PART I

Introduction

1

Orienting the Argument

Efficiency has long been the most important – if not the *exclusive* – normative principle guiding the economic analysis of law. In other words, which legal rule will maximize society's total wealth? However, the problem with efficiency is that total wealth is indifferent to the way it is distributed. According to efficiency, a bigger pie where almost everyone gets a very small slice and only a small handful of people get very large slices is better than a slightly smaller pie where everyone gets the same-sized slice. Adherents and detractors of the economic analysis of law have therefore often tangled over the competing goals of efficiency – the size of the pie – and its distribution – how the pie is divvied up.

Consider the following statements from some well-known representatives of the field. In a widely cited article, Kaplow and Shavell (1994) conclude, "[I]t is appropriate for economic analysis of legal rules to focus on efficiency and to ignore the distribution of income in offering normative judgments" (677). Or, in one of the core textbooks and introductions to law and economics, Cooter and Ulen (2016) reject "the redistributive approach to private law. Pursuing redistributive goals is an exceptional use of private law that special circumstances may justify but that ought not be the usual use of private law." (7). Finally, Weisbach (2003) agrees, writing, "The overwhelming majority of law and economics scholarship looks solely to efficiency to evaluate legal rules" (439). What all of these scholars have in common is a commitment to efficiency as a guiding principle in economics, a worldview that affects how they approach legal and policy challenges in the real-world. Thus, whether we are deciding how long an invention should be protected by patent, whether a merger of two giant corporations should be approved or denied, whether a factory has the right to pollute or the nearby residents a right to clean air, whether to adopt the negligence or strict liability rule in tort, or whether the minimum wage should be increased or abolished, the question always reduces to the distributively indifferent measure of efficiency: Which legal rule would maximize benefits and minimize costs for all of society?

The purpose of this book is to critically examine one of the central, intellectual pillars supporting the primacy of efficiency over distribution in the economic analysis of law. This is Kaplow and Shavell's (1994) argument that the income tax is a more efficient method than the legal system for redistributing income. Kaplow and Shavell's argument has been called the "double-distortion argument" (Sanchirico 2000, 799), a phrase which does indeed succinctly capture its basic reasoning. To put the arugment simply, using legal rules creates two economic "distortions" – losses of wealth in economists' parlance – while the tax system only generates one. Taxes regulate a person's income-earning activities; redistributive legal rules also do that, but in addition they regulate the activity that is the subject of the legal rule – for example, precautionary behavior in the case of torts, substantial performance in the case of contracts, or research and development in the case of intellectual property law. Because one distortion is better than two, the tax system accomplishes redistribution with the least amount of economic waste. We will have the opportunity to look at Kaplow and Shavell's thesis in a bit more detail in Chapter 2. For now, we should note how this argument supports law and economics' broader contention highlighted in the previous paragraph, and is narrowly about the most efficient method of redistribution. If legal rules are a more costly method of redistributing income, then it follows that we should not be concerned about whether or how legal rules affect the distribution of income.

Kaplow and Shavell's article is without question a scholarly success, accumulating over 1,000 citations when I last checked Google Scholar. But more than that, their argument for the superiority of taxation over legal rules is also a uniquely specific articulation and defense of a broader and enormously influential, economist-driven policy zeitgeist. Documenting this influence defies summary. Over the past three or more decades, government policy fundamentally has shifted away from distributive policies that required direct intervention in market activities, something we might call "predistribution" (Hacker 2011), such as a federal jobs guarantee, higher minimum wages, protectionism, stricter antitrust enforcement (or stronger regulatory oversight of monopolistic industries), and stronger unions. Instead, an alternative idea came to dominate: Let the untrammeled market work its wealth-creating magic, and to the extent we do not like the distributive outcomes, use the income tax to clean up the mess. As Jacob Hacker pithily put this attitude: "just let the market rip and clean up afterward" (Irwin 2016). The idea is also crystallized in the famous napkin story of the Laffer curve, which purported to show that the government could actually increase tax revenue by *reducing* taxes.[1] Although tax rates may be lowered, the greater economic activity they should generate will

[1] According to lore, at a 1974 dinner meeting with Ford Administration officials Dick Cheney and Donald Rumsfeld, the economist Arthur Laffer drew a curve on the back of a napkin to illustrate how a too-high tax rate could lower tax revenue by undermining economic and entrepreneurial incentives; conversely, lower taxes could stimulate the economy and create more tax revenue. Hence, the "Laffer curve" was born (Appelbaum 2017).

raise tax revenues. The political consequences of this shift have been profound. According to a recent research paper, the Democratic Party's embrace of this new market logic has contributed to the substantial realignment among the electorate, where the Party has hemorrhaged working-class voters and replaced them with more educated and affluent supporters (Kuziemko, Marx, and Naidu 2023). These consequential policy shifts therefore warrant a close reexamination of their intellectual foundations.

This book is hardly the first contribution to respond critically to Kaplow and Shavell's double-distortion argument. A number of brilliant scholars have already done so (see, e.g., Jolls 1998; Sanchirico 2000; Liscow 2014; Fennell and McAdams 2016). However, most of these responses have been conducted on the same abstract terrain on which Kaplow and Shavell first clarified their objection to the use of redistributive legal rules. To illustrate their claims, Kaplow and Shavell used an example from tort law. This was less because tort law is a major tool for redistribution, either in precedent or in policy, and more because it was a simple way to demonstrate a more abstract claim. Indeed, although there certainly are distributive stakes within the narrower realm of products liability, few people first reach for tort law when contemplating the legal levers we can pull for ameliorating income inequality. Nevertheless, critics of Kaplow and Shavell have responded at the same level of abstraction, often deploying modified versions of their tort-law example.

As insightful as these responses have been, I believe that the abstract nature in which the debate has been conducted has been a disservice to the larger conversation about equity in legal rules.[2] For one thing, no one seems to have closely examined the distributive effects of legal rules that activists, advocates, and policy makers actually propose when talking about how to redistribute income. I am thinking of legal rules such as the minimum wage, collective bargaining legislation, antitrust law, intellectual property, and housing regulation, among others. Does the double-distortion argument continue to hold when the redistributive efficiency of such policies is explicitly compared to the optimal tax-and-transfer system?

But perhaps the most unfortunate consequence of this abstract discourse surrounding the double-distortion argument is that it has allowed Kaplow and Shavell's basic claim to remain relatively unscathed. Precisely because the conversation remains abstract, Kaplow and Shavell have been able to describe each objection as an exception – a mere qualification – to their more fundamentally universal insight. For example, in answering Sanchirico's (2000) critique of their (1994) article,

[2] Recently, it has become common in popular discourse to distinguish between equality and equity. Various definitions abound but, in sum, equality may be used to describe more formal, equal treatment while equity is different treatment in the service of some more substantive, goal-oriented standard of equality. As redistribution can be easily conceptualized as falling into the latter category, the way I use "equity" is consistent with this usage. For similar reasons, equality and equity will be treated as interchangeable in this book.

Kaplow and Shavell (2000b) responded by saying that they had already identified the qualification in question and it had "only a tangential bearing on the question whether legal rules should favor the poor."[3] Likewise, they dismissed Ackerman (1971) and Kennedy (1987), who argued that housing codes could improve the material well-being of tenants with no or little economic cost. Kaplow and Shavell (2002) wrote that while Ackerman and Kennedy had "gone to great lengths to show that it is possible – not necessarily likely – that *some* redistribution can be accomplished in particular legal settings … such illustrations do not establish a *general* ability to achieve substantial redistribution in any systematic manner through use of the sorts of legal rules generally analyzed" (33 n.36, emphasis added). Thus, they allowed for rare cases where it might be appropriate to use legal rules to redistribute income. But they painted those as exceptions, too idiosyncratic to be treated with the same degree of presumptive validity possessed by the double-distortion thesis itself.

This book takes a different approach. Rather than trying to provide some general, abstract reason why legal redistribution will never or will always be more efficient than redistributing income through taxation, the book looks at specific areas of law where the distributive stakes actually lie. While it does address the redistributive potential in more general areas of private law – property, contract, and tort – the book's heart examines the minimum wage, collective bargaining legislation, housing regulation, antitrust law, and intellectual property law. This approach challenges the double-distortion argument in a more effective way. By identifying reasons why legal rules can in fact redistribute income more efficiently than taxes at a more concrete level, this case-by-case approach shows that these reasons are not mere exceptions. That is, if the double-distortion argument fails in too many cases where the redistributive stakes of law matter, it is no longer possible to dismiss these cases as exceptional. As we will also see, a case-by-case approach reveals several different reasons why the double-distortion argument fails. Just as there is not a single, "silver bullet" reason why the income tax is always more efficient than legal rules in redistributing income, there is not a single, "silver bullet" reason for the opposite proposition. But these particular reasons do not – cannot – emerge from a general, abstract analysis.

[3] In their response to Sanchirico (2000), Kaplow and Shavell (2000b) repeat several times the claim that Sanchirico's objection is a mere "qualification" without any significant implication. For example, they say that "we believe Sanchirico's claim that our basic argument is subject to certain qualifications is correct but does not go to the heart of whether legal rules should be systematically adjusted to favor the poor and disfavor the rich in order to further distributive objectives" (828). They also write, "Sanchirico's abstract exploration of one of our qualifications does not, unfortunately, illuminate the empirical question and, more important, does not in our opinion provide any basis for modification of our prior conclusion concerning the proper emphasis of normative economic analysis of legal rules" (835). In this last quote, note the way that Kaplow and Shavell describe Sanchirico's exploration as "abstract."

1.1 SOME CLARIFYING REMARKS

It is easy to misconstrue the preceding remarks, and so this section will offer three clarifications. First, I will explain what is meant when we describe the economic analysis of law's *sole* commitment to efficiency, or wealth maximization. Put simply, while law-and-economics scholars have in recent times embraced approaches in welfare economics that expressly encompass distributive concerns, they have not given up the claim that the income tax redistributes more efficiently than legal rules. As long as this latter claim stands, it will continue to encourage a neglect toward distributive concerns, even if this neglect is unintended.

In considering this first question, some may object that my characterization of law and economics as concerned exclusively with efficiency, rather than distribution, is uncharitable or narrow. Are not economists concerned with maximizing social welfare, rather than wealth, a goal that expressly accounts for the distribution of income and not exclusively its total size? For example, Kaplow and Shavell (2002) have recently made clear their commitment to redistributive policy objectives and that these objectives can be fully subsumed within the economic notion of social welfare. In their book, *Fairness and Welfare* , they write, "[T]he economic notion of social welfare is one that is concerned explicitly with the distribution of income" (4) and also, "Our main point is that many basic concerns about the overall distribution of income are encompassed by the welfare economic approach" (29).[4] Nevertheless, in that same book, they never retract the conclusions made in their prior, 1994 *Journal of Legal Studies* article. Just having claimed that welfare economics is fully adequate to address distributive concerns, Kaplow and Shavell then explain why "ignoring distributive effects in legal policy analysis is often the most sensible course even though the distribution of income is generally viewed to be important, as it is under welfare economics" (32). They then briefly provide three familiar reasons for this conclusion. First, it is often useful to ignore distributive concerns for the sake of "analytical convenience"; second, "many legal rules probably have little effect on the distribution of income"; and third, the income tax system can redistribute income more efficiently than legal rules (32–34). Kaplow's commitment to efficient, rather than redistributive, legal rules is also confirmed in his recent work on market power and inequality, where he concludes, "Perhaps surprisingly, the overall result is to leave largely intact some standard competition policy prescriptions that ignore distribution, labor supply distortion, and income taxation …" (Kaplow 2021, 330).

How do we reconcile these seemingly conflicting statements? On the one hand, Kaplow and Shavell defend the economic notion of social welfare as being fully capable of addressing concerns about inequality and income distribution. On the other

[4] Kaplow and Shavell (2002) also write, "[W]e elaborate on how questions about distribution of income fit within the framework of welfare economics, especially because the relevance of income distribution under welfare economics contrasts sharply with the popular view that income distribution is unimportant under normative economic analysis of law." (28–29)

hand, they show no signs of retreating from their earlier claim that legal rules should ignore the distribution of income and be oriented primarily, even exclusively, toward efficiency. In order to make sense of this apparent contradiction, one has to appreciate the intricate "division of labor" that economists have constructed. According to this view, policymakers should clearly separate the government's "efficiency" goals from its "distributive" goals.[5] Thus, by all means, economists should be concerned about the distribution of income; and economic theory, with the concept of social welfare, is able to determine how much wealth is worth sacrificing for the sake of society's, or the government's, distributive tastes. But Kaplow and Shavell's crucial point is that the best way to achieve these distributive goals is through the income tax system, not the legal system. Thus, to claim that the normative analysis of legal rules should be concerned solely with efficiency is not to argue that efficiency is the only goal economists should pursue. Rather it is only a claim about the proper standard for a "subset" of government policy, that subset concerned with the design of legal rules in both private and public law.

So far, we have only mentioned the distribution of *income*, and have ignored other bases for redistribution and other normative concerns about equity, such as equality before the law, or racial, gender, and other group-based forms of discrimination. This brings us to the second question needing clarification: What exactly is being distributed when we debate legal rules that redistribute? Should we redistribute well-being, income, status, or what? Elucidating this issue will allow us to avoid some pertinent, but side-tracking, objections.

This silence may not only cause confusion about what exactly is being distributed, but also raise concerns about whether economists' basis for redistribution is too narrow. However, clarifying this issue also gives us another way to reconcile Kaplow and Shavell's seemingly conflicting commitments to distribution and efficiency. This book, and the debate about using redistributive legal rules, is primarily about the distribution of income – or, more accurately, if less precisely, the distribution of *material goods*.[6]

Excluding redistribution on the bases of non-income factors has indeed been one way of criticizing Kaplow and Shavell's double-distortion argument. When other

5 The historical and theoretical basis for this division of labor is explained in the next chapter.

6 "Income" remains inaccurate because much government redistribution takes place in-kind, or with cash-like vouchers earmarked for specific purposes. Food stamps, medical services, and public education all come to mind as examples of non-cash transfers. As will be shown in Chapter 2, the debate about using legal rules to redistribute income itself began with a non-income, but material form of redistribution: housing codes and the warranty of habitability. Kaplow and Shavell may themselves protest that the optimal or efficiency form of redistribution is solely through cash transfers. Nevertheless, there is little doubt they would disagree that the warranty of habitability, for example, is an example of "income" redistribution to which their double-distortion argument would apply (see, e.g., Kaplow and Shavell 2002, 33 n.36). To avoid confusion, therefore, it will sometimes be useful to say that "income" in this book is shorthand for something like "material goods."

axes of redistribution exist, it is contended, legal rules may be better equipped than the tax-and-transfer system to address them. Blumkin and Margalioth (2005) use the example of race discrimination. In principle, the income tax could be used to undo the effects of earnings inequalities generated by discrimination based on race rather than ability. The income tax could be used to grant a refundable tax credit to members of the racially disfavored group, calculated to fully eliminate race-based earnings differences. Yet, "[t]ransfers based on ethnic origin are not common in practice because of the desire to eliminate the ability of discriminators to purchase their right to discriminate – which seems intrinsically immoral – and for symbolic reasons" (16). To put it simply, income is inadequate to address all forms of inequity, including and especially the intrinsic wrongness of racial discrimination.

However, Kaplow and Shavell may not entirely disagree with this conclusion and, for them, the difference between income and non-income bases of redistribution probably correlates with the economist's distinction between efficient and distributive policy goals. According to them (e.g., Kaplow and Shavell 2000b, 827–32), redistributing goods or values other than income falls outside the concern of their double-distortion argument. For Kaplow and Shavell, using legal rules "to redistribute" means "to redistribute income."[7] Furthermore, they contend, a legal-rule adjustment made on some non-income basis is "qualitatively different from the adjustments that we suspect most legal academics have in mind when they talk about adjusting legal rules to favor the poor" (829–30).[8] To clarify the objectives of this book, it will focus on the distribution of income, rather than non-income forms of inequality, for these reasons and because the debate about redistributive legal rules has focused primarily on the distribution of income. Non-income forms and axes of redistribution are extremely important topics for discussion, but they remain outside the scope of this work.[9]

The third clarification I would like to make is to situate the debate about redistributive legal rules within the universe of normative discourse and clarify my own commitments in this conversation. Participants in the debate for the most part

[7] Liscow (2014, 2502) recognizes this: "[Kaplow and Shavell] are not 'wrong' in not considering non-income factors; they are just asking a different question. The Kaplow-Shavell argument is a non sequitur in the context of redistribution for non-income reasons."

[8] Lewinsohn-Zamir (2006) makes a more subtle point about the difference between income and other "goods." Using the example of the warranty of habitability, she argues that income is no substitute for a "rat-infested, leaking and broken-down apartment." Such a dwelling "cannot grant the basic security, comfort and means that are essential for advancing self-respect and autonomous action, acquiring knowledge, pursuing long-term goals, or developing deep and meaningful social relationships with other people" (350–51).

[9] Finally, proponents of the double-distortion claim will in fact argue that rules that address other forms of inequality – such as anti-discrimination legislation – may actually be efficient and therefore pose no efficiency-equity trade-off. The absence of the trade-off means that the issue falls outside the debate about redistributive legal rules. For a discussion of the efficiency of disparate impact rules, see, e.g., Ayres (2007).

agree on the ultimate end or goal: the maximization of welfare or well-being. Income inequality or the maldistribution of material goods is "bad" because it lowers social welfare. Conversely, social welfare can be raised by redistributing income – that is, by transferring income to those who value an additional dollar more (the poor) from those who value an additional dollar less (the rich). Of course, welfare maximization, coming from the tradition of utilitarianism, is not above criticism and has frequently, even legitimately, been accused of ignoring other fundamental norms and values – justice, rights, or fairness, for example.[10] Nevertheless, this book does not take issue with the ultimate end or normative goal of welfare maximization. Rather, the crux of the debate, and the focus of this book, is on the *means* or method by which this goal is achieved: Can legal rules or income taxes redistribute income, and therefore raise social welfare, more efficiently than the other? Moreover this means invokes a different metric, *wealth* or *efficiency*, which is translatable into welfare but is not always the same thing. To underscore the distinction, the question is which means of increasing *welfare* is the least destructive of the *wealth* we are attempting to transfer? This book is primarily concerned with the "means" question and not with the "ends" question. In fact, with reference to the terms of the debate itself and the perspectives of the participants, there is little controversy over the ultimate end to be pursued. As far as I can tell, no one takes the redistribution of income as an end in itself. (For further discussion of welfare, wealth, and their maximization, see the book's appendix.)

Thus, this book will set aside the "ends" question, which accepts, for the sake of discussion, that the ultimate goal is to maximize social welfare; the question at the heart of this book is whether the income tax or legal rules can best accomplish this objective. This book functions as an "internal" critique of the law and economics of income inequality, one that accepts the basic assumptions of economic reason but attempts to show that those assumptions do not necessarily lead to the accepted conclusions. I will leave to the side, for a possible future discussion, an "external" critique of law and economics and an examination of its basic assumptions that such a critique would entail. I therefore do not want to be mistaken as subscribing to social-welfare maximization as an appropriate and comprehensive normative framework. I have major reservations about the social welfare point of view, primarily about the

[10] In an extensive series of books and articles, Kaplow and Shavell (1999; 2000a; 2001a; 2001b; 2002; 2003) have made the case that when evaluating legal policies, *exclusive* weight should be put on their effects on individuals' well-being, with no *independent* weight accorded to notions of justice or fairness. For some of the responses to Kaplow and Shavell's approach to fairness versus welfare, see, e.g., Dorff (2001), Craswell (2003), Kornhauser (2003), Waldron (2003), and Markovits (2004). In addition, Adler (2012) has made a detailed and sophisticated case for using well-being as a fully-legitimate *moral* framework for policy evaluation. However, for the purposes of the present volume, Kaplow and Shavell's argument that social welfare is an adequate, or even compelling, language for a comprehensive moral philosophy should be kept distinct from their argument that the tax system is most efficient means for redistributing income.

claim that it can or should be measured and maximized. But I reserve that discussion for another place and time.

Despite those misgivings, I hope that those who have not accepted the economists' normative viewpoint will still find value in the book and find the double-distortion argument worthy of serious reflection and discussion. The argument that legal rules should not be used for distributive objectives is primarily associated with law-and-economics scholarship. But the argument is also deeply ingrained within political liberal thought. The position is quite explicitly found in the work of John Rawls (1999, 254), as well as in that of many other political liberals (e.g., Alstott 1999). The position cannot therefore simply be dismissed as a "pro-market" conservative argument. In addition, even those skeptical of welfare maximization as an adequate moral theory should find the double-distortion thesis worthy of attention. Many, if not most, people who would consider the effects of legal rules on rights, justice, or fairness would also consider their effects on individuals' wealth or well-being. That is, a big part of why we care about economic inequality and poverty is because of their consequences for well-being. So if an argument says that using taxes exclusively will improve the well-being of the poor, it is one we should pay attention to, regardless of the abstract normative justification.

1.2 OUTLINE AND ARGUMENT OF THE BOOK

The argument that legal rules should not be used for distributive objectives is primarily associated with law-and-economics scholarship, which as I have noted can proceed on a rarefied plane, far removed from the complex realities of the actual policy. This overly abstract level of debate has permitted the double-distortion argument to retain a privileged position, so it follows that an argument for legal redistribution should interrogate that argument in more specific settings. This is precisely the approach of this book.

After some preliminary Part I material that reviews the existing literature and the foundational terms of the debate, Part II of this book explores how the question of wealth redistribution plays out in several accepted "common law" areas. These include property in Chapter 3, tort in Chapter 4, and contract in Chapter 5. As the most foundational and "general" areas of the law, these common-law domains are the most frequently analyzed by legal scholars, though they may not always be considered likely areas for redistributive legal rules. These areas' centrality in legal scholarship, including in debates about equity-informed legal rules, makes their inclusion in this book essential. Nevertheless, each chapter will show how, even in places where using the law to redistribute income seems less promising, there are simple reasons and circumstances when the common law can redistribute more efficiently than the income tax.