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The Distributive Deficit in Law and Economics

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THE DISTRIBUTIVE DEFICIT IN LAW AND ECONOMICS

Lee Anne Fennell and Richard H. McAdams

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THE DISTRIBUTIVE DEFICIT IN LAW AND ECONOMICS

Lee Anne Fennell[†] and Richard H. McAdams^{}*

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Welfarist law and economics ignores the distributive consequences of legal rules to focus solely on efficiency, even though distribution unambiguously affects welfare, the normative maximand. The now-conventional justification for disregarding distribution is the claim of tax superiority: that the best means of influencing or correcting distribution is via tax-and-transfer. Critics have observed that optimal redistribution through tax may be politically infeasible, but have generally overlooked the rejoinder that the same political impediments to redistribution through tax will block redistribution through legal rules. This “invariance hypothesis,” as we label it, holds that there is only one distributive equilibrium and that Congress will offset through tax any deviations from it. We highlight the centrality of invariance to the conventional economic wisdom and assert that it is just as relevantly false as the zero transaction cost assumption. In contexts where political impediments to tax-based redistribution exceed the impediments to doctrinal redistribution, it may be possible to increase welfare by redistributing outside of tax. Welfarists should, therefore, devote as much scholarly attention to the “political action costs” of redistribution as they do to transaction costs.

INTRODUCTION

Getting resources or entitlements into the right hands—those in which their highest value can be realized—can be costly.¹ The economic analysis of law is founded on this fact. Were it otherwise, there would be no need to concern ourselves with the efficiency of legal rules and institutions because costless transactions would set everything right in the blink of an eye.² Yet law and economics has neglected a feature of reality that is no less foundational than that of positive transaction costs: the large and variable costs associated with the *political* impediments that must be surmounted to achieve welfare-maximizing distributive results.³ We argue that these

¹ See generally R.H. Coase, *The Problem of Social Cost*, 3 *J. L. & Econ.* 1 (1960).

² See *id.* at 8; see also R.H. Coase, *The Firm, The Market, and the Law* 14-15 (1988). If transaction costs were zero, legal rules could be selected based exclusively on distributive concerns—a point Stewart Schwab has dubbed “the distributive corollary of the Coase Theorem.” Stewart Schwab, *Coase Defends Coase: Why Lawyers Listen and Economists Do Not*, 87 *Mich. L. Rev.* 1171, 1195 (1989). Similar observations appear in Michael J. Meurer, *Fair Division*, 47 *Buff. L. Rev.* 937, 943 (1999); James E. Krier and Stewart J. Schwab, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 *NYU L. Rev.*, 440, 448 (1995); Zachary Liscow, *Reducing Inequality on the Cheap*, 123 *Yale L.J.* 2478, 2500-01 (2014).

³ We use the shorthand “welfare-maximizing” to refer to maximization based on whatever social welfare function has been specified, which might mean maximizing the sum or product of all individual utilities, the utilities of the least well-off, or something different.

*political action costs*⁴ are significant, that they vary in knowable ways among types and methods of redistribution, and that perceptions of fairness, among other things, play a role in their magnitude.⁵ Because both efficiency and distribution matter to welfare, the two impediments to its maximization—transaction costs and political action costs—should be treated in parallel fashion.⁶ If this were done, the now-conventional assumption that tax-and-transfer will always trump other redistributive methods could not stand. Nor could the economic analysis of law ignore distributive deficits⁷—and the political costs of addressing them—when evaluating legal rules.⁸

To begin, compare the following paragraphs:

1. A court must decide whether to allow a factory to pollute to the detriment of nearby neighbors. If it is evident that the factory would gain more wealth from polluting than the neighbors would lose (and no one else is affected by the decision), the court should assign the pollution entitlement to the factory. This is the efficient result. Assigning the entitlement to the neighbors would require a transaction between the neighbors and the factory to achieve the same allocative result, which would be (at best) costly, and possibly prohibitively so. If the distributive effect of assigning the entitlement to the factory rather than to the neighbors is unwanted (because it fails to maximize welfare), this can be readily corrected through a tax-and-transfer system.

2. A court must decide whether to allow a factory to pollute to the detriment of nearby neighbors. If it is evident that the neighbors would glean more welfare from the wealth represented by the

⁴ See text accompanying notes 82-83, *infra* (providing a taxonomy of these costs). These costs are distinct from the technical or administrative challenges involved in adjusting distribution, such as the costs of assessing or collecting taxes. For a discussion of administrative costs, see *infra* note 30.

⁵ We are not the first to note the potential implications of political costs for law and economics. See, for example, Richard S. Markovits, Why Kaplow and Shavell's "Double-Distortion Argument" Articles Are Wrong, 13 *Geo. Mason L. Rev.* 511, 557, 597-601 (2005); Brett H. McDonnell, The Economists' New Arguments, 88 *Minn. L. Rev.* 86, 111 (2003); Cass R. Sunstein, Willingness to Pay vs. Welfare, 1 *Harv. L. & Pol'y Rev.* 303, 314-15 (2007). However, the role of political impediments that might apply differentially to different modes of redistribution has been widely underappreciated.

⁶ See A. Mitchell Polinsky, Economic Analysis as a Potentially Defective Product: A Buyer's Guide to Posner's Economic Analysis of Law, 87 *Harv. L. Rev.* 1655, 1665-69, 1676-81 (1974) (critiquing Posner's focus on the falsity of the zero transaction cost assumption to the exclusion of other artificial assumptions, including costless redistribution). Although Polinsky focuses on the distortive effects of taxes rather than their political costs, his critique emphasizes, as we do here, the importance of treating all impediments to welfare maximization in like fashion.

⁷ A "distributive deficit" represents the degree to which a given distribution fails to maximize welfare for a given total quantity of wealth. Neglect of this deficit has led to a scholarly deficit in the economic analysis of law.

⁸ Except as otherwise specified, we will use the term "legal rules" in this article to refer to *nontax* legal rules and policies, whether enacted by legislative or administrative bodies or adopted by courts.

entitlement than the factory would lose (and no one else is affected by the decision), then the entitlement should be assigned to the neighbors. This facilitates the welfare-maximizing result. Assigning the entitlement to the factory would require a political act to achieve the same distributive result, which would be (at best) costly, and possibly prohibitively so. If the allocative effect of assigning the entitlement to the neighbors rather than the factory would prove inefficient, this can be readily corrected through a transaction between the factory and the neighbors.

The first paragraph represents a standard law and economics account of how entitlements to resources should be assigned.⁹ The last line is crucial to achieving the acknowledged goal of most law and economics scholars: welfare maximization. Yet rarely is there any mention of the political acts necessary to achieve this desired distributive result; the implication, intended or not, is that these costs are too trivial to merit sustained attention.¹⁰ The second paragraph shows how this same account might look if the transactions required to achieve a desired allocative result were deemed to be trivial and the political acts required to achieve a desired distributive result were understood to be costly.

The second paragraph will strike readers as outrageously false, and we agree that it is. But so too is the first paragraph.¹¹ Both the private transactions required to change the allocation of resources and the political acts required to change the distribution of wealth are costly, and at times prohibitively so. Just as we do not invariably get efficient results regardless of the initial assignment of legal entitlements, we do not invariably get welfare-maximizing distributive results regardless of the initial distributive effects of legal rules. On the contrary, different legal rules can produce

⁹ Although such formulations are recognized to employ simplifying assumptions, the usual takeaway message is that the focus on efficiency is justified. See, e.g., A. Mitchell Polinsky, *An Introduction to Law and Economics* 10 (4th ed. 2011) (*[F]or purposes of discussing the legal system, a reasonable simplifying assumption is that income can be costlessly redistributed*); *id.* at 161-62 (concluding, after building in the costs of redistribution, that “legal rules still should be based primarily on efficiency considerations because legal rules generally are more costly than taxes and transfers as a means of redistributing income and are less precise.”).

¹⁰ The primary cost associated with redistribution that receives attention from legal economists is the labor/leisure distortion. But because this is thought to be common to all distributive efforts, including those built into legal rules, it is not viewed as uniquely attaching to the redistributive effort contemplated in the first paragraph. Administrative costs are also understood to exist but are given limited attention on the supposition that they will be lower for tax-and-transfer than for doctrinal methods of redistribution. See *infra* notes ___ and accompanying text.

¹¹ It might be argued that the second paragraph is more misguided than the first, since neither wealth nor welfare can be maximized unless the (actually costly) transaction to change the allocation occurs. In the first paragraph, by contrast, we can be sure that wealth maximization occurs, whether or not welfare maximization ever does. But achieving wealth maximization for a given distribution carries no more inherent value than achieving the most welfare-advancing distribution for a given level of wealth, given that both efficiency and distribution matter to the ultimate goal of welfare. To be sure, we have a word, “efficient,” to describe the first result and have no analogous word for the second result. But this linguistic peculiarity should not be allowed to skew analysis. For a welfarist, both paragraphs should be equally problematic.

different distributive results—ones that will perform better or worse on a given distributive metric.¹² Even where we do manage to get the same distributive result from different starting points, the cost of achieving that outcome will depend on the magnitude of political action costs—just as the cost of achieving a preferred allocative result depends on the magnitude of transaction costs.

If we pay as much attention to these political costs as we do to private transaction costs, we will end up questioning an important tenet of conventional economic wisdom. Suppose a court is confronted with a case like the factory dispute above in which distributive and efficiency considerations point in opposite directions. Should the court weigh the efficiency effect on welfare against the distributional effect on welfare—for example, choose a slightly less efficient rule that will avoid generating large distributive deficits? Conventional law and economics says no: the judge should decide the rule solely on grounds of efficiency and leave distribution to the tax-and-transfer system, because doing so will generate fewer behavioral distortions.¹³

On this view, any distributive deficit associated with the court’s ruling can be better addressed through the tax system. For this to *always* be the case, however, it is not enough to show that tax-and-transfer minimizes the behavioral distortions associated with redistribution;¹⁴ instead, tax-and-transfer must perform better overall at achieving distributive shifts, after the political costs of achieving the desired distributive changes are taken into account. It is plausible that the presence of political action costs would necessitate second-best methods of governmental redistribution,¹⁵ just as positive transaction costs will cause private parties to adopt second-best contracts when transaction costs block the first-best. “Political failure” no less than “market failure,” can thwart efforts at welfare maximization.

The conventional wisdom at this point responds with a crucial but poorly understood claim that we term “the invariance hypothesis”: that any political failure that exists for tax-and-transfer must inevitably plague non-tax methods of distribution to at least the same degree—whether because

¹² As our later discussion makes clear, welfare maximization must be evaluated by reference to a given social welfare function..

¹³ In brief, the labor/leisure distortion is thought to attend all redistributive efforts, while inefficient redistributive legal rules additionally distort behavior in the domain to which the rule applies. See *infra* notes ___ and accompanying text.

¹⁴ See *infra* Part I.A. (discussing the principle of tax superiority and the “double distortion” argument).

¹⁵ See, e.g., Liscow, *supra* note 2, at 2508 (“[I]f transfers are unavailable in practice, their theoretical availability is irrelevant; as a result, the legal rule should adopt the second-best policy of taking equity directly into account[.]”); see also Matthew D. Adler & Eric A. Posner, *New Foundations of Cost-Benefit Analysis* 144-45 (2006) (suggesting that an administrative agency might at times be able to improve “overall well-being” through attention to distributive impacts where tax-and-transfer will not occur, and observing that “if this result is welfare inferior to an alternative that is politically impossible, that is irrelevant”). Although any tax system based on income is already firmly in the realm of the second-best, the claim of tax superiority assumes a first-best political situation, by ignoring the real-world political resistance to the income tax.

the other legal actors are themselves subject to the same political constraints, or because their distributive efforts will be offset by the legislature. If this were true, political failure would make any shortfalls in redistribution inevitable regardless of what distributive methods were employed, so we would still do best to leave redistribution to tax-and-transfer (however inadequately it might accomplish the task). But, as we will show, the invariance hypothesis is not true.

This article makes three claims, corresponding to its three Parts. In Part I, we show that law and economic analysis embeds a distributive invariance hypothesis that the same distributive result will be achieved regardless of how legal rules are configured or how entitlements to resources are assigned.¹⁶ This invariance hypothesis rests in turn on an unstated assumption that political action costs for tax adjustments are equal to or less than for any other method of distributing the same quantum of income.

In Part II, we argue that the invariance hypothesis is false. Political action costs for redistribution are not only frequently large, they also vary dramatically among contexts for a variety of reasons—including political inertia, interest group politics, framing, and real or perceived conformity with background notions of fairness. As a result, legal rules may be able to achieve and maintain distributive results that tax-and-transfer cannot. By the same token, choosing efficient legal rules over less efficient ones may introduce unwanted distributive side effects that tax-and-transfer cannot or will not correct.

In Part III, we argue that attending to political costs leads to different conclusions about how welfarists should approach the task of designing legal rules and institutions than those that are currently dominant in law and economics. Welfarists working in law and economics should give the role of political action costs in sustaining distributive deficits attention on a par with that already given to the role of transaction costs in impeding efficient results. There should be broad recognition within law and economics of the falsity of the invariance hypothesis and the associated possibility that legal rules can have durable, welfare-relevant distributive consequences. Legal rules are thus not axiomatically inferior to tax-and-transfer as a means of achieving or maintaining desired distributive results—though they may be so in many domains as an empirical matter.

Our project's significance goes beyond adding to the debate over the best way to redistribute, however. It also focuses attention on the phenomenon of distributive variance, or multiple distributive equilibria, within a political system. Not only does this phenomenon warrant study as a

¹⁶ This hypothesis sometimes appears in the literature as a modeling assumption that is understood to possibly or definitely depart from reality; at other times, it is cast as an empirical claim about the way distributive results are actually accomplished. See *infra* Part I.C.

positive matter, it also raises interesting normative questions for welfarists. For example, we might wonder if there are independent welfarist reasons for preferring the distributive equilibrium reached through one institutional channel rather than another (such as legislatures rather than courts), apart from the distributional content of the alternatives and the behavioral distortions they produce.¹⁷ A desire to glean the benefits of a less distortionary (or otherwise preferred) redistributive method should also spur interest in mechanisms for addressing distributive variance—such as rules or policies that would make doctrinal choices with distributive implications conditional on corresponding tax adjustments.¹⁸

I. INTRODUCING THE INVARIANCE HYPOTHESIS

A hypothesis of distributive invariance—that the same distributive result will be achieved regardless of how legal entitlements are assigned—underpins much of what has become the standard law and economics approach. It comprises the following cluster of subclaims:

1. Any distributive result that can be achieved at all can be achieved (at lower cost) through tax-and-transfer.

2. The current distribution of political power creates a single equilibrium level of distribution. If any governmental actor or agency produces some other distributive result, whether through intentional distributive efforts or as a side effect of pursuing other goals, the divergence from the equilibrium distributive pattern will be counteracted through the tax-and-transfer system.

3. Whatever distributive pattern we observe at a given time either instantiates society's social welfare function or approximates it as closely as the current political equilibrium will allow. Excising distributive considerations from all non-tax law will allow this distributive pattern to be maintained at minimum cost while introducing distributive considerations into non-tax law will raise the cost of maintaining the distribution, but the distribution itself can never be improved upon.

Such claims fail to account for the costs of political action necessary to produce and maintain society's desired distributive patterns. They rest on an

¹⁷ See *infra* Part III.B.3.

¹⁸ See *infra* Part III.C.3. For example, a shift to congestion pricing of roads might be made conditional on the tax system increasing its progressivity to preserve distributive neutrality.

unstated assumption that the political action costs for redistributing through tax-and-transfer are never greater than for any other method of distribution (including distributive choices that are bundled into judicial and administrative decisions and that require no independent redistributive step). If this assumption is untrue, the invariance hypothesis unravels. If political action entails prohibitive costs from one allocative starting point but becomes affordable or even unnecessary from another, or if redistributing through one means rather than another can reduce the associated political action costs, then distributive results will depend on how law and institutions are structured. We will take up our case against the invariance hypothesis in Part II. First, however, it is helpful to lay out in more detail the arguments and prescriptions that are implicitly premised on it. This establishes what is at stake.

For convenience, we will refer mainly to the work of Louis Kaplow and Steven Shavell (K&S) in the balance of this Part.¹⁹ However, because their position has become mainstream among law and economics scholars, we take ourselves to be critiquing the approach as a whole and not just these scholars in particular. As we hope will become clear, not only does our argument in some respects go beyond merely critiquing K&S, but some of what we say would likely produce agreement from K&S themselves. First, we discuss the claim that tax-and-transfer is categorically preferable to legal rules for achieving distributive results (“the principle of tax superiority”). Second, we show how this approach assumes the invariance hypothesis.

A. *The Principle of Tax Superiority*

Louis Kaplow and Steven Shavell (K&S) famously argue that tax²⁰ is strictly superior to legal doctrine as a means of redistributing income.²¹ They were not the first to make this claim, but they very cogently developed and defended the idea in a series of articles now well known within law and

¹⁹ Kaplow and Shavell develop the principle of tax superiority in both joint and solo work. The primary articles in this vein are Steven Shavell, *A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation?*, 71 *Am Econ Rev* 414 (1981); Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, 23 *J Legal Stud* 667 (1994) [hereinafter Kaplow & Shavell, *Less Efficient*]; Louis Kaplow, *The Optimal Supply of Public Goods and the Distortionary Cost of Taxation*, 49 *Natl Tax J* 513 (1996). For the related public finance literature on commodity taxation, see Anthony B. Atkinson and Joseph E. Stiglitz, *The Design of Tax Structure: Direct Versus Indirect Taxation*, 6 *J Pub Econ* 55 (1976); Emmanuel Saez, *The Desirability of Commodity Taxation Under Non-Linear Income Taxation and Heterogeneous Tastes*, 83 *J Pub Econ* 217 (2002).

²⁰ We use the term “tax” in this essay interchangeably with “tax-and-transfer” to encompass transfer payments.

²¹ See, e.g., Kaplow & Shavell, *supra* note 19. K&S do qualify this claim in some respects. See Kaplow & Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 *J. Legal Stud.* 821, 825-34 (2000) [hereinafter Kaplow & Shavell, *Legal Rules*]. For the most part, these qualifications are highly technical and not relevant to the discussion here. K&S’s treatment of the issue at the heart of our analysis—the possibility that distribution may be changed by other legal actors in a way that Congress does not offset—is detailed extensively below. See *infra* Part I.C.

economics. Their conclusion that welfarists should ignore distributive consequences in most legal contexts, notwithstanding the importance of distribution to welfare, is a strikingly counterintuitive and provocative one.

It is a surprise to some non-economic theorists, but welfare economics places great significance on distribution.²² Distribution matters to welfare maximization in potentially two ways. First, distribution of wealth or other resources can affect individual welfare for a variety of reasons. The most general point is the declining marginal utility of money, which means that moving a dollar from the rich to the poor will typically increase the welfare of the poor more than it diminishes the welfare of the rich.²³ Second, social welfare functions may aggregate individual welfare in a manner that makes the distribution of utility or well-being itself relevant. One may plausibly choose a non-utilitarian social welfare function that gives some weight to the greater equality of welfare.²⁴ K&S dispute neither point. Their argument is one of means rather than ends: given the end of increasing (or decreasing) income equality, the best means is tax.

When K&S first jointly proposed the distributional superiority of tax in 1994, they could plausibly state that they were writing against the conventional wisdom of lawyers and law professors: that legal doctrine offered a superior means of redistributing because it avoided the distortion of labor-leisure decisions.²⁵ K&S argued that this line of reasoning was erroneous: if doctrinal rules operate like a tax by redistributing wealth from the rich to the poor, people will notice themselves earning a lower return on their labor as their income rises, and the same labor-leisure distortion will occur.²⁶ If both tax and legal doctrine distort the labor-leisure decision to

²² [distinguish welfare maximization from wealth maximization].

²³ See, e.g., Louis Kaplow & Steven Shavell, *Fairness versus Welfare* 30 (2002). There are numerous other channels through which distribution might influence utility, although the evidence is often mixed on these effects. See, e.g., Richard H. McAdams, *Economic Costs of Inequality*, 2010 *Univ. of Chicago Legal Forum*, 23 (2010) (discussing contested empirical and theoretical literature finding that inequality increases crime and constrains economic growth); Emily Underwood, *Can disparities be deadly? Controversial research explores whether living in an unequal society can make people sick*, 344 *Science* 829 (May 2014) (examining contested evidence that widespread inequality causes a variety of negative health effects); Juan Jose Ganuza and Fernando Gomez, *Optimal Negligence Rule Under Limited Liability*, UPF Working Paper No. 759 (2004), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=563849 (observing that inequality may result in more people being judgment-proof for many possible torts and therefore not subject to deterrence by a first-best liability rule); Lee Anne Fennell, *Interdependence and Choice in Distributive Justice: The Welfare Conundrum*, 1994 *Wisc. L. Rev.* 235 (1994) (discussing literature on a variety of potential costs of poverty and inequality including the inadequate development of human capital, aesthetic distress from observing people in poverty, crime and rioting, fear of experiencing poverty in the future, and other costs arising from interdependent utility functions or preferences for certain distributive patterns). See generally Richard Wilkinson and Kate Pickett, *The Spirit Level: Why Greater Equality Makes Societies Stronger* (2011).

²⁴ A utilitarian social welfare function seeks to maximize the sum of individual welfare levels, but plausible alternatives involve more complex functions, such as maximizing the sum of the square roots of individual welfare levels, which would have the effect of valuing equality of welfare.

²⁵ See, e.g., A. Mitchell Polinsky, *The Simple Economics of Injunctive and Damage Remedies*, 32 *Stan. L. Rev.* 1075, 1084-85 (1980) (suggesting that a remedial choice might be a less expensive way to redistribute, and observing that “[d]ue to the substantial distortions in work effort, redistribution through the tax system would be quite costly in terms of efficiency”).

²⁶ See, e.g., Kaplow & Shavell, *Less Efficient*, *supra* note 19, at 667-68. This equivalence has been disputed.

the same degree, tax then has the advantage of avoiding the additional distortion created by any deviation from efficient legal rules.²⁷ Although this extra distortion argument has been assailed from various directions,²⁸ we accept it as accurate for purposes of our discussion here; our arguments apply whether it is true or false.

K&S move from the extra distortion argument to a simple policy recommendation: even though distribution matters to social welfare, legal doctrine should focus exclusively on efficiency.²⁹ In doing so, they implicitly assume that there are no other costs in the picture that might vary in a way that would favor a nontax method of distribution.³⁰ The principle of tax superiority has been the subject of numerous critiques and ongoing debate.³¹ Nonetheless, our sense today is that the K&S position has become the conventional wisdom, at least among many law professors who employ

See, e.g., Christine Jolls, Behavioral Economic Analysis of Redistributive Legal Rules, 51 Vand. L. Rev. 1653 (1998) (arguing that legal rules may be less distortive due to cognitive biases); see also Chris William Sanchirico, Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View, 29 J. Legal Stud., 797, 800 (2000) (arguing that the extra distortion argument does not apply to “income-independent, equity-motivated deviations from efficient legal standards”); Liscow, *supra* note 2 (arguing that distortions to labor/leisure can be avoided or mitigated by applying rules that distribute entitlements based on group membership that correlates with income levels rather than on individual income levels).

²⁷ This argument is undermined to the extent that real-world tax and transfer systems embed design choices that can add distortions beyond labor-leisure, including choices about family composition and residential location. These potential distortions have, of course, been staples of discussions about transfers to low-income people for decades. For a recent discussion, see Scott Sumner, Guaranteed Annual Income: Let’s Talk Numbers, TheMoneyIllusion blog, Sept. 27, 2014, www.themoneyillusion.com/?p=27639. As K&S recognize, the matter is also more complex than simply counting the number of distortions, because one distortion might offset rather than add to another distortion. Thus, for example, a behavioral distortion that led someone to consume less of a good that is strongly complementary to leisure might offset rather than add to the labor/leisure distortion. See Kaplow & Shavell, Legal Rules, *supra* note 21, at 825-26.

²⁸ See, e.g., Jolls, *supra* note 26; Sanchirico, *supra* note 26; Liscow, *supra* note 2; Markovits, *supra* note 5.

²⁹ See Kaplow & Shavell, Less Efficient, *supra* note 19, at 677.

³⁰ Administrative costs receive some attention from K&S. See *id.* at 675 n.12 (“[A]lthough we did not consider the possible additional administrative costs of increasing the amount of redistribution through the income tax, it seems plausible that these costs would be less than those of achieving significant, well-targeted redistribution through legal rules.”); Kaplow & Shavell, Legal Rules, *supra* note 21, at 834 n. 30 (“Nor do we address administrative costs, which would seem to be an important factor that weighs against using legal rules to attempt to redistribute *significant* amounts of income.”) (emphasis in original). See also Markovits at 608-10 (discussing and critiquing K&S’s neglect of this topic). A somewhat longer discussion of administrative costs appears in Steven Shavell, Foundations of Economic Analysis of Law 656-67 (2004) (acknowledging that administrative costs of tax system are nontrivial and suggesting that the costs of legal rules blend together high administrative cost elements such as litigation with low administrative cost elements like influencing behavior via deterrence). Because our primary focus in this article is on political action costs, we do not focus on administrative costs but note only that they represent another reason for doubt about the unqualified claim of tax superiority. See Tomer Blumkin & Yoram Margalioth, On the Limits of Redistributive Taxation: Establishing a Case for Equity-Informed Legal Rules, 25 Va. Tax Rev. 1, 11-14 (2005) (arguing that administrative costs might favor redistributing through non-tax rules); see generally Walter Perrin Heller and Karl Shell, On Optimal Taxation with Costly Administration, 64 Amer. Econ. Rev., Papers and Proceedings 338 (May, 1974).

³¹ E.g., Sanchirico, *supra* note 26; Chris William Sanchirico, Deconstructing the New Efficiency Rationale, 86 Cornell L. Rev. 1003 (2001); Daphna Lewinsohn-Zamir, In Defense of Redistribution through Private Law, 91 Minn. L. Rev.326 (2006); Markovits, *supra* note 5; Liscow, *supra* note 2; Ronen Avraham, et al., Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow & Shavell, 89 Iowa L. Rev. 1125 (2004); Blumkin & Margalioth, *supra* note 30; Nicholas L. Georgakopoulos Exploring the Shavellian Boundary: Violations from Judgment-Proofing, Minority Rights, and Signaling, 3 J.L. Econ. & Policy 47-62 (2006); Noah Popp, Wealth vs. Welfare: Correcting for the Marginal Utility of Wealth in Assigning Private Law Entitlements, 30 Quinnipiac L. Rev. 69 (2011).

economic analysis.³²

It is useful to briefly consider how K&S's primary argument for tax superiority fits into other arguments against using non-tax legal doctrine to redistribute income. First, legal rules may actually fail to affect distribution in the desired direction due to private-party adjustments along other dimensions. For example, a living wage or rent control law may not help the poor, if employers or landlords can adjust other terms of the employment or landlord-tenant bargain.³³ This is the futility or "contracting around" objection.³⁴ Second, redistributive legal rules not precisely tied to income can only roughly redistribute in the desired direction – say, from rich to poor – while sometimes pushing money in the wrong direction. This problem of "leakage" is one facet of what is sometimes termed "the haphazardness objection" to redistributive legal rules.³⁵ Another facet of that objection goes to the underinclusiveness of attempting to redistribute through rules that will only directly impact a small subset of people in a

³² See, e.g., Blumkin & Margalioth, *supra* note 30, at 2 (noting that the K&S stance on tax superiority "seems to be the prevailing norm in the law and economics literature"); Kyle Logue & Ronen Avraham, *Redistributing Optimally*, 56 *Tax L. Rev.* 157, 158 (2003) ("[W]e believe it is a safe bet that a majority of legal economists hold the following view: Whatever amount of redistribution is deemed appropriate or desirable, the exclusive policy tool for redistributing to reduce income or wealth inequality should always be the tax-and-transfer system."); Robert Cooter & Thomas Ulen, *Law and Economics* 112 (3d ed. 2000) (presenting administrative and extra-distortion arguments for preferring progressive income taxation over redistributive assignment of property rights and concluding that "economists who favor redistribution and economists who oppose it can agree that property law is usually the wrong way to pursue distributive justice"); Robert C. Ellickson, *The Affirmative Duties of Property Owners*, John M. Olin Center for Studies in Law, Economics, and Public Policy Research Paper No. 499 at 24-25 (2014) available at: <http://ssrn.com/abstract=2464545> ("[M]ost law-and-economics scholars . . . conclude that distributive goals are better pursued by means of broad tax and welfare programs than by the introduction of distributive considerations into the rules for resolving ordinary private law disputes.") (footnotes omitted); Liscow, *supra* note 2, at 2480 ("Kaplow and Shavell's analysis supports what is perhaps the central tenet of law and economics, namely that legal rules should be designed based on their efficiency consequences"); Avraham, et al., *supra* note 31, at 1126 (describing "a view [among economists] that has become the new conventional wisdom: that income (or wealth) redistribution is always better accomplished through the tax-and-transfer system than through the legal system."); It is not only those within law and economics but also those standing outside of it who view the K&S prescription as central to law and economics. See, e.g., Duncan Kennedy, *Law-and-Economics from the Perspective of Critical Legal Studies*, in *The New Palgrave Dictionary of Economics and the Law* 465, 468 (ed. Peter Newman 1998) (presenting tenets of the "mainstream" law and economics approach, which include having courts pursue efficiency and leaving distribution to the legislature through tax-and-transfer).

³³ See, e.g., *Chicago Board of Realtors, Inc v City of Chicago*, 819 F.2d 732, 741 (7th Cir. 1987) (Posner, J., concurring) ("Landlords will try to offset the higher cost [associated with Chicago's landlord-tenant ordinance] by raising rents."). A related point is that poor people may be harmed by behavioral distortions produced by such legal rules, if, for example, fewer jobs or apartments are made available by employers or landlords—although the empirical evidence on such issues is often unclear. See, e.g., Liscow, *supra* note 2, at 2498 n.46 (noting mixed empirical and theoretical findings on the extent to which the minimum wage reduces employment or manages to redistribute).

³⁴ See, e.g., David Weisbach, *Should Legal Rules Be Used to Redistribute Income*, 70 *U Chi L Rev* 439, 448-49 (2003); see also Liscow, *supra* note 2, at 2497-2500 (discussing the economic incidence of redistributive efforts and noting that even pure transfer programs like the EITC have an incidence-shifting effect by pushing more workers into the work force and depressing wages); *Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd.*, 970 F.2d 273, 282 (7th Cir. 1992) (Posner, J.) ("The idea that favoring one side or the other in a class of contract disputes can redistribute wealth is one of the most persistent illusions of judicial power.")

³⁵ See, e.g., Weisbach, *supra* note 34, at 449 (2003) (referring to problems of both underinclusion and overinclusion as "the haphazardness problem"). [Cf. Weisbach 2014 re: subset of markets subject to agency regulation].

given income bracket—those who happen, for example, to suffer injury at the hands of a tortfeasor.

These arguments depend on deeply contextual inquiries. Not all doctrinal efforts to redistribute are futile.³⁶ Arguments premised on underinclusiveness may fail to take into account the way that legal rules shape conduct and expectations outside the courtroom.³⁷ And overinclusiveness is neither unique to doctrinal redistribution³⁸ nor always without its countervailing virtues.³⁹ As a result, neither contracting around nor haphazardness provides a universal argument for tax superiority. This is where K&S's extra-distortion argument comes in to (ostensibly) deal the knock-out punch, providing an across-the-board reason to disfavor redistributive legal rules.⁴⁰

Based on this argument, K&S have straightforward advice for the decision-maker in the present example: never pick a less efficient Rule A over a more efficient Rule B for the reason that it will – in fact – desirably distribute income and enhance social welfare; the apparent distributive virtue of Rule A is illusory because there is always a better way to get the same level of redistribution via tax.⁴¹ The idea that distributive changes are always best pursued through the tax system supports a strict division of labor in which those charged with formulating legal rules use efficiency as

³⁶ See e.g., Weisbach, *supra* note 34, at 449 (noting theoretical and empirical difficulty of determining effects of legal rules and concluding “that some probably help their intended beneficiaries and some probably do not”). If redistribution through legal rules were always illusory, there would be no need to consider K&S's extra-distortion argument, nor our discussion in this paper of political action costs. Redistributive legal rules, like unicorns, would be wholly imaginary phenomena. But no one, including K&S, thinks it is literally impossible for any redistribution to occur through legal rules or doctrines outside of tax law.

³⁷ Legal rules may operate to the benefit or detriment of income classes through deterrence effects, even if relatively few members of those income classes wind up in court. See Logue & Avraham, *supra* note 32, at 185-86. For example, making tort recovery sensitive to actual lost income might be expected to yield less careful driving in low-income neighborhoods or less careful treatment of low-income patients, whereas averaging income would tend to equalize the deterrence effects across income classes. See Ariel Porat, *Misalignments in Tort Law*, 121 *Yale L.J.* 82, 97-99 (2011). See also Logue & Avraham, *supra* note 32, at 186-88 (discussing additional arguments against underinclusiveness, including the potential for insurance markets to translate expected impacts into premium differences); Sanchirico, *supra* note 31, at 1052 (contending that private law as a whole is a comprehensive system, even if particular rules within it are not, and noting that insurance spreads the impact of legal rules that are triggered by specific events).

³⁸ In fact, tax law itself (as it exists on the ground) is riddled with exceptions and examples of poor targeting. See Weisbach, *supra* note 34, at 452 (observing that the tax system is “riven with loopholes” but suggesting legal rules would be no better and “could easily be much worse”). There are also important debates about whether income offers a sufficiently good measurement of well-being to serve as the basis for targeting in the first place. See Sanchirico, *supra* note 26; see also Liscow, *supra* note 2 at 2502-09 (suggesting that some redistributive efforts may be better targeted based on some non-income measure of desert or need, rather than income).

³⁹ See, e.g., notes 96-98, *infra* and accompanying text (noting potential political advantages of imperfect targeting or “leakage”).

⁴⁰ See Avraham, et al., *supra* note 31, at 1127 (noting that K&S “made what seemed to be a decisive argument regarding the use of redistributive legal rules. They argued that income redistribution is always more efficiently accomplished through the tax-and-transfer system, even if the contracting-around and haphazardness issues are placed aside.”).

⁴¹ K&S do not directly address legal decisionmakers in their work, but they do state that their extra distortion argument, when added to the other arguments that support redistribution through tax-and-transfer, “suggests that it is appropriate for economic analysis of legal rules to focus on efficiency and to ignore the distribution of income in offering normative judgments.” K&S, *supra* note 21, at 677 (footnote omitted) (emphasis added).

their maximand.⁴² This is, at any rate, the conventional understanding of K&S's proof.⁴³

This prescription carries obvious implications for the work of courts. To illustrate, consider the following examples:⁴⁴

Arbitration Clause. A court is deciding whether to enforce or invalidate an arbitration clause in a standardized consumer contract. Perhaps enforcing the clause redistributes away from the rich consumers (who value more highly the right to sue in court) and toward low and middle income consumers (who value a cheaper product and a cheaper process).⁴⁵ Or perhaps the opposite is true, because invalidating the arbitration clause preserves the right to bring class action suits, and this would benefit lower income people.⁴⁶

Tort Recovery. A court is deciding whether to award damages for lost income based on the particular plaintiff's actual expected income (the tailored rule) or based on the average expected income of people in the same age cohort living in the community (the untailored rule). The former would favor higher income people over lower income people, while the latter would have the opposite effect.⁴⁷

In cases such as these, the principle of tax superiority suggests the court should focus only on the efficiency implications of these decisions and

⁴² This division of labor tracks the First and Second Fundamental Theorems of Welfare Economics, as well as the more prosaic admonition to separate pie maximization from pie slicing. See, e.g., Edward J. McCaffery A New Understanding of Tax, 103 Mich. L. Rev. 807, 817 fn. 21 (2005) (referencing 'the argument of Louis Kaplow and Steven Shavell, tracking the two welfare theorems, that the general legal system should be evaluated vis-à-vis the goal of welfare maximization or allocative efficiency, leaving the tax system to redistribute wealth.');

Meurer, *supra* note 2, at 941 fn. 28 (1999) (explaining how law and economics "bifurcates efficiency and fairness analysis of the law" and describing the "usual attitude . . . that law should be shaped by efficiency concerns, and [that] the legislature can achieve fairness through taxing and spending policies.');

see also A. Mitchell Polinsky, *An Introduction to Law and Economics* 7 (New York: Wolters Kluwer Law and Business, 4th ed. 2011) ('efficiency corresponds to "the size of the pie," while equity has to do with how it is sliced').

⁴³ We say this with some confidence, having reviewed scores of citations to K&S on this point appearing in articles published from 2005 through 2013.

⁴⁴ The examples provided here and elsewhere in the article are offered for purposes of concreteness, not to defend strong claims about the distributive or efficiency consequences at play in any of these particular scenarios.

⁴⁵ See Omri Ben-Shahar, *Arbitration and Access to Courts: Economic Analysis*, in *Regulatory Competition in Contract Law and Dispute Resolution* 447, 458-62 (Horst Eidenmiller, ed., 2013).

⁴⁶ The analysis here is complex. See *id.* at 462-65. While recoveries are low for class action plaintiffs, the deterrence effect might on some assumptions benefit consumers sufficiently to make up for the more expensive product.

⁴⁷ See, e.g., Keren-Paz at 51-52, 67-69 (noting distributive effects of *restitutio ad integrum*, which provides for tailored compensation). Similarly, administrative agencies must decide whether, in cost-benefit analysis, to use a single measure of the value of a statistical life (VSL) or whether to adjust the value depending on the expected income of the lives saved. [cite]

ignore the distributive consequences. Where efficiency cuts in a different direction than distributive desirability (on a given social welfare function), this amounts to advice to choose a distributively inferior result.

Although K&S emphasize court-made law, the implication of the theory is by no means limited to courts. As a logical matter, their policy prescription applies just as strongly to the legislature, which should redistribute income through its tax mechanisms and not through any other type of law.⁴⁸ For example:

Teacher Tenure. A state legislature must decide whether to keep or discard a teacher tenure provision. Suppose the provision has the effect of increasing the number of school teachers at the high end of the ability distribution (because they value academic freedom) and at the low end of the ability distribution (because they value the ability to shirk without losing their jobs). If we assume that the teachers at the high end of the distribution primarily serve high income schools and those at the low end of the distribution primarily serve low income schools, retaining the provision will distribute toward the wealthy, while discarding it will distribute toward the poor.⁴⁹

Military Recruitment. Congress must decide whether to staff the military with volunteers or conscript by lottery. Because volunteer forces are disproportionately drawn from the poor, this system of government employment tends to transfer income to the poor in times of peace and away from the poor in times of war.

Once again, K&S would urge that these non-tax legislative decisions be made based on their efficiency implications and not based on their distributive consequences.

The same advice applies to the decisions of executives and administrative agencies. Consider the following:

Criminal Enforcement. The mayor of a city orders the

⁴⁸ Indeed, the K&S analysis would specify use of only certain kinds of broad based taxes on income or wages, not merely any policy instrument that happens to appear in the Internal Revenue Code. Using “tax expenditures” like the mortgage interest deduction, for example, introduces distortions into housing consumption choices without alleviating labor/leisure distortions—assuming the same revenues are collected by increasing burdens elsewhere.

⁴⁹ Cf. *Vergara v. California*, California Superior Court, June 2014 (slip op. at 15) (striking down teacher tenure statutes as violative of state constitution and noting that they “disproportionately affect poor and/or minority students”).

police chief to move undercover drug operations from poor to wealthy neighborhoods and target the types of drugs that are more prevalent in those neighborhoods. The district attorney shifts from a priority of pursuing prostitutes to a priority of pursuing their customers. Both measures strongly affect the distribution of the costs and benefits of criminal enforcement.⁵⁰

Environmental Regulations. Proposed administrative regulations aimed at protecting the environment raise the price of electricity in a manner that disproportionately burdens poor households. Other proposed regulations raise property values near polluting facilities in a manner that, on average, benefits poor neighborhoods.⁵¹

In all such cases, if the law is not tax, the advice in selecting a rule is to give no weight to distribution.⁵²

B. Tax Superiority's Foundation in Distributive Invariance

The principle of tax superiority rests on a hypothesis of distributive invariance that occupies a crucial but underappreciated position within the K&S analysis.⁵³ Specifically, K&S assume that the distributive pattern in a society will be invariant to the political form of redistribution.⁵⁴ If the courts uphold arbitration clauses and grant entitlements against pollution to the

⁵⁰ See, e.g., Nirej S. Sekhon, *Redistributive Policing*, 101 *J. Crim. L. & Criminology* 1171 (2013).

⁵¹ Whether property value increases near factories would help poor people in the area depends on whether they own their homes or rent. See Adler & Posner, *supra* note 15, at 143-44 (considering the possible distributive effects of an agency decision about whether to site a park in a wealthy or poor neighborhood).

⁵² Some law and economics scholars working in administrative law have been open to considering distributive considerations in addressing how (or if) cost benefit analysis should be conducted. See, e.g., Adler & Posner, *supra* note 15, at 130-31, 142-46, 188. The distributive issue is presented bluntly in the cost-benefit context because the diminishing marginal utility of money makes the willingness to pay of the rich much greater than that of the poor. Equalizing welfare would require accounting for wealth differences. Although a tax-and-transfer system might be better in theory, its practical unavailability changes the calculus. See *id.* at 144-45. For a critique of this justification for using distributive weights in regulatory policy, see David A. Weisbach, *Distributionally-Weighted Cost Benefit Analysis: Welfare Economics Meets Organizational Design*, (Draft of July 7, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2450142.

⁵³ K&S acknowledge this assumption to some degree, and provide qualifications based on it, as we explain below. See *infra* Part I.C. However, our review of the literature indicates that the significance of the assumption and qualifications it implies for the principle of tax superiority have not been widely appreciated.

⁵⁴ In other words, there will be the same total amount of redistribution from a baseline in which all legal rules are wealth-maximizing. Using legal entitlements to influence distributive patterns can obviously reduce the amount of explicit redistribution that occurs, even if invariance is assumed. It is a semantic question (but not a politically unfreighted one) whether distributive choices that are “baked into” legal rules, institutional structures, and entitlement allocation choices should be regarded as “redistributive” (as opposed to just distributive) whenever they depart from those choices that would maximize wealth. For discussion of the relevance of baselines to the definition of redistribution, see Stanford Encyclopedia of Philosophy, *Redistribution*, available at <http://plato.stanford.edu/entries/redistribution/>; see also Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (2002).

poor and Congress replaces conscription with an all-volunteer force during peacetime, the resulting distributive changes will be offset by tax adjustments to the extent they produce divergence from the distributive pattern corresponding to the current political equilibrium. Conversely, if legal rules and policies are adopted that operate to the detriment of the poor, Congress will again adjust the tax system to restore its preferred distributive pattern. This assumption amounts to a “law of conservation” of redistribution; whatever redistribution the current political equilibrium allows is exactly the amount that will occur, no more and no less, regardless of the methods of redistribution.

On this account, undertaking redistribution through legal rules or non-tax legislation will, at best, substitute a less efficient redistributive mechanism for redistribution that Congress would have otherwise implemented through the tax system; at worst, it will trigger a countervailing distributive move that undoes the redistribution while leaving behind the behavioral distortions. Redistributive legal rules or social policies that will inevitably either crowd out more efficient redistribution or draw costly countermoves cannot improve the distributive picture. If the amount of redistribution is fixed, then it is obvious that one should want to accomplish that redistribution in the most efficient way.

Far from being a mere detail or sideline, the invariance hypothesis is the logical linchpin of tax superiority. Importantly, K&S, along with many law and economics scholars, maintain a position of distributive agnosticism; they do not commit themselves to any particular social welfare function but rather appear open to any welfarist approach, including ones that give weight to the way in which welfare is distributed.⁵⁵ Consistent with that stance, their categorical claim of tax superiority applies regardless of how welfare is aggregated or how heavily a given social welfare function weights the well-being of subsets of the population.⁵⁶ But universal tax

⁵⁵ See Louis Kaplow & Steven Shavell, *Fairness versus Welfare* 27 (2002) (“[W]e do not defend any specific way of aggregating individuals’ well-being; that is, we do not endorse any particular view about the proper distribution of well-being or income.”); *id.* at 28-31 (explaining the ways in which a welfarist approach might call for redistribution, including the possibility that “more weight might be placed on the well-being of less-well-off individuals”); see also Shavell, *supra* note 30, at 597 (observing that welfare economics encompasses “a vast multitude of ways of aggregating individual utilities,” including approaches in which “more equal distributions of utility may be superior to less equal distributions,” without specifying any one method). This agnosticism about distributive matters is sometimes couched in terms of lack of expertise. See, e.g., James J. Heckman, *The Intellectual Roots of the Law and Economics Movement*, 15 *Law & Hist. Rev.* 327 (1997) (“Knight, Robbins, Samuelson, and all modern economists . . . explicitly state in their writings that they have no competence to assess the “appropriate” distribution of resources and they do *not* sanction any particular distribution of resources, much less the existing one.”) (emphasis in original).

⁵⁶ See Shavell, *Economic Analysis of Law* at 107 (“[D]istributional equity under any measure of social welfare is better pursued through our income tax (and welfare) system than through any other social policy.”); see also Kaplow & Shavell, *Less Efficient*, *supra* note 19, at 667 (observing that criticisms about the neglect of distributive issues in economic analysis of law “would be moot if the income tax system—understood here to include possible transfer payments to the poor—could be used freely to achieve any desired distribution of income” before discussing labor-leisure distortions that impede such free redistribution),

superiority can logically coexist with true distributive agnosticism only if one assumes that any distributive pattern that is achievable at all can actually be achieved through the tax system.

To demonstrate, let us assume the opposite: that some distributive outcome, call it Outcome *R*, can only be achieved and maintained through resort (at least in part) to redistributive legal rules. If one is truly agnostic about distribution, then one cannot exclude the possibility that Outcome *R* maximizes overall social welfare. It follows directly from distributive agnosticism that Outcome *R* might dominate the closest politically achievable all-tax alternative, Outcome *T*, on purely distributive grounds. But true distributive agnosticism also implies that distributive differences can be given any weight whatsoever when trading them off against efficiency losses. A welfarist might weight distributive differences heavily due to the way in which a particular social welfare function aggregates the welfare of different people, or because of the way that wealth differences actually influence the welfare of individuals under particular social conditions.⁵⁷ On some imaginable social welfare function, then, combined with some set of welfare-relevant facts, the distributive gains from Outcome *R* relative to Outcome *T* would outweigh the efficiency advantages of Outcome *T* relative to Outcome *R*.

Only if the invariance hypothesis is categorically true can we rule out the possibility of welfare-maximizing outcomes that are uniquely achievable through resort to non-tax methods. Once variance in achievable distributive results is established, the fact that a particular legal rule will perform better on a given distributive metric should receive as much attention in a welfarist analysis as the fact that a particular legal rule will perform better on the efficiency metric.⁵⁸ If a more welfare-enhancing distributive pattern is politically possible through a combination of tax and non-tax law than through tax law alone, we face the following trade-off: suffer the distortions associated with adding nontax redistributive methods to the mix, or suffer the distributive deficits associated with forgoing those methods. Because it is not possible to know a priori which alternative will be less costly in welfare terms, the claim of universal tax superiority fails.

C. The Existing Literature and the Invariance Hypothesis

We will now examine how the invariance hypothesis has been treated in the literature, both to establish that this principle has been recognized and to suggest that its significance has been largely neglected. We note at the

⁵⁷ See supra note 23 (discussing some of the ways that wealth differences can influence welfare).

⁵⁸ The idea of distributive variance thus stands in for the more intuitive idea of a move toward (or away from) distributive optimality.

outset that what we call the invariance hypothesis is not a single, clearly stated proposition but rather a mostly unacknowledged premise revealed in scattered remarks. Moreover, there are at least two distinct ways that the hypothesis might be understood, each of which finds some support in the existing literature. First, it might be understood as an assumption within the K&S model, and hence as an explicit qualification on the model's results.⁵⁹ Second, it might be understood as a truth-claim about the world: that our political system in fact exhibits distributive invariance. We argue that invariance is false as a factual matter. To the extent it is understood as a modeling assumption, its falsity strongly limits the real world application of tax superiority in a way that has not been generally appreciated.⁶⁰

Our literature review begins with the 1979 article that K&S repeatedly cite: Aanund Hylland and Richard Zeckhauser, *Distributional Objectives Should Affect Taxes but Not Program Choice or Design*.⁶¹ As Shavell says in his 1981 paper, when noting the parallel nature of the result, “the choice of a legal rule may be likened to the choice of a [government] project.”⁶² Interesting, then, is the way that Hylland and Zeckhauser qualify their result. After observing that “[r]eal life” political decisions about distribution are often made in a piecemeal fashion, contrary to their model, they explain that an unclear and partial relationship between these decisions could lead to different levels of distribution across different distributive methods and domains:

[O]ur results suggest that the group [with distributional goals] should emphasize tax strategies, but other programs should not necessarily be neglected. . . . For example, a group which works for increased well being for the poor may achieve greater success by urging subsidies for low-income housing than by advocating cash grants to the same low-income groups. That is, the former type of

⁵⁹ There are some difficulties with this reading. While models often bracket large segments of reality to make analysis more tractable, an invariance assumption would mean that K&S were bracketing the availability of a political process capable of achieving the desired distributive result through tax-and-transfer—in other words, they were bracketing *tax availability* in a model purporting to show tax superiority. This would not be problematic if we cast K&S's point as a theoretical exercise rather than as a basis for policy, as discussed below. See note 159 and accompanying text, *infra*.

⁶⁰ An analogy can be drawn here to the way in which Robert Nozick's ideas have been used to support arguments against redistribution. Nozick famously eschewed any “patterned” distributive goal in favor the actual distributions produced under certain strong assumptions about the history of acquisition and transfer. See Robert Nozick, *Anarchy, State, and Utopia* 155-60 (1974); see also *id.* at 150-53 (setting out the conditions that would, under his approach, justify the resulting entitlements). Nozick himself noted the implications of these predicate conditions failing, even if his readers often ignored this point. Nozick, *supra*, at 152; 230-31 (explaining that his “principle of rectification” could call for more state intervention, potentially including approaches like the one endorsed by John Rawls). Similarly, to the extent K&S meant to present the invariance assumption as a strong qualification on their results, most law and economics scholars have either failed to receive that message or chose to ignore it.

⁶¹ Aanund Hylland and Richard Zeckhauser, *Distributional Objectives Should Affect Taxes but Not Program Choice or Design*, 81 *Scandinavian J. Econ.* 264 (1979).

⁶² See Shavell, *supra* note 19, at 418.

support may be more acceptable to the higher-income people who will have to pay the subsidy. . . .⁶³

Hylland and Zeckhauser go on to observe that the different perspectives of “goods egalitarians” and “income egalitarians” could alter the degree to which tax progressivity would respond to changes in other distributive programs.⁶⁴

This theme is also found in the work of Kaplow and Shavell, although it is not presented as a formal assumption of their model. In his 1981 article, Shavell states the qualification quite strongly:

[I]f the income tax would not be altered on adoption of new liability rules, then in strict logic the argument given for use of efficient rules does not apply. Now, of course, no one would really expect the income tax structure to be adjusted in response to each and every change in legal rules (much less to individual changes in other domains), for this would be impractical. Therefore, one’s attitude toward the result under discussion will depend on his expectation that the income tax would be (or could be) altered in response to changes in legal rules whenever these changes resulted in a ‘sufficiently important’ shift in the distribution of income.⁶⁵

By the time of the 1994 joint article, however, K&S present the qualification in a manner that suggests an empirical conjecture:

An argument sometimes offered in favor of redistribution through legal rules is that the tax system falls short of optimal redistributive taxation--perhaps because of the balance of political power in the legislature. This argument raises questions that we do not seek to address about the function of courts in a democracy. In any case, it seems unlikely that courts can accomplish significant redistribution through the legal system without attracting the attention of legislators.⁶⁶

This passage suggests that if optimally redistributive taxes are politically infeasible,⁶⁷ there is little prospect of welfare-enhancing distributive

⁶³ Hylland and Zeckhauser, *supra* note 61, at 282.

⁶⁴ *Id.* at 283.

⁶⁵ Shavell, *supra* note 19, at 417.

⁶⁶ Kaplow & Shavell, *Less Efficient* *supra* note 19, at 675.

⁶⁷ The potential infeasibility of optimally redistributive taxes has often been noted. See, e.g., Meurer, *supra* note 2, at 970 n.117; Sunstein, *supra* note 5, at 314-15; Daniel A. Farber and Brett H. McDonnell, *Why (and How) Fairness Matters at the IP/Antitrust Interface*, 87 *Minn. L. Rev.* 1817, 1826 (2003); Scott Shapiro & Edward F. McClenen, *Law-and-Economics from a Philosophical Perspective*, in 2 *The New Palgrave Dictionary of*

changes outside the realm of tax either. On this account, the very same congressional barriers to achieving the best distribution via tax will also impede the achievement of the best distribution through legal doctrine, because distributive changes will be offset.⁶⁸

Shavell makes the point more categorically in a book designed for beginning students.⁶⁹ There, he asks the question, “What if the wrong people—whoever you think they are—control the income tax system? Isn’t there, then, an argument for redistributing through law?” His answer: “Not really. Suppose, for instance, that you want the poor to have more wealth, so you make it easier for them to bring suit and collect large judgments. But if the people in control of taxes don’t want the poor to get more, presumably they can just raise taxes on the poor (or reduce credits that the poor enjoy) so as to counter the change you sought to effect.”⁷⁰ In a later book, however, he again acknowledges that the argument for tax superiority would not apply “[i]f the political process is imperfect not only in failing to achieve society’s redistributive goals, but also in failing to offset attempts to redistribute through the choice of legal rules.”⁷¹

Kaplow’s separate work on distribution-neutral public policies provides further insight into his understanding of how tax offsetting operates.⁷² In a

Economics and the Law 460, 463 (Peter Newman ed., 1998). Indeed, there is little reason to think that Congress consciously structures the tax system to maximize welfare.

⁶⁸ The passage also embeds an apparent normative suggestion that courts may be inferior institutionally to make distributive decisions. This is a separate point from one premised on invariance and indeed only becomes relevant to the extent there is variance. See Part III.B.3 *infra*.

⁶⁹ Steven Shavell, *Economic Analysis of Law* 108, Box 17 (2004).

⁷⁰ *Id.* Likewise, the teacher’s manual of a recent casebook coauthored by Shavell includes the following:

Suppose that someone says that those in control of the political system, and thus of the income tax system, do not have the socially correct view of how much wealth should be redistributed toward the poor. Would it then make sense for [someone] to recommend taking distributional considerations generally into account in policymaking, such as considering whether to place ceilings on drug prices?

Answer: Those in control of the political system will offset attempts to redistribute...and we will wind up hurting drug co. incentives and not helping poor.

Teacher’s Manual for the casebook, Jackson, Kaplow, Shavell, Viscusi, and Cope’s Analytical Methods for Lawyers 673-674 (or VI-59-60) (Foundation Press, 2d. ed., 2010) (ellipses in original).

⁷¹ Shavell, *supra* note 30, at 659-60.

⁷² See, e.g., Louis Kaplow, *The Optimal Supply of Public Goods and the Distortionary Cost of Taxation*, 49 *Nat’l Tax J.* 513 (1996) [hereinafter, Kaplow, *Public Goods*]; Louis Kaplow, *Optimal Control of Externalities in the Presence of Income Taxation*, 53 *Int’l Econ. Rev.* 487 (2012) [hereinafter, Kaplow, *Externalities*]. These pieces are not centered on the normative claim that legal rules should not redistribute. Indeed, the 2012 *Externalities* piece declares itself to be “a theoretical exercise,” not a basis for policy. See Kaplow, *Externalities*, *supra*, at 499, 503. Rather, these pieces show how policies that would appear to have distributive implications (and, relatedly, impacts on the magnitude of the labor-leisure distortion) can be made distribution-neutral through countervailing adjustments in the tax system, altering the way in which those policies should be evaluated in the first instance. The common thread is the claim that the tax system is well suited to make the necessary distributive adjustments to produce a desired level of redistribution, regardless of what happens in other. The 2000 joint K&S article thus characterized the 1996 *Public Goods* article as “a much more general version of the argument” from the joint 1994 paper. See Louis Kaplow, & Steven M. Shavell, “Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income,” 29 *Journal of Legal Studies* 821, 824 (2000).

1996 article that focuses on the funding of public goods, a qualified empirical conjecture in favor of distributive invariance can be seen in this takeaway:

To be sure, one would not expect tax adjustments to offset the benefits of new public projects completely and precisely. Nevertheless, if one had to guess, it seems plausible that roughly, on average, and over time, changes in the level of public goods will tend to be accompanied by tax adjustments that offset changes in the distributive incidence of the benefits produced by those goods.⁷³

More recently, in a paper addressing externality control, Kaplow queries the degree to which distribution-neutral policies could be implemented “as a practical and political matter,” observing that “[e]ven a legislature that desired to offset distributive effects would be unlikely to do so with precision” where a policy generates “intricate” distributive impacts.⁷⁴ In an earlier footnote, however, he repeats the “conjecture” that “such reforms will, on average, tend to leave the preexisting political equilibrium regarding the extent of redistribution unaltered.”⁷⁵ A similar mix of claims, conjectures, and qualifications appear in other work.⁷⁶

As this review reveals, some articulations of invariance assert that Congress will offset conscious efforts at distributive improvement undertaken by courts or other governmental entities, to the extent those efforts produce distributive results that deviate from congressional preferences. We might think of this as “aspirational invariance”—the claim that any effort to use legal rules to *improve* distribution (according to some metric) beyond the level indicated by the current political equilibrium will be countered by an adjustment to the tax-and-transfer system that will return distribution to its baseline condition. In the examples above, the claim

⁷³ Kaplow, Public Goods, supra note 72, at 521.

⁷⁴ Kaplow, Externalities, supra note __, at 499.

⁷⁵ Id. at 498, n.10.

⁷⁶ See, e.g., Louis Kaplow, Discounting Dollars, Discounting Lives: Intergenerational Distributive Justice and Efficiency, 74 U. Chi. L. Rev. 97 (2007) (observing, in the intergenerational context, that “if one had to predict a priori the most likely long-run distributive impact of a policy change, distribution neutrality would be the best guess” but stressing that this “is merely a conjecture of what may tend to be true roughly, on average, and in the long run, not a precise description of any particular political reality”); Kaplow & Shavell, Fairness versus Welfare supra note __, at 35 n.39 (rehearsing invariance arguments and concluding that “it seems unlikely that judges could succeed in implementing a regime that was significantly more or less redistributive than the one favored by the legislature”); Louis Kaplow, On the (Ir)Relevance of Distribution and Labor Supply Distortion to Government Policy, 18 J Econ Persp 159, 172-73 (Fall 2004) (observing that “[i]f one had to speculate about how redistribution would ultimately tend to be affected by government projects, it seems plausible to suppose, as a first approximation, that the long-run political equilibrium regarding redistribution will not be affected in an obvious, predictable manner by this or that government action,” making distributive neutrality a useful construct, even though “the political process is far more complicated than this”); see also Yew-Kwang Ng, Quasi-Pareto Social Improvements, 74 Am. Econ. Rev. 1033, 1040 (1984) (positing that “[e]specially in the long run, the forces that operate to prevent redistribution through taxation will also operate to prevent redistribution by other means” but noting that “actual political decisions are affected by a host of factors”).

would be that we should not aspire to improve distribution by selecting a new but inefficient rule regarding arbitration of contract disputes, tort damages for lost income, teacher tenure, military conscription, and so on, since any apparent improvement will be undone.

But there is another facet of invariance, which we call “corrective invariance,” that must also be true in order for tax superiority to hold. Corrective invariance refers to the claim that a legal rule or policy that *worsens* distribution (according to some metric) will not have any lasting unwanted effect on distributive results because it will be corrected through tax-and-transfer.⁷⁷ Suppose, to maximize wealth, we would need to adopt a new legal rule regarding arbitration, tort damages, teacher tenure, or military conscription, and this rule will adversely affect distribution. Corrective invariance counsels us to ignore this distributive deficit and adopt the rule because Congress can and will offset the loss through a change in tax-and-transfer. In sum, aspirational invariance holds that it is impossible for courts or policymakers to make the distribution better, while corrective invariance holds that it is impossible for them to make the distribution worse.⁷⁸

These are the claims we reject. Of course, K&S do not assert that invariance (of either form) is true in an absolute sense as an empirical matter. But however one might understand their position(s) on the matter, the implications for tax superiority have not been generally appreciated. With a few exceptions,⁷⁹ the received wisdom seems to accept tax superiority without confronting or even raising the issue of invariance.⁸⁰ Our goal here is to bring invariance to a position of prominence equal to that held by the zero transaction cost assumption. As we establish below, invariance is equally false, and in ways that are just as policy-relevant.

⁷⁷ The notion of corrective invariance encompasses not just instances in which courts or policymakers enact new rules or laws that affirmatively worsen distribution, but also *inaction* by governmental entities when economic or social conditions produce distributive deficits that they would be in a position to address. Tax superiority would assert that these deficits can always be addressed more cheaply through tax and transfer—assuming the political equilibrium allows them to be addressed at all. This last point connects to the possibility that changing distributions alter the political equilibrium and change what it is possible to achieve distributively. See *infra* note 171 and accompanying text.

⁷⁸ We are not aware of anyone previously drawing a clear distinction between these two facets of invariance. A focus on the aspirational flavor of invariance understates the impact of the distributive message associated with the principle of tax superiority. It is not just a matter of recommending that courts and policymakers leave distributive *improvements* to the tax system (what most of us would think of as “redistribution”); tax superiority actually prescribes standing by as legal rules and policies make distributions *worse* in the name of efficiency, on the (empirically unsupported) faith in a countervailing correction.

⁷⁹ To be sure, a few observations along these lines have appeared in existing law and economics scholarship. The most extended discussion of which we are aware is found in Markovits, *supra* note 5. Adler and Posner also appear to expressly recognize the possibility of variance when they observe (in a discussion of whether and how cost-benefit analysis should account for wealth distortions) that “it might be the case that welfare-improving transfers through the tax and welfare system are not made because Congress has other things on its mind, and not because the optimal distribution of wealth has been achieved.” *Id.* at 144-45.

⁸⁰ Our research suggests that references to K&S’s views favoring tax-and-transfer almost never mention the point. The political infeasibility of optimally redistributive taxes is a not uncommon critique, but scholars do not often address K&S’s invariance response to that critique.

II. THE INVARIANCE HYPOTHESIS IS FALSE

So far, we have established that the claim of tax superiority depends on an assumption of distributive invariance that in turn embeds the assumption that political action costs for tax adjustments are equal to or less than the political action costs of any alternative method of distributing the same quantum of income. Having pointed out the centrality of invariance, we now go further to explain why the invariance hypothesis is false. Even the bare assumption that action is costlier than inaction produces enough variance to make implausible the idea that distributive results would remain unchanged no matter how we set up legal rules and institutions.⁸¹ But there are many other reasons to question invariance, including the fact that distributive efforts are carried out at multiple levels of a federal system, that psychological phenomena like framing and salience influence political acceptability, and that fairness preferences play a role in producing political results.

For all these reasons, we would expect to see variation in political action costs, which we define broadly to capture all of the impediments parties encounter in achieving desired distributive outcomes through legal coercion, whether through legislation, litigation, or regulation. While a full explication of the types and determinants of political action costs lies beyond the scope of the present project, it is helpful to briefly classify them in a chronological manner similar to the taxonomy that Carl Dahlman used (and Coase later embraced) for transaction costs.⁸² In Dahlman's schema, there are "search and information costs," "bargaining and decision costs," and "policing and enforcement costs." Parallels can be found in the context of political action.

Proponents of a distributive change must initially identify opportunities to carry out shifts in the desired direction, whether those shifts involve new changes or offsets of undesired changes. After this *search or opportunity-spotting* phase is complete, costs must be incurred to bring the proposed distributive change to the attention of a relevant decisionmaking body and convince the decisionmaker to undertake it. These costs include coordinating collective action, framing the proposal, lobbying or litigating for it, and so on. This might be understood as a *decision influencing* stage designed to bring the party in power to the point of deciding to carry out the

⁸¹ See, e.g., Barak Orbach, A State of Inaction: Regulatory Preferences, Rent, and Income Inequality, forthcoming Theoretical Inquiries in Law (2014).

⁸² See R.H. Coase, The Firm, The Market, and the Law 6 (1988) (quoting Carl J. Dahlman, *The Problem of Externality*, 22 J.L. & ECON. 141, 148 (1979) (internal quotation marks omitted)); see also Robert C. Ellickson, The Case for Coase and Against "Coaseanism," 99 Yale L.J. 611, 614-16 (1989) (noting temporal organization of this taxonomy and proposing a functional alternative).

distributive change. Finally, there is an *execution, enforcement, and maintenance* phase that consists of actually undertaking the costs to effect the distributive shift and ensuring that the efforts are not sidelined or undone by others.⁸³

With these three broad phases in mind, we turn to some of the mechanisms that could cause these costs to be higher or lower depending on the distributive avenue elected.

A. *Offsets and Inertia*

The invariance hypothesis is premised on the ability of Congress to offset distributive changes occurring elsewhere in the system (whether to correct maldistributions unintentionally generated by other actors, or to beat back aspirational efforts to change distribution in ways that clash with congressional preferences). Taken literally, the hypothesis assumes that it is no more costly for Congress to restore its preferred distributive pattern after a disruption to it than it is to maintain it in the absence of that disruption. A focus on political action costs suggests several reasons why restoration might be more costly than mere continuation of the preexisting distributive pattern. First, there are search and information costs in noticing that there is a distributive change to counteract and assessing what it would take to counteract it. Second, there may be costs that fall into the decision-influencing stage, to the extent that the very existence of the target distributive action has altered the political equilibrium—whether by creating entrenched, concentrated interests who are now invested in not losing what they have gained, demonstrating the wisdom of the distributive change in question, or otherwise.⁸⁴ Third, there are costs in simply implementing and executing the offsetting action.

1. Imprecise and Incomplete Offsetting

Kaplow and Shavell separately acknowledge that offsetting is likely to be less than absolute. Shavell says “no one would really expect the income tax structure to be adjusted in response to each and every change in legal rules.”⁸⁵ Kaplow states: “one would not expect tax adjustments to offset the

⁸³ Thus, the political action costs of realizing a desired distributive pattern depend in part on how costly it is for a body with contrary preferences to counteract the change. If countermands are costless, the political action costs of achieving change through the selected body are infinite. This category of executing, enforcing, and maintaining also overlaps to some degree with administrative costs that have been discussed in prior analyses. See *supra* note 30. Although a welfarist analysis would count *all* costs, our interest in this paper is in drawing attention to the previously neglected costs of overcoming impediments that are political rather than administrative in nature.

⁸⁴ See, e.g., Markovits, *supra* note 5 at 599-601; [see also temporary law for demonstration effects]

⁸⁵ Shavell, *supra* note 19, at 417.

benefits of new public projects completely and precisely.”⁸⁶ Thus, for example, if Congress funds the creation of dams for flood control or places military bases in economically depressed areas and thereby redistributes to the poor, we would not expect Congress to “completely and precisely” offset that form of non-tax redistribution with an adjustment to taxes that recoups that benefit from the poor.

Both imprecision and incompleteness in offsetting deserve attention. Offsetting is *imprecise* to the extent that it does not restore all individuals to their pre-change distributive status. K&S contemplate that Congress will use a broad-based tax instrument keyed to income to offset the distributive effects of a legal rule that affects only a subset of the population in ways that correlate only roughly with income. As a result, offsetting will necessarily be haphazard and imprecise. Distributive invariance, then, can at most mean something like preserving a society-wide Gini coefficient⁸⁷ or ensuring that members of particular income deciles or quartiles fare equally well or poorly, on average. Depending on the particular social welfare function in use, however, this may or may not count as an equivalent distributive result.

Incomplete offsetting means that some non-tax distributive changes will stick. This means it is possible to increase, to some unspecified degree, the amount of redistribution by adding non-tax mechanisms to the tax mechanism. It also means that unwanted distributive changes that might accompany the adoption of efficient legal rules will go uncorrected to at least some extent. If we should expect imprecise and incomplete offsetting of the distributive effects of the legislature’s own handiwork, we would expect offsetting to be even less precise and complete when another governmental body (e.g., the courts or administrative agencies, or any of the fifty states or the tens of thousands of local jurisdictions) does the redistribution. Congress would presumably be less aware of, and feel less electoral accountability for the redistribution carried out by other governmental bodies.

2. Legislative Inertia

The qualifications above dovetail with the well discussed ideas of legislative inertia and entrenchment. A standard observation is that it is easier to maintain the status quo than to change it. Congressional bicameralism and the committee system, not to mention the Senatorial filibuster, create multiple legislative veto points, and parliamentary

⁸⁶ Kaplow, Public Goods, *supra* note 72, at 521.

⁸⁷ The Gini coefficient measures the amount of income inequality in a society by plotting a curve that depicts the share of income earned by each income percentile (the Lorenz Curve) and then generating a ratio that reflects the “sag” of the curve compared with a perfectly proportionate income dispersion. [cite].

procedure allows party leaders to set the agenda, all of which makes it possible to defeat legislation that is supported by the median voter. Because there are political costs to enacting legislative changes to the status quo, existing law can diverge to some degree from legislative preferences (however that is understood, such as the preferences of the median legislator).

Consider statutory interpretation. Courts have some latitude in interpreting statutes because the legislature will not overturn every decision that diverges even slightly from its preferred outcome. The literature on strategic judging posits that judges seek to indulge their policy preferences to the maximum degree possible without overstepping the bounds of legislative inertia.⁸⁸ The complexities of political organizing to overcome collective action problems in the formation of winning coalitions mean that tactical victories (such as those achieved in court) can lead to strategic victories.⁸⁹ Distributive invariance would require a political process that is far more simple and deterministic than the one we appear to have.

The inertia we see in legislative action logically extends to the issue of distribution. However, there are some differences in the tax-and-transfer realm. Perhaps most significantly, getting taxes on the agenda and implementing changes to them is trivial; there is major tax reform every few years, and there are annual technical changes such as adjusting the alternative minimum tax (AMT).⁹⁰ Search and information costs—here, knowing what distributive changes have occurred that might require offsetting—might also be streamlined through aggregate data about distribution.⁹¹ Yet the fact that Congress routinely makes technical changes to the tax code and has access to useful data compilations does not mean that it revisits fundamental distributive policy regularly, much less that it

⁸⁸ See, e.g., Pablo T. Spiller and Emerson H. Tiller, *Invitations to Override: Congressional Reversals of Supreme Court Decisions*, 16 *Int'l Rev. L. & Econ.* 503, 503 (1996) (noting that “recent positive political analyses of Supreme Court decision making . . . emphasized that the Court makes its [statutory] decisions in a way that insulates them from legislative override. The Court, for example, may make a decision that takes advantage of the legislative decision-making process (such as bicameralism . . . or the committee system), which can insure against a legislative override.”). See also Alicia Uribe, James F. Spriggs II, and Thomas G. Hansford, *The Influence of Congressional Preferences of Legislative Overrides of Supreme Court Decisions*, 48 *Law & Soc’y Rev.* 921 (2014); John A. Ferejohn and Barry R. Weingast, *A Positive Theory of Statutory Interpretation*, 12 *Int'l Rev. L. & Econ.* 263 (1992).

⁸⁹ These complexities help to solve a puzzle that our rejection of distributive invariance presents: why the forces contending over distribution would not deploy their resources in such a manner as to equalize resistance to unwanted changes in each arena, rather than effectively overinvesting in resistance in some arenas relative to others. An answer may be found in the varying nature of collective action necessary to pursue or resist certain distributive goals in different contexts. If, for example, stopping redistribution through legal rules allows more free-riding by parties affected by the new rule than stopping redistribution through tax-and-transfer, more investments may be made in the latter than the former. Cf. Dhammika Dharmapala *The Congressional Budget Process, Aggregate Spending, and Statutory Budget Rules*, *J. Pub. Econ.* 2006.

⁹⁰ See Weisbach, *supra* note 52, at 35 (citing estimates of 15,000 tax code changes since 1986).

⁹¹ See *id.* at 36. But see K&S 1994 at 675 (observing that it may remain important to trace distributive effects of legal rules “because those formulating income tax policy need to be aware of any significant distributive effects of legal rules that would not otherwise be apparent, such as from studying information on the actual distribution of income.”).

persistently returns distribution to some single set point. We suspect that distribution is subject to political cycling and that some method of entrenchment of any given result is necessary to terminate cycling through all distributive possibilities.⁹² Once in place, interest groups will exploit legislative veto points to defend their distributional benefits.⁹³ As a result, we would not expect to see redistributive legal rules consistently counteracted, either *a la carte* or *en masse*.⁹⁴

Here we note one interesting source of distributive entrenchment that we think features in a lot of tax and non-tax distribution: coalition-building through leakage. As we noted above, another standard (but merely contingent) reason to oppose redistribution through non-tax law is that it will be poorly targeted, causing a form of redistributive leakage. If we assume that redistribution is appropriately targeted at those who have lower incomes, then a tax rule that is based on a precise measurement of incomes will select suitable recipients more accurately than will a legal rule that depends on a proxy for income or wealth.⁹⁵ Such a legal rule will sometimes redistribute away from, rather than toward, the intended targets.

Yet this apparent defect of leakage could be a feature rather than a bug for those seeking redistribution, depending on how it changes the costs of political action. Those who benefit from leakage are induced to prefer the redistributive scheme that produces it. This is why universalist welfare programs enjoy greater political stability than targeted programs and may accomplish more redistribution to the poor despite not being limited to that

⁹² See John C. Roberts and Erwin Chemerinsky, *Entrenchment of Ordinary Legislation: A Reply to Professors Posner and Vermeule*, 91 Cal. L. Rev. 1773, 1814-16 (2003) (identifying reasons that the structure and process of legislation works to entrench existing legislation); Abner J. Mikva & Eric Lane, *Legislative Process* 677-85 (2d ed. 2002) (explaining how the process of legislation works to make change difficult).

⁹³ See citations from *supra* note _____. See also Francis Fukuyama, *Oh For a Democratic Dictatorship and Not a Vetocracy*, *Fin. Times* (Nov. 22, 2011, 5:27 PM), <http://www.ft.com/cms/s/0/d82776c6-14fd-11e1-a2a6-00144feabdc0.html#axzz1zg7rjoNs> (describing the contemporary American form of government as a veto-craze). Put differently, the asymmetry between the political action costs of preserving the status quo and changing it produce path dependence in distributive legislation. Compare Bradley A. Hansen and Mary Eschelbach Hansen, *The role of path dependence in the development of US bankruptcy law, 1880–1938*, 3 J. Inst'l. Econ. 203 (2007); Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 Del J Corp L 147 (2001). See generally Scott E. Page, *Path Dependence*, 1 Q J Polit Sci 87 (2006) (reviewing the use of path dependence in political science theory).

⁹⁴ See, e.g., Markovits at 600, for some reasons why such countering might not occur, including “the fact that legislators may have to incur special costs to pass legislation that in effect reverses judicial decisions, changes the jurisdiction of the courts, controls who is appointed to the courts, or packs the courts.” Markovits goes on to observe that the judicial decision may itself “deter legislative efforts to offset the redistributions the court effectuated by changing the information, distributional value, or awareness of the concrete implications of given distributional values of the members of the legislature in question and/or their constituents,” or otherwise alerting the legislature to how much a particular distributive change is valued. *Id.* at 600-01.

⁹⁵ Income is not, of course, the only possible metric for redistribution. Income is often viewed as a mere proxy for the real variable of interest, ability. Moreover, there are many ways that people can become less well off that might be more appropriately measured through metrics other than income. For example, they might be less healthy or less happy. Without endorsing income as the best possible target for all redistributive efforts, we will assume for purposes of the present discussion that it is the relevant variable, and that legal rules are likely to be less good than tax rules at identifying recipients. See Logue and Avraham. If some other metric of well-being measured who should be the target of redistributive efforts, legal rules might actually do a better job of targeting in some cases. [Sanchirico, Logue & Avraham].

purpose.⁹⁶ Similarly, a judicial decision aimed at benefiting the mostly poor neighbors of a polluting factory might be less prone to being undone legislatively if it also incidentally benefitted a few wealthy neighbors with political clout.⁹⁷ If the political assistance of the wealthy neighbors is pivotal – the legislature overrules the court if and only if the sole beneficiaries are the poor – then leakage produces more redistribution than no leakage.⁹⁸ Whatever one may think of this normatively, the possibility that it can happen (without being legislatively undone) disproves the invariance hypothesis.

3. Offsetting and Inertia in a Federal System

There are additional reasons to doubt that distributive changes will be counterbalanced to produce an invariant distributive outcome. First is the fact that there are fifty states and tens of thousands of local governments that are involved in making distributive choices,⁹⁹ both through taxation choices and the development of legal rules and policies that affect distribution.¹⁰⁰ The conventional wisdom is that all redistribution should occur at centralized levels to avoid the problem of a tax base with feet.¹⁰¹ If people can simply move to avoid being on the losing end of redistribution, local redistributive efforts will accomplish nothing more than introducing costly distortions in locational decisions. Nonetheless, states and localities often undertake efforts that have redistributive aims,¹⁰² and at least some of these efforts are likely to redistribute in the contemplated direction to some extent. How do these real-world efforts fit into the invariance hypothesis?

⁹⁶ See, e.g., Gillian Lester, Can Joe the Plumber Support Redistribution? Law, Social Preferences, and Sustainable Policy Design, 64 Tax L. Rev. 313 (2011)

⁹⁷ The example in the text assumes that a very precise legislative countermand would be sought—one that would turn all of the previous winners into losers and vice versa. This is where leakage would have political traction. If the offsetting were cruder so that it only lowered the position of low-income people in general, and did not reduce the position of those well-off people who fortuitously happened to win out through “leaky” legal rules, then the political advantage indicated in the text would not hold. However, in that case invariance would be independently undermined by the lack of precision in the countermand.

⁹⁸ Of course, the factory owner might respond in other ways in an effort to undo the distributive change. Perhaps the factory owner seeks an offset through a general tax change – e.g., a decrease in corporate tax rates – but that general change would have enormous political action costs, with most of the benefits going elsewhere. The factory owner might seek a unique tax benefit applicable only to it. Yet if the corporate owner has the political clout to acquire special tax treatment (or other benefits, such as factory-friendly infrastructure), we would need to know why this clout had not already been deployed.

⁹⁹ [Add updated census data here]. As of 2008, 39,044 general-purpose local governments (which includes counties, municipalities, and towns or townships). While local governments exhibit heterogeneity in terms of their powers to tax and to enact overtly redistributive policies, virtually all local governments hold the power to make choices that will have distributive implications.

¹⁰⁰ Brian Galle, Is Local Consumer Protection Law a Better Redistributive Mechanism than the Tax System?, 65 N.Y.U. Ann. Surv. Am. L. 525, 530-40 (2010).

¹⁰¹ See, e.g., Clayton P. Gillette, Local Redistribution, Living Wage Ordinances, and Judicial Intervention, 101 Nw. U. L. Rev. 1057, 1058 (2007) (citing “conventional wisdom that localities should play little role in fulfilling the redistributive functions of government”).

¹⁰² See *id.*

Suppose that the Texas Supreme Court adopts a new approach to eminent domain compensation under the state Constitution that effectively increases the compensation provided to low-income displaced households.¹⁰³ Texas does not have an income tax and therefore cannot make adjustments to it to counteract this change. Nor does it seem plausible that Congress would respond to this legal change in Texas by altering the structure of the federal income tax. It could alter the progressivity of the income tax generally, or adjust the EITC program, in order to produce a change that would bring the average distributive results back to a baseline, but only by affecting many people outside Texas, and many within Texas who did not suffer condemnations.¹⁰⁴ A more targeted response would be possible, though it seems even less plausible. For example, Congress could treat amounts of compensation received through the Texas program as offsets against any amounts the household would receive through the EITC.

An empirical question is whether we actually observe such efforts to directly counteract distributive changes made at a lower level of government. If we do not, or do not always, then does it disprove the invariance hypothesis?¹⁰⁵ Invariance proponents might argue that state and local distributive changes are not commonly undone because they contribute to the maximization of (what has just then become) society's current social welfare function. This is a subspecies of a tautological theory we will have more to say about below.¹⁰⁶ It suffices for now to observe that this argument would require us to make the highly unrealistic assumption that Congress is constantly evaluating the distributive incidence of all the policies (not just the tax policies) of tens of thousands of subnational jurisdictions in order to determine which tax changes to implement--and refrain from implementing--federally.¹⁰⁷

¹⁰³ Although this example involves a state, it could just as easily be an example involving a locality. For example, the City of Chicago might enact a housing policy that operates to the benefit of lower-income residents.

¹⁰⁴ Note that such an offset would only produce results that count as distributively equivalent under a social welfare function that is indifferent to whether people in, say, the entire bottom decile are benefited a little, or whether instead a small subset of geographically clustered people falling in that decile are benefited a lot. [cross reference earlier precision discussion].

¹⁰⁵ Importantly, our focus here is on targeted responses that would directly counter specific redistributive efforts. These kinds of countermands could not be informed by aggregate data in the manner suggested by Weisbach, *supra* note 52, at ___. Broader countermands directed at the income distribution generally, nationwide, are possible but would not likely produce meaningful distributive equivalence, as noted above. See note 104, *supra*.

¹⁰⁶ See *infra* Part III.A.1.

¹⁰⁷ An alternative claim might be that the social welfare function is set independently by each state and locality, so that whatever we actually observe at the state or local level represents the invariant local distributive result for that particular place at that particular time. This is a problematic claim for economists to make, however, both because it cuts against the usual preference for centralized redistribution and because states and localities do not always even possess traditional tax and transfer tools. But see Brian Galle [cite] (positing that local redistributive efforts undertaken through non-tax means are less likely to suffer from the distortionary effects that local taxation is generally thought to occasion).

4. A Note About Magnitude

Perhaps readers accept that the invariance hypothesis is technically false, but conjecture that the magnitude of variance is sufficiently small that the doctrine of tax superiority survives intact. Have K&S gotten things right to a first approximation, so that we are quibbling over the distributive equivalent of rounding errors? We do not think so. The discussion above provides ample support for the idea that distribution must diverge from Congress's ideal point by some nontrivial amount before any corrective action will be taken. Changes short of this triggering amount fall within what we might call a Margin of Inaction (MOI). The sections below discuss some factors that can make corrective or countervailing congressional action slower to come, causing the MOI to grow. It is likely, therefore, that the MOI is large, at least in some contexts.

Even a fixed and small MOI is devastating to the categorical claim of tax superiority, however. This is clear when we consider again the stance of distributive agnosticism taken by K&S and other legal economists. As long as legal rules can produce some durable distributive variance, that variance will be enough on some imaginable social welfare function to make a difference to welfare. This is enough to make the choice of distributive mechanism indeterminate.

Moreover, tax superiority has traction as a normative prescription only as contrasted with some other actually available means of redistribution. Thus, the crucial variable is not the absolute size of the MOI, but its size *relative to* the power courts and other governmental actors have to advance welfare through their distributive choices. Suppose, for example, that courts or executives adopt inefficient rules only when: (1) the inefficiency is small; (2) they have good evidence that the rule will actually affect distribution in a welfare-enhancing direction (after accounting for haphazardness and contracting-around);¹⁰⁸ and (3) doing so otherwise fits within the zone of discretion that they have been afforded within their institutional roles. If these worthwhile distributive opportunities are sufficiently scarce and limited in scope, the entire set of them may fall within even a relatively small MOI—meaning that if courts take *every* worthwhile opportunity to redistribute, they cannot cumulatively change distribution enough to trigger a congressional reaction.¹⁰⁹

We need not assume that the MOI is fixed, of course. We might expect

¹⁰⁸ Although usually presented as complements to the K&S distortion argument, the contracting-around and haphazardness objections narrow the set of available distributive opportunities that might be exploited through legal rules. They therefore make it more likely that the remaining opportunities will fall within the operative MOI.

¹⁰⁹ It is possible, of course, that redistributive opportunities exceed the MOI. While this complicates the advice that welfarists might receive, as we discuss below, it does not alter the basic point that a positive MOI disproves invariance and with it the categorical claim of tax superiority. See *infra* notes 172-176 and accompanying text.

it to vary depending on a variety of factors that influence the salience and political valence of different distributive shifts. For example, there might be a different trigger point for corrective offsetting than for aspirational offsetting. Thus, even if we posit that Congress will be relatively quick to counteract efforts to overtly improve distribution through non-tax means, it does not follow that it will be equally quick to correct the unintended distributive consequences of newly adopted efficient legal rules, much less that it will nimbly keep up with societal changes or rent-seeking opportunities that worsen distribution relative to its ideal point.¹¹⁰ The possibility that Congress will lag in its corrective role widens the space within which a court or other actor could effect distributive improvements.

The following sections discuss a number of other reasons that offsetting behavior might vary depending on the source and characteristics of the distributive change. Although the questions are empirical ones, there is no reason to assume that the MOI is so small across all contexts as to make invariance a serviceable foundation for tax superiority.

B. Framing, Salience, and Cognitive Biases

In recent years, large literatures have investigated how human cognitive features may systematically alter the perception of, and hence the response to, a variety of policies and legal rules. One line of analysis, which we will not revisit here, is whether the labor/leisure distortion thought to be common to all redistributive efforts is actually attenuated in some contexts by cognitive features like optimism.¹¹¹ We are interested instead in how the packaging and framing of redistribution influences the political action costs of enacting and maintaining it.

For example, one of the most consistent and important findings of prospect theory is that people weight losses more heavily than gains.¹¹² Thus, framing a particular interaction as one that produces a loss would be expected to generate more disutility and more political resistance than framing it as a mere failure to achieve a gain.¹¹³ Legal rules and policies

¹¹⁰ Rent-seeking by the rich is arguably a major cause of rising inequality. See Orbach, *supra* note 81; Gerrit De Geest, *Removing Rents: Why the Legal System is Superior to the Income Tax at Reducing Income Inequality* (2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2337720; Josh Bivens & Lawrence Michel, *The Pay of Corporate Executives and Financial Professionals as Evidence of Rents in Top 1 Percent Incomes*, 27 *J. Econ Persp.* 57 (2013); Joseph E. Stiglitz, *The Price of Inequality* (2011).

¹¹¹ See Jolls, *supra* note 26. For example, a legal rule that collects more from wealthy tortfeasors would apply only to the subset of wealthy people involved in accidents—the odds of which people are likely to underestimate. A counterargument raised by Logue and Avraham is that insurance markets could turn the uncertain loss into a more certain one. Though we find Jolls's arguments somewhat persuasive (even differential insurance rates are likely to be noticed less than overt redistribution), nothing in this paper depends on accepting them. Our arguments apply whether the assumption that the labor/leisure distortion is invariant across methods of redistribution is true or false.

¹¹² Kahneman & Tversky

¹¹³ [add cites]

that have distributive implications might be susceptible of either frame, depending on how they are presented and perceived. Although design details can accentuate or downplay this effect, tax-and-transfer mechanisms tend to highlight the taking away of something from a person who had previously been endowed with it, and hence are likely to set off cognitive alarms that might be more muted where institutional arrangements assign resources in a different manner in the first instance. Consider this example:

Human Organs. Imagine that at the moment a new transplant technology becomes medically possible, the state enacts a law that does two things: (1) it permits medical institutions, under some circumstances, to buy certain human organs; and (2) it effectively prohibits individuals from purchasing organs, forcing allocation by some institutional notion of medical need.

This rule has a strong distributive effect favoring the poor (the poor would have the option of selling, but would not have to outbid the rich to obtain organs). Yet because it is enacted at the moment that transplantation surgery first becomes possible, the fact that the wealthy cannot outbid the poor for their organs is unlikely to be experienced as a loss. The rule prevents the value of wealth from rising by forbidding one possible new use,¹¹⁴ but nothing is “taken” from the wealthy, not money nor a previously exercised privilege. The alternative policy, based on tax superiority, might instead tax the rich and use the revenue to give the poor more money, which they could use for buying organs if they so chose. In this case, however, the added tax would take away money the rich had previously earned (even though they would receive implicit compensation by now being able to use the rest of their wealth to bid for organs in an open market, albeit against poor people who are now somewhat less poor). Here, the non-tax mechanism plausibly has lower political action costs than the tax mechanism.

Although the timing of the distributive rule to coincide with the emergence of a new technology helps to do the framing work in *Human Organs*, other factors such as bundling can also contribute to framing. Consider:

Landfill. An agency must choose a neighborhood in which to site a landfill. Such a locally undesirable land use will cause property values in the surrounding area to fall.

¹¹⁴ [cites regarding sphere of money and how it influences decisions to earn and accumulate wealth; Sandel, Walzer].

Because this drop in property values will likely result in lower-income people living near the landfill (whether they were there initially or not) there is an efficiency case for placing the landfill in the less wealthy neighborhood.¹¹⁵ Suppose this causes an unwanted distributive result—making people who are already less well-off even worse off. This distributive problem could be addressed in one of two ways: (1) by granting the low-income neighborhood in which the siting will occur a countervailing set of valuable rights over the landfill’s operation, priority for jobs at the landfill, priority for local redevelopment efforts, and so on; or (2) a tax-and-transfer system could redistribute to low-income people to make up for the fact that efficient land use decisions will often disadvantage them distributively.

Under the first approach, the role of “landfill host” would comprise a unified package of benefits and detriments—and the benefits may be of sufficient magnitude to cause competition over which neighborhood will get to host the landfill. This bundling of benefits with detriments involves some inefficiencies, including the possibility that the benefits will be less valuable to recipients than the cash equivalent would be. Low-income households may also be imperfectly targeted by the assistance. But the bundling avoids the need for a second, and overtly redistributive, step. The second approach allows the efficient, uncompensated siting to go forward, thus generating a new baseline in which low-income people have suffered this disadvantage (along with many others wrought by efficient legal rules). There is no way to address this distributive result through tax without causing some people to suffer a loss from the new baseline—something that will be coded as a stand-alone loss, and heavily resisted as such.

Even within the domain of taxes, political action costs can vary. A growing literature on tax salience examines how both political and market responses can vary depending on the degree of attention a particular tax attracts.¹¹⁶ Taxes that can be made lower-salience, as through paycheck withholding or bundling with mortgage payments, may carry lower political action costs.¹¹⁷ Bundling redistribution with various forms of social

¹¹⁵ See Vicki Been, *What’s Fairness Got To Do With It?*; Cf. Adler & Posner at 143-44 (providing an example involving the converse case of siting a park that would increase property values, potentially spurring the rich to move in and the poor to move out).

¹¹⁶ See e.g. Raj Chetty, Adam Looney & Kory Kroft, *Salience and Taxation: Theory and Evidence*, 99 *Am. Econ. Rev.* 1145 (2009); David Gamage and Darien Shanske, *Three Essays on Tax Salience: Market Salience and Political Salience*, 65 *Tax L. Rev.* 19 (2011); Deborah H. Schenk, *Exploiting the Salience Bias in Designing Taxes*, 28 *Yale J. on Reg.* 253 (2011); Andrew T. Hayashi, *The Legal Salience of Taxation* (2012), at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2151867; Jacob Goldin, *Optimal Tax Salience* (2014), at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2009108.

¹¹⁷ E.g. Hayashi on property taxes; see also [news article on no one noticing increase in payroll tax].

insurance, so that the loss is packaged with a potential future benefit, can also make the redistributive element less evident and hence less heavily resisted. All of these manipulations raise normative questions, as we discuss below.¹¹⁸ Regardless of where one comes out on the normative issues, however, the very fact that there is often heated debate over how painful and apparent redistribution should be suggests that political results can vary with a program's framing. If this were not the case, then nothing would turn on decisions that implicate tax salience.

Other work finds that people will assess the fairness of a tax differently based on details like whether the tax rates are expressed in dollars or percentages and whether the tax system is bifurcated into separate pieces or unified.¹¹⁹ It is well recognized that penalties and subsidies are often viewed differently, despite their identical economic impact. A standard example illustrating this point is the different reactions to a child subsidy provided to households versus a childlessness tax imposed on households. Nearly all respondents think that a child subsidy should be larger for low-income families. But when the frame is flipped and the measure is recast as a tax on childlessness, few respondents think that low-income households should be taxed more heavily for *not* bearing children.¹²⁰ More broadly, tax deductions are viewed quite differently from direct government grants, despite their identical economic substance.¹²¹

The cognitive literature thus establishes that people respond differently to measures that have identical incidence depending on how the measures are presented. This variance in responses in experimental settings tracks the variance in political responses that presumably underlies all manner of rhetorical and policy choices.¹²² The cognitive variance supported by existing work strongly undermines the claim of distributive invariance. If economically equivalent measures can morph from acceptable to unacceptable or vice versa due to substantively irrelevant features, we should not expect that the political action costs associated with enacting different measures will be invariant. And if political action costs are not invariant across different methods and formulations of redistribution, then it follows that the amount of redistribution that can be accomplished through

¹¹⁸ [cross reference]

¹¹⁹ McCaffery & Baron, *The Political Psychology of Redistribution*, 52 *UCLA L Rev* 1745 (2005).

¹²⁰ The example is from Schelling, and the reversal is known as the Schelling effect. Schelling, T. C. (1981). *Economic reasoning and the ethics of policy*. *Public Interest*, 63, 37–61. More recent experiments by McCaffery & Baron showing same effect.

¹²¹ For example, Justin Wolfers asked how many people would support the home mortgage deduction if it were framed as an “explicit government handout” that benefits those in the top 1% about 30 times more than average income households. <http://freakonomics.com/2012/04/17/tax-deductions-or-tax-expenditures/>

¹²² For example, the strategic characterization of the estate tax as a “death tax” by its opponents has been credited with catalyzing its widespread political unpopularity (which seemed objectively puzzling, given its extraordinarily narrow targeting). See, e.g., Steven M. Sheffrin, *Tax Fairness and Folk Justice* 144 (2013) (“The conservative leadership sculpted the estate tax’s image; they labeled it the ‘death tax’ to influence the public to confront it as an ominous, universal problem.”).

different methods and formulations would also vary.

One objection might be that for any optimally framed and presented non-tax legal rule or public policy, there is a superior optimally framed and presented tax-and-transfer mechanism. It is not clear this is the case, however. An especially interesting finding in the experimental literature to date is the extra aversion that people attach to charges that are labeled as taxes.¹²³ Moreover, when a salary is stated in pre-tax terms, the difference between this amount and what the employee gets to keep inevitably appears as a loss. To the extent that loss aversion or an endowment effect makes losing things that one already has more painful than not receiving things that one never had, tax-and-transfer may be categorically more cognitively painful than alternative approaches that channel entitlements to the less well off in the first instance or that structure allocation systems to produce less salient cross-subsidies.¹²⁴ Yet even establishing that framing and other cognitive manipulations should be taken into account by welfarists *within* the broad category of tax-and-transfer would move the conversation forward from its present position by establishing that political action costs are positive and that they can vary depending on program design.

C. Fairness Preferences

K&S have famously argued that fairness (which they take to include any non-welfare value, such as morality, justice, or dignity) has no value apart from its effect on welfare.¹²⁵ We will not quarrel with this proposition, but we believe that taking seriously the proviso “apart from its effect on welfare” seriously undermines the point and creates another reason to reject distributive invariance. Of particular relevance to the present discussion is the capacity for a policy or rule’s alignment with fairness intuitions to reduce the political action costs associated with its adoption, or to raise the political action costs that would be associated with counteracting it through some other political means.

1. Fairness Preferences as Inputs to Political Action Costs

Individuals typically possess a variety of beliefs and preferences about what is “fair” or “unfair” in particular contexts. They frequently think of justice in a local, micro-setting, such as fairness among neighbors or co-

¹²³ See, e.g., Edward J. McCaffery & Jonathan Baron, Thinking About Tax, 12 Psych. Pub. Pol’y & L. 106, 117-19 (2006) (describing these findings). See also Edward J. McCaffery & Jonathan Baron, Framing and taxation: Evaluation of tax policies involving household composition, 25 J. Econ. Psych. 679-705 (2004).

¹²⁴ This point also connects to our discussion in the next section, which examines how perceptions of fairness interact with political palatability.

¹²⁵ The thrust of their view is encapsulated in the title they chose for their book exploring this point, Fairness versus Welfare. See Kaplow & Shavell, *supra* note ____.

workers, rather than only what is fair in a global sense.¹²⁶ Put in terms of our critique of the invariance hypothesis, more redistribution might be done (or the same amount might be done more cheaply) through methods perceived as fair than through methods perceived as unfair.¹²⁷ If the degree to which a particular redistributive effort resonates with fairness preferences bears on how cheaply, effectively, and durably it can be carried out, then the study of fairness becomes an important input into welfare maximization efforts that depend on achieving particular distributive outcomes.

This point is subtly different from the one K&S and other law and economics scholars make when they recognize that people may have preferences for fairness, and that satisfying those preferences, like satisfying any other preference, can increase welfare directly (that is, people are made better off by directly experiencing and observing fairness). This is certainly true, and on its own may be extremely important, given that some preferences for fairness can only be satisfied within particular legal contexts.¹²⁸

We would add to this point a second way in which fairness preferences operate: by reducing political action costs associated with redistributive measures. Instead of just positing that citizens “consume” fairness by observing or experiencing it, this argument contemplates an instrumental role for fairness in pursuing welfare. Using fairness criteria to select and formulate redistributive legal rules could ease the political path for those rules. Moving a certain number of dollars from one income class to another might generate less political resistance when done by a substantive legal rule that is popularly perceived as fair than by a tax-and-transfer system that is widely viewed as unfair.¹²⁹ Compare, for example, living wage legislation or housing supports that enable workers to live in the communities in which they are employed with a tax-and-transfer program that draws from and benefits the same income classes.¹³⁰ The public might perceive in the latter

¹²⁶ See Jon Elster, *Local Justice: How Institutions Allocate Scarce Goods and Necessary Burdens* (1993); H. Peyton Young, *Equity in Theory and Practice* (1995); Daniel Kahneman, Jack L. Knetsch, and Richard Thaler, *Fairness as a Constraint on Profit Seeking: Entitlements in the Market*, 76 *Amer. Econ. Rev.* 728 (1986).

¹²⁷ Our concern here is with perceptions of fairness, which are subject to a variety of manipulations through policy design, not with making any statements about what is or is not fair in some deontological sense.

¹²⁸ For example, certain procedural protections that have distributive implications may satisfy a sense of fairness even if they are known to produce some inefficiencies. Yet these must, by their very nature, be provided in kind—that is, in the form of an inefficient procedural rule. [cites] [Cf. racial profiling discussion in Blumkin & Margalioth]. Consider due process protections afforded to public benefit recipients prior to termination. These protections might satisfy fairness preferences even if they reduced the effectiveness of the targeting of assistance (by keeping some ineligible people on the rolls longer). Fairness preferences could provide a reason sounding in welfare for using the procedure despite its inefficiency, solely based on the consumption preferences of people participating in or observing the way that the public benefits system operates.

¹²⁹ This follows from the fact that monetary outcomes are not the sole determinants of people’s evaluations. See, e.g., Daphna Lewinsohn-Zamir, *Taking Outcomes Seriously*, 2012 *Utah L. Rev.* 861..

¹³⁰ This comparison assumes that the legislation in question would actually benefit the target income class, notwithstanding any supply effects or contracting-around that might occur. Although the empirical questions are complex, there is some evidence that minimum wage laws, for example, can have a net redistributive effect. See Lisow, *supra* note 2, at 2498 n.46 (reviewing research on this point). Regardless of whether one agrees with these

case but not the former that we are taking away money from people who have “earned it,” and giving it to others who have not.¹³¹

If common attitudes about deservingness or desert apply differently for substantive legal rules than for the tax system, then the political costs of redistribution through these mechanisms will be asymmetric as well. Resistance to overt redistribution of income is often fueled by the belief that the market system reliably delivers distributionally fair outcomes to individuals, and that, therefore, any shortfalls in outcomes can be readily connected to personal shortfalls of character or effort.¹³² Those who benefit from the system may easily overlook the ways in which it fails to meet this model.¹³³ Institutional changes to the “rules of the game” that generate market results may have a more powerful and stickier effect on distributive results if they are understood to be part of an essentially fair process for producing outcomes. Not only are these changes more likely to be accepted in the first instance than a change that moves money around after the fact in a separate step, they are less likely to be counteracted.

Just as payments for different reasons are not viewed as fungible with each other, so too may the amount of assistance realistically available depend on the form that it takes and the restrictions that it implicitly or explicitly places on recipients. Consider, for example, the debate about whether assistance to poor people should be provided through an unrestricted cash grant or rather in kind, through food stamps, housing vouchers, and so on. The economic case for the unrestricted cash grant is clear—it can be expected to do a better job of advancing the welfare of recipients because they can spend on whatever they value most. But in-kind provision of assistance is ubiquitous, and it seems extraordinarily unlikely that the political will would exist to replace all such programs with their cash equivalents.¹³⁴ One reason might be that people view those who are less well off as having only a moral claim on certain kinds of resources that better their condition in certain well-defined ways.¹³⁵ Changing the form

specific examples, as long as the universe of rules that both resonate with fairness preferences and manage to redistribute in a preferred direction is not a null set, the reasoning in the text holds.

¹³¹ See, e.g., Liam Murphy and Thomas Nagel *The Myth of Ownership*, supra note __ at 35 (‘If people intuitively feel that they are in an absolute sense morally entitled to their net incomes, it is not surprising that politicians can get away with describing tax increases (which diminish net income) as taking from the people what belongs to them.’); Tsachi Keren-Paz, *Torts, Egalitarianism and Distributive Justice* 49 (2007) (arguing that “a transfer payment is more likely to submit the poor to attacks that they are lazy, unproductive, and a burden on hard-working taxpayers” than a change in tort compensation rules that is understood as “a manifestation of the substantive notion of equality before the law according to which it is unacceptable to systematically expose the poor to higher risks”).

¹³² See Friedrich A. Hayek, *Law, Legislation, and Liberty*, Vol. 2: *The Mirage of Social Justice* 73-74 (1976) (expressing ambivalence about “whether without such partly erroneous beliefs [in the deservingness of wealth] the large numbers will tolerate actual differences in rewards which will be based on partly on achievement and partly on mere chance.”).

¹³³ [Babcock et al. on self serving bias; for systems justification bias, see Sheffrin, at 49-53].

¹³⁴ See generally Steven Kelman, *A Case for In-Kind Transfers*, 2 *Econ. & Phil.* 55, 57 (1986).

¹³⁵ See *id.* at 62 (“It is from the right to life and the right to be spared from living in degrading circumstances

may remove the rationale.¹³⁶

Similarly, redistribution prompted by discrete misfortunes that were plainly out of the control of the victim will garner more political support than redistribution prompted by chronic need or an abstract concern with the state of the Gini coefficient.¹³⁷ An obvious example is disaster relief. Although such relief presents well-known moral hazard concerns,¹³⁸ it may also achieve increments of redistribution that are unlikely to be replicated through (or undone by) tax-and-transfer.

2. Punishment Preferences

Fairness preferences include preferences for the punishment of wrongdoers, what an experimental literature calls “altruistic punishment.”¹³⁹ Humans are willing to incur costs to make sure that the punishment of wrongdoers occurs even when it can create no possible strategic gain for the individual, other than satisfying the revealed preference for punishment. Indeed, people are willing to incur these costs even when they were not the victim of the transgression. Thus, fairness demands that people who wrongly gain at the expense of others should suffer a loss.

We will go a step further than the experiments and conjecture that if people will pay to punish (real or perceived) wrongdoing, despite the fact that it will not improve their payoffs, they would also incur costs to prevent

that justifications for rights to health care and to a minimum standard of living can be developed.”). There are other possible explanations too, from pure paternalism to a desire to protect children who cannot control their parents’ purchasing decision, to a desire to make the receipt of welfare as unpleasant and demeaning as possible so as to limit resort to it by anyone who has other options. These too can be cast under the rubric of (someone’s idea of) fairness. Again, our goal is not to defend any particular vision of fairness but rather to show that these perceptions represent inputs into political costs, and hence into distributive outcomes.

¹³⁶ See Kelman, *supra* note 134 at 63 (“[W]hat would be the impact of a decision to move from provision of health care or food stamps to a provision of their cash equivalent? Simply put, such a decision would destroy the justification for the policy in the first place.”)

¹³⁷ *Id.* at 69 (observing that preferences for helping disadvantaged people are sensitive to “the context in which the issue is presented” and that “presenting the problem of the disadvantaged in a multiplicity of contexts, tied to specific problems they face, will tend to increase the willingness of the non-disadvantaged to help, compared to a situation where the problem is presented in a single abstract context.”). See also Hylland and Zeckhauser, *supra* note 61, at 282.

¹³⁸ See, e.g., Kaplow, Louis. “Incentives and Government Relief for Risk,” 4 *Journal of Risk and Uncertainty* 167 (1991); Louis Kaplow, *Transition Policy: A Conceptual Framework*, *J. Contemp. Legal Issues* 13 *J. Contemp. Legal Issues* 161, 172. (2003). Interestingly, the rhetoric of disaster was used during the Depression to galvanize support for social insurance. See Michele L. Landis, *Fate, Responsibility, and “Natural” Disaster Relief: Narrating the American Welfare State*, 33 *Law & Soc. Rev.* 257 (1999).

¹³⁹ See Ernst Fehr & Urs Fischbacher, “Human Altruism – Proximate Patterns and Evolutionary Origins,” 27 *Analyse & Kritik* 6, 8 (2005) (“The ultimatum game (UG) (Guth et al. 1982) nicely illustrates that a sizeable number of people from a wide variety of cultures (Henrich et al. 2001; Roth et al. 1991) facing high monetary stakes (Cameron 1999; Hoffman et al. 1996; Slonim/Roth 1998) are willing to hurt others to . . . punish unfair behaviour.”). Newer experiments confirm this result when the potential punisher was not himself a victim of the wrongdoing. See Ernst Fehr & Urs Fischbacher, “Third-party Punishment and Social Norms,” 25 *Evolution & Human Behav.* 63–87 (2004); Joseph Henrich, et al. “Costly Punishment Across Human Societies,” 312 *Science* 1767 (2006). See also Dominique J.-F. de Quervain, et al., “The Neural Basis of Altruistic Punishment,” 305 *Science* 1254 (2004) (reporting that neural images of subjects undergoing a punishment experiment reveal that effective punishment of norm violators activates a reward center in the brain).

the wrongdoing, even if it will not improve their payoffs.¹⁴⁰ That premise reveals another way that the mode of distribution affects the quantity of distribution: People might choose to bear the cost of living in a world with suboptimal (in their view) levels of redistribution in order to avoid a particularly despised form of redistributive leakage—that in favor of a recipient who might try to cheat the system.

Imagine a taxpayer choosing between two redistributive policies: policy *A*, which takes the form of a tax-and-transfer program, and policy *B*, which is a redistributive legal rule. Both schemes have “leakage” that takes the form of distributing income towards the wrong people—the non-poor, say, when the appropriate targets are only the poor. In equilibrium, policy *A* mis-targets to one person out of 100 per time period and appropriately provides assistance to the other 99 targets. In equilibrium, policy *B* mis-targets to ten people out of 100 per time period and appropriately provides the same level of assistance to the other 90 targets. It would seem that policy *A* strictly dominates policy *B*. But suppose that for *A* the one inappropriate recipient is a cheat, someone who makes himself eligible by fraud, and it is impossible (given the costs) to eliminate the 1% fraud. For policy *B*, the wrong targets are not cheats; they are the passive beneficiaries of an inefficient legal rule or program that haphazardly distributes in the wrong direction 10% of the time.

Anyone might still regard policy *B* as superior if the susceptibility of policy *A* to intentional wrongdoing means that the cheating rate would or might increase over time. But let us suppose that these numbers represent deterrent equilibria with a steady state leakage rates of 1% and 10%, respectively. Without punitive preferences, it is now obvious that citizens would pick policy *A* over policy *B*. With punitive preferences, however, they might anticipate more disutility from policy *A* if they know that unpunished and effectively unpunishable wrongdoers will exploit it, and therefore prefer policy *B*.¹⁴¹ Indeed, if we consider the welfare losses to citizens with these punitive preferences, policy *A*'s redistribution might represent a net loss in welfare, even though it would represent a net gain if these preferences did not exist. As a result, voters who are unwilling to adopt policy *A* may be willing to adopt policy *B*. It may, therefore, be possible to redistribute more through policy *B* than through policy *A*.

By offering this example, we do not mean to argue that tax-and-transfer is always or inherently more prone to cheating (or perceived cheating) than

¹⁴⁰ [Cf. experimental work where people will incur costs or forgo gains to avoid the risk of being suckered]

¹⁴¹ A closely related point is that equivalent behavioral distortions may generate differential amounts of disutility among those observing the distortion. Thus, even if we accept the argument that legal rules distort the labor-leisure choice just as much as direct transfers, observing recipients electing leisure over labor may produce far more outrage among nonrecipients when the transfers are provided on a stand-alone basis, rather than as an accompaniment to, say, a tort judgment following an injury.

redistributive legal rules. Legal rules can also be abused by wrongdoing claimants. Our only point is that there is no reason to assume that the political costs associated with cheating are exactly equal across all policies, nor that they always favor the mechanism of tax-and-transfer. In at least some contexts, the more efficient form of redistribution, judged by the total quantity of leakage, may also be more politically objectionable due to the *quality* of that leakage. If one form of distribution offends fairness preferences more, there may still be room for more of the distribution that offends them less.

3. Fair Bundles

This discussion has mostly focused on the role of fairness perceptions in constructing the preferences that are inputs into political action—the “decision-influencing” phase of political action costs. But fairness considerations can also reduce the search or “opportunity spotting” phase as well. Interactions in which low-income individuals have been wronged or disadvantaged by others present natural opportunities to address distribution in a manner consonant with fairness intuitions. Offering transfer payments for a defensible reason sounding in fairness (e.g., corrective justice) is politically different, and (we argue) easier, than offering transfer payments for no reason other than a net gain in social welfare.¹⁴²

Recall the *Landfill* example, where one option is to tie the siting of a landfill with benefits that go to the neighborhood where the landfill is placed. We introduced the example to describe the importance of framing, but it may also work because voters more readily perceive the compensatory bundle as fair than they would perceive a general system of tax-and-transfer that might have the same distributive result for the neighborhood. The same logic lies behind Trade Adjustment Assistance programs, where Congress attempts to set up job training programs and other benefits targeted to the individuals who lose employment as a result of a free trade agreement.¹⁴³ One could again rely on a general system of tax-and-transfer, but the public is likely to perceive the redistribution as more fair when paired with a specific burden. Our point is not that a deontological theory of corrective justice justifies the distributive benefit (it may or may not), but rather that the public perception of corrective justice eases the political path for providing that benefit.

This general point is even more apparent if we shift to a context where there is no direct analogue to a centralized tax-and-transfer mechanism.

¹⁴² Lewinsohn-Zamir.

¹⁴³ See Eleanor Roberts Lewis and Harry J. Connolly, Jr., Trade Adjustment Assistance for Firms and Industries, 10 U. Pa. J. Int'l Bus. L. 579 (1988); Frank H. Morgan and Helen Wong, Trade Adjustment Assistance Cases: 2007 Developments, 40 Geo. J. Int'l L. 99 (2008).

Consider, for example, the question of how the burdens of carbon reduction should be allocated among countries, given that some developed earlier than others and some are wealthier than others. In a recent book, Eric Posner and David Weisbach argue that the desire to help poor countries (which they endorse) should be kept conceptually separate from questions of what to do about carbon reduction.¹⁴⁴ Although they view it as an empirical question whether a climate change treaty could turn out to be a valid redistributive vehicle,¹⁴⁵ they make clear that any such redistributive approach must prove its merits *as a redistributive vehicle* when compared against other possible redistributive methods.¹⁴⁶

But other possible redistributive methods remain nothing more than theoretical abstractions until they are reduced to real-world mechanisms that are under the control of some decisionmaker with the authority and desire to actually make the transfer.¹⁴⁷ Setting up such a redistributive channel involves large political action costs. Finding a decisionmaker with both the power and the preferences to get the job done is made all the more difficult if the job in question is defined as a stand-alone act of redistribution (essentially, an act of charity), rather than representing elements of something else—like ability-to-pay adjusted contributions to a common goal, or a squaring-up of past injustices. If decisionmakers are already coming together to create a treaty aimed at substantive objectives, especially ones that have significant distributive implications, then the ready-made channel this provides for carrying out distributive objectives should be explored, not rejected out of hand until it can prove its superiority to all other *potential* methods of redistribution.

In sum, the costs of finding an appropriate mechanism for accomplishing redistribution argues for bundling together rather than separating distributive goals and other substantive goals, especially where doing so will enable the leveraging of fairness intuitions to support the distributive move (whether or not those intuitions would survive philosophical scrutiny). Here, as elsewhere, any savings on political action costs and uniquely achievable distributive gains must be weighed against

¹⁴⁴ Climate Change Justice at 73 (arguing that any claim wealthy countries should bear a larger responsibility “improperly tie valid concerns about redistribution to the problem of reducing the effects of climate change”).

¹⁴⁵ Although they personally favor pursuing the two goals on “separate track[s],” *id.* at 192, they view it as “conceivable (but unlikely) that a climate treaty could turn out to be a good way to redistribute wealth,” *id.* at 117, and specify the empirical showings that would be required to support such an approach. See *id.* at 75, 80-96, 176-78. Separately, they reject a corrective justice rationale for burdening the developed countries more heavily. See *id.* at 99-118.

¹⁴⁶ This point is further emphasized in recent independent work by David Weisbach. [WIP paper on “climate change blinders” (arguing that redistribution has been wrongly brought into climate change discussions based on the unproven assumption that it dominates other, and presumptively better, ways to redistribute)]

¹⁴⁷ Adler and Posner recognize just this point in their work on cost-benefit analysis. See Adler & Posner, *supra* note 15, at 144 (observing that even though it might be better to pair an efficient siting decision with a transfer payment, “[w]e know of no agency in the U.S. government that has the authority to order wealth transfers, and there are many good reasons for denying agencies this authority.”).

efficiency losses that may come from using a particular redistributive vehicle. But attention to political action costs offers reasons for investing in making the calculation.

4. A Note About Domain

A possible objection to our focus on the role of fairness in constructing political action costs is that we have shifted our attention outside of the proper domain of “redistribution” in which tax superiority holds. K&S explicitly state that they are limiting their discussion to “the overall distribution of income or wealth, not entitlement to payment based on desert.”¹⁴⁸ Perhaps one would say that if there is a strong public view about the fairness of a particular legal rule or distribution, that we are no longer in the domain to which simple income redistribution applies.

Yet there is no way to cleanly separate income distribution from matters of individual desert. Consider first a legal rule that might seem to sit clearly outside of the domain of redistribution: a ban on racial discrimination in employment. The desert-based justification for protecting individuals from discrimination does not explain why civil rights laws forbid only some parties to discriminate and not others: employers but not employees;¹⁴⁹ public accommodations but not customers;¹⁵⁰ landlords but not homeseekers.¹⁵¹ There are many reasons why we might see these patterns, but one possibility might be to beat back forms of discrimination that are especially damaging to one’s income or wealth. If so, we might understand bans on racial discrimination (and discrimination on other protected grounds) as non-tax rules that in fact address important sources of income inequality. Yet because these laws align with the public preference against the unfairness of discrimination, they are more politically feasible than achieving the same result via tax-and-transfer.¹⁵²

On the other end of the spectrum, programs that seem clearly redistributive, like the Earned Income Tax Credit (EITC), food stamps, and Temporary Assistance for Needy Families (TANF), involve a strong element of desert. Consider the work requirements that helped make TANF and the EITC politically acceptable and the exclusion of felony drug

¹⁴⁸ K&S 1994 at 667 n.1.

¹⁴⁹ [cite]

¹⁵⁰ Public accommodations are prohibited from discriminating against customers on the basis of race, but customers are not banned from discriminating on the basis of race against the owners or managers of public accommodations. See Michael Blake, *The Discriminating Shopper*, 43 *San Diego L. Rev.* 1017 (2006); Katharine T. Bartlett and G. Mitu Gulati, *Why Do We Allow Customer Discrimination?* (2014) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2540334.

¹⁵¹ [Fair Housing Act; Bellwood case]

¹⁵² Blumkin & Margalioth, *supra* note __, at 14-18 (arguing that doctrinal bans on private race discrimination address distributional issues better than race-sensitive taxes); *id.* at 18-21 (arguing that doctrinal bans on racial profiling by police address distributional issues more cheaply than tax).

offenders from the food stamp program.¹⁵³ If “entitlement[s] to payment based on desert” can be understood broadly enough to reach even the actual welfare programs that exist in the world, then virtually no redistributive legal rules would fall within the distributive domain. One could then concede the principle of tax superiority but avoid it in every case of interest.

This is plainly not what proponents of tax superiority have in mind. Indeed, K&S themselves appear to contemplate the domain of tax superiority as reaching into areas like tort and contract law to preclude distribution-sensitive divergences from efficiency,¹⁵⁴ even though those fields also embed desert-based notions. Yet K&S presumably would not want to replace every law’s distributive feature with tax-and-transfer. Antidiscrimination law provides an especially compelling example,¹⁵⁵ but similar points might be made about, say, compensation requirements in tort and property that have distributive effects even as they respond to wrongs.¹⁵⁶

To be sure, cabining off certain domains as too desert-infused to count as redistribution might help to prop up the invariance hypothesis (through the simple expedient of removing from the analysis a set of distributive changes that we would not expect to see replicated or countered through tax law). But if welfare is the goal, all distributive changes count, whether delivered through nominally redistributive measures or otherwise. Here, as elsewhere, the presence of positive political action costs introduces the possibility that one redistributive route will be more successful than another, producing distributive variance.

III. THE IMPLICATIONS OF POSITIVE POLITICAL ACTION COSTS

Positive political action costs, like positive transaction costs, radically change the operating environment for maximizing welfare. Just as

¹⁵³ See 21 U.S.C. 862a (making those convicted of certain drug felonies ineligible for various forms of assistance, including nutritional assistance, subject to state opt-outs); [case law upholding].

¹⁵⁴ See Markovits, *supra* note 5, at __ (noting this point).

¹⁵⁵ Economics does not have a clear agreement on the normative justification for the ban on race discrimination. Richard Epstein famously argued against the prohibition on race discrimination in employment, partly from an economic perspective. See Richard A. Epstein, *Forbidden Grounds: The Case Against Employment Discrimination Law* (1995). For efforts to justify such laws within economics, see John J. Donohue III, *Advocacy versus Analysis*, 44 *Stan. L. Rev.* 1583 (1992) (reviewing Epstein’s book); Richard H. McAdams, *Cooperation and Conflict: The Economics of Group Status Production and Race Discrimination*, 108 *Harv. L. Rev.* 1003 (1995).

¹⁵⁶ The response might be that these other laws have an impetus other than altering distribution; they are responding to a wrong first and foremost, and only incidentally affecting distribution. But on further examination, many compensation requirements (like those associated with the takings clause, or with having tortfeasors compensate victims) can be recast as forms of social insurance. [cites to insurance function of tort and to insurance characterization of the takings clause]. Redistribution is of course often cast in exactly these terms as well. See, e.g., Dworkin. Conversely, many redistributive measures are prompted not by income statistics or Gini coefficients but by discrete events that have unfairly impacted their victims—if not “wrongs” as such, then at least identifiable misfortunes. See Landis, *supra* note 138.

positive transaction costs introduce the possibility of divergence between the existing allocation of resources and the efficient allocation, positive political action costs introduce the possibility of divergence between the existing distributive results and those that would maximize welfare.¹⁵⁷ This possibility follows as a matter of logic from the fact that different distributive results are possible depending on how redistribution is carried out—that is, from the failure of the invariance hypothesis. And, importantly, the point holds regardless of whether one believes that current levels of redistribution undershoot or overshoot the welfare-maximizing level. By analogy, one need not take a stand on whether polluting factories or polluted-upon homeowners should receive more or fewer entitlements in the world in order to believe that transaction costs can interfere with efficiency. Our point is equally fundamental: In the presence of positive political action costs, we cannot wave away the possibility that our political system will fail to achieve welfare-maximizing distributive results.¹⁵⁸

In this Part, we first examine the parallel between political action costs and transaction costs. Second, we explore the case for doctrinal redistribution. In these two sections we raise and respond to some possible objections to our analysis. In the third section, we offer some directions for future research into political actions costs.

A. *The Problem of Political Action Costs*

We can begin, in Coasean fashion, by examining the sort of invariant distributive results we would get if political action costs were zero. In this world, it matters not at all how legal rules and institutional arrangements affect distribution, because a costless redistributive

¹⁵⁷ Of course, different actors and entities will have different views about what constitutes distributive optimality. For concreteness, and not by way of limitation, it may be helpful to think of society possessing a social welfare function that tracks the distributive preferences of the median voter or citizen. For some suggestive evidence of divergences between actual distributions, perceived distributions, and preferred distributions, see, e.g., Sorapop Kiatponsan & Michael Norton, *How Much (More) Should CEOs Make? A Universal Desire for More Equal Pay*, *Persp. Psych. Sci.* (forthcoming) (working paper 2014 on file with authors) (using survey data from 40 countries to trace misperceptions about CEO pay versus average worker pay, and finding divergence among actual, perceived, and “ideal pay” for CEOs); Michael I. Norton & Dan Ariely, *Building a Better America—One Wealth Quintile at a Time*, 6 *Persp. Psych. Sci.* 9 (2011) (finding in nationally representative online panel that people perceived wealth distribution as far more equal than it actually is, and desired wealth distributions that were even more equitable than these erroneous estimates). Welfare maximization might also be assessed based on a social welfare function derived from exogenously selected principles. Our point here is very general: for any given social welfare function, there may be a divergence between the distribution that would maximize welfare and the distribution the political system actually produces.

¹⁵⁸ The analogy we draw between the Coase Theorem and the problem of political action costs is not original to us. See Daron Acemoglu, *Why Not a Political Coase Theorem? Social Conflict, Commitment, and Politics*, 31 *J. Comp. Econ.* 620 (2003). Acemoglu argues that societies pursue inefficient policies due to certain kinds of transaction costs that operate in the political realm, including the inability to bind future decisionmakers. These costs explain why a society capable of achieving redistribution in a less efficient way could not simply bargain to have that same increment of redistribution handled through the tax system. See David Weisbach, *Distributionally-Weighted CBA*, 2014 at 38 (asking why this result would not hold).

mechanism will instantly and perfectly correct any distributive infelicities. No one concerned with distribution would have any incentive to attempt to accomplish distributive goals through means other than the costless tax-and-transfer system, for all the reasons that K&S and others have detailed. First, it would introduce distortions, and second, it would be ineffective in changing the distributive picture because of a costless adjustment by Congress (or whatever fanciful body would make decisions in a world of zero political action costs).

Indeed, a very useful way of reading K&S's contribution is as a purely conceptual demonstration analogous to that undertaken by Coase: for any quantum of redistribution that might be accomplished through legal rules, there exists (in theory) a tax-and-transfer method that would be superior.¹⁵⁹ This is analogous to saying that for any quantum of government coercion that might be used to place resources in the hands of higher valuer, there exists (in theory) a private bargain that would be a better way to accomplish that shift. Just as we do not derive from the Coase Theorem a general principle of "transaction superiority" (given transaction costs), we cannot derive from K&S's demonstration any general principle of "tax superiority" (given political action costs). Instead, Coase's work was designed to focus attention on the existence of transaction costs.¹⁶⁰ The K&S demonstration should likewise turn our attention to political action costs, not divert attention away from them with conjectures and assumptions.

1. Beyond Tautology

Before proceeding, it is necessary to first consider an argument that might seem to rehabilitate the invariance hypothesis: Even if political action costs are positive, they can never interfere with the maximization of social welfare under society's currently-existing social welfare function. According to this argument, the costs of political action are part of the

¹⁵⁹ K&S have been read in this way. See Christopher Curran, *Optimal Techniques of Redistribution in Bibliography of Law and Economics*, Volume IV 301, 309 (edited by Boudewijn Bouckaert and Gerrit De Geest, 2000) (describing the work of K&S and others as "comprising an 'existence theorem - if society decides to redistribute income, there exists a tax schedule for redistributing income that everyone prefers to any other way of redistributing income, including the use of legal rules or institutions.>"). Some aspects of their joint work supports this reading. See Kaplow & Shavell, *Less Efficient*, supra note 19, at 669 ("[A]ny regime with an inefficient legal rule can be replaced by a regime with an efficient legal rule and a modified income tax system designed so every person is made better off.") (emphasis in original). In addition, in later solo work, Kaplow has expressly characterized an analysis of externality control that employs the premise of distributive neutrality as a theoretical exercise rather than a basis for policy. See Kaplow, *Externalities*, supra note 72, at 489, 503.

¹⁶⁰ See R.H. Coase, *The Firm, the Market, and the Law* 13-16 (1988) (explaining that he "examined what would happen in a world in which transaction costs were assumed to be zero . . . not to describe what life would be like in such a world, but to provide a simple setting in which to develop the analysis, and, what was even more important, to make clear the fundamental role which transaction costs do, and should, play in the fashioning of the institutions which make up the economic system").

background conditions that produce the political equilibrium that in turn produces the social welfare function that society is maximizing. There is therefore never any daylight between the welfare-maximizing distribution and the actual distribution because the actual distribution is the product of welfare-maximizing actions under the existing political constraints.

Suppose, for example, that distributive patterns become vastly less egalitarian following changes in earning patterns that are not counteracted to any significant degree by changes in the tax system.¹⁶¹ This distributive result can be interpreted not as the product of a political impediment to the achievement of some stable preexisting social welfare function, but rather as a perfect instantiation of the new social welfare function generated by the new political equilibrium produced by these new earning patterns. So whatever the distribution was in 1990 was just the distribution that political equilibrium allowed. Whatever the distribution is in 2014 is just what the political equilibrium allows.

Not only is this argument nonfalsifiable as an empirical matter, it appears logically unassailable: If we define the social welfare function as being maximized by the distributive pattern that the political system actually produces under each given set of conditions, then we need never worry about distributive results not maximizing welfare. They always will, simply because we have decided to define what it means to “maximize welfare” as whatever the system produces. The fact that different distributive results can in fact follow from different methods of redistributing presents no obstacle to this line of reasoning, since whichever method of redistribution is actually selected can be understood to have itself altered the overall political equilibrium and with it society’s social welfare function.¹⁶²

Of course, accepting this tautology means choosing to ignore distributive considerations, without quite saying one is doing so.¹⁶³ This, we think, is an insupportable position for a welfarist to take. Confronting distributive variance admittedly introduces many complications. Because law and economics scholars are usually gesturing at some as-yet-unspecified social welfare function which maps to our current distributive pattern in unknown or contested ways, it may be unclear whether more or less redistribution is called for to maximize welfare. Once we have a social welfare function in view, we quickly confront knotty problems like trying to determine the rate at which the marginal utility of money diminishes, and

¹⁶¹ [Young, *Equity*, at p.114: table 6.2 shows remarkable stability in effective income tax rates over time.]

¹⁶² We do not dispute that redistributive efforts can have the effect of altering the political equilibrium. See Markovits, *supra* note 5 at 600-01; McDonnell *supra* note 5 at 111. What we are questioning is whether any realistic social welfare function can be understood to be satisfied regardless of which political equilibrium obtains and which distributive outcome is produced.

¹⁶³ Cf. Carl J. Dahlman, *The Problem of Externality*, 22 *J. L. & ECON.* 141 (1979) (addressing a similar tautology involving transaction costs).

how or whether we can make interpersonal utility comparisons.

The invariance hypothesis, if true, would make such inquiries unnecessary. Comparing the welfare generated by two (or more) different distributive results is obviously a much less tractable task than simply examining which of two routes to an invariant distributive result is less costly. Yet because invariance cannot be made true without resort to tautology, it cannot be invoked to push distributive considerations out of the welfarist analysis of legal rules and policies. Law and economics scholars should not, of course, feel compelled to take up distributive questions if they would prefer to focus solely on questions of economic efficiency. But they should be clear about what they are—and are not—doing.

2. Communicating and Collaborating

Consistent with the discussion above, we propose a change in the way that law and economics speaks to those who care about distribution and who believe that our current distributive pattern diverges from what would maximize welfare. Currently the standard message transmitted from law and economics is this:

Standard Message. You care about distribution? Hey, we care about distribution too! We're welfarists and we get it; you don't have to convince us. Hugely important thing, distribution. But you're going about this business of redistribution all wrong. You think you're helping the poor by making legal rules that are sensitive to distribution? Not so. You're just screwing up everything by making legal rules inefficient. There is a better way. Tax-and-transfer will get you to your distributive goal (whatever it may be) more cheaply than whatever plan you have in mind. The pie can be bigger, and everyone can have a bigger slice.

Standard Message sounds ecumenical and open to all distributive approaches. But, as we have seen, it is only possible to defend the invariance hypothesis upon which it is implicitly based by adopting a vision of welfare maximization that aligns with whatever moment-to-moment distributive outcome is actually produced by the political system—a kind of Panglossian social welfare function.¹⁶⁴ People who employ less tautological measures of distributive optimality would find it highly relevant that *different* distributive results are possible depending on the distributive method selected. Such individuals might well be interested in quantifying

¹⁶⁴ In Voltaire's *Candide*, Dr. Pangloss declared the existing state of affairs to be "the best of all possible worlds." cite; see also id. ("'It is demonstrable,' said he, 'that things cannot be otherwise than as they are; . . .'"").

these distributive differences and considering how they might trade off against efficiency considerations. *Standard Message* closes off these lines of inquiry.

In place of *Standard Message*, we argue, law and economics scholars should be sending one of the following two messages.

Honest Disregard. So you are raising a distributive issue. I think that whatever distribution our political equilibrium produces at any given time is probably the right one, or at least that we can't do any better at that point in time. If you agree with me that the existing distribution is always the most normatively justified one, then I can tell you categorically that we should focus only on efficiency in crafting legal rules, and just let the political process do whatever it does. If you have some other idea about what welfare maximization requires in terms of distribution, and you don't trust the political process to get us there, then I can't really say anything to you about that. My work focuses on efficiency, not distribution or politics.

Collaboration. So you are raising a distributive issue. There are many different views about what distribution we should pursue as a society, which is to say that there are many ways our social welfare function could be formulated. But if you tell me that, based on your vision of welfarism, you'd like to see more (less) redistribution in favor of the poor, there are a couple things I can say about that. Right off the bat, there is always an advantage to a tax-and-transfer system because it only distorts the labor-leisure decision, and doesn't distort any other decisions. However, the political action required to redistribute involves costs, and it's possible those costs may be greater in the tax-and-transfer realm under some circumstances. That could potentially tip the balance and cause other kinds of distributive changes to dominate.

The first, *Honest Disregard*, makes clear that the speaker is not interested in exploring distributive issues. Consistent with that position, it declines to give advice about how to achieve a different distribution. The second, *Collaboration*, seeks to invest intellectual effort in showing how someone with a particular distributive objective would go about achieving that goal using available legal tools. Part of the analysis would track the standard discussions we are critiquing, but, importantly, part of the analysis would take into account the role of political action costs. In the spirit of *Collaboration*, then, those concerned about distribution might be told that a given legal rule produces change X in distribution but also causes an

efficiency loss of Y magnitude, leaving it to those who construct and apply social welfare functions to assess if this is a worthwhile trade.¹⁶⁵

B. Doctrinal Redistribution Plausibly Increases Social Welfare

Distributive variance opens up the possibility that a non-tax method of redistribution that makes possible a preferred distributive result will advance welfare on net, despite introducing other distortions. Conversely, an efficient legal rule may produce an enduring distributive deficit that is more costly in welfare terms than a less efficient rule that generates better distribution. We do not claim that doctrinal redistribution will always, or even very frequently, dominate tax-and-transfer—only that it may plausibly do so under some circumstances, and that this possibility warrants investigation. This section examines some dimensions of that inquiry.

1. Burdens of Proof

A pivotal (if often unstated) premise in most debates about the claim of tax superiority concerns who should bear the burden of proof.¹⁶⁶ Our view is that the individuals who would give categorical and counterintuitive advice—that, outside of tax, welfarists should ignore the welfare effects of distribution—bear the burden of proving the advice is well-founded. Given the falsity of invariance, that burden has not been met, at least not as categorical matter.

At the same time, those who seek to justify *particular* inefficient doctrines on the basis of distribution should, at a minimum, bear the burden of showing that the doctrine itself plausibly changes distribution in a way that is likely to produce welfare gains.¹⁶⁷ This is a minimum condition for setting up the possibility that such welfare gains could swamp efficiency losses. That further showing—that welfare gains exceed welfare losses—depends on how heavily different distributive results are weighted within the social welfare function under consideration.

¹⁶⁵ Weisbach, *supra* note 52, at 37, states that it would require “serious analysis” to specify the distributional weights an agency should give for distributionally-sensitive cost-benefit analysis. But the principle of tax superiority stands in the way of collaborating on any such serious analysis. As a starting point, we recommend the scholarly identification of the distributional effects of legal changes as being relevant to a full welfare analysis.

¹⁶⁶ K&S have previously asserted that the burden must fall on those who would challenge tax superiority. See Kaplow & Shavell, *Legal Rules*, *supra* note 21, at 835 (“Although one or another qualification may turn out to be relevant in some instances, we would need to have sufficient evidence (or, at minimum, plausible conjectures) in order to know what, if any, adjustments to legal rules should be made.”); Markovits, *supra* note 5, at 523, 610 (noting and critiquing this assignment of the burden of proof).

¹⁶⁷ As we have seen, the contracting-around argument suggests some purportedly redistributive legal rules are no such thing, and this is an excellent reason not to pursue such rules (ones that stand no chance of changing distribution in a welfare-enhancing direction). See *supra* notes 33-34 and accompanying text. Neither proponents nor opponents of redistributive social policies or legal rules should be relieved of the duty to investigate their actual incidence.

The net effect on welfare also depends on the extent to which distributive changes achieved doctrinally will be countermanded by other legal actors or will merely duplicate results that would have otherwise been achieved through tax-and-transfer. Our discussion above rebuts the strongest version of this claim—complete invariance—but, as the next section explains, even partial offsetting and crowding out can remain costly. Here, it seems as if those debating the merits of different forms of distribution should share the burden of investigating these dynamics.

2. Costly Offsetting and Crowding Out

The existence of distributive variance does not mean that doctrinal redistribution is never offset to any degree—only that any such offsetting is imperfect. Nor does distributive variance rule out the possibility that redistributive legal rules will at times partially or wholly crowd out less distortive tax-and-transfer measures. Both offsetting and crowding out can be very costly. These costs may be worth incurring, depending on how the final distributive and allocative results compare with those that would have obtained in the absence of the initial act of doctrinal redistribution, but they should be taken into account. Although we will focus in this section on the possibility that Congress will offset the distributive impacts of court-enacted legal rules, the analysis applies more broadly to all sorts of offsetting that might occur as between different governmental actors, such as between different courts, courts and administrative agencies, and different administrative agencies.

As an initial matter, it bears emphasis that offsetting may be entirely absent in some settings. It may simply be implausible that certain narrow legal rules or local policies will attract distributive countermands from anyone. Similarly, when an actor's opportunities to redistribute are sufficiently limited, she may be able to take advantage of all of those opportunities without ever producing the sort of aggregate distributive blip necessary to attract political attention or galvanize a countermand. In other words, as we discussed above, the Margin of Inaction (MOI) may be larger than the full set of plausible redistributive opportunities. Legal actors such as courts may also be confronted with circumstances in which it appears unlikely that making a distributive improvement or avoiding a distributive deficit will crowd out similar moves by Congress. In these cases, the welfarist advice might well be the opposite of that given by K&S: Instead of always ignoring distribution, these actors should always take it into account in their decisionmaking.¹⁶⁸

¹⁶⁸This assumes there are not other institutional or process reasons to keep redistribution out of the hands of courts. See *infra* Part III.B.3.

Significantly, the MOI is a double-edged sword that can also keep Congress from making welfare-advancing *corrective* distributive offsets. Thus welfarist courts may decline to adopt distributively harmful efficient legal rules when they predict that Congress would be unlikely to provide a correction.¹⁶⁹ Moreover, the effective MOI encountered by a court could grow if background social and economic factors move distribution in, say, an even more inegalitarian direction than Congress itself would prefer.¹⁷⁰ Under some social and economic conditions, courts may be in a position to both respond to inegalitarian shifts that fly under Congress's radar and (if the court's preferences are yet more egalitarian than Congress's) to overcorrect for them to an extent that Congress will not counteract.¹⁷¹ Things become more complicated if the power of courts to effect welfare-enhancing distributive changes outstrips the MOI; in this case, taking every opportunity to move distribution in a welfare-enhancing direction will cause some or all such efforts to be counteracted by Congress.¹⁷²

Such offsetting can be quite costly. Aside from the resources consumed in carrying out move and countermove, the net effect is to leave in place distortionary legal rules that no longer produce countervailing distributive gains. Offsets may also produce objectionable distributive effects *within* income classes. A doctrinal legal rule that aspires to improve distribution will primarily benefit the particular low-income people who happen to be involved in particular transactions, activities, or legal disputes, not poor people in general.¹⁷³ But a tax-and-transfer offset that applies broadly across income classes will not surgically undo the attempted distributive improvement; rather, it will undo it on average for the income class. In this scenario, every gain for a low-income individual who benefits from an (ostensibly) redistributive legal rule translates into a direct loss for other low-income individuals who did not happen to benefit from the

¹⁶⁹ It is noteworthy that courts have at times been deemed especially well-suited to assess the political power of the litigants and the likelihood that they will be able to achieve their goals politically. [See, e.g., *Carolene Products* FN 4 on discrete and insular minorities]. Thus, courts may have particular institutional competence in recognizing when corrective offsetting will and will not occur, and in determining the circumstances under which legal rules can improve the position of the politically powerless without drawing legislative countermands. We thank Tara Grove for comments on this point.

¹⁷⁰ [cite Piketty]

¹⁷¹ There is still a potential crowding out concern in these contexts—it is possible that if every welfarist court hewed to efficiency as the distributive picture got cumulatively worse that eventually Congress would react to improve distribution. But it is also possible that the deteriorating distributive picture would be accompanied by shifts in the political equilibrium that would entrench the rising inequality. See Markovits, *supra* note 5, at ___. The result could be a sort of “ratchet effect” in which growing inequality begets even more inequality. [cites].

¹⁷² An interesting question is what happens when the MOI is exceeded. One possibility is that the marginal judicial decision that increases redistribution beyond the MOI acts as a tipping point, causing Congress to undo the distributive effects of that and all prior judicial decisions. Alternatively, Congress may engage in partial offsetting by targeting the largest or most salient targets, while leaving some sub-MOI redistribution intact. It is also quite unclear whether and how the individual actions of different courts might aggregate to prompt congressional action, especially given the possibility that different decisions may have offsetting or synergistic distributive effects.

¹⁷³ This is the haphazardness objection. See *supra* notes ___.

redistributive legal rules.¹⁷⁴

Yet the fact that costly offsetting can occur hardly proves that the right amount of redistribution for welfarist courts to pursue is zero. If additional redistribution would enhance welfare, one wants to redistribute as much as the MOI allows, but no more. Similarly, welfarist courts would want to stop redistributing before their efforts start to crowd out measures that Congress would otherwise enact (at lower distortionary cost).¹⁷⁵ To the extent that Congress reacts to aggregations of distributive changes, courts may face an interesting collective action problem. Their success in resolving it depends not only on their ability to coordinate, but also on their ability to gauge how close they are to inducing Congress to alter the progressivity of the income tax. Although the question is an empirical one, the idea that judges are capable of such discernment is not implausible. Strategic theories of statutory interpretation are premised on the analogous idea that judges understand how far an interpretation of a statute can diverge from what the current legislature wants.¹⁷⁶

3. Alternative Objections: Institutional and Process Concerns

The fact that invariance is false means that multiple distributive equilibria are possible within our political system. This result raises questions—ones that are elided when invariance is assumed—about whether there are reasons to prefer one redistributive institution or process over another, independent of the merits of the distributive outcome itself and the distortions associated with it. To a large degree, these questions fall outside the scope of this paper. Our primary purpose is to highlight and criticize the invariance assumption that has played such a large and unacknowledged role in the way legal economists treat distributional issues. Thus, even if institutional or process considerations weigh against doctrinal redistribution, that does not justify using the existing analysis to support tax superiority. Nonetheless, we will briefly consider how such considerations might affect the welfare analysis.

¹⁷⁴ The normative valence of such a distributive result depends on the extent to which income serves as a better basis for welfare-improving redistribution than the trigger condition for benefiting from the legal rule. There is also a converse scenario that must be considered alongside the one in the text. Suppose a court chooses an efficient rule with bad distributive results for those who happen to be engaged in particular interactions. If Congress then engages in a corrective offset using tax-and-transfer, it will make everyone in the income class better off but will leave those who suffered distributive losses in the particular interaction relatively worse off. In other words, this particular drawback of offsetting—that it alters the intra-class distribution—applies whether we are talking about offsetting of aspirational changes (which would not be necessary if we followed K&S's advice) or to corrective offsetting of unwanted effects of distributive rules (which would be continually required if we followed K&S's advice).

¹⁷⁵ The costs of crowding out follow from K&S's extra distortion argument; one is substituting a more distortionary process for a less distortionary one. Consequently, the degree of harm caused by crowding out depends on the validity of the extra distortion argument itself. See *supra* notes __ and accompanying text.

¹⁷⁶ See *supra* note 88 and accompanying text.

First, perhaps there is a normative objection to engaging in redistribution through institutions other than the legislature. At one point K&S come close to claiming that the legislature is institutionally superior, compared to courts, for effecting redistribution in a democracy.¹⁷⁷ Such a claim has real bite when institutional variance exists, because different institutional actors are capable of delivering different distributive outcomes. A welfarist would presumably approach the question by considering both the content of the distributive result available through each alternative avenue and the welfare implications of using that particular avenue—whether administrative costs, costs relating to preferences of the citizenry for particular processes, or otherwise. This calls for comparative institutional analysis capable of capturing all the differences between the distributive routes. We see nothing obvious about the result of this analysis.

Specifically, we do not see why a theorist would categorically endorse courts, for example, to conduct efficiency analysis, but categorically object on welfare grounds to their conducting distributive analysis. Efficiency analysis is just as complex and contested as distributive analysis, and most judges lack formal economic training. Moreover, a court's single-minded pursuit of efficiency in a situated legal context is subject to second-best critiques that seem at least as significant as those that might arise from its efforts to pursue both efficiency and distribution in that same context.¹⁷⁸ Finally, even if a welfarist were to rule out redistribution by courts based on such considerations, other non-tax alternatives would remain open, such as redistributive legal rules enacted by legislatures.

A second objection might be that the doctrinal redistribution is inherently (or at least typically) lacking in transparency. Perhaps the reason for variance is only that the public will fail to recognize some forms of redistribution for what they are and perhaps tax progressivity has the virtue of making redistribution plain and visible. Our discussion of salience and framing might imply that we favor redistributive methods that trick the public into providing support. To be sure, there are difficult normative questions that attend any discussion about shaping public perceptions surrounding redistribution (or efficiency, for that matter). For one thing, failures of transparency can backfire, heightening political action costs or producing other direct welfare losses—losses that must be balanced against whatever expected distributive gains might thereby be achieved. Again, however, we see nothing obvious about how a welfarist analysis would treat these issues.

Significantly, there is no natural “manipulation-free” baseline that

¹⁷⁷ Kaplow & Shavell, *Less Efficient*, supra note 19, at 675. See also Weisbach, supra note 52, at 37 (suggesting, in contesting distributionally weighted cost-benefit analysis, that “the normal course for democracies is for elected legislatures to be allocated the power to make the primary distributive judgments”).

¹⁷⁸ [cites on second best critique].

obviously and uncontroversially reveals the full truth of a distributive situation.¹⁷⁹ One might say that framing redistribution to highlight features like shared contributions to a common goal, reciprocal social insurance, the bundling of costs and benefits, or the correction of unfair background conditions is a “manipulation.” But the same might be said of a system that delivers pre-tax earnings to individuals without making transparent the ways in which the earning of that income is itself dependent on public expenditures,¹⁸⁰ or of a tax code that embeds numerous tax breaks that would look offensive to fairness if cast as direct welfare payments.¹⁸¹ If tax subsidies for parents of young children are the economic equivalent of tax penalties for the childless, yet the former is politically feasible while the latter is not, which policy is manipulative and which is transparent?¹⁸²

These baseline issues are exacerbated by an underappreciated feature of the principle of tax superiority: that it not only directs courts and other actors to refrain from adopting doctrines that would improve distribution, it also directs them to undertake efficient acts that would *worsen* distribution.¹⁸³ Yet we would not ordinarily think of a legal rule that merely maintained the distributive status quo as “redistributive” in nature.¹⁸⁴ In what sense is it more transparent to generate distributive neutrality through a two-step process in which distribution is first worsened (off-stage) and then brought back to baseline through an overtly redistributive process that attracts significant political resistance? As recent research suggests, the fact that a policy generates political resistance does not mean that it also generates an accurate understanding of the incidence of the relevant burdens.¹⁸⁵ There is no obvious welfare-related reason to categorically prefer processes that make preferred distributive patterns maximally difficult to achieve and maintain.

More broadly, welfarists cannot avoid confronting the fact that most voters are not committed welfarists. Instead, voters are more likely to combine a pragmatic concern for consequences with intuitive concerns for non-consequential values like fairness, corrective justice, equality, and

¹⁷⁹ [cites to Gamage & Shanske; Nagel & Murphy, *supra* note 54]. Cf. Thaler & Sunstein, *Nudge* (on inevitability of defaults).

¹⁸⁰ Murphy & Nagel; Gamage.

¹⁸¹ See *supra* note 121 and accompanying text.

¹⁸² Cf. note 120 *supra* and accompanying text (presenting the related Schelling paradox).

¹⁸³ See *supra* notes 77-78 and accompanying text (distinguishing corrective invariance from aspirational invariance).

¹⁸⁴ See *supra* note 54 (on the definition of redistribution).

¹⁸⁵ See Eric J. Brunner et al., *Homeowners, Renters, and the Political Economy of Property Taxation* (Dec. 4, 2014), <http://ssrn.com/abstract=2534044> at 20-21 (finding, using survey data of California homeowner and renter attitudes toward sales and property taxes, “that the strong opposition among homeowners to the property tax is not associated with the relative tax burden faced by the individual homeowner” and concluding these results are most plausibly due to the relatively greater salience of the property tax). Brunner et al. observe that “[w]hile salience is clearly associated with greater sensitivity to tax rates, such sensitivity is clearly no guarantee that taxpayers rationally consider their personal tax burden or effective tax price of public services when making choices concerning public services spending.”

political legitimacy. Thus, it is not enough for a welfarist to find a policy vehicle for redistribution that satisfies purely welfarist criteria; a committed welfarist must also find a political vehicle that aligns or resonates with broadly shared forms of normative thinking to which the public subscribes. That linkage is what is required to maximize welfare. It is not clear what the welfarist objection could be to this approach, especially given that other popular beliefs—such as those regarding the connection between effort and economic success—already form part of the backdrop against which redistributive efforts play out.¹⁸⁶

C. Further Research Into Political Action Costs

Part II surveyed a number of reasons why political action costs might be positive and variable, thus falsifying the invariance hypothesis. Each of the reasons for doubt about invariance represents an area of existing or potential research into the relative magnitude of political action costs, and hence the likely feasibility and stickiness of distributive changes. In this section, we will briefly consider some directions that future research might take in light of the analysis above.

1. Assessing Inputs

Welfarists should be interested in examining the inputs into the magnitude of political action costs. These factors will help to determine the amount of redistribution that may be uniquely achievable outside of the tax system. As in other contexts, our concern should be with identifying regularities (here, in mediating political resistance and acceptance) that are systematic enough to facilitate predictions about how the costs of political action will be affected.

To focus on just one example, fairness perceptions and preferences follow discernible patterns that can be, and have been, uncovered through experimental work.¹⁸⁷ If understandings of fairness did not exhibit any regularities, and instead represented random and highly idiosyncratic reactions to different situational features, then it would not be possible to say anything predictive about how fairness perceptions would impact relative political action costs in different contexts.¹⁸⁸ As it is, fairness research provides reason to believe that redistribution (including cross-

¹⁸⁶ See *supra* notes 132-133 and accompanying text.

¹⁸⁷ See Part II.C, *supra*.

¹⁸⁸ An analogous point has been made in the context of behavioral law and economics. See, e.g., Jolls, *supra* note 26, at 1654 (explaining that behavioral law and economics “shares with [law and economics] the view that human behavior is organized by predictable patterns, which enable the analyst to generate models (often formal ones) and testable hypotheses about the effects of legal rules”).

subsidies) embedded in legal rules outside of the tax-and-transfer system—that is, redistribution that does not advertise itself as such but instead operates within rubrics like the granting of entitlements or the correction of injustice—will be easier to carry out and harder to countermand. Those interested in *Collaboration* will at least want to investigate this prediction.

Similarly, cognitive features and biases, as well as determinants of tax salience, operate in predictable ways. Other regularities might be uncovered surrounding the operation of legislative inertia in response to different types, sources, or magnitudes of distributive changes. Welfarists should be interested in all of these lines of inquiry. By understanding such components of political action costs, it may become possible to formulate policies that can achieve more redistribution, or that can achieve the same amount of redistribution more cheaply.

2. Assessing Outputs

Attending to political action costs can also change the way existing law, policies, and institutions are assessed. The principle of tax superiority is so well accepted that it sometimes permeates positive political analysis. For example, in a conversation with legal colleagues, the positive question was posed: given that peak-load or congestion pricing is efficient, why don't we see more of such pricing of road use in the center of major cities, as we observe in London? One of us speculated as follows: because the poor, and those concerned with the welfare of the poor, oppose the distributional effects of charging the poor to use the roads. Given the K&S claim, the retort was obvious: The efficiency gains from congestion pricing of road use could be allocated to make the change distributionally neutral or even pro-poor, so the distributional effects cannot explain the policy's failure.¹⁸⁹

Thus, the normative claim of tax superiority seems to support a claim of positive political theory: Because the ideal social planner can always improve the condition of the poor by (non-tax) legal rules that ignore distribution, one cannot explain the existence of inefficient legal rules by a political concern for the poor. If one observes inefficient legal rules, then, there must be some other explanation apart from concern for distribution—presumably some political malfunction. Yet this line of analysis erroneously assumes invariance. Given varying political action costs, one plausible explanation for the existence of inefficient rules, to be explored with other plausible public choice theories, is that the inefficiency makes politically feasible more welfare-enhancing distribution than would otherwise be

¹⁸⁹ For discussion of distributive and political economy issues surrounding congestion pricing, see Jonathan Remy Nash, *Efficiency versus Public Choice: The Case of Property Rights in Road Traffic Management*, 49 B.C. L. Rev. 673, 725-38 (2008).

possible.¹⁹⁰

Our discussion raises other areas for inquiry as well. Recall our previous distinction between “corrective invariance” and “aspirational invariance.” It is possible that adjustments in one direction or the other are more likely in Congress. For example, if redistribution in favor of the poor is understood to be more tightly capped by a political ceiling rather than supported by a political floor (or vice versa), then changes that make things worse (better) for the poor might escape correction to a greater extent than changes that make things better (worse) for the poor.¹⁹¹ The question merits empirical study. If corrective variance is much more significant than aspirational variance, for example, then it might be possible for courts to play a crucial role in distributive matters without ever undertaking to “redistribute” from the existing baseline.

These kind of positive questions, the answers to which could alter the way we understand the motivations and democratic responsiveness of government, provide another object for future research.

3. Pursuing Invariance?

As we suggested above, one way to read K&S’s contribution is as a demonstration of the superiority of the tax-and-transfer method for accomplishing a given quantum of redistribution *conditional on the political system actually being willing and able to employ tax-and-transfer to achieve that quantum of redistribution*.¹⁹² The empirical falsity of invariance does not undermine that claim, which raises the interesting question of how we might shift more *actual* redistribution to the tax-and-transfer system.¹⁹³ Put a little differently, if we could do more to make invariance true, should we?

The answer for a welfarist would turn, of course, on whether welfare would thereby be advanced. But the problem is complicated by heterogeneity in redistributive preferences among various actors, who may subscribe to different social welfare functions that weight distribution very differently. Consider two different ways that invariance could be advanced as a positive matter. First, agencies, courts, and legislative bodies at all levels of government could be required to estimate the distributive impacts of their every act and report this to Congress, to facilitate distributive

¹⁹⁰ Compare Gerrit De Geest & Giuseppe Dari-Mattiacci, *The Rise of Carrots and the Decline of Sticks*, 80 U. Chi. L. Rev. 341, 354 (2013) (suggesting that economists miss the positive political explanations of the differential use of carrots and sticks, which depend on their distributional effects, because of the normative belief that taxes alone should determine distribution).

¹⁹¹ [cites – influence of wealthy in political process],

¹⁹² See text accompanying note 159, *supra*.

¹⁹³ This point is tightly connected to the notion of a “political Coase Theorem.” See Acemoglu, *supra* note 158.

offsetting through the tax system,¹⁹⁴ and Congress could adopt the practice of offsetting the net effect of these changes annually.¹⁹⁵ Second, agencies, courts, and legislative bodies at all levels of government could condition their own forbearance in using their redistributive powers on Congress undertaking certain redistributive acts.¹⁹⁶

Both approaches would be aimed at ensuring that whatever redistribution does occur (from a baseline of efficiency), occurs through tax and transfer. This would carry some welfare gains in reducing the behavioral distortions from redistributive legal rules, assuming for present purposes that K&S are correct in their extra distortion argument. But in the first case the distributive preferences of Congress would trump, while in the second the distributive preferences of the other bodies would trump. Variance is removed by allowing one distributive result to dominate; whether this advances or reduces welfare depends on one's social welfare function.

This thought experiment—making invariance true—brings us full circle. A redistributive mechanism's relative merits *as a redistributive mechanism* cannot be evaluated independent of the distribution that it will be used to carry out. Efforts to channel all redistribution into the least distortionary mechanism (whether by institutional reform or academic argument) cannot be supported solely by reference to it being the least distortionary mechanism. The invariance hypothesis tells us we can do no better in distributive terms elsewhere because, in effect, there is no elsewhere. Once we recognize that political action costs drive a wedge between the distributive results that other actors and bodies can achieve and the distributive preferences Congress instantiates through its tax and transfer policy, though, we cannot avoid the difficult normative questions about which distributive preferences—and whose—should take precedence.

CONCLUSION

If transaction costs were zero, we could select legal rules based solely on their welfare-advancing distributive properties and still reach an efficient

¹⁹⁴There are some existing examples of such reporting requirements. See e.g., http://www.whitehouse.gov/sites/default/files/omb/foreg/reqpol/circular-a-4_regulatory-impact-analysis-a-primer.pdf (describing regulatory impact analysis standards which include “distributional effects”).

¹⁹⁵ An alternative would be for Congress to key its tax responses to changes in an objective benchmark, such as the Gini coefficient. See Robert J. Shiller, *The New Financial Order* 149-64 (2003) (discussing the possibility of conditioning tax rates on achievement of certain measures of after-tax income equality, to provide a form of societal “inequality insurance”).

¹⁹⁶ Cf. *supra* note ___ and accompanying text (discussing “trade adjustment assistance” programs that compensate those who lose out from free trade agreements); *Jones v. City of Los Angeles*, 444 F.3d 1118, 1138 (9th Cir. 2006) vacated as moot, No. 04-55324, 2007 WL 3010591, at *1 (9th Cir. Oct. 15, 2007) (enjoining enforcement of ordinance against sitting, lying, or sleeping in public streets or sidewalks unless enough shelter beds are provided).

outcome in every instance. Transaction costs, then, drive the insistence on efficient rules that underpins the principle of tax superiority. But tax superiority also depends on an assumption about another impediment to welfare maximization: that the political action costs necessary to achieve a desired distributive effect will never be larger for taxes than they are for doctrinal rules. This assumption, in turn, underpins the invariance hypothesis that we have criticized here. In fact, the costs of redistribution can vary across redistributive contexts in ways that make some distributive patterns impossible to achieve and maintain through tax alone. This distributive variance carries profound implications for the pursuit of social welfare, ones that welfarists should be interested in tracing.

Clearing away the assumption of distributive invariance upon which the principle of tax superiority is founded opens up new avenues of research for law and economics scholars. In addition to providing a reason why distributive goals might at times be better pursued through legal rules than through tax mechanisms, our analysis invites inquiry into the factors that influence the magnitude and operation of political action costs. Incorporating these elements into the analysis is admittedly messy; it upends the tidy division of labor that the invariance hypothesis supports.¹⁹⁷ But as Nobel Laureate James Heckman has recognized, law and economics is “analytically incomplete” without “a satisfactory framework within which to analyze redistribution.”¹⁹⁸ In his words, “A fully satisfactory analysis would require a careful accounting of the politics of redistribution and the gap between ideal policies and those that are actually used by governments as they emerge from political compromises.”¹⁹⁹ We agree.

¹⁹⁷ Cf. Coase, *The Firm, the Market, and the Law* at 15 (“The world of zero transaction costs, to which the Coase Theorem applies, is the world of modern economic analysis, and economists therefore feel quite comfortable handling the intellectual problems it poses, remote from the real world though they may be.”),

¹⁹⁸ Heckman, *supra* note 55, at 332.

¹⁹⁹ *Id.*

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