REDISTRIBUTION FOR REALISTS

Zachary Liscow[*]

ABSTRACT. Inequality is a defining issue of our time. Yet the longstanding orthodoxy for addressing inequality—so prevalent it's been dubbed "the Brookings religion"—is that we should redistribute solely through tax and transfer policies because those are the most efficient means for doing so.

While the orthodoxy holds in theory, it fails in practice. Individuals compartmentalize their policy views: many are reluctant to redistribute through taxes and transfers but are willing to do so in other policy domains, like provision of necessities such as transportation, food, and housing. We've thus restricted our redistribution efforts to a policy domain where redistribution is unpopular while neglecting the many policy domains where redistributive policies are popular. The current orthodoxy may be more efficient, but it is also a prescription for widespread inequality.

We need to flip the old economic orthodoxy on its head by spreading our redistribution efforts across many policy domains, but doing so modestly in each domain. This "thousand points of equity" approach has the virtue of redistributing where it can be achieved, by allowing policymakers to seek modest and attainable redistribution in many domains rather than pushing for massive redistribution in a single domain where it is difficult to attain. This approach would allow us to make substantial inroads on inequality while doing the most good at the least cost. The approach does so by retaining the traditional economic goal of efficiency, but combining it with data-driven behavioral insights about what redistribution is politically realistic. The Article illustrates how the approach would apply to areas across the law, including regulatory cost-benefit analysis, labor law, tax law, social insurance, tort law, and housing law.

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[*] Associate Professor, Yale Law School; zachary.liscow@yale.edu. Thanks to Bruce Ackerman, Anne Alstott, Ian Ayres, Joe Bankman, Lily Batchelder, Rachel Bayefsky, Jake Brooks, Raj Chetty, Conor Clarke, Miranda Fleischer, Brian Galle, David Gamage, Heather Gerken, Jacob Goldin, Henry Hansmann, Alex Hertel-Fernandez, Dan Ho, Paul Kahn, Amy Kapczynski, Noah Kazis, Al Klevorick, Lewis Kornhauser, Tony Kronman, Doug Kysar, Leandra Lederman, Yair Listokin, Jon Macey, Daniel Markovits, Alison Morantz, Sam Moyn, Liam Murphy, Ricky Revesz, Diane Ring, Emmanuel Saez, David Schleicher, Scott Shapiro, Dan Shaviro, Steve Sheffrin, Reva Siegel, Manoj Viswanathan, Gui Woolston, Gideon Yaffe, and participants at the Virginia Law School Tax Invitational, University of Michigan Tax Policy Workshop, Duke Law and Economics Workshop, Tulane-Boston College Tax Policy Invitational, NYU Tax and Public Finance Colloquium, Queens Law School, Yale Law School, Indiana University Tax Policy Colloquium, University of British Columbia Tax Policy Colloquium, and National Tax Association Annual Meetings for helpful comments and to Audrey Cheng, Zohaib Chida, Benedict Choi, Mia Dana, Kay Dannenmaier, Rebecca Lewis, Joe Liss, Brian McGrail, and Jacob Waggoner for excellent research assistance.

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INTRODUCTION

We confront widespread alarm about inequality in America. Voters list it as one of their major concerns.[1] Politicians across the political spectrum describe a "rigged" economy.[2] There is a sense that the American Dream is not what it once was.[3] What should be done?

The standard economic approach has an answer for nearly all of the law: nothing. Consider the federal Department of Transportation's longstanding practice for distributing grant funds across projects: the Department relies on cost-benefit analysis to determine where money is best spent. The most important factor in the analysis is the value of time saved. Under current Department guidelines, saving the time of relatively poor people on buses counts for $25 per hour.[4] But, because rich people earn more money per hour, saving the time of richer people at airports counts for well over twice as much: $63 per hour. This practice tends to push transportation spending toward the rich instead of the poor. As a result, many lower-income individuals have difficulty accessing decent jobs, thereby reinforcing existing patterns of income inequality.[5]

How could it possibly be that baked into our transportation policies is a method that spends more on the well-to-do than on the needy, especially at a time when we

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[1] *See, e.g.*, PEW RESEARCH CENTER, THE GENERATIONAL GAP IN AMERICAN POLITICS 18 (2018), http://www.people-press.org/wp-content/uploads/sites/4/2018/03/03-01-18-Generations-release.pdf (noting that 62% of survey respondents felt that the U.S. economic system unfairly favors powerful interests, and 82% felt that income inequality in the U.S. was either a very big or moderately big problem).

[2] Republicans have increasingly expressed concern about rising inequality, even before President Trump's populist rhetoric during the 2016 campaign. For example, Mitt Romney, Jeb Bush, and Rand Paul all complained about the continuing rise in inequality during the Obama presidency. *See, e.g.,* Catherine Rampell, *Republicans Have Started to Care About Income Inequality*, WASH. POST (Jan. 22, 2015), https://www.washingtonpost.com/opinions/catherine-rampell-republicans-have-started-to-care-about-income-inequality/2015/01/22/f1ee7686-a276-11e4-903f-9f2faf7cd9fe_story.html?utm_term=.92d3a15e5c57.

[3] Raj Chetty et al., *Is the United States Still a Land of Opportunity? Recent Trends in Intergenerational Mobility,* 104 AM. ECON. REV. 141 (2014) (discussing the decline of intergenerational mobility in the US).

[4] Vinn White, *The Value of Travel Time Savings: Departmental Guidance for Conducting Economic Evaluations Revision* 2 (2016 Update), US DEPARTMENT OF TRANSPORTATION (Sept. 27, 2016), https://www.transportation.gov/sites/dot.gov/files/docs/2016%20Revised%20Value%20of%20Travel%20Time%20Guidance.pdf (providing recommended hourly values of time travel savings).

[5] Gillian White, *Stranded: How America's Failing Public Transportation Increases Inequality*, The Atlantic (May 16, 2015), https://www.theatlantic.com/business/archive/2015/05/stranded-how-americas-failing-public-transportation-increases-inequality/393419/ (describing how living in areas with poor public transit limits access to jobs for those with lower incomes).

are so conscious of the importance of economic mobility?[6] Policymakers are not stupid. They have just come to think that redistribution isn't part of their job description.

The reason for this siloed approach to redistribution is simple: efficiency.[7] Standard economics suggests that policymakers should find the most cost-effective way to redistribute—and then redistribute there *and only there*.[8] And if efficiency is your sole guide for choosing how to redistribute, taxes and transfers provide the most benefit at the least cost: cash lets recipients choose what to spend money on and payers choose what to give up. As leading law and economics scholars Louis Kaplow and Steve Shavell famously argued, across the board, the design of *nontax* "legal rules should be primarily concerned with efficiency rather than the distribution of income."[9] In other words, with distribution taken care of by tax policy, all other laws should ignore distributional concerns and instead focus on maximizing the size of the economic pie. Given a limited budget, economic orthodoxy says, such a method does the most social good. In the case of transportation spending, spending more on the rich than the poor maximizes social welfare because the rich can work an extra hour, earning an extra $63, and then an imagined "benevolent dictator" can tax the rich to transfer at least $25 of it to the poor, so that both parties are better off.[10]

The standard approach makes a lot of sense in theory: it addresses tradeoffs among various options, reflecting the reality of resource constraints. Every dollar that the government raises can only be used on one thing. It has a theory of the whole and a prescription for each part.

This standard economics approach is prominent among the policy elite that staffs Washington DC think tanks,[11] advises political candidates and elected

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[6] Mikayla Bouchard, *Transportation Emerges as Crucial to Escaping Poverty,* N.Y. TIMES (May 7, 2015), https://www.nytimes.com/2015/05/07/upshot/transportation-emerges-as-crucial-to-escaping-poverty.html (describing work by Raj Chetty and co-authors in which "commuting time has emerged as the single strongest factor in the odds of escaping poverty").

[7] LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE (2009) (describing the approach). *See also* discussion of "Kaldor-Hicks efficiency" *infra* note 34 and surrounding text.

[8] Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994); KAPLOW & SHAVELL, *supra* note 7; A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 127 (2d ed. 1989); ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 7–8 (6th ed.2012).

[9] Kaplow & Shavell, *supra* note 8, at 675.

[10] N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 145 (7th ed. 2015).

[11] See, for example, the large number of economists at think tanks. *See, e.g.*, *Experts*, BROOKINGS INST. (2020), https://www.brookings.edu/experts/; *Our Scholars,* AM. ENTERPRISE INST. (2020), https://www.aei.org/our-scholars/; *Experts,* PETERSON INST. INT'L. ECON. (2020), https://www.piie.com/experts.

officeholders,[12] and implements policies such as regulatory cost-benefit analysis.[13] Indeed, this thinking is so standard among economic policy elites across the country that it has been called the "Brookings religion."[14] As a result, it has had tremendous real-world influence.[15]

While the reigning orthodoxy makes sense in theory, it is destined to fail in practice. It ignores how ordinary Americans think about the law and thus ends up exacerbating inequality rather than mitigating it.

In order to find a better path, it is essential that we pay attention to two aspects of voters' social and political psychology.[16] First, people *compartmentalize* their policy views. They do not think carefully about tradeoffs across different policy areas, and their views on redistribution change with the policy domain. For example, the public may support significant redistribution through transportation policy or other felt "necessities," like food, housing, and education, while opposing redistribution through taxation. The Article introduces the "theory of policy compartmentalization" to describe this phenomenon.[17]

Second, if one is looking for a domain to realistically expect all redistribution to take place in, tax policy is the wrong choice. Most think the money people earn is in some meaningful sense "theirs" and are thus reluctant to adopt—even hostile to—heavily redistributionist taxation. The irony, then, is that the one domain where economic theory has insisted all redistribution should take place[18] is also one of the

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[12] *See, e.g.*, *Council of Economic Advisers: Staff*, WHITE HOUSE (2020), https://www.whitehouse.gov/cea/staff/.

[13] *See* Exec. Order No. 12,866, 3 C.F.R. § 638 (1994) (requiring cost-benefit analysis based on efficiency in federal agencies); *see generally* Tyler Cowen, *Where in the Federal Government Do the Economists Work?*, MARGINAL REVOLUTION (Jan. 17, 2011), https://marginalrevolution.com/marginalrevolution/2011/01/where-in-the-federal-government-do-the-economists-work.html (describing the outsized influence of economists on government, explaining there were 4,130 individuals with "economist" in their title in the federal bureaucracy in 2008, excluding the Federal Reserve); Justin Fox, *How Economics PhDs Took Over the Federal Reserve*, HARV. BUS. REV. (Feb. 3, 2014), https://hbr.org/2014/02/how-economics-phds-took-over-the-federal-reserve (describing how economists took over key Federal Reserve leadership positions).

[14] Zachary Liscow, *Is Efficiency Biased?*, 85 U. CHI. L. REV. 1649, 1651 (2018). *See also* CASS R. SUNSTEIN, THE COST-BENEFIT REVOLUTION 6-21 (2019) (discussing the "Triumph of the Technocrats" across the Reagan, Clinton, and Obama administrations); Richard A. Posner & William M. Landes, *The Influence of Economics on Law: A Quantitative Study,* 51 (Chi. L. & Econ. Working Paper No. 9, 1992) ("[T]he growth in the influence of economics on law exceeded that of any other interdisciplinary or untraditional approach to law. . . .").

[15] See *infra* Section I.C.

[16] *See, e.g.*, Richard H. Thaler, *Anomalies: Saving, Fungibility, and Mental Accounts*, 4 J. ECON. PERSP. 193 (1990) (arguing that mental accounts prevent people from thinking about money as fungible across types of wealth). *See infra* Part II.

[17] *See infra* Section II.A.

[18] KAPLOW & SHAVELL, *supra* note 7; N. Gregory Mankiw et al., *Optimal Taxation in Theory and Practice*, 23 J. ECON. PERSP. 147 (2009).

places where redistribution proves most difficult.[19] The economist's recipe for reducing inequality turns out to be a recipe for failure: a "worst of both worlds" approach of insufficient redistribution through any type of policy that leaves society far worse off.

We need a new approach for remedying economic inequality. Given public attitudes, we should look beyond the one domain of tax policy, where there is such reluctance to redistribute, toward the rest of the law. This Article introduces the "thousand points of equity" approach to show how to do so:[20] laws in each policy domain should typically redistribute toward the poor, but do so modestly. This strategy does the most good at the least cost. The approach represents a rigorous economic model of how to respond to political reality, yet it rests on two commonsense premises: take wins where you can get them, but still weigh cost-effectiveness. Like the old approach, the new one takes efficiency seriously—but it takes data about psychology and political feasibility just as seriously, analyzing policies in the world we live in, not the world as law-and-economics scholars imagine it. It thereby combines the technocratic and the political in ways needed for good policymaking in a democracy.

Consider how the "thousand point of equity" approach suggests that the federal Department of Transportation should allocate its funds. An equity-minded transportation planner should shift funding toward the poor. But she should also consider efficiency. Transportation projects face diminishing returns: the first new project for the poor helps them a lot, but the thousandth new project—such as a bus line through a sparsely populated neighborhood—helps them little. These diminishing returns suggest a *modest* shift toward the poor in transportation spending.[21]

Each area of the law typically has some relatively efficient ways of redistributing, and we should take advantage of these cost-effective ways of redistributing across the law. In short, to get the most distributive bang for the buck given limited resources, we should not redistribute heavily in a small number of areas, where each additional dollar of redistribution would bring diminishing benefits at increasing cost. Instead, an important strategy for increasing

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[19] *See* SHEFFRIN, TAX FAIRNESS AND FOLK JUSTICE (2013); Matthew C. Weinzierl, *Popular Acceptance of Inequality Due to Innate Brute Luck and Support for Classical Benefit-based Taxation,* 155 J. PUB. ECON. 54 (2017); *see generally infra* Section II.B.

[20] This term was introduced by George H.W. Bush in his speech accepting the Republican presidential nomination, where he argued that common goals should be accomplished through the actions of America's diverse array of community and civic organizations, which represent "a thousand points of light in a broad and peaceful sky." George H. W. Bush, *Address Accepting the Presidential Nomination at the Republican National Convention in New Orleans,* AM. PRESIDENCY PROJECT (Aug. 18, 1988), https://www.presidency.ucsb.edu/documents/address-accepting-the-presidential-nomination-the-republican-national-convention-new. The Article means to use the term to convey the availability of many areas of the law, rather than an emphasis on voluntarism.

[21] JONATHAN GRUBER, PUBLIC FINANCE AND PUBLIC POLICY (2005).

redistribution should be doing a modest amount in transportation and a modest amount in many other areas of law. The Article suggests examples from across the law—including regulatory cost-benefit analysis, labor law, antitrust, social insurance, civil penalties, torts, and specific aspects of tax law itself—where such an approach could be implemented.

Before continuing, I address three features of the paper. First, in making legal prescriptions, the Article assumes the standard economics goal of maximizing well-being by considering both efficiency and fair distribution. Since these goals are important pieces of the picture for many egalitarians, the implications are broadly useful.[22] The Article also takes as given the need for further reductions in inequality. However, it cannot say what the exact right distribution of resources is.

Second, the Article does not make a claim about whether it is normatively correct that people deserve to keep much of the income they earn. The belief could be normatively right, or could reflect biases or confusion. The claim about taxation here is only an empirical one: because of public attitudes about taxation, redistribution through income taxation is limited in practice.[23]

Third, the Article describes current, but longstanding attitudes in the United States, without making any claims about "human nature" or other societies, current or future. It also describes general tendencies, not absolute rules. For example, a general aversion toward high tax rates on the rich to permanently provide cash to help the poor does not preclude the adoption of modest cash payments as economic stimulus during a 100-year pandemic and depression-level unemployment.[24]

Finally, it's worth noting the precise nature of this paper's contribution. Needless to say, critique of efficient but inegalitarian lawmaking is longstanding.[25] This Article makes two main contributions: one descriptive and one prescriptive.

The descriptive contribution introduces the theory of policy compartmentalization and makes the empirical case that depending on taxes alone to achieve distributive justice is not realistic. Much earlier work rejects the normative framework of economics.[26] Of the work that does accept it, other critiques have been offered, like frictions in policymaking or the power of the rich.[27] But frictions can be undone over time, and the interests of the rich do not explain why one redistributionist policy in particular does not succeed while others do. In

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[22] *See infra* Section II.C.

[23] To the extent that taxation based on desert in pretax income is a mistake, this is a "second-best" approach. *See* Richard G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11 (1956).

[24] CARES Act, Pub. L. No. 116-136, § 2201 (2020) (providing tax refunds of $1,200 to individuals with incomes up to $75,000 as a part of COVID-19 economic relief).

[25] *See, e.g.*, Ronald Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 191 (1980); C. Edwin Baker, *The Ideology of the Economic Analysis of Law*, 5 PHIL. & PUB. AFF. 3, 16–19 (1975).

[26] *See, e.g.*, Dworkin, *supra* note 25.

[27] *See infra* Section IV.A.

contrast, little attention has been paid to public attitudes.[28] As an internal critique, this Article accepts the basic tenets of mainstream economic theory but shows how a particular set of durable public attitudes about taxes upends the standard economics approach to inequality and the law.

The contributions of this Article go beyond critique, however. The Article merges rigorous economic reasoning with political realism in order to articulate a new approach for lawmakers who want to enhance equality but are also attentive to resource constraints and trade-offs. The prescriptive analysis provides a new framework for policymakers to address one of the core issues of our time.

The Article proceeds as follows. Part I describes the standard law and economics prescription: adopt efficient nontax policies that do nothing to address inequality, along with "optimally" redistributive taxes. Part II shows that this standard approach fails because the public compartmentalizes its policy attitudes and believes that people deserve to keep much of their income, hindering redistribution through taxation and making the standard approach a recipe for spiraling income inequality. Part III introduces a better economic approach to inequality and the law: the "thousand points of equity" approach, which suggests redistributing modestly across many legal domains, thereby doing the most good at the least cost. Part IV addresses critiques.

I. THE STANDARD ECONOMIC APPROACH TO LAW AND INEQUALITY: "ONE-PIEISM"

The standard economic approach for setting policy considers all policies as a unified whole. This approach is mistaken and produces law that increases inequality, but before critiquing it, we must first understand it. This approach assumes that policies can be implemented in a coherent and coordinated manner, as if there were a benevolent dictator overseeing all of them.[29] Its normative aim is to recommend the set of policies that maximize social welfare.[30] This Article terms this approach "one-pieism." Underlying "one-pieism" is the assumption that there is a single economic pie consisting of perfectly commensurable ingredients. Therefore, it makes no difference whether a desired policy outcome is achieved through cash transfers, healthcare, tort law, or other "in-kind" (non-cash) government provisions and regulations.[31] Because the "one-pieist" approach

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[28] *But see* Lee Anne Fennell & Richard H. McAdams, *The Distributive Deficit in Law and Economics*, 100 MINN. L. REV. 1051, 1097 (2015) (discussing fairness preferences).
[29] *See* MANKIW, *supra* note 10.
[30] *See* MANKIW, *supra* note 10, at 145.
[31] *See* Oren Cass, *Economic Piety Is a Crisis for Workers*, ATLANTIC (Nov. 27, 2018), https://www.theatlantic.com/ideas/archive/2018/11/emphasize-production-not-consumption/576625/ (describing the emphasis on economic growth in policymaking outside of taxes and transfers).

considers inputs (like the specific policy tool used) fungible, it focuses instead on two key outputs: 1) the size of the pie, and 2) the division of the pie.

The first aim of the "one-pieist" approach is to maximize the size of the pie. By doing so, everyone can be made better off, because with a larger pie, there is more to go around. To maximize the size of the pie, traditional economic reasoning suggests that policymakers focus on efficiency—that is, for a given cost, policymakers should implement policy in the way that creates the most benefit, as measured by recipients' willingness to pay for the benefit to themselves. At the initial stage, policymakers should not consider distributive implications.

However, adherents to the "one-pieist" approach do remain concerned with distributive justice. They simply consider it at the second stage—when the pie is divided up. In the one-pie framework, any adjustments to the initial division should be accomplished through cash transfers and taxes. The standard argument is that taxes and transfers are typically the most efficient means of redistributing.[32] Giving cash to the poor allows them to choose how to spend it, and presumably they will spend it on what they need most. Taking cash (through taxes) from the rich allows them to choose what to give up, and presumably they will give up what they benefit from least. Thus, according to the standard economics perspective, everyone is better off when taxes and transfers, as opposed to other policy tools, are used to redistribute.

"One-pieism" ultimately leaves us with the following policy prescription: make all nontax policies as efficient as possible and redistribute, to whatever extent desired, through taxes and cash transfers. This maximizes the size of the pie and then ensures that it is shared fairly.[33] A key assumption of this approach, to which we will return later, is that it is politically feasible to accomplish all desired redistribution through taxes and transfers.

A. Efficient Nontax Policies

The one-pieist argument proceeds in two steps—first, make nontax policies efficient, and second, redistribute using taxes. This Section describes the first step:

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[32] Kaplow & Shavell, *supra* note 8. Even more stringently, the taxes need to be on labor income. Alan J. Auerbach & James R. Hines Jr., *Taxation and Economic Efficiency*, in 3 HANDBOOK OF PUBLIC ECONOMICS 1347 (Alan J. Auerbach & Martin Feldstein eds., 2002) (describing the Atkinson-Stiglitz result that, under a certain set of assumptions, there should be no taxes on capital).

[33] Though this is the dominant view, there have been a variety of internal critiques to this view as well. *See* Zachary Liscow, Note, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 YALE L.J. 2478, 2481 (2013) (describing how redistribution through legal rules can be more efficient); Chris Sanchirico, *Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View,* 29 J. LEGAL STUD. 797, 805-06 (2000) (similar). This Article differs from earlier work in that these works accepted the basic framework of finding the most efficient opportunities for redistribution among all possible choices. This Article, in contrast, rejects that framework as conflicting with social reality.

setting efficient nontax policies to maximize the size of the pie. By "efficient," I mean the "Kaldor-Hicks" definition in which the optimal policies are those that maximize the sum of each individual's willingness to pay to avoid harm and bring benefits to herself, given the existing distribution of wealth.[34] That is, first find what each individual is willing to pay for the adoption of each possible policy, thereby quantifying how much each policy satisfies her preferences. Then, aggregate the willingness to pay across everyone for each policy; the policy that fetches the highest amount maximizes efficiency.

Consider again the example that runs throughout the Article of the regulatory cost-benefit analysis of transportation spending. As mentioned in the Introduction, the federal Department of Transportation's longstanding practice for distributing grant funds across projects is to conduct cost-benefit analysis to determine where money is best spent and then spend it there. The most important factor in the analysis is the "value" of time saved. Saving the time of relatively poor people on buses counts for \$25 per hour, while saving the time of richer people at airports counts for \$63 per hour.[35] This practice tends to push transportation spending toward the rich instead of the poor. But it is efficient: the rich, with their higher wages, are willing to pay more to reduce their commutes.

Suppose that the government has enough money to save one hour of commuting time for some people. It can spend that money exclusively on the rich, exclusively on the poor, or split it between the rich and the poor (helping each group in proportion to the amount of money the group receives). And suppose, for simplicity, that an hour of time savings costs the government the same amount for both rich and poor. Whom should the money be spent on?

The standard economics answer is that the money should *all* be spent on the rich. That might seem completely unfair. But the economist's answer is that doing so makes everyone better off because the rich can work their extra hour, earn an extra \$63, and then transfer at least \$25 of it to the poor, so that both parties are better off than under an arrangement with equal transportation spending but no transfer. The poor get more than they would have earned if they had worked because of the cash transfer, and the rich have plenty left after the transfer. Put differently, the two parties—rich and poor—should (and, the standard approach presumes, will) strike a trade that makes both better off:[36] both accept an efficient transportation spending rule, and the rich pay more in taxes to fund transfers to the poor.

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[34] *See* Lewis A. Kornhauser, *Wealth Maximization*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 679–84 (Peter Newman ed., 1998) (describing Kaldor-Hicks efficiency); Liscow, *supra* note 14, at 1652 (same).

[35] White, *supra* note 4.

[36] KAPLOW & SHAVELL, *supra* note 7; Louis Kaplow & Steven Shavell, *Any Non-Welfarist Method of Policy Assessment Violates the Pareto Principle*, 109 J. POL. ECON. 281 (2001).

This two-step analysis has a more common lay description: maximize the size of the pie and then divide it up equitably. One sees such reasoning, for example, in the context of international trade: we should have free trade, maximize the size of the pie, and then divide up the pie to achieve a fair distribution.[37]

Efficiency reasons may still dictate government provision of nontax benefits to the poor. For example, in reality, there will be some low-cost, high-time-saving investments for the poor, so they will get some funds. But the spending is heavily tilted toward the rich, since their time counts for over twice as much. (See the Appendix for a formal model and numerical example.) Similarly, information problems in insurance markets can justify a significant role for the government in healthcare provision.[38] And sometimes, it can be efficient to provide in-kind benefits (like low-end housing) rather than cash benefits to "target" the truly poor, who would be especially willing to accept the in-kind benefits.[39] One can imagine many such arguments. But these noncash benefits all have one thing in common: the reason for providing them is efficiency.

The standard story thus reduces policy into one pie made up of the willingness to pay of each individual for the slice of harms, public goods, and income that she receives. In other words, it reduces policymaking analysis to the consideration of a single "pie" with two essential characteristics: size and distribution. The views of the general population about what is in the slices (e.g., healthcare and environmental health versus bananas and automobiles) play no role. And the process by which the final arrangement comes about—whether people, say, have income because they worked for it or because they received it from the government[40]—also plays no role.

B. Redistribution Through Income Taxes

The standard economics approach cares about distribution too. But according to the standard approach, redistribution should take place through taxes and transfers, not other means. The key intuition for redistributing with cash through

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[37] *See, e.g.*, N. Gregory Mankiw et al., *An Open Letter*, GREG MANKIW'S BLOG (Mar. 5, 2015), http://gregmankiw.blogspot.com/2015/03/an-open-letter.html (open letter from more than a dozen prominent economists to congressional leaders arguing that "[t]rade is beneficial for our society as a whole, but the benefits are unevenly distributed" yet "economy-wide benefits resulting from increased trade provide resources[,]" which can be used to "help[…] those who are adversely affected"); Robert Whaples, *The Policy Views of American Economic Association Members: The Results of a New Survey*, 6 ECON. J. WATCH 337, 340 (2009) (finding support among economists for the position that the U.S. should continue to liberalize trade and increase support for affected workers).

[38] GRUBER, *supra* note 21.

[39] Janet Currie & Firouz Gahvari, *Transfers in Cash and In-Kind: Theory Meets Data,* 46 J. ECON. LITERATURE 333, 341-342 (2008).

[40] Of course, the fact that working for money involves costly labor would be factored into the analysis. But the income itself would be treated the same.

taxation rather than redistributing with in-kind goods, services, or legal rules is that cash lets the poor choose what to spend the money on, thus increasing the likelihood that resources are used in the way that most makes them better off. By the same logic, decreasing the cash income of the rich through taxes, rather than removing some legal entitlement the rich may highly value, aims to harm the rich the least and thereby enables greater redistribution to the poor. Given that the government has limited resources and thus faces trade-offs in how it addresses equality, cash—and thus taxes—is viewed as the superior means of redistribution. But how should those taxes and transfers redistribute?

Returning to the example of the transportation spending, few are so unrealistic as to imagine that the Department of Transportation itself would make cash transfers to the poor when it spends on projects that favor the rich. It lacks such legal authority. Instead, the two-step process imagines that the cash will typically be transferred through the income tax and transfer system, in ways not specifically tied to transportation spending but rather in ways that will yield roughly fair distributions in the end.[41]

"Optimal tax theory" in economics describes how taxes should be used to maximize well-being. It sums individuals' utilities and then finds the taxes and transfers that maximizes that sum. The goal is to raise a given amount of money for public goods while also redistributing income from the rich to the poor through taxes and transfers. These taxes are imposed on "earned," or labor, income. Capital income taxes have traditionally been viewed as inefficient, in part because capital is so mobile, and thus a bad means of redistributing.[42] These optimal labor income taxes are the taxes and transfers that the prescription of "efficient nontax policies" depends upon.[43] So, when the Article discusses public attitudes about taxes, it means the taxation of *labor income*.

Modern optimal tax theory dates to the 1970s.[44] At that time, well before the advent of behavioral economics, it was standard in economics to assume rational, self-interested individuals with simple tastes. Optimal tax theory assumes that individuals want to consume more and that they do not care about how redistribution should take place.[45] This theory has played an important role in the

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[41] KAPLOW & SHAVELL, *supra* note 7, at 24-27.

[42] The traditional view has been to have low, possibly even zero, tax rates on capital income. Mankiw et al., *supra* note 18. That view is under some flux. Peter Diamond & Emmanuel Saez, *The Case for a Progressive Tax: From Basic Research to Policy Recommendations*, 25 J. ECON. PERSP. 165 (2011). For the purpose of this Article, view capital income as in the same category as "nontax" legal rules, as it is not a tax on labor income.

[43] Liscow, *supra* note 14, at 1664; Fennell & McAdams, *supra* note 28.

[44] James A. Mirrlees, *The Theory of Optimal Taxation*, *in* 3 HANDBOOK OF MATHEMATICAL ECONOMICS 1197 (Kenneth J. Arrow & Michael D. Intriligator eds., 1986) (describing the classic treatment).

[45] Richard H. Thaler, *Behavioral Economics: Past, Present, and Future*, 106 AM. ECON. REV. 1577 (2016).

development of modern law and economics by providing a (supposedly) clean and efficient tool for achieving desired distributional outcomes.[46]

As part of the standard economics prescription, optimal tax theory takes welfare maximization as its normative end.[47] Welfare maximization requires attention to efficiency in order to maximize the size of the economic pie, as discussed in Section A. It also requires attention to distribution because the welfare that a rich person gets from an additional dollar of consumption is generally less than the welfare that a poor person would get from that additional dollar. Thus, maximizing *overall* welfare often requires transferring money from the rich to the poor. Optimal tax theory provides a justification for doing so (maximizing overall welfare) as well as the tools (tax policy). At the same time, the desire to redistribute to the poor could also be grounded in broader equality concerns shared by a variety of theories of justice, so one need not accept the specific normative underpinnings of optimal tax theory to value its recommendations on how to set redistributive tax policy.[48]

Optimal tax theory does not recommend fully equalizing income. Under full redistribution, incentives to work would be so dulled that welfare would actually decrease because there would be less to redistribute to the poor. Essentially, only three things are taken to matter when setting optimal taxes: raising revenue to provide services, keeping tax rates low enough to maintain incentives to work, and achieving fair post-tax outcomes through redistribution. The next Part describes specific implications of optimal tax theory. For now, the key point to know is how standard economics imagines tax policy to work. There's some goal for redistribution. That goal could come from a variety of external sources, including the declining marginal utility of income, the distribution of well-being, and interdependent preferences for well-being, but most often it is assumed that members of the public have distributional preferences.[49] Whatever that distributional goal is, taxes achieve it—all of it, on their own, without help from other policies. Importantly, for setting taxes, it does not matter who earns the money, except for the incentives. In other words, making the money yourself gives you *no moral entitlement at all* to keep it. Of course, there may be incentive-based reasons to not tax income away. But the theory implies that people are not entitled to any of their income. As Part II shows, this theory prescribes some specific and, in some cases, surprising, things—things that have not come to pass in practice.

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[46] Kaplow & Shavell, *supra* note 8.

[47] *See* ANDREU MAS-COLELL ET AL., MICROECONOMIC THEORY 117-22, 817-50 (1995); Lewis Kornhauser, *The Economic Analysis of Law*, 6 STAN. ENCYCLOPEDIA PHIL. (2017) ("The evaluative tradition in economics is resolutely welfarist.").

[48] Lily Batchelder, *Optimal Tax Theory as a Theory of Distributive Justice*, (draft, Oct. 2, 2019) (describing the similarity between optimal tax theory and other egalitarian theories of justice).

[49] KAPLOW & SHAVELL, *supra* note 7, at 27, 30-1.

C. Legal Impacts

The *efficiency* part of the standard economics prescription—the first prong—has had huge impacts on many areas of the law: it has reshaped diverse swathes of legal rules to become more efficient but less egalitarian. Consider two examples: tort law and civil procedure. Tort law has been strongly influenced by the national movement for tort reform, which emphasizes a goal of efficiency.[50] The movement has "foster[ed] efficient behavior" by, among other things, ensuring that damages awarded "do not exceed the amount necessary to provide 'reasonable compensation,'"[51] even though such changes tend to benefit (often richer) defendants over (often poorer) plaintiffs.[52] To achieve its goals, the tort reform movement pursues "pro-defense changes in tort law," including reducing the amount of damages available by altering tort doctrines such as joint and several liability, collateral sources, punitive damages, and noneconomic damages.[53]

Shifts in civil procedure—for example, towards arbitration over trial—also embody the law and economics emphasis on efficiency over redistribution. Access to a full trial and to jury adjudication of civil wrongs has long been an important method for redistributing wealth away from defendants (who are, again, often corporate and richer) to plaintiffs (who are, again, often lower income).[54] But the law and economics quest for efficiency is slowly shutting off these traditional methods of access to the court system. For example, in the Supreme Court decision *AT&T Mobility v. Concepcion*,[55] which strengthened the role of arbitration, the majority opinion began by "extolling the virtues of arbitration over court adjudication in terms of efficiency" and discussing "the ill effects of class action on businesses."[56]

Scholars describe similar trajectories in corporate law, environmental law, antitrust law, housing law, administrative law, and many other areas of law.[57] The impact of the efficiency approach—the first prong of one-pieism—has been tremendous in the real world. As we will soon see, the second prong—

[50] F. Patrick Hubbard, *The Nature and Impact of the "Tort Reform Movement,"* 35 HOFSTRA L. REV. 437, 469-70 (2006).
[51] *Id.* at 472.
[52] *Id.* at 453.
[53] *Id.* at 473.
[54] Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 682 (1996) (listing ways in which poorer plaintiffs are procedurally and monetarily disadvantaged by arbitration over jury trial, including sympathy by juries "to the claims of a consumer over a large company").
[55] 563 U.S. 333 (2011).
[56] Erwin Chemerinsky, *Closing the Courthouse Doors,* 90 DENV. U.L. REV. 317, 319 (2012). *See also* Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 YALE L.J. 2804, 2891 (2015).
[57] Jedidiah Britton-Purdy et al., *Building a Law-And-Political-Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784 (2020) (summarizing the evidence).

redistributionist taxation to address distributive concerns—has had less of an impact in the real world. This asymmetry is the key to the failure of the standard economic approach.

Of course, the widespread adoption of efficient but inegalitarian legal rules under the influence of law and economics has not gone uncritiqued. Outside of economics, many have criticized economic policy prescriptions.[58] Political scientists have proposed alternatives, such as "predistribution," that would redistribute "through the market," though without a specific account of what counts as predistribution, why it is superior to the economics prescription, or how to redistribute that way.[59] This Article provides a specific account of what is wrong with the standard approach and a program for what to do about it, based on recent insights from psychology and economics.

Inside economics, scholars have also provided reasons why using taxes and transfers to compensate for legal rules that benefit the rich could be politically challenging. These reasons include legislative inertia, political capture, fairness norms, cognitive failures, or generally differing political action costs of redistribution through different means.[60] But the critiques thus far have not carefully explored a core empirical flaw with the economics approach, which is that our political system does not act like one-pieism assumes because much of the public fundamentally does not think that way. The Article rigorously considers the social reality of income taxation, which is at the crux of the law and economics arguments, shows how this reality transforms economic policy prescriptions, and develops a new approach given this reality.

II. THE STANDARD APPROACH FAILS AND EXACERBATES INEQUALITY

The standard one-pieist economic theory of having all redistribution take place through taxes does not work in reality; by relying solely on taxation, it leads to too much inequality. As this Part details, redistribution through taxation is strikingly limited. Two key factors from social psychology help explain why. First, the public compartmentalizes its attitudes about policies: rather than thinking holistically

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[58] *See, e.g.*, ROBERTO UNGER, WHAT SHOULD LEGAL ANALYSIS BECOME? 9 (1996); Baker, *supra* note 25; Dworkin, *supra* note 25; Richard S. Markovits, *Why Kaplow and Shavell's "Double-Distortion Argument" Articles Are Wrong*, 13 GEO. MASON L. REV. 511 (2005).

[59] Jacob S. Hacker, *The Institutional Foundations of Middle Class Democracy*, POL'Y NETWORK (May 6, 2011), https://www.jacobhacker.com/assets/hacker_pn.pdf (coining the term); Ed Miliband, *Leader of the Labour Party and Leader of the Opposition, Speech at the Stock Exchange* (co-hosted by the Policy Network) (Sept. 6, 2012) (transcript available at http://www.politics.co.uk/comment-analysis/2012/09/06/ed-miliband-s-redistribution-speech-in-full) (using the term).

[60] *See* Fennell & McAdams, *supra* note 28, at 1056 (reviewing mechanisms); Markovits, *supra* note 58; *see also* STEARNS, ZYWICKI & MICELI, LAW AND ECONOMICS: PRIVATE AND PUBLIC 417-480 (2018) (describing the application of public choice theory to law and economics generally).

about all policies, the public tends to think about policies in isolation and apply different attitudes to different policies. This Article introduces the "theory of policy compartmentalization," which derives from commonplace social and political psychology, to explain these public attitudes. Second, the public associates the particular compartment through which all redistribution is supposed to take place—taxation—with attitudes that hinder redistribution: to a significant extent, the public believes that people deserve to keep their income. They believe they deserve to keep it because they worked for it and own it, which makes it harder to tax away. For the standard economic prescriptions to work, with income taxed and transferred away to produce a fair distribution, the public must believe that—apart from producing good incentives—your money is as much mine as yours. But the public does not believe that, as this Part shows much evidence to support. As a result, taxation is insufficiently redistributive, and an approach of adopting efficient but inegalitarian nontax policies increases inequality and harms well-being. Consequently the standard economics approach should be rejected.

A. The Public Compartmentalizes Its Policy Attitudes

Most ordinary people do not view policy like one-pieist economists do. Ordinary people typically do not think like economistic benevolent dictators, trading off one policy against another to find the most efficient way to redistribute. Rather, according to the theory of policy compartmentalization introduced by this Article, ordinary people hold category-by-category views about what is just for a given policy and apply those views partly in isolation. They have "policy compartments" and apply certain attitudes to one compartment but not to others. Thus, individuals' support for redistribution can differ depending upon whether they are considering taxation or other means of redistribution. The level of redistribution through taxation they support can differ from their overall distributive preferences, as well.

This theory may simultaneously be intuitive to some readers—which is good, as the argument is that this is commonplace psychology—and also upend standard policy prescriptions. For example, people may think that it is good policy to spend on transportation to the poor, thus "redistributing" to them, so that they have the opportunity to get to work, but oppose "giving out" cash transfers through the tax system. More to the point, people think about transportation and taxation at least partially separably, not as part of one big fully fungible system.

The theory of policy compartmentalization builds in part on behavioral economics work on "mental accounts." The example typically given for mental accounting is savings behavior.[61] Standard economics assumes that money is fungible: people should treat a dollar the same way regardless of how they receive

[61] Thaler, *supra* note 16.

it.[62] But people do not act that way. For example, even though a dollar is basically the same whether it is earned through one's wages, appreciation in stock, or another means, the likelihood of people increasing their consumption in response to earning an additional dollar is often different depending upon which "mental account" that dollar falls into. Economics Nobel Laureate Richard Thaler's explanation is that people adopt prudent rules-of-thumb in their financial decision-making. For example, believing that one should "live within your means," people consume out of their current wage income much more than out of increases in the value of their stock.[63]

The theory of policy compartmentalization holds that, in many ways, individuals view policy in the same way that they view their personal mental accounts: with different attitudes applied to each compartment. Economists tend to view welfare maximization as beginning with one big pie, containing taxes, environmental health, healthcare, education, transportation spending, minimum wage laws, etc., that can be distributed with perfect commensurability across policies as the social planner sees fit. This Article suggests that many people, instead, view distributional issues on a category-by-category basis, like they view their personal finances. Of particular importance for this Article is that people have policy views on taxes, which are often not only about proper incentives and redistribution but also about people deserving to keep the money that they earn.

This Article focuses on the tax policy compartment, which is described at length in the next Section. A description of all potential policy compartments is beyond the scope of the Article. But, to illustrate distributional attitudes in one policy compartment that are at variance with those imagined in the standard approach, consider government provision of in-kind "necessities." The standard approach holds that the government should not redistribute through provision of necessities beyond the "efficient" amount. Nevertheless, support for redistribution through necessities appears widespread. There are various indications of how redistributive attitudes are particular to the compartment for necessities. For one, rhetoric regarding necessities is often about rights. For example, UN Declaration of Human Rights delineates in-kind rights "including food, clothing, housing and medical care;"[64] it does not say that people should get cash to spend as they wish. Even in the U.S., many seem to believe in a "right" to healthcare based on polls.[65] And across countries, there is widespread in-kind redistribution in areas considered

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[62] *Id*. at 194.
[63] *Id*. at 195.
[64] *The Universal Declaration of Human Rights, Art. 25,* UNITED NATIONS (1948).
[65] Larry Bye & Alyssa Ghirardeli, *American Health Values Survey*, ROBERT WOOD JOHNSON FOUND. 5 (2016), https://www.rwjf.org/content/dam/farm/reports/reports/2016/rwjf437263 (finding that an overwhelming majority of Americans believe that "[e]nsuring that low income Americans have the same chance to get good quality health care as those who are better off financially" should be a "top" or "high" priority).

necessities, such as healthcare, education, housing, food, and childcare.[66] Some of that spending can be justified on standard efficiency grounds, such as high returns to education for children who cannot pay for it themselves.[67] But not all spending can be justified that way. For example, there is lots of redistribution through housing even to the elderly, who could presumably choose whether to spend cash on housing or other things absent a behavioral failing.[68] And the U.S. likely provides healthcare to people that costs far in excess of what poor people would be willing to pay for it.[69] This policy is so notwithstanding the traditional efficiency analysis suggesting an improvement that would make everyone be better off: providing those people unwilling to pay for a full complement of healthcare with (lower value) cash transfers through the tax system.

One could consider many other separate policy compartments as well.[70] For example, people seem unwilling to tolerate valuing the lives of the rich more highly than the lives of the poor for the purpose of regulatory cost-benefit analysis—which would be required in any efficient regime, since the rich are "willing to pay" more for their lives owing to their greater ability to pay.[71] Other nontax policy compartments may be indifferent to the needs of the poor. For example, in the context of torts for property damage, the goals may be primarily compensatory or to deter bad behavior, rather than to address distributional impacts between the rich and poor.[72] It seems clear that people hold category-specific redistributive attitudes. And just because an individual gets more in one category does not mean that people think that she should get less in another category: that's how economists think, but often not how non-economists think. These category-specific attitudes about

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[66] Currie & Gahvari, *supra* note 39, at 335-37 (describing the in-kind programs across countries).
[67] GRUBER, *supra* note 21.
[68] *Id*.
[69] Consider someone in her 50s who earns $20,000 per year. Based on average expenditures, healthcare costs about $8,000 to provide to this person. Bradley Sawyer & Gary Claxton, *How Do Health Expenditures Vary Across the Population?*, PETERSON-KAISER HEALTH SYSTEM TRACKER (Jan. 16, 2019), https://www.healthsystemtracker.org/chart-collection/health-expenditures-vary-across-population/#item-start; *2019 Health Insurance Plans and Prices*, HEALTHCARE.GOV (Accessed Sept. 18, 2019), https://www.healthcare.gov/see-plans/#/plan/results. It seems likely that someone so poor would prefer the cash to the full $8,000 in healthcare. For Medicaid beneficiaries ages 19-64, average annual spending per enrollee was $9,079 in 2010. David Lassman et al., *US Health Spending Trends by Age and Gender: Selected Years 2002–10*, 33 HEALTH AFF. 815, 820 exhibit 4 (May 2014).
[70] *See*, *e.g.*, Douglas A. Kysar, *Preferences for Processes: The Process/Product Distinction and the Regulation of Consumer Choice*, 118 HARV. L. REV. 526 (2004) (arguing for the centrality of non-standard preferences for process, not just products, in the context of consumer choice).
[71] MICHAEL A. LIVERMORE & RICHARD L. REVESZ, RETAKING RATIONALITY 83-84 (2008) (arguing that "a cost-benefit analysis using an average value of a statistical life is unmoored from its economic justification").
[72] JAMES A. HENDERSON JR., RICHARD N. PEARSON, & DOUGLAS A. KYSAR, THE TORTS PROCESS 35-39 (8th ed., 2012) (describing how major theories of tort law, including instrumental, corrective justice, and civil recourse, do not focus on redistribution from the rich to the poor for its own sake).

fairness have major implications for the right policy to adopt in a given real-world situation across economic questions in the law. Part III addresses those implications for questions about inequality.

Ample evidence supports the idea that people compartmentalize policies. Consider a few examples. First, new evidence from survey experiments shows a wide gulf between support for a "cash" transfer and a transfer to be spent on "necessities."[73] A large, demographically representative group of Americans were randomly presented with one of two identical scenarios with a $2,000 transfer to the poor. In one scenario, the money could be spent on anything. In the other, "necessities account" scenario, the money could be spent only on healthcare, food, and housing. Support for this "necessities account" was a gaping 29 percentage points higher after presented with both options, and the difference was even larger for the richest, possibly most politically influential,[74] respondents. Respondents were asked how they think about this issue, and the most common responses were about ensuring that people buy "basic necessities" with "taxpayer" money. Necessities appear to be a different compartment than cash—and one in which government redistribution seems far more appropriate.

Similarly, a second study shows how support for programs that seem identical to economists have considerably different support based on how they are administered. The study compares support for government programs to fund individuals' expenditures, such as rent. The authors randomly asked respondents about support in one of two ways to help cover rent: through reducing taxes by $1,000 or through having a separately administered spending program.[75] Although the two programs would be considered by economists to be essentially identical, since $1,000 in reduced taxes should be the same as getting a $1,000 check in the mail, support is considerably higher for the program reducing taxes than the program increasing spending. The tax compartment appears different from the government spending compartment; letting people keep their pretax income appears more popular than taxing it away and then having the government spend it.

People compartmentalize even between different types of taxation, a third study shows. One experiment considered how support for taxation varied depending on whether it was split between two different forms of taxation: a tax on incomes and a separate tax on "payroll," which was effectively the same as a tax on income in the context.[76] Respondents preferred a considerably higher total amount of taxation

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[73] Zachary Liscow & Abigail Pershing, *Why is So Much Redistribution in Cash and Not In-Kind?*, Yale Law School Working Paper, 2020 (finding in an online survey experiment greater support for cash than for in kind redistribution of the same value).

[74] MARTIN GILENS, AFFLUENCE AND INFLUENCE (2014).

[75] Conor Clarke & Edward Fox, *Perceptions of Taxing and Spending: A Survey Experiment*, 124 YALE L. J. 1252 (2015) (describing the apparent ease of providing tax breaks instead of economically equivalent direct transfers).

[76] Edward J. McCaffery & Jonathan Baron, *The Humpty Dumpty Blues: Disaggregation Bias in the Evaluation of Tax Systems,* 91 ORGAN BEHAV. & HUM. DECIS. PROCESS 230 (2003).

when both forms of taxes were present—on income as well as payroll—than when only one was present. The payroll tax and the income tax seem to be in different compartments.

People could have policy compartments for a variety of reasons. The third study, on preferring higher total taxes when both income and "payroll" taxes are enacted, looks more like a bias of failing to aggregate across two types of taxes. If, even in personal financial decision-making, with huge individual stakes, people tend to fail to aggregate across financial accounts, it is unsurprising that in their thinking about policy issues, where the personal stakes of one's actions like voting are trivial by comparison, they would make similar errors. The first study, on preferring necessities accounts rather than cash, may look more like a value about certain necessities being good to spend money on or at least good for a government to provide. This could be akin to the different "spheres of justice" that Michael Walzer describes, each with its own notion of the proper role of the state in adjudicating distributive issues.[77] Or as the survey experiment suggests, it could also partly reflect confusion about how poor people spend their money, with many people paternalistically—and incorrectly—believing that the poor will spend a large share of their funds on things other than "necessities."[78] The second study, showing a preference for reducing taxes over increasing government spending, could be a bias, a value, or something else. In other cases, voters may consider policy-by-policy fairness to more easily monitor politicians. There is a huge amount to unpack in the theory of compartmentalization, with potential normative and practical implications across law and economics that is mostly left to future work. The key point for the Article's purposes is only that policy compartmentalization about redistribution is an important feature of reality.

B. Public Attitudes Hinder Redistribution Through Taxation

This Article focuses on one particular policy compartment—taxation of labor income—because such taxes are supposed to be *the* means of redistributing. Public attitudes substantially hinder redistribution through taxation. The reason is that, in the tax policy compartment, many people care about desert based on pretax income. That is, many believe that if people earn more money they deserve to keep a decent share of it, and, if they earn less, they deserve less money, all for reasons unrelated to incentives to work. This commonplace attitude is inconsistent with the standard economic approach's tax policy prescription of adopting all redistribution through taxation. With partially compartmentalized policy views, it is completely consistent to resist redistribution through the *specific process* of taxes, while at the same time supporting either more equal outcomes overall or more egalitarian provisions

[77] MICHAEL WALZER, SPHERES OF JUSTICE: A DEFENSE OF PLURALISM AND EQUALITY 7-11 (1984).
[78] Liscow & Pershing, *supra* note 73.

through specific goods (like healthcare) or processes (like regulatory cost-benefit analysis).

Policy compartmentalization is a key frame for understanding public attitudes because moral desert and a host of other concerns may enter each policy compartment, but may apply differently. For example, people may deserve to keep their incomes, limiting redistribution through one means, but they may also deserve to receive support from the government for certain necessities, increasing redistribution through another means. Ignoring this reality dooms the standard economic approach to make poor policy prescriptions.

Four sources of evidence suggest that notions of desert in pretax income that limit tax-based redistribution are important to how people think: 1) philosophical reflection, 2) survey experiments, 3) the large gulf between the real world and the standard economics prescriptions for taxation, and 4) political rhetoric. This Section reviews each in turn.

1. Philosophical Reflection and Introspection

Turning first to philosophical reflection and introspection, the seminal statement on tax desert is Liam Murphy and Thomas Nagel's *The Myth of Ownership: Taxes and Justice*.[79] They argue that the belief that people deserve to keep a substantial share of their pretax income comes from two sources: the senses that people *own* and *earn* their pretax income.[80] Ownership can seem to confer a sense of "unqualified moral entitlement to what we earn in the market."[81] And the idea "that higher market returns are in some sense deserved as a reward arise[s] naturally within the everyday outlook of participants in a capitalist economy."[82] Desert is then strengthened by the sense that people not only *own* their pretax income but also *earn* it, either from thrift in savings or from industrious hard work or skill. This belief then easily "slides into the much broader notion that all of pretax income can be regarded as a reward for those virtues."[83]

Murphy and Nagel argue that desert in pretax income is mistaken because pretax income is largely determined by legal structures for which individuals have little direct responsibility. Nevertheless, "banishing [these ideas] from our everyday

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[79] LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: TAXES AND JUSTICE 34 (2002).
[80] Murphy and Nagel use somewhat different terminology. They distinguish between the normative concept of "pre-institutional desert" and the sociological or empirical concept of "entitlement," also known as "institutional desert," or how our institutions in fact generate deservingness. *See Desert,* STAN. ENCYCLOPEDIA PHIL. (Oct 9, 2015), https://plato.stanford.edu/entries/desert/. Since this Article is primarily interested in describing people's views on tax policy, rather than investigating where they come from, it combines the two ideas under the heading of "desert."
[81] *Id.* at 36.
[82] *Id.* at 36.
[83] *Id.* at 36.

thinking" is difficult,[84] as such a notion of income would be "counterintuitive" because "[t]axes are naturally perceived by most people as expropriations of their property."[85] It would be difficult for the idea that income is not "theirs" to "become psychologically real to most people" because "[p]retax economic transactions are so salient in our lives."[86] Instead, what is psychologically real is "the robust and compelling fantasy that we earn our income and the government takes some of it away from us, or in some cases supplements it with what it has taken from others."[87] They suggest that "[c]hanging this habit of thought would require a kind of gestalt shift, and it may be unrealistic to hope that such a shift in perception could easily become widespread."[88] The claim is not that taxation is impossible but that such views lead to a drag on the ability of the state to redistribute through taxation.

The commonplace attitudes that Murphy and Nagel describe are inconsistent with the standard economics approach. That approach imagines all resources combined into one pie and then reallocated to maximize welfare It does not matter who has what to begin with; there are no rights, and there is no desert based on pretax income. Individuals are completely dissolved in optimal tax theory, except as producers of income facing incentives and then as consumers of income, untied to who produced what. Of course, allowing people to keep part of their income is important to encourage work. But desert-based attitudes are different. With such attitudes, pretax income generates desert, so that a more unequal pretax income distribution will tend to increase the desired inequality in post-tax incomes, even ignoring incentives.

2. Empirical Evidence in Psychology and Economics

Emerging empirical evidence in psychology and economics further shows how public attitudes support limiting tax-based redistribution in ways inconsistent with one-pieist goals of maximizing the size of the pie and dividing it up to achieve a fair distribution. The studies work by isolating how people reason about distributional concerns tax policy. While there have now been several survey experiments on the topic,[89] consider two illustrative ones.

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[84] *Id.*
[85] *Id.* at 175.
[86] *Id.* at 176.
[87] *Id.* at 176.
[88] *Id.* at 175.
[89] *See, e.g.*, SHEFFRIN, *supra* note 19 (assembling sources); Alberto Alesina et al., *Intergenerational Mobility and Preferences for Redistribution*, 108 AM. ECON. REV 521 (2018); Jimmy Charite et al., *Reference Points and Redistributive Preferences: Experiment Evidence* (Nat'l Bureau of Econ. Research, Working Paper No. 21009, 2019); Raymond Fisman et al., *Do Americans Want to Tax Capital? Evidence from Online Surveys*, (Nat'l Bureau of Econ. Research, Working Paper No. 23907, 2017); Matthew C. Weinzierl, *A Welfarist Role for Nonwelfarist Rules: An Example with Envy* (Harv. Bus. Sch., Working Paper No. 17-021, 2017).

One study shows the widespread perception that people deserve to keep what they earn, even for genetic advantages. Christopher Freiman and Shaun Nichols present respondents with a case of two jazz singers, each of whom works equally hard, but one of whom is a better singer because of genetic differences.[90] Respondents said that the better singer deserved more money and that it was fair for her to receive it. This empirical result conflicts with the prescription from optimal tax theory that both singers should receive the same post-tax income, apart from incentive considerations—which are not at play here because these skills are inborn.[91] This evidence suggests that instead even pretax income arising from inborn skills generates perceptions of desert.

In another experiment, Matthew Weinzierl shows the prevalence of beliefs that desert inheres in pretax income, even if earned for reasons unrelated to effort.[92] Survey respondents are presented a hypothetical in which two people arbitrarily have different pretax incomes, one richer and one poorer. Respondents are then asked how much tax each party should pay to help fund a specified amount for necessary public goods, as well as potentially redistribute across the two parties.[93] This setup removes incentive effects of taxation, since the parties receive the money irrespective of behavior. As a result, the standard economics approach prescribes equalizing the incomes of the two people because a dollar continues to produce more utility for the poorer person until the incomes are equalized, and higher taxes will not shrink the total income available to the two parties. Nevertheless, a large majority of respondents—75%—stop short of full equalization, and many stop well short.[94] Put differently, the entirely arbitrary "pretax income" appeared to have moral weight. Pretax incomes appear to generate perceptions of desert.

Nothing in the experiment suggests that people are not also motivated in part by standard goals of achieving fairer outcomes; respondents preferred some redistribution. Nevertheless, this evidence suggests that people have some attitudes quite distinct from the one-pieist redistributionist ones that economists typically focus on. Pretax income—even if entirely arbitrary, arising from factors like natural ability over which people have no control—appears to drive many people's views of fair taxation.

Summarizing the empirical literature on attitudes about redistribution in taxation, Steven Sheffrin writes in *Tax Fairness and Folk Justice* that ordinary people are often less concerned with "distributional issues, or 'who gets what'" than of having a fair method linking pretax incomes and post-tax outcomes.[95] Since to

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[90] Christopher Freiman & Shaun Nichols, *Is Desert in the Details?*, 82 PHIL. & PHENOMENOLOGICAL RES. 121 (2011).
[91] Gregory Mankiw, *Defending the One Percent*, 27 J. ECON. PERSP. 21, 29 (2013).
[92] Weinzierl, *supra* note 19.
[93] The interface clearly showed how much money each party ended up with given a proposed allocation, making outcomes salient. *Id.* at 58.
[94] *Id.* at 56.
[95] *Id.* at 3.

many people a fair method requires connecting a person's ultimate distributional outcome to what he initially earned, they tend to resist the redistribution imagined under one-pieism for achieving distributional objectives purely through taxation.

3. Failure of Existing Institutions to Follow Optimal Tax Theory

Existing institutions provide additional evidence of the dissonance between reality and what taxes would actually need to do under the standard approach. Economists have now extensively studied the tax rates required to achieve a welfare-maximizing distribution of income, given the behavioral response to taxation,[96] though this optimal taxation literature has received little notice in the legal literature outside of tax scholars themselves.[97] Of course, there is no exact agreement on what an "optimal" income tax would look like.[98] However, there is broad agreement on several features that maximize the benefits and minimize the costs of using taxation as a redistributive tool.[99] Wherever tax policy is used for redistributive ends, these features are likely to appear. However, the magnitudes will differ depending upon the desired distributive outcome which, in turn, will depend upon one's prior normative commitments.

This Article is the first to carefully juxtapose the high level of redistribution predicted by optimal tax theory with the substantially more modest redistribution we see in reality, and draw out implications for the law *outside of taxation*. Existing redistribution is telling about commonplace views on taxation, assuming that the real-world evolution of political institutions reflects those commitments to some extent. This subsection reviews five important prescriptions of optimal tax theory, none of which are borne out in practice. It then concludes by comparing the redistributive views implicit in the tax code with the redistributive views people tend to hold about their own incomes.

First, optimal tax theory typically prescribes a large cash "demogrant" (essentially, a universal basic income) to let people choose what to spend their money on.[100] This demogrant goes by many names but has received support from thinkers on the left and the right. For example, in the 1970s, Richard Nixon and Milton Friedman advocated for such a "negative income tax," essentially a

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[96] Mankiw et al*., supra* note 18, at 147 (summarizing the literature); Diamond & Saez, *supra* note 42 (disagreeing in some respects, but establishing many points of consensus).
[97] For an example of tax scholars' discussion of optimal taxation, see Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905 (1987).
[98] See, for example, the debate between Mankiw et al. on one side and Diamond and Saez on the other. Mankiw et al*., supra* note 18, at 155-59; Diamond & Saez*, supra* note 42, at 175-77.
[99] *Id.*
[100] Emmanuel Saez, *Optimal Income Transfer Programs: Intensive Versus Extensive Labor Supply Responses,* 117 Q.J. ECON. 1039, 1059-66 (2002).

universal basic income by a different name.[101] Though the exact size that would maximize overall welfare is unclear, estimates are generally in the range of several thousands of dollars annually. Most recently, a sophisticated estimation by economist Emmanuel Saez recommends an annual demogrant of $11,900 (in 2018 dollars).[102]

Without denying that some policies give some cash to some people, the government provides no such demogrant or anything close to it.[103] For example, a childless adult who is neither working nor in training may be eligible for little or no cash support from the government.[104] This outcome is consistent with the importance of desert and a resulting distaste for unrestricted cash transfers: the state

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[101] MILTON FRIEDMAN, CAPITALISM AND FREEDOM (1962), http://circuloliberal.org/livros/capitalismo-e-liberdade.pdf; DANIEL P. MOYNIHAN, *THE POLITICS OF A GUARANTEED INCOME: THE NIXON ADMINISTRATION AND THE FAMILY ASSISTANCE PLAN* (1973); Robert Moffitt, *Welfare Work Requirements with Paternalistic Government Preferences*, 116 ECON. J. F441, F441 (2006).

[102] Saez, *supra* note 100, at 1060 tbl. 1 pnl. B (showing a guaranteed income of $7,300 in 1996 dollars). If anything, this demogrant estimate is small, given recent estimates. *See* Raj Chetty, *Bounds on Elasticities with Optimization Frictions: A Synthesis of Micro and Macro Evidence on Labor Supply*, 80 ECONOMETRICA 969, 1008 (2012) (showing that the average estimate of the extensive margin elasticity is 0.25, which would imply an even larger demogrant than the one described in the text above). *See also* Mankiw et al., *supra* note 18 (providing calibrations showing an even larger demogrant "equal to just over 60 percent of average income per worker in the economy"). Importantly, this analysis does not include "tagging," allowing larger transfers to those, like the disabled, who have lower earnings abilities; incorporating tagging would lower the size of the demogrant. Nor does it include the possibility of provision of services like healthcare, which would also presumably lower the size of the optimal demogrant. *See also* Batchelder, *supra* note 48 (describing how similar estimates have been around since the beginning of the Mirrlees model).

[103] Probably the closest in United States is the Alaska Permanent Fund, which used revenue from oil drilling to fund a "dividend" that averaged $1,300 per resident per year between 2009 and 2018. *See Summary of Dividend Applications & Payments* (2016), ALASKA DEP'T OF REVENUE, PERM. FUND DIVIDEND DIV., https://pfd.alaska.gov/Division-Info/Summary-of-Applications-and-Payments. Whether something similar would be feasible in the rest of the country without significant oil wealth is an open question. The U.S. Internal Revenue Code does not provide transfers at all to those who do not work, even those with children. For those who earn no money, none of the (per child) $2,000 Child Tax Credit is available. I.R.C. § 24(d)(1)(B). Nor is the Earned Income Tax Credit available, as that also requires earned income. I.R.C. § 32. Temporary Assistance for Needy Families benefits have work requirements and typically have time limits. *See Policy Basics: An Introduction to TANF* (2018), CENTER ON BUDGET AND POLICY PRIORITIES, https://www.cbpp.org/research/family-income-support/policy-basics-an-introduction-to-tanf.
Probably the closest federal program to a cash transfer is Supplemental Nutrition Assistance Program benefits, with a maximum benefit of $353 per month of food for a single parent with a child. But, for adults without children, benefits are typically limited to three months over three years, unless beneficiaries are working or training. *See A Quick Guide to SNAP Eligibility and Benefits* (2019), CENTER ON BUDGET AND POLICY PRIORITIES, https://www.cbpp.org/research/food-assistance/a-quick-guide-to-snap-eligibility-and-benefits.

[104] *Id.*

typically does not give out money to those who do not work for it, without some strings attached.[105]

Second, the demogrant is taxed away at fairly high marginal tax rates for moderate income-earners (roughly those earning around median income). For example, Saez's model has 37% marginal tax rates on such incomes.[106] This will maximize tax revenue (since lots of taxpayers earn *at least* modest amounts of income) while distorting the behavior of relatively few taxpayers (since many taxpayers will earn well beyond that amount in any case).[107] Nevertheless, this creates a large disincentive to work for lower-income taxpayers—indeed, Saez estimates a resulting nonemployment rate of 13.8% because of the large demogrant and high taxes. The disincentive to work for lower-income earners is considered a worthwhile efficiency cost because of the taxes collected on higher-income earners.

Again, we do not see high tax rates on modest incomes. Rather, it seems unfair to have high tax rates because they would not be getting a fair share of output of their labor. Indeed, those high tax rates would discourage large numbers of people from working at all, eliminating their workplace contribution to the state altogether.

Third, fixed attributes of people should be "tagged"[108] to observable characteristics correlated with earnings ability.[109] That is, for two taxpayers earning the same income, the one with the characteristics that are correlated with having

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[105] An interesting question is what other countries do, as that may suggest what is possible in the U.S. Some Gulf States have an "implicit government job guarantee" for nationals, but that is different from a demogrant because it involves work. Steffen Hertog, *The GCC's National Employment Challenge*, WASH. POST (July 31, 2014). As well, some Scandinavian countries have generous unemployment programs. For example, unemployment insurance in Denmark allows beneficiaries to receive up to 90% of their previous salary. However, receipt of unemployment benefits requires previous work experience (with exceptions for those who have just finished education or training) and active job searching, and a person is only entitled to benefits for 2 years within a 3-year period. *Denmark–Unemployment Benefit*, EUR. COMMISSION: EMP., SOC. AFFAIRS & INCLUSION, http://ec.europa.eu/social/main.jsp?catId=1107&langId=en&intPageId=4496 (last visited July 27, 2020). Again, this policy is not a demogrant because it is tied to work. Finally, the UK passed a small Child Trust Fund, in which children were given £500 from the government and the opportunity for parents and grandparents to save additional money tax-free, but these are far smaller than the sum of annual demogrants and in any case only go to children. *See* Child Trust Funds Act 2004, c. 6 (U.K.); Zoe Williams, *Why We Cannot Afford to Raid the Child Trust Fund Piggy Bank*, GUARDIAN (May 2, 2010); *see also Child Trust Fund Statistics: Detailed Distributional Analysis*, HM REVENUE & CUSTOMS tbl.2 (Feb. 2013), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/255881/dda.pdf.

[106] Saez, *supra* note 100, at 1061.

[107] In technical terms, the best way to raise money from middle and high-income earners is to have high tax rates on their "inframarginal" earnings, which are the dollars they earn that are far from their decision-making margin. For example, if a worker makes $40,000 per year and the government places high taxes on any earnings below $25,000, the worker is unlikely to cut back their hours in order to get under the $25,000 threshold.

[108] The idea originally comes from George A. Akerlof, *The Economics of "Tagging" as Applied to the Optimal Income Tax, Welfare Programs and Manpower Planning*, 68 AM. ECON. REV. 8 (1978).

[109] Mankiw et al., *supra* note 18, at 161-64; Diamond & Saez*, supra* note 42, at 166.

the higher earnings potential, like height, should be taxed more.[110] While taxing income incentivizes people to work less, taxing based on *fixed* characteristics that are correlated with earnings ability reduces the efficiency loss. It still partially taxes those who can earn more, but because fixed characteristics cannot be changed, it does not discourage work. In the extreme, if the government were omniscient, it could tax based on its knowledge of an individual's earnings ability and not cause any distortion at all, since people would not be able to reduce their tax burden by changing their behavior.[111] Additionally, since the highly-skilled are so much more productive, they should pay high taxes, possibly so high that they need to work long hours in jobs that they dislike to provide more resources to be redistributed.[112] That is, since the costs of work are presumably similar for everyone but the benefits for society of work are so much higher for the high-skilled, the high-skilled should effectively be forced to work much more.

In practice, though we do see some tags like disability, we do not see taxation based on tags like height.[113] Nor does a tax based on height seem like a plausible policy to adopt, since taxing differently two different-height people who earn the same income may simply seem unfair. Evidence from survey experiments confirms that very few people support such tags.[114] This result is also consistent with an aversion to setting taxes on the basis only of incentives and redistribution, rather than also internal fairness norms. If two people produce the same amount, they should be treated the same by the state, even if one is tall and one is short.

Fourth, optimal tax theory says that, as inequality increases, taxes should become more redistributive.[115] That is, as the share of income earned by those with the highest incomes goes up, their tax rates should go up.[116] This makes sense: as the rich get richer, their marginal utility of consumption declines yet more, making it worth taxing them more.

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[110] N. Gregory Mankiw & Matthew Weinzierl, *The Optimal Taxation of Height: A Case Study of Utilitarian Income Redistribution*, 2 AM. ECON. J.: ECON. POL'Y 155 (2010).
[111] With advancements in genetics, an arguably dystopian future could be prescribed in which taxes are based not principally on earnings but instead on one's genetic endowment.
[112] *But see* Lily Batchelder, *supra* note 48, at 30-38 (arguing that the consequences need not be severe).
[113] Mankiw et al., *supra* note 18.
[114] Emmanuel Saez & Stefanie Stantcheva, *Generalized Social Marginal Welfare Weights for Optimal Tax Theory*, 106 AM. ECON. REV. 24 App. 14-20 (2016) (presenting survey evidence suggesting that virtually no one supports tagging in their context).
[115] Mankiw et al., *supra* note 18, at 159-61; Diamond & Saez, *supra* note 42, at 189.
[116] SHEFFRIN, *supra* note 19, at 130-31.

Yet, despite the well-documented rise in income inequality,[117] there is widespread agreement that taxes have not kept up.[118] This failure could be due in part be to a the strikingly low support for high taxes on the rich: recent surveys show only roughly half of Americans want high taxes on the rich.[119] The large numbers of relatively poor people who do not want higher taxes on the rich is especially striking, with 26% earning less than $25,000 opposing higher taxes on the rich and an additional 17% neutral.[120] This result is also consistent with the importance of desert: people get what they deserve. And, if inequality goes up, that does not necessarily mean that the rich should pay much more because their skill and work effort produce pretax income, of which people deserve to keep a large share.[121]

Fifth and relatedly, taxes should roughly be set to maximize revenue from the rich. With a declining marginal utility of income, at very high incomes, the benefit of an additional dollar is essentially zero.[122] Thus, taxes should be set such that the government can collect as much as possible, setting a rate that discourages work somewhat, but not to the point of reducing tax revenue. In other words, rich individuals are treated "only as the revenue producing property of the state."[123]

We do not see such tax rates, perhaps because (absent a war or some perceived great social need, recent historical research suggests[124]) people believe that well-off individuals—as individuals who have large talents and work hard—deserve to keep a decent share of their income.

Recent advances allow economists to quantify and summarize the redistributive views implicit in the tax code, by extrapolating the value we must place on income

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[117] Thomas Piketty & Emmanuel Saez, *Income Inequality in the United States, 1913 – 1998*, 118 Q.J. ECON. 1 (2003). The extent of the rise is disputed. *E.g.,* Richard Burkhauser et al., *Recent Trends in Top Income Shares in the United States: Reconciling Estimates from March CPS and IRS Tax Return Data*, 94 REV. ECON. & STAT. 371 (2012); Alan J. Auerbach et al., *U.S. Inequality, Fiscal Progressivity, and Work Disincentives: An Intragenerational Accounting* (Nat'l Bureau of Econ. Research, Working Paper No. 22032, 2016).

[118] *See, e.g.,* Benjamin B. Lockwood & Matthew Weinzierl, *Positive and Normative Judgments Implicit in US Tax Policy, and the Costs of Unequal Growth and Recessions*, 77 J. MONETARY ECON. 30 (2016) (showing that taxation has redistributed considerably less to the poor over time, even considering changing economic circumstances).

[119] Karlyn Bowman & Andrew Rugg, *Public Opinion on Taxes: 1937 to Today,* AM. ENTERPRISE INST. 25 (Apr. 2012), http://www.aei.org/wp-content/uploads/2012/04/-aei-public-opinion-study-on-taxes-2012_082833686158.pdf; SHEFFRIN, *supra* note 19, at 119-20.

[120] Rebecca Reed-Arthurs & Steve Sheffrin, *Windows into Public Attitudes Towards Redistribution*, 102 PROC. OF THE NAT'L TAX ASS'N 165 (2009).

[121] *See* DANIEL MARKOVITS, THE MERITOCRACY TRAP (2019) (arguing that an ethos of "meritocracy" pervades our age, including the idea that, because success is meritocratic, the earnings from career success are thus deserved).

[122] Martin Feldstein, *The Mirrlees Review*, 50 J. ECON. LIT. 781, 783 (2012).

[123] Feldstein, *supra* note 122, at 783.

[124] KENNETH SCHEVE & DAVID STASAVAGE, TAXING THE RICH: A HISTORY OF FISCAL FAIRNESS IN THE UNITED STATES AND EUROPE (2016) (making this argument).

in the hands of the poor to be willing to distort behavior with taxes and transfers to help them.[125] Nathaniel Hendren shows that our current tax code implicitly values a dollar in the hands of someone at the 10th percentile of income ($14,000) 1.5 times as much as someone at the 90th percentile of income ($179,000).[126]

By contrast, individuals' own personal behavior regarding risk implies a far higher weight on the poor relative to the rich.[127] For themselves, they value an extra dollar about *thirteen*[128] times more highly if they had an income at the 10th percentile than if they had an income at the 90th percentile.[129] The reason is that people value the things (often necessities) they would buy at low incomes more than the things (often luxuries) they would buy at high incomes. The results come from looking at, for example, how much people are willing to pay for insurance, which essentially redistributes money to times when the individual is poorer because of loss of an asset like a house burning down.

So our current tax code redistributes across people nowhere remotely close to the amount that individuals do internally for themselves. Given the implicit ratio of values between the 10th and 90th percentile income-earners of 1.5 in the tax code versus 13 internal to individuals, the tax code implicitly only gives poor individuals 12% of the weight implied by people's own behavior. Of course, there are major issues of interpersonal comparability in going from within-person to between-person comparisons. And by no means does this method necessarily produce the normatively right distribution of resources. Nevertheless, this vast divergence from a common economics baseline is suggestive.

Inferring commonplace views from existing policies while trying to offer recommendations to improve policy leads to an obvious circularity problem.[130]

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[125] The method first considers the incentive effects of taxation: if people's incomes are taxed, they will tend to work less. And then it asks how much people implicitly weight, or value, a dollar in the hands of a rich versus poor person, given those incentive effects and the taxes that we see. So, the more redistribution there is to the poor, despite the efficiency harms of doing so, the larger the implicit weight on the poor relative to the rich. Nathaniel Hendren, *Efficient Welfare Weights* (draft, March 2019); Lockwood & Weinzierl, *supra* note 118.

[126] Hendren, *supra* note 125*,* at 24 (Fig. 6).

[127] These results are conservatively, and roughly, approximated by the "logarithm" function.

[128] For incomes, see *Average, Median, Top 1%, and Income Percentiles in 2018 in the United States*, DQYDJ, https://dqydj.com/united-states-household-income-brackets-percentiles/ (last visited Sept. 24, 2019).

[129] *See, e.g.,* Raj Chetty, *A New Method of Estimating Risk Aversion*, 96 AM. EC. REV. 1821 (2006) (finding a "coefficient of relative risk aversion" of approximately one, which has this implication). The "logarithmic" utility function implied by this analysis is also suggested by cross-country studies measuring stated happiness. Nestor Gandelman & Rubén Hernández-Murillo, *Risk Aversion at the Country Level,* 97 FED. RES. BANK ST. LOUIS REV. 53 (2015). Note that, as Chetty at 1821 points out, many other estimates imply even higher risk aversion, which suggest an even larger divergence in distributional weights between the rich and the poor.

[130] *See, e.g.*, RAYMOND GUESS, PHILOSOPHY AND REAL POLITICS 49-50 (2008) (describing how conceptual instruments used to analyze social reality are often inextricable from social reality itself: "Often, you can't see the original problem clearly until you have the conceptual instrument, but

Policies could look the way they do for many reasons, including political capture.[131] Nevertheless, the difference between what taxes would probably need to do under optimal tax theory and what they in fact do is remarkably gaping. This is especially so because there are no technological barriers to any of the implications of optimal taxes: a demogrant, high marginal tax rates for low-income earners, or taxation based on tags. We have just chosen not to do those things. And, in any case, as the previous subsection explained, another account would need to explain the great deal of redistribution through nontax means. Maybe asking the tax code to provide the redistribution necessary for a just society is simply asking ordinary people to accept something inconsistent with their moral intuitions.

4. Political Discourse

The fourth reason to think that many people believe that desert inheres in pretax income is that our political discourse—which presumably is in part designed to appeal to people's basic intuitions—reflects such concerns. For example, President George W. Bush often described tax cuts as letting Americans "keep more of their hard-earned dollars," an apparent appeal to hard work generating desert.[132] While Bush mentioned incentives too, the issue of distributive justice—setting tax rates based on need, a key factor in optimal taxation—was often entirely absent. The liberal crop of 2020 Democratic presidential candidates seems to at least partially agree: with the exception of Andrew Yang (who polled in the low single digits and got 0.42% of the primary vote),[133] even the most liberal candidates did not propose providing large unrestricted cash transfers to the poor. And Democrats commonly use similar language about desert.[134] For example, in response to the question,

having the instrument can then change the 'real' situation with which one is confronted so that other, unforeseen problems emerge.").

[131] *See, e.g.*, Philip Bump, *Who Actually Wants Congressional Republicans to Pass Trump's Tax Bill?*, WASH. POST (Nov. 2, 2017), https://www.washingtonpost.com/news/politics/wp/2017/11/02/who-actually-wants-congressional-republicans-to-pass-trumps-tax-bill/; Marissa Schultz, *GOP's Big Donors Threaten to Close Wallets if Tax Reform Isn't Passed*, N.Y. POST (Nov. 6, 2017), https://nypost.com/2017/11/06/gops-big-donors-threaten-to-close-wallets-if-tax-reform-isnt-passed/; Dylan Scott, *House Republican: My Donors Told Me to Pass the Tax Bill or "Don't Ever Call Me Again"*, VOX (Nov. 7, 2017), https://www.vox.com/policy-and-politics/2017/11/7/16618038/house-republicans-tax-bill-donors-chris-collins.

[132] President George W. Bush, *President's Weekly Radio Address*, ARCHIVES.GOV (Apr. 15, 2006), https://georgewbush-whitehouse.archives.gov/news/releases/2006/04/text/20060415.html.

[133] *Latest Polls: President: Democratic primary,* FIVETHIRTYEIGHT, projects.fivethirtyeight.com/polls/president-primary-d/ (last visited July 27, 2020); *2020 Democratic Popular Vote*, REAL CLEAR POLITICS, https://www.realclearpolitics.com/epolls/2020/president/democratic_vote_count.html (Accessed May 30, 2020) (showing primary vote totals through May 2020).

[134] President Barack Obama said, "Understand we've never begrudged success in America. We aspire to it. We admire folks who start new businesses, create jobs, and invent the products that

"Does anyone deserve to have $1 billion?" Senator Kamala Harris responded, "If they earn it and work hard for it, sure."[135]

5. Summary

In short, one of the two implications for the law and economics two-step is imposing an "optimal" tax. Yet people appear to hold attitudes at odds with the implications of optimal taxation, and current policy is far off from those implications. Scholars disagree about whether desert *should* inhere in pretax income.[136] But there is broad agreement that this attitude is commonplace, which is the only claim this Article makes. What has been missed in the debate thus far—which has focused on the implications of these attitudes *for taxation*—is the implication of the apparently durable[137] commonplace attitudes for vast array of *nontax policies*.

Overall then, the Article operates from a theory about the social and political psychology of voters: many have, in significant part, desert-based views about taxes, believing that the well-off deserve to keep much of their earnings, and the poor mostly deserve only what they work for. This thinking directly contradicts the logic underlying optimal tax theory and, in turn, the efficiency-minded stance of law and economics. People think this way because they have separate policy compartments for taxation and other policies, each with its own distributive views. As a result, there is imperfect fungibility across the compartments. And distributive attitudes about taxation—just one of many policies—do not necessarily reflect distributive attitudes about other means or about distribution overall.

Rather, under the theory of polity compartmentalization, it is completely consistent for people to both dislike strongly redistributive taxation and wish to have more egalitarian policies toward the poor. Taxation is *just one particular means* for addressing inequality.

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enrich our lives. And we expect them to be rewarded handsomely for it." *President Obama on Inequality (transcript)*, POLITICO (Dec. 4, 2013), https://www.politico.com/story/2013/12/obama-income-inequality-100662. *See also* MARKOVITS, *supra* note 121.

[135] Alexander Burns et al., *Meet the Candidates: Does Anyone Deserve to Have a Billion Dollars?*, N.Y. TIMES (2019), https://www.nytimes.com/interactive/2019/us/politics/billionaires-democratic-candidates.html.

[136] *See* Mankiw, *supra* note 91, at 32 (arguing for a "just deserts" goal on taxation, in which "people should receive compensation congruent with their contributions"); MURPHY & NAGEL *supra* note 79 (arguing the opposite). *See also* SHEFFRIN, *supra* note 19, at 8-9 (describing "consonance" with existing policies).

[137] Of course, policy views can change rapidly. As the Article discusses below, this factor should be considered, including by changing policies if those views do change. Desert inhering in pretax income, though, seems like a durable feature of the U.S., and likely will continue into the future.

The key takeaway, if Congressional policymaking reflects the public's views to a significant extent,[138] is that taxes alone will not provide enough redistribution. People have an aversion to both redistributive taxation and inequality. Under the standard economic logic, these should be the same thing because taxes should do the work of redistribution—but that is not so with separate policy compartments.

To be sure, many questions remain and urgently need more research: What are the precise contours of desert-based thinking? How important is status quo bias? How important is an appearance of "ownership" versus a sense of "earning"? How specific are these sentiments to taxation versus other owned things (e.g., property in the case of eminent domain[139])? How are different types of taxation implicated? How malleable are these ideas? What do they seem to change in response to? Nevertheless, this Article provides a novel account that fits with what we see in the world, explaining that the public treats taxes differently as a means of redistribution.

C. *Policymakers Should Reject the Standard Approach*

The standard economic approach to law and inequality does not work and must be replaced. Economics tries to find the most efficient way to help the poor given limited resources, and it says that giving cash through taxes and transfers is typically the best way to do that. Doing so leaves a relatively clean and practical prescribed approach to law: adopt the efficient legal rule.[140] Efficiency also has the appearance of "neutrality" in considering everyone's willingness to pay equally.[141]

However, with policy compartmentalization, the one-pieist method that underlies law and economics textbooks and much lawmaking[142] simply ceases to be a useful heuristic in deciding any individual policy question. It works okay with

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[138] *See* SHEFFRIN, *supra* note 19, at 125-28 (finding those with incomes greater than $200,000 generally oppose using the tax system to redistribute, while those making less $25,000 strongly support doing so, and assembling other evidence); Alberto F. Alesina & Paola Giuliano, *Preferences for Redistribution*, 1, 27-35 (NBER Working Paper No. 14825, 2009), https://www.nber.org/papers/w14825.pdf (finding income is negatively correlated with preferences for redistribution). Of course, the relationship between voters' policy views and actual policymaking is unclear. For example, some argue that the policy preferences of none but the richest drive policy. *See generally* GILENS, *supra* note 74 (showing that, controlling for the views of the well-off, the views of the poor show no relationship with actual policy). Nevertheless, it seems reasonable to argue that widespread voters' views—especially among the well-off, who are likely most inclined to value desert—have an important impact on those that they elect.

[139] Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1156 (1967).

[140] Recall that efficient policies are based on willingness to pay. We can often infer willingness to pay by observing what people actually choose—and are thus willing—to pay for a given good or service. *Supra* notes 34-35 and surrounding text.

[141] *See* Liscow, *supra* note 14 (discussing efficiency and neutrality).

[142] Britton-Purdy et al., *supra* note 57.

the one benevolent social planner that economists imagine in a hypothetical world that lacks politics. But once there are multiple real-world actors implementing policy in a democracy and the attitudes of voters matter in practice, the fallibility of standard economics approach comes into view. Because of the tax policy compartment, we cannot depend on Congress to address *all* distributive issues through taxes, so long as Congress is to some extent responsive to public attitudes.[143] Thus, since the prescription of adopting efficient nontax laws that do nothing for inequality depends upon an unrealistic assumption about redistributiveness in taxation, that prescription does not hold.

Worse yet, efficiency is not "neutral" in the sense of providing the same legal entitlements to rich and poor.[144] Since it is based on willingness to pay, and the rich tend to be willing to pay more, efficient policies tend to endow the rich with larger legal entitlements than the poor. The transportation spending example, in which more money is spent on the rich than the poor because the rich are willing to pay more to commute more quickly, exemplifies this non-neutrality. Of course, this effect matters little if taxes and transfers make up the difference. But, if there is a drag on those taxes and transfers, then the standard economics prescription for efficient legal rules leads to not just a failure to address income inequality but actually *increasing* income inequality. Thus, the standard approach fails on its own account of providing good prescriptions for achieving just distributional outcomes. Especially at a time of such concern over inequality, this approach is unacceptable. It has been a mistake to adopt in a democracy an uber-norm that is so unintuitive to the public.

Thus far, the Article has been a critique: The standard economic approach to law and inequality does not work on its own terms. The prescription that nontax legal rules should be efficient and do nothing to address inequality ignores reality. Going forward, the Article turns prescriptive. For that, we need a new economic approach to law and inequality.

That approach begins with two stipulations. First, we need greater economic equality. This stipulation could be based on a variety of foundations: the apparent preference of the American population across the political spectrum,[145] first principles in economics about the declining marginal utility of income, or first principles from one of the many other egalitarian traditions that find the current amount of inequality unacceptable.

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[143] Benjamin Page & Robert Shapiro, *Effects of Public Opinion on Policy*, 77 AM. POL. SCI. REV. 175, 175 (1983) (a classic study finding Congress responsive, though imperfectly so, to public attitudes); GILENS, *supra* note 74 (finding Congress responsive at least to the attitudes of the wealthy).

[144] *Id.* (discussing when efficiency is and is not neutral and describing how it tends to provide larger legal entitlements to the rich); Dworkin, *supra* note 25 (providing a prominent early example of non-neutrality).

[145] PEW RESEARCH CENTER, *supra* note 1; *See* Rampell, *supra* note 2.

Second, for analytical clarity, while rejecting the standard approach's view of how policy is made in practice, the approach here retains the standard approach's *normative* stance described in Part I of basing policy on the combination of efficiency and achieving a fair ultimate distribution. At the same time, the analysis going forward is meant to be an economics *reference point*, rather than a fully articulated theory of justice. As such, it is meant to be broadly appealing to egalitarians. Many normative traditions[146] accept some basic principles: (1) it tends be good to move resources from the rich to the poor, all else equal, (2) individuals' choices should typically (though not always) be respected, and (3) we face resource constraints, so that there are tradeoffs in helping the poor. For some economists, this is the complete story. Other people have a different or more plural normative understanding and consider values such as legality, legitimacy, dignity, autonomy, basic rights, procedural justice, and social solidarity. And, political economy concerns, such as crafting policy that is politically durable, may also be important.[147] So, while the thin standard economics normative framework may be incomplete, it is still often an important piece of the whole and thus a useful reference point. And, more than anything, what economics needs now is a new baseline.

Beginning with these three basic principles clarifies which questions to answer, provides techniques to help answer them, and describes some of the tradeoffs in answering them. And it provides policy suggestions. It is to those questions and suggestions that the Article now turns. Far too often, the economics model is taken literally, but not seriously: prescribing its literal output even if doing so seems to not take its equality concerns seriously. The rest of the Article flips the script, taking the model seriously, but not literally, as it misses essential social realities.

III. A NEW APPROACH TO LAW AND INEQUALITY: A THOUSAND POINTS OF EQUITY

Currently economics has a standard prescription: outside of taxes, the law should be efficient, even if that means hurting the poor. The harm to the poor is justified by the assumption that taxes and transfers will make up for it. As this Article has shown, common psychology creates significant barriers to the

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[146] For example, though some would disagree with the prescribed degree of redistribution, the Rawlsian goal of achieving the maximum benefit for the least well-off is broadly consistent with the normative approach in this paper, as it is still concerned with helping the less well-off under resource constraints. JOHN RAWLS, A THEORY OF JUSTICE (1971). Rawls also prescribes equal basic liberties, which is consistent with the approach: the parsimonious goal of addressing tradeoffs among limited resources is just a partial one and does not defeat the many other important background principles.

[147] Alexander Hertel-Fernandez, *How Policymakers Can Craft Measures That Endure and Build Political Power*, ROOSEVELT INST. (June 17, 2020), https://rooseveltinstitute.org/wp-content/uploads/2020/06/RI_How-Policymakers-Can-Craft-Measures-that-Endure-and-Build-Political-Power-Working-Paper-2020.pdf.

implementation of these taxes and transfers in practice. The standard prescription is thus a recipe for spiraling inequality. We need to replace that prescription with a new one. This Article rewrites the playbook and provides a new starting point for economic policymaking, called the "thousand points of equity" approach. Under this approach, laws should typically modestly tilt toward towards redistribution, where doing so is consistent with other values. This Part begins by illustrating how one particular institutional actor, the Department of Transportation, could use this approach. It then develops the new approach in general, drawing lessons from both policy compartmentalization and standard economics efficiency logic, to offer guidance on how egalitarians should promote distributive justice. Policy compartmentalization—and, in particular popular resistance to using the tax compartment for redistribution—suggests that much redistribution must come through nontax policy. Efficiency—which remains an important consideration for egalitarians—suggests that redistribution should occur at a modest level across many policies. The Part ends by offering concrete examples from across the law of potential "thousand points of equity" responses in areas including civil penalties, social insurance, labor law, antitrust, housing law, tort law, and specific features of tax law.

A. *Example of Regulatory Cost-Benefit Analysis for Transportation Spending*

Suppose that a new Secretary of the Department of Transportation is considering how to allocate the transportation funds that Congress appropriates to it. As described in Part I, current practice is to value the time of the poor at $25 an hour and the time of the rich at $63 an hour. This system encourages spending funds on the rich instead of the poor because saving time for the rich through transportation improvements is more valuable than an equivalent time savings for the poor. This regime is efficient and is thus the standard economics prescription. The government should spend the bulk of its transportation funds on the rich and then share the ensuing benefits with the poor through large cash transfers, funded by high taxes on the rich. However, that tax regime is not realistic. Income tax policy redistributes insufficiently now and likely in the future as well. What is a Secretary of Transportation attentive to this social psychology to do in spending these billions of dollars?

The transportation planners have a choice: spend inequitably and exacerbate inequality, or do something about inequality. The Appendix provides a model of how a Department of Transportation might approach addressing inequality, while remaining attentive to efficiency concerns. It then runs the numbers using some plausible assumptions about the value of redistribution, as well as the benefits and costs of transportation improvements. The estimates show that the Department of Transportation should spend roughly the same amount on the rich and the poor. The

Secretary should therefore change the current guidance[148] that values the time of the rich at more than the time of the poor and instead should value the time of each equally.

The status quo is bad: it immiserates the poor by spending less on them than the rich, while providing relatively little cash aid in compensation for the inequitable distribution of spending. The poor get the worst of both worlds: little cash and little transportation funding. Nevertheless, regulators continue to allocate transportation spending efficiently. That is, transportation planners are naïve and allocate spending as if there were large cash transfers, even though we have no such thing. This policy harms the poor. Evidence suggests that access to transportation is a key factor in the ability of the poor to achieve economic mobility.[149] Current Department of Transportation policy is erroneous because it is inattentive to Congress's actions on cash transfers. The poor receive too little cash from Congress and too little transportation assistance from the Department of Transportation.

Politically attentive regulators will recognize that there is nothing "neutral" about valuing the time of the rich more than the time of the poor and thus spending more on the rich than the poor. That is efficient, but it is not "neutral." In fact, it transparently biases allocations toward the rich. And, without the justification that taxes and transfers will address the problem of distributive equity, the rationale for purely efficient policymaking disappears. And remember, "redistribution" to the poor that just treats the rich and poor alike would not require violating a fairness norm of equal treatment. It would just mean spending equal amounts and valuing the time of the rich and the poor similarly.

Importantly, the recommendations here are based not on the idea that rich and poor should be treated equally in this particular instance, though that could also be important. Rather, the recommendations are based on the fairly standard economics reasoning: we need to get the poor more resources somehow, and this is a relatively efficient way to do it. It is relatively efficient because, in a regime that values the time of the poor at only $25 per hour, there are a lot of unfunded projects that will save considerable transportation time for the poor and thereby help them earn quite a lot of money. We should build those projects. One need not appeal to norms of procedural fairness in a specific context to arrive at the conclusion that the rich and poor should be treated equally in that context.

Nevertheless, difficult questions can arise when considering alternatives to efficiency in regulatory agencies: Even though efficient cost-benefit analysis is typically not Congressionally mandated[150] and efficiency is not "neutral," it might

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[148] White, *supra* note 4.

[149] Raj Chetty, Nathaniel Hendren, Patrick Kline & Emmanuel Saez, *Where is the Land of Opportunity? The Geography of Intergenerational Mobility in the United States*, 129 Q.J. ECON. 1553 (2014).

[150] Lisa Heinzerling, *Cost-Nothing Analysis: Environmental Economics in the Age of Trump*, 30 COLO. NAT. RESOURCES, ENERGY & ENVTL. L. REV. 287, 288 (2019) (describing how standard CBA

be unclear what the alternative should be. While the tax policy compartment implies that efficient nontax policy is not justified by redistributive taxation, the desirable distributive outcome remains unclear. And it may still be normatively problematic to set such explicit distributional goals administratively. Perhaps a President could dictate such a goal. But the desirable distribution is a deep question that is beyond the scope of the Article. America's high levels of income and wealth inequality[151] may mean that, at present, moves to modestly reduce inequality are particularly normatively appealing. Nevertheless, it remains the case that there is no normatively neutral place from which to set distributional goals. All policies have distributional consequences and, if efficient policymaking is not desirable, then there will be some other distributional consequence to its alternative. In other words, a dictate from the top may be problematic, but making *some choice* is unavoidable. This Article at least suggests a fruitful direction for policy.

None of this is to say that there is not a cost to shifting transportation funding from the rich to the poor. There is a cost: a quicker commute for the rich, who would then work more, contributes more to economic output than a quicker commute for the poor. There will be some bus projects that save a lot of time for the poor, so are worth doing in any case, and there will be some airport projects that save little time for the rich, so are not worth doing in any case. The question is how to handle projects that save a modest amount of time for either group. Under the "efficient" status quo scenario, such projects would only be built for the rich, not the poor. Under the "thousand points of equity" scenario, some would be built for the rich and some for the poor.

As the Appendix shows, the welfare impacts of adopting "worst of both worlds" policies can be large. Regulators' adoption of efficient policy prescriptions risks considerably reducing welfare when Congress does not also use economists' chosen tool of taxes to redistribute. And, recall, cutting-edge research in economics suggests that the US tax code currently redistributes remarkably little.[152] There is a lot of redistributive space for nontax policy to productively fill.

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is typically an innovation of the executive branch, noting that of all the major environmental statutes, Congress prescribed formal CBA in only one); Robert P. Bartlett, *The Institutional Framework for Cost-Benefit Analysis in Financial Regulation: A Tale of Four Paradigms?*, 43 J. LEGAL STUD. S379, 384-87 (2014) (similar, for financial regulations); Amy Sinden, *The Economics of Endangered Species: Why Less Is More in the Economic Analysis of Critical Habitat Designations*, 28 HARV. ENVTL. L. REV. 129, 190-92 (2004) (arguing that, at least the Congresses of the 1970s—which were responsible for much of the environmental legislation that has typified Congressional CBA use—not only did not intend to require the formal, highly quantified form of CBA that we now consider standard practice, but in some cases explicitly looked to avoid it).

[151] Juliana Menasche Horowitz, Ruth Igielnik & Rakesh Kochhar, *Trends in Income and Wealth Inequality*, PEW RESEARCH CENTER (Jan. 9, 2020), https://www.pewsocialtrends.org/2020/01/09/trends-in-income-and-wealth-inequality/#the-wealth-of-american-families-is-currently-no-higher-than-its-level-two-decades-ago.

[152] Hendren, *supra* note 125.

B. The Approach in General

Policy compartmentalization and the importance of "desert" in the tax compartment mean that sufficient levels of redistribution will not occur if taxes are the sole redistributive mechanism. The level of redistribution that voters desire is unlikely to be achieved through taxes alone, since the evidence suggests that general support for redistribution is greater than support for redistribution using the particular tool of taxation.[153] So those looking to make policy more redistributive, either out of prior normative commitments or to better match voter preferences, must turn to nontax policies. The transportation example described in Section A is one option. There are many others. Indeed, as this Section explains, policymakers should adopt a "thousand points of equity:" redistributing modestly across many policies. Since reliance on taxes alone for redistributive aims is insufficient, there must be more than *one* point of equity in the system.

But why "a thousand points" of equity? The answer comes from economics, particularly its insights about efficiency. While egalitarians are united by their concern over distributive justice, many remain concerned with efficiency as well. All else equal, more efficient policies mean that there is more to go around, making everyone (at least potentially) better off. Egalitarians may be less willing than others to sacrifice equity on the altar of efficiency, but they are not indifferent to efficiency concerns. Two important lessons from economics suggest that, as a baseline, redistribution should take a "thousand points of equity" approach by redistributing a modest amount across a large number of areas, rather than a lot in a few areas. Of course, any number of factors could alter this conclusion in any given case, but these lessons provide a useful starting point. This Section discusses these general lessons and then develops the new approach further.

The first insight is that, for modest amounts of redistribution in any given policy, the redistributive benefits are large and net costs are typically small.[154] Consider shifting transportation spending from the rich to the poor, starting from the efficient policy of maximizing total income, in which there is much more spending on the rich than the poor. As transportation planners shift money from rich to poor, they start funding the best available projects for the poor and stop funding the worst currently funded projects for the rich. So the first shifted dollar is very similar to the efficient level of spending, producing roughly as much income for the poor as is lost for the rich and thereby resulting in miniscule net costs. The same reasoning applies generally: typically the net costs of adopting modest amounts of redistribution in any given area are small and the redistributive benefits are large because of the availability of high-return ways of spending money close to the "efficient" use of resources. Thus, even for the most efficiency-minded person, the costs of modest differences from the efficient ideal to achieve greater

[153] *See supra* Section II.B.
[154] GRUBER, *supra* note 21.

equality are not very big. So, we can be fairly relaxed about the cost of modest deviations from efficiency and excited about the redistributive benefits.

The second key insight is that, while efficiency costs are small at first, they tend to accelerate as redistribution in a given area increases. Consider again shifting transportation funding from the efficient policy. As more and more funding shifts, each dollar increasingly produces less income for the poor—for example, from building bus routes in less-trafficked neighborhoods. And each shifted dollar increasingly loses more income for the rich—for example, from losing train projects in highly-trafficked neighborhoods. So, while shifting $1 million from rich to poor might result in only $10,000 in lost income overall, shifting a *second* $1 million might result in several times that amount in lost income because it produces little income for the poor and loses a lot for the rich.

These two insights together suggest that, as a baseline, we should adopt a "thousand points of equity" approach of redistributing modestly in many places. The first insight says that there should be at least some redistribution in lots of places because, for any given policy, there are likely some low-cost opportunities to redistribute. The second insight says that, for any given policy, that amount of redistribution should be modest, or else there can be accelerating costs and diminishing returns. For example, rather than redistributing yet more from transportation, it is better to redistribute somewhere else—ideally, many places, taking advantage of the low-cost redistributive opportunities from other policies.

That is not to say that we should redistribute everywhere; sometimes the benefits will not justify the costs. But, since the efficiency costs of redistributing are typically small at first and then climb for any given policy, it is all else equal better to increase redistribution a modest amount through many policies rather than increase redistribution a lot through few policies.

The thousand points of equity approach accomplishes at least two goals. First, adopting it significantly helps the poor at modest cost to the rich while avoiding policies that become so redistributive that they start doing relatively little to help the poor at high cost to the rich.[155] So, if the marginal consumption of relatively rich people (say, those earning $63 per hour, in the transportation example) still counts for something, then the policy avoids doing harm to them that is not justified by very small gains to the poor. Second, even someone maximally concerned about inequality and minimally concerned about efficiency should still care about efficiency because we want to make sure that any given policy does not do too much harm to the economy, thereby limiting the resources to redistribute through other policies. With the thousand points of equity strategy, the poor can get more because the rich lose less from any given policy and thus the rich have more to redistribute through other policies. Notwithstanding the presence of policy

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[155] *See* David Gamage, *How Should Governments Promote Distributive Justice: A Framework for Analyzing the Optimal Choice of Tax Instruments,* 68 TAX L. REV. 1, 11 (2014) (making a related point about how imperfections in taxation mean that a variety of tax instruments should be used).

compartmentalization as a matter of how ordinary people think, there is still only one economy, but lots of policies that we can use to redistribute.

The "thousand points of equity" approach does not require a central planner. Rather, each actor needs to have some sense of how much a marginal dollar is worth in the hands of the poor versus the rich and the efficiency costs of redistribution through the means available to that actor. If there is more or less redistribution generally over time, each actor can, in principle, adjust on her own. Of course, these changes would need to operate against a backdrop of other values beyond the scope of the Article.

The next three subsections further explore the thousand-points-of-equity approach.

1. Unimportance of Normative Status of Desert in Income Taxation

The thousand-points-of-equity approach is a better baseline than the efficient one, regardless of one's views about the normative status of desert to keep pretax income. Compartmentalized tax policy attitudes about desert raise a host of deeper normative questions: Does pretax income have moral weight? Does desert inhere in effort, in inborn talent, in talent that one works for? Does taking individuals seriously as individuals mean that the government should not tax based on genetic predisposition to earn money? This Article cannot answer those questions. And it does not need to in order to advocate for the thousand-points-of-equity approach. Of course, the normative status matters for the kind of *income tax policy* that one would ideally want to adopt. If people actually deserve to keep the income they earn, then more redistributionist taxation is less normatively desirable. This kind of debate about the relation between moral intuitions and ideal policy is a common one—for example, in torts.[156]

But the question here is different: what is the impact of views about income tax policy on the *other policies* that we should adopt? For that, the thousand-points-of-equity approach is equally appealing either way. The reason is simply that, whether or not it is good to redistribute a lot through cash taxes and transfers, so long as the social fact is that such redistribution is and will be insufficient to address demands for equality, we will need to look elsewhere to achieve equality goals. For those who are formally inclined, the Appendix presents a model, showing this result.

On one hand, if people are durably mistaken in their belief that pretax income generates desert, then policymakers will need to look elsewhere to achieve

[156] Gary T. Schwartz, *Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice*, 75 TEX L. REV. 1801 (1996-1997). *See generally* Judith Jarvis Thomson, *The Trolley Problem,* 94 YALE L.J. 1395, 1409 (1985) (describing conflicting moral intuitions about sacrificing one person to save five, depending upon how the one is sacrificed).

distributional goals. In this case, the thousand-points-of-equity approach is "second best:" there is a better approach, but it's just not politically feasible.[157]

On the other hand, if people really do deserve their pretax income, the conclusion is the same. In this case, the thousand-points-of-equity approach is "first best." The approach results not from a political constraint but rather because it is right thing to do for policymakers to not redistribute as much through taxation. But, that doesn't change the fact that greater overall equality is still a goal, notwithstanding the particular distaste for using income taxes, which suggests that policymakers should look elsewhere to achieve equality.

In both cases, efficient but inegalitarian nontax policies are not in general justified and redistribution through other policies is justified—indeed, to the same degree because the same amount of redistribution is needed in either case. The Article is agnostic on whether people deserve the income that they earn, and indeed a powerful point of the Article is that the conclusion about *nontax* policies is the same either way.

2. How Much Redistribution?

This Article cannot answer how much redistribution should take place in each point of equity. That's a normative question that is beyond the Article's scope. But, in pointing to the *political* nature of policy adoption surrounding redistribution, it can point to a couple of empirical factors affecting the amount of desirable redistribution. First, of course, the more redistribution there is through either tax or nontax means today, the less other policies need to increase their redistribution. Second, there is a risk that less efficient redistribution today preempts more efficient redistribution later on. To the extent that that is true, new policies should redistribute less. One way such a bad equilibrium could arise is that, since people are educated through policymaking,[158] the less of one type of redistribution we have, the less they learn about it, further reducing its use.[159] Another is that Congress may simply see more redistribution elsewhere and, in response, reduce redistribution through taxation. Partly because of policy compartmentalization, there is reason to suspect that this factor is not large. For example, rigorous empirical work shows that more redistribution through schools has zero effect on

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[157] Lipsey and Lancaster, *supra* note 23.

[158] For example, congestion pricing schemes have sometimes faced opposition that then subsides after they are implemented. *See, e.g.*, John M. Quigley & Bjorn Harsman, *Political and Public Acceptability of Congestion: Ideology and Self-Interest*, 29 J. POL'Y ANALYSIS & MGMT. 854 (2010).

[159] The political process is often where policy views are adjudicated—and, indeed, often where they are formed in the first place. *See, e.g.*, Reva Siegel, *Constitutional Culture, Social Movement Conflict and Constitutional Change: The Case of the De Facto ERA*, 94 CALIF. L. REV. 1323 (2006).

redistribution through taxation.[160] Nevertheless, this is an empirical parameter in need of more measurement.

3. Distinguishing a Thousand Points of Equity from Other Egalitarian Traditions

The thousand-points-of-equity approach does not call for simply doing what seems fair in any given policy area. The goal is rather to redistribute modestly relative to an *efficient* policy. Sometimes the approach will suggest doing what seems intuitively fair, as in the transportation example; other times, not. An example helps illustrate.

Consider the following example from torts: a rich plaintiff and a poor plaintiff have their cars rear-ended by the same middle-income defendant, and each incurs $5,000 in costs to their cars. The efficient legal rule is for the defendant to pay $5,000 in each case: this is the amount of harm that the defendant causes, and charging him that amount will deter his behavior exactly to the extent that he causes harm.[161] The thousand-points-of-equity approach suggests redistributing modestly relative to this efficient baseline. So it suggests that the damages paid to the poor person should be larger than those to the rich person. To many people, that may seem unfair in this setting. Compensatory torts process norms may make different treatment of two people who suffered the exact same financial damages appear unfair. So the thousand points of equity prescription is not the same as a standard egalitarian may offer. Nevertheless, this is a relatively efficient way to redistribute because it is close to the efficient $5,000-in-both-cases solution.

Similarly, some egalitarians may find that everyone should have access to the best-available healthcare. A thousand-points-of-equity approach would caution against that, as recipients of much of the healthcare provided, especially to lower-income individuals, may not value the healthcare at nearly the amount that it costs to provide and would prefer to receive those resources in other forms where redistribution is not as high.

Of course, lawmakers could do what seems fair in both cases—sending $5,000 to both the rich and the poor tort victims and providing high healthcare coverage to the poor. One might call this an approach of adopting within-policy fairness. Indeed, that might make sense, depending upon one's values. As the Article emphasized above, the thousand-points-of-equity approach is a starting point. It cannot speak to the appropriate role in policymaking for many other values such as

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[160] Zachary Liscow, *Are Court Orders Sticky? Evidence on Distributional Impacts from School Finance Litigation*, 15 J. EMPIRICAL LEGAL STUD. 4 (2018). *But see* Richard T. Boylan & Naci Mocan, *Intended and Unintended Consequences of Prison Reform*, 30 J. L. ECON. & ORG. 558 (2014) (showing evidence from a much smaller change—mandating more spending on prisoners—suggesting that social welfare spending was cut to pay for it).
[161] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 152 (1986).

procedural fairness, legality, legitimacy, dignity, autonomy, basic rights, and social solidarity.

But we can say that there is a cost to an approach of adopting within-policy fairness. Though voters may not often see things that way, it is fundamentally true that as a society we face tradeoffs. We can only redistribute so much. More redistribution one way places limitations on redistribution in other ways. The within-policy fairness approach has efficiency costs compared to the thousand-points-of-equity approach because in some cases it redistributes "too little" and in other cases it redistributes "too much."[162] Averaging out legal rules with insufficient redistribution with legal rules with excessive redistribution would create costs for two reasons. First, doing so might redistribute the wrong amount. Second, the approach would miss efficient opportunities to redistribute, which could make the poor worse off by providing them with fewer resources.

A value of the thousand-points-of-equity approach is pointing out such possibilities—that, for example, lawmakers should consider more generous payouts to poorer torts victims. The poor do, after all, need the money more. Of course, the attitudes in the torts policy compartment that torts should be driven by compensatory norms may make such redistribution politically infeasible or ethically undesirable. But we don't know how people would react to such a proposal. And the goal here is just to say: on distributive and efficiency grounds alone, it is a good policy to consider. The next Section describes policies that are viewed as bad under the standard paradigm but are desirable under the thousand-points-of-equity paradigm. These policies are chosen to have the feel of being fair, thereby showing that, contrary to the standard economics logic, what feels intuitively right is in fact right, even by basic economics logic. But it is nevertheless worth keeping in mind harder, less intuitive cases like this torts example as other opportunities in which we should consider testing our intuitions.

C. Other Legal Applications

The thousand points of equity approach opens up wide frontiers in the law for addressing inequality. In many policy areas, the standard approach's prescription is: do nothing at all to address inequality. Under the standard approach, adopting something other than the efficient but inegalitarian law, while perhaps intuitive, is soft-headed: the better approach is to maximize the size of the pie and then redistribute through cash taxes and transfers. This Article flips the script: laws that address inequality are often the right ones precisely because they are hard-headed: they reflect the reality of policy compartmentalization. This Section offers a selection of egalitarian legal changes that are unwise under the standard approach but that the thousand points of equity approach shows actually may be the right

[162] These places where within-policy fairness would redistribute too much and too little in part map onto the categories of legal rules established in Liscow, *supra* note 14.

policies to adopt, as they modestly redistribute at low efficiency costs. Some possible fruitful areas for policy development include:

- Regulation:

Regulatory cost-benefit analysis: Beyond transportation spending, current federal regulatory cost-benefit analysis is typically based on efficiency to the detriment of distributional impacts.[163] This regime is supported by economics-oriented scholars, on the grounds that taxes and transfers will undo the distributional consequences of regulations.[164] The theory of policy compartmentalization explains why this is a bad premise and provides guidance on the extent to which distribution should be considered: the more we fail to redistribute through taxes, the more we should do so through regulations. At the same time, there could be procedural justice concerns with actually providing *more* to the poor than to the rich, rather than just equalizing; that is an ethical concern beyond the Article's scope.

Pro-poor regulation in areas like collective bargaining or antitrust: The case for a variety of regulatory changes that benefit the poor are strengthened by the theory of policy compartmentalization. For example, some propose strengthening labor law to improve the ability of workers to collectively bargain.[165] Such changes could harm efficiency and be subject to the critique that workers should work without strong unions and then money can be redistributed after wages are earned. One could make similar statements about considering distributional impacts in antitrust law[166] or a minimum wage.[167] The case for such regulations is substantially strengthened by this Article. Modest legal adjustments—say, a modest minimum wage or antitrust rules that stop mergers in the cases with the worst effects on low-income workers and least benefits for others—could yield significant benefits to lower-income individuals at only a small cost, while also being intuitively appealing to the public.

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[163] See discussion *supra* Part I.A.

[164] *See, e.g.*, David A. Weisbach, *Distributionally Weighted Cost–Benefit Analysis: Welfare Economics Meets Organizational Design*, 7 J. L. ANALYSIS 151, 178 (2014) (pointing to "a version of a political Coase theorem" in which these tax changes occur). *But see* MATTHEW D. ADLER & ERIC A. POSNER, NEW FOUNDATIONS OF COST-BENEFIT ANALYSIS 130–31, 142–46, 152 (2006) (discussing adjustments to willingness to pay to compensate for parties' different incomes, but without rooting it in a particular political economy); Richard L. Revesz, *Regulation and Distribution,* 93 N.Y.U. L. REV. 1489, 1578 (2018) (arguing for the establishment of a body to consider the distributional consequences of regulations on a case-by-case basis, but explicitly not considering general distributional consequences).

[165] *See*, *e.g.*, Kate Andrias, *The New Labor Law*, 126 YALE L.J. 2 (2016).

[166] Lina Khan & Sandeep Vaheesan, *Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents*, 11 HARV. L. & POL'Y REV. 235 (2017).

[167] David H. Autor, Alan Manning & Christopher L. Smith, *The Contribution of the Minimum Wage to US Wage Inequality Over Three Decades: A Reassessment*, 8 AM. ECON. J.: APPLIED ECON. 58 (2016).

- Punishment:

Income-dependent fines: The classic efficiency argument is that fines should not be based on income.[168] So, if a rich person speeds, she gets a $200 ticket. And, if a poor person speeds, she gets the same ticket, even though that it causes greater hardship to the poor person.[169] But the desirability of efficient fines depends upon policymakers treating distributional outcomes through fines and through taxes fungibly. If instead there is a drag on tax-based redistribution, then charging the rich more than the poor for speeding or other civil infractions is good policy, even on standard economics grounds. Essentially, since the poor feel the pain of a given amount of fine more acutely, it makes sense to have smaller fines for them.

Torts and damages: A widespread movement has cut back on tort awards for pain and suffering,[170] even in the face of evidence suggesting that juries used to provide larger damages to poorer groups.[171] Statutes could return that latitude to juries to conduct such redistribution. Additionally, "economic damages" in torts are typically based on lost wages, so that a higher-paid person receives larger damages than a lower-paid person.[172] This policy is efficient because people are willing to pay for their wages. A similar mechanism was at play in the September 11 Victim Compensation Fund, in which higher-paid victims received higher compensation.[173] Tort rules could be modified to reduce the reliance on income to reduce these disparities.

- Social expenditures:

Social insurance like parental leave and childcare: Standard logic suggests that low-income parents would likely prefer to receive cash instead of either subsidies or directly provided childcare. Childcare is expensive, and low-income people need cash. Of course, there may be important standard efficiency reasons for childcare provision, such as increasing the children's lifetime earning capacity, for which parents may be unwilling or unable to pay. But, even apparently "inefficient"

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[168] *See, e.g.*, Robert Cooter, *Prices and Sanctions*, 84 COLUM. L. REV. 1523 (1984).

[169] For example, Finland has income-based fines. Joe Pinsker, *Finland, Home of the $103,000 Speeding Ticket,* ATLANTIC (Mar. 12, 2015), https://www.theatlantic.com/business/archive/2015/03/finland-home-of-the-103000-speeding-ticket/387484/.

[170] *See Caps on Damages*, AMERICAN MEDICAL ASSOCIATION (2017), https://www.ama-assn.org/sites/ama-assn.org/files/corp/media-browser/premium/arc/caps-on-damages_0.pdf. *See also* Jonathan D. Glater, *To the Trenches: The Tort War is Raging On*, N.Y. TIMES (June 22, 2008), https://www.nytimes.com/2008/06/22/business/22tort.html.

[171] Lucinda Findley, *The Hidden Victims of Tort Reform: Women, Children, and the Elderly*, 53 EMORY L.J. 1263 (2004) (arguing that damages caps had a disproportionate impact on women, children, the elderly, the disabled, since juries had been implicitly using categories like pain and suffering to make up for the fact that actual damages awards for these categories—being based on lost income—often were disproportionately low).

[172] *See, e.g.*, Martha Chamallas, *Civil Rights in Ordinary Tort Cases: Race, Gender, and the Calculation of Economic Loss*, 38 LOY. L.A. L. REV. 1435 (2005).

[173] *Victim Compensation Fund Frequently Asked Questions,* U.S. DEPT. JUSTICE (Apr. 13, 2004), https://www.justice.gov/archive/victimcompensation/faq5.pdf.

childcare is good if desert-based taxation places considerable limits on how redistributive taxes will be and if the willingness to pay of the poor is close enough to the cost of provision to justify the expense. For example, if the poor would be willing to pay $5,000 for childcare, but it costs $8,000 to provide, provision very well may make sense because the social value of directing resources to the poor is high. Similar reasoning can be applied to spending on education, paid parental leave, nutrition, and a panoply of other social insurance programs.

Necessities accounts: Some direct transfers can de facto redistribute cash without appearing to do so. Consider, for example, a "necessities account" that can only be used on necessities like food, utilities, commuting, housing, clothing, education, and healthcare. It would be functionally similar to a cash transfer without looking that way because the poor spend most of their money on those things anyway.[174] And, as the discussion in Part II introducing policy compartmentalization suggested, a necessities account would likely be considerably more popular than an unrestricted cash program.[175] The account could be phased out at higher incomes, and it would effectively function like a cash transfer to the poor.

Recasting in-kind support like housing: At least from the standard perspective of economics, widespread government support for in-kind transfers like housing is surprising.[176] Why not just provide cash? While the right to housing or the desire to ensure that children live in good conditions may provide compelling reasons, another reason is that in-kind transfers represent a politically popular alternative to cash.[177] Everyone needs housing, so providing at least some housing support is not likely to encourage recipients to spend hugely more on housing relative to other things that they need. If, indeed, an important reason for providing housing support is not really about funding housing in particular but is instead about finding a popular alternative to cash, then certain design elements come into focus: support should be flexible to use and focused on helping more people rather than a smaller benefit to only a share of the poor, as is the case now.

Lowering taxes that employers pay on low-income workers: Since there appears be an aversion to providing cash transfers or tax credits in excess of an individual's tax liability, as that seems to violate desert norms, lowering taxes that *employers*

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[174] *See* Jacob Goldstein, *How The Poor, The Middle Class And The Rich Spend Their Money,* NPR (August 1, 2012), https://www.npr.org/sections/money/2012/08/01/157664524/how-the-poor-the-middle-class-and-the-rich-spend-their-money (showing that the poor overwhelmingly spend their money on such "necessities").

[175] Liscow & Pershing, *supra* note 73.

[176] Currie & Gahvari, *supra* note 39.

[177] *See Public Opinion Polling on Housing Affordability,* OPPORTUNITY STARTS AT HOME (Mar. 28, 2019), https://www.opportunityhome.org/resources/poll2019/ (finding that 85% of respondents believe that "ensuring everyone has a safe, decent, affordable place to live should be a 'top national priority'" and that 78% of respondents believe that "government has an important role to play in making sure there are enough affordable places for everyone to live").

pay upon hiring low-income workers could instead be used to help workers.[178] We are accustomed to thinking of employees as earning a salary and then paying taxes based on that salary. In fact, employers also pay taxes based on their employees' salaries, through payroll taxes that nominally fund Social Security and Medicare[179] and for purposes like unemployment insurance.[180] Reducing these taxes, which have likely played a significant role in reducing the wages of low-income workers,[181] could drive up demand for low-skilled workers, increasing employment and wages for low-skilled workers without running afoul of desert norms.

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While some changes (e.g., reallocating transportation funds or changing some legal rules) would not cost the government money, others would require additional revenue.[182] There are many options for doing so even given desert-based income tax norms:

Raising taxes that employers pay on high-income workers: Congress could tax high-income workers on the employer side, lowering their pretax income. Such a tax would presumably lower the pretax wages paid to these employees because employers would have to foot a larger tax bill.[183] For high-income executives, the tax code limits the amount of compensation that publicly-traded employers can count as business expenses—notably one of the few areas in which taxes on the rich *increased* in the 2017 tax bill.[184] Of course, there would be implementation difficulties, such as the incentive for a high-income employee to split his job at one company into two lower-paid jobs at two companies to avoid the tax. But, if voters read such taxes partly as taxes on businesses, rather than as taxes on the earners themselves, who are more deserving, then it may be tolerable to impose such taxes on employers.[185]

Taxing capital at higher rates: Recall that under standard economic theory, even though the rich tend to get more of their income from capital than the poor do, taxes on capital should be zero or low, since they are viewed as less efficient than

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[178] VANESSA WILLIAMSON, READ MY LIPS: WHY AMERICANS ARE PROUD TO PAY TAXES (2017).

[179] I.R.C. § 3111 (2018) (imposing taxes on employers based on employee wages for hospital and old age and disability insurance).

[180] I.R.C. §§ 3301-11 (2018) (imposing unemployment taxes on employers and setting out the approval process for state unemployment systems).

[181] EMMANUEL SAEZ & GABRIEL ZUCMAN, THE TRIUMPH OF INJUSTICE: HOW THE RICH DODGE TAXES AND HOW TO MAKE THEM PAY (2020).

[182] For tax policy implications when pretax income has moral weight, see Steven M. Sheffrin, *What Role Can Desert Play in Designing Tax Policies*, 15 PITT. TAX REV. 137, 152-60 (2017). This Article is agnostic on that question.

[183] GRUBER, *supra* note 21.

[184] I.R.C. § 162(m) (2018) (limiting the deductibility of certain employees' salaries at publicly held corporations).

[185] McCaffery & Baron, *supra* note 76.

taxes on labor.[186] Federal income taxes on capital are, in fact, typically considerably lower than those on labor.[187] But, if labor income taxes stay relatively low, we could raise capital income taxes on the rich—perhaps to the point where capital income no longer had a lower, preferential rate.[188] Indeed, there are many options for taxing capital, which could raise trillions of dollars.[189] Taxes could be placed on individuals who own parts of businesses or on the businesses themselves, for which evidence suggests strong popular support.[190] Indeed, survey experiments suggest broad support for at least taxing capital income like labor income; this fits with what one would predict with desert-based taxation, since, while prudence in saving may be a virtue, it is probably not more of one than exerting effort.[191]

Higher consumption taxes: Alternatively, the U.S. could do what every other advanced country has done and adopt a national "value-added tax," which is similar to a tax on consumption.[192] Consumption taxes are regressive, since poorer people consume a larger share of their income, but not nearly as regressive as social spending is progressive, so a value-added tax to fund more social spending would go far to reduce inequality.[193] Indeed, this combination of only modestly progressive taxes and very progressive spending is exactly what the Nordic countries have employed, while becoming some of most progressive—and also rich—countries in the world.[194]

Higher state and local taxes: Redistribution by state and local governments has typically been criticized by scholars as distortive of location decisions by households and businesses. In the face of insufficient redistribution through a

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[186] Mankiw et al., *supra* note 18; Diamond & Saez, *supra* note 42.

[187] I.R.C. §1 (h) (establishing preferential tax rates on capital gains and dividends).

[188] I.R.C. §1 (providing income tax rates).

[189] *See, e.g.*, David Kamin, *Taxing Capital: Paths to a Fairer and Broader U.S. Tax System*, WASH. CENTER EQUITABLE GROWTH (August 2016), https://equitablegrowth.org/wp-content/uploads/2016/08/081016-kamin-taxing-capital.pdf.

[190] McCaffery & Baron, *supra* note 76; Steven Sheffrin & Rujun Zhao, *Public Perceptions of the Tax Avoidance of Corporations and the Wealthy*, EMPIRICAL ECON. (forthcoming 2020).

[191] Ilyana Kuziemko et al., *How Elastic Are Preferences for Redistribution? Evidence from Randomized Survey Experiments*, 105 AM. ECON. REV. 1478 (2015) (trying to measure these preferences).

[192] *Worldwide Tax Summaries: Value-Added Tax (VAT) Rates*, PRICEWATERHOUSECOOPERS (Feb. 1 2020), http://taxsummaries.pwc.com/ID/Value-added-tax-(VAT)-rates (showing taxes across countries).

[193] Gilbert E. Metcalf, *Value-Added Taxation: A Tax Whose Time Has Come?*, 9 J. ECON. PERSP. 121, 133-34 (1995) (describing the regressivity of the tax, but also noting some debate on the topic).

[194] Kyle Pomerleau, *How Scandinavian Countries Pay for Their Government Spending*, TAX FOUND. (June 10, 2015), https://taxfoundation.org/how-scandinavian-countries-pay-their-government-spending/ (describing the Nordic model); *Income Inequality,* OECD (last visited Feb. 1, 2020), https://data.oecd.org/inequality/income-inequality.htm (similar).

national-level income tax, local governments could fruitfully play a larger role in financing social spending.[195]

As one can see, the implications of the thousand-points-of-equity approach are sweeping. Across the law, policymakers should consider opportunities to make policies more equitable, even if it means being less than perfectly efficient.

IV. ADDRESSING CRITIQUES

This Part addresses several potential critiques about both the descriptive and prescriptive contributions of the Article.

A. Alternative Explanations for Lacking Redistribution Through Taxation

One might be concerned that mechanisms other than compartmentalized public attitudes about people deserving to keep their income explain the observed lack of redistribution through taxation. Nothing here implies that this is the only mechanism, just that it is important. Nevertheless, it is worth explaining why other potential explanations are incomplete.

One alternative explanation is capture of the political system by powerful, moneyed interests.[196] On that account, we do not have enough redistribution through taxes because powerful, moneyed interests stop it. This could easily be an important explanation operating alongside the policy compartments explanation. But it is probably not the full story. There is overwhelming evidence that people care about more than their own self-interest in forming policy preferences.[197] They also care about fairness. Partly as a result of these fairness preferences, we do see egalitarian policymaking and rhetoric outside of taxes on earned income.[198] As described earlier, people care a great deal about access to necessities. Even Republican politicians talk about universal access to healthcare, for example.[199] And we see concerns with inequality in a host of other places as well, such as when regulatory cost-benefit analyses value the lives of rich and poor equally. While acknowledging that we need to know more, it seems like there is something particular about redistributing with cash taxation based on earned income.

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[195] *See, e.g.*, Clayton Gillette, *Local Redistribution, Living Wage Ordinances, and Judicial Intervention*, 101 NW. U.L. REV. 1057 (2007) (summarizing the traditional criticism).
[196] GILENS, *supra* note 74; NANCY MACLEAN, DEMOCRACY IN CHAINS: THE DEEP HISTORY OF THE RADICAL RIGHT'S STEALTH PLAN FOR AMERICA (2017).
[197] SCHEVE & STASAVAGE, *supra* note 124.
[198] For this paragraph, see *supra* notes 68-69 and surrounding text.
[199] Robert Pear & Thomas Kaplan, *G.O.P. Plans to Replace Health Care Law With 'Universal Access',* N.Y. TIMES (Dec. 15, 2016) (describing House Republicans' plan of achieving "universal access" to quality, affordable healthcare).

Another potential explanation is that people just do not care much about economic inequality. But, polls consistently show the opposite.[200] So does our politicians' rhetoric, such as that for both parties decrying inequality and a rigged system.[201] And so do all the egalitarian attitudes that were just listed, such as the right to healthcare declared across party lines.[202] Rather, as the theory of policy compartmentalization says is the case, people have different views on overall distribution than on redistribution through taxes specifically. In particular, Gallup polls have long found that a considerably larger share of the public believes that the distribution of income should be fairer than believes that heavier taxes on the rich should be used to achieve that greater equality.[203] Resistance to redistribution through taxation specifically is not the same thing as resistance to greater economic equality, for which support is strong.

A third possibility is an institutional failure in which, if institution A (e.g., the courts) makes a policy change with distributional consequences, institution B (e.g., Congress) does not compensate for those consequences, out of inertia or otherwise. For example, work in law and economics commonly discusses this critique about a potential failure of taxes and transfers to compensate for distributional changes.[204] However, such thinking sometimes reflects a basic confusion: compensation for efficient policies that harm the poor is neither necessary nor sufficient to maximize welfare. Suppose that the adoption of every single efficient nontax policy that harms the poor results in compensation to the poor. Redistribution could still be massively insufficient because of a background failure to redistribute enough through taxes. So this Article's critique is considerably deeper than the compensation critique. Considering policy responses one-by-one does not ask the most important question if society is not distributionally just to begin with. The government can compensate policy-by-policy but still leave inequality far too high if efficient but inegalitarian nontax policies are the policy prescription.

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[200] *See, e.g.*, PEW RESEARCH CENTER, *supra* note 1.
[201] *See, e.g.*, Rampell, *supra* note 2.
[202] *See* Pear & Kaplan, *supra* note 199; Bye & Ghirardeli, *supra* note 65.
[203] Frank Newport, *Americans Continue to Say U.S. Wealth Distribution is Unfair,* GALLUP (May 4, 2015), https://news.gallup.com/poll/182987/americans-continue-say-wealth-distribution-unfair.aspx.
[204] *See, e.g.*, Antonia Cornwell & John Creedy, *Measuring the Welfare Effects of Tax Changes Using the LES: An Application to a Carbon Tax*, 22 EMPIRICAL ECON. 589, 589 (1997) (considering "transfer payments to compensate for adverse distributional effects of a carbon tax"); Aanund Hylland & Richard Zeckhauser, *Distributional Objectives Should Affect Taxes but Not Program Choice or Design*, 81 SCANDANAVIAN J. ECON. 264, 281 (1979) (using the tax system to compensate for distributional impacts); Weisbach, *supra* note 164, at 161 ("[W]e can replace the redistributive regulations with efficient ones and make a corresponding adjustment to the income tax. We keep the redistributive effects but eliminate the inefficiency."); Liscow, *supra* note 33, at 2507 n.60 ("For example, the executive order currently governing federal cost-benefit analysis makes no mention of compensating those who lose from a policy, even if the utility loss from the losers exceeds the gains from the gainers."); Liscow, *supra* note 160 (same).

B. Why Might Policy Compartmentalization Lead to Too Little Redistribution?

The theory of policy compartmentalization raises something of a puzzle: if public attitudes in the tax compartment hinder redistribution through taxes, but people still want more redistribution, why do we not see enough economic equality by the lights of voters,[205] especially given pro-redistribution attitudes about categories like necessities in other compartments? We cannot know, but we can speculate. The first reason is institutional: Voters' opposition to redistribution through taxation may play a larger role in setting tax policy than voters' support of redistribution through nontax means does in setting nontax policy. The reason is the unusually large role of Congress in setting tax policy,[206] with the tax code specifying exact tax rates for exact incomes,[207] which are typically set in heated, public political battles.[208] In other policy areas, experts in agencies and judges on courts, with potentially less responsiveness to voters, may hold more sway.[209] For example, with transportation spending, Congress appropriates money to the executive branch, which decides how to allocate the funds with little guidance.[210] Indeed, for many regulatory and spending programs, Congress delegates to agencies a major role in distributional decisions, whether because of concerns about expertise, limited capacity, reducing logrolling, or otherwise.[211] Of course, Congress and legislatures are quite prescriptive in some areas, such as provision of health insurance and housing vouchers. But in many other nontax areas—for

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[205] Pew Research Center, *supra* note 1.
[206] DAVID EPSTEIN & SHARON O'HALLORAN, DELEGATING POWERS 199 tbl.8.1, 202-03 tbl.8.2 (1999) (finding that Congress delegates less in the area of taxation than almost any other policy area); James R. Hines Jr. & Kyle D. Logue, *Delegating Tax*, 114 MICH. L. REV. 235, 252, 248-53 (2015) (explaining that Congress rarely delegates taxing authority to the IRS and Treasury Department, noting that "[i]t is commonly understood that U.S. tax policy is, to a remarkable (and unusual) extent, determined by Congress not only in its broad outlines but also in its details.").
[207] I.R.C. § 1 (setting tax rates at specific rates for specific income levels for specific types of income).
[208] MICHAEL J. GRAETZ ET AL., FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 6-12 (8th ed. 2018) (providing a history of the income tax, including battles over the rates and structure).
[209] Of course, many factors influence Congressional decision-making, but one important factor is the views of their constituents, especially in salient political battles. GARY C. JACOBSON & JAMIE L. CARSON, THE POLITICS OF CONGRESSIONAL ELECTIONS 261-267 (2019) (finding relationship between constituent beliefs and member votes).
[210] *See* White, *supra* note 4 and surrounding text (explaining how the Department of Transportation allocates funds).
[211] *See* Cary Conglianese & John Yoo, *The Bounds of Executive Discretion in the Regulatory State*, 164 U. PENN. L. REV. 1587, 1597 (2016) (describing Congress's broad delegations of authority to agencies under most statutes); David Epstein & Sharyn O'Halloran, *Administrative Procedures, Information, and Agency Discretion*, 38 AM. J. POL. SCI. 697, 698 (1994) (discussing these reasons for delegation).

example, antitrust law,[212] tort law,[213] and environmental law[214]—agencies and courts hold great sway. If those nontax experts focus on efficiency, perhaps because of their economics-oriented training,[215] then the combination of efficient nontax policy and insufficiently redistributive taxes (disproportionately reflecting lay desert-based tax views) would yield insufficient redistribution overall.

A second explanation is that there is nothing requiring coherence among lay policy attitudes. Nothing requires similarly strong beliefs across different domains. About the one big, high-salience issue that is supposed to be used for redistribution—taxes—people may have strong views. In contrast, about the myriad and often low-profile nontax issues, people may simply have less strong views on average, as it may be difficult to have strong views on so many issues. So, even if voters feel strongly about inequality, if courts and agencies do not act to instantiate those values in the areas over which they have authority, overall economic outcomes may end up unequal because of tax policy to which voters are attentive.

Again, this discussion is speculative. The Article makes a strong claim that there should be more redistribution through nontax means relative to an efficient baseline. The claim that there should be more redistribution through nontax means relative to current policy is weaker, but there is at least a plausible argument for it, arising from the interaction between public concern over inequality and the existence of separate policy compartments.

C. What if Public Attitudes Change?

Commonplace attitudes change—sometimes dramatically. Nothing in the Article suggests that desert-based tax views are innate. Suppose that desert-based tax attitudes dissipate, allowing taxes to become more redistributive. If there is inertia in policymaking, then policy could end up in a combination of excessive and

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[212] Laura Phillips Sawyer, *US Antitrust Law and Policy in Historical Perspective* (Harv. Bus. Sch. Working Paper No. 19-110, 2019), https://www.hbs.edu/faculty/Publication%20Files/19-110_e21447ad-d98a-451f-8ef0-ba42209018e6.pdf (tracing the history of judges' interpretation of antitrust law).

[213] GUIDO CALIBRASI, A COMMON LAW FOR THE AGE OF STATUTES 32-34 (1985) (tracing the history of judicial interpretation of the Federal Employers Liability Act and common law tort law); Keith N. Hylton, *Evolution of Tort Law*, *in* TORT LAW: A MODERN PERSPECTIVE 32 (2016) (tracing the evolution of tort law and negligence theories).

[214] David S. Tatel, *Administrative Process and the Rule of Environmental Law*, 34 HARV. ENVIRON. L. REV. 1 (2010) ("As environmental lawyers well know, admin is where the action is.").

[215] SUNSTEIN, *supra* note 14, at 6-21 (discussing the "Triumph of the Technocrats" across the Reagan, Clinton, and Obama administrations); Heinzerling, *supra* note 150 (describing "how, over several decades, cost-benefit analysis came to dominate federal environmental policy"); Posner & Landes, *supra* note 14; Elliott Ash et al., *Ideas Have Consequences: The Impact of Law and Economics on American Justice*, March 2019 (draft) (showing the influence of economics training in the judiciary).

inefficient "second-best"[216] redistribution.[217] In this case, current nontax policy should redistribute less.

However, there are several reasons to redistribute more today, pushing in favor of even second-best redistribution. First, policy is not completely inertial and, if desert-based views dissipate in the future and taxes become more redistributive, policymakers could just change their policies to become more efficient and less redistributive. Second, given standard discount rates, redistribution today matters a lot relative to hypothetical future policy. Even at an 8% annual discount rate, $1 in 10 years is worth only $0.45 now.[218] So, the costs of waiting for views to change to allow for the most efficient means of redistribution are high. Third, we do not know in which direction policy views will head. Policy views could move toward or away from one-pieism. For example, over the last few decades, policy has in many ways moved away from the kind of cash provision suggested by economics and toward work requirements.[219] Nevertheless, the risks of inertia in inefficient redistribution do remain a consideration against second-best redistribution.

A related concern is that attitudes can change through education and that such education is a good alternative to adopting such second-best policies. That is, if one is convinced that desert-based tax views result from misunderstanding rather than valid normative judgments, then the first response should be to educate people. However, without denying that education can have an impact,[220] there is strong reason to think that desert-based tax attitudes are durable. Indeed, while some of the specific implications of optimal tax theory have only more recently come into focus, arguments on similar grounds for cash transfers date at least to Milton Friedman in the 1960s,[221] and optimal tax theory itself dates to the 1970s. The project of economics—especially law and economics—over the past several decades has been one of educating the population partly along these lines, at least with respect to an emphasis on tradeoffs.[222] Over all this time, tax institutions have not appeared to change much to incorporate these old ideas, perhaps because they cut against significant aspects of social psychology or just commonplace intuitions.[223] Nevertheless, the more educable people seem about policies that we

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[216] Lipsey & Lancaster, *supra* note 23.

[217] Steven M. Teles, *Kludgeocracy in America*, NAT'L AFF. (2013), https://www.nationalaffairs.com/publications/detail/kludgeocracy-in-america.

[218] Liscow, *supra* note 14, at 1665.

[219] Council of Economic Advisors, *Expanding Work Requirements in Non-Cash Welfare Programs,* WHITE HOUSE (2018), https://www.whitehouse.gov/wpcontent/uploads/2018/07/Expanding-Work-Requirements-in-Non-Cash-Welfare-Programs.pdf (giving a history of work requirements for SNAP, Medicaid, and Housing programs since the 1990s).

[220] Evidence suggests that students can be swayed by economics educations. Robert H. Frank et al., *Does Studying Economics Inhibit Cooperation?*, 7 J. ECON. PERSP. 159 (1993).

[221] FRIEDMAN, *supra* note 101.

[222] MANKIW, *supra* note 10; POLINSKY, *supra* note 8; COOTER & ULEN, *supra* note 8.

[223] *See supra* Section II.B.

are certain are the correct ones, the less it makes sense to adopt alternatives to those correct policies today.

D. The Contracting-Around Problem

For some policies, like transportation spending, the affected parties do not bear the costs of policies: if poor people receive more federal funding for transportation, they do not have to pay more. For other types of policies, affected parties may effectively bear the costs. Consider two such examples. First, the "implied warranty of habitability," which requires landlords to maintain rentals up to certain standards. It may on its face seem to benefit the poor.[224] But, since such requirements may lead landlords to raise rent, low-income lessees can end up worse-off. Second, some regulations impact the prices that parties pay or the wages that they receive,[225] such as workplace regulations that could reduce demand for workers and lower their wages. Complex empirical questions are involved here. But, to the extent that higher prices or lower wages harm intended beneficiaries, the Article's argument about redistributing to them via nontax means does not apply. The stronger cases are where the government provides the funding or sets background legal rules, like those for torts, when parties are not themselves in a contractual relationship that allows price shifts to mitigate distributive gains.[226]

E. Uncertainty About the Right Distribution of Resources

One may also object that there is uncertainty about the right distribution of resources, which makes attempts to redistribute likely to end up at the wrong level. It is the case that, for nontax legal rules, the standard paradigm neatly elides the question of the right distribution by making taxes and transfers the sole domain of distributional concerns. However, Part II of the Article shows that this bifurcation does not work because of policy compartmentalization. And uncertainty about the right distribution does not imply a default to the standard economic prescription of efficient nontax policymaking that is inattentive to equity, as that leads to too much inequality.

Part of the issue here is that economics not only is unable to answer what the right distribution is but also has never even given a clear answer on how to approach the question. As Part I described, this answer could come from external first

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[224] *See* Javins v. First Nat'l Realty Corp., 428 F.2d 1071, 1072-73 (1970) (establishing the implied warranty of habitability).

[225] SUNSTEIN, *supra* note 14 (describing the "easy cases" for efficient policymaking).

[226] One significant exception to the concern that redistributive regulation of contractual relationships because of price changes will not benefit the intended party is when the price itself is regulated. For example, establishing a modest minimum wage (at least ignoring long-term effects) can shift resources from richer employers to poorer employees. Behavioral factors could also play a major role.

principles or from voters' preferences.[227] But first principles may not give clear and widely-accepted answers. And, on top of the difficulty in general of knowing voters' preferences, policy compartmentalization raises the specter that voters may have preferences about overall redistribution *and* preferences about distribution on a policy-by-policy basis.[228] So, policy compartmentalization makes the task for those who wish to rely on voters' preferences all the harder.

Two ways of viewing the Article parallel these two ways of judging distributive issues. One way to view this Article is that it describes how to address redistribution within legal rules, *given a certain desire for redistribution*, relying on first principles. And, even if one is certain that the current distribution is fair, then the descriptive contribution in Parts I and II stand. But the Article would have little to contribute prescriptively today versus current policy. If, on the other hand, one believes that the distribution is currently unfair, then this Article gives guidance on how to set policy under the theory of separate policy compartments with desert-based taxation. Another way to understand the Article is that, if one is uncertain about what the right distribution of resources is, perhaps because of reliance on voters for guidance on overall redistribution, the tax policy compartment gives a strong reason to think that the political system will not yield enough redistribution if it only redistributes through taxes and makes other policies efficient. Thus, we ought to redistribute at least some through nontax means, given the likelihood that taxes are inadequately redistributive.

Indeed, the thousand points of equity approach suggests how to address such uncertainty. As the Appendix explains, even if we are unsure whether taxes redistribute too little, we should still redistribute through nontax means. The reason for still redistributing under these circumstances is the same as why it is good to redistribute a modest amount across many policies: the costs of deviating from the ideal policy increase as one gets further from the ideal. So, if we are unsure which of two policies is ideal, adopting a policy close to the middle of the two possibilities is prudent, so that there are not large deviations from either. Consider again the case of the Department of Transportation planner. The planner could then tailor policy through reasoning resembling "error cost" analysis in antitrust, which compares the costs of, say, erroneously allowing and erroneously preventing a merger.[229]

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[227] KAPLOW & SHAVELL, *supra* note 7 & surrounding text.

[228] KAPLOW & SHAVELL, *supra* note 7, at 27, 30-1. *See also* Kuziemko, *supra* note 191.

[229] *See, e.g.*, Paul L. Joskow & Alvin K. Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 YALE L.J. 213, 222–25 (1979); Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984); Alan Devlin & Michael Jacobs, *Antitrust Error*, 52 WM. & MARY L. REV. 75, 97 (2010).

F. Legitimacy of Redistribution Outside of Congress

One may also argue that it is illegitimate to "redistribute" through institutions other than Congress, as that would mean doing something that the public itself does not want.[230] It is indeed the case that policy compartmentalization makes questions of legality and legitimacy—which seem less urgent under the neutral-seeming goal of efficiency—come roaring back; questions that seemed answered no longer are. If administrators and judges no longer have the distributive alibi of taxation, what ought their goal be? Should they be considering economic equality themselves? Divining the popular views (or reflected-upon views?) in the particular area they are adjudicating?

However, it is not at all clear that the public wishes for no "redistribution" outside of Congress. Recall that "redistribution" is a term of art here, and "efficiency" is hardly neutral. Economists measure "redistribution" relative to an efficient baseline.[231] In the example of the Department of Transportation's allocation of spending, the efficient rule is to *spend more on the rich*. But Congress has not dictated to the Department of Transportation how to allocate the funds between the rich and the poor.[232] And it is not at all clear that voters or Congresspeople want to value the time of the rich more than the time of the poor or to spend more on the rich. The theory of policy compartmentalization holds that a large number of ordinary people do not think of the appropriate amount of "redistribution" across all policies, as economic policy wonks do. Rather, they have norms regarding a variety of means—like transportation that can lead to equality of opportunity—and processes—like taxes, where people "deserve" to keep some of their income. The fact that Congress does not redistribute enough to achieve distributive justice through taxes alone does not imply that people are opposed to, say, valuing the rich and the poor equally in transportation cost-benefit analysis and, thus, spending more on the poor *relative to the efficient baseline*. Taxes and transportation are different means, each with possibly different distributive attitudes.

But the transportation spending example is a relatively easy one. Redistribution there just means spending similarly on the rich and the poor. What about harder cases, in which regulators spend more on the poor or judges put a finger on the scale in *favor* of the poor relative to a possibly inegalitarian but efficient status quo? At this point, while there are longstanding academic debates,[233] we cannot say what

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[230] TOM TYLER, WHY PEOPLE OBEY THE LAW (2006) (describing legitimacy).
[231] KAPLOW & SHAVELL, *supra* note 7.
[232] *See* White, *supra* note 4.
[233] *See, e.g.*, Ralph Winter, *Poverty, Economic Equality, and the Equal Protection Clause*, 1972 SUP. CT. REV. 41 (1972) (arguing that the Supreme Court should not take distributional concerns into account when applying the Equal Protection Clause); Aditi Bagchi, *Distributive Injustice and Private Law,* 60 HASTINGS L.J. 105 (2008) (summarizing the literature and arguing that courts should and often do take distribution into account in private law).

the public would find legitimate, since little research has been done on what people actually think about administrative or judicial "redistribution."[234] By developing the theory of compartmentalization, the Article opens up wide frontiers in understanding what legitimate redistribution is in particular contexts, now that the standard justification for efficient decision-making no longer holds.

CONCLUSION

The standard policy approach among the economic policy elite prescribes addressing inequality only through taxes and transfers—and for the rest of the law to be efficient but inegalitarian. This approach depends upon empirical assumptions that are deeply at odds with social reality. The result has been skyrocketing inequality.

The theory of policy compartmentalization explains that that it is not realistic for one type of policy—taxation—to take on the burden of *all* needed redistribution. Rather, people compartmentalize their policy attitudes, and attitudes about taxation hinder redistribution through taxation because many people believe that people deserve to keep their pretax income. This attitude means that, in the U.S. at present, taxes will not redistribute enough. Therefore, the economics heuristic that nontax policy should not redistribute dooms us to perpetual inequality and should be rejected.

We need a new economic approach to addressing alarm about inequality. The thousand points of equity approach introduced here points the way forward: by modestly redistributing across many policies, we can have the most redistributive gain at the least cost, given limited resources and inevitable tradeoffs. The approach combines insights from economics about efficiency with data-driven insights from behavioral economics about what is politically realistic. The standard economic policy prescription puts a distributive straightjacket around all policy outside of the income tax. Policymakers should take the straightjacket off and adopt this approach.

For the past few decades, standard economic expertise has not yielded robust

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[234] There is work measuring attitudes for equality in various outcomes. *See, e.g.*, Maureen Cropper, Alan Krupnick & William Raich, *Preferences for Equality in Environmental Outcomes* (Nat'l Bureau of Econ. Res., Working Paper 22644, 2016). However, I am unaware of any work understanding attitudes about redistributing through specific programs by specific branches of government.

economic growth,[235] greater economic equality,[236] or greater trust in government policy.[237] Populist revolts around the world have put economic policy up for grabs. It may be time to try something a little different.

The future of economic policymaking and analysis is one of wide frontiers. It will include skepticism about any one totalizing approach, conflict between competing values, debate over the right distribution of income, and questions about the legitimacy of using various institutions to achieve distributive justice. But that's democracy. And the policies that our democracy deserves are not those generated by a blinkered benevolent dictator, but rather those that embrace the richness and messiness inherent in self-government by the people.

APPENDIX – MODEL OF REGULATORY COST-BENEFIT ANALYSIS FOR TRANSPORTATION SPENDING

Consider a new presidential Administration conducting regulatory cost-benefit analysis for transportation spending to allocate funding between the rich and the poor. This Appendix model shows concretely how the Administration can incorporate both a concern for distributional outcomes as well as a distaste for addressing the issue through the particular *means* of cash taxes and transfers, using a standard welfarist framework. In other words, taxes are treated as one among many possible means of redistribution, and people may have preferences over these means. This is a way of reconciling a distaste for using taxes and transfers to redistribute because of desert-based beliefs with widespread concern about economic inequality. At the same time, the model allows for *tradeoffs*: in particular, the declining marginal utility of income driving redistribution to the poor versus the relatively low and diminishing returns to investment in infrastructure for the poor.

Four main insights come from the model. First, the model shows a concrete framework for how policymakers can *think conceptually and practically* about distributive questions given the reality of political constraints. Second, under the theory of policy compartmentalization, the Department of Transportation's current policy is mistaken. Desert-based tax views lower redistribution through that means,

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[235] The causes of reduced growth are myriad, *see, e.g.*, Robert Gordon, THE RISE AND FALL OF AMERICAN GROWTH: THE U.S. STANDARD OF LIVING SINCE THE CIVIL WAR 7-8 (2016) (arguing that "the pace of innovation since 1970 has not been as broad or as deep as that spurred by the innovations" of the century before), and the contribution of economic policy is unclear.

[236] Piketty & Saez, *supra* note 117. *But see* STEVEN PINKER, ENLIGHTENMENT NOW: THE CASE FOR REASON, SCIENCE, HUMANISM, AND PROGRESS (2018) (arguing that, in many ways, outcomes in the world are improving).

[237] Uri Friedman, *Trust is Collapsing in America*, ATLANTIC (Jan. 21, 2018), https://www.theatlantic.com/international/archive/2018/01/trust-trump-america-world/550964.

but people still care about inequality. The Department of Transportation errs in not equalizing its transportation spending to help reduce inequality. And the welfare losses of erroneously spending only the "efficient" amount on the poor can be large. Third, one can remain agnostic on whether considering desert in taxation is normatively correct. The transportation planner's right choice is unaffected. And fourth, even in the face of normative uncertainty, regulators should often still act to help the poor.

A. Model Setup

Consider two representative economic agents of the rich and poor are indexed by r and p. Each chooses to supply L_i units (e.g., hours per week) of labor, paid at fixed wages w_r for the rich and w_p for the poor.

The government has a flat tax τ with which it funds government spending. Government revenue can be used for three things: a cash transfer to the poor (s), transportation spending for the rich, such as runways at airports (T_r), or transportation spending for the poor, such as buses (T_p). The revenue constraints binding the social planner are thus given by

$$R = w_r L_r \tau + w_p L_p \tau$$

$$R \geq T_r + T_p + s$$

Each of the poor and the rich receives utility from income after taxes, but also experiences disutility from providing labor. The individuals spend H_i units of time (e.g., hours per week) commuting to work, an activity that also detracts from utility. Additionally, the poor can receive a cash transfer s ($s \geq 0$). In a standard but heroic assumption, these preferences are represented with log utility functions (as is used for cost-benefit analysis in the UK)[238] with a declining marginal utility of income given by[239]

$$U_r = \log\left(w_r L_r (1-\tau) - \frac{1}{k+1}(L_r + H_r)^{k+1}\right) \tag{1}$$

$$U_p = \log\left(w_p L_p (1-\tau) + s - \frac{1}{k+1}\left(L_p + H_p\right)^{k+1}\right) \tag{2}$$

Here, k is the inverse of the labor supply elasticity. The first term, $w_i L_i (1-\tau)$, plus s for the poor, is the post-tax-and-transfer income. The second term, $\frac{1}{k+1}(L_i + H_i)^{k+1}$, is the disutility from supplying labor and commuting to work.

[238] HM Treasury, *The Green Book: Appraisal and Evaluation in Central Government*, GOV.UK (Mar. 19, 2019).

[239] *See*, *e.g.*, Emmanuel Saez, *Using Elasticities to Derive Optimal Income Tax Rates*, 68 REV. ECON. STUD. 222 (2001).

The effect of taxes on labor supply is what generates the distortion to efficiency in the model.

Transportation spending separately reduces each party's commuting time, allowing more time working. As transportation spending increases, the rich and poor face the same declining marginal reduction in commuting time. In particular, H_i is a convex function of the level of government spending T_i on transportation services for each group. Specifically,

$$H_i = \alpha \frac{T_i^2}{2} + T_i z + Q \qquad (3)$$

where $\alpha > 0$, $z < 0$, $Q > 0$, which yields a linear marginal impact of T on H. As a result, some transportation investments that save a lot of time at little cost are available to each of the rich and the poor, and then costs increase.

T_i, τ, and s are and chosen to maximize one of two welfare functions. The first, "standard" one is

$$W = U_r + U_p \qquad (4)$$

The second represents, in a simplified way, the possibility that many people may have a distaste for redistributing through cash by adding to equations (1) and (2) a preference that the poor not receive transfers without working for them. A distaste parameter λ, shared by both the rich and poor on the transfer s (with $\lambda > 0$), expresses this preference. Thus, the social welfare function becomes:

$$W = (U_r - \lambda s) + \left(U_p - \lambda s\right) \qquad (5)$$

There are three primary policy regimes: First, in the "standard" model (model A), one social planner optimizes equation (4), without distaste for cash transfers, subject to the revenue constraint (representing box 2 in Table 1).

Second, in model B, Congress first chooses s and the transportation budget $(T_r + T_p)$ to optimize equation (5), anticipating that the Department of Transportation will also optimize equation (5). As is common in real policymaking, although Congress precisely specifies the distributional impacts of tax policy,[240] it leaves considerable discretion to the executive branch for the distributional impacts of regulatory and expenditure policy.[241] Being politically attentive, the Department of Transportation then does in fact optimize equation (5) in dividing the spending between T_r and T_p. This roughly represents box 4 in Table 1 (the thousand points of equity approach).

Third, in model C, Congress does the same thing as in model B. However, being naïve, the Department of Transportation still does what it does in reality: transportation planners choose the efficient allocation of spending that maximizes income. This roughly represents box 1 in Table 1 (the status quo approach).

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[240] *See supra* note 206 & surrounding text.
[241] *See supra* note 211 & surrounding text.

In all cases, welfare is given by equation (4), the standard welfare function. That is, model (5) is just the "decision utility" reflecting what the government does. However, note that, since the Department of Transportation has no control over s, λs falls out of its decisionmaking. Thus, it optimally chooses the same allocation whether equation (4) or equation (5) provides the correct welfare function.

To reflect current practice, the illustrative calibration uses the current wage parameters $w_p = 25$ and $w_r = 63$. It also uses $k = 1.075$, $\alpha = 0.00013$, $z = -0.05, Q = 10$, and $\lambda = 0.001$. The roughly weekly primary output of the model is multiplied in the presentation below to represent annual numbers.

B. Main Results

Table 1 presents results of the calibration. In addition to providing the allocations of cash and transportation funding, it also includes the "distributive weights," or the relative contribution to social welfare of a dollar in the hands of a given person. The question that matters for the transportation spender is not the distributive weight in the abstract—that is, not for an omniscient social planner pulling all levers of policy. Rather, what matters for the Department of Transportation is the distributive weight after Congress has redistributed through cash transfers, which is what is shown.

Model A provides a very large cash transfer to the poor that is roughly in line with the demogrant suggested in the existing economics literature. However, it provides far more spending on the rich than the poor on transportation that is roughly in line with current practice of choosing spending to maximize income, supposing that all time savings result in hours worked. It has roughly the efficient distributional weights: weigh the rich and poor equally.

Model B, with desert-based tax views, significantly redistricts the cash transfer to an amount that is roughly in line with reality. The result is that transportation planners who are politically attentive to what taxes look like spend roughly the same amount on the rich and poor—though actually a little more on the poor than on the rich. And a dollar of spending for the poor is weighed about three times as high for the poor as the rich.

Model C also has desert-based tax views, but the transportation regulators are naïve and continue to maximize efficiency despite the low cash transfers to the poor. They continue to spend far more on transportation for the rich than for the poor because they are counting a dollar in the hands of the rich and poor equally for welfare purposes.

We can then measure the welfare impact of adopting the transportation spending of model C instead of model B. Welfare impacts are measured in two steps: First, calculate the welfare under models B and C. Second, calculate the amount of money that one must take away from the rich under model B to lower welfare to its model C level. And then divide that amount by the total income that parties earn when in model B. Again, for this exercise, it does not matter whether equation (4) or (5) represents the true welfare because the social value of a dollar in the hands of the rich is not impacted by the presence of λ.

The welfare loss is large for just one policy: 4.5%. The welfare loss arises because there is not enough spending on the poor when cash transfers redistribute little. Multiplying the impact across even a handful of policies would quickly yield very large shares of welfare. Thus, current Department of Transportation policy is erroneous because it is inattentive to Congress's actions on cash transfers. The poor receive too little cash from Congress and too little transportation assistance from the Department of Transportation. Thus, current policy reduces social welfare because of the high social value of the income the poor earn from being able to commute to work more quickly.

Table 1: Annual Transportation Spending and Cash Transfer Under Three Models

	Transportation spending	Cash transfer to the poor	Distributive weight to transportation planner, poor : rich	
Model A: Standard model	Poor: \$2,692 Rich: \$7,053	\$12,312	1 : 1	
Model B: Desert-based view on cash transfers and politically attentive regulators	Poor: \$7,304 Rich: \$6,832	\$4,346	3 : 1	
Model C: Political constraints with naïve efficient regulator	Poor: \$4,307 Rich: \$9,829	\$4,346	1 : 1	Welfare cost of adopting efficient transportation spending: 4.5% of income

C. *Model Extension: Uncertain Normative Goal*

Thus far, the model has assumed that we know the social value of redistribution. A separate question considers which policies to adopt under uncertainty about the appropriate normative model—not in the sense of whether cash transfers are particularly normatively costly (which does not matter for the transportation planner), but rather the right amount of overall redistribution. This question leads to an error cost analysis like that described in Section IV.E.

Suppose for simplicity that there are two possibly correct social values of redistribution. The first is model B, in which Congress does not redistribute as much through taxes because of a distaste for redistributing through cash in particular and the Department of Transportation optimally responds.

The second model (model D) adds a new parameter, F, which discounts the utility of the poor, such that the social welfare function is

$$W = U_r + F \cdot U_p \tag{6}$$

where $0 < F < 1$. F is calibrated to generate the same optimal s as model B produces. It thus captures an alternate explanation for low cash transfers other than a disutility of cash transfers (i.e., $\lambda > 0$): distaste for the utility of the poor itself.

Consider the error costs under both models. If model B is accurate but the Department of Transportation adopts model D's prescription, transportation spending is insufficiently redistributive and there is a welfare loss of 3.6%. (Recall that this is the case whether the dispreference for cash transfers is either normatively correct or merely a political constraint, as described in the previous subsection.) If model D is normatively right (i.e., there is just a weak preference for redistributing), but regulators adopt the more redistributive transportation spending of model B, then there is also a welfare loss, though a smaller one: of 2.1%.

In principle, regulators could compare the error costs in any given situation to help with their decision-making: the larger the welfare cost of adopting the wrong policy, the more consideration that normative framework should get. Suppose, for example, that there is a 50% chance of each possibility being correct. The resulting optimal spending is $5,773 on the poor and $7,025 on the rich. This resulting ratio of spending on the rich and poor is between the two extremes, though closer to the model B outcome because the welfare costs of deviating from it are larger than the welfare costs of deviating from model D.

This illustration again reflects the rule in economics that the marginal cost of deviating from the optimal policy increases in the size of the deviation.[242] That is, being a little off from the optimal outcome for either model B or model D is not very costly: the transportation planner is close to indifferent for the marginal transportation cent. Only when spending deviates further from the optimal amount do the marginal costs get large.

[242] *See supra* Section III.B.