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# Kaplow and Shavell and the Priority of Income Taxation and Transfer

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## Articles

# Kaplow and Shavell and the Priority of Income Taxation and Transfer

DAVID BLANKFEIN-TABACHNICK\* & KEVIN A. KORDANA\*\*

*This Article rejects a central claim of taxation and private law theory, namely, Kaplow and Shavell's prominent thesis that egalitarian social goals are most efficiently achieved through income taxation and transfer, as opposed to egalitarian alterations in private law rules. Kaplow and Shavell compare the efficiency of rules of tort to rules of tax and transfer in meeting egalitarian goals, concluding that taxation and transfer is always more efficient than other private law legal rules. We argue that Kaplow and Shavell reach this conclusion only through inattention to the body of private law that informs the very basis of their discussion: underlying property entitlements. This Article contends that Kaplow and Shavell's comparison of rules of taxation to rules of tort fails to take proper account of the powerful role that (re)assigning underlying property entitlements plays in achieving egalitarian goals, even at the level of formal theory. We conclude that, contrary to Kaplow and Shavell's prominent claim, as a matter of efficiency, the rules of income taxation and transfer are not always preferable to alterations in the initial assignment of property entitlements in achieving distributive or egalitarian goals.*

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## INTRODUCTION

A central question in the construction of rules for any legal regime is what demands or values govern which sets of rules or legal doctrines. In terms of “private law” (for example, property, contract and tort), a perennial debate has centered on the tension between welfare or wealth maximization and the distributive consequences of legal rules.<sup>1</sup> Consider a hotel located on a stretch of beach. The governing legal regime will need to construct property rules about beach access.<sup>2</sup> If the legal regime aims

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1. See, e.g., Anthony Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472 (1980); Richard A. Posner, *Economic Analysis of Law* (9th ed. 2014); Todd D. Rakoff, *The Five Justices of Contract Law*, 2016 WISC. L. REV. 733 (2016); ADITI BAGCHI, DISTRIBUTIVE JUSTICE AND CONTRACT, in *PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW* 193 (Gregory Klass et al. eds., 2014).

2. E.g., *State of Oregon ex rel. Thornton v. Hay*, 462 P.2d 671, 672 (Or. 1969) (contemplating allowing private enclosure of the dry sand portion of the beach, a prescriptive easement, or open access by way of custom).

at wealth maximization, perhaps access will be limited to hotel guests. The privacy may attract wealthy clients and, all things considered, promote the overall maximization of wealth. On the other hand, if the legal regime aims to promote the interests of the least well-off, public access to the beach might be selected as the relevant property rule.

Other such trade-offs abound: In a tort case, a worker has lost his hand while operating a meat-grinding machine. From a welfare or wealth maximization perspective, if the Learned Hand balancing test results in favor of the manufacturer,<sup>3</sup> no liability should be imposed. That is, doctrinally, tort should be constructed so as to impose the cost of the lost hand on the injured worker, such as through the operation of a doctrine of contributory negligence.<sup>4</sup> However, if the same scenario is considered from the perspective of the least well-off, more cost might be borne by the manufacturer to protect workers, even the clumsy or illiterate, from serious bodily harm. Meeting this alternative concern might demand that the manufacturer be held liable, such as through the construction of a doctrine of negligence or product liability.<sup>5</sup>

Consider yet another example, a landlord and tenant have a dispute over the condition of rented premises. Perhaps a doctrinal construction answering to the wealth maximization principle should rule in favor of the landlord, while one concerned with the position of the least well-off should rule for the tenant.<sup>6</sup> Finally, in another property case, a poor property-owner is subject to a public taking of her land.<sup>7</sup> Again, assume

3. See *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947) (L. Hand, J.) (balancing cost of precautions versus probability of accident and magnitude of harm).

4. See *Masters v. N.Y. Cent. R. Co.*, 70 N.E.2d 898, 903 (Ohio 1947).

5. *Liriano v. Hobart Corp.*, 170 F.3d 264, 271 (2d Cir. 1999) (Calabresi, J.) (affirming the jury's verdict imposing liability on manufacturer on the grounds that it "could reasonably find that there exist people who are employed as meat grinders and who do not know (a) that it is feasible to reduce the risk with safety guards . . . and (c) that the grinders should be used only with the guards."); *cf.*, *Lorenzo v. Wirth*, 49 N.E. 1010, 1011 (Mass. 1898) (Holmes, J.) ("A heap of coal on a sidewalk in Boston is an indication, according to common experience, that there very possibly may be a coal hole to receive it.").

6. See *Javins v. First Nat'l Realty Corp.*, 428 F.2d 1071, 1079–80 (D.C. Cir. 1970) (Wright, J.): The inequality in bargaining power between landlord and tenant has been well documented. Tenants have very little leverage to enforce demands for better housing. Various impediments to competition in the rental housing market, such as racial and class discrimination and standardized form leases, mean that landlords place tenants in a take it or leave it situation. The increasingly severe shortage of adequate housing further increases the landlord's bargaining power and escalates the need for maintaining and improving the existing stock. Finally, the findings by various studies of the social impact of bad housing has led to the realization that poor housing is detrimental to the whole society, not merely to the unlucky ones who must suffer the daily indignity of living in a slum . . . *In our judgment the common law itself must recognize the landlord's obligation to keep his premises in a habitable condition.*

*Id.*

7. See *Kelo v. New London*, 545 U.S. 469, 477 (2005):

that wealth maximization, beyond mere transaction costs, requires that the seizure of property proceed, but distributive concerns for the least well-off will demand an outcome in favor of the property owner. These examples illustrate the pervasive nature of the tension between wealth maximization and distributive concerns, and the necessity for law to adjudicate between these competing values.

The examples above, drawn from tort and property law, illustrate that the substance of private law is closely implicated in the distributive pattern of wealth. This connection between private law structures and public distributive values is so pervasive that legal scholars acknowledge the difficulty of isolating exactly *where* in law any such distinction lies, and to what extent particular bodies of law represent public versus private values.<sup>8</sup>

Noted legal scholars Louis Kaplow and Steven Shavell famously offer an ingenious solution to this conundrum. Their claim is that, even if one is committed to the welfare of the least well-off members of society, the rules of private law should nonetheless be constructed with the aim

Two polar propositions are perfectly clear. On the one hand, it has long been accepted that the sovereign may not take the property of *A* for the sole purpose of transferring it to another private party *B*, even though *A* is paid just compensation. On the other hand, it is equally clear that a State may transfer property from one private party to another if future ‘use by the public’ is the purpose of the taking; the condemnation of land for a railroad with common-carrier duties is a familiar example.

*Id.*

For cases with even clearer equity-welfare tensions, consider Columbia University’s dispute with its neighbors, including a modest auto-repair shop, see Robin Finn, *Pushing Back as Columbia Moves to Spread Out*, N.Y. TIMES (Jan. 11, 2008), as well as China’s recent experience in deploying ‘takings’ to expand economic growth. Michael Wines & Jonathan Ansfield, *Trampled in a Land Rush, Chinese Resist*, N.Y. TIMES (May 26, 2010) (“The country’s property boom has spawned new cities, remade older ones and—not incidentally—helped float the buoyant economy that is a bedrock of Communist Party legitimacy. But its benefits are spread unevenly.”).

8. Leon Green, *Tort Law Public Law in Disguise*, 38 TEX. L. REV. 257, 257 (1960); Charles A. Reich, *The New Property*, 73 YALE L.J. 733 (1964) (calling the bounds of the traditional distinction into question); Kevin A. Kordana & David H. Tabachnick, *On Belling the Cat: Rawls and Tort as Corrective Justice*, 92 VA. L. REV. 1279, 1289 (2006) (“[t]here is no principled or foundational distinction in Rawls between public and private matters; for Rawls, freedom and the private realm are constructed by the principles of justice.”); Thomas Scanlon has distinguished between legal rules or legal rights and underlying values, maintaining that legal rules and rights can take many forms, but must ultimately be designed to account for the correct balance of values or principles:

Rights, understood as institutional constraints and prerogatives, can “clash” . . . What we need to do in such a case is to adjust our understanding of these [legal] rights so as to make them coherent. This adjustment is not best understood, I think, as a matter of ‘balancing’ [legal] rights against one another . . . . It is true, however, that in deciding which readjustment of these [legal] rights to accept, we may need to “balance” certain values . . . against one another . . . . [V]alues are balanced, [legal] rights are adjusted, or redefined.

T. M. Scanlon, *Adjusting Rights and Balancing Values*, 72 FORDHAM L. REV. 1477, 1478–79 (2004).

of wealth maximization. Any distributive pattern is more efficiently met through the use of income taxation and its inverse, equity-oriented income transfer, rather than through the construction and deployment of more egalitarian private law rules.<sup>9</sup> Kaplow and Shavell's prominent conclusion calls into question the wisdom of directly focusing on the needs of the least well-off in constructing rules of private law. To be clear, they address the efficiency of the competing *means* of achieving distributive goals, and not the desirability of egalitarian goals themselves.

Kaplow and Shavell's claim is significant. If their conclusion is correct, equity-oriented private law rules can be best understood as inefficient, though well-intentioned, means to achieve egalitarian political goals. This implicates a vast range of law and legal doctrine: minimum wage laws,<sup>10</sup> much of landlord-tenant doctrine,<sup>11</sup> substantive unconscionability,<sup>12</sup> many nonjudicial remedies for past injustices (that is government established minority "set-asides" in contracting,<sup>13</sup> reparations for slavery or Jim Crow<sup>14</sup> or affirmative action programs in hiring and education<sup>15</sup>), protection of pregnancy and maternity in an employment relationship,<sup>16</sup> the invocation of the "role model" theory in educational hiring,<sup>17</sup> and section 1981 legislation.<sup>18</sup> Kaplow and Shavell

9. LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 35–37 (2002) [hereinafter FAIRNESS VERSUS WELFARE]; Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. LEGAL STUD. 821, 821 (2000) [hereinafter Kaplow & Shavell, *Should Legal Rules Favor the Poor?*]; Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 669 (1994) [hereinafter Kaplow & Shavell, *Why the Legal System Is Less Efficient*]; see also Steven Shavell, *A Note on Efficiency vs. Distributional Equity in Legal Rule Making: Should Distributional Equity Matter Given Optimal Income Taxation?*, 71 AM. ECON. REV. 414 (1981).

10. For a discussion of efficiency, fairness, and their implications for the scope of minimum wage laws, see generally Christine Jolls, *Fairness, Minimum Wage Law and Employee Benefits*, 77 N.Y.U. L. REV. 47 (2002).

11. See *Javins*, 428 F.2d at 1071.

12. *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449–50 (D.C. Cir. 1965) (Wright, J.).

13. *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 493–99 (1989).

14. E.g., Charles J. Ogletree, *Repairing the Past: New Efforts in the Reparations Debate in America*, 38 HARV. C.R.-C.L. L. REV. 279 (2003).

15. *Grutter v. Bollinger*, 539 U.S. 306 (2003); *Gratz v. Bollinger*, 539 U.S. 244 (2003).

16. Deborah Dinner, *The Divorce Bargain: The Fathers' Rights Movement and Family Inequalities*, 102 VA. L. REV. 79 (2016); Deborah Dinner, *The Costs of Reproduction: History and the Legal Construction of Sex Equality*, 46 HARV. C.R.-C.L. L. REV. 415, 492–93 (2011).

17. *Wygant v. Jackson Bd. of Educ.*, 476 U.S. 267 (1986).

18. 42 U.S.C. § 1981(A) (2009):

All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens, and shall be subject to like punishment, pains, penalties,

counsel against the use of private law rules and instead favor the use of income taxation and transfer.

Contemporary political liberalism typically demands that political and economic institutions reflect, in some measure, equity-oriented distributive aims.<sup>19</sup> But, as previously mentioned, legal scholars disagree over *which* institutions should be designated to serve the goals of distributive principles. Some argue that equity-oriented values are best served not only by a system of taxation and transfer, but also by the application of other legal rules, such as the rules of contract and tort.<sup>20</sup> Other scholars, agreeing with Kaplow and Shavell, argue that, for efficiency reasons, non-tax and transfer legal rules ought to be constructed to maximize wealth, and demand that these rules be sanitized of equity-oriented values. These scholars maintain that those egalitarian values are most efficiently met by a system of income taxation and transfer. It is important to note that this controversy is *not* over differing conceptions of political liberalism, or the distributive principles they bear. Instead, the dispute takes as given the equity-oriented institutional demands of distributive principles associated with various forms of contemporary egalitarian liberalism. The controversy, then, is distinctly over institutional design; namely, the question of which aspects

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taxes, licenses, and exactions of every kind, and to no other.

19. *E.g.*, BRUCE A. ACKERMAN, *SOCIAL JUSTICE IN THE LIBERAL STATE* (1980); Samuel Freeman, *Illiberal Libertarians: Why Libertarianism is Not a Liberal View*, 30 PHIL. & PUB. AFF. 105 (2002); THOMAS NAGEL, *EQUALITY AND PARTIALITY* (1991); JOHN RAWLS, *A THEORY OF JUSTICE* (1971).

20. *E.g.*, RONALD DWORKIN, *LAW'S EMPIRE* 276–312 (1986) (for at least tort law if not contract law); Patrick Emerton & Kathryn James, *The Justice of the Tax Base and the Case for Income Tax*, in PHILOSOPHICAL FOUNDATIONS OF TAX LAW 125 (Monica Bhandari ed., 2017); LYN K L TJON SOEI LEN, *MINIMUM CONTRACT JUSTICE: A CAPABILITIES PERSPECTIVE ON SWEATSHOPS AND CONSUMER CONTRACTS* (2017); Bruce Ackerman, *Regulating Slum Housing Markets on Behalf of the Poor: Of Housing Codes, Housing Subsidies and Income Redistribution Policy*, 80 YALE L.J. 1093 (1971); Aditi Bagchi, *Distributive Justice and Private Law*, 60 HASTINGS L.J. 105, 107 (2008); Guido Calabresi, *The New Economic Analysis of Law: Scholarship, Sophistry, or Self-Indulgence?*, 68 PROC. BRITISH ACAD. 85, 95–96 (1982); Daniela Caruso, *Contract Law and Distribution in the Age of Welfare Reform*, 49 ARIZ. L. REV. 665, 668 (2007); Josse Klijnsma, *Contract Law as Fairness*, 28 RATIO JURIS 68, 74 (2015); Kevin A. Kordana & David H. Tabachnick, *Taxation, the Private Law, and Distributive Justice*, 23 SOC. PHIL. & POL'Y 142, 146 (2006); Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, 1994 U. ILL. L. REV. 1, 3–5 (1994) (arguing that bankruptcy, but not, for example, tort law, should be set to wealth-maximization); Chris Sanchirico, *Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View*, 29 J. LEGAL STUD. 797, 800 (2000); Samuel Scheffler, *Distributive Justice, the Basic Structure and the Place of Private Law*, 35 OXFORD J.L. STUD. 213 (2015); Gary T. Schwartz, *Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice*, 75 TEX. L. REV. 1801, 1802, 1831 (1997) (“[d]eterrence can [serve] . . . the somewhat austere goal of economic efficiency, [it] also has deep roots in a humane and compassionate view of the law’s functions [and continues] But if accident prevention is an economic goal, it is also a generous, warm-hearted, compassionate, and humane goal. As such, it is a goal that can be and is in fact supported by a broad range of scholars.”); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 338–40 (1993); Kronman, *supra* note 1.

of economic, legal and political institutions most *efficiently* serve the equity-oriented demands of liberalism.

Kaplow and Shavell's claim that political liberalism's distributive demands are most efficiently met through income taxation and transfer is one of the most prominent claims in private law and tax policy scholarship.<sup>21</sup> If correct, the claim invites the conclusion that contemporary egalitarian liberals ought to adopt the wealth-maximizing conception of private law and achieve all desired equity-oriented demands through income taxation and transfer. The truth of this theoretical claim would have wide ranging ramifications for public policy and "real world" legal and political institutions. The claim purports to prescribe a rare efficiency-improving option to political liberalism.<sup>22</sup>

There have been criticisms of Kaplow and Shavell's claim at the practical or policy level. We will briefly discuss these criticisms below, however, our critique engages primarily with their *theoretical* claim.

Chris Sanchirico relaxes the assumption that individuals are equally able to exercise the care needed to avoid accidents.<sup>23</sup> If the least-skilled (in terms of producing income) are also the most likely to commit torts, Sanchirico finds that tort damages should be set below the level that is maximally efficient to wealth-creation,<sup>24</sup> given that one's conception of liberalism involves a commitment to equity-oriented values. Christine

21. See, e.g., ROBERT C. ELICKSON, ET AL., PERSPECTIVES ON PROPERTY LAW 117 n.8 (3d ed. 2002) ("Should private law take into account the wealth of litigants involved in a particular civil case? Most law-and-economics scholars argue it should not, on the grounds that private-law rules are inferior distributive mechanisms compared to broader tax and welfare programs.") (citing Kaplow & Shavell, *Should Legal Rules Favor the Poor?*, *supra* note 9); ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 112 (3d ed. 2000); A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 124 (2d ed. 1989); Robert C. Ellickson, *The Affirmative Duties of Property Owners: An Essay for Tom Merrill*, 3 BRIGHAM-KANNER PROP. RTS. CONF. J. 43, 66 (2014) ("[m]ost law-and-economics scholars . . . conclude that distributive goals are better pursued by means of broad tax and welfare programs than by the introduction of distributive considerations into the rules for resolving ordinary private law disputes.") [hereinafter Ellickson, *The Affirmative Duties of Property Owners*]; Lee Anne Fennell & Richard H. McAdams, *The Distributive Deficit in Law and Economics*, 100 MINN. L. REV. 1051, 1062 (2016) ("Our sense today is that both the K&S result and the policy advice have become the conventional wisdom, at least among many law professors who employ economic analysis."); Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 TAX L. REV. 157 (2003); Christine Jolls, *Behavioral Economic Analysis of Redistributive Legal Rules*, 51 VAND. L. REV. 1653, 1654 (1998) ("Many law and economics scholars have urged that legal rules be chosen solely with an eye towards Kaldor-Hicks efficiency . . . these scholars often urge that distributional considerations be addressed (if they are to be addressed at all) exclusively through the tax and welfare systems.") (citing Kaplow and Shavell, *Why the Legal System Is Less Efficient*, *supra* note 9).

22. See James M. Buchanan, *The Relevance of Pareto Optimality*, 6 J. CONFLICT RESOL. 341 (1962); Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 YALE L.J. 1211, 1212 (1991).

23. Sanchirico, *supra* note 20, at 801–02.

24. Sanchirico, *supra* note 20, at 818.

Jolls has called attention to the fact that, given the insights of behavioral economics, equal (expected) amounts of (re)distribution via taxation and the tort system may not cause equivalent effects on work effort,<sup>25</sup> as Kaplow and Shavell assume. Richard Markovits has objected to Kaplow and Shavell's conclusion regarding tax and transfer not only on moral grounds, but also argues that certain qualifications to their argument are, empirically, quite important.<sup>26</sup> In a recent article,<sup>27</sup> Lee Anne Fennell and Richard H. McAdams make a critique that is grounded in a transaction cost (and political action cost) analysis. They do not, however, engage with Kaplow and Shavell's theoretical claim.<sup>28</sup>

This Article addresses an essential aspect of Kaplow and Shavell's argument which appears to be incompletely understood:<sup>29</sup> the manner in which the most fundamental legal rules are constructed, that is the rules which define entitlements and property arrangements, the very question of what counts as property, and the role that transaction costs play in making proper property assignments. This Article addresses the question of the form that property rules might take; that is, the question of whether equity-oriented values are most efficiently met entirely through income taxation and transfer, or, to some degree, through the selection of the rules of property and entitlement. Kaplow and Shavell's purported efficiency advantage of tax and transfer is cast as a comparison of tax and transfer to individual rules of tort or contract,<sup>30</sup> *without* attention to the selection of underlying property arrangements, thereby generating the broad conclusion that tax and transfer is preferable because it is most efficient. However, each body of law, whether contract, tort, or taxation, requires underlying property rules that define the details of ownership. We argue that Kaplow and Shavell's conclusion that income taxation and transfer is most efficient has failed to properly take into account these underlying property rules, and for this reason, it should be rejected. This Article argues that maximal efficiency in meeting equity-oriented distributive aims will, at times, *demand* that such aims be met via non-tax and transfer legal rules, such as those of property and basic entitlement.

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25. Jolls, *supra* note 21, at 1656–67.

26. Richard S. Markovits, *Why Kaplow and Shavell's "Double-Distortion Argument" Articles Are Wrong*, 13 GEO. MASON L. REV. 511, 519–20 (2005).

27. Fennell & McAdams, *supra* note 21.

28. *Id.* at 1056–57 (distinguishing between Kaplow and Shavell's formal theoretical claim and policy prescriptions and stating “we do not take issue with” the former).

29. See Zachary Liscow, Note, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 YALE L.J. 2478 (2014); see also *infra* notes 81–88 and accompanying text.

30. *E.g.*, Polinsky, *supra* note 21, at 124.

To illustrate this point, return to our first example concerning beach access (based on the Oregon case of *Thornton v. Hay*<sup>31</sup>). Assume that the applicable legal regime was initially aimed at wealth maximization, limiting beach access to hotel guests. However, perhaps the political process has changed the nature of the legal regime, such that it now aims to maximize the position of the least advantaged of society. Kaplow and Shavell's advice would be to retain the limited beach access, and to limit the pursuit of welfare for the disadvantaged to tax and transfer. But this cannot always be the correct advice. By abandoning the pursuit of wealth maximization, the new legal regime will, by definition, feature less wealth, but also improved equality. This may entail fewer wealthy vacationers, making it suboptimal to devote the entire beach to hotel guests. A new property rule may be called for, allowing for some public access. This new property entitlement may not emerge through contract. Thus, in these circumstances, the legal regime pursuing the new maximand must alter the property rule governing beach access in order to promote the interests of the least well-off. Legal rules, other than those related to tax, must respond to an increased interest in distributional outcomes.

## I. KAPLOW AND SHAVELL

### A. KAPLOW AND SHAVELL'S ARGUMENT

Kaplow and Shavell's argument has a clear and intuitive appeal: whatever equity-oriented distribution might be obtained through harnessing legal rules could also be obtained through a system of income taxation and transfer.<sup>32</sup> The use of non-tax and transfer legal rules, however, has additional inefficiencies associated with it. That is, it

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31. State of Oregon *ex rel.* *Thornton v. Hay*, 462 P.2d 671 (Or. 1969).

32. Kaplow and Shavell's argument assumes that individuals maximize expected utility, Kaplow & Shavell, *Why the Legal System Is Less Efficient*, *supra* note 9, at 678. They do not, however, appear to hold (unrealistically) that the conditions under which the Coase Theorem applies are in place across the entire range of private legal rules. "The result might appear to depend on some features of the utility function—notably, risk neutrality, the lack of income effects, and care being independent of ability. Relaxing these assumptions would make determination of the efficient legal rule more complicated. It would remain true, however, that if the redistribution accomplished through an inefficient legal rule were instead achieved through a modification of the tax system, resources would be saved and all individuals could be made better off." *Supra* note 9, 679. Thus, the Coase Theorem's assumption of no wealth effects is not assumed in Kaplow and Shavell's discussion. They do not mention perfect information or zero transaction costs (which imply no strategic bargaining), assumptions which would be very strong indeed across the range of all legal rules, particularly once one considers property regimes, where bargaining and information problems are endemic. *Cf.* Herbert Hovenkamp, *Marginal Utility and the Coase Theorem*, 75 CORNELL L. REV. 782, 787 (1990). One cannot assume, therefore, in the context of Kaplow and Shavell's analysis, assets find themselves assigned to their highest value use through private bargaining.

achieves its distributive goal by affecting economic activity in ways other than through the direct redistribution of income (tax and transfer's only direct effect).<sup>33</sup> Tax and transfer, Kaplow and Shavell argue, is more efficient in meeting equity-oriented aims than is the harnessing of other legal rules because tax and transfer creates fewer economic "distortions" than, for example, the use of tort, which not only would redistribute income, but also would be departing from optimal deterrence. Redistribution of income away from the wealth-maximizing outcome, whether done via taxation or tort, creates economic "dead-weight loss." But according to Kaplow and Shavell, tort imposes the added burden of inefficiently altering standards of due care.<sup>34</sup>

Kaplow and Shavell's analysis considers the use of a tort rule to transfer wealth from the better-off to the less well-off in order to satisfy equity-oriented demands. Tort liability for the less well-off might be reduced, leaving them with more money than they would otherwise have, were they subject to a more optimally wealth-maximizing liability rule. Such a move, however, in addition to effecting some amount of efficiency loss during the transfer and the attendant impact on work and investment incentives, would deviate from optimal deterrence.<sup>35</sup> The result is that the less-advantaged would, on average, use less than the optimal standard of care, resulting in a socially inefficient increase in accidents. Contrast this scenario with one that uses income taxation and transfer to achieve the identical equity-oriented distributive end. In that scenario, one also creates the standard inefficiency associated with taxation,<sup>36</sup> namely, the "distortion" of the investment incentive and labor-leisure trade-off,<sup>37</sup> but not the "additional" loss from nonoptimal incentives to take due care. This additional loss is what one might describe as a "double distortion."

The argument goes, when legal rules are constructed to maximize wealth, and equity-oriented demands are to be met solely through taxation and transfer, maximal efficiency will be achieved. This arrangement is purportedly conducive to the creation of additional wealth, which may, in turn, be taxed in service to distributive aims.

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33. Kaplow & Shavell, *Why the Legal System Is Less Efficient*, *supra* note 9, at 667.

34. Kaplow & Shavell, *Why the Legal System Is Less Efficient*, *supra* note 9, at 669.

35. See *United States v. Carroll Towing Co.*, 159 F.2d 169 (2d Cir. 1947) (L. Hand, J.); WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF TORT LAW* (1987).

36. While Kaplow and Shavell focus on the labor-leisure tradeoff, Kaplow & Shavell, *Why the Legal System Is Less Efficient*, *supra* note 9, at 670-71 n.5, this effect can be seen as an example of the broader case in which increasing income tax rates leads to decreasing net taxable income. See Martin Feldstein, *The Effect of Marginal Tax Rates on Taxable Income*, 103 J. POL. ECON. 551, 552-55 (1995).

37. *E.g.*, Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905, 1920 (1987).

Egalitarian liberals would thus be well advised to prefer systems of income taxation and transfer to address equity-oriented demands. In order to avoid economic waste (an important constraint in meeting most plausible distributive aims), egalitarian political liberals ought to adopt a scheme of wealth-maximizing private law rules, in conjunction with a tax and transfer scheme that serves any desired equity-oriented distributive aims.

#### B. THE SCOPE OF KAPLOW AND SHAVELL'S CLAIM

Kaplow and Shavell conclude that a rule of taxation is more efficient than a rule of tort in achieving a given equity-oriented distributive end.<sup>38</sup> For the concept of taxation and transfer to make sense, however, one requires an underlying or initial conception of entitlement. Similarly, the concepts of injury and redress, the frequent subject of tort doctrine, require the construction of initial entitlement baselines. The question then naturally arises: should such entitlement baselines be set in conformity with the “wealth-maximization” demand, regardless of the aims of the overall scheme? If Kaplow and Shavell understand such entitlement baselines to be among what they describe as “other” non-tax and transfer “legal rules,”<sup>39</sup> then the answer is yes. Alternatively, should such entitlement baselines be set so as to directly achieve any given distributional goals in the first instance? Kaplow and Shavell's comparison of tax and tort rules fails to address this fundamental question of entitlement.

All political and legal institutions are constructed by legal rules. Kaplow and Shavell's discussion isolates a particular subset of legal rules (namely, the rules of income taxation and transfer), and contrasts their efficiency in achieving equity-oriented distributive aims with the *private law* rules of tort. Their argument considers such tort rules one at a time, much like the way in which a court, while deciding individual cases, might consider crafting a legal rule. Kaplow and Shavell directly address rules involving negligence or other risk, and they appear to presume their argument can be adapted to extend to other rules (such as minimum wage laws).<sup>40</sup> However, Kaplow and Shavell never address the general case. Further, they are silent about the form property rules, which necessarily underlie their analysis take; thereby introducing significant ambiguity.

Kaplow and Shavell claim that “[f]or purposes of [their argument], the term ‘legal rules’ refers to rules other than those that define the

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38. Kaplow & Shavell, *supra* note 9, at 667.

39. Kaplow & Shavell, *supra* note 9, at 667 n.1.

40. Kaplow & Shavell, *supra* note 9, at 674 n.10.

income tax and welfare system.”<sup>41</sup> They understand the term non-tax and transfer “legal rules” broadly. The very rules that inform or constitute taxation, that is, rules of property and entitlement, are therefore to be understood as among “all other legal rules.”<sup>42</sup> Their discussion of income taxation, analytically speaking, takes place against the background of this constitutive set of legal rules that defines the details of property ownership.

Our concern is the very question of the form that entitlement rules that define and inform their discussion of tort or tax are to take. An argument that compares taxation to a rule of tort, isolated from any conception of entitlement, and concludes that tax and transfer is superior to all other legal rules in terms of its economic efficiency, is incomplete. Our point is that Kaplow and Shavell’s argument requires, and turns upon, a conception of property. Kaplow and Shavell’s contrast, therefore, *cannot* be limited to a comparison of the rules of tort and the rules of tax and transfer. Since it is clear that legal rules construct the background of property ownership and markets that form the very basis of Kaplow and Shavell’s discussion of tort and tax, what their claim requires is an efficiency comparison of competing sets of property entitlement rules, in conjunction with a change in the rules of income taxation and transfer. In other words, in order to draw Kaplow and Shavell’s conclusion, what is required is not the singular comparison of rules of tort with rules of income taxation, but rather the comparison of complete schemes of rules, inclusive of entitlement, income taxation, and tort.

## II. KAPLOW AND SHAVELL AND POSSIBLE PROPERTY CONCEPTIONS

While it is clear that, for Kaplow and Shavell, property and rules of entitlement lie under the rubric of non-tax and transfer legal rules, it is not clear from their discussion which of many forms these rules should take. Kaplow and Shavell directly discuss constructing the rules of tort in service to the wealth maximization principle, but their discussion of income taxation and tort also requires an account of basic entitlement.<sup>43</sup> It would appear that there are two plausible property conceptions open to Kaplow and Shavell. First, they may simply believe that the majority of property rules are to be understood in a conventional manner, meaning their analysis may simply take the set of specific property rules of any legal system as given. In other words, one possible position is that *given* any actual system of property law, income taxation and transfer

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41. Kaplow & Shavell, *supra* note 9, at 667 n.1.

42. Kaplow & Shavell, *supra* note 9, at 667 n.1.

43. Kaplow & Shavell, *Why the Legal System Is Less Efficient*, *supra* note 9, at 672.

can more efficiently achieve an equity-oriented end than can the rules of tort.

Second, Kaplow and Shavell might believe that, while a narrow range of basic entitlements should be constructed by the demands of non-wealth-maximizing values, the remaining, expansive domain of property law should be governed by the wealth maximization principle. There is significant support in Kaplow and Shavell's own work (as well as in the law and economics literature, more generally<sup>44</sup>) of the view that the wealth maximization principle should *not* properly be understood to apply to the entirety of property and entitlement, even in the context of a scheme of legal rules otherwise aimed at wealth maximization. This position, now dominant in the law and economics literature, may help explain Kaplow and Shavell's omission of a direct discussion of property in their analysis of legal rules. Kaplow and Shavell, as well as many other law and economics scholars (that is, wealth-maximizing theorists), have been drawn to a less-than-general conception of the wealth maximization principle, one which specifically exempts "basic entitlement" from its domain, such as those entitlements typically understood as fundamental constitutional rights, self-ownership, and security in one's person. These limitations arise for a variety of reasons: some pragmatic, others conceptual and normative. This view holds that any expansive or detailed account of property rules must, in conjunction with all other rules (other than those of income taxation and transfer), be constructed in service to the wealth maximization principle, while leaving the details of more basic entitlements subject to some other values. In the next section of this Article, we will address the important ramifications and difficulties that the application of either of these two property conceptions have for Kaplow and Shavell's claim.

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44. Kaplow and Shavell, for example, concede that wealth-maximization is not a principle for *general* application and that distributive concerns may be appropriately applied in certain settings. They write, "there are sound reasons for much normative economic analysis of law not to take explicit account of the distribution of income . . . . If these reasons are *inapplicable* in a particular setting, a proper welfare economic analysis will take distributional concerns exogenous to wealth maximization itself, adding "to compute wealth, one must know the prices of into account." FAIRNESS VERSUS WELFARE, *supra* note 9, at 35. They write, "wealth—and thus wealth maximization—is not a well-defined concept," and, seemingly recognizing the necessity of a property baseline different goods and services, yet there is no natural set of prices to use." *Supra* note 9, 35–36. Kaplow and Shavell then go on to discuss Richard Posner's view of one such setting in which the wealth maximization principle ought *not* to apply—namely, initial property arrangements. *Id.* at 35–36 n.41 (quoting Posner, "stating 'I concede the incompleteness of "wealth" [because] the concept of wealth is dependent on the assignment of property rights.').

## A. THE CONVENTIONALIST VIEW OF PROPERTY

Again, the first possible understanding of Kaplow and Shavell's view is that a significant portion of property is simply understood as conventional or given.<sup>45</sup> Their claim might be understood to say that, for whatever property regime is in place, any equity-oriented distributional demand of that system can most efficiently be met through income taxation and transfer, compared to other non-property legal rules. Their advice, then, for purposes of institutional design, would be that in order to efficiently achieve a given equitable aim, the only legal doctrine one should manipulate is the income tax rate. In this view, their analysis takes as given that property arrangements are simply held constant.

As we have seen, there are reasons for narrowing the scope of the wealth maximization principle so as to exclude many property entitlements from its domain. Scholars have at times maintained that the wealth maximization imperative is best understood as incomplete as opposed to being a foundational or general normative principle.<sup>46</sup> Under this view, wealth maximization does not construct the *complete* scheme of basic entitlements. Given the need for a property conception, this may, then, yield the conclusion that, for Kaplow and Shavell, property entitlements are to be best understood conventionally, or simply as given.

However, consider the ramifications that such an approach would have for Kaplow and Shavell's claim. If property rules are to be understood conventionally (that is, taken as one finds them in any given system), then many inexpensive possibilities for maximizing the position of the least economically advantaged may be ignored. Kaplow and Shavell's conclusion that equity-oriented moves are always more efficiently made in tax and transfer as opposed to all other legal rules thus appears to be significantly problematic.

To clarify this point, consider a distributive principle which demands the maximization of the position of the least well-off.<sup>47</sup> Imagine

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45. Ezra Rosser, *Destabilizing Property*, 48 CONN. L. REV. 397, 471 (2015) (discussing the conventional view of property and how alterations in property entitlement might improve the well-being of the poor).

46. RICHARD A. POSNER, *THE PROBLEMS OF JURISPRUDENCE* 375 (1990); FAIRNESS VERSUS WELFARE, *supra* note 9, at 35 n.41.

47. Rawls famously describes the "difference principle" component of his two principles of justice as requiring the maximization of the position of the least well-off, subject to lexically prior basic liberties and equality of opportunity. JOHN RAWLS, *JUSTICE AS FAIRNESS: A RESTATEMENT* 42–43 (Erin Kelly ed., 2001):

(A) Each person has the same infeasible claim to a fully adequate scheme of equal basic liberties, which scheme is compatible with the same scheme of liberties for all; and (B) Social and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and

that the least well-off own rural land that is nearly valueless, given currently overbroad environmental rules and regulations. If these regulations were relaxed, the least well-off would be able to sell this land for development as a recreational area, perhaps for substantial economic gain. Given that the environmental regulations are, by stipulation, overbroad, significant income could be realized by the least well-off at little cost. The alternative to such a property law rearrangement would be taxing the wealthy, then transferring the proceeds to the least well-off. Here, it would seem the income taxation and transfer alternative would, in contravention to Kaplow and Shavell's claim, impose a greater cost through the deadweight loss associated with income taxation than would shifting the overbroad environmental property rules. In short, the latter is more efficient to the goals of the scheme. This is particularly true given the value that could be "unlocked" with a shift away from conventional, but highly inefficient, property rules.<sup>48</sup>

The point is that if Kaplow and Shavell assume that significant entitlements in property should be taken as they are found in any actual legal system, then their claim ought to be narrowed so as to specifically exclude property law from "other legal rules." Otherwise, the claim appears to be false. If their claim of tax and transfer preference over "other legal rules" were so narrowed to exclude property, then given the ability of property entitlements to unlock large amounts of value, the import of the claim is significantly reduced. That said, there is little reason to believe that all property-oriented rules ought to remain entirely beyond the scope of legal regulation. For instance, consider the very *purpose* of takings cases, which alter property holdings in keeping with distributive aims.

To make this point plain, consider the implication of this narrow conventionalist view if one were to compare complete schemes of legal and political rules constructed in service to differential distributive principles, for example, changing a wealth maximization scheme to a more egalitarian scheme committed to maximizing the position of the least well-off. The Kaplow and Shavell position on how best to change the rules of the scheme, given the new distributive principle, would be, of course, to alter only income taxation and transfer to satisfy the new, more equity-oriented principle. If, as we are assuming, one is to take the rules of property entitlement as they are found, this would imply that no change in property entitlements should occur. Our insight, however,

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second, they are to be to the greatest benefit of the least advantaged members of society (the difference principle).

48. See, e.g., Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs, in THE WEST AND FAILS EVERYWHERE ELSE* 49–50 (2000) (discussing important role of property titling as improving position of urban poor by making borrowing possible).

amounts to the claim that a change in the overall distributive goal of the scheme necessitates that *all* the rules of the new scheme are to be constructed so as to maximize the position of the least well-off.

To conclude, Kaplow and Shavell's claim, broadly understood, cannot be true if the rules of property are not set in accordance with distributive principles; setting property rules according to norms other than wealth maximization or working from the property rules in a "conventional" legal setting would be sufficient to show the over-breadth of their claim. Still, the problem with holding "property" as conventional goes deeper: If one is to "freeze" property entitlements as they are found in existing legal regimes, it is not clear what Kaplow and Shavell are comparing when they measure the relative "distortion" involved in implementing a rule of "income taxation" versus a rule of "tort" to achieve a given distributive end.<sup>49</sup> Both tax and tort significantly impact entitlements. For example, my entitlement right in my automobile is relatively stronger when the income I generate from collecting taxicab fares is untaxed versus when it is taxed, and when third parties are liable for damaging it versus when they are entitled to damage it in certain circumstances without liability. So if my entitlement in my automobile is to be held constant in a conventional sense, it would appear that altering any relevant rules of taxation and of tort would also be blocked. In short, it appears that if Kaplow and Shavell mean to take property entitlements as fixed or given, their claim is incoherent. They must, then, have in mind that at least much of property law is to be set to or in some measure answer to wealth maximization and not be taken as conventionally given by any actual legal system.

#### B. BASIC ENTITLEMENTS AND A WEALTH-MAXIMIZING PROPERTY REGIME

The question of what exactly a wealth-maximizing property law scheme looks like is, itself, problematic. Even if most of what is doctrinally labeled as "property law" is subjected to wealth maximization, scholars have drawn attention to pragmatic, conceptual, and normative reasons that would seem to require a narrowing of the scope of the wealth maximization principle, such that it would not encompass *all* property entitlements. Specifically, scholars in the law and economics vein have been drawn to a constrained conception of the wealth maximization principle. Many scholars hold that the very concept of "wealth" is incomplete.<sup>50</sup> That is, in order to evaluate prices or discern economic

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49. Kaplow & Shavell, *Why the Legal System Is Less Efficient*, *supra* note 9, at 674.

50. Richard Posner has emphasized "that wealth maximization is inherently incomplete as a guide to social action because it has nothing to say about the distribution of rights—or at least nothing we want to hear . . . . If wealth maximization is indifferent to the initial distribution of rights, it is a truncated concept of justice." POSNER, *supra* note 46, at 375.

value, one must first set entitlement baselines.<sup>51</sup> Such baselines must be established, conceptually, prior to the very concept of wealth and, thus, the wealth maximization principle. The idea is that it would be illogical to speak of wealth absent an initial assignment of property rights; and if this is correct, the wealth maximization principle cannot govern such arrangements, making any such argument incoherent.<sup>52</sup>

Although these conceptual reasons tend to be grouped among or alongside the normative reasons for the rejection of the wealth maximization principle as a guide to the construction of property and entitlement rules in the literature, they are actually distinct. That is, even if one were to show that this baseline problem could be overcome—say, by assigning initial entitlements to those who will make the most of them and measuring wealth on an *objective* index—there still would be strong normative reasons for rejecting the notion that wealth maximization should govern the entire assignment of property entitlements. Even if the economic analysis of law could produce a wealth-maximizing conception of property which does not fall prey to *conceptual* incoherence, wealth maximization scholars have concluded that one still needs to show that a “through and through” wealth-maximizing conception of property would be *normatively* acceptable.

Indeed, in the context of significant debate, some law and economics scholars have maintained that applying the wealth-maximization principle to the most basic of property entitlements is objectionable on *normative* grounds. They argue that it may well produce or even demand normatively unacceptable (deeply illiberal) outcomes.<sup>53</sup> The idea is that conceptions of freedom and equality, self-ownership of one’s body, labor, thought and conscience, dignitary interests, personal property and a basic or decent social minimum require property baselines defended on grounds other than wealth-maximization. Wealth maximization, given its aim of maximal net aggregate wealth, is consistent with, and may even

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51. Lewis A. Kornhauser, *Wealth Maximization*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 679 (Peter Newman ed., 1998); Mark A. Geistfeld, *Due Process and the Determination of Pain and Suffering Tort Damages*, 55 DEPAUL L. REV. 331, 349 n.65 (2006) (“The appropriate baseline cannot be determined by economic analysis, since cost-benefit analysis depends on prices which in turn depend on the initial allocation of property rights . . . . The initial allocation of property rights must instead depend upon [other] normative justification, and so the normatively justified tort rule defines the appropriate baseline for evaluating the distributive impact.”); FAIRNESS VERSUS WELFARE, *supra* note 9, at 36.

52. See LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: TAXES AND JUSTICE (2002).

53. “Given the distribution of rights (whatever it is), wealth maximization can be used to derive the policies that will maximize the value of those rights. But this does not go far enough, because naturally we are curious about whether it would be just to start off with a society in which, say, one member owned all the others.” POSNER, *supra* note 46, at 375.

demand, troublingly illiberal property arrangements, including but not limited to, as Rawls points out, chattel slavery.<sup>54</sup>

The basic idea here is that wealth maximization, like utilitarianism, fails to seriously consider the moral distinction between persons. Interestingly, it is the recognition of this point that leads Rawls to develop a theory of basic liberties and their priority to economic arrangements.<sup>55</sup> Law and economics scholars typically resolve this problem by narrowing the scope of the wealth maximization principle, requiring that non-wealth-maximizing values are at play in defining a narrow set of basic entitlements, thereby ultimately accepting what might be described as constrained wealth maximization.<sup>56</sup> There are, then, good reasons to believe that Kaplow and Shavell do not hold that *all* property arrangements are to be subject to the wealth maximization principle. Instead, it would appear that they hold that some narrow class of basic property entitlements are to be directly set via non-wealth-maximizing (that is, equity-oriented) values, leaving the rest of property law to be governed by wealth maximization.

A normative requirement that some basic entitlements reflect equity-oriented values is the *rejection* of a thoroughgoing wealth maximization in favor of a more equity-oriented, constrained wealth-maximizing principle. That is, the wealth maximization principle is abandoned in favor of suffusing basic entitlements with distinct, and more importantly, equity-oriented values. In favoring a more equity-oriented conception, Kaplow and Shavell appear not to hold that *all* equity-oriented moves are to be made in tax and transfer, but would

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54. RAWLS, *supra* note 19, at 8.

55. RAWLS, *supra* note 19, at 243–44; JOHN RAWLS, *The Basic Liberties and Their Priority*, in *POLITICAL LIBERALISM* 291 (1993). For similar points, see RONALD DWORKIN, *TAKING RIGHTS SERIOUSLY* (1977); Margaret Jane Radin, *Property and Personhood*, 34 *STAN. L. REV.* 957, 958 (1982) (discussing “strand of liberal property theory that focuses on personal embodiment or self-constitution in terms of ‘things.’”); Anthony T. Kronman, *Wealth Maximization as a Normative Principle*, 9 *J. LEGAL STUD.* 227 (1980).

56. POSNER, *supra* note 46; FAIRNESS VERSUS WELFARE, *supra* note 9, at 35 n.41, 35–37. Indeed, a commitment to “constrained wealth maximization” may be more complicated than it initially appears. The range of values that motivate a constraint on wealth maximization may not be so easily placed to one side or “cabined-off” to a few basic property entitlements such as self-ownership, thereby leaving the wealth maximization principle otherwise free to operate. Consider for example, defamation law, conventionally understood as a rule of tort law. Samuel Warren & Louis Brandeis, *The Right to Privacy*, 4 *HARV. L. REV.* 193, 205 (1890) (discussing common law of defamation). On the plausible assumption that the same values that cause one to reject the possibility of (wealth-maximizing) chattel slavery may to require some measure of protection from defamation that might not be constructed under wealth maximization, the basic entitlement scheme might thus intrude into tort law itself, which would then be, importantly, in part non wealth-maximizing. For the sake of argument, however, we will proceed as if basic entitlements only involve a few rules of property law, as appears to be Kaplow and Shavell’s position.

instead include some such moves in the basic entitlement component of property law rules.

Given that, as we have argued above, Kaplow and Shavell's claim cannot be correct if it posits that property should be taken as merely conventional, it would seem that they hold that the *non-basic* aspects of entitlement should respond to the same maximand as does, for example, tort—namely, wealth maximization. Since Kaplow and Shavell, to their credit, have noted the deeply problematic nature of extending the range of the wealth maximization principle to cover basic entitlements (which, as we have said, would call into question the status of self-ownership, freedom of conscience, and constitutional essentials), they place these matters under the control of non-wealth-maximizing, equity-oriented values.<sup>57</sup> With these basic matters left to one side, Kaplow and Shavell thus hold a “constrained wealth-maximizing” view of property: legal rules of basic entitlement are governed by non-wealth-maximizing values, while all other (non-tax and transfer) legal rules are to be constructed by appeal to wealth maximization. In this constrained wealth-maximizing view, conventional or “positive” accounts of property are rejected and the *expansive* or *non-basic* rules of property are constructed in service to the wealth maximization principle.<sup>58</sup>

Since Kaplow and Shavell themselves take as given that some *non-tax* and transfer legal rules—those of basic entitlement—are to be constructed in an equity-oriented fashion, their bold conclusion assumes that some equity-oriented moves *must* be made in the basic entitlement component of property law construction. For example, if a particular set of rules governing minimum wage is demanded or required of any entitlement scheme that sufficiently protects human dignity, it could be, in Kaplow and Shavell's view, justified on exogenous moral (as opposed to efficiency grounds) since efficiency by their own lights has already been determined not to be the controlling value in the construction of rules governing basic entitlement. The existence of equity-oriented values in the construction of basic entitlements reduces the scope of Kaplow and Shavell's claim. The efficiency preference of “tax and transfer” over “other legal rules” is then limited in range, applying only to what we have called non-basic entitlement. Given the conceptual and

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57. FAIRNESS VERSUS WELFARE, *supra* note 9, at 35–37.

58. Note that the basic entitlements adopted as the constraints to a plausible theory of wealth maximization might not remain unchanged if a new distributive principle were to be implemented. If such a change in the distributive principle necessitated a change in basic entitlements, then this alone would be sufficient to refute Kaplow and Shavell's thesis regarding the tax and transfer preference. In other words, if the “wealth maximization” basic entitlement package is not maximally efficient at satisfying a new, more equity-oriented distributive principle, then adoption of such a principle requires changes in property entitlement.

normative difficulty with a thoroughgoing wealth maximization approach to property, difficulties that Kaplow and Shavell themselves accept, any broader claim is problematic. However, Kaplow and Shavell may reasonably advance a narrower claim of an efficiency preference for tax and transfer over all *non*-basic entitlement legal rules, including the expansive rules of property law. We will argue, however, that there are conclusive reasons which demonstrate that the narrow claim that income taxation and transfer is *more* efficient in meeting equity-oriented demands than changes to an expansive property law regime is false, and should therefore be rejected.

To summarize our argument, we have noted that Kaplow and Shavell leave the role of property law unattended in making their claim that income taxation and transfer are superior to “all other legal rules” in attaining equity-oriented goals. One is left to guess what their conception of property may be. We reject the possibility that they hold either a conventional view or a thoroughgoing wealth-maximization view (see chart below, first row) and conclude that they must hold a constrained wealth-maximization view. In this view, basic entitlements are set by equity-oriented values, but expansive property law constructions are governed by the wealth maximization principle (see chart below, second row). Since what is essential to a thoroughgoing refutation of Kaplow and Shavell’s thesis is showing that, as a matter of efficiency (that is, independent of moral reasons), equity-oriented moves are sometimes more cheaply made through the rules of *expansive* property law rather than through income taxation and transfer (see chart below, third row), we turn to this issue in the next section.

	Property Law: Basic Entitlements	Property Law: Expansive Constructions
Distributive Principle: <i>Wealth Maximization</i>	Objectionable	Wealth Maximization
Distributive Principle: <i>Constrained Wealth Maximization</i>	Equity-Oriented	Wealth Maximization
Distributive Principle: <i>Difference Principle</i>	Equity-Oriented	K and S claim: Wealth Maximization; this claim we refute.

### III. THE PROPERTY LAW REFUTATION OF THE TAX AND TRANSFER PREFERENCE

#### A. PROPERTY LAW AND DIFFERING DISTRIBUTIVE PRINCIPLES

Different forms of liberalism feature different levels of commitment to the central liberal values of freedom and equality. In order to illustrate how legal rules are constructed under different conceptions of liberalism, let us turn to several examples.

First consider Kaplow and Shavell's constrained wealth-maximizing conception. With such a distributive principle, the rules of the complete scheme of *economic* institutions are to be arranged instrumentally so as to maximize net aggregate wealth, subject to the basic entitlement constraints (or range limitation). The rules of this arrangement of economic institutions are constructed in service to the over-arching demands of the distributive end: constrained wealth maximization.

It is important to emphasize that, even within the context of such a wealth-oriented scheme of legal and political institutions, not all rules are to be constructed in a way that patterns a "free market" as would be found in Lockean-libertarianism or in the doctrine of laissez-faire.<sup>59</sup> To be clear, wealth maximization and the doctrine of laissez-faire are not the same—in the context of constrained wealth maximization, there is no principled commitment to values such as near-absolute rights in holdings and transfer as would be found in a libertarian scheme. Constrained wealth maximization likely requires some "collectivist" or state ownership.

For example, consider a scheme of legal institutions in which air travel has recently been introduced. The assumptions behind the Coase Theorem,<sup>60</sup> of course, would not apply to transactions between airplane owners and numerous landowners, due to bargaining costs and the possibility of strategic holdout. But this is *not* our present concern. Property rights allowing airplanes to fly overhead might be more *valuably* assigned to airlines, given a wealth-maximizing property scheme, than being left to the discretion of would-be libertarian holders of fees simple absolute. If this were indeed the case then subsequent to the introduction of the airplane, wealth-maximizing private law rules

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59. ROBERT A. NOZICK, ANARCHY, STATE, AND UTOPIA (1974).

60. See R. H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960). The assumptions of the Coase Theorem include no wealth effects and no transactions or bargaining costs. Elizabeth Hoffman & Matthew L. Spitzer, *Experimental Law and Economics: An Introduction*, 85 COLUM. L. REV. 991, 1010 (1985).

would presumably (1) reduce the *ad coelum* rights<sup>61</sup> of landowners from the baseline of libertarianism, that is, shave down fees simple absolute and assign air rights to airlines, (2) change the landowners' property-rule protection as against airborne incursions to liability rule protection,<sup>62</sup> or (3) "collectivize" air-rights, with the new government owner allowing openaccess to airplane owners or perhaps charging a relatively small usage fee.<sup>63</sup>

Where the reassignment of property rights "unlocks" net aggregate wealth, it is *required* within a set of legal and economic institutions aimed at wealth maximization, independent of the question of transaction costs. Once one accepts Kaplow and Shavell's constrained wealth maximization principle, there can be no reasonable objection to the details of this change in property entitlement—the only real objection would be to the constrained wealth maximization principle itself, not to its instantiation in this particular instance in which private property rights were reduced.<sup>64</sup> Our point is that differential governing distributive principles demand differential property conceptions—for example, the move from Lockean-libertarianism to wealth maximization.

As a further example, stipulate that the construction of a public park in a growing city would be wealth-maximizing; however, the city's attempt to secure a suitable plot of land is hampered by a small group of would-be libertarians refusing to sell land to the city. Constrained wealth

61. For hundreds of years, the common law dictum of *cujus est solum, ejus est usque ad coelum et ad infernos*, or "To whomever the soil belong, he owns also to the sky and to the depths" gave unlimited air-rights to landowners. *Ad coelum et ad infernos*, BLACK'S LAW DICTIONARY (6th ed. 1990).

62. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

63. See *United States v. Causby*, 328 U.S. 256, 261 (1946) ("[The] *ad coelum* . . . doctrine has no place in the modern world. The air is a public highway . . . . Were that not true, every transcontinental flight would subject the operator to countless trespass suits. Common sense revolts at the idea. To recognize such private claims to the airspace would clog these highways [and] seriously interfere with their control and development in the public interest"); Lord Bernstein of Leigh v. *Skyviews & Gen. Ltd.*, n.5 [1978] QB 479 (Eng.):

[t]he maxim, usque ad coelum, [is] a fanciful phrase, to which I would add that if applied literally it is a fanciful notion leading to the absurdity of a trespass at common law being committed by a satellite every time it passes over a suburban garden. The academic writers speak with one voice in rejecting the uncritical and literal application of the maxim . . . . I accept their collective approach as correct. The problem is to balance the rights of an owner to enjoy the use of his land against the rights of the general public to take advantage of all that science now offers in the use of air space. This balance is in my judgment best struck in our present society by restricting the rights of an owner in the air space above his land to such height as is necessary for the ordinary use and enjoyment of his land and the structures upon it, and declaring that above that height he has no greater rights in the air space than any other member of the public.

64. Murphy & Nagel, *supra* note 52, at 98; Douglas A. Kahn & Jeffrey S. Lehman, *Tax Expenditure Budgets: A Critical View*, 54 TAX NOTES 1661, 1663 (1992) (arguing that there are no fixed baselines in taxation: "The choice among perspectives is a contestable, contingent . . . decision.").

maximization, here, might be satisfied by altering these property owners' rights—from, for example, property-rule protection to liability-rule protection—thus allowing the city to engage in a “taking” of the land and requiring the provision of fair market compensation. So, to be clear, constrained wealth maximization might *require* that the scheme reassign property rights in a “collectivist” manner in order to increase wealth.

These examples show that a commitment to a constrained wealth maximization principle has a significant effect on the form that entitlements in property take (that is, the proverbial “bundle of sticks”). The point is that commitment to the constrained wealth maximization principle requires that property entitlements be constructed in service to its demands. The idea, not a transaction cost story, is that one cannot succeed in meeting the demands of constrained wealth maximization by simply adjusting the rules of income taxation and transfer in a direction more conducive to economic growth, without *attention* to property entitlements.

Instead, one would need to construct the rules in conjunction with one another, so as to produce a complete scheme of legal and economic institutions that complies with the distributive goal: constrained wealth maximization. The principle requires an optimal set of property rights and entitlements, just as it requires an optimal rate of taxation; importantly, the tax rate in a scheme of legal and political rules governed by constrained wealth maximization is not zero.

In significant contrast to constrained wealth maximization, consider a form of liberal egalitarianism that subscribes to Rawls's “difference principle,” which demands that the rules of all economic and legal institutions be arranged so as to maximize the position of the least well-off, subject to satisfying the lexically prior first principle of justice and equal opportunity.<sup>65</sup> Rawlsianism, of course, measures the position of the least well-off not in terms of wealth, but by counting what Rawls calls the objective index of the “primary goods.”<sup>66</sup> Importantly, this means that Kaplow and Shavell's claim does not, given their assumptions, apply to Rawlsianism. However, as is often done for illustrative purposes,<sup>67</sup> consider a quasi-Rawlsian approach that seeks to maximize the position of the least well-off in terms of dollars which, for the moment, complies with Kaplow and Shavell's idealizations which are distinct from Rawls's. Such a liberal egalitarian approach is analogous to constrained wealth maximization in that it is instrumentalist and

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65. RAWLS, *supra* note 19, at 75.

66. RAWLS, *supra* note 19, at 90.

67. *E.g.*, THOMAS W. POGGE, REALIZING RAWLS 66 (1989) (“Let me give a crude illustration of Rawls's position, based, once again, upon his difference principle in its simplest form (where it governs only income).”).

maximizing (subject to the first principle of justice and equal opportunity) with regard to the rules of a complete set of economic institutions, inclusive of expansive property conceptions, contract, property, tort, corporate, bankruptcy, and commercial law.<sup>68</sup>

As in the constrained wealth maximization case, then, here too we are required to meet the demands of a maximizing principle—in this case, one focused on the position of the least well-off. For reasons of equality, this principle, unlike the wealth maximization principle which focuses on net aggregate wealth, requires that the position of the least well-off be maximized. From a wealth maximization perspective, the difference principle is significantly more equity-oriented and, again, the rules of the economic scheme are to be constructed in service to its maximizing demands. So, as in the wealth maximization example, non-tax and transfer legal rules are constructed, instrumentally and in conjunction with one another, in service to the new equity-oriented difference principle. Changing the maximand from focusing on net aggregate wealth to focusing on the wealth of the position of the least well-off should require property law to be employed instrumentally in the direct satisfaction of the scheme's demands. More precisely, Kaplow and Shavell hold that in order to meet the demands of the newly governing difference principle, the expansive rules of property law should be constructed so as to maximize wealth—that is, remain constant in an inter-schemic comparison *despite* the change in the distributive principle that governs the *entire* scheme of legal and economic rules. For Kaplow and Shavell, only the rate of income taxation and its inverse, the transfer rate, changes.

The setting of initial property entitlements can have significant effects on the achievement of the desired ends of an economic scheme.<sup>69</sup> Consider again the park example: imagine a complete scheme of legal and economic rules in which the position of the least well-off would be improved considerably by adding a park to a crowded neighborhood. While there might be holdouts or other collective action problems attendant to acquiring property for the park through voluntary contract, our point goes deeper. A scheme of property rules focused on maximizing the position of the least well-off might, then, assign the plot or the right to purchase it for an objectively determined price to the state, even in the absence of transaction costs. This would be an equity-oriented rule of

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68. See Kevin A. Kordana & David H. Tabachnick, *Rawls and Contract Law*, 73 GEO. WASH. L. REV. 598, 609 (2005).

69. Richard A. Epstein, *Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase*, 36 J.L. & ECON. 553 (1993); Lloyd Cohen, *Holdouts and Free Riders*, 20 J. LEGAL STUD. 351 (1991).

property law, and it would be adopted because it maximizes the position of the least well-off.

This example demonstrates that property law constructions remain, in a scheme responding to the difference principle, instrumental to the service of that principle. Kaplow and Shavell's claim is that the satisfaction of the new maximand can be most efficiently achieved by having the expansive rules of property law *ignore* the switch in maximands. That is, the expansive rules of property law are to continue to respond to a *different* maximizing distributive principle: One focused exclusively on net aggregate wealth. Consider, however, the implication of constructing private law rules so as to maximize *net aggregate wealth* in a system subject to the maximizing demands of the difference principle. The expansive rules of property law function to maximize net aggregate wealth *regardless* of their effect on the actual goal of the overall scheme, which is to maximize the position of the least well-off. Put this way, the claim is highly counterintuitive: Kaplow and Shavell would hold that in order to maximize the position of the least well-off, one is best advised to start by maximizing wealth, making all changes through income taxation and transfer.

So, property assignments must answer to the demands of the maximand, which may require certain specified entitlement assignments. While these assignments might at times solve transaction cost problems, this is decidedly *not* our principal point. Assignments might overcome subjective preferences in order to satisfy the maximand. Consider a newly developed drone technology that allows low-cost delivery of pharmaceuticals to underserved neighborhoods. A maximand that focuses on the position of the least well-off might demand that drones be able to establish flight paths over wealthy neighborhoods *even if* wealthy residents had no interest in selling their air rights. The reassignment of air rights is not done to solve a transaction cost problem<sup>70</sup>—instead it is done to satisfy a direct demand of the maximand—to improve the position of the least well-off.<sup>71</sup>

#### B. ANALYSIS OF THE TAX AND TRANSFER PREFERENCE

It can now be demonstrated why Kaplow and Shavell's tax and transfer preference is problematic. The expansive conception of property law, constructed so as to maximize net aggregate wealth would, by definition, instantiate a rule that increased net aggregate wealth by 0.5 but which decreased the position of the least well-off by 100. In returning

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70. Cf. Fennell & McAdams, *supra* note 21 at 1057.

71. Analogously, Rawlsian contract law would "close" certain options that would be "open" in wealth maximization. Kordana & Tabachnick, *supra* note 68, at 598.

to our initial example, this may mean constructing a property rule limiting public access to beaches that has the effect of increasing beach-front land values and, on net, slightly increasing overall wealth. However, such a rule comes at a cost to lower-income would-be beachgoers. This decrease in the position of the least well-off should, according to Kaplow and Shavell, be “undone” through income taxation and transfer, even given the latter’s attendant “distortion” of the labor-leisure trade-off and associated dead-weight loss. However, crucially, if the “loss” from this distortion (plus administrative and transactions costs) was greater than 0.5—given that 100.5 is being sought to be taxed and transferred—then the scheme would do better to have avoided adopting that particular wealth-maximizing property law. An economic scheme aimed at maximizing the position of the least well-off should *not* “eke out” every last drop of wealth in its construction of property law.

This example is sufficient to refute Kaplow and Shavell’s claim. The outcome, once the issue has been properly framed as involving the construction of a new scheme of legal and economic rules, subject to a new maximand, is not terribly surprising. Working at cross-purposes to an overarching maximizing principle (that is, the difference principle) by invoking the distinct wealth maximization principle, to govern what we have shown to be crucial expansive property constructions, seems an unlikely—and curious—way to *maximize* the position of the least well-off. We argue that, in a such a scheme governed by a new distributive principle, many property (re)arrangements that directly improve the position of the least well-off could be made at a lower cost than through the use of taxation and transfer—largely by (re)constructing expansive property law rules that had been adopted in service to wealth-maximization but which can now be seen as extremely costly in terms of the satisfaction of the new, equity-oriented difference principle. It is significant that these costs or inefficiencies are “new”—they are relevant only given the new distributive principle. A reduction in the position of the least well-off did not count against a rule under the wealth maximization principle, so long as net aggregate wealth was increased.

Thus, for a given distributive principle, it is simply too “costly,” in terms of the aims of that principle, to construct a scheme of legal and economic rules by subjecting (large) portions of the scheme to a distinct maximand. A maximizing distributive principle, metaphorically speaking, “sucks the air out of the room.” That is, maximization requires, in principle, the construction of a complete set of legal and economic rules that ekes out every bit of value or benefit (however small) in terms of one distributive principle, to the exclusion of all others. It is far better, in terms of efficiency, to satisfy an overarching distributive scheme by constructing *all* parts of the system to be responsive to a distributive

principle, as opposed to another aim. In the presence of one maximizing distributive principle, there is simply no “air” in the system to sustain the demands of another competing maximizing principle.

As our example demonstrates, setting expansive rules of property law to wealth-maximize when some other maximizing distributive principle is in place can be extremely costly, by dramatically increasing the amount of “redistribution” that needs to be done—in a manner that can overwhelm whatever per-unit advantage (from the lack of a “double distortion”) that taxation may have over the private law in achieving, intra-schemically, a fixed amount of additional “equity.”

This is not an insignificant point. It is true that where one’s global aim is the maximization of the least well-off, one must take care not to destroy the production of wealth. However, it does not follow from this mere cautionary instruction that all non-tax and transfer legal rules should be constructed instrumentally to an alternative maximand (that is, wealth maximization). The important lesson to learn from Kaplow and Shavell is that when tax and transfer can more efficiently distribute value to the least well-off than changes in other legal rules, it should be done. However, such a decision always requires further analysis of the cost of the imposition of wealth-maximizing legal rules upon the least well-off (in terms of their own wealth maximization) and the efficiency of compensating that loss via tax and transfer. It is clear that since various property assignments within a wealth-maximizing property scheme have a differential impact on net aggregate wealth, there is no reason *a priori* to believe that tax and transfer is more efficient than alterations to property rules. In any situation where a specific wealth-maximizing rule within the complete set of legal and economic institutions is contributing little real value to net aggregate wealth (meaning it creates little revenue for purposes of taxation) and at the same time serves to reduce the wealth of the least well-off, a deviation from the wealth-maximizing property rule will be more efficient than tax and transfer in maximizing the position of the least well-off. The continued imposition of such property rules would simply be operating in contravention to the goal of maximizing the position of the least well-off.

### C. COUNTER-EXAMPLE TO THE TAX AND TRANSFER PREFERENCE

The effect of switching away from constrained wealth maximization on expansive property constructions illuminates an even greater difficulty with Kaplow and Shavell’s thesis than our discussion thus far has suggested. Consider the following example. In service to the demands of constrained wealth maximization, entitlement to a remote fishery has been assigned to F, a highly skilled fisherman who is its highest value owner and will use expensive equipment to harvest caviar from

sturgeon.<sup>72</sup> Now assume that the difference principle has been put in place. Kaplow and Shavell would advise that one should maximize the position of the least well-off only through the use of income taxation and transfer, that is, only the income tax rate (and its inverse transfer rate) would change; all other legal rules would remain unchanged, in their constrained wealth maximization construction. Keep in mind, however, that we cannot assume that the fishery will continue to operate in the new scheme governed by the difference principle. When we shift the maximand from constrained wealth maximization to the difference principle we are, by definition, accepting less net aggregate wealth, or a smaller economic pie.<sup>73</sup> The fact that net aggregate wealth decreases has an effect on prices within the scheme. For example, the relative price and proliferation of luxury goods may decline precipitously as compared to the price of basic commodities. Given this hypothesized drop in the price of luxury items like caviar, the remote caviar-fishery might best be abandoned in the new scheme, according to the difference principle's demands. The economic activities that are constructed in the new scheme are different from those constructed in service to the demands of constrained wealth maximization. Luxurious mansions might need to be reconfigured into apartments for the least well-off.

It is useful to recall a now-canonical example from property law scholarship. Demsetz famously argued that one should understand the transformation from communal holding of property to private land ownership among the Native Americans in northeastern Canada as a result of the increased value of furs once the Europeans arrived.<sup>74</sup> As the value of fur increased, the cost of overhunting fur-bearing animals also increased.<sup>75</sup> This made it suddenly cost-effective to bear the costs of private land-ownership (for example, demarcating and policing boundaries<sup>76</sup>), internalizing the externality of overhunting through communal ownership. The point is that the change in the relative price of fur necessitated a reconstruction of the bundle of property rights and entitlements. Another now-canonical example is the invention of barbed wire which lowered the cost of fencing, and spurred greater subdivision of land in the American West.<sup>77</sup> So too we argue that the change in

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72. This appears to be consistent with the assumptions of Kaplow and Shavell's argument. "Individuals differ in their ability [ $\alpha$ ] to earn income  $y$  through labor effort." Kaplow & Shavell, *Why the Legal System Is Less Efficient*, *supra* note 9, at 677.

73. See RAWLS, *supra* note 19, at 71 n.10 ("This fact is generally recognized in welfare economics, as when it is said that [wealth maximization] is to be balanced against equity.").

74. Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 356-58 (1967) (Papers and Proceedings).

75. *Id.*

76. Robert C. Ellickson, *Property in Land*, 102 YALE L.J. 1315, 1327-30 (1993).

77. *Id.* at 1330.

relative prices that will occur under a new maximand which has decreased net aggregate wealth will necessitate the reconstruction of property entitlements.

The idea is this: if legal and economic institutions are arranged to maximize wealth, then they are, by definition, arranged such that assets are in the possession of the highest value user. Thus, such an arrangement marks the wealth-production ceiling. If expansive property entitlements are rearranged to maximize the position of the least well-off instead, the system incurs significant loss in net aggregate wealth, which cannot be preserved in the newly created property and entitlement scheme. Kaplow and Shavell would argue that the wealth created for the least well-off by any alternative property arrangement cannot be greater than the wealth created by the wealth-maximizing set of property arrangements, so one might as well use income tax and transfer in conjunction with wealth-maximizing property rules to maximize the position of the least well-off. One cannot switch between a wealth maximization regime and a scheme designed to maximize the position of the least well-off without significantly altering prices and economic activity. The economic activity available for taxation in a wealth-maximizing scheme is not necessarily available for similar taxation in a scheme arranged to maximize the position of the least well-off. Thus, while a wealth-maximizing scheme requires assigning rights in the remote fishery to F, one cannot assume that F's involvement in the production of a luxury item (caviar) would exist, and thus be available for similar treatment through taxation once property entitlements are instead set to maximize the position of the least well-off.

Once taxation and property entitlements are set instrumentally to a "non-wealth-maximizing" demand, prices and economic activity cannot be held constant. When one adopts legal rules that aim to maximize the position of the least well-off, net aggregate wealth is self-consciously *decreased* in favor of a specific (more egalitarian) distributive pattern. This pattern, in turn, creates a new and distinct set of prices. Expansive property entitlements should not be held constant in drawing comparisons between complete legal and economic schemes. The continued assignment of property rights to the now-defunct, though previously profitable, remote fishery to F is clearly inefficient in maximizing the position of the least well-off. Such rights should instead be assigned to someone other than F, perhaps to a local group of less-skilled people, G, that can engage, for example, in subsistence fishing, which will in turn be more instrumental to satisfying the difference principle. Notice that this asset reassignment is *required* by the collapse in the caviar market, as compared to an attempt to impose taxation on a now nonexistent caviar fishery, if one is to satisfy the demands of the difference principle.

Thus, the entitlement to the fishery must change when the maximand has changed from wealth maximization to maximizing the position of the least well-off. This demonstrates that property rights and entitlements must be altered in order to most efficiently satisfy the demands of the new distributive principle. In a scheme governed by wealth maximization, the fishery is assigned to F. In a scheme governed by the difference principle, the fishery is instead assigned to G. In essence, the reassignment of the fishery to G creates more income than is taken from F. Thus, unlike a rule of income taxation or tort, which transfer dollars between individuals, the added (or, “double”) distortion of transferring property assignments can be *positive* in nature, such that it is more efficient to the ends of the new (non-wealth-maximizing) maximand than an equivalent taxing of F with associated transfer of dollars to G.

Nevertheless, one might object that the fishery in this example has been, given the contingencies of the new scheme, assigned to its highest value user and therefore property law is best understood as remaining under the “governance” of wealth maximization. In this vein, consider the following: The fishery was assigned to G instead of another less talented local group, G2, which is notorious for its fear of the water. This assignment was made on the grounds that G would create more value by engaging in subsistence fishing than would G2, who would fish inefficiently due to their hydrophobia. This view, however, embodies a failure to properly understand wealth maximization. The objection appears to conflate an anti-waste dictum, or a mandate to meet the difference principle efficiently, with wealth maximization. Imagine F’s complaint against the new scheme. He complains that he has lost the entitlement to the fishery, and that this loss is objectionable because the new scheme fails to create property entitlements which maximize wealth. The administrators of the new scheme would likely reply that the fishery was reassigned in service to the difference principle, and the reassignment was justified in terms of that governing principle. It was made as a matter of the new, more equity-oriented commitment (an aim of the new system, but not of the previous system). The point, however, of F’s complaint is that the new arrangement fails to maximize wealth, and given his talents, he objects to his place in the new scheme. However, what has occurred is the reassignment of the fishery as a matter of efficiently serving the new maximand.<sup>78</sup>

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78. Different distributive principles require that distinct steps be taken in order to be satisfied efficiently. See RAWLS, *supra* note 19, at 68 (“The principle of efficiency does not by itself select one particular distribution of commodities as the efficient one. To select among the efficient distributions some other principle, a principle of justice, say, is necessary.”).

In response to this objection, importantly, the reassignment of the fishery does *not* follow the pattern of wealth maximization. Wealth maximization would assign the fishery to the least well-off if and only if its value to the least well-off (L) was greater than its value to the most talented person(s) (M) within the new scheme. However, if one is seeking to satisfy the difference principle, it must be noted that if the asset is assigned to the most talented, with the least well-off being compensated via tax and transfer, the least well-off will benefit only by  $t_i M$ , where  $t_i$  is the optimal income tax rate (with an associated “transfer” rate of  $-t_i$ ) within the scheme that is applicable to that asset in the hands of the most talented. In other words, given optimal tax policy, not all of the value created by the assignment to the most talented is available to benefit the least well-off. Thus, the assignment of the asset must be given directly to the least well-off if  $L > t_i M$ . To be clear, this is *not* the wealth maximization decision-rule, in which the assignment is to the least well off only if  $L > M$ . The objection cannot be sustained.

Kaplow and Shavell appear to not fully recognize the *fixed* role that taxation and transfer must play in the context of maximizing schemes. Our concern is perhaps most readily understood in the context of constrained wealth maximization. Here, all non-basic legal and economic institutions should be set to maximize wealth—this must, of course, include the tax and transfer regime. To be clear, taxation in a wealth maximization scheme is not zero;<sup>79</sup> in order to achieve wealth maximization, some tax revenue is needed, for example, for the creation of public goods.<sup>80</sup> Taxation in a wealth-maximizing scheme is higher than it would be in the context of a political system designed to keep with the doctrine of laissez-faire or libertarianism, and (presumably) lower than it would be in the context of a Rawlsian distributive scheme maximizing the position of the least well-off. Our point is that in the context of wealth maximization, there is an *optimal* set of tax-policies, including optimal tax rates that are necessitated by the maximand. There simply is little “openness” in the context of a maximizing scheme for competing tax and transfer schemes; again, tax policy including the optimal rate of taxation is fixed by the maximand. If one is to maximize, it is crucial that *all* legal rules be constructed in a nonarbitrary and instrumentalist fashion.

Zachary Liscow observes that, in the context of a wealth-maximizing regime, pollution levels will be the same under both a negligence and

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79. See, e.g., Joel Slemrod, *Optimal Taxation and Optimal Tax Systems*, 4 J. ECON. PERSP. 157, 172 (1990); cf. Matthew Dimick, *Should the Law Do Anything About Economic Inequality?*, 26 CORNELL J.L. & PUB. POL'Y 1, 40 (2016) (“Since taxation can only reduce wealth, no taxation is justified under the utilitarian’s preferences.”).

80. See Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387 (1954).

strict liability tort regime.<sup>81</sup> He then argues that if one is interested in helping the poor, one should construct a strict liability regime, as that will not, compared to negligence, affect pollution levels and will result in more money in the hands of the poor. He describes this transfer as “costless.”<sup>82</sup>

We have two objections. First, tort governs more than pollution levels. It also affects, for example, investment decisions and incentives. So, switching to strict liability, while it may not affect pollution levels, is not costless, as it likely upsets wealth maximization along a number of important dimensions, such as investment.

Second, the true analysis of the Kaplow and Shavell claim needs to be inter-schematic, for example, between a full set of legal rules constructed so as to maximize wealth versus the position of the least well-off. His analysis does not account for the complete (re)arrangement of legal entitlements that may be required in the face of a new maximand. Instead he appears to assume the opposite: That in the context of a maximand, legal rules can be altered in a globally cost free manner (whatever the pollution level). Here, one must note that the factory may, in the Rawlsian scheme, disappear, pollute more or less, and change what counts as costs and benefits, and indeed as pollution. These are all defined in terms of the maximand. None of these changes are “free”; each is required in service of the new maximand, as deviations come at a cost.

In the context of a wealth-maximizing system, Liscow argues that a factory would continue to pollute the same amount under both a negligence and strict liability tort regime.<sup>83</sup> In light of this, he holds that money can be “costless[ly]” transferred to the poor via shifting tort liability from negligence to strict liability.<sup>84</sup> While it is plausible, as he states, that factory owners are wealthier than those who live close to polluting factories, importantly, it is not clear why this change in tort law policy is “costless” from the perspective of wealth maximization. Tort policy affects more than pollution levels, and such levels, in and of themselves, are not the final aim of wealth maximization. As we have said, the comparison, properly understood, is inter-schematic: A system of legal rules constructed by wealth maximization on the one hand versus a system of legal rules constructed by equity-oriented principles (such as Rawls’s difference principle maximizing the position of the least well-off) on the other. The factory may be shut down entirely, or the substance of what is defined as pollution—or baselines that determine what counts as

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81. Zachary Liscow, Note, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 *YALE L.J.* 2478, 2486 (2014).

82. *Id.* at 2487.

83. *Id.* at 2486 (assuming “factories do not shut down”).

84. *Id.* at 2487.

costs and benefits—is likely to be altered in the new global equity-oriented scheme.<sup>85</sup>

So the choice of tort policy is not “free,” as Liscow argues, but rather mandated or required by the new, equity-oriented maximand. The very quantum of pollution, the choice of tort liability and the value of the factory are determined by the overarching maximand, so as to maximize, say, the position of the least well-off. While it is true that a change in tort liability may or may not be required, and true that such assignments are properly “defined as *distribution* rather than *redistribution*” and perhaps “perfect” where assigned in keeping with the maximand, Liscow’s conclusion that such a change is “costless”<sup>86</sup> simply does not follow. It transfers a sum of money from the factory’s owners—thus lowering the value of the factory—with all of its attendant distortions (from the perspective of wealth maximization). In other words, while it is true that torts are defined by the distributive scheme,<sup>87</sup> and that such a

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85. Kordana & Tabachnick, *supra* note 8, at 1300–01 n.54 (“[T]he details of any protections against economic harms the right against economic injury or harm are a function of property rules that provide the relevant ... baseline” and “the specific details of rights of ownership, transfer, and compensation for harm require a property baseline ... thus, economic aspects of the private law are ... constructed in service to the maximizing demands of the difference principle.”); Kordana & Tabachnick, *supra* note 68, at 614–15:

One might question a “reliance on taxation and transfer to satisfy the demands of the difference principle. It is not clear ... that a Rawlsian *must* hold that the demands of the difference principle are best met *entirely* through a system of taxation and transfer. Assume for the sake of argument, as Rawls sometimes does, that the political institutions adopted to meet the demands of the difference principle will include a market economy and a system of private law. Assume further that the latter includes contract and tort law. It then is not clear why contract and tort law cannot be leveraged to help in meeting the demands of the difference principle. Political and legal institutions have complex and dynamic effects on one another. It thus seems unlikely that an economic scheme that maximizes the position of the least well-off would rely exclusively on tax and transfer for distribution. For example, the manner in which the rules of tort law function may have dramatic effects on the position of the least advantaged. To the extent that tort law is one of the means through which accidents are deterred and accident victims are compensated, it seems that it (in addition to tax) could be harnessed to meet the demands of the difference principle.

Henry E. Smith, *Property as the Law of Things*, 125 HARV. L. REV. 1691 (2012) (discussing the import of property baselines); Kahn & Lehman, *supra* note 64 (discussing entitlement baselines in the context of the tax expenditure budget).

86. Liscow, *supra* note 81, at 2487.

87. Kordana & Tabachnick, *supra* note 68, at 616–17 (There is no “reason for a Rawlsian to prefer the exclusive use of tax and transfer for the achievement of distributional aims” nor is it even possible to “distinguish between “taxation” and “other legal rules” . . . the very objects of taxation (for example, property and income) are themselves post-institutionally created and defined *by* legal rules,” distinctions “between property law, contract law, [tort law] and taxation . . . are blurred.” That is, “a Rawlsian might plausibly view the required remittance of fifty percent of one’s wages to the government as constituting “taxation” at a fifty-percent rate, but could also plausibly characterize that remittance as instantiating a “property” rule.”); Kordana & Tabachnick, *supra* note 8, at 1307 (“the rules of tort law are constructed by the principles of justice in conjunction with all other bodies of law so as to create a *complete scheme* of legal and political institution that is maximally instrumental to

construction can transfer assets to the disadvantaged, such transfer comes at a cost from the global wealth maximization perspective.

Liscow's analysis may be seen as myopically focused on the possibility of a "tie" in pollution levels when one compares strict liability with negligence. He moves from the fact of a tie in pollution levels to the conclusion that a change in private law rules is free. However, interschemically, a good deal more is at stake than mere pollution levels. Unlike his belief, this is not only a distributive matter.<sup>88</sup> Crucially, the selection of tort policy affects total wealth. While choice of tort policy may not alter pollution activity intra-schemically, it is not free.

It appears that Liscow achieves a tie in pollution by holding crucial incentive effects of the competing schemes of legal rules constant, thereby inadvertently disabling the competing maximands. His example produces a tie with regard to pollution levels only, owing to the well understood, if counterintuitive, fact that, all else being constant, changes in private law rules cannot guarantee alteration in pollution activity levels.

But, all else is not constant in the face of alternative maximands. Again, the proper analysis is between complete schemes of legal rules and their respective governing maximands. Tort policy aims to govern more than just pollution levels. It is also a mechanism of wealth creation and distribution and their many component parts: for example, investment decisions and spreading the costs of accidents. Since choice of tort policy is not free globally, Liscow has not demonstrated that alterations in private law rules are more efficient than income taxation and transfer in achieving equity oriented demands, as Kaplow and Shavell maintain.

#### D. MAXIMIZING PRINCIPLES AND THE DEMAND FOR OPTIMAL TAX RATES

Any assumption that tax and transfer can be "freely" invoked to bring the entire scheme of legal rules into compliance with the maximand is unwarranted. The point is that, in terms of the relentless demands of wealth maximization, any moves away from *optimal* taxation are not cost free. Such moves produce significant economic distortion which would prevent the entire scheme from maximizing. It is not the case that any failure to maximize wealth in expansive property law rules can simply be efficiently "compensated" through the use of tax and transfer by raising

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the demands of the principles of justice" and "principles of justice enjoin only the conclusion that the *entire* scheme best meets the demands of the principles of justice.").

88. Liscow, *supra* note 81, at 2487 ("Although there is no difference in the behavior of the polluter, there is a difference in the *distribution* of money.").

or lowering income taxation.<sup>89</sup> If one is to maximize, *all* legal rules need to be set to wealth maximization, with significant attention to optimal tax policy; given the maximand, there is simply little latitude in this regard.

Return now to the context of a system governed by the difference principle. Here, of course, the goal is not to create the greatest net aggregate wealth, but rather to maximize the size of the smallest distributive share, compared with all other possible schemes of legal and economic rules. Notably, there is no demand to maximize the net aggregate size of the total economic “pie”; indeed, the goal of maximizing the position of the least well-off is in significant *conflict* with the aim of maximizing net aggregate wealth, a goal which is indifferent to any distributive pattern. Nevertheless, taxation functions in an analogous fashion: given the maximand, there must be an *optimal* level of taxation.<sup>90</sup> Again, tax policy, inclusive of tax rates, is not “open” or “free”; it must be set instrumentally in service to the demands of the difference principle. The point is that departures in taxation from optimal tax policy will cause significant economic distortions (for example, less than

89. See MURPHY & NAGEL, *supra* note 52, at 136 (“[Optimal taxation’s] central question is what level of taxation would best promote welfare (either weighted in favor of the worse off or not), given the welfare losses caused by the behavioral effects of the income tax.”).

90. Kordana & Tabachnick, *supra* note 68, at 150 (“arguments about property, contract, bankruptcy, and tax policy per se are moot . . . maximizing theorist[s] needs to select bankruptcy policy as part of the overall scheme that best satisfies the distributive principles . . . the maximizing scheme has obliterated the principled distinction between [all private law rules] and taxation . . .”); Kordana & Tabachnick, *supra* note 68, at 614 (“given Rawls’s post-institutional conception of property, taxation is not a matter of redistribution, as it is typically understood in our public lexicon, but rather a matter of *distribution*.”); David H. Blankfein-Tabachnick, *Intellectual Property Doctrine and Midlevel Principles*, 101 CALIF. L. REV. 1315, 1347 (2013) (“In selecting legal rules and institutions, there is not much latitude, given the maximizing demands of the distributive principles. Maximizing principles require a specific set of property rules conjoined with an optimal tax rate . . . The important insight can be pushed a step further, the conception of what is optimal changes when one shifts between maximands. What is optimal for a utilitarian regime (maximizing net aggregate utility) cannot also be optimal for a Rawlsian (maximizing the position of the least well-off).”); David Blankfein-Tabachnick, *Property, Duress and Consensual Relationships*, 114 MICH. L. REV. 1013, 1027 (2016) (details of ownership and . . . economic exchange...in conjunction with contract law, property, and the system of taxation and transfer . . . [are] components[s] of the complete set of economic institutions.”); cf. Dimick, *supra* note 79, at 12 n.41:

This also strongly affects whether the legal system or the tax system should be used to redistribute income. Depending on how much society or a policy-maker is willing to reduce inequality, an inefficient legal redistribution may or may not be a preferable alternative . . . An inefficient legal redistribution may reduce inequality more, but may deliver lower social welfare because of greater economic distortions. In contrast, this same legal redistribution may well be superior to the optimal tax policy under a Rawlsian social welfare function, which creates larger economic distortions.

Dimick recognizes that alternative distributive goals demand changes to tax policy but seemingly fails to recognize that in a Rawlsian legal scheme tax and property rules must be set in conjunction with one another for optimal taxation to obtain, due to the unyielding demands of the maximand. This causes Dimick to erroneously tinker with what he describes as “optimal tax” in the Rawlsian scheme.

efficient maximization of the position of the least well-off). In other words, tax policy is not available to “undo” the consequences of other non-optimal legal rules in terms of meeting the demands of the maximand (that is, the valueless, in the hands of F, fishery in the new difference-principle-oriented scheme).

#### E. PROPERTY ALLOCATIONS AND PROPERTY LAW RULES

Return now to the fishery example, where another possible response from a proponent of the Kaplow and Shavell claim would perhaps be that a property “allocation” (that is, who owns the fishery) has changed, but that “property law rules” need not change. In the wealth-maximizing scheme, property law rules consistent with the maximand were crafted. Now, in the new scheme, one might maintain, under that same rubric, F would sell the fishery to G, on the grounds that it was no longer valuable to him since his talent for caviar production is irrelevant now that the industry has collapsed; however, the fishery is of some value to G. Thus, it could be maintained that the “rules” or doctrines of property law have not been altered in the new scheme, only particular property “allocations” have been changed. Arguably, given the insights of the Coase Theorem, the fishery will be given to the highest value user in the new scheme, G, without requiring a change in property law rules.

Such an argument, however, ignores the fact that it is implausible that the new scheme *can* afford to rely on consensual transactions, across all non-tax and transfer legal rules, in order to best satisfy the demands of the difference principle. Neither wealth-maximizers nor proponents of the Rawlsian difference principle are committed in principle to consensual transactions, as found in Lockean-libertarianism. Both would be *required* to *assign* property entitlements in an instrumentalist fashion, given the demands of their respective maximands in situations where voluntary transacting would not yield as efficient (to the goals of the scheme) a result.<sup>91</sup> So, for example, wealth maximization would

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91. Kordana & Tabachnick, *supra* note 68, at 598, 600 (“[f]or the Rawlsian, contract law is a matter of (re)distribution, consistent with a *post-institutional* right to freedom of contract . . . freedom of contract, for Rawlsianism, is to be defined as the scheme of contracting options constructed as *open* or *free* (in the post-institutional sense) in conjunction with the overall scheme of legal and political institutions that, when taken as a whole, best serves the demands of the two principles of justice”). Consider, for example, the *Gautreaux* case, where section 8 housing vouchers were provided to the poor in an attempt to achieve the goal of “deconcentration” in the urban ghetto. This aim was thought to be achievable only under the rubric of entitlement rules that had been altered so as to meet a distributive aim; the acceptance of section 8 housing vouchers on the part of landlords is mandatory, as opposed to being left open to fully consensual market transactions. *Hills v. Gautreaux*, 425 U.S. 284 (1976). For discussion on deconcentration, see Owen M. Fiss, *What Should Be Done for Those Who Have Been Left Behind*, in *A WAY OUT: AMERICA’S GHETTOS AND THE LEGACY OF RACISM* 34 (Joshua Cohen et al. eds., 2003) (“Putting an end to the social dynamics that have transformed the ghetto over

assign air rights to airlines rather than landowners, so as to avoid the loss of wealth-creating flying occurring in a scheme in which air rights remained bundled with land rights in a fee simple.

Imagine that in a wealth-maximizing scheme a certain asset was to be allocated to an entrepreneur on the grounds of her being able to best utilize the asset. Due to decreased net aggregate wealth, that particular opportunity is no longer available in the new scheme governed by the Rawlsian difference principle, as was the case in the caviar fishery example above, where an alternative use of the fishery was necessitated. This necessitates a change in the expansive property rules which govern allocations. G's lack of skill or capital cannot as efficiently be overcome through an infusion of tax dollars; as a mandatory asset allocation is, in our example, less costly, while introducing additional taxation to pay for additional transfer to G itself introduces further distortions (see chart below, row 4).

Our argument, then, is that, if assets are, in the new scheme governed by the difference principle, left assigned as they were in the previous wealth-maximizing scheme because following Kaplow and Shavell's dictum, no changes would be made to any legal rules other than income taxation and transfer, the new scheme will *fail to maximize* the position of the least well-off (see chart below, row 2). The reason for this is that given the decrease in net aggregate wealth in the new scheme, some assets have decreased in value such that their reassignment is now required in order to satisfy the new maximand. Attempting to tax the income derived from the asset in its original assignment in order to transfer income to the least well-off cannot possibly satisfy the new scheme's maximand as compared to directly reassigning the asset (see chart below, row 1). Thus, the expansive rules of property law must, contra Kaplow and Shavell's dictum, be reconstructed in response to the new distributive principle.

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the last . . . forty years into a structure of subordination would require . . . many deep interventions into the life of that community").

	<b>S<sub>1</sub>:</b> Constrained Wealth Maximization Governing All Legal Rules	<b>S<sub>2</sub>:</b> Kaplow and Shavell's position: Difference Principle governing Taxation and Transfer as sole instrument for Equity-Oriented Distributive Aim; Other Legal Rules Remain as in S <sub>1</sub>	<b>S<sub>3</sub>:</b> Our position: Difference Principle Governing All Legal Rules with Some Property Reassignments; No Commitment to S <sub>1</sub> Rules
"Luxury" Asset Value	100	50	70
Income of Least Well-Off	10	15	17
Income of Most Well-Off	50	30	31
Tax rate	20%	60%	55%

#### F. SUMMARY AND DISCUSSION

We are now in a position to discuss the scope of our claim that changes in expansive property law can dominate changes in income taxation and transfer when satisfying equity-oriented demands. Consider first a scheme which maximizes net aggregate wealth. Assets will be assigned to their highest value use.<sup>92</sup> That is, an asset's ownership entitlement will be assigned to the person(s) who will use it to create the most wealth. The asset's entitlement could be assigned to other person(s), but all such persons would provide less (or, perhaps on occasion, the same) wealth, and so such potential assignments would be rejected in favor of the wealth-maximizing assignment. Keep in mind that in maximizing net aggregate wealth, distributive justice-oriented patterns are ignored.

Now consider a second scheme, with a different distributive principle in place—the quasi-Rawlsian difference principle, maximizing

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92. Assignments occur either directly, if the assumptions of the Coase Theorem are not in place such that initial entitlements are crucial, or through the operation of consensual transactions if the alienability of particular assets is instrumental to wealth maximization.

the position of the least well-off.<sup>93</sup> With respect to a particular asset, that asset might be left assigned to the person(s) who owned it in the first scheme. Importantly, because the difference principle will inevitably result in a scheme with *less* net aggregate wealth than in the wealth-maximizing scheme, those who used the asset to create the most wealth in the original scheme may no longer serve to maximize wealth with the asset in the new scheme. Additionally, the amount of wealth generated by the allocation of the asset to particular person(s) will also likely be different than in the first scheme (on average, it will be lower, given that the scheme is overall less wealthy, but on occasion a particular asset might be worth more in the difference principle scheme than it was under wealth maximization).

Alternatively, the asset might be reassigned to some new person(s) on grounds that such assignment is useful to satisfying the demands of the scheme's maximand. The new maximand demands that the position of the least well-off be improved, and one way to do this is to assign property to them. Another way is to assign the property to a high-value user who will produce enough wealth with it that, given the optimal tax to be applied to that asset, it will result in a transfer to the least well-off that improves their position. The original assignment of the asset was not made with this result in mind; it therefore may not be the assignment that is instrumental to the maximization of the least well-off's position. Therefore, and crucially, the income "delivered" to the least well-off by the reassignment of the asset may generate, in that scheme, *both* more net income *and* more income to the least well-off than does the original assignment (see chart above, columns 2 and 3).

Take, for example, ML the mediocre lawyer. In a wealth-maximizing scheme, ML is assigned to BigLaw on the grounds that he contributes more net aggregate wealth (say, \$200,000) under this assignment than under all other assignments, including his next best assignment, which is as a teacher (say, \$180,000). Now, consider the situation when the distributive principle has been changed. Assume that ML continues to create the most net aggregate wealth if he remains assigned to BigLaw. However, since taxes have been increased in order to generate revenue to transfer to the least well-off, net aggregate wealth has decreased, as compared to the initial scheme. As a result ML's assignment to BigLaw

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93. Note that our analysis remains the same if the new equity-orientation required the satisfaction of some "fixed" goal, such as the provision of a "decent social minimum" to all. The new scheme, subject to such a goal, is still a constrained maximizing scheme (that is, wealth maximization, now subject to both the basic entitlement constraint and the decent social minimum constraint). Again, the new scheme drops below the wealth maximization ceiling, relative prices change, and the reassignment of some assets is required in order to meet the demands of the (constrained) maximizing distributive principle.

now contributes less net aggregate wealth (say, \$100,000) than it did in the initial scheme.

In the alternative, ML might be assigned to teaching. This contributes even less net aggregate wealth (say, \$90,000) than his assignment to BigLaw. Importantly, however, the distribution of that wealth differs. Assume for simplicity that ML's salary is the same in either assignment (say, \$40,000), but that BigLaw benefits by \$60,000 while his students benefit by \$50,000 if he teaches. If the students constitute the least well-off, and if the optimal tax rate on BigLaw is, say,  $t_i=67\%$ , then his assignment to BigLaw only improves the position of the least well-off by \$40,000. Crucially, an equity-oriented tax scheme is not merely a matter of redividing the revenue derived from a wealth-maximizing scheme since net aggregate wealth decreases when income taxation increases as would be demanded by the new distributive principle. The direct assignment of ML to teaching satisfies the demands of the difference principle; his assignment to BigLaw fails to do so. The difference principle scheme mandates his reassignment to teaching. It is not possible that the failure to increase the position of the least well-off by assigning ML to teaching can be compensated by instead assigning ML to what would be his position in a wealth-maximizing scheme, BigLaw. Such an assignment produces an additional \$10,000 of wealth, but that is insufficient, given the scheme's optimal tax regime, to provide *enough* revenue for transfer to the least well-off so as to, as the scheme demands, *maximize* their position. Thus, the expansive rules of property law *must* reflect the new equity-orientation of the scheme. Kaplow and Shavell's tax and transfer preference is unfounded.

Of course, sometimes income taxation and transfer is the preferred instrument. If ML were a terrific rather than a mediocre lawyer he might well remain with the BigLaw assignment even as the maximand shifted (that is, if he produces enough more wealth as a lawyer versus as a teacher). Analogously, if ML is an *outstanding* teacher then the assignment of ML to teaching might be the best assignment under both maximands. It is the conjunction of his being a mediocre lawyer and a reasonable teacher that leads the wealth-maximizing scheme to assign him to BigLaw, thus creating a slightly wealthier society, while the equity-oriented scheme *instead* better achieves its goal of maximizing the position of the least well-off by harnessing his talents at teaching.

#### IV. THE DEMAND FOR FORMAL EQUALITY AND THE USE OF PRIVATE LAW RULES AS EQUITY-ORIENTED INSTRUMENTS

A standard objection to the use of private law instruments for equity-oriented aims, perhaps, is that adjudication based on the relative wealth of parties in civil litigation is a violation of what one might call

formal equality. That is, the relative wealth of litigants should, as a matter of fundamental legality, be understood as irrelevant because an arbitrary quality of the litigants, such as race or sex. The objection invites the conclusion that the use of private law rules for equity-oriented purposes would lead to unjustifiably unequal treatment of civil litigants.

Our response to this objection is twofold. First, the objection fails to recognize that the outcome of *any* civil litigation is contingent upon property baselines; civil litigation often is the very question of which property baselines ought to be adopted and why. Taking property assignments as given, conventional or “natural” is to adopt a conception of entitlement. However, the question in civil litigation is often over the warrant or justification for such entitlement arrangements.

Second, though closely related, the objection that achieving equity-oriented aims through private law rules yields unequal treatment is addressed at the wrong level. The establishment of private law rules, like the setting of income taxation rates, is not, in the first instance, about particular litigating parties, but rather is a matter of general institutional design or rulemaking. The manner in which private law rules are constructed (for example, the first-in-time-rule,<sup>94</sup> the choice of limited versus unlimited liability for business enterprises,<sup>95</sup> the relative preference of tort versus contract creditors in bankruptcy,<sup>96</sup> or the demand for unitization where landowners’ interests conflict in oil-drilling<sup>97</sup>) are to be determined according to the demands of overarching distributive principles or aims which govern the scheme.

Raising an objection from “inequality” to an aspect of the scheme must sound in a differing conception or principled account of equality from that embodied in the scheme. Where private law rules are set to keep with fully justified government aims, or governed by morally or politically justifiable distributive principles, the mere fact of differential treatment of parties is insufficient to raise a claim of unjustifiable or wrongful inequality; the objection is addressed to the wrong level. Our point is that once one acknowledges that a scheme of legal and political rules is *fully justified* by morally acceptable overarching distributive aims, which themselves embody a *conception* of equality, one cannot

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94. *E.g.*, *Pierson v. Post*, 3 CAL. R. 175, 178–80 (N.Y. 1805) (constructing a rule that hot pursuit of a wild animal does not create any rights in the pursuer). For a discussion of the socioeconomic clash between the parties in this classic case, see Bethany R. Berger, *It’s Not About the Fox: The Untold History of Pierson v. Post*, 55 DUKE L.J. 1089 (2006).

95. *E.g.*, Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991).

96. *E.g.*, Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996).

97. *E.g.*, Steven N. Wiggins & Gary D. Libecap, *Oil Field Unitization: Contractual Failure in the Presence of Imperfect Information*, 75 AM. ECON. REV. 368 (1985).

coherently raise an objection of unjust inequality simply owing to the fact of nonequivalent treatment. Any difference in treatment is justified by the distributive principles, which define a conception of equality. Any objection needs to be addressed to the governing principles themselves, as opposed to the outcome of the application of legal rules designed instrumentally in service to the principles' demands. In this, private law rules are identical to income taxation in all relevant respects.

To be clear, for example, the question of whether tort creditors should be given preference over contract creditors (as they presently are not) in bankruptcy is a question coherently answered only by appeal to distributive goals. If one accepts, for instance, the wealth maximization principle and also acknowledges that wealth can be maximized if and only if tort creditors are given such preference in bankruptcy so as to provide a disincentive to externalize costs, it would be incoherent to then raise an objection on behalf of contract creditors owing to disparate treatment at trial. Such bankruptcy preference rules are governed by distributive principles which define the conception of equality; disparate treatment is insufficient to demonstrate an unjustifiable outcome.

#### CONCLUSION

Equity-oriented distributive goals are not always more efficiently achieved via income taxation and transfer rather than private law rules. This claim, chiefly associated with Kaplow and Shavell, is not about the acceptability of equity-oriented political values or distributive patterns, but rather, the most economically efficient manner of achieving such ends. Were Kaplow and Shavell correct in this claim, equity-oriented private law constructions would be best understood as inefficient means of achieving equity-oriented ends. As a matter of institutional design, such equity-oriented aims would be more efficiently achieved via the use of income taxation and transfer, while at the same time constructing private law rules in a manner in keeping with constrained wealth maximization. We have shown that Kaplow and Shavell's conclusion in favor of the tax and transfer preference, however prominent, is significantly problematic. Their claim fails to acknowledge the crucial efficiency role that property law entitlements must play in achieving any distributive end, equity-oriented or otherwise. We have shown that once this point is recognized, the tax and transfer preference no longer holds. Maximally efficient institutional design at times requires that equity-oriented demands be met through the private law rules of property and that income taxation and transfer is not always superior in its efficiency to such constructions.

Given the maximizing goal, no rules can be ignored, that is, merely "taken as they are found" in any actual conventional property scheme.

What is needed is the selection of the complete scheme of legal and political rules which maximizes the position of the least well-off in comparison to all other possible schemes. In this *inter*-schematic comparison, failing to consider altering the full range of legal rules simply because they are, for some unstated exogenous reason, to be taken as conventional or merely as they are found, is to fail to maximize, that is, fail to implement the distributive principle. For example, it is our understanding that takings cases represent the altering of property entitlements in service to distributive aims.<sup>98</sup>

Kaplow and Shavell's analysis appears to focus on changes to specific rules within an otherwise fixed scheme, without comment on the nature of the remainder of the scheme's other legal rules, specifically the structure of the details of ownership. In other words, their analysis seems to be *intra*-schematic rather than *inter*-schematic: It contrasts changes of specific rules *within* a single scheme as opposed to the relative comparison of competing complete schemes.<sup>99</sup> Therefore, their analysis seems not to recognize that once a change in maximand (that is, the difference principle versus wealth maximization) is adopted, *all* rules must be constructed in its service. The conclusion that tax and transfer is more efficient than other legal rules in achieving equity-oriented ends requires *inter*-schematic comparisons among complete schemes of legal and political rules.

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98. *Kelo v. New London*, 545 U.S. 469 (2005); *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104 (1978); Frank I. Michelman, *Property, Utility and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967).

99. See POGGE, *supra* note 67, at 71.

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