessarily coincide with the economic — just as returns of profits for fiscal purposes differ from actual commercial profits — but may be formed with an eye on the peculiar needs of fiscal laws; besides, modern fiscal technique offers sufficient means of favouring or discriminating against some kinds of income in relation to other. Suffice it to recall in this respect the manifold graduations and differentiations to be found in all modern income tax tariffs: apart from the progressive rates of the British Surtax, the German «Reichseinkommensteuer» and the French «impôt général sur le revenu», the differentiation of charges on «earned» and «unearned» income in Anglo-American tax practice, the systematic discriminations by rates in the French «impôts cédulaires» and the Italian «imposta sulla richezza mobile» [12]), and the voluminous catalogue of exemptions to be found in every modern income tax act [13]). Furthermore, because income, as something essentially personal and individual, stands opposed to the impersonal category of yields, I think that *only physical persons* should be considered as recipients of «income», and not collective bodies, such as corporations, trusts, etc. Nevertheless it may prove convenient to treat the profit of corporate bodies *as though it were income* for *fiscal* purposes. On the other hand, modern income tax laws, as is well known, exempt from taxation the so-called minimum of subsistence. Although there are authors who think that the subsistence

[11]) Nevertheless there are also some authors, like **Haig, H. C. Simons, B. Moll** and **Gobbi**, who adhere to a conception coinciding more or less with that of **Schanz.**

[12]) For details reference is made to **F. Neumark**: Income Taxes (in Turkish), İstanbul 1945.

[13]) See **O. Deppe**: Die Ausnahmen von der objektiven Steuerpflicht in der Einkommensteuer (thesis Frankfurt), Stuttgart 1930.

minimum should be deducted from (net) income as representing the «expenses of acquisition» of the wage-earner[14]), the majority of modern economists rightly do not share this view. In other words, although the deduction of a sum equivalent to the minimum of subsistence is legitimate from the social and fiscal viewpoint, it would be wrong to conclude that this minimum is not a component of income within the meaning of economic theory. The same line has been taken with regard to other controversial kinds of receipts by the famous American financial theorist, Prof. *Haig* [15]); according to that author it may be advisable to exempt from income tax unrealized increases of wealth or the rental value of a house inhabited by the owner; but such exemptions cannot be justified on the ground that the items mentioned are not genuine elements of income.

7. — Even if we are disposed to make the economic definition of income as broad as possible, we must admit that we cannot regard as income elements *all* the receipts coming to an economic subject in the course of a year. But *what criteria* should be used in order to make the proper selection? In other words: what conditions must be satisfied by receipts in order to be considered as parts of income? In my opinion there are two such criteria: Firstly, receipts must be *amounts arising from the participation of the recipient in the formation of the social product;* secondly, even such receipts are elements of income only *if and insofar as they result in an effective accretion to the economic disposing power of the recipient.*

What are the consequences of the acceptance of these criteria from the point of view of the income concept?

8. — Let us first point out that neither «derived» [16]) nor «ineffective» receipts [17]) could then be part of income.

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[14]) **Britzelmayer:** Vermögensteuer oder Nachlaßsteuer?, Jena 1930, and **W. Lotz:** Finanzwissenschaft, second edition, Tübingen 1931, p. 340. — See also the remarks of **L. M. Fraser:** Economic thought and language, London 1937, pp. 336-37. (It is only after finishing the present article that I have had the opportunity to consult this very interesting book.)

[15]) **R. M. Haig:** The Federal Income Tax, New York 1921, p. 14.

[16]) The meaning of «derived receipts» has repeatedly ohauged in the course of two centuries of evolution; see **Neumark:** Theory of economics, op. cit., vol. II, pp. 207-210.

[17]) **W. Winkler:** Einkommen, «Handwörterbuch der Staatswissenschaften». 4. ed., vol. III (1926), p. 368. — In this connection we may mention that the concept of «effective receipts» plays also a part in the Italian budget («entrate effettive»). See **Graziani:** Istituzioni di Scienza delle Finanze, 2. ed., Torino 1911, p. 118, and **A. De Stefani:** Manuale di Finanza, new ed., Bologna 1932, p. 270.

a) *Derived receipts* (which are often called «derived *incomes*» in contrast to «primary incomes») are transferred without compensation from one economic subject — which may be an individual or a public body — to another; the reason for such transfers of value is found in social or charitable motives and observances, and not in any tangible contribution by the recipient to the volume of the social product. All kind of gifts, donations, alms, allowances to relatives and friends, etc., are included among such derived receipts. Although the recipients can dispose of them *as if* they were actually income, I think it preferable to link the concept of income with the sphere of production, especially because only in this way can troublesome double-counting be avoided.

According to an opinion which was largely adhered to in the last century and has even today some adherents (e. g. *H. Ritschl* and *H. Jecht*) *taxes* also would be a kind of «derived income». At first sight this conception seems to be quite reasonable. Is not individual income the original source of taxes? Is taxation not a shifting of the flow of private incomes to the channel of public finances? A more thorough examination of the problem, however, shows that those ideas are in no way compatible with the very nature of the modern State and of taxation[18]). For, in view of the compulsory character of present taxation, any analogy with donations etc. necessarily breaks down, just as the parallel drawn by some authors between taxes and robbery. Altogether every attempt to compare taxation with any category of income available to private individual economies is fundamentally erroneous, since such a comparison neglects the essential difference between private individual receipts realized by way of exchange on the one hand, and authoritatively fixed taxes which are not based on a quid-pro-quo principle, on the other[19]). If one thinks it necessary to consider certain receipts of public authorities as income elements, such a viewpoint may be taken, if at all, only with reference to net profits of public enterprises. (Even that is in my opinion not very proper.) Let us add, however, that in estimating national income, there may arise problems the solution of which re-

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[18]) In this connection we may also refer to C. Perreau (Cours d'Economie Politique, 4. ed., Paris 1928, vol. II, p. 288) according to whom taxes, together with wage, profit, rent and interest, represent a «fifth category of income».

[19]) The nature of modern taxation has been examined in an article by the present author: Begriff und Wesen der Besteuerung, «Revue de la Faculté de Sciences Economiques d'Istanbul», vol. I, 1939-40, pp. 271-96.

quires us to take account of public revenue, perhaps even of certain taxes [20]). But from this no objection to our view can be derived, for the concept of national income cannot be formed in full harmony with that of individual income as construed by economic theory.

b) As for *ineffective receipts*, these fall into two groups: The first includes all sort of cash receipts such as withdrawals from saving accounts, cashing of credits, liquidation of capital assets, etc., which do not represent any increase in economic disposing power but only a shift in the capital or property structure, cash receipts being balanced by corresponding decreases on capital accounts. The second includes those parts of receipts of income character which are equivalent in value to the expenditure necessary to obtain these receipts. While there seems to be no need to deal at greater length with the first of these groups, the second brings up the entire complex problem of what might be termed «expenditure of acquisition of income», which is given more attention later in this study. I may confine myself here to stating provisionally that the above argument implies that income is by definition a net quantity, for we arrive at it only after deducting from the gross receipts coming to an economic subject such items as can be assembled under the comprehensive heading of «expenses for the acquisition and maintenance of income» („Werbungskosten"). When calculating national income, or in commercial accounting, it might be useful or even necessary to make the distinction between gross profit (or gross product) and net profit (or net product); but individual income should be defined in advance as a net quantity.

9. — Although in principle we think it necessary to assume as one of the criteria of income the «compensation character» („Ent-

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[20]) The literature dealing with these problems has recently much increased. See, e. g., **S. Kuznets:** National income, «Encyclopedia of the Social Sciences», vol. XI, p. 205. — **C. Clark:** National income and outlay, London 1937, pp. 12, 82. — **H. Barger:** Outlay and income in the United States 1921-1938, New York 1942, p. 32. — The recent British White Papers on national income, e. g. «An analysis of the sources of war finance and an estimate of the national income and expenditure in 1938, 1940, 1941 and 1942», Cmd. 6438, London 1943, as well as the studies dealing with these Papers which have been published in the «Economic Journal» by **R. Stones, N. Kaldor** and **M. Gilberts** (vol. 52, 1942, pp. 154, 206, and vol. 53, 1943, pp. 60, 76). — Numerous articles in the «Bank-Archiv» 1942 (especially those by **Kelser, Pfleiderer, Jostock** and **Lautenbach**) and in the «Weltwirtschaftliches Archiv» (particulary the studies by **C. Clark:** vol. 47, 1938, p. 58, **Derksen:** vol. 54, 1941, p. 257, **Dehen:** vol. 57, 1943, p. 238, and **H. Moeller:** vol. 58, 1943, p. 64).

geltsnatur") of receipts we must admit that the application of this criterion meets with certain difficulties in cases where the income character of receipts is not usually questioned. Thus, while wages and salaries as well as entrepreneur's profit proper [21]) would probably be accounted as income under any conceivable definition of the term, in the case of interest and rent the question might well be raised of what constitutes here the «contributions» of the recipients to the formation of the social product for which they are «compensated» by these receipts.

Indeed, it is not any active participation — at any rate, not any *actual* participation — of the capitalist or land-owner in the process of production which justifies interest and rent. An *economic* explanation of these phenomena is open only to the theory of *functional* distribution. From the angle of the theory of *personal* distribution, however, the fact that the surplus value due, and therefore imputable, to the participation of capital and land accrues to the owners of material agents of production can be explained only by a *juridical* line of reasoning, or more precisely, by reference to the legal institution of private property, essential for our economic order. The well-known reference to «past labour» of the owner or his ancestors serves less as an explanation than as an ethical justification of the receipt of interest and rent; moreover, it breaks down completely in many cases, particularly with regard to certain rent receipts.

After all, the pertinent «service» to production of capitalists and landowners, which procures for them an income in the form of interest or rent, consists merely in their letting the material means of production in their possession play an active part in the formation of the social product, either under their own direction or by loaning

[21]) According to **J. Schumpeter** (Theorie der wirtschaftlichen Entwicklung, 3. ed., München-Leipzig 1931, p. 236) entrepreneur's profit is «no income category at all, provided one accounts the regular recurrence of a receipt a characteristic of income quality». But although we do not consider periodicity as an essential criterion of the income character of receipts, we think that **Schumpeter**'s conclusion, even if one accepts the periodicity criterion (and: the profit theory of the author himself), is in no way cogent. For though **from the viewpoint of an individual enterprise** entrepreneur's profit is something essentially transitory, it represents **from the viewpoint of a national economy as a whole** a permanent category of income, as each moment some entrepreneurs — however their number and successes may fluctuate — endeavour to «carry through new combinations» owing to which genuine entrepreneur's profit arises. The antinomy automatically disappears if one accepts the distinction urged by **Wueller** (op. cit., p. 99, note 34) between «category periodicity» and «recipient periodicity».

them temporarily to third persons for a certain remuneration. In any case it is, in the last resort, rules of private property law which allow land and capital owners to appropriate the yields resulting from the productive utilization of their agents of production. While in the case of certain rent receipts the situation is complicated by the interference of natural or accidental monopoly powers, there can be no doubt that, in the case of interest, primary significance within the framework of the theory of personal distribution attaches to the interest on loans. Only inasmuch as the capitalist as such receives from third persons a remuneration for the temporary loan of «capital disposal» on the basis of conventional or legal norms, he may, or even should, impute for himself an appropriate interest also where his capital is invested in his own enterprise. This view is a logical inference from principles indispensable to a capitalist economy, bound up as it is with uniform and exact cost accounting [22]).

10. — If we accept the two criteria mentioned above another conclusion would be that not only the periodicity of receipts but also the question whether they are *in cash* or *in kind* makes no difference to their income character. It is a moot point, however, *which* actual receipts in kind can, or must, be considered as income elements.

Special significance in this connection attaches to the problem of the income status of «*self-consumption*». I think that no solution of this question can claim absolute validity, because it will always depend largely upon the purposes pursued by the investigation. Besides, the solution will vary according to the concept of social product adhered to by the investigator, and the side he takes in the argument mentioned by *J. Stamp* [23]) between «materialists» and «idealists».

a) If we join the main body of modern opinion in calling «social product» that *fraction* of the annual output of an economic society which passes through the market and so enters, by means of the price mechanism, the process of distribution, it is evident

[22]) The above-mentioned view enjoys nowadays ever increasing recognition, though, strangely enough, by economic theory rather than by accountancy. Reference is made to **Neumark:** Economic Theory, op. cit., vol. II, pp. 330, 349-50 and the studies there mentioned. Besides cf. **Kester:** Advanced Accounting, 3. ed., New York 1938, pp. 515 ff. — **E. Schmalenbach:** Dynamische Bilanz, 6. ed., Leipzig 1933, pp. 161-62. — **G. Zappa:** Il reddito di impresa, 2. ed., Milano 1943, pp. 316 ff.

[23]) **J. Stamp:** The national capital, London 1937, p. 76.

that the value of «self-consumption» can *not* be considered as part of income. It is true that, for the supply situation and the consumption possibilities of a farmer, there is no essential difference between the value of the butter which he has produced and consumed himself, and the money value of the proceeds he obtains by selling such butter; but we must bear in mind that the goods consumed by their producers remain outside the process of personal distribution and in this respect differ considerably from receipts which by virtue of the market and price mechanism, accrue in the form of cash that is characteristic of our present-day economic system. In view of this dilemma it seems advisable to eliminate the value of self-supplied goods and services from the concept of income in the strict sense, but to admit for certain definite research purposes outside this concept one that is *wider* and contains not only all receipts that fall within the scope of the strict concept, but also tangible goods that are directly consumed by their producers, provided these goods are customary objects of market exchange.

b) In specifying «*tangible goods which are customary objects of market exchange*» I am obviously restricting even the sphere of the wider income concept in a twofold way, which can be justified, as I said, only by considerations of expediency. I am far from espousing unreservedly the cause of the «materialists» in their above-mentioned argument with the «idealists». But while I have no doubt that it is correct to consider payment for «intangible goods» (i. e. all sort of services) as income proper, provided these goods are exchanged in the market, I think we are faced with a serious dilemma the moment we attempt to include in the income category the value of what *B. Moll* terms «*the self-consumption of services*», i. e. of services produced and consumed within the confines of the same private economy [24]). If we want to include also the utilities derived from «consumers' capital», i. e. from durable consumption goods, the logical and statistical difficulties increase considerably, as will be seen further on.

All the above question traditionally play their largest part in studies of national income, but at least some of them may be brought up also in connection with individual income. Here we must adopt the view, in common with the majority of modern writers, especially Anglo-American economists, that the decision is largely a matter of

[24]) This point has been stressed by **Kleinwächter**: Das Einkommen und seine Verteilung, Leipzig 1896.

convention and that only services or material goods which «are exchanged, or capable of exchange» *(Stamp)* can be considered as income elements [25]). Consequently, in computations of national income as well as taxable individual income, economic practice commonly[26]) recognises as income components only the imputed rental income to home-owners, but not the value of domestic services rendered by members of the family, or that of furniture, household utensils, pictures, etc., in short, things which are not customarily intended for exchange. The author of a recent study about Canada's national income, *Cudmore,* rightly states that «certainly most people never think of their non-money income at all, and would never dream of putting the rental value of their owned houses into their income tax returns». The same might be said with even greater justification of the domestic services of married women and services to oneself such as shaving one's own beard rather than buying the services of a barber. Apart from these cases that may be grouped under the heading of self-consumption in a broad sense, we might also examine the utilities derived by an individual from public services such as public education, highways, the dispensation of justice, cultural services, etc.; we should have to admit that these, too, cannot properly be considered part of the individual's income. (Investigators of national income may adopt a different view.) For on the one hand, few public services are «capable of exchange», and on the other hand, it would be incorrect to think of the individual's share of such services as the equivalent value of the taxes paid by him to the State for establishing and maintaining such services [27]).

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[25]) **Stamp:** op. cit., p. 74. See also **C. Clark:** op. cit., p. 6.

[26]) Sometimes the regulations are more rigorous. According to the German income tax law of 1939 (§ 4, al. 1), e. g., «all economic goods (withdrawals in cash, commodities, products, **utilities and services**) which the taxpayer takes out of the enterprise for himself, his household or other purposes not connected with business» are to be reckoned as part of income (profit). From the explanations of a competent commentator, however (see **W. Blümich:** Einkommensteuergesetz, 5. ed., Berlin 1943, pp. 106-8), it results that the legislator is not particular as «to the utility the withdrawals represent to the entrepreneur (viz. as an individual)» but only interested in whether such a «self-consumption of services» involves costs to the enterprise as such.

[27]) Recently the eminent American economist **S. Kuznets,** in his research on the national income of the U. S. (National income and capital formation, 1919-1935, New York 1937), has in a way revived the old «exchange-theory» of taxation, considering taxes as prices of public services paid by social consent.

I am aware, however, that the narrow definition of self-consumption that I am suggesting is unsatisfactory on several scores. Thus in the investigation of the volume of consumption of individual economies the omission of «self-consumed services» (or for that matter, utilities of durable consumption goods and the benefits derived from public services) may appear as a regrettable gap. It should be remembered, though, that where this gap is even more important, viz. in computations of national income, it can be filled more or less adequately by estimates, and that such injustices as might arise from the acceptance of our concept in income taxation can readily be removed by appropriate provisions of tax legislation, which is independent of economic theory. Moreover, the decisive fact, already alluded to above, is that every step across the limit marked «exchangeable tangible goods» leads into a veritable jungle of logical difficulties and invites the danger of disrupting the close systematic connection between income and production (or distribution). This is true not only for the broader income concept which includes self-consumption, but also for our narrower concept of income proper, for which in this connection there only arises the question of how to treat the utilities from durable consumption goods.

11. — I have only been strengthened in my conviction that the values of «intangible goods» must be excluded from the economic definition of individual income (unless they represent values of services realized through market exchange) by a recently published study of «*imputed income*» [28]) which, while primarily guided by consideration of fiscal policy, presents a shrewd analysis of the problem. Its author, *Donald B. Marsh*, regards «imputed income» as that species of «income in kind» which «arises outside the ordinary processess of the market» and defines it as «a flow of satisfactions from durable goods out of the personal exertions of the tax-payer on his own behalf». Defined thus, imputed income comprises a) self-consumption of tangible goods, b) self-consumption of services, c) satisfactions from durable goods. If we leave aside the first item, which is not controversial, the following may be said:

Speaking of self-consumption of services, *Marsh* mentions as a «major source of imputed income» the much-quoted «tedious and un-

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Although defended with much acumen by the author this conception seems to mistake the real nature of modern taxation.

[28]) **D. B. Marsh**: The taxation of imputed income, «Political Science Quarterly», vol. LVIII, 1943, pp. 514-36.

requited labor of housewives», and furthermore states the case of «a suburban dweller who has to decide whether to hire a gardener to care for his lawn or whether to do the job himself». Now it may at first glance appear startling that the intermediate value only of «imputed wages from housework» in the United States has been put at nearly $ 22 billion in 1940; but closer inspection of the problem reveals that little is gained by such estimates for the determination of the income status of such «imputed» receipts. Leaving aside the problematic nature of the computations themselves [29]), it should be kept in mind that there are «imputed» receipts for which analogies from the realm of market exchanges, and consequently bases for quantitative assessment, are lacking. The difficulties arising there — which *Marsh* perfectly realizes — are those confronting every income theory which defines income in terms of an «inflow of satisfactions from services and utilities», i. e. as a psychic category. (I shall return to this type of theory in another context). Moreover, how is this formulation of income to cope with the requirement, indispensable for the notion of income, of determining quantities, in cases where there is a question of «enjoyment of leisure», which *Marsh* [30]) rightly calls «of all satisfactions, the least susceptible of measurement in monetary terms»? In the case of «gentleman gardening» cited above, if one assumes that an imputed income is enjoyed by the owner, and simutaneously admits that a psychic kind of imputed income accrues to him if he «likes tall grass and the leisure of contemplating it», how is one to arrive at a logically clear and sharp separation of those imputed receipts which should be incorporated in the economic income concept? Pursuing his fiscal line of inquiry, *Marsh* winds up by defining as elements of taxable income only those imputed receipts which can be assessed with relative ease and promise a sizeable revenue, i. e. besides the imputed rent on owner-occupied houses, the imputed interest on such durable consumption goods as automobiles, furnishings, electrical apparatus, radios, and air-planes. (Let us mention here that *H. C. Simons* [31]) who takes much the same view as *Marsh* proposes the use of some multiple of

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[29]) These estimations have to suppose, e. g., that the market price which they are based on, will be the same as that, which would result if the whole supply of the commodities and services in question (i. e. including the self-consumption) would have been brought to market. This hypothesis, however, is in no way absolutely cogent.

[30]) **Marsh:** op. cit., p. 519.

[31]) **Simons:** op. cit., p. 121.

home rentals which are presumed to correlate highly with the net rental values of furniture.) There may be weighty arguments of fiscal and economic policy in favour of including such imputed receipts in taxable income [32]). But economic income theory must follow the rule of «all or nothing»; since «all» it cannot be it must be «nothing», i. e. the values of self-consumed services must be neglected in the same way as the utilities of consumer's capital.

12. — A problem that has long been the subject of controversial discussions is concerned with the income character of so-called *capital gains;* in such discussions the distinction between «realized» and «unrealized» capital gains usually plays a prominent part [33]). The problem has frequently been tied up, especially by American theorists, with another and essentially distinct one, which enquires whether the use which is made of receipts is of significance in determining their income character, i. e. practically whether those receipts which are not destined for consumption but for capital formation (savings) should or should not be thought of as income [34]).

In both these questions the positions taken up by the authors are greatly influenced by ideologies of economic policy which themselves are not independent of prevailing economic realities. Particular clear examples of this interdependence are afforded by certain American theories, notably those of *R. E. A. Seligman* and *I. Fisher*. Both authors, regardless of other differences, are agreed that income is a psychic category consisting in a flow of utilities or satisfactions. The arguments of these theorists, highly artificial and questionable on both logical and terminological grounds [34*]), have the

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[32]) See **Marsh:** op. cit., pp. 518 and 534 ff.

[33]) The significance of «realization» has been examined especially by American anthors. Cf. — besides **Seligman** and **Simons** — **R. Magill:** Taxable income, New York 1936.

[34]) **Seligman**: The Income Tax, New York 1911 (and further editions), and: Are stock dividends income? («Studies in Public Finance», New York 1925, pp. 98 ff.). — **I. Fisher**: The theory of interest, New York 1930, as well as the following studies of the same author: Der Einkommensbegriff im Lichte der Erfahrung («Wirtschaftstheorie der Gegenwart» — Festgabe für Wieser — vol. III, Wien 1928); Income in theory and practice, «Econometrica», vol. 5, 1937, p. I ff.; Double taxation of savings, «American Economic Review», vol. XXIX, 1939, p. 16 ff.; Constructive income taxation, New York 1942. — For a critical analysis of these ideas see **Simons:** op. cit., p. 85, and **Wueller:** op. cit., pp. 558, 571.

[34*]) It is noteworthy that **Fisher's** conception has lately been rejected even by accountants as «intenable»; see **Norris:** op. cit., p. 376, and p. 381, note 1, as well as the critics by **Zappa:** op. cit., p. 260, note 4.

practical effect of severely restricting the concept of income while seeming to give it the broadest conceivable definition; thus in the end not only donations and inheritances but also most capital gains are excluded from the definitions of income, and may consequently be postulated as exempt from income tax.

It is undeniably true that theories like those of *Fisher* and *Seligman* were in complete harmony with the extreme capitalist ideology and practice which dominated U.S. economic policy up to the New Deal period, and which, among other results, caused the bulk of receipts from public loans to be exempted from income tax [35]. Notwithstanding this, or perhaps because of it, those theories (which *Wueller* justly describes as «normative rather than analytical» [36]), in effect prejudice independent theoretical research in favour of certain axioms of financial and economic policy which are by no means uncontroversial, and cannot claim universal validity. The economic desirability of maximum formation of private capital which forms their kernel has been made to appear very questionable — for certain sets of conditions at any rate — by recent economic theory under the influence of *J. M. Keynes*. It is probable that a combination of data which made maximum capital formation appear desirable did exist until the first World War in the U.S.A. and several other countries, notably Italy, where *Fisher's* theories met with particularly keen approval [37]; in the immediate future, following the unprecedented capital wastage of the present war, it may again exist temporarily

[35]) Which **Simons** (op. cit., p. 170) rightly terms «the most flagrant and least pardonable of all such errors of omission». — Further works dealing with the «tax-exempt securities» problem are **G. Jèze:** La technique du crédit public, Paris 1925, pp. 116, 210. — **O. Schulze:** Der «New Deal» . . ., Jena 1940, p. 92. — **S. Rainer:** American taxation, NewYork 1942, pp. 485 ff. — **J. W. Martin:** The social aspects of tax exemption, «The Annals» (Am. Academy of Pol. and Soc. Science). Jan. 1936, p. 48, and the recent book of the same author: Tax exemptions, New York 1939.

[36]) **Wueller:** op. cit., p. 580.

[37]) In this respect reference is made — besides **F. Flora** a. o. — especially to **Einaudi:** Intorno al concetto di reddito imponibile . . ., Torino 1912. — **Einaudi's** ideas, particularly his postulate to exempt savings from taxation, have been severely criticised by **Fanno, Griziotti,** and especially **U. Ricci:** Reddito e imposta, Roma 1914, p. 45; La taxation de l'épargne, «Revue d'Economie Politique», 1927, pp. 860ff.; Ancora la tassazione del risparmio (Estratto da «Studi economici finanziari corporativi», ed. by the «Istituto di Finanza della R. Università di Napoli», Roma 1942). See also the remarks of **E. D'Albergo:** Principii di Scienza delle Finanze, Milano 1940, p. 361, and **Wueller:** op. cit., vol. LIV, 1939, p. 572.

even in economies which, like the British, had on the whole already passed on to a different phase of development. But evidently quite different sets of conditions may, and do, occur, such as a dangerous propensity to «over-saving», which could only be sharply aggravated by actions on the lines of *Fisher's* and *Seligman's* theories. This being so, it is evident that the answer to the theoretical questions raised here must not be sought in relation to any axioms of economic policy or to fiscal considerations, the applicability of which varies in space and time.

The general remarks above may serve to introduce a short discussion of the two specific problems to be raised here which concern the places of capital gains and savings in income theory.

13. — As regards *capital gains,* a difference has to be made between the financial results of professional speculation, which consciously aims at realizing such gains, on the one hand, and changes in the value of capital (property) due to structural and, particularly, cyclical changes, on the other hand, which are not imputable to any productive activity on the part of the capital owner. While there can hardly be a doubt concerning the income character of professional speculation gains — except from the angle of an income theory which stresses periodic recurrence as a criterion — the nature of accidental capital gains is not so clearly defined. Their siginificance varies depending upon the accounting viewpoint accepted, which may be that of the «static balance» serving to establish the capital (property) situation, or that of the «dynamic balance» serving to establish the profit results of current economic activity. For our enquiry only the latter is relevant. Taking this stand, then, it becomes evident that by our two income criteria, *unrealized* gains from changes in capital value not due to speculation must be disregarded in the calculation of net income, because they represent at most a potential, but not an actual and real increase in economic disposing power. Such an increase cannot appear until the gain is *realized* through the sale of the object in question. But even in this case it must be taken into account that the realized gain does not represent receipts resulting *from* the participation of the recipient in the formation of the social product, though the gain is realized *on the occasion of* such participation.

The conclusion from the above argument is that even realized capital gains must not be regarded as elements of income, but as *increments of capital* (property). This conclusion appears all the more justified as in many cases the gains in question are purely inflationary, i. e. fictitious and nominal in character, and are moreover — to the extent that they are caused by factors inherent in the business cycle — offset in the long run by corresponding capital losses. I should add, however, that my stand taken in economic theory does not exclude or invalidate a different treatment of capital gains and losses in commercial and tax legislation. I mention in this connection that practically no modern income tax law[38]) regards unrealized increments of capital values as taxable income, whereas the fiscal treatment of such gains, when they are realized, differs widely in space and time.

14. — *I. Fisher* is one of the most prominent exponents of the view that only consumed receipts constitute genuine income, while *savings do not.* If, on the other hand, our two criteria are accepted as valid, it becomes clear that all receipts satisfying them partake of the character of income, regardless of whether they are used for consumption or saving. Here again it should be conceded that this *theoretical* recognition notwithstanding, a preferential fiscal treatment of savings may appear desirable under certain conditions as a measure of *economic policy.* But all arguments advanced by *Fisher, Seligman, Einaudi* and others should not tempt us to overlook the fact that in the theoretical definition of income it is of primary importance to establish the economic nature of the *derivation* of receipts; their *destination* constitutes a quite distinct and independent subject of inquiry. In other words, in exploring the income character of receipts the problem consists in clarifying their relation to a social product already formed or on the point of being formed, whereas in examining the utilization of receipts the problem is to find how this utilization affects the formation of a future social product: in the first case receipts are looked upon as *results,* in the second case as *factors* of the process of production.

15. — There are cases in which our view that all saved receipts belong to the category of income seems to lead to inconsistent conclusions. One of these is the case of certain business reserves (in French terminology «provisions», in recent German terminology

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[38]) «Internationaler Steuerbelastungsvergleich», Einzelschriften zur Statistik des Deutschen Reichs No. *23,* Berlin *1933,* p. *206.* — **Blümich:** op. cit., pp. 168, 232, 300 and passim. — **H. Laufenburger:** Précis, op. cit., vol. I, p. 40.

«Rückstellungen» as distinct from «Rücklagen»)[39]) which represent provision made for probable working expenses and losses. The detachment of such items from income in the interest of a correct determination of net profits is as legitimate as the deduction made on account of depreciation, wear and tear, obsolescence, loss of substance, etc. of capital goods.

With this remark we touch upon the intricate and ramified problem of *deductible working and acquisition expenses,* which is of particular importance for all receipts having the character of yields [40]). Even if it is agreed that «income» can never be anything but a net quantity, and that consequently from gross returns must be deducted all expenses «caused by the running of the entreprise as such» as well as all expenditure incurred «for acquiring, preserving and maintaining the receipts», the question still remains, of *which concrete items* either of these two groups of allowances is actually made up. This is not a problem which is susceptible to any great extent to treatment on principle and by definition but one which must be solved *casuistically* and through close collaboration between economic theory and the science of business management. In this collaboration the rôles are distributed in such a way that economic theory can contribute only some general principles like the axiom that income or net profit can only be spoken of when the «maintenance of capital intact» (in the sense *A. C. Pigou* confers to this postulate) is assured; individual decisions, on the other hand, assigning the character of «working expenses» wholly or in part to this part of expenditure or that, evaluating objects of plant, machinery, fixtures and fittings etc., evolving the correct accounting

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[39]) «Internationaler Steuerbelastungsvergleich», op. cit., pp. 250-52. — **Blümich:** op. cit., p. 196 and passim. — In order to avoid misunderstandings we should add that the so-called «épargnes-réserves» (**Rist**) which are genuine savings — except for not yet having been assigned unlike «épargnes-créatrices», to definite purposes — do not belong to the cases mentioned in the text, but are to be accounted entirely as income. For this distinction see **Ch. Rist:** Essais sur quelques problèmes économiques et monétaires, Paris 1933, p. 179, and **H. Laufenburger:** Le commerce et l'organisation des marchés, Paris 1938, p. 134 ff.

[40]) Expenses of «income acquisition and maintenance» have indeed a certain significance also for incomes of lawyers, doctors, etc. and even for «pure» labour incomes. (That is why modern income tax laws allow deductions for expenditure for items such as professional clothing costs, fares for transport to working places, etc.) But both from the theoretical and practical viewpoint the problems dealt with in the text are most important by far for the computation of business profits.

treatment for costs of new equipment, replacements etc., properly belong to the sphere of business economics where such questions are being treated with increasing penetration and refinement under the stimulus of modern income taxation and on lines parallel to the development of fiscal law.

But despite, or even because, of this progressive refinement of methods of establishing a correct profit and loss account and, thus, the actual «business net profit» (whether it be primarily actuated by the requirements of the enterprise itself or by wants of tax administration) the concept of net business profit has lost much of its objective unequivocality and general validity. The farther the investigator penetrates from the axiomatic core into the diversity of practical phenomena, the more he is compelled to allow for the peculiarities of the individual case [41]). Thus, e. g., in evaluating certain assets or in determining rates of depreciation he must confine himself to fix only upper and lower limits. Consequently, in the field of income taxation, the definite stipulation has often to be left to ad hoc agreements between the taxpayer and taxing authority, there being no generally recognized evaluation and accounting principles applicable to every detailed question.

Furthermore, the particular purpose which the computation of profit is intended to serve will influence the methods of accounting and evaluating [41*]). Finally, any decision as to whether this or that actual receipt properly belongs to «income» or not depends in many cases upon «popular conventions» *(Marshall)* [42]) and statistical or other practical considerations rather than purely theoretical criteria — which, to complicate matters further, are themselves subject to frequent changes.

Thus it must be admitted that *Keynes* is justified in stating [43]) that «net income» (in his sense of the term) is «not perfectly clear-cut». Here it has to be remarked that *Keynes'* distinction between

[41]) See e. g. «Internationaler Steuerbelastungsvergleich», op. cit., p. 179, and **Blümich:** op. cit., p. 151.

[41*]) See, e. g., **Kester:** op. cit., p. 494 («Profits an estimate»), and **Norris:** op. cit., p. 376. — The importance of «custom» for profit accounting methods is frequently stressed by modern Business Economics; cf. e. g. **H. P. Dutton:** Business organization and management, 9. ed., New York London, 1937, passim, e. g. pp. 203-204.

[42]) **A. Marshall:** Principles of Economics, 8. ed., London 1925, p. 78.

[43]) **J. M. Keynes:** The general theory of employment, interest and money, London 1936, pp. 52-61.

«income» and «net income» turns on the postulate that in net income not only the so-called «user cost» but also «supplementary cost» are deducted. This «supplementary cost» consists of that part of «involuntary losses» which are unavoidable but not unexpected, wherein they are distinguished from «windfall losses» which are both involuntary and unforeseen. But this distinction from the realm of economic theory, justified and seemingly plain as it is, setting apart «supplementary cost» to be debited to income account and «windfall losses» to be charged to capital account, encounters considerable difficulties in its practical application, as *Keynes* himself admits. It is, he says, «partly a conventional or psychological one, depending on what are the commonly accepted criteria for estimating supplementary costs». Finally *Keynes*, much like *Marshall* half a century before him, ends up by regarding as «net income» a quantity which depends largely upon what a «*typical entrepreneur*» considers as «supplementary cost» when reckoning his net profit. Such a low curtsey to business practice may appear unavoidable, but it will be admitted that it hardly can satisfy the theorist's longing for clear-cut, unequivocal solutions [43*]), the less so as the businessman, especially the «typical entrepreneur», even if he adheres to one of the numerous accounting or valuation theories developed by business economists, usually makes decisions varying in accordance with the tangible requirements of his particular case and with the cylical fluctuations of trade, etc.

16. — The foregoing discussion of the problems connected with the determination of business net profit requires some supplementary remarks as to whether it is justified to include among the items to be deducted from gross profit an amount supposed to represent the «*entrepreneur's wage*» (wage of management).

Whereas some earlier theorists (such as e. g. *W. Roscher* and *N. G. Pierson*) consider the whole of entrepreneur's profit proper as «entrepreneur's wage» — actuated in part by an ideological desire to prove profit to be equally justified economically and socially as the wages of labour — modern theory[44]) generally employs the term of

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[43*]) See in this connection the objections **G. Zappa** (op. cit., p. 251, note 1) makes against the Anglo-American tendency to base profit accounting upon convention and common sense rather than general theoretical principles.

[44]) This narrower conception of «entrepreneur's wage» has already been urged by **H. K. E. v. Mangoldt** (Die Lehre vom Unternehmergewinn, Leipzig 1855). — **Besides see Fairchild-Buck-Furniss:** Elementary Economics, 3. ed. New

«entrepreneur's wage» only for that *part* of an entrepreneur's income which is imputable to his active collaboration in his enterprise, and thus represents a kind of «imputed income». Accordingly it is sought to determine the approximate level of the entrepreneurs's wage by reference to the salaries paid in other enterprises to executive directors engaged there for roughly corresponding services.

Against this conception various objections have been raised. Some of these have regard to the practical difficulties accompanying the attempt to determine the level of the entrepreneur's wage and to divorce it from its association with other income elements [45]). It is indeed hardly possible to carry out a clean separation of the various items in cases where the specific entrepreneur function of active management work, the «disposal function» or, as *Schumpeter* terms it, the function of «carrying through new combinations» (viz. of capital elements), has not yet become independent from «routine functions» of an administrative or technical character carried on by the same person. Such a state of affairs prevails especially in medium-sized enterprises, while in small units a proper entrepreneur function as a rule does not exist at all. Others point out [46]) that an entrepreneur's activity could not properly be compared with the functions of an employed director or manager and that consequently the remuneration of such persons could not serve as a basis for determinating the imputed «entrepreneur's wage».

It cannot be denied that these arguments contain a large element of truth, making it desirable, e. g., from the angle of tax policy, to disallow the deduction of entrepreneur's wage from gross profit as likely to lead to abuses. Yet I believe that the concept has its justified place in economic theory and that it is legitimate and useful in cases where an entrepreneur discharges executive functions of an administrative or technical kind beyond the specific entrepreneur activity of disposal and management, to allow for a remuneration for such executive work among the running charges. Otherwise, indeed,

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York 1936, vol. 1, p. 455, and **G. Cassel:** Theoretische Nationalökonomie, 3. ed., Erlangen-Leipzig 1923, p. 154.

[45]) See, e. g., **K. Diehl:** Die Lehre von der Distribution (Theoretische Nationalökonomie, vol. IV), Jena 1933, p. 282, and **F. Perroux:** La notion du profit normal et la loi française du 3 décembre 1926, Lyon 1928, p. 7.

[46]) **P. Leroy-Beaulieu:** Traité d'Economie Politique, 3. ed., vol. II, Paris 1900, p. 189. — Furtheron see **J. H. von Thünen:** Der isolierte Staat in Beziehung auf Landwirtschaft und Nationalökonomie, II, Rostock 1850, pp. 80 ff., especially 83-84.

the entrepreneur income proper, i. e. profit in the purest sense, cannot become fully apparent. (As already stated above, the same is true with respect to entrepreneur's imputed interest).

I should add, however, that the whole problem is of significance only when either the *functional distribution* of the proceeds of production or the division of one individual's total income in *categories of receipts* is under consideration. If it is only desired to determine the income as such of Mr. Brown who besides the factory he owns and runs himself possesses no other source of receipts, it is evidently immaterial whether the £ 10,000 which represent the net returns of commercial activity after deduction of all other working costs, losses, etc. are split up into, say, £ 3,000 of «entrepreneur's wage» and £ 7,000 of «profit», or not: Mr. Brown'n income will in any case consist of the full £ 10,000. The case is different if one regards the enterprise itself — at least in so far as a corporate body is under consideration — as an independent recipient of income. That such an interpretation comes easily to the *legal* mind does not in the least affect the issue of its *economic* soundness. Economic theory, in our opinion, does not know of any «income» of limited liability companies, partnerships etc. that could be distinguished from the aggregate incomes of the various partners as individuals. As a strictly «personal» individual category, income stands opposed to the «objective» category of returns. All returns (yields) habitually commute themselves sooner or later in one way or another into income constituents; but this does not dispose of the necessity of distinguishing clearly returns from income because of their different functional significance.

17. — The problem adumbrated above is familiar from the prominent part it plays in modern income taxation [47]). Yet all attempts to establish an *economic* justification for separate taxes on corporation profits have failed; it is only from the *fiscal* viewpoint that such a justification may be undertaken. There the question of undistributed company profits forms the centre of discussion, because such gains — which are of ever-increasing significance in all

[47]) **H. Lauienburger:** L'impôt sur le revenu des sociétés commerciales, Strasbourg 1926, and: Précis, op. cit., vol. I, pp. 122 ff. — **C. Dietzel:** Die Besteuerung der Aktiengesellschaften . . ., Köln 1859. — **J. Popitz:** Körperschaftssteuer, «Handwörterbuch der Staatswissenschaften», 4. ed., vol. 5, pp. 895 ff. — **A. Lampe:** Körperschaftssteuer, «Wörterbuch der Volkswirtschaft», 4. ed., vol. II, pp. 632 ff. — **Seligman:** Essays in taxation, 9. ed., New York 1923, chap. VI-VII. — **A. Buehler:** Public Finance, New York 1936, pp. 386, 447 ff. — **H. Lutz:** Public Finance, 3. ed., New York 1936, pp. 587 ff.

industrial countries — may evidently escape taxation if it is confined to incomes proper, i. e. incomes of physical persons. However, if the fiscal aspect of the matter is disregarded, it becomes clear that undistributed company profits too are elements of shareholder income and as such in no way different in character from receipts actually collected, and later on saved and invested, by an individual.

It may be not irrelevant to add here that although one should refrain from applying the concept of income to companies and other corporate bodies and confine it to physical persons, economic theory cannot object to, and should perhaps even require, conceding it to *groups of individuals united in «households»* [48]. Evidently the same individual income may have widely varying standard of living significance depending upon the economic situations of the recipient's household members. From the consideration of «ability to pay taxation», i. e. taxation according to principles such as that of «equal (viz. individual) sacrifice», the increasing tendency of modern income taxation to tax households [49]) as such is fully justified, and income statisticians rightly call today for methods permitting the grouping of national income by households [50]).

18. — The last series of problems to be pointed out here — an adequate investigation would require a voluminous monograph — is connected with the *relationship between income and time*.

a) That income is understood to be the sum of receipts accruing to a given person *within an annual period* is merely a matter of convention. Nothing prevents us theoretically from taking a longer or a shorter period as a basis. Certain difficulties, however, are bound to arise as a result of such parceling of time which — though indispensable for theoretical investigations — is inevitably arbitrary and incompatible with the «flow» character of income accretion. These difficulties become most evident in the discussion of the treatment of *net losses*, which is of particular significance with commer-

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[48]) **O. Pfleiderer:** Die Staatswirtschaft und das Sozialprodukt, Jena 1930, p. 2: «Income belongs to the world of householding».

[49]) The so-called «principle of household-taxation», i. e. the assessment of the aggregate incomes of a married couple and their minor children, is recognised in the income tax laws of Great Britain, France, Germany, etc.

[50]) «Das Deutsche Volkseinkommen», Einzelschriften zur Statistik des Deutschen Reichs No. 24, Berlin 1932, pp. 102-3, 105-6, 117. — **P. Jostock:** Wieweit sind Volkseinkommen international vergleichbar?, «Weltwirtschaftliches Archiv», vol. 49, 1939, pp. 268-69.

cial and industrial incomes, but in principle involves other categories of income also.

Evidently it is not sufficient in cases where a net loss, or, as it may be called, a «negative income», has been sustained to assume that for the year in question no income has occurred. In view of the continuity of economic processes *the loss must be «carried forward»*, i. e. deducted from, or set-off against, the amount of the net income of the following year or years. Unless this is done the principle of capital preservation is violated. Recognizing this, modern income tax legislation in most — not all! — states acknowledges the principle of loss carry-forward, though sometimes with certain restrictions, and only in connection with the imputation of commercial profit. The theorist, however, cannot recognize any difference in principle that should make the same rule inapplicable to other types of income, however great the practical difficulties might be in cases of non-commercial incomes. Let us take the case of a physician or lawyer who finds himself unable as a result of protracted illness to meet his fixed «expenses of acquisition of income» from his gross receipts, and is compelled to liquidate part of his capital or to contract loans. It is evident that in such cases too, it is economically admissible to carry forward the loss — at least to the extent of the difference between gross receipts and expenses of acquisition. But what if, although there is no such difference, nothing is left of gross receipts to meet unavoidable subsistence costs, and debts are to be contracted for *this* reason (as may happen also in the case of the unemployed worker)? I consider that an adequate deduction from the next years income should be allowed in *all* cases where an individual's economie situation has deteriorated as a direct result of an insufficient income, i. e. an income which with all forthcoming additions from social insurance or public assistance does not allow of the defrayal of minimum subsistence costs.

It may be noted that the continuity of the income-creating economic activity is being taken into account more and more in the *valuation principles* developed by modern business economics and tax legislation. Whereas formerly in the valuation of capital items such as machines each object was given a «detached value» (Einzelwert), i. e. was considered in artificial detachment from its functional associations and from the passage of time (often on the basis of a fictious liquidation of the enterprise in question), there has been a tendency lately to establish the value attributable to each object *in* *relation to the economic and technological ensemble of which it forms part*, assuming *a continous unchanged functioning of the enterprise* («component value» or «Teilwert»)[51]); in other words, the assessment of each item proceeds «upon the basis of its value to the particular business as a going concern» [52]).

b) The connection between income and time assumes even a greater significance in the field of *trade cycle theory*. Though general income theory certainly cannot aspire to providing a solution of the entire complex problem presented by cyclic phenomena, it can pave the way for the solution of some of its constituent questions. We allude in this respect to what *Zwiedineck* [53]) calls «das Gesetz der zeitlichen Einkommensfolge» (law of time succession of income) which as far as I can see has not hitherto found articulate appreciation in international literature [53*]), although its fundamental ideas figure prominently in contemporary theoretical discussions.

These basic ideas in a sense date back more than a century, inasmuch as they are stated — though still in a somewhat obscure form — by *Sismondi* [54]), who in the preface to the second edition of his «Nouveaux Principes» accuses *J. B. Say* and *D. Ricardo* of having neglected the nature and significance of income because of overattention to those of capital and production. *Sismondi* develops a species of under-consumption theory which is largely conditioned by the author's observation of the profound economic crisis that followed the Napoleonic wars. Opposing the optimistic classical assumption that every production necessarily brings in its train a corresponding consumption, he seeks to prove that the magnitude of the present incomes which buy the product of the preceding production period

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[51]) For the «Teilwert», see **Blümich:** op. cit., pp. 228, 253, and the literature there mentioned.

[52]) **De Paula:** The principles of auditing, London, p. 94. (Cited after «Internationaler Steuerbelastungsvergleich», op. cit., p. 217.)

[53]) **O. von Zwiedineck-Südenhorst:** Die Arbeitslosigkeit und das Gesetz der zeitlichen Einkommensfolge, «Weltwirtschaftliches Archiv», vol. 34, 1931 pp. 361 ff. — **V. Bloch:** Krise und Einkommen, Wien 1932. — According to **J. Dobretsberger** (Die monetären Konjunkturerklärungen und die Erfahrungen seit der letzten Krise, «Jahrbücher f. Nationalök. u. Statistik», vol. 141, 1935, p. 402) the kernel of **Zwiedineck's** theory is already to be found with **Schäffle.**

[53*]) Even **G. Haberler's** excellent book «Prospérité et dépression» (3. ed., Genève 1943) does not make mention of **Zwiedlneck's** theory.

[54]) **S. de Sismondi:** Nouveaux Principes d'Economie Politique, 2. ed., Paris 1827, t. I, Livre II, chap. 6.

by no means necessarily equals the value of that product, but generally is smaller. The difference thus arising, while harmless if economic development proceeds slowly and steadily, reaches crisis-generating proportions if a massive realization of technological advances, partly occasioned by artificial stimulation, is concentrated into a short period. What is objectionable is not the transformation of production technique which takes place unhurriedly as a result of industry's «natural progress», but only that occasioned by «the present organization of society», meaning by the fully developed capitalistic system which in *Sismondi*'s time had «only just begun»[55]).

Zwiedineck, who justly points out «the danger of overlooking the time factor in the economic process», also maintains that there is no necessary «identity of a nation's annual output and its annual income» [56]). His analysis of the various types of income shows that the incomes which can make the demand for the product of consumption goods effective are only partly to be derived from the proceeds of this same product. A large proportion of the product must thus be bought by purchasing power representing the compensation for productive activity in a *subsequent* period. While hitherto the prevalent assumption had been that the double aspect of incomes as a cost factor on the one hand, and a substratum of purchasing power and effective demand on the other, did not affect its quantitiative identity, *Zwiedineck* emphasizes the stresses generated by the fact that the sums involved are «*heterochronous*». Most significant in this connection is the fact that present supplies of consumption goods, as far as they are demanded by wage-earners, are not paid for from the wages that were part of their cost of production, but from wages that are being earned in the present, i. e. in the production of goods which will become marketable only in the future. According to *Zwiedineck*, especially where the population is stationary, there is great danger of a disproportion between the labour income derived from a given production and that which is later going to buy the product of that production. This is not all. The production technique characteristic of a capitalistic economy, which tends towards a continuous «lengthening of the roundabout processes of production», causes the above mentioned «heterochronism» to become more and

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[55]) **Sismondi**'s above mentioned ideas have been expressed in an article about the «equilibrium between consumption and production» which forms an annex to the second edition of the «Nouveaux Principes» (op. cit, t. II, p. 408 ff.)

[56]) **Zwiedineck:** op. cit., p. 364.

more pronounced and the danger of discrepancies between supply and demand (purchasing power) to become the greater — ceteris paribus — the larger the share of wage income is in the national income [57]).

When *Zwiedineck* wrote his essay, the significance of the relation between saving, consumption, and investment for the business cycle was already being discussed, although *Keynes*' «General Theory» was yet unpublished. *Zwiedineck* paid pratically no attention to this discussion, but it is evident that its results are of the utmost importance for the continuation and perfection of his train of thought. A systematic integration of *Zwiedineck*'s and *Keynes*' ideas whould in fact yield fruitful results for both general income theory and trade cycle theory. It is interesting to note that here again the germs of such a synthesis are already found in *Sismondi*'s writings; [58]) this author even states that «the basic problem of political economy» which consists according to him in «keeping consumption in equilibrium with production», was recognized and tackled already in antiquity. One of the remedies then applied, particularly in Egypt, consisted in utilizing the surplus of consumption goods to support labourers engaged in «unproductive» work, viz. the construction of public and devotional edifices, like pyramids, etc.; another consisted in encouraging the consumption of luxury goods by the rich, a third in preventing citizens from active participation in the process of production by a preoccupation with public and cultural concerns and activities.

19. — In closing the present study, I desire to repeat that, far from claiming to give a complete survey of the problems of general income theory, I wish to present merely certain consituent questions that, to me, appear to be of outstanding importance. Not only were the complex dynamics of income dismissed with barely a hint, but such vital matters as the nature and mutual relations of various income categories and the set of problems related to the national income concept have had to be neglected here. Nevertheless I hope that even this fragment may prove useful in kindling a new discussion of general income theory.

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[57]) **Zwiedineck**: op. cit., pp. 375 and 386.

[58]) See **Sismondi's** article mentioned in note 55 (op. cit., p. 439 ff.).