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Forget (Arguing About) Redistribution

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Abstract

Reformers often argue that the benefits of ameliorating inequality are worth the cost in higher tax rates and reduced economic efficiency that redistributive social policy supposedly requires. This paper suggests that these arguments are mostly misplaced. Focusing solely on the marginal benefit of government- versus private-sector spending, there is ample reason to conclude that many governmental expenditures directed to reducing inequality are independently justifiable on the basis that they increase efficiency and, over time, more than pay for themselves. Because the efficiency argument directly addresses concerns that might otherwise counsel restraint in redistributive programs, treating the reduction of inequality as a worthwhile tradeoff against efficiency or higher tax rates is mostly counterproductive from a social policy perspective. In fact, the failure to adopt or enhance many spending programs itself represents a form of upward redistribution as measured from a baseline of social wealth maximization. This redistribution is difficult or impossible to justify from either a welfarist perspective or a libertarian one.

In making the argument, this paper develops the concept of "budget policy endogeneity," or the idea that in judging the affordability of various programs one must take into account the allocative and distributional effects of current spending on the future allocation of resources, since revenue for current projects may be raised in the future. If current spending enhances allocative efficiency, programs that can only be funded with borrowing today create the conditions for their relatively less burdensome repayment tomorrow.

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I. Introduction

Deficit spending, infrastructure decay and widening inequality have been features of the political and economic landscape in the U.S. since at least the 1980s.[1] Commentators have advanced many proposals to address these problems, but with decidedly mixed success. In the legal literature, the proposals have tended to rest on analysis of the often competing goals of maximizing efficiency and achieving an appropriate level of redistribution.[2] For the most part the proposals never achieve policy salience.[3] Instead, policy choices are consistently framed in terms of whether current levels of public spending are sustainable, whether additional revenue is available to fund desirable but expensive programs, and, if not (as is nearly always

1. On widening inequality, *see generally* James R. Repetti, *The Appropriate Roles for Equity and Efficiency in a Progressive Individual Income Tax*, 23 Fla. Tax Rev. 522 (2020). On deficits, *see Federal Surplus or Deficit*, Fed. Rsrv. Bank of St. Louis, https://fred.stlouisfed.org/series/FYFSD (last visited Dec. 4, 2021) (graphing U.S. deficits from 1901 forward). On infrastructure decay, *see* Jerry Zhirong Zhao et al., *America's Trillion Dollar Repair Bill: Capital Budgeting and the Disclosure of State Infrastructure Needs* 1 (The Volcker All., Working Paper, Nov. 2019), https://www.volckeralliance.org/sites/default/files/attachments/Americas%20Trillion-Dollar%20Repair%20Bill%20-%20Capital%20Budgeting%20and%20the%20Disclosure%20of%20State%20Infrastructure%20Needs.pdf (estimating total deferred maintenance in the U.S. as of 2019 at $1 trillion).

2. For a recent example, *see* Repetti, *supra* note 1, at *passim* (noting measurement problems with efficiency analysis and contrasting uncertainties in efficiency measures with documented benefits of reducing inequality).

3. Some of the many examples include Edward D. Kleinbard, *The Right Tax at the Right Time*, 21 Fla. Tax Rev. 208 (2017); U.S. Dep't of the Treasury, Integration of the Individual and Corporate Tax Systems: Taxing Business Income Once (1992); H.R. 1, 113th Cong. (2014). For a more general treatment adopting the same basic approach, *see* Lee Anne Fennell & Richard H. McAdams, *The Distributive Deficit in Law and Economics*, 100 Minn. L. Rev. 1051 (2016).

concluded), whether instead tax relief can be made more widely available to spur growth and increase wealth at lower and middle income levels.[4]

The thesis of this paper is that the failure of proposals of this type to gain traction is largely traceable to two distinct but related phenomena. The first is the framing of the problem as a tradeoff between affordability and a proper level of redistribution. Government spending appears as a type of redistribution that must be justified in fairness terms because spending costs money, reduces efficiency and compromises liberal property rights.[5] So understood, the case for spending remains only as strong as the intuitions that support a particular version of fairness dominate those that support the supposedly countervailing values of promoting growth and keeping tax burdens manageable. At all events, proponents and opponents can legitimately disagree on the proper balance between these considerations. If, however, increased government spending also promotes efficiency and affordability, the case for spending strengthens dramatically. Indeed, it strengthens even against the case for protecting liberal property rights. As the discussion below develops in some detail, the efficiency and affordability cases for many types of government spending are quite robust.

In public debate the point has gone underemphasized, if not unnoticed, that much tax revenue funds the purchase of goods that have significant value, indeed value that cannot be purchased as cheaply, if at all, through private markets.[6] While the role of government in the procurement of public goods is well understood,[7] the linkage between taxes and public goods spending has remained largely offstage. A better framing of tax policy would tie it much more closely to spending policy: What assets are we purchasing with marginal tax dollars, and how does the return to those assets compare to the return from marginal private investment? When placed in this frame, it becomes clear that a great deal of taxation is not inherently a cost but rather an economically important and rational finance mechanism for the purchase of assets. Assets so purchased can be paid for precisely because of their value; a focus on cash-flows (affordability) is a red herring.

The second phenomenon concerns timing. Most discussions of tax and spending policy consider the problem of optimal resource allocation in narrow temporal terms: How much public spending should there be given reasonably available revenues now?[8] This framing arbitrarily constrains policy choices by requiring

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4. *See, e.g.*, Lily Batchelder, *Preliminary Estimates Show Build Back Better Legislation Will Reduce Deficits* (Nov. 4, 2021) (discussing "pay-for" in pending legislation), *at* https://home.treasury.gov/news/featured-stories/preliminary-estimates-show-build-back-better-legislation-will-reduce-deficits (last visited Dec. 10, 2021).

5. For a property rights-based criticism of redistributive programs, *see, e.g.*, ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA (1974). For an efficiency-based critique, *see, e.g.*, Alan Reynolds, *The Fundamental Fallacy of Redistribution*, CATO AT LIBERTY BLOG (Feb. 11, 2016, 1:22 PM), https://www.cato.org/blog/fundamental-fallacy-redistribution.

6. The literature on public goods and their funding is vast. Perhaps the seminal paper is Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387 (1954).

7. *See id.*

8. For one example among many, consider Lily Batchelder & David Kamin, *Taxing the Rich: Issues and Options*, ASPEN INST. ECON. STRATEGY GRP., Sept. 11, 2019, at 3 (using static revenue assumptions to evaluate the affordability of spending programs).

spending programs to be paid for roughly in the period (or periods) in which they are undertaken. As an example, the question often is posed whether there is "enough" available taxable income or wealth in the very highest strata to cover anticipated revenue shortfalls given existing commitments, and given that lower strata simply lack the resources to pay additional tax.[9] In this framing, the question becomes whether a sufficiently progressive income (or wealth or consumption) tax is available to fund desired programs.[10] Implicit in the question is the assumption that an inability to pay now means that the programs are unaffordable, at least in their more fulsome versions. In fact, the opposite conclusion is often correct in the most important cases. Borrowing, after all, is hardly an unfamiliar form of finance in the private sector. Individuals and firms borrow because of the value in many instances that derives from moving an investment forward in time relative to the time of payment for it. It is unclear why governments should not do the same.

More subtly, and perhaps more importantly, even when discussions take a longer view, they typically fail to address the distributive and allocative effects of current *spending* policy on future *revenue* policy. Because these future effects will in turn affect the affordability of present and future spending programs, steady-state spending that is not sustainable given the current allocation of resources may become sustainable under future allocations that result from current spending. In short, if the allocation of resources shifts favorably, the sources of possible tax revenue will grow. If it is possible to use current spending to induce that favorable shift, the arguments for constraining current spending by current revenue sources are weak. I refer to this dependence of future revenue policy on current spending policy as "budget policy endogeneity."[11] As developed below, a more equal distribution of societal resources would both enhance resources available for public goods and, perhaps most critically, reflect a more efficient allocation of resources than the current allocation does, meaning that total social wealth would be greater than under the current allocation.

Taken together, these observations suggest that arguments for tax and spending reform should focus on two points. First, at a practical level, reformers should emphasize the need for spending programs that enhance total social wealth in present value terms rather than on snapshots of revenues versus expenditures. Prominent proposals to raise additional revenue, while promising in some respects, tend to be self-defeating because even the most optimistic assessments under current allocations must acknowledge that those resources fall dramatically

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9. *See id.*

10. *See, e.g.*, Huaqun Li & Karl Smith, *Analysis of Sen. Warren and Sen. Sanders' Wealth Tax Plans*, TAX FOUND. FISCAL FACT NO. 691, Jan. 2020, at 7.

11. Neil Buchanan develops at some length the idea that the marginal return to certain types of public spending may exceed, indeed greatly exceed, the marginal return to private investment. *See* Neil H. Buchanan, *Good Deficits: Protecting the Public Interest from Deficit Hysteria*, 31 VA. TAX REV. 75, 106–14 (2011). This paper extends Buchanan's argument by explicitly considering the effects of current public investment on the capacity of future generations to pay for that investment.

short of existing, much less projected, revenue commitments.[12] A focus on the related but different question of net present value to public spending outlays and on the comparative advantage of government over private spending for certain types of essential goods is likely to be more effective.

Second, and relatedly, scholars should more forcefully take up the cause lately championed by some commentators of insisting on looking at the tax and spending sides together when evaluating both the efficiency and the distributional properties of government policy.[13] This paper's contribution to the debate is its focus on budget policy endogeneity. Public goods spending does not merely procure valuable assets; it also creates the capacity to pay for those assets by profitably adjusting resources and entitlements in the future.

The overall thesis is that success on the spending side ought to result in the long run in allocative rebalancing and an increase in productivity that ultimately makes it possible to address the long-range budgetary effects of increased public spending. The mechanism is indirect: raising public goods spending both enhances total productivity and economically empowers disadvantaged populations, many of whom are victims of what is in effect a market failure. This market failure not only reduces their wealth; by definition, it reduces total social wealth and, from an efficiency perspective, represents an economic distortion. Once market failures are ameliorated, tax policy can shift in ways that distribute the tax burden equitably and sustainably, namely, in ways that do not perpetuate the same market failure. In something of an irony, this shift would be to a less rather than more progressive distribution of the tax burden (though to higher total taxes), precisely because resources would be more evenly distributed across income strata. In short, by raising the welfare of individuals at the bottom of the income and wealth distributions first, the resulting improvement in resource allocation creates a stable and sustainable source of tax revenue across a broader spectrum needed to support funding adequate for these very objectives. In the meantime, these developments in turn reduce the need for explicitly redistributive programs, helping to ensure the long-run sustainability of robust funding for public goods.[14]

Such a program might seem fanciful if examples that go well beyond a proof of concept were not already available. Most industrialized countries invest considerably more in public goods than does the United States,[15] and they do so with

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12. *See, e.g.*, Batchelder & Kamin, *supra* note 8, at 11 (conceding that an ambitious wealth tax will still fail to meet existing commitments over the long term).

13. Kleinbard is the most prominent proponent of this view in legal academia. *See* EDWARD D. KLEINBARD, WE ARE BETTER THAN THIS: HOW GOVERNMENT SHOULD SPEND OUR MONEY xxii (2015) ("Tax policy is the handmaiden, and spending policy the sovereign . . .").

14. Daniel Hemel & Ethan Porter, *Aligning Taxes and Spending: Theory and Experimental Evidence*, BEHAV. PUB. POL. 1, 1–2 (2019). Hemel and Porter corroborate the proposition that public support for government spending tends to be correlated with the extent to which source and use are tied. This tying is not possible in the case of explicitly redistributive spending.

15. *See* OECD, *General Government Spending*, (ranking U.S. twenty-six out of OECD nations listed on spending as a percentage of GDP for 2020 (or latest year for which data are available); each of the eight lower-ranked countries is either a less-developed country or a tax haven).

a mix of taxes that is considerably more regressive than is the United States'.[16] They are able to do this because their mix of taxes funds spending that is much more progressive in effect than is U.S. spending. Further, for reasons developed below, much of the spending is actually efficiency-enhancing.[17] Connecting the dots, it turns out that industrialized countries enhance efficiency by compensating for market failures through the robust provision of public goods. Stated somewhat differently, market failures lock illiquid human capital in unproductive arrangements, meaning that a great deal of wealth resides not only in the portfolios of upper income and wealth strata but also, and more importantly, in the native but undeveloped human capital of vast numbers of people in less well-off cohorts. Neither the normative nor the rhetorical force of this point should go unappreciated. Normatively, it means that under-investment in public goods is in effect both a transfer from lower income levels to upper levels—"redistribution up," as one might put it—and a form of rent-seeking that destroys social wealth. The case for reversing these effects through robust income support and related programs is particularly compelling. Rhetorically, it allows a (proper) framing of a great deal of public goods spending in terms that no longer require a weighing of fairness against productivity or affordability: we are underproductive because of allocative inefficiency measured against the baseline of what non-distorted allocations would produce. We can forget (arguing about) redistribution.

The discussion proceeds in three parts. Part II details some of the problems just sketched. Part III discusses budget policy endogeneity and offers reform suggestions. Part IV briefly addresses the philosophical question whether increased taxation to pay for public goods programs is a kind of unjust redistribution. It answers the question in the negative.

II. Trends in Taxation and Resource Allocation

A. Tax Policy

The overall decline in tax revenue relative to revenue commitments in the U.S. is a well-known and well-documented phenomenon.[18] This part focuses on the case of corporate tax policy as a window into the structural nature of the problem. In many ways, the history of the U.S. corporate tax in the post-World War II period is a microcosm of problems that plague the revenue side in the U.S.

Perhaps the most striking fact in this history is that U.S. corporate tax receipts, as a percentage of total tax receipts, have fallen by more than two-thirds

16. OECD, Revenue Statistics 2019: Tax Revenue Trends in the OECD 8 fig.5 (2019) (U.S. tax revenue as a percentage of GDP is 10 percent below unweighted average among OECD nations).

17. A full (welfare) measure of the extent to which it is efficiency-enhancing should include the amelioration of income volatility for individuals in lower socio-economic strata, for whom risk premia are unaffordable.

18. *See, e.g.*, Cong. Budget Off., Options for Reducing the Budget Deficit: 2019–2028 2 fig.1-1 (2018).

in the last sixty-five years.[19] While some of the reduction is due to falling corporate tax rates, some is due to the capacity of U.S.-parented multinationals (MNEs) to defer inclusion of foreign-source income in the U.S. tax base and to strip income out of the U.S. to low-tax jurisdictions.[20]

One consequence of the falloff in corporate tax receipts is a shift in the distribution of the overall tax burden. The best estimates of the economic incidence of the corporate tax place around 75% of the burden on owners of capital (including noncorporate capital), with most of the balance on labor.[21] Since owners of capital overwhelmingly occupy higher income and wealth brackets, a reduction in corporate tax tends to be regressive even before accounting for ways in which the resulting shortfall may be made up.[22] In fact, Congress has not fully compensated for declining corporate tax receipts and, to the extent it has compensated, has done so by raising largely regressive taxes in other sectors, such as employment.[23] Speaking generally, employment taxes are regressive because they apply at a flat rate to the first dollar of earned income and because most of the tax burden ceases at approximately $140,000 of annual wage income.[24] The combined effect has been a reduction in federal revenues and spending, together with a substantial increase in tax regressivity. In light of the highly progressive nature of most government spending, the net regressivity, that is, taking into account the spending side of the ledger, is even greater.[25]

These developments suggest that the problem of under-taxation of MNEs in particular, and of capital more generally, is worse than feared. It is not primarily technical in nature but rather a problem of political economy. It is serious enough that one might legitimately despair of real solutions in the absence of political

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19. Total federal tax receipts for 1955 amounted to approximately $64 billion, of which corporate tax receipts composed $20.5 billion, or 32%. In 2019, the figures were $2.165 trillion and $217 billion, respectively, or approximately 10%. *Federal Government: Tax Receipts on Corporate Income*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/FCTAX (last visited Dec. 8, 2021); *Federal government current tax receipts*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/W006RC1Q027SBEA (last visited Dec. 8, 2021).

20. *See generally* Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699 (2011).

21. *See* Batchelder & Kamin, *supra* note 8, at 11 (summarizing the recent literature). More recently, analyzing cash flows, Edward Fox has argued that most of the corporate tax burden falls on capital. Edward G. Fox, *Does Capital Bear the U.S. Corporate Tax After All? New Evidence from Corporate Tax Returns*, 17 J. EMP. LEG. STUD. 71, 91 (2020).

22. *See, e.g.*, CHUCK MARR ET AL., CTR. ON BUDGET AND POL'Y PRIORITIES, SUBSTANTIAL INCOME OF WEALTHY HOUSEHOLDS ESCAPES TAXATION OR ENJOYS SPECIAL TAX BREAKS: REFORM IS NEEDED 14 fig.5 (2019) (stating that in 2018 the top 1% of households by wealth received 69% of long-term capital gain income).

23. Social Security Administration, *Social Security and Medicare Tax Rates* (indicating that the combined employer and employee rate has risen from 1.5 percent in 1950 to 7.65 percent since 1990), https://www.ssa.gov/oact/progdata/taxRates.html; Social Security Administration, *Contribution and Benefit Base* (showing that the contribution and benefit base for the OASDI portion (currently 6.2 percent) has risen from $3,000 in 1950 to $147,000 for 2022), https://www.ssa.gov/oact/COLA/cbb.html#Series.

24. *See* 42 U.S.C. § 430.

25. For an extended analysis of the distributional impact of federal spending, *see* KLEINBARD, *supra* note 13, at 87–90.

and economic developments that themselves might qualify as extremely untoward. Several circumstances support this gloomy assessment. First, as is widely recognized, MNE tax avoidance is a game involving at least three significant groups of players, not two: MNEs, the tax regime and its enforcement agency, and tax havens.[26] In other words, the problem is global, not national. Both direct and indirect evidence support the proposition that tax havens market their sovereignty to MNEs in ways that are particularly hard for other countries to combat.[27] Direct evidence includes the notorious success of tax avoidance strategies that exploit tax havens, including, for example, the "Double Irish Dutch Sandwich"[28] and the extensive use of hybrid entities to exploit inconsistencies in home and host country source rules.[29] Indirect evidence includes, more subtly, the fact that countries seeking to protect their corporate tax bases generally employ strategies designed to recover tax revenue leakage to other high-tax countries rather than to tax havens.[30] The likely reason is that MNEs do not much care if they must pay additional tax to high-tax State A as long as doing so reduces their tax burden in high-tax State B. By contrast, MNEs stand to lose after-tax revenue if income is reallocated from a tax haven to a high-tax state. The fact that tax authorities tend to cooperate in this enterprise suggests either a significant level of regulatory capture or a simple lack of regulatory power or resources to combat tax avoidance.[31] Meanwhile, even tax administrators within these groups may be at odds with each other, further hampering tax collection efforts. For example, in 2016, the EU sought to require Irish tax authorities to collect €13 billion in tax from Apple Corp.'s Irish operations.[32] That effort was opposed by the U.S., which stood to suffer because of the potential for a large foreign tax credit that the payment would create for Apple in the U.S.[33]

A second circumstance relevant to the problem is the power of lobbying groups to control government measures to reduce tax avoidance. Recently-passed

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26. *See generally* Thomas R. Tørsløv et al., *The Missing Profits of Nations*, (Nat'l Bureau of Econ. Rsch., Working Paper No. 24701, 2020).

27. For a compelling illustration, *see* Omri Marian, *Is Something Rotten in the Grand Duchy of Luxemburg?*, TAX NOTES INT'L 281 (2016).

28. *See* Kleinbard, *supra* note 20, at 706–13, for a description of the arrangement.

29. Treasury regulations under the U.S. income tax provide for elective treatment of many entities as taxable or non-taxable (either flow-through or, more commonly, disregarded entirely for income tax purposes). *See* Treas. Reg. § 301.7701–3 (2020). These rules generally do not require consistency of treatment by home and host jurisdictions. *Id.*

30. Tørsløv et al., *supra* note 26, at 4 ("Our analysis shows, consistent with the theory, that the vast majority of high-tax countries[']enforcement effort are directed at other high-tax countries.").

31. Consistently declining budgets for U.S. tax authorities both suggest legislative capture and highlight the difficulties of collecting tax from resource-rich taxpayers. *See* BRANDON DEBOT ET AL., CTR. ON BUDGET & POL'Y PRIORITIES, TRUMP BUDGET CONTINUES MULTI-YEAR ASSAULT ON IRS FUNDING DESPITE MNUCHIN'S CALL FOR MORE RESOURCES 1–6 (2017) (detailing declining IRS budgets from 2010 forward).

32. Commission Decision 2017/1283, 2017 O.J. (L 187).

33. Amanda M. Milhet, *Are European State Aid Payments Creditable Foreign Taxes?*, 105 GEO. L.J. 1433, 1435 (2017).

international tax reform in the U.S. presents a case in point.[34] The legislation includes a number of anti-avoidance provisions, but on balance they are inadequate to deal effectively with the capacity of U.S.-parented MNEs to book profits for tax purposes in low-tax jurisdictions or otherwise to defer inclusion of income in the U.S. tax base, because they do not eliminate the rate differential that makes investment in tax havens attractive.[35] In this connection one should bear in mind that the anti-distortionary provisions of the new law, which include a new worldwide tax on intangible income[36] and new limitations on interest-stripping of profits out of the U.S.,[37] are paired with a low 21% corporate rate[38] and, more importantly, an even lower rate on non-U.S. source income of U.S. MNEs.[39] The fact that roads not taken would likely have addressed the problem, while also substantially simplifying the U.S. Tax Code, further supports the hypothesis that legislative capture has mostly taken meaningful tax reform off the table.[40] These roads include a worldwide anti-deferral regime, or a territorial regime with more robust anti-base erosion provisions.[41]

Finally, the persistence of worldwide wealth accumulation means that consumption taxes, which constitute the most widely-used supplement to income as a base (by revenues raised),[42] are unlikely to supply the revenue necessary to meet government revenue targets given existing allocations of resources.[43] By way of illustration, the (unweighted) average income tax revenue (national and subnational) as a percentage of GDP in OECD countries for 2017 was 11.4%, while for

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34. An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054.

35. *Government Current Receipts and Expenditures: Quarterly tbl3.1 line 5,* FED. RSRV. BANK OF ST. LOUIS, *https://fred.stlouisfed.org/release/tables?eid=5223&rid=53* (last visited Dec. 8, 2021) (showing annual U.S. federal and state corporate tax receipts falling by approximately $500 billion, or 38%, following enactment of the Tax Cuts and Jobs Act).

36. I.R.C. § 250 (GILTI).

37. I.R.C. § 59A (BEAT).

38. I.R.C. § 11.

39. *See Statutory Corporate Income Tax Rate: 2021*, tbl.II.1., OECD.STAT, https://stats.oecd.org/index.aspx?DataSetCode=TABLE_II1 (last visited Dec. 8, 2021).

40. *See* Daniel Shaviro, *Evaluating the New US Pass-Through Rules*, 2018 BRIT. TAX REV. 49, 66 ("In addition to promoting both vertical and horizontal inequity, the pass-through rules' mindless industrial policy favours some lines of business over others for no discernible reason.").

41. As of this writing, the U.S., along with a broad coalition of industrial countries, is considering the adoption of a 15% minimum tax on cross-border income. *See* Daniel Bunn, *What's in the New Global Tax Agreement?* TAX FOUND. (Oct. 8, 2021), https://taxfoundation.org/global-tax-agreement/. If it is adopted, it would represent a major inroad on corporate tax avoidance. Nevertheless, neither the revenue nor the efficiency benefits of the plan in its current form would come close to meeting existing and projected revenue needs. The proposal is projected to raise only approximately $150 billion worldwide annually. *130 Countries and Jurisdictions Join Bold New Framework for International Tax Reform*, OECD (July 1, 2021), https://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm.

42. With the exception of the United States, every member of the OECD employs a national-level, consumption-based value-added tax. OECD, CONSUMPTION TAX TRENDS 181 (2016).

43. *See* Edward D. Kleinbard, *Capital Taxation in an Age of Inequality*, 90 S. CAL L. REV. 593, 636–37 (2017).

the U.S. it was 12.4%.[44] Meanwhile, the unweighted average general consumption tax revenue (VAT and retail sales taxes combined, national and subnational) as a percentage of GDP was 7.1%, but for the U.S. it was 2.0%.[45] Thus, in order to raise tax revenue to the average level in the OECD for combined income and general consumption taxes, the U.S. would need to levy a consumption tax raising 4.1% of GDP, or about $792 billion annually. This amounts to about $2,429 per person, or $6,207 per household.[46]

Even these figures substantially understate U.S. tax revenue needs, for two reasons. First, the OECD includes many economies that have a substantially lower GDP per capita than most industrialized countries.[47] Limiting the comparison to peer countries changes the picture considerably. If, for example, one considers only the top fifteen economies (by GDP per capita) and excludes very small countries (fewer than five million population) and larger countries that also are tax havens (Ireland, Switzerland), average unweighted income tax revenue is 14.4% of GDP, while average unweighted consumption tax revenue is 6.6%.[48] For the U.S., this amounts to an overall annual revenue shortfall of 6.6% of GDP, or $1.286 trillion per year, which comes to about $3,945 per year per person or $10,206 per household.[49]

Second, the U.S. defense sector, at $778 billion and 3.74% of GDP,[50] is much larger than that of any other country both in absolute terms and relative to comparably developed economies, where defense spending runs about 1.5% of GDP as an unweighted average.[51] Assuming the U.S. funds a defense sector twice as large per capita as the average, this comes to another $1,133 per person[52] or $2,958 per

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44. *Revenue Statistics - OECD Countries: Comparative Tables*, OECD.STAT, https://stats.oecd.org/Index.aspx?DataSetCode=REV# (last visited Dec. 8, 2021).

45. As contrasted with every other OECD country, neither the U.S. federal government nor any state uses a VAT. Thus, the consumption tax revenue reported for the U.S. derives from general retail sales taxes. *Id.*

46. Based on 326 million for U.S. population and 126 million for the number of U.S. households. *Total Households*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/TTLHH (last visited Dec. 8, 2021).

47. Member countries of the OECD include, for example, Mexico, the Czech Republic and Turkey, all of which have substantially less-developed economies than does the U.S. *Gross Domestic Product*, OECD DATA, https://data.oecd.org/gdp/gross-domestic-product-gdp.htm (last visited Dec. 8, 2021). For information on the composition of the OECD and related matters, *see generally* OECD, *About the OECD,* http://www.oecd.org/about/ (last visited Dec. 8, 2021).

48. The fifteen countries are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, Sweden, the United Kingdom, and the United States. Figures are from 2017. Data from the OECD, *supra* note 44. Figures are based on the same tables with adjustments as noted in the text.

49. *Id.*

50. Dollar figure is for Fiscal Year 2020. *SIPRI Military Expenditure Database*, STOCKHOLM INT'L PEACE RSCH. INST., https://www.sipri.org/databases/milex (last visited Dec. 8, 2021).

51. The estimate is for the same fifteen countries. *See* OECD *supra* notes 44, 48.

52. Figure derived by author based on U.S. population in 2020 of 331 million. *See Population Data*, U.N. DEP'T OF ECON. AND SOC. AFFS., https://population.un.org/wpp/Download/Standard/Population/ (last visited Dec. 8, 2021).

household annually.[53] In total, supplementing existing income taxes with a national-level consumption tax would require collection of nearly $5,000 per person on top of existing tax burdens to make overall tax revenue from these sources as a percentage of GDP comparable to that in other industrialized countries.

Recently, a number of proposals have surfaced to tax wealth in addition to or in place of the capital income tax (in whole or part).[54] Theoretical projections suggest that a well-crafted wealth tax could overcome many of the difficulties of taxing capital under an income tax, including the notorious problem of the realization requirement, as well as the apparent result that a capital income tax that is optimal from an efficiency perspective actually takes the form of a subsidy (a negative tax), thereby exacerbating rather than ameliorating inequality.[55] But though this research brings welcome news, it is easier to take it for more than it is worth. Even the most optimistic assessments of the revenue-enhancing properties of an accretive wealth tax acknowledge that the additional revenue would not close the existing fiscal gap.[56]

The fact that a robust wealth tax taken by itself would not close the fiscal gap might suggest—and commonly is taken to suggest—that long-run equilibrium requires cuts to government services.[57] But the better inference is the opposite. If other industrialized nations develop greater public infrastructure with more regressive taxes, it seems that the real problem is wealth concentration and that an excessively progressive tax system is a symptom rather than a cause of chronic budget deficits. High progressivity in the United States, coupled with a low overall tax burden relative to those in other industrialized countries—even when compared to upper-income cohorts—points to under-investment in public goods, not over-investment. Greater public investment would support a less progressive tax system but one capable of more robustly financing public goods over the longer term. As developed below, the better-financed public sector would fuel a

53. Figure derived by author based on U.S. households numbering 120,756,000. *See Quick Facts*, U.S. CENSUS BUREAU, https://www.census.gov/quickfacts/fact/table/US/HSD410219 (last visited Dec. 8, 2021).

54. *See, e.g.*, Batchelder & Kamin, *supra* note 8, at 1820 (discussing Senator Elizabeth Warren's wealth tax proposal).

55. Fatih Guvenen et al., *Use It or Lose It: Efficiency Gains from Wealth Taxation* 4 (Nat'l Bureau of Econ. Rsch. Working Paper No. 26284, 2019).

56. Batchelder & Kamin, *supra* note 8, at 11. Further, substantial questions remain about the constitutionality of a wealth tax, as the analysis hinges on formalistic distinctions that may have little or no economic significance but carry great weight in Constitutional analysis. Perhaps the most prominent difficulty is that a wealth tax on its face appears to be a "direct" tax that must be apportioned by state population. U.S. CONST., art. I, § 9, cl. 4. The constitutional questions would be whether a wealth tax is a direct tax and, if it is, whether its close similarity to an income tax would entitle it to the exemption from the above requirement for taxes on "income." U.S. CONST., amend. XVI.

57. *See, e.g.*, Howard Gleckman, *Can a Wealth Tax Raise the Revenues Its Sponsors Hope?*, TAX POL'Y CTR.: TAXVOX (Sept. 24, 2019), https://www.taxpolicycenter.org/taxvox/can-wealth-tax-raise-revenue-its-sponsors-hope (noting revenue estimates from a wealth tax of approximately $80 to $160 billion per year over a ten-year period, far less than current deficits as detailed in the text).

reallocation of resources that distributes them more broadly through wealth strata and, crucially, more efficiently as well.

In summary, these observations raise the question of how to respond to chronic revenue shortages when technical fixes are infeasible. How, in short, can governments redirect public resources in the face of chronic underfunding? Notably, other industrialized countries having comparable levels of GDP per capita do not seem to face the same chronic fiscal shortfalls, suggesting that the problem has its roots in allocative and distributional outcomes in the U.S. that may be subject to policy adjustment. These considerations suggest that a focus on static outlays versus static revenues, or even on these figures over time but without adjusting for the effects of spending on the potential to increase revenues, is to miss the forest for the trees. One way to address the problem is to include the value of what spending is directed to in evaluating spending proposals. Just as the purchase of equipment for business purposes is not deemed a loss, investment in public welfare spending that increases social wealth should not be considered a cost that must be offset by revenue but instead should be considered the purchase of a valuable asset.

B. Spending

Unsurprisingly, U.S. public-sector spending lags that of other industrialized nations. Among OECD countries, as of 2017 U.S. government spending as a fraction of GDP ranked twenty-seven out of thirty-four.[58] Once one factors in defense spending and the especially high health care costs Americans face, the gap between the U.S. and other countries in spending on public goods widens.[59] The U.S. ranked even lower on deficit spending as a fraction of GDP. In 2017, the U.S. placed third to last on this metric among OECD countries at 4.28%.[60] Over the eighteen-year period from 2000 through 2017, the U.S. also ranked second to last at 6.056%.[61] This compares to a median average deficit over the period of 2.393%.[62] And, as with tax revenue, if one narrows the comparison group to peer economies, the discrepancy widens. Among the same group of advanced industrialized nations examined in Subpart A, the average median deficit over the eighteen-year period is 1.753% and the U.S. ranks last among this group.[63]

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58. *General Government Spending, Total, % of GDP, 2014–2017*, OECD DATA, https://data.oecd.org/gga/general-government-spending.htm (last visited Dec. 8, 2021).

59. On health care spending and outcomes, *see* Roosa Tikkanen & Melinda K. Abrams, *U.S. Health Care from a Global Perspective, 2019: Higher Spending, Worse Outcomes?*, THE COMMONWEALTH FUND (Jan. 30, 2020), https://www.commonwealthfund.org/publications/issue-briefs/2020/jan/us-health-care-global-perspective-2019 (noting that U.S. spends more on health care as a percentage of GDP than any other country and has worse health outcomes than other OECD countries).

60. *General Government Deficit, Total % of GDP, 2000–2020*, OECD DATA, https://data.oecd.org/gga/general-government-deficit.htm (last visited Dec. 8, 2021).

61. *Id.* (calculation by author—data for some years unavailable for Chile, China, Colombia, Indonesia, Japan, Mexico, Russia, and Turkey).

62. *Id.* (calculation by author, subject to same data limitations as described in the preceding note).

63. *Id.* (calculation by author, subject to same data limitations as described in the preceding note). For list of countries, *see supra* note 48.

At a more granular level, U.S. federal spending seems poorly targeted as a mechanism for building social wealth. For example, Hilary Hoynes and Diane Schanzenbach find that federal spending on childhood anti-poverty programs tends to target children above, rather than below, the poverty line.[64] Noting the net benefits of spending on children, they conclude:

> [W]e are spending too little on children and their families. And the decline in the availability of benefits for the most disadvantaged children, primarily due to welfare reform, is likely to lead to worse outcomes for these children in adulthood. Any cuts to current programs that will reduce resources going to children would have direct, negative effects on children in both the short and long terms.[65]

Hoynes and Schanzenbach also observe that current spending levels on children reflect a trend that began in approximately 1990 to reduce spending on families below the poverty line and instead target spending for children on cohorts at higher income and wealth levels.[66] Simultaneously, the proportion and amount of spending on the elderly have increased dramatically over the same period (likely due mostly to rising health care costs and an aging population).[67] Setting aside their distributional consequences, these choices are particularly troubling because a much greater proportion of the spending thereby financed would have been privately financed anyway. For example, more-affluent families will take up the child tax credit even though the total resources they expend on children may be largely unaffected. From a welfare perspective, these outlays are highly wasteful. The same families will make sure that their children receive adequate health care and nutrition regardless of whether the government covers part of the cost with a transfer payment.

In a similar vein, while the net benefits of large-scale infrastructure projects are widely appreciated, the U.S. failed to enact a robust infrastructure program for more than a decade.[68] When it finally did, in 2021, the bill fell dramatically short of anticipated public investment needs.[69] Instead, resources have been allocated to the private sector in the form of reduced taxes, with hopes that private spending will produce equivalent or superior returns to investment. For reasons developed

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64. Hilary W. Hoynes & Diane W. Schanzenbach, *Safety Net Investments in Children*, BROOKINGS PAPERS ON ECON. ACTIVITY, Spring 2018, at 89, 91–92, 122.

65. *Id.* at 92.

66. *Id.* at 114.

67. *Id.* at 95–96.

68. *See generally* Govtrack, *Infrastructure Development* (tracking bills introduced but not passed from 2009 to date), https://www.govtrack.us/congress/bills/subjects/infrastructure_development/6363.

69. In November 2021, Congress passed, and the President signed into law a bill that includes approximately $1 trillion in spending on infrastructure. *See* Infrastructure Investment and Jobs Act, H.R. 3684, 117th Cong. (2021). Most estimates of infrastructure needs, however, place the number at more than $2 trillion. *See infra* text accompanying notes 122 and 123.

in the next part of this Paper, there is ample basis to conclude that these returns will not materialize.

C. Overall Effects

The just-described picture of taxing and spending combined is not pretty. Constant annual deficits translate to an unsustainable, constantly increasing revenue shortfall. If spending, whether public or private, does not lead to the creation of assets that bolster the capacity of the government to raise adequate revenue in the future, the government eventually becomes unable to fund core programs. This pattern ultimately leads to fiscal shock. In the meantime, the dramatic departure of actual spending from an optimal mix of public and private outlays tends to impoverish large segments of the population, making it ever harder to get from here to there.[70]

Many of the consequences of the failure to fund public goods at adequate levels are obvious. When spending on transportation infrastructure or access to justice lags, consumers of these goods experience tangible, often significant harms. It becomes more costly and time-consuming to make it to work; it becomes prohibitively expensive to vindicate contractual rights, leading to an inefficient allocation of losses where they originate rather than to the least cost avoider.

The readily apparent harms, however, may be relatively minor compared to less-obvious ones, which also tend to generate outcomes that are harder to reverse. To foreshadow, underfunding of public goods results in the transfer of economic rents from members of less well-off socioeconomic strata to members of higher strata. This "upward redistribution," clearly observable in U.S. fiscal and economic policy, is powerfully self-reinforcing and inclines towards resolution only by powerful economic or political shocks, such as war, natural disaster, or civil unrest.[71] The phenomenon also generates a collective action problem for rentiers because economic rents to be siphoned off from members of less well-off strata become increasingly scarce. Consequently, sustaining upward redistribution requires continually harsher and more punitive economic and social policy, thereby hastening the likelihood of shock, to say nothing of intensifying exploitation.

Studies on the income and health effects of early childhood education and support programs provide a window into the nature of the problem. The unambiguous conclusion of a very large body of research is that increased spending on prenatal and early childhood services pays dividends well in excess of their cost.[72] As a familiar example, consider Head Start, a preschool education

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70. *See* Batchelder & Kamin, *supra* note 8, at 3 (noting that under current law debt is expected to rise from 80 percent of GDP in 2018 to 150 percent of GDP in 2050).

71. *See* Daniel Shaviro, The Long-Term U.S. Fiscal Gap: Is the Main Problem Generational Inequity?, 77 GEO. WASH. U. L. REV. 1298, 1311-16 (2009) (discussing adverse effects of not planning to avoid a fiscal crisis).

72. For a recent, comprehensive review of the literature, *see* Douglas Almond et al., *Childhood Circumstances and Adult Outcomes: Act II*, 56 J. ECON. LIT. 1360 (2018).

program for underprivileged children.[73] Most Head Start participants are three- and four-year-olds. The program is federally funded but locally administered and provides such services as a nurturing learning environment, medical care, and nutritional supplements.[74] A number of studies have documented the beneficial long-term effects of participation in Head Start, which include higher graduation rates, better self-control in later life, and elevated earnings compared to members of control groups who did not participate in Head Start.[75] The evidence also indicates that Head Start, like many such income supplement programs, more than pays for itself after factoring in the cost to the government of providing the service.[76]

If the provision of education and related goods through Head Start improves outcomes for participants as described and pays for itself, it follows that some form of allocative failure exists to the extent such programs are inadequately funded.[77] That is, total social wealth without the programs is less than it would be with them.[78] Put somewhat differently, if it were possible for potential Head Start beneficiaries to contract for Head Start services *ex ante*, they would.

One can reframe the observation as follows: the marginal return to certain categories of public investment exceeds that to private investment. Consequently, seeking to address chronic revenue shortfalls by reducing public investment —"tax cuts"—exacerbates rather than ameliorates, the problem. This phenomenon is observable in the disparity between per capita public spending in the United States and in other industrialized countries, as previously discussed. Those countries, perhaps counterintuitively, rely to a much greater extent than does the United States on consumption taxes, which taken in themselves tend to be regressive. The reason that consumption taxation in these settings is desirable, however, is that the offsetting effects of effective public investment of governmental revenues both improve the productivity of middle- and lower-level earners and make the burden of payment much lower in utility terms.

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73. Diane Whitmore Schanzenbach & Lauren Bauer, *The Long-Term Impact of the Head Start Program*, BROOKINGS (Aug. 19, 2016), https://www.brookings.edu/research/the-long-term-impact-of-the-head-start-program/ (characterizing Head Start as "the large-scale federal preschool program").

74. Eliana Garces et al., *Longer-Term Effects of Head Start*, 92 AM. ECON. REV. 999, 1000 (2002).

75. *See* JASON P. NANCE, A FEDERAL RIGHT TO EDUCATION: FUNDAMENTAL QUESTIONS FOR OUR DEMOCRACY 35–64 (Kimberly J. Robinson ed., 2019); Garces et al., *supra* note 74 at 999–1000; *see also* Schanzenbach & Bauer, *supra* note 73.

76. NANCE, *supra* note 75 at 39-40. *See* Patrick Kline & Christopher R. Walters, *Evaluating Public Programs with Close Substitutes: The Case of Head Start*, 131 Q.J. ECON. 1795, 1797 (2016) (finding that Head Start "yields benefits nearly twice as large as costs" substitution and other effects are accounted for); *see also id.* at 1844 ("We find evidence that Head Start generates especially large benefits for children who would not otherwise attend preschool and for children with weak unobserved tastes for the program. This suggests that the program's rate of return can be boosted by reforms that target new populations, though this necessitates the existence of a cost-effective technology for attracting these children.").

77. *See generally* JOSEPH E. STIGLITZ, THE PRICE OF INEQUALITY; HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE 42 (W.W. Norton & Co. ed. 2012).

78. *See* Almond et al., *supra* note 72, at 1361 (noting that the literature on fetal origins of welfare losses resonates with economists because of its focus on efficiency).

A second consequence of the underfunding of public goods is the production of a larger class of unskilled and under-skilled workers. The oversupply of such workers depresses wages, resulting in the upward wealth transfer alluded to previously. Evidence suggests that an oversupply of unskilled labor has a substantial long-term effect on wages. In an extensive meta-analysis of studies of the own-wage elasticity of labor demand, Lichter et al. found a long-term elasticity of -0.414 for the U.S., meaning that a 10% increase in wages reduces employment by 4.14%.[79] Turning the analysis around and treating labor supply as the independent variable and wages as the dependent, the data support the conclusion that a 10% reduction in labor supply would raise wages by nearly 25%. Lichter et al. also note that the elasticity is substantially greater for unskilled labor, meaning that a given reduction in labor supply would result in a greater increase in wages.[80]

A further consequence is that the budget target is lower on a steady-state basis than it would be if programs were adequately funded. A lower budget target also translates to reduced long-term tax burdens. Framed in standard economic terms, "consumer surplus" associated with the provision of the program goes uncreated because not enough of the program is purchased.[81]

Framed in welfare terms, the short- to medium-term effects of this underfunding are as follows: At any given time, a net $1 reduction in funding for public goods results in a total social welfare loss in excess of $1. This loss is allocated among classes so that lower strata absorb more than $1 of loss and upper strata actually experience a gain (albeit smaller than the loss the first group experiences). Broadly speaking, there are two sources for the gain. The first is a simple reduction in tax burdens, and the second is a reduction in the cost of goods and services resulting from an excessively large pool of unskilled or low-skilled labor.

In the absence of this allocative failure, members of the large pool would be able to procure the skills necessary to increase both their wages and their buying power. This would increase total social wealth but result in less wealth for members of upper income and wealth strata, at least in the short to medium term. By contrast, when it is not possible to remedy the allocative failure, the process produces a vicious cycle because it depends on extracting surplus from an underclass that is increasingly underfunded. There is only so much surplus that can be distributed upward; doing so calls for ever harsher measures to compensate for the reduction in surplus available for the upward transfer.

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79. Andreas Lichter et al., *The Own-Wage Elasticity of Labor Demand: A Meta-Regression Analysis*, 80 EUR. ECON. REV. 80, 103 fig.4 (2015).

80. *Id.* at 100.

81. This is the familiar problem of deadweight loss. If the price is artificially high, too little is supplied and the surplus that would go to marginal purchasers is lost. *See, e.g.*, Janes R. Hines, Jr., *Three Sides of Harberger Triangles*, 13 J. ECON. PERSP. 167, 167–68 (1999) (explaining deadweight loss).

There is ample evidence to suggest that this dynamic describes the U.S. over recent decades. Since 1964, real wages have remained essentially flat.[82] Most of the wage growth that has taken place has gone to high-income workers, with wage earners in the bottom quintile enjoying very modest increases (on the order of 20%, or less than 0.4% annually on average).[83] Over the more recent period running from 1979 to 2017, real wages fell for the bottom fifth of U.S. workers.[84] At the same time, inequality has become much more acute, with income and wealth growth of the top 1% dramatically outpacing income growth among lower-income cohorts.[85] Meanwhile, federal tax receipts as a percentage of GDP, though fluctuating substantially from year to year, have been generally flat[86] but consistently below the levels needed[87] to match federal obligations[88] and consistently below the levels of peer countries.[89] Correspondingly, taxes as a percentage of GDP are lower in the U.S. than in all but four of the thirty-five OECD countries surveyed, and none of those four is a large industrialized country.[90]

III. Budget Policy Endogeneity

The precariousness of U.S. finances raises the question whether it is possible to rectify the problems described above by means of the levers of tax and spending policy. Can we get "there" from "here"? If sources of revenue under current conditions are inadequate to fund committed and beneficial public spending, are we remitted over the long term to lower levels of public spending and lower total social welfare than would be optimal? More importantly, are we remitted to a

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82. *See* Drew Desilver, *For Most U.S. Workers, Real Wages Have Barely Budged in Decades*, Pew Rsch. Ctr. (Aug. 7, 2018), http://www.pewresearch.org/fact-tank/2018/08/07/for-most-us-workers-real-wages-have-barely-budged-for-decades/.

83. *Historical Income Tables: Households* tbl.H-3, U.S. Census Bureau https://www.census.gov/data/tables/time-series/demo/income-poverty/historical-income-households.html (last visited Dec. 8, 2021).

84. Jay Shambaugh et al., The Hamilton Project, Thirteen Facts about Wage Growth 2 fig.2 (Sept. 2017).

85. *See* Repetti, *supra* note 1, at 528–39 (reviewing and discussing CBO (Congressional Budget Office) and other data).

86. St. Louis Federal Reserve Archival Economic Data, *Federal government current tax receipts/Gross Domestic Product*, https://fred.stlouisfed.org/series/W006RC1Q027SBEA, (last visited Dec. 22, 2021) (data derived using FRED figures for absolute dollars for both the numerator and the denominator).

87. For a relatively comprehensive review of the data up to 2013, *see generally* Leonard E. Burman, *Taxes and Inequality*, 66 Tax L. Rev. 563 (2013).

88. Over the period from 1964 to 2023, on average there has been (or is projected to be) an annual deficit of 3.1% of GDP. *See Historical Tables* tbl.1.2, The White House Off. of Mgmt. & Budget, https://www.whitehouse.gov/omb/historical-tables/ (last visited Dec. 8, 2021).

89. The OECD average is 34.26% for 2016 (the latest year for which data for most OECD countries are available), while the U.S. average is 26.02% (federal and sub-federal combined). The U.S. ranks 29th out of 35 countries for 2015 (the latest year for which data for all OECD countries are available). *See Tax Revenue*, *2000–2019,* OECD, https://data.oecd.org/tax/tax-revenue.htm (last visited Dec. 8, 2021).

90. The four are Indonesia, Mexico, Ireland, and Costa Rica. *General Gov't Revenue*, *2020*, OECD, https://data.oecd.org/gga/general-government-revenue.htm (last visited Dec. 8, 2021).

cycle of ever-increasing disparities between budget commitments and the capacity to meet them?

Data and theory suggest the answer is no to both questions. This part briefly explores both. Throughout, it is important to keep in mind two points, both of which, though appreciated in some quarters, are often left out of public discussion. The first is that the distributive and allocative effects of government policy are the result of taxation and spending combined. It may not much matter if a given tax, or even the tax system as a whole, when viewed in isolation from spending, is regressive relative to some baseline of desirable progressivity (assuming one could be agreed on). If tax revenues purchase goods that have progressively distributed benefits, the overall effect may be progressive. Without knowing how revenues are expended, it is difficult to judge the efficacy of the tax system or the distributive properties of government policy generally. Secondly, Edward Kleinbard's observation about the relationship between taxing and spending previously cited bears repeating: tax policy is the handmaiden, and spending is the sovereign.[91] By this Kleinbard means not only that the purpose of taxation is to spend, but also that the allocative and distributive effects of spending dominate those of taxation.

To this last observation, the discussion below suggests a slight emendation and also an expansion. The emendation is that fiscal policy no less than tax policy is the handmaiden to spending's sovereignty. The question of how to optimize the provision of revenue to the government is not confined to determining how to raise revenue at the lowest cost at any given time; it also involves the question of when to raise it—of identifying the period or periods from which the revenue should be raised. The endogeneity of tax policy to spending policy means the metaphor must be extended even further. Spending policy itself in great measure determines the extent to which tax policy is effective. If tax policy is the handmaiden, the instruments it uses to serve the sovereign are in large measure furnished by the sovereign.

A. Comparable Fiscal Systems

Progressivity is not entirely well defined, but as a general matter it embodies the idea that taxpayers in higher income (or consumption, wealth, etc.) cohorts pay a larger percentage of whatever the tax base includes than do those in lower cohorts.[92] By many measures that implement this idea, the U.S. tax system, viewed in isolation from spending, is more progressive than most if not all of its developed country counterparts. The Mercatus Center at George Mason University, using OECD data, concluded that in the mid-2000s the U.S. tax system (all levels combined) was more progressive than that of any other OECD

91. *See* KLEINBARD, *supra* note 13, at xxi–xxii.

92. *See, e.g.*, *How Should Progressivity Be Measured?*, TAX POL'Y CTR.: BRIEFING BOOK, https://www.taxpolicycenter.org/briefing-book/how-should-progressivity-be-measured (last visited Dec. 8, 2021) ("A tax is progressive if, on average, household tax burdens rise with incomes."). A slightly more precise definition would measure progressivity by the extent to which higher income (or consumption or wealth, depending on the tax base) cohorts pay a disproportionately larger fraction of tax per dollar of taxed item.

country.[93] The Mercatus Center used the percentage of governmental outlays paid by the top 10% of households (by income distribution) as its measure of progressivity.[94] Similarly, the Tax Policy Center notes that federal taxes (primarily income and employment taxes) are highly progressive in relation to comparable taxes in other countries.[95]

At the same time, the U.S. has some of the highest levels of income inequality among OECD countries, ranking, as of 2014, tenth most unequal on a pre-tax and transfer basis and, surprisingly, fourth (behind Chile, Mexico, and Turkey) on an after-tax and transfer basis.[96] If one focuses only on the tax side of the ledger, these facts seem puzzling, perhaps even paradoxical. Why does a highly progressive tax system produce a greater degree of inequality? And why does the U.S. system perform even worse on an after-tax and transfer basis than on a pre-tax basis?

Neither question can be answered satisfactorily unless one combines these observations with two circumstances already discussed. First, overall tax levels in the United States are low. Second, over time, low tax rates lower the productivity of large segments of the population, making them unable to participate in funding even bare bones government spending, much less programs to create human capital. Taking all of these points into consideration, it appears that while the tax system in isolation may be too progressive, the overall system of taxing and spending is too regressive. Perhaps ironically, that regressivity manifests itself on the tax side, in part, in excess progressivity. The fact that the U.S. does worse on equality measures relative to peer countries on an after-tax basis than it does on a pretax basis corroborates the point.[97] When tax revenues are too low for a long enough period of time, public spending that would finance productivity-enhancing public goods and would create human capital dries up. As lower and middle-income strata become impoverished, only those at the top of the income or wealth

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93. *Progressivity of Taxes in OECD Countries, Mid-2000s*, MERCATUS CTR., https://www.mercatus.org/system/files/progressivity-of-taxes-oecd-countries-analysis-pdf_1.pdf (last visited Dec. 8, 2021). (The calculation is based on a simple measure of the share of total taxes paid by the richest 10% of the population. Other measures could come out differently, as there is no accepted metric for progressivity other than that upper tiers of the base pay more as a percentage of the base than do lower tiers.).

94. *See id.*; *see also* OECD, GROWING UNEQUAL? INCOME DISTRIBUTION AND POVERTY IN OECD COUNTRIES 107 tbl.4.5 col.B.1 (2008).

95. Roberton C. Williams, *Federal Taxes Are Very Progressive*, TAX POL'Y CTR.: TAXVOX (Aug. 11, 2016) https://www.taxpolicycenter.org/taxvox/federal-taxes-are-very-progressive ("The US federal tax system is highly progressive, primarily because individual income tax rates rise sharply with income and refundable tax credits lead to negative income taxes for households with low income."). It would be more accurate to say that the primary reason is low rates on high earners and even lower rates on low earners, relative to their counterparts in other industrialized countries.

96. CHYE-CHING HUANG & NATHANIEL FRENTZ, CTR. ON BUDGET AND POL'Y PRIORITIES, WHAT DO OECD DATA REALLY SHOW ABOUT U.S. TAXES AND REDUCING INEQUALITY? 4–5 (May 12, 2014).

97. *Inequality of Incomes Before and After Taxes and Transfers, 2014*, OUR WORLD IN DATA, https://ourworldindata.org/grapher/inequality-of-incomes-before-and-after-taxes-and-transfers-scatter (last visited Dec. 8, 2021) (finding, on a pretax basis, in 2014 the U.S. was tied for seventh worst out of the (then-) thirty-six OECD member states, at 0.51; on an after-tax basis, it was tied for third worst, at 0.39).

distributions can afford to pay for any public goods, much less an efficiency-optimizing level. Those lower down necessarily experience a drop in effective tax rates because they cannot earn enough to pay for much of anything, resulting in greater tax progressivity. However, because government revenue declines, revenues that the government does realize are available only to fund a smaller public sector, thereby curtailing or omitting financing for programs other than defense, police protection, and other basic needs, creating a downward spending spiral.

Under this analysis, steep tax progressivity in the company of low overall rates on high earners (compared to the rates of peer countries) is less a weapon against inequality than an artifact of it. Specifically, as taxes were reduced across the board starting in the 1980s, revenues fell and funding for social programs came under intense pressure. This pressure has been only incompletely relieved through deficit spending, and significant, even disastrous, cuts to programs to develop and maintain human capital have persisted.[98] Critically, these programs are highly progressive in effect, as the earlier discussion of Head Start illustrated.[99] The result over time of the reduction or elimination of anti-poverty programs is to deprive their beneficiaries of the capacity to finance them (in substantial measure). Instead, revenue sources for necessary government operations become skewed to higher income and wealth brackets because these are the only groups (now) that can afford to pay to keep the lights on. The overall effect (compared to peer countries) is lower taxes for upper-income and wealth strata, but necessarily still lower taxes for those in lower strata because they simply cannot afford to pay more. Thus, we observe progressivity at the same time as a seemingly puzzling inability to pay for social programs. The missing link is the fact that taxes nevertheless remain low, even on higher-income cohorts.[100]

As evidence that this dynamic describes the U.S. experience, consider the differences between the U.S. tax base and the typical tax base of comparably developed countries with respect to consumption taxes. Apart from the U.S., every OECD country imposes a value-added tax (VAT).[101] By contrast, consumption taxes in the U.S. are much lower and for the most part are levied at subnational levels (mostly retail sales taxes, or RSTs). Viewed in isolation, the VAT, which in

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98. *E.g.*, U.S. DEP'T OF HEALTH & HUM. SRVS., INDICATIONS OF WELFARE DEPENDENCE: ANNUAL REPORT TO CONGRESS (Dec. 19, 2008) (using as an example that TANF (formerly AFDC) spending declined from $238 per month per recipient to $154 between 1977 and 2006 (in 2006 dollars)).

99. *See generally* KLEINBARD, *supra* note 13, at 63–101, for a general discussion of the progressive effects of many spending programs.

100. Gustav Fritzon & Jacob L. Timbro, *Taxing High Incomes: A Comparison of 41 Countries*, Fig. 1 (ranking U.S. 32nd out of 41, with all countries from 33 through 41 being non-peers (either much lower GDP per capita, tax havens or very small)), *available at*: https://files.taxfoundation.org/20191022160341/Taxing-High-Income-A-Comparison-of-41-Countries-PDF.pdf.

101. Michael Keen & Ben Lockwood, *The Value-Added Tax: Its Causes and Consequences* 3 (Int'l. Monetary Fund, Working Paper No. 07/183, 2007). A VAT base in theory also can be income or even gross receipts, but all extant VATs are consumption rates. *See also* NEIL BRUCE, WASH. STATE TAX STRUCTURE STUDY COMM., VAT CHOICES, https://dor.wa.gov/sites/default/files/legacy/Content/AboutUs/StatisticsAndReports/WAtaxstudy/VAT_Choices.pdf ("A VAT can be levied on a *gross product*, *income*, or *consumption-type* base.").

economic incidence is very similar to an RST,[102] is more regressive than almost any income tax because it does not tax savings and is not graduated (in any administered form). Nevertheless, because the tax typically functions as part of a revenue system that funds public goods that dramatically increase the resources of lower socio-economic strata, it is "affordable" (and indeed progressive in effect).[103] Middle class taxpayers have more resources in these systems than do their U.S. counterparts, and these resources are available as revenue sources for public goods that ensure their continuing availability. Meanwhile, the advantages of adding a VAT to the mix in efficiency terms are probably substantial. As a number of commentators have noted, the optimal tax system from an efficiency perspective is probably a combination of taxes that each reach a somewhat different base at reasonably low rates.[104]

These considerations suggest that, in broad strokes, the following range of policy options is available as measured over the long term (say, three to four decades).

1. Government spending remains so low that a spiral of ever-smaller government and increasing inequality results, with some sort of collapse or shock at the terminus, as wealth becomes so concentrated that meaningful governmental programs, even those to support basic infrastructure, disappear. This seems to be our current trajectory, though the first six to eight months of the Biden Administration give some indications of a shift towards options 2. and 3., below.[105]
2. Government spending increases to the point where an inefficient equilibrium is reached. For example, taxes might go up modestly (measured on an average annual basis over many years) so that total social wealth through the income distribution is sufficient to fund the programs that maintain social welfare at a constant level. This suboptimal result effectively would perpetuate successful rent-

102. Keen & Lockwood, *supra* note 101, at 5. By substituting depreciation and amortization for immediate expensing, a VAT can also mimic an income tax. *See* Joel Slemrod, *Deconstructing the Income Tax*, 87 AM. ECON. REV. 151, 154 (1997). In practice, however, no country uses an income VAT. *See* ERIC TODER ET AL., TAX POL'Y CTR., USING A VAT TO REFORM THE INCOME TAX 2 (2012) , https://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/412489-Using-a-VAT-to-Reform-the-Income-Tax.PDF (noting that the VAT is a broad-based consumption tax used in more than 130 countries).

103. *See* KLEINBARD, *supra* note 13, at 21–25, for an extended discussion of this point.

104. *See, e.g.*, David Gamage, *The Case for Taxing (All of) Labor Income, Consumption, Capital Income, and Wealth*, 68 TAX L. REV. 355, 380–81 (2014) (noting that because deadweight loss generally increases as the square of the tax rate, the use of two tax instruments along different dimensions may sum to less total distortion than the use of either alone at a higher rate).

105. As of November 2021, Congress is debating the Administration's $3.5 trillion 2022 budget blueprint, which proposes much more robust public spending than in recent history. *See* OFF. OF MGMT. & BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2022, 1–12 (2021) (detailing extensive new spending proposals).

seeking at upper-tier income and wealth levels when measured against the allocation of public and private outlays that maximizes total social wealth (or that maximizes some other specified utility function), but it would reduce the short-term siphoning of resources to upper income strata that has marked the last four decades of policy.

3. Funding at a level and of a type that on average and over the long term maximizes the chosen utility function, whatever that may be.

B. Budget Policy Endogeneity

If the choices above seem difficult, a brighter side is that budget policy endogeneity remains a powerful, if underappreciated tool to adjust the current trajectory. Again, the term "budget policy endogeneity" denotes the phenomenon that current spending choices have significant effects on the capacity of the system to raise revenue in the future.[106]

Taking a step back, the basic public finance question is how to allocate societal resources in the manner that maximizes some social welfare function, such as overall utility or some combination of total utility and equitable resource distribution.[107] Societal resources are distributed, however, both across sectors and over time, meaning that budget policy endogeneity ought to figure heavily in any answer to that question. There is no requirement that spending and revenue match temporally, any more than there is a requirement that public and private sector revenues in any given period be proportional to public and private outlays. The optimal mix of outlays includes both public and private spending and taxing in varying proportions, and spending and taxing now and later. By decoupling the taxing and spending sides (in the short- to medium-term), policy makers have greater flexibility to maximize social welfare by taking advantage of the fact that it may be cheaper in real terms to pay for a good in a period different from that of its production and consumption. Recognizing the endogeneity of tax reform to revenue-raising, the case for decoupling becomes stronger.

Suppose the government needs to spend $X now to create some greater amount, $Y, of wealth over time. In many cases, spending $X now and paying for it later will result in more total social wealth than does matching revenues and outlays, because today's $X outlay will make $Y available down the road to pay the $X, making the burden lower in real terms than it would be currently, even with the interest cost. So viewed, spending the $X now together with deferral of

106. *See* Buchanan, *supra* note 11.

107. Russell S. Sobel, "Welfare Economics and Public Finance," 25, *in* HANDBOOK OF PUBLIC FINANCE (Jürgen G. Bockhaus & Richard E. Wagner, eds. 2004) ("Operationally, it has been standard practice in public finance for economists to incorporate equity goals into economic models through an explicit representation of a social welfare function, the social welfare function simply being some algebraic transformation of the utility levels of the members of the society." (citing footnote omitted)).

payment actually represents the creation of an asset that would not exist if either spending were deferred, or revenue were not. Indeed, one can reframe the question of when to spend and when to tax in terms of maximizing net present value. If the future benefit of current spending policies is reduced to present value, then what appears on a cash flow basis as a deficit is in fact the creation of a present surplus. As an example, the U.S., lacking a VAT, could spend in the short term as though it had one. If the spending increased the resources of individuals who will then help pay the VAT, the programs would then have become "affordable" after all, albeit with an added financing cost from governmental borrowing. Given the dire condition of middle- and lower-income tiers in the U.S., that borrowing cost is less in welfare terms than would be the cost of an additional concurrent tax.

C. Political Economy Considerations

One might agree with the preceding analysis as a theoretical matter but object that making the political case for budgeting on a net asset value basis will be impossible. This section makes a few observations about the current state of public discourse and offers some thoughts about moving forward.

1. Reframing Tax Policy as Budget Policy

A better framing of policy choices would more closely link taxing and spending decisions than does current discourse. There appears to be almost no public awareness of the idea that some goods are best purchased in private markets and others through some kind of public provision, depending on the extent to which the goods are private, public, or somewhere in between.[108] Instead, the usual framing is whether various governmental programs are affordable or, what is the same, what can be done to limit deficits. For example, the Congressional Budget Office (CBO) periodically issues a volume of policy options called "Options for Reducing the Deficit."[109] As of 2019 it included a list of 121 options that would reduce federal spending or increase federal revenues (that is, through enhanced collections). Unsurprisingly, with one exception, none of the options considers the positive revenue effects of funding the programs identified in the document. The point of this observation is not that the list fails to take revenue effects into account, but rather that the document itself reveals the myopic orientation of the federal government and public discourse toward budgeting matters.

It is notable that the list includes one item, increased funding for the Internal Revenue Service as a revenue raiser,[110] which reflects the shift in orientation suggested here. The basis for this choice is that the marginal revenue from additional audit resources is estimated to exceed the marginal cost by nearly three-to-one

108. For a general description of the differences among public, private, club and common goods, *see* David Collier, Judy LaPorte & Jason Seawright, *Putting Typologies to Work: Concept Formation, Measurement, and Analytic Rigor*, 65 POL. RES. Q. 217, 224 (2012).

109. *See, e.g.*, CONG. BUDGET OFF., OPTIONS FOR REDUCING THE DEFICIT: 2019 TO 2028 (Dec. 13, 2018).

110. *See id.*

over the ten-year window from 2019 to 2028.[111] Although the link between the outlay and revenue is perhaps clearer here than it is for other social programs, there is no reason why the same approach should not be applied more widely. Adopting this approach would reorient the focus from the inevitably partial analysis of spending to the more general one of optimal purchasing decisions. For example, consider the debate on a recent proposal to extend paid family leave through a bill that would enhance family leave and provide protections to employees and employers.[112] Among the questions raised, the principal question was how the federal government would pay for the proposal. The provision includes an increase in payroll taxes that the CBO estimates would raise a net of $319 billion over a ten-year window; the increased federal outlays over the same period of time would be a net of $547 billion.[113] Because the associated tax increase will not fully pay for the program, it is likely dead as a political matter until someone can persuade elected officials (including, presumably, a Democratic president) that the benefits of the program justify the cost.

But this framing importantly distorts the debate on whether the act should be passed. To simplify matters, suppose that no other superior public spending program —in the sense of return on dollars invested—is available. And suppose further that the value of the spending in terms of continuity of worker employment, maintenance of skills, and other quantifiable factors was added as a dollar line item. If the return on spending for the program also exceeds the marginal return to private spending, the government should enact the program without regard to whether it has a revenue offset. To be sure, the legislation must be "paid for" at some point, but there is no reason to tie passage of the legislation to an associated revenue raiser. The government does not need, nor should it try, to associate every outlay with an associated revenue item any more than a business ought to limit profitable spending on the basis that its cash on hand is less than the cost. One reason for this is that the return may not materialize for a number of years. For another and more compelling reason, the government seeks to cover its costs but not necessarily by associating each outlay with an associated revenue raiser. Rather the government ought to raise revenue as efficiently as possible—that is, by minimizing deadweight loss.[114] The question of how to meet the revenue target is distinct from that of how the revenue should be spent.

There is precedent for such a reorientation in thinking. In the early 1960s, Stanley Surrey, then a professor at Harvard Law School and later the Assistant Treasury Secretary for Tax Policy, introduced and popularized the idea of the "tax expenditure budget" (TEB).[115] Concerned that Congress had strayed too far from

111. *Id.* at 306.

112. H.R. 1185, 116th Cong. (2020).

113. Letter from Phillip L. Swagel, Dir., Cong. Budget Office, to Hon. Kevin Brady, Ranking Member, Comm. on Ways and Means (Feb. 13, 2020) (on file with author).

114. *See* Harvey S. Rosen, *Public Finance*, in THE ENCYCLOPEDIA OF PUBLIC CHOICE 252, 252-62 (Charles K. Rowley & Friedrich Schneider eds., 2004).

115. Edward D. Kleinbard, *Tax Expenditure Framework Legislation*, 63 NAT. TAX J. 353, 357–60 (2010).

its mission of using the tax system to raise revenue efficiently, Surrey advocated the adoption of the TEB as a measure of the extent to which Congress implemented what were in effect spending programs through the tax code.[116] For example, a research and experimentation (R&E) deduction, though cast as a tax break, is economically identical to a federal subsidy for R&E, not a refinement of the income concept.[117] Therefore, a R&E deduction should be listed as a government spending program, not as an adjustment to the tax base. Similarly, a deduction for "home mortgage interest" expenses represents a subsidy to owner-occupied housing, not a more accurate measure of homeowners' income.[118] The main purpose of the TEB was to discipline Congress to acknowledge its programmatic spending by accounting for it with an annual dollar value and publicizing the numbers.[119]

Although not without controversy, the TEB concept has had a significant impact on budgeting.[120] By statute, the federal government annually compiles and publishes a TEB.[121] As a result, an estimate of the cost of running social programs through the federal income tax becomes widely available and features prominently in budgeting decisions.[122] There is no reason in principle why a similar reorientation of taxing and spending could not take place again. Under such a program, the government would include estimates of both costs and benefits from spending programs over a relevant budget window. The resulting table would give an estimate of the net increase or reduction in national wealth rather than (just) a comparison of revenues to expenses for each budget item. As a further refinement, the government could compare the expected rate of return on each item to the risk-free rate or some other benchmark as a way of prioritizing both its own spending items and whether marginal dollars should be left in private hands or remitted as tax revenue.

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116. *See, e.g.*, Paul R. McDaniel & Stanley S. Surrey, *Tax Expenditures: How to Identify Them; How to Control Them*, 15 TAX NOTES 595, 596 (May 24, 1982).

117. I.R.C. § 174.

118. I.R.C. § 163(h)(3).

119. Leonard E. Burman*, Is the Tax Expenditure Concept Still Relevant?*, 56 NAT. TAX J. 613, 613 (2003).

120. Among other reasons, the TEB is controversial because it presupposes as a baseline a "normative income tax" and it is not clear that such a concept exists. For example, does the realization rule, which generally operates to defer taxation of gains and losses on assets until the taxpayer disposes of them, count as part of a normative income tax? Are deductions for state and local taxes entirely tax expenditures or do they count at least in part as a measure of real economic income? *See* Douglas A. Kahn & Jeffrey S. Lehman, *Tax Expenditure Budgets: A Critical View*, 54 TAX NOTES 1661, 1662–63 (Mar. 30, 1992) for a discussion of these and other problems. Nevertheless, the concept of a TEB is useful because there is wide agreement that some tax rules plainly implement a normative income tax base and others do not. *See generally* Edward D. Kleinbard, *Tax Expenditure Framework Legislation*, 63 NAT'L TAX J. 353 (2010) (discussing the advantages of a TEB and many of the flaws associated with its current incarnation).

121. The Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93–344, §§ 101(c), 102(a), 88 Stat. 297 (1974). Both the Office of Management and Budget and the Joint Committee on Taxation publish TEBs.

122. *See, e.g.*, *What Is the Tax Expenditure Budget*, TAX POL'Y CTR.: BRIEFING BOOK, https://www.taxpolicycenter.org/briefing-book/what-tax-expenditure-budget (last visited Dec. 8, 2021) (detailing the TEB and commentary thereon).

2. Introduction of Net Present Value ("NPV") Concepts

A second mechanism to improve public discourse would be to decouple short- to medium-term spending from short- to medium-term revenue raising. Instead, a focus on budgeting over time for some reasonable period, such as one or two generations, rather than on current balances or even on a ten-year window, would permit a better evaluation of the effects of both tax and fiscal policy.[123] Within the larger window, the temporal questions are when to spend and when to save, such that the relevant social welfare function is maximized. Congress could implement this idea by adopting a horizon over which all taxing and spending programs are measured and, within that horizon, estimating the optimal times for spending and for revenue-raising (including, of course, the time-value cost of early spending and the time-value benefit of early taxing). As in the case of the TEB, there is some precedent for this type of orientation. A sizable literature addresses the cyclical or counter-cyclical effects of various tax bases on the business cycle.[124] One focus of this literature is the question of how to adjust taxes in relation to economic conditions as a way to minimize the burden that taxes impose.[125] As a general matter, for instance, an income tax is thought to be beneficially counter-cyclical, because it tends to be lower in recessionary periods and higher when taxpayers have more income. By contrast, consumption taxes do not become less burdensome in recessionary periods. This focus is similar to the one advocated here, except it would also include the spending side of the equation.

As an example, one might put a price of $3 trillion on necessary federal infrastructure spending. The timing questions become when to make the outlay and when to pay for it. The likely answers are, respectively, as soon as possible and at some point in the future, as determined by maximizing the difference between overall gains in productivity and the costs of borrowing.

3. Shorter-Term Political Considerations

As the preceding arguments suggest, from a political economy perspective, it seems that a reform effort focused on raising tax revenue is unlikely to succeed. Rather, the appropriate course for reform is to focus initially on the spending side, marshaling arguments in favor of a broad provision of public goods spending programs without regard to the short- or even medium-term cost.

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123. For a thoughtful discussion of some of the advantages and shortcomings of generational accounting, see Shaviro *supra* note 71. For an example of the deleterious effects of a focus only on short-term fiscal consequences of government policy, consider the wrangling over federal infrastructure spending. Viewed in terms of generational effects, it is obvious that spending well in excess of current levels would dramatically improve total social welfare. Instead, an undue focus on current budgetary effects of infrastructure spending ("How will we pay for it?") hobbles federal spending because of the immediate budgetary consequences.

124. *See, e.g.*, Yair Listokin, *Stabilizing the Economy Through the Income Tax Code*, 123 TAX NOTES 1575, 1577 (2009) (noting the automatic stabilization feature of an income tax, which imposes a lower burden in recessionary periods than in other periods).

125. *Id.*

Quantification of the benefits would go some way towards addressing this problem. Such an approach is necessary because inequality in resources and the resulting imbalance in control over the terms of public discourse on the revenue side make tax reform that is directly responsive to fiscal shortfalls infeasible. An indirect approach that focuses initially on the benefits of increased spending (net of costs) raises the prospect of providing resources to constituencies who are resource-limited, and thus lack political power. Moreover, pointing to the recent history of deficit spending, including enlarging deficits to finance tax reductions,[126] tends to emasculate political arguments that fiscal probity requires a shrinkage of government spending.

The failure of efforts to increase revenues to fund needed public goods and redistribution is to a large extent traceable to manipulation of the terms of political debate and to the susceptibility of the public to anti-tax rhetoric, as noted in the Introduction. As long as the connection between taxation and the unique capacity of the government to provide certain goods remains obscure, the argument that lower taxes raise everyone's welfare retains a surface plausibility: lower taxes mean that taxpayers have greater resources to purchase needed goods and services. Ideally, one would counter this intuition by making the connection between taxing and efficiency explicit. It becomes necessary to highlight the greater capacity of the government than private markets to supply certain goods. Children *in utero* cannot contract for basic services needed through childhood, but the government can.

By contrast, technical or policy-based efforts to combat the logic that equates lower taxes with higher welfare are likely to remain unsuccessful because of the susceptibility of political actors to control through, most prominently, various forms of media and the influence of money in American politics. The 2017 tax legislation provides a particularly compelling example, though by no means the only one. One of its central provisions is the new Section 199A, the so-called "pass-through deduction."[127] Stated in very general terms, Section 199A reduces the tax rate on business income of certain non-corporate taxpayers by up to 20%.[128] Eligible persons generally include non-employees in non-service sector jobs,[129] though non-employees in service sectors are also eligible for the deduction at lower income levels.[130]

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126. *See* Cong. Budget Off., The Budget and Economic Outlook: 2020 to 2030 6 fig.1-1 (2020). The 2017 Tax Cuts and Jobs Act is a prominent example, but the 2001 and 2003 Tax Acts also marked large tax reductions that were not "paid for" in the sense that they increased the budget deficit over the relevant 10-year windows. *See* Emily Horton, *The Legacy of the 2001 and 2003 "Bush" Tax Cuts*, Center on Budget and Policy Priorities (Oct. 23, 2017), n. 4 ("Another methodology for estimating the cost of the Bush tax cuts, which focuses on the initial costs of enacting the original 2001 and 2003 tax bills, finds that EGTRRA and JGTRRA combined decreased revenues by about 2.1 percent of GDP in 2004."), https://www.cbpp.org/research/federal-tax/the-legacy-of-the-2001-and-2003-bush-tax-cuts (last visited Dec. 22, 2021).

127. 26 U.S.C. § 199A.

128. 26 U.S.C. § 199A(a)(1)(B).

129. 26 U.S.C. § 199A(d).

130. 26 U.S.C. §§ 199A(b)(3), (e)(2).

As has been widely noted,[131] there appears to be no cogent policy rationale that supports Section 199A. It is unclear why a reduction in the rate that applies specifically to non-corporate income should apply only (at higher income levels) to non-service income, much less why the reduction does not apply to employees at any income level. It is also unclear why Congress would enact a provision as susceptible to manipulation as Section 199A, which relies on unstable distinctions, such as that between employee and independent contractor status or between a service business and a non-service business, to draw lines between qualifying and non-qualifying income. And it is unclear why supporters of the larger bill, who were overwhelmingly Republicans, would support Section 199A, much less the larger bill, once the revenue costs are factored in.[132]

As another example, to take just one more, consider the case of infrastructure funding discussed above. Agreement exists across a wide segment of the political spectrum that such funding would be beneficial, including among both members of the public and elected representatives.[133] Despite this consensus, which has existed for a number of years, only inadequate action has been taken to date. In the fall of 2021, Congress passed the Biden Administration's $1 trillion infrastructure plan.[134] But that plan falls well short—perhaps two-thirds short—of reasonably anticipated infrastructure needs.[135] As of this writing, the Biden Administration's much larger proposed "Build Back Better" legislation, which if passed would substantially complement the measures in the infrastructure bill, seems unlikely to pass.

In each of these cases, as in countless others, the policy failure mystery largely disappears on consideration of the incentives that political actors face in the current environment. Essentially unlimited amounts can be donated to political campaigns, and the threat that donors will withdraw funding, or will fund opponents (especially at the primary stage), exerts considerable influence on political actors.[136] It therefore becomes particularly important to develop a narrative

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131. *See, e.g.*, Daniel Shaviro, *Evaluating the New US Pass-Through Rules*, 2018 BRIT. TAX REV. 49, 67 (2018).

132. These approximate $1.5 trillion. JOINT COMM'N. ON TAX'N, JCX-67-17, ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT" 8 (Dec. 18, 2017).

133. *See* Jim Puzzanghera, *Rebuilding Crumbling Infrastructure Has Bipartisan Support. But Who Has to Pay for It?*, L.A. TIMES (Dec. 2, 2018), https://www.latimes.com/business/la-fi-infrastructure-congress-trump-20181202-story.html. *See also* R.J. Reinhart, *In the News: Public Supports More Infrastructure Spending*, GALLUP (Feb. 12, 2018), https://news.gallup.com/poll/226961/news-public-backs-infrastructure-spending.aspx (noting that 64% of Americans support a $1 trillion federal infrastructure spending program).

134. Pub. Law No. 117-58.

135. The American Society of Civil Engineers projects a $2.6 trillion shortfall in the 2020s on U. S. infrastructure spending. AM. SOC'Y OF CIV. ENG'RS, A COMPREHENSIVE ASSESSMENT OF AMERICA'S INFRASTRUCTURE: 2021 REPORT CARD FOR AMERICA'S INFRASTRUCTURE 9 (2021).

136. WENDY WEISER & ALICIA BANNON, eds., BRENNAN CTR. FOR JUSTICE, DEMOCRACY: AN ELECTION AGENDA FOR CANDIDATES, ACTIVISTS, AND LEGISLATORS 20 (2018) ("Since the Supreme Court's 2010 decision in *Citizens United v. FEC*, which unleashed unlimited political spending, vast

in favor of public investment that associates certain kinds of revenue-raising with wealth creation—that is, that frames spending as the purchase of productive assets. Over time, the success of such an effort would enable sustained funding for public investment that would, in turn, be financed with a more robust yet less progressive tax system applied to more equitably distributed resources.

IV. "Redistribution"

To this point the argument has focused on the allocative effects of governmental spending policy, with particular emphasis on the consequences of attenuated funding of public goods. I have characterized one of these consequences as "redistribution upward." The characterization supposes that an efficient allocation of resources serves as the baseline from which redistribution in any direction is measured. For anyone operating in the tradition of modern economic analysis, this normative orientation likely seems sensible, perhaps even intuitive. The canonical approach of the economics discipline to normative questions is to adopt only the proposition that "more is better."[137] That is, all else equal, it is better to have more of a commodity than less. In contrast, questions about how the "more" should be distributed are a matter of political concern that falls outside of the purview of technical economics.[138] In short, the baseline from a public finance perspective is social wealth maximization. The principle does not imply that departures from wealth maximization are not permitted, but only that one would need to make independent arguments in support of departures given the superiority of "more" to "less." Including spending in that calculus, as I have done in this article, does not fundamentally alter the basic approach.

Many philosophers, however, do not adopt efficiency maximization as a normative measuring stick. Instead, rights-based theorists from John Locke to Robert Nozick have argued for different baselines from which to measure the extent to which actual allocations (or principles of allocation) reflect unwarranted wealth transfers.[139] To be sure, many of these theorists seek to justify departures from market outcomes on the basis of fairness or other principles,[140] and for them, the characterization of insufficient public sector spending as a form of unwarranted upward redistribution likely resonates.[141] But one subset of thinkers for whom the

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sums from a few large donors have come to dominate elections."). For the specific case of the 2017 tax legislation, *see* Shaviro, *supra* note 131, at 62.

137. Sobel, *supra* note 107, at 22 (noting that a condition of economic efficiency is that "all actions generating more social benefits than costs should be undertaken").

138. *See* Eugene Silberberg & Wing Suen, The Structure of Economics: A Mathematical Analysis 256–57 (3d ed. 2000).

139. *See, e.g.*, John Locke, Two Treatises on Government Ch. V (Thomas I. Cook, ed., 1947); Robert Nozick, Anarchy, State, and Utopia 150 (1974); *see also* John Rawls, A Theory of Justice 4 (1971) (arguing justice is not subject "to the calculus of social interests").

140. *See, e.g.*, John Rawls, A Theory of Justice 54 (rev. ed. 1999) (arguing for a guarantee of "primary goods" because principles of justice require social arrangements be structured to the advantage of the least advantaged class).

141. Exemplars include Dworkin and Rawls. *See generally supra* notes 139-40.

characterization might not resonate is rights-based libertarians such as Robert Nozick. Persons in this camp may consider tax-financed programs that depart from market outcomes as a form of taking (or "forced labor," in Nozick's memorable characterization)[142] that is no more justifiable when it enhances efficiency than when it does not. Animating this approach is the idea that market allocations represent voluntary transfers, whereas government "command-and-control" allocations require an override to individual actors' freedom to allocate their resources as they see fit.[143]

Here I defend the relatively modest claim that the allocation of resources that results from under-funding of certain public goods is not consistent with a rights-based libertarian framework either. Rather, such an allocation is morally arbitrary in a way that even respecting the benefits flowing from the arbitrary distribution of talents is not.

The controversy over the rights of ownership of individual talents has a long pedigree but has become particularly salient in the half-century since the publication of John Rawls's *A Theory of Justice*. Rawls argued that individual talents should be regarded as a common asset for certain purposes on the basis that their distribution is arbitrary and the benefits that flow from their social use are due in part to a system of social cooperation; individuals do nothing to deserve the talents with which they are born.[144] Because, in Rawls's view, talents are in some measure common assets, the individual possessor's right to the fruits of the asset is qualified.[145] In particular, while society typically has no right to override an individual's decision to use or not use her talents, it does have some claim on the extent to which the market-derived benefits that flow from their use redound to her.[146]

A number of theorists have strongly resisted Rawls's argument,[147] and one might think that, to the extent the resistance is successful, it applies as well to the problem of upward redistribution that I have discussed in this article. Here, however, I defend a weaker claim than Rawls does. I assume, solely for the sake of argument, that opponents of Rawls's view are correct: society has no claim to the benefits that flow to an individual from the use of her talents in market transactions because the talents are properly the possession of the person in whom they reside. On this view, it does not make sense to say that A's capacity to play basketball or construct a legal argument is in some sense owned by B or anyone else, and it is not possible to justify the transfer of those benefits to others simply

142. *See* NOZICK, *supra* note 139, at 169.

143. *See, e.g.*, Adam D. Moore, *Taxation, Forced Labor, and Theft: Why Taxation Is "on a Par" with Forced Labor*, 59 S. J. PHIL. 362, 363 (2021) ("I will present a new argument establishing that Nozick was basically correct—many, perhaps most, forms of taxation utilized by modern redistributive democracies are immoral.").

144. RAWLS, *supra* note 140, at 101.

145. *Id.* at 310–15.

146. *Id.*

147. *E.g.*, Andrew Kernohan, *Rawls and the Collective Ownership of Natural Abilities*, 20 CAN. J. PHIL. 19, 19–20 (1990).

because their erstwhile owner does not deserve them. Only A experiences the exercise of the talent.

Taking that position as correct (again, for the sake of argument), it suffices to point out that the allocative failures that are the focus of the present discussion and result in the already-described benefits and detriments to various classes of people are not the property of anyone. Rectifying them would not require making a claim on assets otherwise held by individuals (before they engaged in economic activity that furnished them benefits);[148] rather, it requires merely that one not respect the arbitrary distribution of benefits and burdens that arise from allocative failures. Unlike talents, which in some real sense reside in the person of their physical owner, where the effects of market failures land are adventitious.

Consider the difference between two otherwise identical children, one of whom has ready access to resources that will enable her to develop her abilities to their full potential and the other of whom does not. For purposes of the present discussion, the issue is not whether the second child ought to be given resources to level the playing field. Without taking a position on that question, one can note that she is still disadvantaged relative to the first child because, unlike the first, she lacks a method by which she can acquire liquidity. In other words, we can assume she is (or would be) entirely willing to pay the actual cost to finance her upbringing and education given the substantial return on that investment that she can expect. The problem is that there happens to be no market for her to do that. It is not that she must pay more (in the form of borrowing costs) than her more fortunately situated counterpart; it is that there is no mechanism by which her willingness to pay more can be realized. Unlike talents, the question of which types of goods happen to be subject to market failure and which are not has no relationship to the intrinsic attributes of any person.

The case for rectifying the situation with government transfers is stronger still because the effects of leaving allocations where they lie go beyond placing impecunious individuals at a disadvantage relative to others. The effects also include actually allocating to those other individuals resources that would go to those who are disadvantaged because their wage rate is reduced. If A's lack of access to resources expands the pool of unskilled labor, then B pays less for labor hired from that pool. The case for using the tax and transfer system to remedy the allocative failure seems particularly strong.

V. Conclusion

A blinkered focus on federal deficits has generated a series of budgetary decisions that have severely impaired our ability to pay for programs. Many of these programs are necessary to maintain, to say nothing of enhance, productivity and to ameliorate endemic market failure. Ironically, this focus also has perpetuated the deficits themselves. Nothing short of a reorientation in thinking about the

148. *See* Nozick, *supra* note 139, at 150 (articulating a theory of entitlements based on justice in original acquisition and compliance with constraints on transfer thereafter).

relationship between revenue raising and spending is necessary to address this problem. I have argued that there are two dimensions to the reorientation, both of which must take a place front-and-center in any successful reform effort. The first is a re-conceptualization of spending decisions so that the focus of government policy is making outlays that maximize social welfare. In other words, much governmental spending should be conceptualized as investment. Such an approach requires as a threshold consideration determining which type of outlay provides the most marginal benefit for a given policy goal—private spending or public spending. For decades, the unique capacity of the government to fund certain types of programs has been downplayed, if not ignored. These programs include education, child poverty relief, and others. If budgeting reflects the net value (rather than simply the cost measured in cash flow terms) of government outlays, government spending items that have a positive net present value, such as certain forms of income and educational assistance and various types of infrastructure spending, more accurately appear as net value creation than as net costs that must be "paid for" with current or currently-projected tax receipts.

The second reorientation is a more conscious de-coupling of the timing of the revenue raising function from the timing of the spending function. Just as the marginal dollar may be best spent publicly or privately, depending on the nature of the good purchased, the timing and manner of revenue raising and revenue spending depend on marginal costs and benefits. In any given case, it may be better to spend now and pay later, or vice versa, and it may be better to raise funds in a manner unconnected to what is purchased. An important part of this calculus includes the effects of current spending on future wealth and, in consequence, on future prospects for raising revenue. The analysis therefore depends both on borrowing costs and on the extent of the benefit that comes from spending or taxing now versus later. By identifying cost and benefit curves, it is possible to determine the optimal times to spend and the optimal times to pay for spending.