Chapter 3  Income concepts – a more formal consideration

ECONOMIC INCOME

What exactly do we mean by ‘better-offness’? One answer to this is represented by the economist Irving Fisher. He argued that better-offness is strictly only created or affected by something within the mind of an individual. It is thus essentially a personal, subjective, psychological concept:

For each individual, only those events which come within the purview of his experience are of direct concern. It is these events – the psychic experiences of the individual mind – which constitute ultimate income for that individual.

Money is of no use to us until it is spent. The ultimate wages are not paid in terms of money but in the enjoyment it buys. The dividend cheque becomes income in the ultimate sense only when we eat the food, wear the clothes, or ride in the automobile which are bought with the cheque.

Clearly such ‘enjoyment’ income or ‘psychic’ income cannot be directly measured. However, Fisher suggests that we can use what he terms real income as a first approximation. Real income consists:

... of those final physical events in the outer world which give us our inner enjoyments. This real income includes the shelter of a house, the music of a radio, the use of clothes, the eating of food ...

These events are also difficult to quantify, so we have to move to a second approximation:

... the cost of living, the money measure of real income.

i.e. the amount of money paid for the shelter of a house, the music of a radio, and so on. But obviously money paid out does not seem to make much sense
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as a measure of income in money terms. The cost of living in the sense used by Fisher is a measure of ‘outgo’, not of ‘income’. There is, therefore, yet one more step backwards to be taken, a third approximation, before we arrive at a notion of income that corresponds to the generally accepted everyday meaning. This is money income:

All money received and readily available and intended to be used for spending is money income.

We can illustrate Fisher’s arguments by considering the eating of a meal. If we wish to eat, we have to go out and earn some money. This means that we have a money income— in this case, wages. This money income, of course, is the idea that corresponds to the everyday use of the words ‘income’ or ‘earnings’. Having some money, we go out to a restaurant where we eat, and pay for, a meal. Here we have real income. We have the ‘final physical event’, namely the actual eating of the food. This is approximately measured by the ‘cost of living’, i.e. by the cost of the meal— the amount we pay the restaurant. This idea of taking a cost-based approach is clearly not a new idea to an accountant.

But this is not the end of the story. Fisher argues further. We did not earn money for the sake of it, we earned money to buy a meal. Not only this, but we did not eat a meal for the sake of it, we ate a meal to receive the satisfaction, the pleasure of having eaten (or to avoid the unpleasantness, the pain, of feeling hungry). This satisfaction, this pleasure, is the ‘enjoyment’ or ‘psychic’ income. It may be unmeasureable, at least in a manner that can be recorded, but it is still, argues Fisher, the most important. After all— if it did not exist, we would have had no reason to buy the meal. And without a reason to buy the meal, we have no reason to earn the wages.

Fisher summarizes his argument as follows: The underlying principles of this argument, expressed in its simplest form, are that:

1. People do what, on balance, they prefer to do.
2. People make choices, presumably rational ones, between alternative actions.
3. This involves a comparison of alternative ‘sensations and experiences’, which are therefore of vital importance to the decision-making process.

This seems unarguably correct as far as it goes. But it raises many problems. Some of these are theoretical ones and are outside our present scope. Some of them are definitional ones, and great care must be taken. For example, Fisher uses the word ‘income’ to mean what many economists mean by the word ‘consumption’, and the words ‘real’ and ‘cost of living’ do not have here the same meanings as they will be seen to have in the inflation debate.