

## **Optimal Tax Theory as a Theory of Distributive Justice**

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Welfarist and non-welfarist approaches to justice are often viewed as at odds, with each finding the other's approach fundamentally unpersuasive. In many cases, these differences may be insurmountable. But because the consequences of social institutions seeking to further distributive justice can differ so dramatically from their intent, common ground may be more likely in the area of distributive justice.

One of the most important contributions to the welfarist literature on distributive justice is optimal tax theory, a line of literature in economics and the law concerned with the ideal level and form of economic redistribution. The optimal tax literature seeks to determine how government can maximize social welfare through taxes and transfers, given empirical realities and different views of the relative importance of equity and efficiency. This essay seeks to map the fundamental principles of optimal tax theory on to non-welfarist theories of distributive justice, identifying points of overlap and divergence.

It concludes that, whether conscious or not, optimal tax theory actually embodies a resource egalitarian view of distributive justice to a large extent. However, the reasoning behind their shared principles differs substantially. While resource egalitarians emphasize responsibility and objective resources, optimal tax theorists emphasizes incentives, efficiency, and the information that choices reveal about individual well-being. In addition, closer consideration of optimal tax theory challenges the conventional

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view that welfarist approaches to distributive justice cannot adequately address concerns about utility monsters, talent slavery, non-market work, expensive tastes, and anti-social preferences. It also highlights how the practical implications of optimal tax theory and resource egalitarianism can turn on seemingly secondary issues. These include responsiveness to taxes, the distribution of talents, difficulties in valuation and verification, externalities, and the horizons over which people make decisions.

Overall, this essay is concerned with the question posed by Sen and others: equality of what?<sup>1</sup> Put differently, what measure should we ideally be equalizing if we believe that morality demands some reduction in inequality? This is, of course, a massive topic. Before beginning, I should therefore acknowledge some ways in which I have tried to limit the scope. First, this essay only considers distributive justice in the context of economic institutions. While important and interrelated, it saves the questions of what distributive justice implies for political institutions and personal ethics for another day.<sup>2</sup> It also brackets the questions of how government should finance public goods and what distributive justice implies about potential life.<sup>3</sup> Finally, it operates at the level of the ideal. It is unconcerned with practical difficulties in actually measuring whatever we should be equalizing, which some refer to as the “*equilisandum*.” Indeed, virtually every ideal measure discussed is utterly impractical. Nonetheless, at points I do note what optimal tax theorists consider to be second best approaches to advancing distributive

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<sup>1</sup> Amartya Sen, *Equality of What?*, THE TANNER LECTURES ON HUMAN VALUES (May 22, 1979). See also Ronald Dworkin, *What is Equality? Part 1: Equality of Welfare*, 10:3 PHIL. & PUB. AFFAIRS 185, 187 (1981) (hereinafter, Dworkin I).

<sup>2</sup> For persuasive arguments of why these issues may be more important than distributive justice in the context of economic institutions, see Elizabeth Anderson, *What is the Point of Equality?*, 109 ETHICS 287 (1999); Liam B. Murphy, *Institutions and the Demands of Justice*, 27:4 PHIL. & PUB. AFFAIRS 251 (1999); Samuel Scheffler, *What is Egalitarianism?*, 31:1 PHIL. & PUB. AFFAIRS 5 (2003).

<sup>3</sup> For an excellent philosophical discussion of how this issue interacts with distributive justice, see LIAM MURPHY AND THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE* (2002).

justice in light of real world constraints, and how current fiscal policy does and does not embody these methods.

The essay proceeds as follows. Section I provides a brief overview of optimal tax theory that is devoid of normative justification. Section II tries to frame the comparison between optimal tax theory and non-welfarist theories of distributive justice more precisely. Section III considers how optimal tax theory and resource egalitarianism each treat, and try to distinguish, inequalities that arise from ability versus effort. Sections IV and V address the same question in the context of altruistic versus harmful preferences, and disabilities versus tastes, respectively. Finally, Section VI notes some implications of the prior discussion for how much each theory is ultimately concerned with equalizing opportunities versus outcomes.

### ***I. A Brief Overview of Optimal Tax Theory***

Optimal tax theory seeks to determine the set of taxes and transfers that maximize a social welfare function through a stylized model with a limited number of goods, and estimates of empirical realities.<sup>4</sup> It is a welfarist approach, meaning that it considers distributive justice to be solely some function of individual utility.<sup>5</sup> Utility in turn is defined as simply an expression of individual preferences, a definition that is the modern norm in economics but sometimes misunderstood. For example, if I choose to write another paper, or have a child, I may know that the choice will not make me feel happier

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<sup>4</sup> For an overview of the literature, see N. Gregory Mankiw, Matthew Weinzierl, and Danny Yagan, *Optimal Taxation in Theory and Practice* (Nat'l Bur. Econ. Research working paper no. 15071, June, 2009).

<sup>5</sup> See, e.g., Dworkin, *What is Equality I*, *supra* note \* at 244. Some dispute this definition. They distinguish between individualist social welfare functions, which are solely a function of individual utility, and non-individualistic social welfare functions, which can also be a function of the magnitude or distribution of specific goods independent of their effect on individual utility. See, e.g., LOUIS KAPLOW, *THE THEORY OF TAXATION AND PUBLIC ECONOMICS* 348 (2008).

or more successful. I may expect that it will make me tired and overwhelmed. But provided that I duly considered the choice, it is my preference. Perhaps I made the decision because I believe it will make my life more meaningful or complete, and that is what I truly care about. Regardless, this decision by definition gives me more utility, at least for the foreseeable future.

Optimal tax theory recognizes the indeterminacy of comparing utility across different human beings. As a result, it considers the question of what we should be equalizing to be an information problem. We know that we want to equalize utility. And we know that we have done so when no person prefers another person's life. But because we cannot actually present people with the choice of living another's life, we must identify a proxy—or set of proxies—for how well-off different individuals are relative to each other. We can then use those proxies to determine the level of inequality, and how to mitigate it.

The foundational piece in the optimal tax literature relating to distributive justice is Mirrlees' 1971 paper, *An Exploration in the Theory of Optimum Taxation*.<sup>6</sup> Mirrlees assumes that individuals differ only on in one exogenous characteristic—ability—which determines their utility and wage rate. Individuals know their own ability, but do not know the ability level of each other. Instead, the only thing that others and the government can observe is each individual's income, which is the product of their wage rate and hours worked. There are only two goods, consumption and leisure.

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<sup>6</sup> James Mirrlees, *An Exploration in the Theory of Optimum Taxation*, 38 REV. ECON. STUDIES 175 (1971). Foundational work by Ramsey, Atkinson, and Stiglitz is also considered part of the optimal tax literature, but it is less relevant for this essay because it assumes that social welfare is maximized by maximizing efficiency, and that commodity taxes are the only possible taxes. See Frank P. Ramsey, *A Contribution to the Theory of Taxation*, 37 ECON. J. 47 (1927); Anthony B. Atkinson and Joseph E. Stiglitz, LECTURES ON PUBLIC ECONOMICS (1980). [Check last]

In order to make the math tractable, the Mirrlees model also assumes that all individuals have the same utility function for consumption and leisure. This means that every individual gets the same utility from a fixed amount of consumption and a fixed amount of leisure, and that all individuals at a given ability or wage level choose the same mix of work and leisure. Individuals may, of course, choose to consume different things, though, like cars or vacations.

The brilliance of Mirrlees' model is threefold. First, it was among the first work to identify the problem of how best to further distributive justice as one of information asymmetries.<sup>7</sup> We want to redistribute based on utility but, because this is unknowable, we must use proxies that generate behavioral responses as individuals try to minimize taxes owed and maximize transfers received. Second, it was the first to address this problem through a mathematical model to which empirical parameters were applied. Specifically, Mirrlees used empirical estimates of the distribution of wages and the responsiveness of labor supply to taxes in order to estimate the optimal tax schedule for advancing distributive justice. Third, this math involved was incredibly complex.

Based on this model, Mirrlees estimated that the optimal income tax was one that couples a universal lump-sum transfer, which is significant but not massive, with an income tax with marginal tax rates that decline as income rises. The lump-sum transfer is typically referred to as a "demogrant" and is considered part of the tax system because it is a "negative tax." He found that, under a utilitarian social welfare function, the optimal demogrant was 17 percent of median income and income tax had a top marginal rate of 26 percent that declined to 17 percent for those with the highest incomes. Mirrlees also

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<sup>7</sup> This issue was also identified by Vickrey in William Vickrey, *Measuring Marginal Utility by Reactions to Risk*, 13 *ECONOMETRICA* 215 (1945). He and Mirrlees shared the Nobel Prize in 1996 for this insight.

considered a more egalitarian social welfare function that maximized the product of utilities. The optimal demogrant then rose to 30 percent of median income and the top marginal tax rate rose to 34 percent, declining to 20 percent as income increased.

Despite their declining marginal tax rates, both of these tax systems are progressive in the sense that taxes as a share of income (the average tax rate) rise with the income. This is because the demogrant becomes a smaller share of income as income rises. Lower-income households therefore have a low or negative average tax rate, while higher-income households have a higher average tax rate. The intuition behind the finding that declining marginal rates are optimal is that it results in fewer high-ability workers working less at the margin in response to the tax. This increases the overall amount of taxes collected and the size of the demogrant relative to a scenario in which high-ability workers faced a higher marginal tax rate. While lower-ability workers then face relatively high marginal tax rates, these can be offset through the demogrant.

Since Mirrlees' seminal paper, there have been a number of advances in optimal tax theory. For a period of time, these advances principally involved using more accurate empirical estimates and different social welfare functions. This generally resulted in a larger demogrant and higher top marginal tax rates. For example, Tuomala used updated estimates of labor supply elasticities and found that the optimal demogrant was actually 40 percent of mean income under a utilitarian social welfare function, and 58 percent when the social welfare function was the product of utilities. The associated top marginal rates were 50 and 68 percent, respectively. Nevertheless, Mirrlees' core findings—that the optimal income tax was one with declining marginal rates and a demogrant—remained unchallenged.

During this period, the fiscal policies of developed countries around the world moved haltingly in the direction of his recommendations. Generally the marginal tax rates facing high earners declined, and income tax rate schedules (which typically rise with income) became flatter.<sup>8</sup> A number of countries also implemented guaranteed income programs, with the U.S. as a prominent exception.<sup>9</sup>

A new generation of optimal tax theorists, however, have begun to question some of Mirrlees' core findings. For example, Saez (2001) has found that optimal tax rate schedule is actually U-shaped. This was based on a different mathematical model and more refined empirical estimates.<sup>10</sup> He estimates that the optimal rate schedule for the U.S. would decline with income until about \$75,000 in earnings and then increase until about \$200,000 in earnings, after which point it would become roughly flat.<sup>11</sup> Many countries, including the U.S., currently exhibit this type of rate structure once transfers are included. This is the case because transfer programs tend to phase-out with income, which generates high implicit tax rates in the phase-out range.<sup>12</sup> Once the phase-out is complete, marginal tax rates drop precipitously and then gradually rise with income.

Under a maximin social welfare function,<sup>13</sup> he further finds that the top marginal tax rate on high earners should be between 70 and 80 percent, and the demogrant should

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<sup>8</sup> See Mankiw et al, *supra* note 4.

<sup>9</sup> See OECD, Social Expenditures, Aggregated Data (on file with author).

<sup>10</sup> Emmanuel Saez, *Using Elasticities to Derive Optimal Income Tax Rates*, 68 REV. ECON. STUDIES 205 (2001).

<sup>11</sup> *Id.* at 223.

<sup>12</sup> See, e.g., Steven D. Holt and Jennifer L. Romich, *Marginal Tax Rates Facing Low- and Moderate-Income Workers Who Participate in Means-Tested Transfer Programs*, 60 NAT'L TAX J. 253 (June, 2007); Daniel Shaviro, *The Minimum Wage, the Earned Income Credit and Optimal Subsidy Policy*, 64 UNIV. CHIC. L. REV. 405 (1997).

<sup>13</sup> Technically a maximin social welfare function first maximizes the utility of the least well-off person, then, if that person's utility cannot be increased further, in maximizes the utility of the second least well-off person holding harmless the least well-off person, and so forth.

be between 50 and 60 percent of mean income.<sup>14</sup> This demogrant may seem small. But it is important to understand that a demogrant that is 100 percent of mean income implies complete (and efficient) confiscation and redistribution. In other words, it can only occur if all individuals face a 100 percent tax rate on all of their earnings, there are no efficiency effects, and all the revenues collected are used to fund the demogrant.

In a further permutation, Saez (2002) considers the implications for optimal tax theory if jobs are lumpy and people therefore tend to make decisions about how much to work at the “extensive margin”—that is, whether to work full-time or not at all.<sup>15</sup> If so, he finds that the optimal tax combines a smaller demogrant with negative marginal tax rates (earnings subsidies) for low earners, much like the Earned Income Tax Credit in the U.S.<sup>16</sup> Thus, the long-standing consensus that marginal rates should ideally decline with income has begun to break down, even under the traditional assumptions of the Mirrlees model.

Further work in the field has altered or expanded upon some of the Mirrlees model’s basic assumptions. For example, Sandmo and others have found that the optimal tax system is typically less redistributive if individuals do not have the same utility function for consumption and leisure, but rather heterogeneous preferences.<sup>17</sup> Batchelder considers the ideal tax treatment of inheritances, which are excluded from the Mirrlees model, and concludes that heirs should be taxed on inherited income, but at a rate that rises from negative to positive as the earned income of the heir, and the amount inherited,

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<sup>14</sup> Saez (2001), *supra* note 10.

<sup>15</sup> Emmanuel Saez, *Optimal Income Transfer Programs: Intensive Versus Extensive Labor Supply Responses*, Q. J. ECON 1039 (June, 2002).

<sup>16</sup> *Id.*

<sup>17</sup> See, e.g., Agnar Sandmo, *Optimal Redistribution when Tastes Differ*, 50:2 FINANZARCHIV (1993), *cited in* Mankiw et al, *supra* note 4.

increase.<sup>18</sup> Weisbach assumes that individuals differ not only in their earning ability, but also in whether they are disabled in a way that affects their quality of life apart from their earnings.<sup>19</sup> He concludes that optimal tax would transfer more to people with such disabilities. But if a disability was unobservable, a larger share of transfers would take the form of in-kind transfers instead of in cash.

Another important innovation in the literature is the concept of “tags.” Tags are immutable or semi-immutable traits that are correlated with earning potential, such as gender, race, height, and parental education. In an article published shortly after Mirrlees’, Akerlof showed that adjusting tax rates based on tags can improve the efficiency and fairness of a redistributive scheme because of the information they provide about underlying earning potential.<sup>20</sup>

Recent research expands upon the concept of tags and considers multiple periods. (The Mirrlees model, and most that followed, assumed there was only one period or that lifetime earnings were certain.) The implications of this newer work, which is called the New Dynamic Public Finance literature, are complex. For example, if the government knows an individual’s earning history, this information can be used as a tag for earning ability, especially if an individual’s earnings suddenly drop or rise.<sup>21</sup> In addition, large amounts of capital income can suggest that an individual has reduced his work effort and

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<sup>18</sup> Lily L. Batchelder, *What Should Society Expect from Heirs? A Proposal for a Comprehensive Inheritance Tax*, \_\_ TAX L. REV. \_\_ (forthcoming, 2010). See also Wojciech Kopczuk, *Economics of Estate Taxation: Review of Theory and Evidence*, \_\_ TAX L. REV. \_\_ (forthcoming, 2010) (suggesting that the optimal tax rate on wealth transfers between those at the top of the economic distribution is positive).

<sup>19</sup> David A. Weisbach, *A Welfarist Approach to Disabilities* (Chicago John M. Olin Law & Economics Working Paper No. 355, Aug. 2007).

<sup>20</sup> George Akerlof, *The Economics of 'Tagging' as Applied to the Optimal Income Tax, Welfare Programs, and Manpower Planning*, 68 AM. ECON. REV. 1 (1978).

<sup>21</sup> See, e.g., Mikhail Golosov, Narayana Kocherlakota and Aleh Tsyvinski, *Optimal Indirect and Capital Taxation*, 70 REV. ECON. STUD. 569, 570-71, 577 (2003).

is living off saving.<sup>22</sup> Further, if people's economic planning horizons are shorter than a lifetime, it may be appropriate to treat them as effectively different people at different points in their life.<sup>23</sup> These later two findings have challenged another long-standing, rough consensus that tax systems that only tax consumption or labor earnings are more efficient and fair than those that tax capital income as well.

A final important thread in the optimal tax literature involves "externalities." A positive (or negative) externality arises whenever a choice by one person makes another better (or worse) off, but the first person does not receive the benefits (or bear the costs). As a result, the person making the choice does not incorporate the benefits or costs to others into his decision. When externalities apply to broad sections of the population, there is often no market for them, and Coasian bargaining is not a solution. Instead, the government can enhance efficiency by correcting for externalities through fiscal incentives.<sup>24</sup> Because this concept was developed by Pigou, these incentives are aptly referred to as Pigouvian taxes and Pigouvian subsidies.

The ideal Pigouvian tax, for example, corrects for a negative externality by taxing the good generating social costs so that its market price reflects its social value, not solely the value that the purchaser places to it. The optimal tax rate is the marginal cost it imposes on others. This causes the marginal decision maker to fully internalize the social costs to others of his or her choice, and results in the optimal supply of the good. Pigouvian subsidies are simply the reverse.

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<sup>22</sup> Id.

<sup>23</sup> See Daniel Shaviro, *Beyond the Pro-Consumption Tax Consensus*, 60 STAN. L. REV. 745 (2007); Lawrence Zelenak, *Tax Policy and Personal Identity over Time*, 62 TAX L. REV. 333 (2009).

<sup>24</sup> ARTHUR C. PIGOU, *WEALTH AND WELFARE* (1912). See also W.J. Baumol, *On Taxation and the Control of Externalities*, 62:3 AM. ECON. REV. 307 (1972).

Traditionally, externalities were viewed purely as an efficiency issue. However, Pigouvian taxes and subsidies raise distributive issues for optimal tax theorists as well because they raise revenue or cost money, and can also alter the economic distribution. The general conclusion from work in this area is that—if the social welfare is a function of individual utility, and if certain groups disproportionately generate negative externalities or are burdened by them—the optimal Pigouvian tax should be welfare-weighted to take this into account.<sup>25</sup> In addition, the revenue raised should be used offset the general distributional effects of the tax through lump-sum transfers (if the tax system was optimal prior to the negative externality arising). The net effect is that the revenue is returned to individuals in the same class as those whose choices were generating the negative externalities, but the price of making such choices is higher. An optimal Pigouvian tax also generates efficiency gains. These should be redistributed in whatever way is implied by the social welfare function.<sup>26</sup>

## ***II. Framing the Question***

With this rough grounding in optimal tax theory, we can now turn to this essay's central question—how does optimal tax theory relate to non-welfarist theories of distributive justice and resource egalitarianism in particular? The potential connection

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<sup>25</sup> C.f., Wojciech Kopschuk, *Economics of Estate Taxation: Review of Theory and Evidence*, \_\_ TAX L. REV. \_\_ (forthcoming 2010); Luca Micheletto, *Redistribution and Optimal Mixed Taxation in the Presence of Consumption Externalities*, 92:10-11 J. PUB. ECON. 2262 (2008).

<sup>26</sup> While the ideal response in the case of positive externalities is simply the reverse, for completeness, it is as follows. The optimal subsidy should equal the marginal benefits the choice generates for others, and should be welfare-weighted if the certain groups disproportionate generate the positive externalities or benefit from them. If the tax system was optimal previously, the subsidy should be financed through a lump sum tax that mimics the general incidence of the subsidy. That is, individuals making choices that generate social benefits would effectively share part or most of the cost of their welfare-enhancing choices with their income class. They would also share the cost with those who become new beneficiaries because more people make such welfare-enhancing choices in response to the subsidy.

between resource egalitarianism and one aspect of optimal tax theory—endowment taxation—has been raised by others, including Murphy, Nagel, Shaviro, and Stark.<sup>27</sup> My aim is to explore the relationship in more detail in order uncover where these theories overlap and diverge, and what supporters of each can teach supporters of the other.

To this end, it is necessary to define what we are comparing more precisely. First, I would like to narrow the field of social welfare functions under consideration. Welfarists are often accused of not taking differences between individuals seriously.<sup>28</sup> This is a fair charge against utilitarians. But welfarists typically consider many non-utilitarian social welfare functions, especially in the optimal tax literature. In order to compare apples to apples, I will therefore restrict the discussion of welfarist views to those grounded in social welfare functions that aim to equalize individual utility to some degree. This category includes maximin social welfare functions, those that aim to maximize the product of utilities, and many others.<sup>29</sup> Similarly, I will limit the discussion of non-welfarist theories to those concerned with mitigating inequalities between individuals.<sup>30</sup>

Second, because optimal tax theory focuses on a single objective, and does not differentiate between specific goods, I will generally focus on non-welfarist theories of distributive justice that share these features. Two prominent theories of distributive

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<sup>27</sup> See MURPHY AND NAGEL, *supra* note 3 at 104-5; Daniel Shaviro, *Endowment and Inequality* 30-31 (NYU Law School, Public Law and Legal Theory Working Paper No. 4, 1999); Kirk J. Stark, *Enslaving the Beachcomber: Some Thoughts on the Liberty Objections to Endowment Taxation*, 18 CANADIAN J. L. & JURIS. 47, 65-66 (2005); Batchelder, *supra* note 18.

<sup>28</sup> JOHN RAWLS, A THEORY OF JUSTICE 19-26 (2005).

<sup>29</sup> Maximin social welfare functions are akin to Rawls' difference principle (with some important differences), and other egalitarian social welfare functions are akin to weighted beneficence. See Liam Murphy, *Liberty, Equality, Well-Being: Rakowski on Wealth Transfer Taxation*, 51 TAX L. REV. 473, 480 (1996).

<sup>30</sup> For example, I will not be discussing Nozick because his theory of justice is concerned with entitlements, not inequalities. ROBERT NOZICK, ANARCHY, STATE AND UTOPIA 150-53 (1974, 2001 ed.).

justice that fall outside of this category are Rawls' theory of justice<sup>31</sup> and Sen's and Nussbaum's capabilities approach.<sup>32</sup> Rawls' theory accords special significance to primary goods and is multi-layered, with certain objectives coming in to play once others are satisfied. Sen and Nussbaum focus on specific functionings and capabilities. Thus, somewhat arbitrarily and with some exceptions, I will instead focus the discussion of non-welfarist theories on Dworkin's concept of equal resources.<sup>33</sup>

Even with the comparison thus narrowed, at one level optimal tax theory remains fundamentally distinct. It is concerned with equalizing individual utility so that no individual prefers another's life. One way to think of this concern is by reference to a parent. Ideally a parent cares equally about her children, and her treatment of them is an expression of this equal care. Equal care probably means that she would pay particular attention to a child who is suffering, regardless of whether that suffering has a rational or objective explanation. At the same time, she would be concerned if her disproportionate concern for that child was enabling him to continue making choices that were contributing to his suffering, or was so extreme that it was causing comparable levels of suffering for her other children.

The fundamental concern embodied in resource egalitarianism, by contrast, is more objective. As Dworkin, has put it, the equal resources approach is concerned with treating people as equals.<sup>34</sup> It aims to reduce or eliminate inequalities that arise from objective and morally arbitrary sources. It is unconcerned with inequalities in people's

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<sup>31</sup> See generally RAWLS, *supra* note 28 at 60-83.

<sup>32</sup> See generally Sen, *supra* note 1 at 217-220; MARTHA C. NUSSBAUM, *WOMEN AND HUMAN DEVELOPMENT: THE CAPABILITIES APPROACH* (2000).

<sup>33</sup> Some prominent theories of distributive justice on which I will not focus but may align even more with optimal tax theory are weighted beneficence and equal opportunity for welfare. See Murphy, *supra* note 29; John E. Roemer, *Three Egalitarian Views and American Law*, 20 *LAW & PHIL* 433 (2001); Richard Arneson, *Equality and Equal Opportunity for Welfare*, 56 *Phil. Studies* 77, 85-92 (1989).

<sup>34</sup> Dworkin I, *supra* note 1 at 185.

subjective perceptions of their lives or with inequalities that arise from morally relevant sources. By morally relevant, I mean that the individual bears some responsibility because he made a free choice that resulted in him being worse off. That is, the inequality arose from option luck.<sup>35</sup>

At this point, I find it necessary to distinguish between concerns, principles, and policy implications. The differences between optimal tax theory and resource egalitarianism just described are fundamental. But they are differences of motivation and concern. The two theories may nevertheless share many general principles that flow from these concerns and, in all likelihood, many policy implications as well. My goal here is to focus on principles. How does each theory treat different sources of inequality as a general matter? How can proponents tell when distributive justice has been achieved?

Perhaps the most important example of this distinction between concerns and principles is the assumption in optimal tax theory that all individuals have the same utility function for consumption and leisure, absent evidence to the contrary. The net effect, purely as a default matter, is to convert a welfarist's fundamental concern with equalizing subjective utility into a resource egalitarian's concern with equalizing objective goods. This assumption also effectively collapses several social welfare functions. For example, the utilitarian goal of equalizing marginal utility and the egalitarian goal of equalizing individual well-being become one and the same. In addition, it addresses the concern that a "utility monster," who has higher total and marginal utility in all circumstances, will get the lion's share of society's resources, absent evidence that his or her utility function

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<sup>35</sup> Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10:4 PHIL. & PUB. AFFAIRS 283, 293 (1981) (hereinafter, Dworkin II).

truly differs.<sup>36</sup> (When such evidence is present, this concern is addressed by egalitarian social welfare functions, but not utilitarian ones.)

While Mirrlees and other optimal tax theorists have generally adopted this assumption for mathematical convenience, it can, nevertheless, be justified on purely welfarist grounds. Whenever there is uncertainty about how utility functions differ in form or intensity across different people—and we believe that people generally experience declining marginal utility—the most efficient response is to treat all people as having identical utility functions.<sup>37</sup> This is the case because the deadweight loss of policy errors tends to rise with the square of the error. This assumption of identical utility functions reduces the variance of errors. This, in turn, reduces the likelihood of relative large mistakes.

Resource egalitarianism shares the same principle of distributive justice in the most general case: we should seek to equalize the objective resources of individuals. Clearly the motivation for this principle is different, though. Resource egalitarians are not concerned about deadweight losses or exponential functions. With this first, very general shared principle established, we can now consider how well the principles of the two theories track each other in more specific cases.

### ***III. Ability versus Effort: Talent Slavery***

The first issue is how optimal tax theory and resource egalitarianism treat inequalities that arise from ability versus effort. Suppose that individuals differ only in their earning ability and level of ambition, rather than the material resources with which

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<sup>36</sup> See Shaviro, *supra* note 23.

<sup>37</sup> See, e.g., ABBA P. LERNER, THE ECONOMICS OF CONTROL 29-32 (1944), *cited in* [Shaviro]; BGO (applying the same intuition to tax externalities).

they begin life. Suppose further that earning ability is purely innate and ambition is purely chosen. This is a slightly modified version of the Mirrlees model where all individuals who share an ability level have the same overall utility, but they have different preferences for market consumption versus leisure.

In this situation, optimal tax theory would view earning ability as the ideal tax base, and basis for redistribution.<sup>38</sup> The reason is that we have no reason to believe that individuals with the same ability level have different levels of utility (or, more precisely, it is efficient to assume they do not, absent evidence to the contrary). If one individual chooses to work for one more hour, that is because she gets more utility from the resultant income than from leisure. If another with the same earning potential decides not to work that extra hour, she must receive at least as much utility—referred to as “imputed income”—from her leisure as she would from her forgone earnings. Otherwise, she would not make that decision. Optimal tax theorists therefore believe ability is the fairest tax base in this scenario. It is also the most efficient because people cannot change their innate earning ability and, as a result, there are no efficiency losses due to behavioral responses. They refer to this ideal tax as an “endowment tax.”

Resource egalitarians tend to approach the question differently. At first blush, one would think that they would reach the same principle. After all, the equal resources approach strives, to the extent possible, to make the distribution of resources at any moment ambition-sensitive but not endowment-sensitive.<sup>39</sup> It does so because individuals with high ability at birth have no particular moral claim to their innate ability

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<sup>38</sup> See, e.g., DAVID F. BRADFORD AND U.S. TREASURY TAX POLICY STAFF, BLUEPRINTS FOR TAX REFORM 36 (2nd Ed., 1984).

<sup>39</sup> Dworkin II, *supra* note 35 at 311.

and the pre-tax income it yields.<sup>40</sup> They have done nothing to deserve it. Similarly, individuals with low ability have done nothing to deserve their lower earning potential. Ambition, on the other hand, is freely chosen and its consequences are therefore deserved. Put differently, the consequences of differential innate ability are brute luck and should be mitigated, while the consequences of freely-chosen ambition are option luck and should not.<sup>41</sup> The next logical conclusion seems to be that the fairest tax base is earning ability. But resource egalitarians and others have generally declined to take the argument this next step. Instead they oppose endowment taxation because they argue it could or would generate “talent slavery.”<sup>42</sup>

There are several strands to this argument and I would like to tackle each separately, but ultimately I find it unpersuasive. In my view, endowment taxation is the fairest tax base in this scenario from an optimal tax perspective, and it should be from a resource egalitarian perspective as well.

The first argument sometimes lodged against endowment taxation is that talents and ambitions are so intertwined that it is unrealistic to believe that we can separate out the effects of each on inequality.<sup>43</sup> A related concern is that, if we try, we will end up with a distribution of resources that does not adequately reflect differences in ambition. This will deny those who are ambitious a core element of their chosen selves.

While it may be true that talent and ambition are fundamentally intertwined, this essay (and much of the work it discusses) operates at the level of the ideal. Surely it is

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<sup>40</sup> See MURPHY AND NAGEL, *supra* note 3 at 119.

<sup>41</sup> Dworkin II, *supra* note 35 at 292-97.

<sup>42</sup> See, e.g., Dworkin II, *supra* note 35 at 311-12, MURPHY AND NAGEL, *supra* note 3 at 122-23, Linda Sugin, *Let the Beachcomber Drown: Why Taxing Endowment is Unjust* (Fordham Legal Studies Research Paper No. 959710, Feb. 2008).

<sup>43</sup> Dworkin II, *supra* note 35 at 313.

impossible to identify endowment accurately. But that doesn't deny the importance of determining whether it is the ideal thing, or *equilisandum*, that we are trying to equalize. Moreover, there are techniques that we can use to identify earning ability more accurately in the real world. As Roemer argues, we could consider what earnings we would expect for an individual, controlling for education, parental wealth, race, gender, IQ, personality type, height, etc.<sup>44</sup> This is precisely the reason why optimal tax theorists advocate the use of tags to refine the proxy measure of actual income for earning ability.

The next line of argument typically advanced against endowment taxation is that, even if we could identify innate earning ability, doing so would enslave the talented, condemning them to a life of working flat out in the occupation that compensates their talents the most highly.<sup>45</sup> An investment banker who decides to give up her banking career and spend the rest of her life surfing would be taxed forced back to Wall Street because she would continue to owe just as much taxes as her former colleagues. Her only alternative would be jailed by the IRS for not paying.

This is surely a nightmarish scenario. But I would argue that it is only that—a nightmare and not an actual possibility. The concern is partly based on some misunderstandings about what endowment taxation would really entail. It is also, to some extent, based on the unpleasant reality of what egalitarianism implies for people who are lucky enough to be born with genes or social capital that provides them with high earning potential. Such individuals would face more limited options of how to live their lives than they do now. But that is the cost of providing more options to those with

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<sup>44</sup> Roemer, *supra* note 33 at 450-51.

<sup>45</sup> See, e.g., Dworkin II, *supra* note 35 at 320; MURPHY AND NAGEL, *supra* note 3 at 122.

low earning ability. The talented would still face fewer limits than people do today who experience the brute luck of not having high innate earning ability.

To start with the most straightforward misunderstanding, one concern about endowment taxation is that in many occupations, work is an all or nothing choice. It is difficult to be a CEO part-time. Optimal tax theorists would certainly acknowledge this possibility and indeed have built it into some models.<sup>46</sup> The simple solution is to define endowment as one's hourly earning potential, or something similar.<sup>47</sup> Then our investment banker may have to continue to work part-time in order to fulfill her obligations to society, but she won't necessarily be forced to work every waking hour at a job she hates.

The next concern might be that an endowment tax is akin to forced labor even if the work is part-time. It makes the state or others a part-owner of you. On some level, this is certainly the case. We are all partly owned by something. That is what justice is. As Nagel argues, if we believe that a person who doesn't care about anyone else has no obligations to others—that he can do absolutely whatever he wants—then there is no right or wrong.<sup>48</sup> But if we believe that there is right and wrong, we must believe that each person should do what something tells them, whether that thing is others, justice, God, or the democratically-elected state in which he lives.<sup>49</sup> If we believe this, we accept that each of us is partly owned by something.

But perhaps I have framed the concern about endowment taxation resulting in forced labor too extremely. Nozick argues that any tax above that necessary to finance

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<sup>46</sup> See, e.g., Saez, *supra* note 15.

<sup>47</sup> Stark, *supra* note 27 at 59, note 64.

<sup>48</sup> THOMAS NAGEL, WHAT DOES IT ALL MEAN? 61-67 (1987).

<sup>49</sup> *Id.*

the minimal state is forced labor and unjust,<sup>50</sup> but resource egalitarians and others disagree. Instead, their concern is that the talented will be forced into a single occupation. They worry that our investment banker who wants to be a surfer will be forced to work only as an investment banker, or will be forced to choose between investment banking and a few other occupations.<sup>51</sup> This, they argue, is illiberal and unjust. Our occupation is a fundamental part of our lives. If we cannot choose our occupation, we do not have an equal chance to pursue our vision of the good.<sup>52</sup> And if we do not have an equal chance at that, we have defeated the whole point of equalizing resources in the first place.

While compelling, I am ultimately unconvinced by this argument and think resource egalitarians should be as well. My reasons are threefold. First, it seems to be premised on an unreasonable assumption that the talented are particularly work averse, or that they will have fewer or worse occupational choices than others under an endowment tax. Second, if this is not the case, it seems to exclude the value leisure from what we are trying to equalize. Third, if neither of these assumptions holds, the only way that I can see endowment taxation conceivably enslaving the talented is under a utilitarian welfare function. This is not surprising. Of course egalitarians are troubled by the inegalitarian implications a social welfare function that is not egalitarian. That is why this essay sets utilitarianism aside.

Let's start with the first issue. One reason that one might naturally react against taxing the surfer on her earning potential is that we think that her decision to become a surfer reveals something about how well-off she is. Surely someone who gives up an

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<sup>50</sup> NOZICK, *supra* note 30 at 150-53.

<sup>51</sup> MURPHY AND NAGEL, *supra* note 3 at 122-23.

<sup>52</sup> Sugin, *supra* note 42.

investment banking salary must really hate it, or at least hate it more than her colleagues who stay. But it actually reveals nothing of the sort. Unless one believes that people should prefer market consumption to surfing, all it reveals is that she has a different utility function for work and leisure. It doesn't tell us that her overall utility level is lower than her former colleagues. It is just as possible that it is higher. For example, perhaps her colleagues stay because they don't derive much satisfaction from anything so they might as well work. Perhaps she leaves, not because she is dissatisfied with her work, but because she loves surfing even more.<sup>53</sup> To be sure it is possible that she left investment banking because she became depressed or physically ill and could not do the work anymore. Then she might be less well-off and have fewer resources. But that is a question of disabilities that I will defer to Section V.

Another potential reason to object to taxing her as if she is still an investment banker is if her quitting reveals something about how she feels about work in general. Suppose she starts working part-time as a surf instructor and asserts that she should owe the same amount of taxes as her fellow surf instructors who cannot get higher paying jobs. One could argue on her behalf that she is clearly very work-averse. The fact that she gave up a lucrative job seems to suggest that working simply makes her less happy (or more miserable) than it does for the average person. Therefore, she should be taxed like her fellow surf instructors because she finds work in general particularly distasteful, and this offsets any greater well-being she gets from her unusually high earning potential.

But, once again, we have no reason to believe that this is the case. As discussed, it is equally possible that she is better off or worse off than the average investment banker. Thus, the only way that we might be able to assume that she has the same level

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<sup>53</sup> See Lawrence Zelenak, *Taxing Endowment*, 55 DUKE L. J. 1145, 1167 (2006).

of well-being as her fellow surf instructors is if people with high earning potential, in general, are no better-off than those with low earning potential. This could be because money does not make one better-off. It could be because, putting money aside, low-ability people as a group like the experience of working more. Neither possibility seems particularly plausible.

This brings us to the issue of her potentially narrow occupational choices. As discussed below, I don't think an endowment tax would force high-ability individuals to work full-time (or more than full-time) under an egalitarian social welfare function. For now at least, let's assume that is the case. It is nevertheless possible that taxing endowment would force the highly talented to work part-time in relatively lucrative occupations. The question is whether this is the kind of talent slavery that resource egalitarians should find unjust. I would argue that it is not.

There are, admittedly, fewer jobs that are highly lucrative than there are low-paying jobs. In that sense, the highly talented might have relatively fewer occupational choices than those with low earning potential under an endowment tax. But number of jobs is not a particularly good proxy for job diversity or quality. To make a gross generalization, most low-paying jobs are in the service industry or involve manual labor. Typically they are relatively uncreative, intellectually unchallenging, and physically taxing. They bring little status or attention. They are, in short, boring, tiresome, and invisible.<sup>54</sup> By contrast, most highly compensated jobs, are relatively creative and intellectually challenging. They pay more because relatively few people can do them, and they bring prestige and status. Certainly there are rewarding, low-paying jobs; for example, those that benefit people we care about, which are discussed in Section IV. But

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<sup>54</sup> See, e.g., [Shipler].

putting those aside, even if highly-compensated jobs paid the same, my guess is that most people would prefer to be condemned to working part-time in such jobs than part-time in very poorly compensated occupations.

If so, we have no reason to think that forcing the talented to work part-time in relatively well-paid jobs will enslave them. The fact that a talented person chooses to leave a high-paying job does not tell us that she is worse-off because she is unusually dissatisfied with the job she left.<sup>55</sup> It does not tell us that she should owe fewer taxes because she is unusually dissatisfied by work in general. Moreover, taxing her at a level that requires her to work part-time in a highly compensated job (or perhaps full-time in a less well paying job) does not enslave her nearly as much as current low-skill workers. Typically they are forced to work full-time (or more) in order to pay for basic needs. The only reason to fear that endowment taxation will generate talent slavery, therefore, is if the talented will be forced to work full-time or more. Let's turn to that argument next.

One way the talented might be forced to work all the time is if the basis on which an endowment tax allocates tax burdens (earning ability) is also the basis on which it determines when equality has been reached. For example, suppose there are three people in the economy. One person, H, can earn \$1 million per year. The innate ability of the other two, the Ls, limits their potential earnings to \$10,000. One might think that equality requires H to pay almost \$1 million in tax in order to fund a demogrant that leaves each with the same amount of consumption after-tax. But this would be a mistake.

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<sup>55</sup> Once again, I set aside the issue of disabilities, which is addressed in Section V. I also set aside the issue raised by Roemer of whether this hypothetical insurance scheme would result in some choosing not to insure at all. This could occur if an individual knows in advance that she has expensive tastes and will be miserable if they aren't fulfilled, so she chooses to use the insurance market to maximize her chances of being rich, rather than minimize her chances of being poor. Roemer, *supra* note 33 at 446-48. Dworkin apparently does not intend for the insurance market to have this result. *Id.*

Instead, social welfare functions measure inequality by reference to the after-tax distribution of all goods that potentially contribute to utility, which in this case are actual consumption and leisure, not earning potential.<sup>56</sup> As a result, a government seeking to maximize an egalitarian social welfare function might well conclude that H is worse off under this first approach because the Ls could consume almost the same amount without working at all. If so, it might next consider imposing a \$750,000 tax on H in order to fund a demogrant of \$250,000 for all. Let's say H decides to work full-time and is left with \$500,000, while the Ls decide not to work. The question would then be whether H would prefer not to work and live on \$250,000 or, conversely, whether the Ls would prefer to work full-time and receive \$500,000. If H would prefer not to work, the government has redistributed too much. If the Ls would prefer to be in H's shoes, it has redistributed too little. But if neither prefers the other's bundle of consumption and leisure, then it has reached equality.

Resource egalitarians, I would argue, should make the same distinction between what measure is used to allocate tax burdens and what measure is used to determine the degree of inequality. Indeed, this is evident in Dworkin's hypothetical insurance scheme approach, under which he argues that people might decide to insure against low ability, but probably would not decide to insure to the point that all have the same income because this would make the talented worse off.<sup>57</sup> Markovitz makes the same point in arguing that resource egalitarianism does not imply insuring up to the mean talent level because that implies talent slavery.<sup>58</sup> Instead, if people are risk-averse, it implies insuring

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<sup>56</sup> See Zelenak, *supra* note 53 at 1163-64 discussing Richard Musgrave, *Maximin, Uncertainty, and the Leisure Trade-Off*, 88 Q.J. ECON. 625 (1974)

<sup>57</sup> Dworkin II, *supra* note 35 at 316-23.

<sup>58</sup> Daniel Markovitz, *How Much Redistribution Should There Be?*, 112 YALE L. J. 2291, 2307-09 (2003).

up to the point where one would be equally happy if one turned out to be high-ability or low-ability. Being high-ability requires working a lot but allows one to have higher income. Being low-ability permits one to work very little, but at the cost of having less income.

The only remaining way that I can see for an endowment tax to result in talent slavery is if the social welfare function is not, in fact, egalitarian. For example, it is possible that a utilitarian social welfare function would imply forcing an incredibly talented person to work every waking hour. Her total utility would be very low and her marginal utility for leisure would be extremely high. She might even wish that she was born with low innate ability. But if another hour of her work produced, say, \$1 million, it is possible that her marginal utility for leisure would be lower than the marginal utility everyone else would gain from forcing her to work in order to fund a larger demogrant. Then, a utilitarian social welfare function would imply forcing her to work that extra hour.

This proposition undoubtedly troubles resource egalitarians and many others. But that is not surprising because utilitarianism is, at its core, unconcerned with inequality between individuals. If one's social welfare function is inequality averse, this possibility becomes much less likely. And if it is truly egalitarian (for example, a maximin function), this possibility falls away entirely. As argued above, if we want to compare apples to apples, we should assume that a social welfare function that is as egalitarian as resource egalitarianism, or whatever variant of it that theory that one holds.

It is worth noting that the approach to endowment taxation discussed in this section also addresses a concern that might be lingering about the interconnection

between talents and ambitions. What if earning potential is not purely innate but also the product of the effort one puts into cultivating one's talents? Then wouldn't an endowment tax result in people failing to cultivate their talents in order to avoid the tax?

To consider this final possibility, let's relax the assumption that earning potential is strictly innate, and assume instead that it is partially chosen as well. H can choose to earn \$1.5 million or can fail to cultivate his talents and earn only \$500,000. But this is simply a somewhat more complicated version of our investment banker problem. An egalitarian social welfare function would consider equality to be achieved when one is equally happy if one turns out to be H or an L. Let's say H decides to spend part of his time cultivating his talents and part of his time working in response to a \$750,000 tax. The net result is that he works more than the Ls, but has more income as well. Once again, H and L would be equally well-off if they were indifferent between these two bundles of consumption and leisure.

In summary, an endowment tax as described will not result in talent slavery if one's goal is equality and one defines equality properly. Under such a tax, the talented would only work full-time (or more than full-time) by choice. An endowment tax will not constrain the occupational choice of the talented anymore than the occupational choice of those who have low ability would be constrained. Resource egalitarians and others should take another look at endowment taxation because the principle of ideally allocating social burdens based on innate earning potential seems to flow logically from their concerns.

***IV. Altruism versus Anti-Social Preferences: Public Servants and Sociopaths***

The discussion thus far has set aside two issues: the possibility of work that benefits others, and disabilities. This section returns to the first. It considers more broadly how optimal tax theory deals with preferences that benefit or hurt others, and whether its approach is responsive to the concerns of resource egalitarians.

Let's consider first the case of the stay-at-home parent. Say our investment banker decides to leave her well-paying job not to surf, but rather to be a full-time mother because she cares about her children's well-being. A resource egalitarian might argue, following Sugin, that taxing her based on her earning potential is unfair because she is contributing to society.<sup>59</sup> She is not a surfer or someone who has decided to live off the land, while still benefitting from all the protections that society provides. She is working hard, and she should get credit for this hard work by owing less in taxes, regardless of whether it is monetized or not.<sup>60</sup> Further, a resource egalitarian might argue that an endowment tax would be fundamentally illiberal in this scenario because it denies her the ability to achieve her vision of the good life.<sup>61</sup> Indeed, this is precisely the kind of talent slavery that resource egalitarians should seek to prevent.

An optimal tax theorist's approach to the issue would be quite different. They would view this as a case of positive externalities and new potential sources of inequality. Starting with first, they would view our investment banker's decision to stay at home with her children as potentially producing an "altruistic externality." She must receive at least as much utility from being a stay-at-home mother as she did from earning a great deal as an investment banker or she wouldn't have made this choice. But her children

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<sup>59</sup> Sugin, *supra* note 42.

<sup>60</sup> Id. See also MURPHY AND NAGEL, *supra* note 3 at 123-24.

<sup>61</sup> Id.

presumably benefit as well. They grow up with a parent who is constantly available, and who is likely passing on her high skills to her children by reading to them and talking with them. When she makes the decision to leave investment banking, she takes into account the utility that she derives from being a stay-at-home mother (which may be a function of the utility her children gain). But she does not take into account the completely separate utility that her children derive from this decision.

To give an example, suppose her children gain 100 utils from her being a stay-at-home mother relative to her being an investment banker (and earning the accompanying after-tax salary). She values her children's utility as if it were her own, but also likes her old job. The decision to quit then generates 100 new utils for her as a result of the benefits to her children. She will quit as long as this exceeds her utility loss from no longer being an investment banker. But, in reality, her decision generates 200 new utils—100 for her and 100 for her children. The 100 utils that her children gain are the “altruistic externality” that she does not adequately take into account.

As discussed in Section I, the ideal response from the perspective of optimal tax theory would be to provide her with a Pigouvian subsidy that equals the welfare-weighted marginal benefits her choice generates for others. If the tax system was optimal previously, the subsidy would be financed through a lump sum tax that mimics the general incidence of the subsidy. That is, investment bankers (and others with high ability) who decided not to become stay-at-home parents would effectively share the cost of the subsidy with her and others who make this decision.<sup>62</sup> The net effect is to give our investment banker a subsidy for deciding to become a full-time mother, but only equal to

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<sup>62</sup> Technically the cost should also be shared with the children who benefit from the subsidy because their parent decides to become a full-time parent in response.

the welfare-weighted value of her doing so. The welfare-weighted value is, roughly speaking, the amount that the social welfare function would otherwise determine should be given to her children to compensate for the fact that they do not have a stay-at-home mother.

While the details of this analysis are fairly dry and probably do not strike resource egalitarians as particularly compelling, it does yield an interesting principle. Effectively our investment banker is being treated as contributing to society and is getting “credit” for her choice—but only to the extent that she is doing something that a just government otherwise would have done. The same principle would apply to a lawyer who decides to accept a lower salary and become a human rights advocate or a doctor who decides to become an internist in a disadvantaged community. Each could reduce the amount of endowment tax they owe by the amount that they have saved the government. The loss would be recouped by from individuals in the same ability class who choose occupations that do not generate as many welfare-weighted benefits for others.

This principle is interesting because it potentially addresses the Dworkinian concern about how a welfare egalitarian would treat political or impersonal preferences.<sup>63</sup> The optimal tax theorist’s response seems to be that “real” justice trumps our personal views about what is fair.<sup>64</sup> You only get credit for furthering your political beliefs if they do, in fact, advance distributive justice. This may be the same principle a resource egalitarian would reach. But, as Shaviro points out, an optimal tax theorist’s justification is grounded in incentives and getting prices right.<sup>65</sup> A resource egalitarian, by contrast, would probably be grounded this principle in the view that individuals should be able to

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<sup>63</sup> Dworkin I, *supra* note 1 at 197-204.

<sup>64</sup> As noted in the introduction, I am setting aside issues of public goods and political equality.

<sup>65</sup> Shaviro, *supra* note 27 at 30.

choose whether to fulfill their legitimate obligations to society through monetized or non-monetized contributions.<sup>66</sup>

Turning to the second issue from an optimal tax perspective, the inclusion of children complicates the model we have discussed thus far. In particular, it generates new potential sources of inequality. Suppose that the decision to have children is purely a choice, and that individual utility is solely a function of market consumption and leisure, which includes time spent raising one's children. Let's also set aside the question of how to value potential life. We can do this by assuming that the decision to have a child neither provides a benefit to, nor imposes a burden on, society overall.

In this scenario, an optimal tax theorist would still argue that the fairest tax is an endowment tax. But in setting the rate, the question now becomes what opportunity set would make people equally happy if they turn out to be an H or an L *and* if they end up being born into an H or L household, when leisure includes time spent with children. There are many considerations. Starting with single parents, H in our earlier example might prefer to be an L and have less consumption if that meant that she could spend more time with her children. Effectively, the value of leisure to her has increased. On the other hand, an L might prefer to be H so that she can have more money for herself and her children, even if it entails working more.<sup>67</sup> The possibility of couples complicates the matter further. Then one might prefer to be an H because (at

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<sup>66</sup> See Sugin, *supra* note 42 at 20.

<sup>67</sup> One way to address both concerns might be to provide a larger demogrant for parents when their children are young. But this privileges those who choose to become parents and we are making the (highly questionably) assumption that parenthood is purely a choice and there is no value to people continuing to have children. Therefore, we cannot say that the decision to have children benefits society. We are also assuming that people who choose to have children are any worse-off than those with the same innate earning ability who do not.

least in the current world) Hs tend to marry Hs. This tendency would increase the probability that at least one member of an H couple could stay at home most of the time.

Turning to the children, equality means that one is equally happy to be born into an H family or an L family. To simplify the issue, let's make the admittedly heroic assumption that we can separate out resources devoted to a parent from resources devoted to their children. Then the advantage of the H family is the potential for more material resources, social capital, etc., but at the expense of less time spent with one's parent(s) during the workday. The advantage of the L family is more potential time spent with one's parents because their tax obligations do not require them to work much, if at all. But this time is at the expense of less potential for material resources, social capital, and so on.

When sorting through these various considerations, the key once again would be to find the point of indifference. It is not at all clear that this would involve a tax on H that is so low that she could afford to pay it and stay at home full-time while her children. Doing so would have the effect of reducing the demogrant available to the Ls, potentially leaving them worse-off. It would also require reducing the demogrant to the L's children, potentially leaving them far worse-off than H's children, simply because of the family into which they were born.

While perhaps dry again, this analysis casts in a new light the resource egalitarian argument that an endowment tax is illiberal because it would deny our investment banker the ability to achieve her vision of the good life. What seems to be missing is an equal concern for the ability of low-ability parents and their children to achieve their visions of the good life too.

Indeed the optimal tax theory principle of indifference between lives can be rephrased in resource egalitarian terms. If the decision to have children really is purely a choice and neither provides benefits to, nor imposes costs on, society, then we should seek be neutral between visions of the good life that involve having children and those that do not. One's obligations to society, therefore, should not vary depending on whether one decides to have children. Among parents, we should strive to provide equal opportunities for different visions of the good life. This could involve reducing tax burdens on high-ability individuals so that they can stay at home with their children full-time if they decide to have children. But it seems more likely that it would not. Such a tax cut would result in low-ability individuals having less opportunity to pursue their vision of the good life if it involves raising a family with a certain level of material resources. In addition, it would probably reduce the likelihood that equal resources would be devoted to both H's and L's children. Thus, once again, the principles implied by optimal tax theory seem to track well those implied by resource egalitarianism.

But perhaps the issue of the stay-at-home mother is too easy. Often resource egalitarians object to welfarism, not because of how it treats altruists, but because of what it implies about preferences that harm others. Welfarists are often accused of condoning slavery or genocide if the benefits for the many exceed the costs imposed on the few.

These extreme cases certainly would not be countenanced by an egalitarian social welfare function. They are really objections to utilitarianism. Indeed, it is not surprising that utilitarianism might produce such repugnant results. As discussed, it is completely unconcerned with inequality between individuals. Nevertheless, a resource egalitarian

might still be concerned about what this possibility implies about the treatment of harmful preferences under more egalitarian social welfare functions.

To address this issue, suppose there is an individual who loves screaming at people once in a while. Indeed, he would prefer to be able to do this over many things. This preference is purely a choice. He was not born with an innate need to scream, which might be considered a disability (discussed in the next section). Instead he has cultivated this preference and enjoys seeing just how upset and startled he can make people. Suppose further that the tax system was optimal prior to his developing this preference. Some people are only willing to be screamed at for \$100 or more. But others (maybe New Yorkers) don't really mind as much and would be willing to be screamed at for \$10 or less.

In this situation, optimal tax theory would apply a Pigouvian tax. If our screamer can control himself so he only screams at New Yorkers, it would charge him \$10 each time he screams at someone. Any revenue raised would be used to compensate those who have to listen to him. The result would be that everyone is better off. He would probably reduce his screaming in response to the tax so there would be less screaming. His victims would be fully compensated or more so. And our screamer would be pleased because he still gets to scream, as long as he values doing so more than the costs it imposes on others.

Resource egalitarians probably would not be comfortable with this solution. This is even more likely if the screamer's preference was, say, to punch people. Many views of distributive justice that are generally consequentialist incorporate deontological values

when it comes to physical harm.<sup>68</sup> It is instructive to consider why resource egalitarians might find this approach troubling and how optimal tax theorists would respond.

Resource egalitarians might first object that nobody would really consent to be punched. The welfarist might reply that some certainly would if the price was high enough (say, \$10,000) and it meant they could get a trip around the world. After all, isn't this what professional boxing is? The next concern might be that people might be forced into accepting \$10,000 because they have far fewer resources. But under an egalitarian social welfare function, each individual would have roughly equal resources. The resource egalitarian might next worry that people would agree because, even though they had equal resources, they depleted them in the past when their preferences were different. But under optimal tax theory (as discussed in Section VI), the period over which equality is measured should correspond to the horizons over which people can make decisions. As a result, if an individual could not have foreseen facing this choice, he should be allotted equal resource over a period starting when he could. Finally, one might object that it hurts third parties to know that such punching is occurring. But the optimal tax theorist would respond that this simply implies incorporating these harm into the Pigouvian tax as well, and rebating that portion of the revenue raised to them.

An optimal tax theorist might also argue that this hypothetical is unfair to begin with. It implicitly mixes distributive justice with the other issues of justice that we said we would set aside. Such a Pigouvian tax is the fairest way to adjust economic resources in response to this preference for punching. But it has nothing to say about other fields of justice, such as how the assailant should be treated under criminal law.

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<sup>68</sup> C.f. RAWLS, *supra* note 28.

It is unclear whether resource egalitarians would be satisfied with these responses. They might agree with the principle of Pigouvian taxes and subsidies in the context of altruistic choices or less pointed examples of negative externalities, such as pollution. Thus, there is still much potential overlap in this area. But if a resource egalitarian would draw the line at proximate physical harm, or somewhere else, it is worth considering why. Perhaps resource egalitarians are being too squeamish in their conception of the good life. After all, is the question whether boxing should be legal really an issue of distributive justice? Should some choices be banned no matter how sure we are that no coercion was involved? On the other hand, perhaps optimal tax theorists are being too hasty. Perhaps there is a no moral distinction between an individual expressly consenting in advance to be paid an amount in exchange for being harmed, and simply receiving that payment without be asked as under Pigouvian taxation.

*[The remaining two sections are omitted but can be briefly summarized as follows:*

*Section V considers how disabilities are defined and treated differently from cultivated tastes under both theories. Disabilities are defined as characteristics that lower expected utility controlling for innate earning ability. It argues that both theories again seem to imply the same general principles. First, the fairest tax base is an endowment tax that considers disabilities to be part of endowment. Second, distributive justice should seek to mitigate inequalities resulting from disabilities but not tastes. It then discusses how both theories distinguish disabilities from expensive tastes based on the extent to which they are chosen. However, choice matters for different reasons. For resource egalitarians it matters because it signifies responsibility, while for optimal tax*

*theorists it matters because of the potential for moral hazard and incentive effects. Finally, the section considers the tools that optimal tax theory uses to distinguish disabilities from cultivated tastes in practice, which include observability, screening devices, and tags. One implication for resource egalitarians is that the equity of accepting inequalities derived from tastes but not on ability/disabilities depends on how well they can be distinguished in practice, and whether equality or responsibility is more important if they cannot.*

*Section VI considers the extent to which each theory is concerned with opportunities versus outcomes. Under optimal tax theory, endowment and inequality should be measured over individuals' actual decision horizons. Given the weak evidence in favor of the permanent income hypothesis, this horizon is probably less than a lifetime, which has some interesting implications for both theories. It suggests that, as decisions horizons become shorter, distributive justice should increasingly focus on equalizing outcomes and actual income, rather than earning potential or lifetime resources. It also potentially implies that distributive justice should focus more on outcomes later in life because, as we age, our material resources are increasingly likely to be a product of choices made by our past selves rather than our present selves.]*