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A Philosophical Objection to the Optimal Tax Model

LINDA SUGIN*

I. INTRODUCTION

The most intractable problem in tax design has long been the conflict between equity and efficiency. A tax system should be fair, and it should seek to raise the maximum revenue with the minimum cost. In economic theory, fairness is about the distribution of the tax burden and efficiency is about the social costs of raising revenue.¹ The problem is that a tax that distributes the burden in a desirable way may simultaneously impose costs. For example, a tax that collects more from the rich than the poor may be distributionally fair, but it may also discourage the rich from earning, reducing overall productivity. The perennial challenge for tax policymakers is managing these trade-offs.

The theory of optimal taxation is the most important twentieth-century development in tax policy analysis because it provides mathematical tools for determining a desirable tax by balancing equity against efficiency.² Users of the model can input various patterns of income distribution and efficiency costs of taxation to evaluate alternative tax regimes. The model is amenable to different definitions of distributional fairness and can adjust to accommodate specific limitations in tax design that may arise from political or administrative constraints. Because of the model's wide range and flexibility, the optimal tax literature is extensive, and offers insights on many fundamental tax

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¹ Harvey S. Rosen, *Public Finance* 323 (5th ed. 1999).

² See generally J.A. Mirrlees, *An Exploration in the Theory of Optimum Income Taxation*, 38 *Rev. Econ. Stud.* 175 (1971).

policy issues, including the two most paradigmatic—progressivity³ and choice of tax base.⁴

The optimal income tax model was developed by economist James Mirrlees for the purpose of determining how progressive an income tax should be if the system's goal is maximization of social welfare.⁵ His work was groundbreaking because it offered a way to derive a particular tax rate schedule from equity and efficiency concerns, replacing a vague intuition in the economics literature that progressive taxation would increase social welfare.⁶ The model was named "optimal" for a reason—twenty years ago, a leading economist called optimal tax theory "the reigning normative approach to taxation."⁷

While the optimal income tax model surely deserves its central place in the literature, there is an assumption underlying it that has not been fully considered in evaluating its normative authority and its capacity to produce a truly optimal tax scheme in practice. Mirrlees assumed that taxation should be based on "a man's income-earning potential," and that "the most reliable indicator of his income-earning potential is his income."⁸ Thus, Mirrlees used actual income as a proxy for a person's ability to earn on the dual assumptions that (1) ability to earn or earning potential—what is often called "endowment" in the literature—is ideally what we want to tax,⁹ and (2) a person generally earns as much as he is potentially able to earn. Mirrlees proceeded to design his model using actual earned income as a discernible, though inexact, substitute for one's ability to earn.¹⁰

This Article questions the normative power of the optimal tax model by examining Mirrlees' dual assumptions. It makes a case for moving beyond utilitarian conceptions of social welfare that are at the foundation of the optimal tax model, and that have become the dominant construct in tax policy analysis. In explaining why the Mirrlees

³ See, e.g., Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 *Calif. L. Rev.* 1905, 1964–65 (1987); Lawrence Zelenak & Kemper Moreland, *Can the Graduated Income Tax Survive Optimal Tax Analysis?*, 53 *Tax L. Rev.* 51 (1999).

⁴ See, e.g., Joseph Bankman & David Weisbach, *The Superiority of an Ideal Consumption Tax over an Ideal Income Tax*, 58 *Stan. L. Rev.* 1413 (2006).

⁵ Mirrlees, note 2.

⁶ *Id.* at 175. The analysis is a proof with over 100 equations, and it comes to the surprising conclusion that the optimum is not steeply progressive at all. See *id.* at 202-04 (rate tables).

⁷ Joel Slemrod, *Optimal Taxation and Optimal Tax Systems*, 4 *J. Econ. Persp.* 157, 157 (1990).

⁸ Mirrlees, note 2, at 175 (internal punctuation mark omitted).

⁹ This Article uses "endowment tax" and "ability tax" interchangeably to refer to Mirrlees' ideal.

¹⁰ Mirrlees, note 2, at 175. The Mirrlees model further simplifies by assuming that all income is from labor. *Id.* at 176.

assumptions are problematic, the Article argues for a nuanced, philosophical understanding of fairness that incorporates the role of taxation into a broader conception of a just society. A fair tax must satisfy the full range of demands that a just society places on government exercising its coercive power over individuals. Applying that philosophical approach to tax fairness reveals significant deficiencies in the assumption that a tax on ability to earn is truly optimal as a matter of justice.

The Article proceeds as follows. The next Part explores why the Mirrlees ideal is attractive to economists, and expresses skepticism about the economic analysis on its own terms. Part III introduces the legal literature and describes why ability taxation has been attractive to those who care about fairness in taxation. It shifts the focus to fairness in political theory, contending that fairness in taxation must be understood as a conception of equality.¹¹ It critiques endowment taxation as an ideal on those terms, arguing that endowment tells us much less about inequality among individuals than we might hope; the proponents of ability taxation have misunderstood the nature of liberty and equality essential to liberal egalitarian political theory. The Article concludes by considering why the discussion about inequality in taxation has focused on human endowment rather than financial endowment, and suggests a way forward for breaking out of the utilitarian mold and using a philosophical conception of fairness more broadly in thinking about justice in taxation.

II. EXAMINING THE ECONOMIST'S IDEAL

The endowment tax ideal originated with economists and grew out of their belief that the best way to design a tax system is to raise revenue with the fewest possible distortions.¹² Economists use an economy with lump sum taxation as the baseline because it allows the market to operate freely.¹³ Lump sum taxes are those that do not change as a result of taxpayer behavior. A head tax is the prime example because it is levied on account of mere existence. Because a head tax is due in a fixed and equal amount no matter a person's financial circumstance, it strikes most people as fundamentally unfair

¹¹ This approach is just starting to show life in the tax policy literature. See James R. Repetti, *Democracy and Opportunity: A New Paradigm in Tax Equity*, 61 *Vand. L. Rev.* 1129 (2008).

¹² See David F. Bradford, *Untangling the Income Tax* 174–76 (1986).

¹³ See Joel Slemrod & Jon Bakija, *Taxing Ourselves: A Citizen's Guide to the Debate over Taxes* 121 (3d ed. 2004).

and arbitrary.¹⁴ Some people cannot afford a head tax no matter how hard they try, while others can pay it with no discernible sacrifice.¹⁵

The ideal tax in the optimal tax model, an endowment tax, is a lump sum tax that seems to overcome the distributional objections to head taxes. It is lump sum because it cannot be avoided by changing behavior, so it is efficient in the economists' sense. It also seems fairer and less arbitrary than a head tax because people who would have an easier time earning more money are required to pay more tax.¹⁶ It is attractive because it appears both efficient (in the economist's sense of not distorting behavior) and equitable (because it is sensitive to differing abilities to pay).

Endowment taxation also has an appealing neutrality connected to its economic efficiency. It is indifferent to choices that people make; the tax remains fixed whether a person chooses more work or more leisure, higher- or lower-paying work. This is where Mirrlees' second assumption becomes crucial because ability taxation is a neutral baseline, free of distortions, only if people actually maximize earnings. Mirrlees assumed that they do maximize when he designed the model to use actual earnings as the proxy for ability to earn.¹⁷ Without the assumption that individuals maximize earnings, distortions reappear, and taxation based on ability can affect many choices. Because a lump sum tax requires that individuals earn at least enough money income to pay the tax, a lump sum tax distorts the decisions of an individual who would maximize nonmarket activities in the absence of the tax. By relaxing Mirrlees' assumption that individuals always maximize earnings, it becomes clear that his ideal tax on potential earnings can produce a significant behavioral effect by incentivizing

¹⁴ A head tax, or poll tax, was reportedly a cause of the downfall of Margaret Thatcher's government in England. See Peter Passell, *Furor over British Poll Tax Imperils Thatcher Ideology*, N.Y. Times, Apr. 23, 1990, at D1; see also Slemrod & Bakija, note 13, at 55. The tax policy literature is largely devoid of head tax proponents. One defense is Jeffrey A. Schoenblum, *Tax Fairness or Unfairness? A Consideration of the Philosophical Bases for Unequal Taxation of Individuals*, 12 Am. J. Tax Pol'y 221, 270–71 (1995).

¹⁵ In one of the classic works on tax justice, John Stuart Mill defined a fair tax as one that produced equal sacrifice. John Stuart Mill, *Principles of Political Economy* bk. V, ch. II § 2 (Prometheus Books 2004) (1848). ("Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person towards the expenses of government so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his.")

¹⁶ Daniel Shaviro has argued that an endowment tax may be the best understanding of the well-established ability-to-pay norm. Daniel Shaviro, *Endowment and Inequality*, in *Tax Justice: The Ongoing Debate* 123, 125 (Joseph J. Thorndike & Dennis J. Ventry Jr. eds., 2002).

¹⁷ Mirrlees, note 2, at 200–07; cf. Chris William Sanchirico, *Progressivity and Potential Income: Measuring the Effect of Changing Work Patterns on Income Tax Progressivity*, 108 Colum. L. Rev. 1551 (2008) (assuming that people modify their hours, but not their wage rates).

individuals to maximize earnings. Thus, the economic approach that incorporates lump sum taxation as a neutral baseline contains an unstated normative bias in favor of earnings maximization. That bias has become part of every analysis that compares alternative tax systems pursuant to the optimal tax model.

The economists' efficiency criterion concentrates on distortions that are caused by people changing their behavior to avoid tax. For example, a tax on oranges might cause people to eat more apples and fewer oranges. But if they really like oranges better than apples, the tax makes them worse off without bringing in any revenue, producing what economists call "deadweight loss."¹⁸ That loss arises from the "substitution effect,"¹⁹ which is concerned with how people change their behavior to avoid a tax, such as eating more apples and fewer oranges. The substitution effect present in an income tax that makes endowment taxation attractive is the substitution of leisure for work;²⁰ in an endowment tax one cannot avoid tax by working less.²¹ The easier it is to avoid tax by substituting nontaxed activities, the more distortion the tax produces. This is why broader-based taxes are more efficient;²² a tax on all fruit (or all food or all purchases) produces less distortion than one imposed only on oranges. The economist's judgment of the efficiency of a tax focuses on substitution effects, since only substitution effects produce deadweight loss.²³ A major objective of tax design is minimizing deadweight loss.

Substitution effects are troublesome, but they are not the only distortions produced by taxation. Those distortions depend on "income effects" in addition to substitution effects.²⁴ Income effects look at how people manage their income in response to a tax. For example, an orange lover might earn more money to afford the expensive oranges that he craves. An income tax may cause people to work more so they have the same after-tax income they would have had in the absence of the tax.²⁵ From the perspective of the income effect, there

¹⁸ Deadweight loss is the social cost of taxation that produces no revenue. See Richard Musgrave & Peggy Musgrave, *Public Finance in Theory and Practice* 235-36 (5th ed. 1989).

¹⁹ *Id.* at 299.

²⁰ *Id.*

²¹ See, e.g., Lawrence Zelenak, *Taxing Endowment*, 55 *Duke L.J.* 1145, 1149-53 (2006).

²² See Bradford, note 12, at 174-76; Bankman & Weisbach, note 4, at 1420-21.

²³ I am grateful to Chris Sanchirico for helping me work out this analysis.

²⁴ See generally Laurie L. Malman, Linda F. Sugin, Lewis D. Solomon & Jerome M. Hesch, *The Individual Tax Base: Cases, Problems, and Policies in Federal Taxation* 9 (2002).

²⁵ Non-income-based taxes also have income effects. For example, a tax on consumption might encourage greater earning to maintain after-tax levels of consumption. Imposition of a wealth tax might encourage greater earning to achieve set levels of wealth accumulation, while a reduction in wealth taxes might reduce levels of earnings.

is no advantage to endowment taxation compared to income taxation, and income taxation may even be preferable.

The centrality of deadweight loss and substitution effects in the efficiency analysis of taxation downplays the real importance of income effects to individuals making choices in their lives. If economists focused more on income effects and how they distort behavior, ability taxation might not seem optimal at all, even from an efficiency perspective. An endowment tax has no substitution effect—and no deadweight loss—because a person cannot change her behavior to avoid the tax. There can be no social cost incurred in avoiding the tax where it is not possible to avoid the tax. But there is social cost in being required to pay an endowment tax, even if that cost does not appear in the economic model.²⁶ An ability tax has a very powerful income effect because a person is likely to increase her income to cover the costs of the tax and her other needs.

All taxes have income effects since all taxes are payable in money that needs to come from somewhere. It is, therefore, tempting to disregard them when considering alternative taxes.²⁷ Nevertheless, large income effects should be important in measuring the overall distortion produced by a tax, and should not be ignored when comparing alternative systems with different distorting effects.²⁸ Income effects may be more likely than substitution effects to reduce individual well-being because people who substitute leisure for work may be happier for having more leisure,²⁹ while people who work more to cover the tax have no offsetting welfare gain from that choice. Given the utility gains from substituting leisure for work, it is surprising that the literature is so focused on the substitution effect.³⁰

²⁶ Such a tax may distort an individual's choices in ways that are not categorized as loss of either consumer or producer surplus, the identified losses in the economic model. See Mirrlees, note 2, at 178-80 (introducing shadow rates for consumption and labor to the model); see also Brian Galle, *Hidden Taxes*, 87 *Wash. U. L. Rev.* 59, 65-81 (2009) (relating consumer and producer surplus to the elasticity of demand and discussing the Mirrlees model); see generally Anthony Vitarelli, *Happiness Metrics in Federal Rulemaking*, 27 *Yale J. on Reg.* 115, 125-27 (2010) (discussing consumer and producer surplus as well as shadow pricing in the context of government rulemaking).

²⁷ The tax literature often focuses on substitution effects. Arguments in favor of low rates, for example, are based on concerns over the substitution effect. See 1 Treasury Dep't, *Tax Reform for Fairness, Simplicity, and Economic Growth* 13 (1984).

²⁸ One exception to the general disregard of income effects in the tax literature is Martin J. McMahon, Jr. & Alice G. Abreu, *Winner-Take-All Markets: Easing the Case for Progressive Taxation*, 4 *Fla. Tax Rev.* 1, 43-45 (1998) (analyzing the income effect for lower-income taxpayers compared to the substitution effect for high-income taxpayers).

²⁹ See Thomas D. Griffith, *Progressive Taxation and Happiness*, 45 *B.C. L. Rev.* 1363, 1391 (2004).

³⁰ The Mirrlees model assumes a very high elasticity of substitution, which has been questioned. See Bankman & Griffith, note 3, at 1964-65.

While all taxes produce some income effect, it would be a mistake to ignore income effects as an evil that is the same for all taxes. The magnitude of the income effect differs; a tax that makes a person work a few additional hours is considerably less distortionary than a tax that forecloses an individual's choice of occupation. On these terms, an endowment tax is particularly troubling. Consider an investment banker and a disaster-relief worker with equal abilities. In a world without taxes,³¹ each could have chosen the other's profession. If one makes \$1 million and the other \$40,000, the optimal tax model treats them the same, since they each could have chosen the other's work. But the imposition of an endowment tax drastically changes their relative positions. Whereas they may have had equivalent welfare before imposition of a tax, a \$30,000 tax (calculated at 3% of a \$1 million endowment) leaves the relief worker with a tremendous reduction in welfare, while the investment banker suffers only a small reduction. After tax, they are in very different positions because now the relief worker, even if she cares much less about money than the investment banker when she makes \$40,000, has so little that she is unlikely to cover her basic needs. If the tax rate—while still low—is 5% of endowment, the relief worker must choose other work—her choice is foreclosed by her high ability to earn. Thus, the endowment tax clearly distorts the choices of the high-ability individual in favor of higher-paying market work. Nevertheless, the tax produces no dead-weight loss.

When comparing an ability tax with any other possible tax, the relative distortions must be considered, and the total resulting distortions, as well as their character, are important. For example, an endowment tax is significantly more distortionary than is a head tax, although as lump sum taxes neither produces deadweight loss. That is because an endowment tax is much more likely to encourage individuals to maximize their earnings—producing a greater income effect. A head tax would make everyone work some, but an endowment tax would require that the exceptionally able work significantly more than every-

³¹ In judging the efficiency of alternative tax bases beyond lump sum taxes, one can compare relative distortions without any reference baseline at all. An income tax has both income and substitution effects, but the total distortions could be smaller or less troubling than the income effects alone of an endowment tax. That determination depends on whose behavior is distorted and how the distortions affect different people's welfare. Since a no-tax world is not a viable option, it is generally not a helpful baseline in thinking about tax policy. In this case, however, it may be helpful to think about the distortion question against the baseline of a no-tax world because the endowment tax inquiry is an attempt to identify an ideal. Moreover, in comparing alternatives, the issue is identifying not only the magnitude but also the nature of the distortions. In deciding among tax systems, we may want to choose the system that minimizes the most troubling distortions, rather than the largest ones.

one else since their tax would be much higher, particularly if the tax has graduated rates.

Compare the relative distortions of an endowment tax with an income tax. The income effect in an income tax (increased work to achieve a set level of after-tax wage) is tempered by the offsetting substitution effect (decreased work on account of avoiding the tax by choosing leisure instead of work) so that the two distortions together might add up to less than either one separately.³² Since the substitution effect would be absent in an endowment tax, the effective distortion produced by the income effect would be bigger than in an income tax. An endowment tax would likely produce even more lawyers and bankers than does our current system. It is puzzling that economists treat a tax with such a strong income effect as a neutral baseline simply because it produces no deadweight loss, even though the overall distortions it can produce are so significant.

From a social policy perspective, the economists' approach is troubling. As this analysis of the income effect shows, choosing ability taxation over other taxes because it is more efficient privileges some distortions over others and interferes with social values apart from efficiency. In the economic approach, distorting the choice of one's occupation is considered less significant than distorting the labor/leisure choice. A comparison of taxes must consider both the degree and the nature of the distortions produced by each tax. The choice between income or consumption tax, on the one hand, and endowment tax, on the other, involves deciding which distortions to tolerate: more versus less work under an income or consumption tax, or occupation *A* versus occupation *B* under an endowment tax.³³

While economists may be most concerned with taxpayers changing their behavior to avoid tax, others may consider distortions that affect fundamental life decisions, like the choice of occupation, to be more important for evaluating justice in taxation. It is not necessary for the choice of occupation to be reduced to just one for the decision to be fundamentally distorted by the tax.³⁴ Comparing the labor/leisure

³² This is a well-known aspect of the theory of second best. See generally R.G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 *Rev. Econ. Stud.* 11 (1956).

³³ While an income tax also might affect the choice of occupation, the offsetting income and substitution effects would be part of that calculation, and the occupation chosen would affect the tax liability, so we might expect an endowment tax to be a much more significant factor in that decision.

³⁴ The debate on endowment taxation has taken the unfortunate turn of arguing about just how restrictive the endowment tax would be. See Liam Murphy & Thomas Nagel, *The Myth of Ownership: Taxes and Justice* 123 (2002) (arguing the problem with endowment taxation is not merely that it limits a person's career choices, but that it may leave them with only one career choice); Kirk J. Stark, *Enslaving the Beachcomber: Some Thoughts on the Liberty Objections to Endowment Taxation*, 18 *Can. J.L. & Jurisprudence* 47, 48-49

choice with the choice of occupation highlights the importance of the latter choice compared to the former. The choice of occupation is central to individual autonomy; it is something that individuals need to do to assert their personal identity. This is why the free choice of occupation is included in the Universal Declaration of Human Rights³⁵ and the European Union Constitution,³⁶ as well as the liberal egalitarian understanding of justice.³⁷ The choice of a little more or less work seems a smaller and less important distortion for the tax system to impose. From an individual autonomy perspective, the labor/leisure distortion is not very troubling. Thus, the “neutrality” in the efficiency of the endowment tax is a false one because it treads so heavily on one of the central decisions in a person’s life.

III. TAXATION AND EQUALITY: REFRAMING THE DEBATE IN PHILOSOPHICAL TERMS

Compared to economists, lawyers and legal theorists traditionally have not been enamored with endowment taxation. It is impractical—if not impossible—to collect tax based on something that cannot be observed, so it is not a tax capable of implementation. In addition, some legal scholars have been repelled by an ability tax because it challenges intuitive notions of liberty and autonomy.³⁸

Nevertheless, some legal thinkers have become increasingly drawn to the endowment tax ideal as a model for designing an actual tax system.³⁹ Unlike economists, who are drawn to endowment taxation on efficiency grounds, legal scholars have started to defend it on eq-

(2005) (refuting arguments that the limitations on personal autonomy are the same for an endowment tax and an earnings tax). My argument here (and below, see Part V) is equally compelling even if there is only one choice that is foreclosed.

³⁵ Universal Declaration of Human Rights, G.A. Res. 217 (III)A, U.N. Doc. A/Res/217(III), at 75 (Dec. 10, 1948).

³⁶ Treaty Establishing a Constitution for Europe art. 11-75, opened for signature Nov. 11, 2004, 2004 O.J. (C 310) 1 (rejected by France and Netherlands in 2005, unimplemented) (“Everyone has the right to engage in work and to pursue a freely chosen or accepted at occupation.”).

³⁷ John Rawls, Social Unity and Primary Goods, in *Collected Papers* 359, 366 (Samuel Freeman ed., 1999) (“[F]ree choice of occupation . . . [is] required for the pursuit of final ends as well as to give effect to a decision to revise and change them, if one so desires.”).

³⁸ See Mark G. Kelman, Personal Deductions Revisited: Why They Fit Poorly in an “Ideal” Income Tax and Why They Fit Worse in a Far from Ideal World, 31 *Stan. L. Rev.* 831, 841–44 (1979) (contending the fundamental flaw in an ability tax is that a tax system ought not to force people into the market).

³⁹ See, e.g., Shaviro, note 16, at 144 (arguing the endowment tax model helps clarify real-world tax policy debates and decisions); Stark, note 34, at 65-57 (using the endowment tax as a means to evaluate the current tax base and considering the earned income tax credit as a leisure tax); Zelenak, note 21, at 1172-81 (evaluating proposals to partially implement an endowment tax).

uity grounds.⁴⁰ For those who believe that the project of tax policy should be devising a just tax scheme, the search for an ideal measure of distributive justice is an important starting point in the search for a just tax. Serious consideration of taxation based on ability to earn is a positive development in the legal literature because it reflects a search for fundamental principles of fairness, and engages both economists and legal thinkers in a dialogue on issues of taxation that concern both groups. Even if everyone agrees that a tax is impractical and impossible to administer, it should still be examined if it embodies the ultimate measure of fairness in taxation. If it is the best ideal, then actual tax systems should be evaluated against it.

Taxation according to potential to earn is alluring to those concerned with distributional fairness because it imposes more tax on people with greater abilities than those with lesser abilities. Ability to earn must correlate with ability to pay tax; two people who earn the same income are not equally able to pay tax if one had to work much longer or harder than the other to earn the income. Those with greater abilities to earn have more choices and can choose leisure over work without giving up as much in material goods. This is the approach taken by Daniel Shaviro, who argued that taxation based on ability to earn should be embraced—with some reservations—by both utilitarians, who define fairness by maximizing social welfare,⁴¹ and liberal egalitarians, who define fairness with reference to protecting certain rights and liberties.⁴² He claimed that ability taxation captures the equality norm driving both the utilitarian and liberal egalitarian conceptions of fairness.⁴³ In this way, Shaviro follows one of the dominant approaches of contemporary political thought in interpreting diverse political theories as competing in their various interpretations of a shared equality norm.⁴⁴ Other legal scholars have supported ability taxation on fairness grounds as well, to a greater⁴⁵ or lesser⁴⁶ extent.

⁴⁰ See, e.g., Shaviro, note 16, at 125-32 (arguing endowment is the best underlying measure of inequality).

⁴¹ Murphy & Nagel, note 34, at 51.

⁴² Will Kymlicka, *Contemporary Political Philosophy: An Introduction* 50 (1990).

⁴³ Shaviro, note 16, at 143-44.

⁴⁴ See generally Kymlicka, note 42 (evaluating competing theories of a just society).

⁴⁵ Kirk Stark proceeded even further than Shaviro to argue that endowment taxation best implements the interpretation of liberty in liberal egalitarian political thought, making it an attractive ideal in those terms. Stark, note 34, at 65-66. He claims that liberal egalitarians have no principled difference with libertarians on the centrality of individual choice to justice, so that liberal egalitarians, like libertarians, must either reject all taxation as interference with rights as libertarians do, or must accept endowment taxation along with income and consumption taxation. *Id.* at 67-68. For a comparison of libertarian and liberal egalitarian approaches, see Section V.B.

⁴⁶ David Hasen, while rejecting endowment taxation for the purpose of redistributing resources, accepts it as a legitimate means of financing public goods under liberal social

This Article now turns more fully to engaging the equity arguments for endowment taxation. It argues that those who have embraced endowment taxation on liberal egalitarian grounds have misunderstood the demands of those political theories and the meaning of fairness that they embody. By undertaking a rigorous analysis of liberal egalitarian theories, this Article explains why endowment taxation fails to fulfill the equality norm that motivates liberal egalitarian thinkers. It explains that equality is not a matter of wage rates, as an endowment tax implies, but of designing institutions that guarantee equal concern and respect for everyone. Each individual is entitled to develop her own conception of a meaningful life. Political institutions, such as the tax system, must be part of that design.

On those terms, endowment taxation fails to deliver by denying both the highly endowed and the less endowed their due: The highly endowed are constrained in their ability to determine their life plans, while the poorly-endowed are the subject of societal pity and stripped of their self-respect. Allowing governments to define individuals in terms of their endowments adopts too spare a view of what a person is and therefore misunderstands why every person is entitled to equal respect and concern. An endowment tax elevates fate above free will, and returns our public institutions to the days of status over merit. It levels people down for equality. It reflects the antithesis of justice.

A. *Utilitarian, Libertarian, and Liberal Egalitarian Approaches to Equality in Taxation*

The current debate over justice in taxation reflects a tension between utilitarianism and deontological, nonconsequentialist political theories,⁴⁷ even though both approaches can be understood to strive for equality in taxation. Utilitarianism treats individuals equally by counting everyone's preferences the same. Liberal egalitarians treat individuals equally by requiring that institutions afford them equal respect and concern; nonconsequentialists are generally concerned with rights. A utilitarian tax system is one that contributes most to maximizing along a single dimension of outcomes. Utilitarians have had the upper hand in the tax policy literature for quite some time because their arguments sound in a combination of fairness and efficiency, and

contract theories. David Hasen, *Liberalism and Ability Taxation*, 85 *Tex. L. Rev.* 1057, 1061-62 (2007). Hasen is quite critical of the endowment tax, arguing that it generally fails the test of Pareto superiority underlying social contractarian political theory. *Id.* at 1098. But he employs a benefits taxation analysis to conclude that there are situations in which endowment taxation would be an acceptable liberal social institution. *Id.* at 1092-93.

⁴⁷ See Joseph Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles*, 58 *Tax L. Rev.* 399, 407-10 (2005) (comparing utilitarianism and deontological liberalism as theories of social justice).

resonate as specific and determinative. To the contrary, nonconsequentialist theories have had less influence in the literature because they are less likely to produce specific results.⁴⁸ A utilitarian tax scheme might resemble a system predicated on rights, but there is no intrinsic reason why it should. Failure to distinguish utilitarian, liberal egalitarian, and libertarian justifications from each other has produced significant confusion in the discussion of tax fairness. By explicitly grounding its analysis in political theory, this Article attempts to improve the clarity of the discussion.

Both utilitarian and deontological approaches can claim to offer standards for justice in taxation, and it is not the goal of this Article to convince readers that nonconsequentialist theories are more compelling than utilitarian ones. Instead, this Article parses nonconsequentialist theories in order to identify how they differ in their approach to just taxation, and to explain why the economist's ideal tax on ability to earn fails to carry out the ideals of any of the leading theories. It distinguishes the libertarian approach of Robert Nozick from other nonconsequentialist theories to argue that Nozick's objections to all taxation differ fundamentally from the objections that John Rawls and Ronald Dworkin would have to endowment taxation in particular. It also distinguishes the conceptions of distributive justice espoused by Rawls and Dworkin because different ideas that have shared the "liberal egalitarian" label in the tax policy literature require different analyses of the endowment tax ideal. Before delving into the specific critiques, it may be helpful to review where the debate on the justice of ability taxation has been.

The seeds of the contemporary debate on ability taxation were planted in the legal literature by Mark Kelman in 1979, who argued that justice required that a distinction be made between market and nonmarket production.⁴⁹ He offered a theory of implied consent in which the decision to go into the market and earn money represents consent to taxation by the state, but that private nonmarket production should be beyond the reach of taxation.⁵⁰ Although his central concern was crafting a normative justification for deducting charitable contributions and medical expenses in an income tax,⁵¹ his approach also forecloses an endowment tax because it taxes nonmarket benefits.⁵²

⁴⁸ See Repetti, note 11, at 1130-31 (noting that part of the difficulty in comparing efficiency and equity benefits is because of the difficulty in measuring equity benefits).

⁴⁹ Kelman, note 38, at 840-42.

⁵⁰ *Id.* at 842.

⁵¹ *Id.* at 831-34.

⁵² *Id.* at 842-44.

Shaviro explicitly rejects Kelman's framework distinguishing market and nonmarket production.⁵³ Considering endowment taxation more directly than Kelman did, Shaviro explores the fundamental distributional concern underlying the choice of tax base.⁵⁴ Where his framework is utilitarian, his intuition is that tax bases are attempting to differentiate levels of welfare. He considers what makes one person better off than another, and concludes that individuals with higher wage rates are categorically better off than those with lower wage rates because a person with a higher wage rate has more choices.⁵⁵ This is so no matter what each actually earns because if a high-wage individual chooses leisure over work, it must be because he values the leisure more than the money he would earn from choosing to work.⁵⁶

Shaviro argues that a system with a goal of taxing those who are better off more heavily than those who are less well-off should be concerned with wage rates rather than actual wages.⁵⁷ This reasoning treats wage rate as a good proxy for utility because it defines the limits of a person's ability to choose, which translates to his welfare. A lesser-endowed individual has fewer choices and is therefore not so well-off. Shaviro argues that a tax on earnings is precisely the wrong solution in a world with unequal wage rates because a person with a higher wage rate but lower earnings is better off than someone with a lower wage rate and higher earnings on account of the welfare-maximizing choices they are presumed to make.⁵⁸ An income tax increases that inequality by taxing the worse-off person more than the person with greater welfare and less cash.⁵⁹ Thus, an income tax is unjust on these terms. Shaviro tempers his enthusiasm for endowment taxation in his utilitarian analysis by considering varying levels of work aversion⁶⁰ and "'lumpy' labor market[s]."⁶¹ On account of these complications to the basic model, Shaviro ultimately concludes that there is no clear utilitarian justification for an endowment tax.⁶²

⁵³ Shaviro, note 16, at 133-34.

⁵⁴ *Id.* at 124.

⁵⁵ *Id.* at 127-31. Differences in taste are not relevant for distributional consequences. *Id.* at 123.

⁵⁶ *Id.* at 130-31.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.* at 137. A more recent contribution to the endowment tax debate treats the differences in utility associated with labor effort as particularly important. See Zelenak, note 21, at 1165-69.

⁶¹ Shaviro, note 16, at 137-38.

⁶² *Id.* at 139-40. Even though endowment might provide a good measure of inequality, he concludes that taxing it may not be the best way to achieve a welfarist distributional policy because translating endowment into welfare in the real world is trickier than in the ideal. *Id.*

Turning from utilitarianism, Shaviro argues that an ability tax should appeal to nonconsequentialists.⁶³ He suggests that the liberal egalitarian case for endowment taxation is stronger than the utilitarian case because liberal egalitarians place value on allowing people to choose what they want, for its own sake, rather than as an instrument for achieving something else.⁶⁴ Endowment distinguishes a person's circumstances from his choices,⁶⁵ and liberal egalitarians are "not concerned with the welfare content of outcomes," but rather with their entitlement to resources or opportunities, for which endowment is a good measure.⁶⁶ Thus, high-endowment individuals are better off because they have more opportunities than individuals with lower endowments. Thus, Shaviro's liberal egalitarian analysis is structured in utilitarian terms.

Stark makes a more radical claim than does Shaviro about deontological theories and endowment taxation. He compares liberal egalitarian objections to endowment taxation with libertarian objections, explaining that his project is to question whether liberal egalitarian "opponents of endowment taxation can distinguish their liberty objections from Nozick's claim that taxation of earnings is on a par with forced labor."⁶⁷ He concludes that they cannot—that liberal egalitarians either must accept Nozick's liberty objections to all forms of taxation, or concede that there are none.⁶⁸ The line that liberal egalitarians draw between endowment taxation on one side and income and consumption taxes on the other is unprincipled. He argues that "by offering greater liberty protection to [nonmarket activities], the liberal egalitarian is assigning greater moral worth to those activities" which is inconsistent with "the liberal commitment to neutrality among alternative visions of the good life."⁶⁹ For Stark, the market is a value-neutral, apolitical baseline, and nonmarket activities are valued at the opportunity cost of wage work. Like Shaviro, Stark focuses on the importance of individual choice within the liberal egalitarian framework. And like Shaviro, Stark misunderstands the liberal egalitarian project and its lessons for fair taxation.

⁶³ *Id.* at 142-43.

⁶⁴ *Id.* at 141-42.

⁶⁵ *Id.* at 140-41. There is a substantial philosophical literature exploring this question. See, e.g., Eric Rakowski, *Equal Justice* (1991); Ronald Dworkin, *What Is Equality? Part 2: Equality of Resources*, 10 *Phil. & Pub. Aff.* 283 (1981). Some commentators do not believe that the dichotomy is a useful way to think about distributive justice. See notes 137-41 and accompanying text.

⁶⁶ Shaviro, note 16, at 140.

⁶⁷ Stark, note 34, at 49.

⁶⁸ *Id.*

⁶⁹ *Id.* at 65.

In their survey of the issues of justice raised by taxation, Liam Murphy and Thomas Nagel rejected endowment taxation as too much interference with individual autonomy, though not a unique type of interference.⁷⁰ They identified autonomy concerns with both endowment taxation and income taxation, but concluded that the intrusion on autonomy in income taxation was small enough to balance acceptably against the need to fund the state. They were concerned that an endowment tax may leave a person with only one choice in life.⁷¹ The function of autonomy in the political theories with which Murphy and Nagel were concerned is to foster moral agency. In promoting moral agency, it is important to guarantee individual self-respect⁷² and allow that “the principles of [a person’s] action are chosen by him as the most adequate possible expression of his nature as a free and equal rational being.”⁷³ Autonomy is a part of freedom understood as the moral power to have a conception of the good and the power to change that conception.⁷⁴ Contrary to the premise underlying endowment taxation, in which you are defined by your endowment, autonomy means “freedom from the determination of our choices by ‘natural contingencies and social accident.’”⁷⁵ It does not require equalizing potential across individuals.

B. *Let the Beachcomber Drown*

The discussion about endowment taxation has taken an unfortunate turn by focusing on beachcombers, a paradigm that implicitly rejects the central project of liberal egalitarian political theory—how to allocate the benefits and burdens of social cooperation.⁷⁶ The beach-

⁷⁰ Murphy & Nagel, note 34, at 122–25.

⁷¹ *Id.* at 123.

⁷² Rawls states that the most important primary good is self-respect. “[I]t includes a person’s sense of his own value, his secure conviction that his conception of his good, his plan of life, is worth carrying out.” John Rawls, *A Theory of Justice* 440 (1971).

⁷³ *Id.* at 252.

⁷⁴ John Rawls, *Political Liberalism* 30 (1993).

⁷⁵ Robert S. Taylor, *Rawls’s Defense of the Priority of Liberty: A Kantian Reconstruction*, 31 *Phil. & Pub. Aff.* 246, 256 (2003).

⁷⁶ I have heard the following hypothetical raised by those who would accept an endowment tax: If there are two people in a society and one is incapable of productive work, while the other is disinclined to work, is it just to tax the lazy one on his endowment to prevent them both from starving? It is a curious hypothetical that asks whether the state (Is that what it is in a two-person society?) can compel its citizens to work at all, under any circumstances. But it does not seem quite to fit the issues presented by an endowment tax, and it fails to challenge the Rawlsian rejection of endowment taxation because it is beyond the scope of Rawls’ analysis. Rawls explains that basic needs must be fulfilled before the first principle is even applied—the priority of liberty assumes that people can enter into society. Rawls, note 37, at 365. “[T]he Priority of Liberty would be meaningless in a society that could not even establish the basic liberties themselves due to social and economic conditions.” Taylor, note 75, at 263. He explains, “we start by assuming that citizens are

comber opts out of the cooperative project, and the beachcomber paradigm accepts the notion of atomistic individuals, rather than interrelated social functioning.⁷⁷ Beachcombers who have truly opted out of civilized society are too scarce to care about. And even if they were more common, why should they be relevant to the question of society's ordering, given that they are not part of it?⁷⁸ The beachcomber paradigm suggests that resources are plentiful enough and available in a way that starvation is not a problem, even for those who choose not to participate in society. The interesting question about the beachcomber is not whether he should be obligated to contribute anything to society, as an endowment tax would require, but whether society has any obligation to prevent him from starving if he does not. Taxation has nothing to say about the latter question, and social contract theories generally do not extend beyond the bounds of society. Remaining a participant in society distinguishes the potential taxpayer from the beachcomber. Volunteers, homemakers,⁷⁹ and low-wage workers, because of their contributions to the social product, are entitled to more from society than the beachcomber who contributes nothing.

The focus on beachcombers has distracted us from fundamental questions of economic and political justice that ability taxation ought to raise, such as whether value in society is properly measured by reference to market rates on labor and how nonmarket labor (or below-market labor) is counted in dividing the benefits and burdens of social cooperation.⁸⁰ Whereas the beachcomber forsakes the market and produces nothing, many people are productive outside the market or not fully compensated within it. Liberal egalitarians are more likely than utilitarians or libertarians to reject market price as a reliable measure for the benefits of social cooperation.

We must choose a paradigm that better considers what individuals in a community owe each other and what the sovereign owes all individuals. Productive work—even if not well-paying—is an important

free and equal moral persons who can contribute to, and honor the constraints of, social cooperation for the mutual benefit of all.” Rawls, note 37, at 365. This means that Rawls is not talking about the society of two people in which only one of them is able to work and both depend on him to prevent starvation. He is concerned with fair terms of cooperation among people in society.

⁷⁷ See Elizabeth S. Anderson, *What Is the Point of Equality?*, 109 *Ethics* 287, 321 (1999).

⁷⁸ Part of the definition of a well-ordered society for Rawls is one in which “[t]he scheme of basic institutions is a more or less self-sufficient and productive scheme of social cooperation for mutual good.” John Rawls, *Reply to Alexander and Musgrave*, in *Collected Papers*, note 37, at 232, 234.

⁷⁹ Homemakers are an important paradigm for Shaviro and for me. See Shaviro, note 16, at 138-39; Sections III.C, V.D.

⁸⁰ See Section III.D.

element of the social contract and a reasonable condition for citizenship. From that perspective, the better paradigm is the low-wage worker, homemaker, or volunteer. Requiring every individual to make some contribution to the social project is a far cry from the conclusion that such contribution should be based on an individual's ability to earn income within the given structures of the society. It is not necessary to impose tax based on endowment to make productive cooperation a necessary requirement for social entitlements.

C. Unpacking the Strands of Taxing Leisure: Below-Market Work, Nonmarket Work, and Pure Recreation

An endowment tax is more efficient than an income tax or a consumption tax because it taxes leisure, which neither of the other bases reaches. An endowment tax taxes leisure because in addition to actual income, it includes the excess of ability to earn over actual earnings. The assumption behind including everything in this undifferentiated category of leisure is that all activities that fail to produce one's maximum wage rate provide equivalent levels of well-being. Thus, unpaid housework is measured at full endowment rates, whether it consists of reading to one's children or washing the floors, regardless of the recreational pleasure or social benefits of the activity. Low-paid work that is measured at partial endowment rates imagines that the down-and-out CEO gets almost as much leisure from working in the mailroom as he does playing golf all day. This definition of leisure would not only be unrecognizable to most people, but it also aggregates different things that might be better separated in thinking about a just tax system.

The label "leisure," which is standard in both the legal and economic tax literature, implies that the difference between actual earnings and potential earnings is (1) nonproductive, (2) self-regarding, and (3) chosen. Each of these implications is questionable. If the failure to earn one's maximum wage rate is not all three of these things, then the endowment tax may measure ability in an arbitrary way. A tax system trying to reach self-regarding leisure only should be concerned with whether the difference between actual wage and potential wage is in the nature of production or consumption. Productive activities outside the market are important in determining how individuals participate in social cooperation, and some activities might appropriately substitute for tax paid in money. Unpacking the meaning of the leisure that enters the tax base in an endowment tax sheds doubt on whether inequality is appropriately measured by differences in wage rates.

The excess of wage rate over actual wage includes a much broader variety of activities than pure recreation. When people are not working for their maximum possible market wage or enjoying pure recreation, they may be engaged in non-wage-maximizing work or unpaid work that is productive, though not remunerated. These two categories in the spectrum between wage-maximizing work and pure recreation need separate attention in the tax debate. An endowment tax treats all these iterations of leisure the same, and taxes them all. But those most concerned with fairness in taxation would distinguish these different categories, and anyone interested in moral agency would be particularly solicitous of the nonmarket activities that express a person's individuality.

D. Productivity Cannot Be Measured in Market Valuation

There is a normative bias in favor of market work contained in the definition of leisure taken for granted in the tax policy literature. By collapsing nonmarket productivity and low-paid work performed by high-endowment individuals into leisure, the labor/leisure distinction undervalues nonmarket labor and all work that fails to garner an individual's maximum wage. Leisure, defined as any non-wage-maximizing work, is a meaningless category in the design of a fair tax since not all leisure is equal.

Underlying the attraction of an endowment tax is an intuition that favors productivity, but productivity does not always entail maximum market wage activity. Taxing ability to earn implies that the market is a neutral baseline because the tax system accepts the measure of potential earnings by reference to the value that markets create. But to really capture leisure in its more nuanced form, an endowment tax must distinguish between productivity and consumption without accepting the correctness of market valuation. There are activities that take place outside the market that produce social value, but a tax that lumps all non-wage-maximizing activities into the leisure category fails to account for them. A tax that considers a mediocre lawyer's wage rate to be the highest and best use of a great sculptor's endowment presumes that sculpting is in the nature of leisure for him. The sculptor's talent may not ever be reflected in his wage rate but that does not transform his work into recreation.

Stark argued that the tax system assigns greater "moral worth" to nonmarket activities if it does not treat the choice to earn money and the choice to create art as equal commodity choices.⁸¹ But taxing them the same—when one produces money that may exceed any in-

⁸¹ Stark, note 34, at 65.

trinsic value (and vice versa)—assigns greater moral worth to highly-compensated market activities. The argument for taxing them the same institutionalizes the moral capacity of the market by allowing those who enter markets to retain greater after-tax rewards.

Taxation is crucial in determining what is valued in society—it does not just reflect value that is otherwise fixed outside of it.⁸² The relationship of taxation and justice is dynamic in the sense that a just tax must vary along a dimension that measures inequality, but choosing that dimension legitimizes it as a measure of value in society. Ability to earn is attractive as a measure because it speaks to undeserved or accidental advantages that allow some individuals to reap rewards unavailable to others. But the consequence of using taxation to correct for differences in abilities to earn reinforces market-based earnings as an accurate indication of social contribution. Any tax that accepts wage rate as the measure of a person's worth adopts a limited view of the value of individuals.

Taxing based on ability to earn also has a highly-gendered implication, given the fact that women are more likely to compromise their wage work for family production. The homemaker is unlikely to be maximizing leisure (as recreation) as opposed to productivity (as work) when she invests her time in her children. A narrow focus that only validates wage-rate productivity ignores how diverse applied endowments otherwise affect society. Many activities—including activities characterized both as work and as leisure—have social values that are not reflected in the wages they command in the market. The market does not value many things that are important to society. By looking only at a person's potential to earn income, an endowment tax takes too narrow a view of being a person and institutionalizes the market as the prime mechanism for determining that value.

In requiring full recognition of social value, it becomes clear why beachcombers, who produce nothing, are irrelevant to the justice of the tax system. But the homemaker and the relief worker produce something important that should count in determining obligation for society's support. A fair tax should give credit for citizenship obligations paid in the form of social productivity, particularly if that work is paid poorly. It is a mistake to argue that such credit would privilege relief workers and homemakers compared to their wage-maximizing neighbors. Instead, that credit would be a societal acknowledgement that the discount they accept from their maximum wage rate is a valuable social contribution. It would also, as importantly, reject the valuation of markets as the measure of social worth. A tax on ability to

⁸² See, e.g., Nancy C. Staudt, *Taxing Housework*, 84 *Geo. L.J.* 1571 (1996) (arguing that the failure to tax housework devalues that work).

earn gets that calculation backwards by imposing a greater real sacrifice on those who have already contributed in kind to the social product.

Once we recognize the problem of assigning moral content to the wage-rate baseline, the more difficult task of determining value without that reference is imperative. Unfortunately, it is much easier to seize on a market price than to quantify intrinsic value. But that is no excuse for ignoring the fact that some people contribute their fair share to society despite small tax payments. Proponents of equality in taxation must consider how best to incorporate the complexities of measuring valuation and productivity into the standard analyses of ability to pay and equal sacrifice.⁸³ Relying on market wage rates and taxing abilities to earn according to them is too thin a conception of distributive justice.

E. It Matters that Taxes Need to Be Paid in Money

In addition to the valuation challenge, another problem with enriching the conception of social contribution and obligation beyond market measures is that taxes are collected in money. All taxes, but an endowment tax especially, discourage productive nonmarket work and low-paying market work because the tax must be paid in money. This is the reason why some have worried that an endowment tax would enslave the able.⁸⁴ It is a problem for those concerned with fair taxation, but the objection is not properly understood as slavery of the talented. Rather, because taxes must be paid in money, a tax that is due without regard to activities that involve money forces individuals to engage in money-producing endeavors,⁸⁵ which may conflict with core fairness concerns.

A central tenet of liberal egalitarian political theories is that the state may not dictate the individual's life plan.⁸⁶ Each individual is entitled to develop her own conception of what makes life worthwhile.

⁸³ Can the optimal tax model accommodate that demand? I leave it to the economists to work on the math.

⁸⁴ See, e.g., Eric Rakowski, *Can Wealth Taxes Be Justified?*, 53 *Tax L. Rev.* 263, 267 n.10 (2000) (arguing that taxing a person on their talents would "effectively enslave the able, by forcing them to put their highly taxed talents to some lucrative employ, on pain of sitting in a debtors' prison, however unpalatable the person found richly compensated work").

⁸⁵ Kelman, note 38, at 841-42. This concern is what prompted Kelman to start this debate by distinguishing income taxes from endowment taxes and distinguishing activities that take place in the market from those that take place outside of it. The liberal egalitarian objection to endowment taxation should be understood as more specific than Kelman's market/nonmarket dichotomy.

⁸⁶ See *id.* at 842 (an endowment tax would "violate the simple libertarian principle that the state should not require people, directly or indirectly, to engage in particular activities").

An endowment tax is a problem under that approach only where an individual's idea of a meaningful life conflicts with the need to monetize productivity in order to pay tax. For some people, market work may conflict with an their idea of a meaningful life.

To test the nature of the philosophical objection to ability taxation, imagine that the tax did not need to be paid in money. If we could remove the bias in favor of market work by allowing individuals to pay the tax with productive nonmarket work, then individuals ministering to the poor could satisfy their obligations to the community by engaging in their good works, and there would be no constraint on the decision to work without pay. In that case, liberal egalitarians might be more comfortable with endowment taxation because the determination of what makes life meaningful is what they are intent on protecting.⁸⁷ The reason that endowment taxation is problematic is because it forces the individual to come up with the money to pay the tax, even if it prevents him from living the only meaningful life he would otherwise choose. From this perspective, the endowment tax does not need to enslave the talented to be repugnant. It only needs to foreclose—for any individual—the possibility of living a meaningful life.

This objection to ability taxation paid in money does not challenge a requirement of social contribution, or taxation more generally. Justice in taxation is about what society legitimately demands from individuals who are part of it, and institutions of taxation and social obligations within communities are consistent with just government.⁸⁸ An endowment tax is unacceptable because it may prevent an individual's life plan, not because it imposes a social obligation. Many people who do not earn enough money to pay an endowment tax or who earn sufficiently little to be forced to change their occupation on account of the tax, could easily satisfy an in kind obligation to the community. The volunteer and relief worker would each be likely to qualify. The in kind contribution of services might even exceed the money tax that would have been levied based on ability to earn. The only person for whom such a service-in-lieu-of-taxes regime would be intractable is the beachcomber, or another individual like him with high endowment and no productivity either within or outside the market.⁸⁹

⁸⁷ See notes 71-75 and accompanying text.

⁸⁸ Marjorie Kornhauser has argued specifically for progressive taxation on communitarian terms. See Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 Mich. L. Rev. 465, 522 (1987) (“The progressive income tax is a good way to reaffirm our nation’s sense of community against the pulls of individuality.”).

⁸⁹ But liberal egalitarians should not really care. See Section III.B.

Showing equal concern and respect for each person in determining her own life plans requires that the state refrain from forcing individuals into the market because nonmarket activities—such as volunteering and childcare—are often more integral to an individual's sense of self than are the market activities in which they engage. A bias in favor of nonmarket production over market work is more consistent with liberal egalitarian concerns than the opposite because of the personal autonomy importance of many nonmarket activities.

This thought experiment—paying the tax in productive work, rather than money—creates a host of questions that we avoid by requiring that the tax be paid in money. If we allow productive work benefiting the community to substitute for money paid to the state, we need to decide what work qualifies as socially valuable enough to satisfy a person's obligation. We might quibble over the value of that work, and also over how much of the value should be treated as social value. Homemakers, for example, produce both personal consumption for their families and value for the community. While their activities certainly constitute work as opposed to recreation, that determination is not the end of the inquiry that the thought experiment would require in practice.⁹⁰ Nevertheless, the point of the experiment is to flesh out the nature of the fairness objections to endowment taxation; it is not to advocate adoption of such a tax. Accounting for nonmarket productivity challenges us first, to separate production from recreation and then, to place a value on the productivity. Both of these tasks are difficult, but necessary if we are serious about defining the extent to which individuals fail to “work” up to their ability, as an endowment tax requires. By exploring the implications of the Mirrlees ideal,⁹¹ its flaws become more apparent.

The tax-in-production paradigm should remain a thought experiment because there are good reasons for making taxation depend on money. Government needs money, regardless of anything else it collects from its people. Taxation in money allows some internal tax norms to operate consistently and independent of the full complement of political and social institutions.⁹² Rawls wrote that “[i]ncome and wealth, understood broadly as they must be, are all-purpose means (having an exchange value) for achieving directly or indirectly a wide range of ends, whatever they happen to be.”⁹³ This may be why it is equitable to treat money as the measure for redistribution through

⁹⁰ For an in-depth discussion of the issues implicated by a tax on household labor, see Staudt, note 82.

⁹¹ See notes 5-10 and accompanying text.

⁹² See Dodge, note 47, at 450–61.

⁹³ Rawls, note 37, at 366.

taxation: Its redistribution preserves the individual agency that societies must guarantee.

One of Kelman's arguments for rejecting endowment taxation was that the tax system does not try to measure satisfaction or utility—it is about the money.⁹⁴ A tax system that differentiates between activities that produce money and those that do not may appropriately reflect the limitations inherent in any system of taxation. Nevertheless, a tax paid in money does not have to justify the moral status of the market. In designing institutions of taxation, it may be necessary to look narrowly for money, but without elevating it above all other arbiters of social value.

IV. THE PRACTICAL AND THEORETICAL PROBLEMS IN TAXING ABILITY ARE INSEPARABLE

A. *The Definition of Endowment Is Unstable*

Recall Mirrlees' first assumption: Earning potential is what we would ideally tax.⁹⁵ Embedded in that assumption is an additional assumption: Earning potential means something. This Section argues that earning potential is an incoherent ideal. It is unstable because any individual's ability is simultaneously dynamic and socially constructed. Consequently, it is not possible to bracket the practical problems of implementing an ability tax and analyze it on fairness grounds.

Exploration of the endowment tax ideal requires development of a definition of "endowment," even if its impracticality dispenses with the need to measure it. Those drawn to ability taxation have put aside the insurmountable practical problems to focus on the theoretical ideal, and have distilled the concept of ability to earn to something measurable, that is, wage rate.

Consider the definition that Shaviro offers:

[Endowment] merely describe[s] some aspect of the available interactions between individuals and the world in which they find themselves. Intellect may be a part of ability, along with sound judgment, self-discipline, and the other aspects of what has been dubbed "emotional intelligence." The same, however, may go for good looks, parental influence, possessing a white skin if customers are racists, having profitable

⁹⁴ Kelman, note 38, at 839.

⁹⁵ See note 9 and accompanying text.

bad taste as an artist or performer, and the capacity for fraud or violence.⁹⁶

This description of endowment shows it to be highly contextual and fluid. Endowment depends on fixed inherited traits, cultivation of natural talents, and the changing market in which a person functions; it depends on both actions taken by individuals and effects on them that are outside their individual control, but subject to the political will of the community. It is explicitly dependent on the market's inputs. While personal choices and cultural effects may be relevant for justice in taxation, those factors conflict with the reasons why ability taxation is attractive in the first place.

Recall that an endowment tax is appealing to economists because it is free of substitution effects.⁹⁷ But if ability is fluid and changes over time as people make choices and market forces and cultural norms shift, then the tax creates deadweight loss, and its attractiveness wanes. Recalibrating endowment on a periodic basis means that people can affect their future tax liability by failing to educate themselves or by neglecting to develop their talents, creating social costs that lump sum taxes are designed to avoid. An efficient ability tax cannot contend with a dynamic endowment.

From the perspective of fairness, the instability of endowment is also troubling. An endowment tax resonates from a fairness perspective because it recognizes that some individuals start with natural and social advantages that others lack, and those advantages offend notions of equality. A tax based on ability to earn seems tempting because it separates choices from circumstances, allowing individuals to keep the rewards of hard work, but not of lucky breaks. Once endowment is allowed to be fluid, there is no separation between choices and circumstances—they are in a dynamic relationship that prevents theoretical identification of endowment as a separable measure. The only way for endowment taxation to be free of distortion is for endowment to be fixed.

The problem with ability is not merely that we lack the tools to measure it, but that it is not measurable, even as a theoretical matter. Rawls observed that “potential earnings capacity is not something independent from the social forms and the particular contingencies over the course of life.”⁹⁸ A person's endowment changes as she makes choices that enlarge or constrict her subsequent opportunities, and as

⁹⁶ Shaviro, note 16, at 131 (citation omitted).

⁹⁷ See notes 18-23 and accompanying text.

⁹⁸ Rawls, note 37, at 253.

circumstances around her change. It can never be reduced to a single line on a graph, as its proponents contend.⁹⁹

The frozen ideal of a fixed and measurable endowment takes a static, *ex ante* approach to justice that undermines the vibrant nature of being a person. If society is to respect individual agency, then ability must be allowed to change over time. But for endowment taxation to be an attractive ideal from the perspective of either efficiency or fairness, ability to earn must be both determinable and prepolitical. Because it is neither of those things, it fails as a theoretical, as well as a practical ideal.

B. Luck Matters in Turning Ability into Earnings

There is a gap between one's ability to earn and one's actual earnings that needs to be understood in a just tax system. A tax on potential earnings presumes that those earning less than they are able to earn are slacking off or underperforming. But ability is inseparable from luck, which plays an important role both in determining a person's natural endowments and in influencing how they develop. A person with high ability, but mediocre earnings may be unlucky rather than lazy, particularly in societies where prizes are scarce and many eligible individuals are competing for them. In winner-take-all markets,¹⁰⁰ which the United States has increasingly become, there are only a limited number of big prizes available (like major-league sports contracts and movie-star roles, but also law-firm partnerships and CEO positions) and many qualified people striving for them. The ultimate winners are likely to have profited from a significant dose of good luck in addition to high potential. They need talent and drive, which are presumably included in measuring their endowment. But winner-take-all markets, by definition, imply that there are many people who share the potential for such returns, even though only a few actually achieve them. In such a system, we should be wary about connecting tax burdens to potential returns, since reaching one's potential is highly contingent on factors other than personal choice.

Over time, luck can change. This is another way that endowment is dynamic. Most simply, a highly-endowed person will be more success-

⁹⁹ See Shaviro, note 16, at 130 fig.5.2.

¹⁰⁰ See generally Robert H. Frank & Phillip J. Cook, *The Winner-Take-All Society: How More and More Americans Compete for Ever Fewer and Bigger Prizes, Encouraging Economic Waste, Income Inequality, and an Impoverished Cultural Life* (1995). The tax literature has been intrigued by the implications of winner-take-all markets for tax policy. See Neil H. Buchanan, *The Case Against Income Averaging*, 25 *Va. Tax Rev.* 1151, 1214–16 (2006) (noting that the winner-take-all theory suggests progressive taxation); McMahon & Abreu, note 28, at 3–11 (providing data supporting the growth of the winner-take-all phenomenon and suggesting that it favors progressive taxation).

ful if he is in the right place at the right time, or if he is lucky enough to have a quality that is in style at a particular moment. An aptitude for numbers may have been very valuable before computers became ubiquitous. In a more complex way, every choice made in the past by an individual affects all the available choices that succeed it; there is no going back to the precise choices that an individual previously failed to make. While people can always change their lives, it is foolhardy to believe that all doors remain open forever. At some point in every person's life, potential to earn and actual earnings are likely to converge. The sum of past choices determine future opportunities.

In addition to the problem of taxing high-ability, low-earning individuals excessive amounts, an ability tax is troubling at the other extreme. Some lucky people earn vastly more money than their endowments would reasonably allow them to expect. If endowment is tied to human capital, then windfalls unrelated to wages seem to be beyond the scope of an endowment tax. Consider the pop star with only mediocre talent, or the lottery winner who reasonably should have expected to lose. Do these winners get a windfall under an endowment tax that allows them to keep their outsized gains free of tax since they exceeded their potential? That seems even more perverse than taxing those who fall short of theirs. In defining endowment, is it even possible for a person to succeed beyond her endowment, or does the concept of endowment define the maximum possible earnings, no matter how unlikely? Recent research suggests that hard work and practice is more important in creating success than is inherent ability, and that "the trait we commonly call talent is highly overrated."¹⁰¹ Given that, it is hard to argue that society's ultimate measure of inequality should be so dependent on it.

These many questions show that the practical problems of measurement are not the major barrier in using ability as the tax base. Either endowment is a moving target that makes taxing it subject to the same criticisms directed at income and consumption taxes, or it is limited in a way that fails to reflect important differences among individuals and across lifetimes. Recognizing that endowment changes over time is attractive from the perspective of fair taxation because it reflects the real opportunity costs of a given course of action, but it also makes endowment partly a product of individual choice, which is problematic from the perspective of efficient taxation. If individual potential is understood to be culturally created and culturally specific, a person's

¹⁰¹ Stephen J. Dubner & Steven D. Levitt, *A Star Is Made: Where Does Talent Really Come From?*, *N.Y. Times Mag.*, May 7, 2006, at 24 (discussing *The Cambridge Handbook of Expertise and Expert Performance* (K. Anders Ericsson, Neil Charness, Paul J. Feltovich & Robert R. Hoffman eds., 2006)).

endowment depends on the values of a particular society at a particular moment and can change many times over the course of a single life. In order to be an attractive ideal, endowment must overcome this problem of theoretical indetermination.

V. EQUALITY, LIBERTY, AND PROPERTY: WHY LIBERTARIANS AND LIBERAL EGALITARIANS DIFFER ON TAXATION

A. *Equality Is About Institutions, Not Wage Rates*

Liberal egalitarians are concerned with the relationship of individuals to one another in society, and with the structure of society. Equality is a matter of guaranteeing equal respect for each person in the design of social institutions.¹⁰² This Section explains why endowment taxation fails to satisfy the demands of equality understood in this way. Because liberal egalitarians reject the reduction of the individual to a one-dimensional measure, a fair tax cannot be based on any single isolated variable. If a person's relationship with the state depends on his endowment, there is no social significance to what he makes of his life. An ability tax defines people by their endowments, and thereby makes individual reason and agency irrelevant because the social consequences to individuals do not depend on their choices at all.

Although liberal egalitarians disagree about the precise content of equality, inequality in wage rate clearly fails to capture their concern that government respect all individuals equally. Rawls wrote: "That [people] are equal is expressed by the supposition that they each have, and view themselves as having, a right to equal respect and consideration in determining the principles by which the basic arrangements of their society are to be regulated."¹⁰³ Equality therefore can be understood as a guarantee of citizenship. People are entitled to make claims on their institutions in advancing their conception of the good.¹⁰⁴ The fairness objections to endowment taxation derive from this understanding of equality. Endowment taxation is inconsistent with treating people as equal moral agents because their agency is ignored by its design; in its indifference to choice it forecloses certain choices.

¹⁰² Anderson, note 77, at 289 ("[T]he most fundamental test any egalitarian theory must meet [is] that its principles express equal respect and concern for all citizens.").

¹⁰³ John Rawls, A Kantian Conception of Equality, in *Collected Papers*, note 37, at 254, 255.

¹⁰⁴ Rawls, note 74, at 32.

B. The Meaning of Liberty Differs for Libertarians and Egalitarians

The liberal egalitarian objections to endowment taxation have unfortunately been described as “liberty” objections, creating confusion among the libertarian and liberal egalitarian concerns. Unlike utilitarians, libertarians and liberal egalitarians value individual freedom for its own sake. Their conceptions of that freedom, however, are significantly different from one another, and those differences explain why libertarians are skeptical of all taxation, while liberal egalitarians are generally accepting of taxation, but consider ability taxation unacceptable.¹⁰⁵

Libertarians are opposed to endowment taxation, but not because it particularly troubles them; all taxation is akin to slavery for libertarians because they assign to individuals absolute property rights in all human production. Robert Nozick argues that taxation makes the state a “part owner” of individuals, giving it a “property right” in people.¹⁰⁶ That perspective rejects all forms of taxation, regardless of tax base. It arises from the libertarian notion of liberty as a negative guarantee, consistent with an atomistic approach to the individual. To the contrary, liberal egalitarians do not understand liberty as derivative of property rights in people, so the libertarian approach to liberty cannot be transferred into a liberal egalitarian framework. Rather, liberties are prior to property rights, clearly distinguishing them from the libertarian’s “liberty,” which is defined in terms of prepolitical property rights.

Rawls treats “liberties” as a set of values that rejects the preeminence of a single merit like property. He explains that “no priority is assigned to liberty as such, as if the exercise of something called ‘liberty’ had a preeminent value and were the main, if not the sole, end of political and social justice.”¹⁰⁷ There is “no special priority for any particular liberty.”¹⁰⁸ Thus, Rawls presents a set of liberties, all of which are to be maximized for everyone, unlike Nozick’s liberty, which is singular and exclusive. In addition, in a Rawlsian conception, not all liberties are basic, so not all liberties are deserving of the same high level of respect (the freedom to contract, for example).¹⁰⁹ It is consequently a mistake to equate the liberty that libertarians define in terms of absolute property rights with the liberties that liberal egal-

¹⁰⁵ This may explain why Stark seizes upon libertarian concepts in analyzing the liberal objections to an endowment tax. See Stark, note 34, at 49.

¹⁰⁶ Robert Nozick, *Anarchy, State, and Utopia* 172 (1974) (emphasis omitted).

¹⁰⁷ John Rawls, *Justice as Fairness: A Restatement* 44 (Erin Kelly ed., 2001).

¹⁰⁸ *Id.*

¹⁰⁹ Rawls, note 103, at 260.

itarians value. The latter derive from the guarantee of equal respect for each person to choose her own life within the social context that includes others doing the same thing. Under a liberal egalitarian framework, liberty objections to endowment taxation must arise out of the set of liberties and cannot be based on an understanding of liberty as absolute and prepolitical ownership of one's person.

Not all taxation is an intrusion on liberty because taxation is one of the institutions that is necessary in order for individuals to exercise their freedom. Taxation allows the state to exist, so it is one component of a just society, even though its particular design is not mandated. In specifically discussing endowment taxation, Rawls wrote:

I had mentioned that there is [a nonpractical] difficulty [with endowment taxation], namely, the interference with liberty. By that I meant, although I did not explain, interference with the basic liberties To influence by taxation the trade-off between leisure and income, say, is not an interference with liberty until it infringes upon the basic liberties¹¹⁰

The basic liberties are political, rather than economic: the right to vote, freedom of speech, liberty of conscience, freedom from arrest, and the right to hold property.¹¹¹ Influencing the trade-off between leisure and income is what income and consumption taxes do that endowment tax avoids. But that trade-off is not a matter of justice because it does not implicate the freedoms that are necessary to guarantee basic liberties. Rawls is not concerned with every limitation on absolute freedom, but only on limitations that interfere with the equal respect and concern each individual deserves. Most tax systems—including the income and consumption taxes that make leisure a bit more attractive than work—can easily satisfy Rawls' demand for freedom. The "liberties" approach that Rawls adopts allows broad government participation, while the more expansive libertarian notion of liberty is very restrictive of government action.

In rejecting the libertarian framework, Ronald Dworkin argues that the idea of property ownership in one's labor is incoherent because "the idea of pre-political entitlement based on something other than equality" is "inconsistent with the premise of the scheme of equality" that Dworkin explicates as the meaning of distributive justice.¹¹² He argues that liberty is part of the conception of equality that he adopts—equality of resources.¹¹³ Equality of resources requires that

¹¹⁰ Rawls, note 78, at 252.

¹¹¹ Rawls, note 72, at 61.

¹¹² Dworkin, note 65, at 312.

¹¹³ Ronald Dworkin, *Sovereign Virtue: The Theory and Practice of Equality* 121 (2000).

individuals have equal opportunities to choose their life plans and that they pay the true costs of the lives they lead, as measured by their effects on others.¹¹⁴ Like Rawls' approach, Dworkin's understanding of liberty is limited and positive. He interprets liberty as "[r]ights [n]ot [l]icense,"¹¹⁵ which fails to create an impermeable sphere in the Nozickian manner. He also allows liberty to be compromised in the name of equality as long as nobody is victimized by that constraint.¹¹⁶

The libertarian understanding of liberty cannot be mapped onto the liberal egalitarian critique of endowment taxation. Thus, Stark's arguments about liberty make the mistake of incorporating the libertarian notion into a discussion of the liberal egalitarian understanding, collapsing one into the other. He offers the example of a lawyer and a sculptor, and argues that a tax on the lawyer but not the sculptor creates a "liberty cost" for the lawyer that the sculptor does not have.¹¹⁷ But he does not explain what makes the tax a "liberty" cost in the liberal egalitarian understanding of liberty, in which it is limited and positive. A tax concededly raises the price of the lawyer's profession, but the trade-off between leisure and labor is not a matter of justice. The increased price is only a liberty cost if liberty is property, and any interference with one's right to keep everything produced in the market is a matter of justice.

The liberal egalitarian understanding of liberty requires a more nuanced analysis of the limitations that the tax actually imposes in a specific social context. A tax creates an issue of justice only if it interferes with the ability of the individual to make claims on others in society and on the institutions of government, and undermines her ability to make her life meaningful. But there is no liberty objection every time that government affects the price of individuals' choices. Individuals can be required to pay a tax without any imposition on their ability to pursue their conception of the good.¹¹⁸ Not every increased cost is a liberty imposition where liberty is understood as political freedoms and institutional design, and the pretax market price of any choice has no normative significance in that framework.

¹¹⁴ Dworkin, note 65, at 295.

¹¹⁵ Dworkin, note 113, at 126–27.

¹¹⁶ Victimization is defined as "when the value of the liberty citizens retain is at least as great as the value of the unconstrained freedom they would have had in a defensible distribution." *Id.* at 175.

¹¹⁷ Stark, note 34, at 60.

¹¹⁸ See Rawls, note 37, at 365–70.

C. Liberty Protects Decisions and Property Protects Rewards

In the liberal egalitarian framework, liberty is better understood as concerned with restrictions that attach to decisionmaking, and property is better understood as restrictions that attach to rewards. The tax imposed only on the lawyer (who makes money) and not the sculptor (who does not) does not reduce the lawyer's set of options, but does make certain choices more expensive than others. There is no restriction on the lawyer's pursuit of his conception of the good, so there is no fairness objection to the tax.¹¹⁹ Only if the restrictions on the rewards negate the ability to choose *ex ante* is the initial ability to choose a conception of the good implicated in the division of property rights. If a tax allowed an individual only one choice in life, it would tread upon his liberty.¹²⁰ However, it is not necessary for the tax to leave only a single choice for it to create a liberty concern; if it forecloses any choice that must be preserved to allow an individual a meaningful life, the tax violates principles of justice. This is why endowment taxation is fundamentally different from income and consumption taxes and uniquely inequitable. Unlike income and consumption taxation, endowment taxation forecloses individuals from pursuing some conceptions of the good.¹²¹ Such a tax is particularly troublesome because the foreclosed options, though limited, are most likely to be those most connected to an individual's personal agency, such as the choice to stay home with one's children or to devote one's life to helping others.

The notion that the state's ability to tax "extinguish[es]" the individual's liberty interest¹²² depends not only on a conception of liberty that is absolute, but also a liberty without corresponding obligations. Even Nozick maintains that while he generally should be allowed to put his knife where he wants, that freedom does not include placing it in your chest.¹²³ In any social system, absolute liberty is impossible and mutual obligations are necessary. Richard Epstein, legal academia's most influential libertarian, concedes that absolute free-

¹¹⁹ Perhaps Murphy and Nagel were similarly distinguishing between limits on decisions and rewards when they argued that endowment taxation is too much interference with autonomy, though not a unique type of interference. Murphy & Nagel, note 34, at 122–25.

¹²⁰ *Id.* at 123.

¹²¹ Contrary to Stark, I understand Louis Kaplow's maximum endowment tax—a proposed tax on endowment subject to a cap of 90% of earnings—to concede this distinction because the cap preserves the ability to make choices by limiting the effects to price. Stark argues that Kaplow's cap "takes the wind out of the liberty objections." Stark, note 34, at 63. I believe that his proposal actually accommodates those objections.

¹²² *Id.* at 60.

¹²³ Nozick, note 106, at 171.

dom from government intervention delegitimizes much of law as we know it.¹²⁴ Freedom without obligation is inconsistent with society.

Murphy and Nagel plot interference with liberty along a continuum that treats all individual interests as intricately balanced in society. In that respect, their approach is consistent with Rawls, who believed that “none of these liberties is absolute; but however they are adjusted to form one system, this system is to be the same for all.”¹²⁵ Thus, the comparison of endowment taxation with income or consumption taxation must account for the degree of interference with liberty and the countervailing obligations that attend to that liberty. A tax presents problems on these terms when freedom to pursue one’s vision of the good is abrogated by the fiscal claims of the state. It is important whether government interference prevents a person from pursuing her conception of a meaningful life. That issue *is* often one of degree, as Murphy and Nagel suggest. Intrusive or onerous taxation may interfere with a person’s ability to pursue her conception of the good, while the same tax in less onerous form may not. For example, a 100% income tax would leave a person at the mercy of the state, while a 20% tax on income above a threshold would not.

As long as we conceptualize the difference between income and endowment taxation in terms of degree of interference with liberty, the objections to both taxes are on the same terms. The debate has stalled because some believe that the degree of interference with liberty is a matter of justice,¹²⁶ while others maintain that only the kind of interference—but not the degree—is a matter of justice.¹²⁷ While their conclusions about endowment taxation differ, they share a common approach that depends on a particular understanding of the relationship between labor and leisure, and accepts the assumption that everything is substitutable. It is worthwhile to shift the terms of the debate by moving away from the labor-leisure trade-off and the substitutability that it implies. Then, an endowment tax is an interference that differs *in kind* from an income or consumption tax.

D. *What If Labor and Leisure Cannot Be Traded Off?*

If labor and leisure are not always substitutes for one another, then the difference between an endowment tax and an income tax is not just one of degree, but one of kind. By privileging leisure, an income tax never requires that a person work for money. By taxing regardless

¹²⁴ See Richard A. Epstein, *One Step Beyond Nozick’s Minimal State: The Role of Forced Exchanges in Political Theory*, 22 Soc. Phil. & Pol’y 286, 289–91 (2005).

¹²⁵ Rawls, note 103, at 259.

¹²⁶ Murphy & Nagel, note 34, at 121–25.

¹²⁷ Stark, note 34, at 65.

of work, an endowment tax forces those who prefer 100% nonwage activity (whether nonmarket work or recreation) to work enough to pay the tax. It may be helpful to understand the debate as a “disagreement over the social construction of the good ‘leisure.’”¹²⁸ Writing from a philosophical perspective, Andrew Stark argues that the debate about equality could more profitably be channeled into a discussion about the social construction of goods, and about the assumptions we have about whether goods are (1) generic or specific (what he terms “coarse-grained” versus “fine-grained”) and (2) more or less easily substituted for one another.¹²⁹ He argues that the endowment tax question turns on the conceptualization of leisure, and that an endowment tax is no more enslaving¹³⁰ than an income tax if leisure is treated as a wholly substitutable good.

In deciding whether leisure is substitutable, it must be categorized either as a coarse-grained or fine-grained good. A coarse-grained understanding generalizes leisure, treating everyone’s leisure as the same good despite the fact that different individual wage rates imply different costs of leisure for different individuals. A fine-grained understanding treats each individual’s leisure as a separate and distinct good. The more fine-grained is our understanding of a good, the less substitutable it is likely to be (Andrew Stark uses self-respect as the model for a nonsubstitutable good).¹³¹ If we adopt a coarse-grained understanding of leisure, then a fair distribution of goods may require reallocating leisure, but if we treat leisure as essentially connected to the individual (that is, you have no use for my leisure) then there is no unfairness arising from its unequal distribution.¹³² An endowment tax is more enslaving than an income tax if leisure is fine-grained and nonsubstitutable because “any range of work-leisure choices that does not include a life of leisure—however otherwise unconstrained—cannot substitute for one that does.”¹³³ Thus, even though an endowment tax leaves open many choices of work and leisure, it does not allow an individual to choose not to work at all.

¹²⁸ Andrew Stark, *Beyond Choice: Rethinking the Post-Rawlsian Debate over Egalitarian Justice*, 30 *Pol. Theory* 36, 47 (2002).

¹²⁹ *Id.* at 61.

¹³⁰ The endowment tax debate has been largely concerned with whether an endowment tax “enslaves” the able. Rawls suggested that it might. Rawls, note 78, at 252. Murphy and Nagel and Stark specifically consider the question. Murphy & Nagel, note 34, at 121-29; Stark, note 128, at 49-51. This Article tries to move away from framing the issue as slavery of the more able, and argues that endowment taxation is problematic even if it does not rise to the level of slavery for the talented.

¹³¹ Stark, note 128, at 57.

¹³² *Id.* at 49-51.

¹³³ *Id.* at 49.

This framework of substitutability is helpful in thinking about the full-time homemaker and why she is important in analyzing the fairness of an ability tax. If the good in question is a generic understanding of childcare, then a combination of purchased daycare and market employment is a substitute for staying home. If it is, then an endowment tax differs from an income tax in degree and not in kind; neither is more burdensome in kind because they both allow the mother to adjust her home and work hours to maximize her overall well-being after tax. But many homemakers have chosen to care for their children at a very high cost in lost market wages and opportunities precisely because they believe that there is no life of work and delegated care of children that substitutes for staying home and raising them. So an endowment tax, which might allow a homemaker to have a wide range of occupations and combinations of labor and leisure, does not allow her to have the one life that she chooses, and the life for which there is no substitute—the life of caring for her children herself. Understood this way, protection of that choice is imperative in a just society because it guarantees that the mother may choose the *only* life that she thinks is worth living.

Even if an inheritance or a rich spouse finances the homemaker's endowment tax¹³⁴ and allows her to have the life she wants despite the tax, the state's demand on endowment is still not legitimate. The tax presents a necessary question of justice because it is an institution of government that is designed to foreclose the individual's choice. This is the central concern of equality, and the state may not design an institution that fails to give the homemaker's life plans equal respect and concern, even if she finds ways to compensate. The state's role differs when it simply fails to enable a particular vision; if I believe that the only way to have a meaningful life is to jet around the world like an heiress, my inability to choose that life is not a question of justice if no government institution is responsible in any way for foreclosing it.

This framework is also illuminating in thinking about the relief worker. He differs from the homemaker because his chosen occupation allows him to earn money, just not as much as his endowment might have allowed him to earn. An ability tax could leave the relief worker with tax liability in excess of income, despite full-time market employment, an untenable situation. He may not have only one choice of profession in that case, but he is foreclosed from the choice that he preferred and that he would have made in the absence of the tax. Considering whether a tax enslaves by allowing a person only a

¹³⁴ Then, the state might consider the significance of the inheritance or the spouses' wealth or income in designing a tax.

single course in life approaches the question backwards, compared to this framework of social construction. This approach requires a focus on whether the tax forecloses any single choice that must be maintained in order for an individual to have the ability to design her life's plans.

Any tax system, including an endowment tax, could impose a small enough tax to permit its satisfaction with a wide variety of occupational choices. Only an endowment tax at a confiscatory rate would truly enslave the talented or tax the relief worker in excess of income. So if the standard for liberty depends on leaving people only a single choice of occupation, there is really no liberty limitation on tax systems. But the standard for liberal egalitarians is not dependent on leaving only one choice. In this Section, I have tried to give a variety of reasons why liberal egalitarians should be understood as concerned with foreclosing choices. An endowment tax need not be confiscatory and enslaving in order to be objectionable to liberal egalitarians; it just needs to prevent a person from pursuing her unique conception of the good. From this perspective, the question of substitutability is important because where there are no substitutes, the tax prevents the individual from exercising her freedom. To the contrary, where a tax raises the relative price of some choices in a market that determines value without implying intrinsic worth, there is not necessarily any imposition on liberty because an individual's choices may remain unconstrained despite those effects. Thus, even though an endowment tax may not so limit a person's life choices so as to rise to the level of "slavery," it is nonetheless unacceptable in a just society.

VI. EQUAL OPPORTUNITY AND ENDOWMENT TAXATION

A. *The Affinity of Equal Opportunity and Taxation Based on Ability to Earn*

The equal opportunity norm that has inspired some of the most recent considerations of justice in taxation¹³⁵ explains some of the initial attraction of endowment taxation. An endowment tax reflects a commitment to equal opportunity because it depends on whether a person had a greater or lesser opportunity to succeed in the society. Those with greater endowments within a given social structure are advantaged in the opportunity for welfare, so an endowment tax burdens them more than individuals who had less opportunity for welfare. Al-

¹³⁵ See generally Anne Alstott, *Equal Opportunity and Inheritance Taxation*, 121 *Harv. L. Rev.* 469 (2007) (evaluating whether the inheritance tax is designed to reflect the principle of equal opportunity); Repetti, note 11, at 1131 (arguing the principle underlying a just government is the creation of equal opportunities).

though no liberal egalitarian theory considers equal opportunity sufficient to constitute justice, it is a shared concern, reflected in Dworkin's ideal of equality of resources and Rawls' second principle of justice. An equal opportunity norm allows differences in welfare on account of different ambitions and effort, but not on account of natural talents and social hierarchy. A commitment to equal opportunity means attention to whether individuals start with advantages that others do not have. Social institutions should be designed to equalize the potential welfare of every individual.

The problem with ability taxation is not that it fails to promote equal opportunity, but that it takes the interest in equal opportunity and allows it to undermine itself and trump other norms. It uses the institution of taxation to reduce the opportunities of some without necessarily increasing the opportunities of others. It ignores everything that actually happens in a person's life, whether by choice or not. Because the tax has to treat endowment as a fixed and immutable characteristic,¹³⁶ it institutionalizes the hierarchy of abilities, even while it attempts to adjust the outcomes they produce. It reduces a person to a single dimension outside of her control.

The debate in the legal literature parallels a debate taking place in the philosophy literature in which scholars have been debating the role of "choice" versus "circumstances" in thinking about equality. There is broad consensus across the philosophical spectrum that some inequality can be just, but liberal egalitarians have been struggling with determining when and on what basis differences in distributive shares are consistent with an equality norm. Rawls believed that inequality in wealth and income could be just, but that differences in shares that arise on account of differences in natural abilities and talents are "arbitrary from a moral point of view."¹³⁷ Dworkin also believed that economic inequalities are just, but only those that arise from differences in ambitions, rather than abilities.¹³⁸ Thus, inequality in material goods and well-being is acceptable in a just society if it flows from choices, but not from circumstances.

The distinction between choice and circumstances potentially establishes a basis for the dichotomy between just and unjust market rewards and endowment may be the way to separate those rewards because it presents a mechanism for isolating circumstances. Taxation is an obvious choice for neutralizing the effects of arbitrary differences; its attraction is in its apparent power to level the starting place

¹³⁶ See discussion in Section IV.A (explaining that a fluid understanding of endowment collapses choice and circumstances and undermines the attractions of an endowment tax).

¹³⁷ Rawls, note 72, at 72.

¹³⁸ Dworkin, note 65, at 311.

for individuals with different potentials. An endowment tax pinpoints the cause of unjust gains that some individuals enjoy in society. Presumably, though not necessarily, it also redistributes to those with less potential to earn disproportionate shares.¹³⁹ Unfortunately, it operates by handicapping those most likely to succeed. By burdening the most talented, an endowment tax targets one of the impediments to equal opportunity in society, but simultaneously treads on individual integrity and self-respect, other important norms.

The most effective solution to the equal opportunity challenge would make the talents of all members of society a common good shared by all—each person would be entitled to a pro rata share of the total returns to ability in the community. Both Rawls and Dworkin consider this possibility and explicitly reject it. Rawls wrote:

[E]ven if an equal distribution of natural assets seemed more in keeping with the equality of free persons, the question of redistributing these assets . . . does not arise, since it is incompatible with the integrity of the person. . . . We have a right to our natural abilities and a right to whatever we become entitled to by taking part in a fair social process. The problem is to characterize this process.¹⁴⁰

Thus, for Rawls, injustice does not arise from the mere existence of different endowments or circumstances. It arises on account of the social consequences of those differences. Where Nozick takes for granted that a person owns whatever he produces, Rawls defines the question of justice in terms of how society assigns those rewards. From this perspective, different endowments are not the root of social or economic inequality or injustice. The social *consequences* of endowment are where injustice may arise. It is because the market rewards those who are beautiful or smart or white-skinned or male, and

¹³⁹ An institution other than taxation would determine the patterns of government spending. Whether the system is just depends on all the relevant policies combined. See Murphy & Nagel, note 34, at 76–78 (noting that the government’s role in distribution should be kept analytically separate from the government’s decisions regarding taxation); Linda Sugin, *Theories of Distributive Justice and Limitations on Taxation: What Rawls Demands from Tax Systems*, 72 *Fordham L. Rev.* 1991, 1991–93 (2004). Hasen analyzes taxation as inextricably related to purposes that it finances, concluding that an endowment tax that finances public goods is consistent with social contract theory, but one that finances redistribution is not. Hasen, note 46, at 1061–62. His analysis of public goods explicitly adopts a benefits-tax perspective. *Id.* at 1089. His discussion of redistribution, however, only implicitly adopts such a justification through his interpretation of the social contract. *Id.* at 1075–80. Like Shaviro, I believe that the centrality of the equality question in analyzing endowment taxation reflects an ability-to-pay perspective. Shaviro, note 16, at 125.

¹⁴⁰ Rawls, note 37, at 263.

those are the problems that need to be addressed by the institutions of society. Differences in endowments themselves are not the social problem.

In considering the issue, Dworkin wrote: "We might mention, but only to dismiss, one possib[ility: allowing] our initial auction to include, as resources to be auctioned, the labor of the immigrants themselves."¹⁴¹ But he rejects it since it fails to guarantee equality of resources to the most talented individuals, who would be required to purchase their leisure at a very high rate.¹⁴² Making leisure expensive for those with higher abilities to earn is precisely what an endowment tax sets out to do because the tax is designed to fall on them most heavily. Such a scheme fails Dworkin's envy test because it makes the most talented individuals envy the lives of less talented individuals, who can better afford their leisure.¹⁴³ In rejecting an explicit communal sharing of natural abilities, Rawls and Dworkin must figure out how to implement a commitment to equal opportunity while simultaneously preserving the integrity of the individual.

The tax policy literature has not distinguished different egalitarian theories, but the debate in the philosophical literature shows that different interpretations of egalitarianism might have different responses to endowment taxation. One of the problems in the tax policy literature is that it has often generalized too broadly about liberal egalitarian theories, even where they differ in important respects. It is necessary to separate different theories that have been lumped together under the liberal egalitarian label to consider the proper role of equal opportunity in designing systems of taxation. This Section tries to specifically ground the objections to endowment taxation in the disparate frameworks presented by Rawls and Dworkin. While both Rawls and Dworkin would ultimately reject endowment taxation, their reasons differ. For Rawls, endowment taxation is fundamentally inconsistent with the first and most important principle: the guarantee of equal liberties, and his concern for the least well-off cannot com-

¹⁴¹ Dworkin, note 65, at 311. But Dworkin rejects this possibility, explaining:

[T]he principle that people should not be penalized for talent is simply part of the same principle we relied on in rejecting the apparently opposite idea, that people should be allowed to retain the benefits of superior talent. The envy test forbids both of these results. If [Talented] is treated as owning whatever his talents enable him to produce, then [Clumsy] envies the package of resources, including occupation, that [Talented] has over his life as a whole. But if [Talented] is required to purchase leisure time or the right to a less productive occupation at the cost of other resources, then [Talented] will envy [Clumsy's] package.

Id. at 312.

¹⁴² Id.

¹⁴³ Id.

promise that guarantee.¹⁴⁴ Dworkin's equality of resources is directed to guaranteeing equal opportunity, but over a whole life, rather than just at the starting gate, so it is concerned with both opportunities and outcomes. Even so, it is properly understood as a more limited rejection of endowment taxation than Rawls' two principles of justice.

B. Rawls Clearly Rejects Endowment Taxation, Despite its Equal Opportunity Appeal

Rawls' rejection of endowment taxation arises outside his discussion of economic justice. His theory of justice consists of two principles, hierarchically related.¹⁴⁵ The first principle demands equal liberties and the second provides the framework for economic justice.¹⁴⁶ Rawls includes fair equality of opportunity in the second principle.¹⁴⁷ That means that the first principle's equal basic liberties are prior to equal opportunity and that there may be limits imposed on equal opportunity if necessary to fulfill the requirements of equal liberties. Rawls lists the basic liberties as: freedom of thought and liberty of conscience, political liberties (for example, the right to vote and to participate in politics), and freedom of association, as well as the rights and liberties specified by the liberty and integrity (physical and psychological) of the person, and finally, the rights and liberties covered by the rule of law.¹⁴⁸ An endowment tax would undermine the guarantee of human agency and personal integrity that the first principle provides. If our endowment is the immutable measure that makes it attractive to economists, then directly taxing it undermines the humanity of the person, which requires the exercise of reason and conviction during a person's life. Rawls treats natural goods, like health and intelligence, as beyond the scope of his inquiry because they are not controlled by the social structure.¹⁴⁹

For Rawls, equality of opportunity is an imperative in the design of institutions of society, rather than an individual constraint. Rawls writes in terms of institutions, expectations, and representative persons because a just society operates at that level of abstraction, rather than at the individual level of entitlement. In other words, his project does not include a guarantee of equal opportunity for each individual directly. Rather, it asks what institution of taxation would be most likely to provide both the greatest protection for basic human liberties

¹⁴⁴ Rawls, note 72, at 60.

¹⁴⁵ *Id.* at 61.

¹⁴⁶ *Id.* at 60.

¹⁴⁷ But it is prior to the difference principle. *Id.* at 61.

¹⁴⁸ *Id.* at 61.

¹⁴⁹ *Id.* at 62.

and fair equality of opportunity. The imperative is to design institutions that take account of natural talent differences so that social institutions do not reinforce natural differences. Striving for equal opportunity in the design of institutions is respectful to individual agency because at the institutional level, there is no danger of devaluing individuals. There is no reason to erase the differences among individuals as long as social institutions do not translate those differences into inequality in basic liberties or primary goods.

The most important reason why endowment taxation is unacceptable in a Rawlsian framework is because it intrudes on the highest interest that individuals have—the free choice of ends, that is, an interest in being able to shape their other interests as free people.¹⁵⁰ Autonomy is related to liberty.¹⁵¹ Rawls defines autonomy as “acting from principles . . . that best express [individuals] as free and equal rational beings.”¹⁵² In *A Theory of Justice*, he wrote:

[A] person is acting autonomously when the principles of his action are chosen by him as the most adequate possible expression of his nature as a free and equal rational being [A]cting unjustly is acting in a manner that fails to express our nature as a free and equal rational being. Such actions therefore strike at our self-respect, our sense of our own worth We have acted as though we belonged to a lower order, as though we were a creature whose first principles are decided by natural contingencies.¹⁵³

Just institutions “enable human beings to express their nature as free and equal moral persons.”¹⁵⁴ An ability tax is repellant because it treats people as determined by their natural contingencies, lacking autonomy in Rawls’ sense. An endowment tax circumscribes the choice of ends that each individual has because all choices must be made in the face of an unvarying liability that must be paid in money. Once a person’s endowment is determined to be high, fewer choices of ends remain available to her.

An endowment tax makes it exceedingly difficult to ensure that all individuals have the “primary good of self-respect”¹⁵⁵ because it defines people in the social structure by their potential ability to earn

¹⁵⁰ This notion derives from Rawls’ Kantian conception of autonomy. Taylor, note 75, at 254–55.

¹⁵¹ See Part V.

¹⁵² Rawls, note 72, at 515.

¹⁵³ *Id.* at 252, 256.

¹⁵⁴ *Id.* at 513.

¹⁵⁵ *Id.* at 546.

income. While it might fund redistribution to the most lowly-endowed, it simultaneously labels them as the least valuable members of society. “None should view their situation as humiliating or degrading, nor should they be subject to circumstances they cannot help but resent and acquiesce in only from timidity and fear of reprisal.”¹⁵⁶ Rawls’ conception of the person thus rejects endowment taxation because it undermines the self-esteem of poorly-endowed people by labeling them inferior, and the self-respect of highly-endowed people who find themselves unable to do what they believe is important in life.

C. Does the Difference Principle Support Endowment Taxation?

In his second principle of justice, Rawls explicates the difference principle, which he states as: “Social and economic inequalities are to be arranged so that they are . . . to the greatest benefit of the least advantaged”¹⁵⁷ It has been called “maximin” in some of the literature because it seeks to maximize the prospects of the least well-off group.¹⁵⁸ Richard Musgrave suggested that the worst-off in society might be better-off with an endowment tax than with an income or consumption tax because both of the latter allow substitution of leisure for labor to affect taxation.¹⁵⁹ An endowment tax would make leisure expensive for highly-endowed individuals and cheap for poorly-endowed individuals. Thus, the worst-off group (in terms of endowment) might gain an economic advantage in this system. Rawls responded to Musgrave by rejecting the welfare-based premise underlying Musgrave’s argument, and the transformation of primary goods into measurements of welfare.¹⁶⁰ Instead of debating the welfare of individuals, Rawls speaks in terms of the social bases of self-respect and the social institutions that are necessary to support self-esteem.¹⁶¹ The mere categorization of some people as highly-endowed and others as poorly-endowed under a tax would clash with that requirement. Thus, the only way that the difference principle can be understood to justify endowment taxation is by redefining the principle in utilitarian terms, a mistake often made in applying Rawls to tax policy.¹⁶² But Rawls’ theory of distributive justice is a rejection of utilitarianism.

¹⁵⁶ Rawls, note 78, at 250.

¹⁵⁷ Rawls, note 72, at 83.

¹⁵⁸ See, e.g., R.A. Musgrave, Maximin, Uncertainty, and the Leisure Trade-Off, 88 Q.J. Econ. 625 (1974).

¹⁵⁹ See *id.* at 629-30.

¹⁶⁰ Rawls, note 78, at 253.

¹⁶¹ *Id.* at 240.

¹⁶² See, e.g., Bankman & Griffith, note 3, at 1915-16.

The simplest explanation for why the difference principle cannot mandate an ability tax is that the difference principle is hierarchically inferior to the first principle, with which such a tax directly conflicts. “[J]ustice in the relative shares of material means, is relegated to a subordinate place.”¹⁶³ Focusing on the least well-off in designing the tax system is unnecessary because the requirements of the difference principle can be fulfilled by a wide variety of tax systems, as long as the society’s spending patterns are designed to fulfill it.¹⁶⁴ The difference principle requires that society devote more resources to the least well-off, but that doesn’t imply anything about how we should garner those resources from those better-off. Rawls rejects any attempt to adjust endowments themselves, preferring to direct resources to the more-challenged.¹⁶⁵ He says:

Now the difference principle is not of course the principle of redress. It does not require society to try to even out handicaps as if all were expected to compete on a fair basis in the same race. But the difference principle would allocate resources in education, say, so as to improve the long-term expectation of the least favored.¹⁶⁶

If anyone misinterpreted the difference principle and its application to differences in endowment, he explains:

No one deserves his greater natural capacity nor merits a more favorable starting place in society. But it does not follow that one should eliminate these distinctions The basic structure can be arranged so that these contingencies work for the good of the least fortunate Aristocratic and caste societies are unjust because they make these contingencies the ascriptive basis for belonging to more or less enclosed and privileged social classes.¹⁶⁷

That some people have higher endowments than others is not unjust in itself, according to Rawls. What may be unjust is what social institutions make of those natural facts.

Any story about the difference principle that supports ability taxation must also include redistribution to or investment in the least well-off. The difference principle says that we should design institutions so

¹⁶³ Rawls, note 72, at 546.

¹⁶⁴ Sugin, note 139, at 1994–97.

¹⁶⁵ Rawls, note 72, at 100–01.

¹⁶⁶ *Id.* at 101.

¹⁶⁷ *Id.* at 102.

as to maximize the prospects of the least well-off members of society. It is acceptable to improve the prospects of those better-off as well, as long as the prospects of the worst-off are made better. Rawls wants institutions to focus on increasing the prospects of the least well-off.¹⁶⁸ Nothing about an endowment tax increases anyone's prospects—it can only decrease the relative prospects of the more highly-endowed. It could even depress the prospects of the worst-off group, if the system failed to include sufficient redistribution or investment. An endowment tax, by increasing the likelihood that individuals will be lawyers or bankers instead of teachers or relief workers could as easily reduce the prospects of the least well-off members of society. If teachers and relief workers produce social benefits for the less well-off members of society, an endowment tax could leave those people worse off by reducing the pool of people willing to do those jobs. The highly-endowed would-be teachers and drug-addiction counselors might respond to the tax by choosing professions that provide less benefit to the least well-off, precisely the opposite of Rawls' difference principle.

Under the difference principle, it is not unjust if people with higher endowments have greater resources than people with lower endowments as long as the increase at the top inures to the benefit of those at the bottom.¹⁶⁹ Rawls accepts the possibility that a just structure would reduce the prospects of the most well-off, but he does not choose that consequence as the goal of a just institution, as it is for an ability tax. The difference principle requires that the expectations of the least well-off be improved; reducing the expectations of those better-off, as an endowment tax does, does nothing to guarantee that the prospects of the less well-off would be improved.

D. Dworkin's Ex Anteism Is Sympathetic to Endowment Taxation

In contrast to Rawls, Dworkin makes equal opportunity central and the distinction between endowment and effort a touchstone for justice.¹⁷⁰ Consequently, an endowment tax may fit better with his theory than with Rawls'. In his classic treatment of distributive justice,

¹⁶⁸ *Id.* at 101-02.

¹⁶⁹ *Id.*

¹⁷⁰ See Dworkin, note 113, at 4-7. The initial appeal of endowment taxation within equality of resources may arise from the fact that Dworkin explicitly analyzes distributive justice alone, as distinct from other aspects of his political theory. Dworkin starts his discussion of distributive justice with the caveat that “[d]istributional equality, as I describe it, is not concerned with the distribution of political power, for example, or with individual rights other than rights to some amount or share of resources.” *Id.* at 12. Thus, he fails to address the possibility that certain mechanisms of distributing or redistributing resources might conflict with other rights. It is easier to identify Rawls' objections to endowment

Dworkin queried whether the ideal of distributive justice should be equality of welfare or equality of resources. He chose equality of resources because it reflects a conception of equality in which any scheme of distribution must “be sensitive to the cost of one person’s life to other people,”¹⁷¹ and individuals must “pay the true cost of the lives that they lead.”¹⁷² Equality of resources endorses an equal initial distribution of shares, even though shares will become unequal over time. Dworkin posits a desert island in which each individual has an equal opportunity to secure his desired set of goods through an auction procedure that continues until nobody envies the bundle of goods that anyone else possesses (the “envy test”).¹⁷³

The desert island replicates an ideal starting point of equal opportunity, but even where equal opportunity is initially established, unequal shares develop over time, and Dworkin is concerned with those unequal shares.¹⁷⁴ Inequalities that result from extra effort are not unjust in equality of resources. They do not fail the envy test—if one person has a greater share of wealth on account of greater effort compared to another who has less because she chose to work less hard, neither should envy the other’s overall bundle.¹⁷⁵ To the contrary, inequalities that result from bad luck is a problem for fairness. Dworkin takes care to distinguish “brute luck,” such as being hit by lightning, from “option luck,” which resembles a reasoned gamble.¹⁷⁶ A person should be required to bear the consequences of purposeful risk-taking, so only bad brute luck is something that society might care to remedy.¹⁷⁷ Insurance provides a bridge between the two so that individuals who fail to secure insurance for brute luck are, in effect, taking a reasoned gamble.¹⁷⁸

Nevertheless, Dworkin is not fully satisfied with insurance as the solution to unequal opportunity because opportunity is not really equal when people enter the market with different abilities.¹⁷⁹ Since Dworkin demands repeated satisfaction of the envy test over time, the initial distribution, even if perfect, will not insure continuing equality because people have unequal talents that will produce shares that fail

taxation precisely because he incorporates his ideas about economic justice into his general theory that is primarily about political justice.

¹⁷¹ Dworkin, note 65, at 334.

¹⁷² *Id.* at 295.

¹⁷³ *Id.* at 283-90.

¹⁷⁴ *Id.*

¹⁷⁵ See *id.* at 304-05 (noting that where “talents are equal, efficiency simply is fairness”).

¹⁷⁶ *Id.* at 293.

¹⁷⁷ See *id.* at 293-97.

¹⁷⁸ *Id.*

¹⁷⁹ See *id.* at 296-97.

the test.¹⁸⁰ Dworkin attempts to separate out the returns to natural abilities (that others should envy) from the returns to effort (that others should not envy). Returns to hard work are the earned product of individual choice, while returns to talent are unearned and therefore subject to greater redistribution. This is where an endowment tax seems like the solution to Dworkin's concerns because it accounts for the differences in natural abilities among people entering the market with equal material resources. An endowment tax appears to be a mechanism for satisfying the envy test by taking from the more-able the excess returns to their abilities, and presumably transferring that excess to the less-able until the envy test is satisfied. Any conception of equality that makes a central distinction between brute luck and option luck invites a focus on the abilities that individuals bring to society. Equal opportunity demands that everyone face the same range of choices for which they will bear the consequences. An ability tax seems an elegant solution to the whole problem of equality of resources precisely because it is forward looking and leaves individuals with the consequences of their choices.

A tax that corrects for different abilities to earn still fails to account for the differences in earnings that depend on luck, as opposed to either endowment or effort. The transformation of brute luck into option luck with insurance that Dworkin posits can never be complete, so individuals remain subject to the vicissitudes of luck. The persistence of brute luck, even in a world with insurance, presents a challenge to the application of equality of resources in taxation. If Dworkin is really concerned about the consequences of bad luck that people cannot avoid, then a tax system designed to implement equality of resources needs to be more sensitive to inequalities that result from risks that society demands that people take.

Applying Dworkin's theory to taxation raises some questions about the implications of the theory. Some have challenged Dworkin's interpretation of equality on account of its *ex ante*/equal opportunity perspective and its correspondingly rigid treatment of luck and desert.¹⁸¹ Barbara Fried is critical of Dworkin's "equal opportunity egalitarianism"¹⁸² because we (1) might not be rational decisionmakers,¹⁸³ (2) are unable to properly assess risks,¹⁸⁴ and (3) may not be able to avoid the risks we want to avoid because of how they are presented to us.¹⁸⁵ She argues that a commitment to *ex ante*ism is

¹⁸⁰ *Id.* at 307.

¹⁸¹ See, e.g., Barbara H. Fried, *Ex Ante/Ex Post*, 13 *J. Contemp. Legal Issues* 123 (2003).

¹⁸² *Id.* at 132.

¹⁸³ *Id.* at 157-58.

¹⁸⁴ *Id.* at 140.

¹⁸⁵ *Id.* at 144-46.

foundational to Dworkin's approach, and therefore problematic.¹⁸⁶ If justice requires that shares not depend on luck, then equality of resources needs a mechanism for continually correcting for all the issues attendant to risk.

If equality of resources depends on transforming brute luck into option luck, then the problems with doing that may undermine the premise of equality of resources. Elizabeth Anderson argues that Dworkin and others, whom she describes as luck egalitarians, have a "flawed understanding of the point of equality . . . dominated by the view that the fundamental aim of equality is to compensate people for undeserved bad luck."¹⁸⁷ She argues that luck egalitarians do not satisfy the basic requirement of treating people as equals because entitlements to resources in their theories arise from inferiority to others, rather than from equality.¹⁸⁸ Luck egalitarians, she claims, "have forgotten that the primary subject of justice is the institutional arrangements that generate people's opportunities over time."¹⁸⁹ The market is completely irrelevant in determining questions of justice.¹⁹⁰ Her critique highlights the different approaches that Rawls and Dworkin have taken.

These critiques of ex anteism in equality of resources are important to the endowment tax debate because they support the interpretation of equality of resources that accepts the ex anteism implicit in endowment taxation. Ability taxation treats those with higher potential income as better able to pay tax, even if they do not actually reach that potential. It treats economic justice as concerned only with starting points and never with results.

E. Equality of Resources Is Concerned with Outcomes as Well as Opportunities

If Dworkin's commitment to ex anteism is as great as his critics describe it, then an endowment tax might be an acceptable institution within equality of resources.¹⁹¹ But equality of resources does not

¹⁸⁶ *Id.* at 131, 137.

¹⁸⁷ Anderson, note 77, at 288.

¹⁸⁸ *Id.* at 306.

¹⁸⁹ *Id.* at 309. This is consistent with Rawls' approach. See Section V.A.

¹⁹⁰ Anderson, note 77, at 309-10.

¹⁹¹ My approach in this Article is consistent with my prior work in treating political theories as constraints on the design of tax systems, rather than imposing specific requirements on tax design. Because institutions of society are varied and interacting, it is impossible to isolate the tax system and determine whether it carries out the political theory. See generally Sugin, note 139, at 1993 (arguing that because of the myriad rules, policies, resources, markets, and educational opportunities that affect a society, a consideration of the tax system alone is never enough to determine if a particular ideal is being met); see also Murphy & Nagel, note 34, at 8 ("Taxes must be evaluated as part of the overall system of

stop at “equal opportunity egalitarianism” because Dworkin specifically rejects the purely ex-ante notion of equality of opportunity as the full meaning of equality of resources.¹⁹² He rejects the “starting gate theory of fairness,” and argues that equality of resources is concerned with maintaining equality over time, as defined by continuing satisfaction of the envy test.¹⁹³ Equality of resources requires regular reassessment of distributive shares, which requires sensitivity to outcomes as well as opportunities.¹⁹⁴ This approach to distributive justice is inconsistent with endowment taxation, which isolates ability to earn and must fix the measure of that ability.

In addition, Dworkin’s insurance scheme, which he chooses to implement equality of resources, is inconsistent with an endowment tax. The insurance scheme he describes is a progressive income tax system that he adopts in order to “neutralize the effects of differential talents, yet preserve the consequences of one person choosing an occupation, in response to his sense of what he wants to do with his life, that is more expensive for the community than the choice another makes.”¹⁹⁵ Dworkin refuses to treat a person’s physical and mental powers as part of his resources, and therefore refuses to “provide for an initial compensation to alleviate differences,”¹⁹⁶ which is fundamentally the goal of an endowment tax. His refusal is based, at least in part, on problems of substitutability and incommensurability.¹⁹⁷

An endowment tax attempts to neutralize the effects of different talents, but it fails to account for the costs and benefits to the community from an individual’s choices, which equality of resources also demands. The relief worker, who earns little but produces great benefits for society, should be taxed less under equality of resources than his equal endowment counterpart who chose a different occupation because his life alleviates other costs to the community. In fact, the insurance/tax scheme that Dworkin chooses belies some discomfort with the brute luck/option luck dichotomy that he initially describes because it makes the winners share with the losers even if they both took the same calculated risks, but each turned out differently. Dworkin’s insurance/income tax is actually an ex post system.¹⁹⁸ Thus, Dwor-

property rights that they help to create. Justice or injustice in taxation can only mean justice or injustice in the system of property rights and entitlements that result from a particular tax regime.”).

¹⁹² Dworkin, note 65, at 309.

¹⁹³ *Id.* at 308–10.

¹⁹⁴ *Id.* at 309–10.

¹⁹⁵ *Id.* at 313.

¹⁹⁶ *Id.* at 300.

¹⁹⁷ *Id.* at 300–01.

¹⁹⁸ Dworkin explicitly rejects a consumption tax or a wealth tax as a solution to the problem of differential talents. *Id.* at 312 n.9.

kin's commitment to equal opportunity at the outset is not sufficient to complete his definition of justice. A continuing application of the envy test requires attention to both opportunities and outcomes.

Dworkin's commitment to continued intervention in the market over time distinguishes equality of resources from the laissez-faire market approach taken by Nozick. Just as liberal egalitarians and libertarians differ in their understanding of liberty, they also differ in the normative role of the market. For Nozick, the market defines justice because his standard is purely procedural.¹⁹⁹ In equality of resources, the market does not define justice, but serves justice by requiring that individuals bear the costs of the lives that they choose as measured by the effects of their choices on others. The market is a crucial part of equality of resources because Dworkin defines equality in dynamic, social terms,²⁰⁰ but not because an "invisible hand" achieves justice.

Dworkin's understanding of the interrelationship of endowment and ambition makes an ability tax too simplistic a response to the problem of unequal talents in society. By rejecting the characterization of endowment as resources, Dworkin's theory—which defines distributive justice as equality of resources over a life²⁰¹—ultimately cannot countenance endowment taxation. He considers whether the insurance premium in his scheme should be based on potential income, but he rejects it.²⁰² He concedes that endowment and effort are inseparable.²⁰³ Effort and talent are interdependent and inseparable and in the end, equality of resources treats the distinction between them as theoretically suspect.²⁰⁴

Dworkin's choice of income as the tax base, rather than ability, better accommodates the competing demands of equality in designing a tax system. An income tax offers a compromise for Dworkin between equal opportunity, concern for outcomes, and individual integrity.²⁰⁵ It minimizes the consequences that flow from differences in talent, while allowing those talents to take part in the dynamic process of choosing a particular life.²⁰⁶ Ultimately, Dworkin's equality of resources reflects discomfort with the idea that endowment can be isolated, and he recognizes that ability and ambition are in a reciprocal relationship.²⁰⁷ Thus, while he is concerned that there is something

¹⁹⁹ See Nozick, note 106, at 150–51.

²⁰⁰ See notes 171–73 and accompanying text.

²⁰¹ Dworkin, note 65, at 309.

²⁰² He did not fully explicate whether his objections to it are fundamental or merely instrumental. *Id.* at 326.

²⁰³ *Id.* at 324.

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.* at 313.

²⁰⁷ *Id.* at 316.

unfair about some people having greater abilities to earn than others, which might push his theory to embrace an endowment tax, it is also unfair to strip the highly-endowed of control over their individuality, which ultimately pushes his theory away from it.²⁰⁸

VII. LEISURE AND WEALTH

As discussed above,²⁰⁹ in the economic model, leisure includes anything that prevents full use of one's endowment—low-paying work, unpaid work, and pure recreation. But redefining leisure only as pure recreation raises additional issues of justice that the endowment tax debate has neglected. Limiting leisure to recreation forces consideration of the fact that money is necessary to buy real leisure. People who enjoy recreation without work can generally do so because they have a source of money income, stored wealth, or other financial support. The leisure vs. work debate therefore leads not to a conclusion that human capital endowment needs to be taxed, but that we may need to reconsider the way that we tax people who inherit wealth or receive gifts that support their lifestyle.²¹⁰ The lucky housewife discussed above,²¹¹ may need to pay tax in a just society, but it should not be on account of her potential to earn income.

Endowment, in its colloquial sense of a store of financial capital held by an institution that produces a stream of income for current use, may be a more accurate measure of ability-to-pay tax than human-capital endowment, which is subject to so many contingencies. A post-paid consumption tax or an accessions tax may be a more targeted way than an endowment tax to reach the nonproductive recreation that an income tax or prepaid consumption tax may miss.²¹² While it is true that gazing at the sunset would escape tax in that case, big-ticket leisure items generally cost money, which would be taxed in all the conventional systems. It is not necessary to tax potential earnings to levy on leisure more fully than does the current system.

These thoughts about the connection between money and leisure should make us reconsider the Mirrlees model's centrality in the tax policy literature, and the consequent focus on labor endowment as the most important determinant of inequality. Imagining that human-cap-

²⁰⁸ See *id.* at 307.

²⁰⁹ See Section III.C.

²¹⁰ See generally Lily L. Batchelder, *Taxing Privilege More Effectively: Replacing the Estate Tax with an Inheritance Tax*, in *Path to Prosperity: Hamilton Project Ideas on Income Security, Education, and Taxes* 345, 347 (Jason Furman & Jason E. Bordoff eds., 2008) (suggesting that an inheritance tax borne by the recipients of wealth transfers would be a more equitable system than the estate tax).

²¹¹ See Section V.D.

²¹² See IRC §§ 102, 1014 (allowing significant consumption out of untaxed funds).

ital endowment is the central issue of economic inequality in our society is seriously flawed.²¹³ Financial capital is much more important than human capital, but if endowment taxation is based on wage rates, then there is no place to account for the effects of wealth in the tax system. Perhaps that means that an endowment tax would be better complemented by a wealth tax than some other forms of taxation—to capture the inequality in human and financial capital, but I have not seen wealth taxes presented as a component necessary to carry out the norms underlying endowment taxation.²¹⁴ Nevertheless, if endowment is important because it gives people choices in life that make them better-off than others, how much more true that is for material endowment than labor endowment, which needs hard work and development by the person.²¹⁵ “Democratic equality calls into question the very idea that inferior native endowments have much to do with observed income inequalities in capitalist economies. The biggest fortunes are made not by those who work but by those who own the means of production.”²¹⁶ Fair taxation must recognize the sources of social inequality.

VIII. CONCLUSION

This Article presented a rigorous critique of the assumptions underlying the optimal tax model. It evaluated those assumptions from the perspectives of both fairness and efficiency, and questioned the coherence of the ideal and the power of the model to recommend desirable tax structures. In the process of analyzing the central assumption that an ideal tax would be based on one’s ability to earn, it offered a variety of original insights about the demands of fair taxation. It argued that fair taxation must distinguish productive from nonproductive leisure, reconsider the substitutability of labor and leisure, look beyond

²¹³ People are most likely to be rich if their parents are rich. See James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. Rev. 825, 838–40 (2001). Zelenak disagrees with my assessment of the significance of human compared to financial capital. See Zelenak, note 21, at 1154.

²¹⁴ Lily Batchelder has come closest to this by thinking about endowment in the transfer tax context. See Batchelder, note 210, at 348–50 (asserting that her model of inheritance taxation will take into account the heirs’ ability to pay). Some proponents of consumption taxation believe that wealth taxes are a desirable complement. See William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 Harv. L. Rev. 1113, 1118–19 (1974) (suggesting a strengthening of estate and gift taxes to reach wealth accumulation); Deborah H. Schenk, *Saving the Income Tax with a Wealth Tax*, 53 Tax L. Rev. 423, 424–25 (2000) (arguing for a consumption tax supplemented by a “low-rate wealth tax” to replace the income tax).

²¹⁵ See Hal R. Varian, *Distributive Justice, Welfare Economics, and the Theory of Fairness*, 4 Phil. & Pub. Aff. 223, 234 (1975) (distinguishing the impracticality of valuing labor power and the relative ease of valuing physical wealth).

²¹⁶ Anderson, note 77, at 325.

market valuation for measuring social worth, and account for luck in addition to effort and ability. It redefined tax fairness in non-utilitarian terms, where taxation is one of the institutional structures of society designed to guarantee equal concern and respect for each individual. It explained why libertarians and liberal egalitarians have different approaches to justice in taxation, clarifying some of the confusion about nonconsequentialist theories that has plagued the tax policy literature. Finally, it engaged in a close analysis of the ideas of John Rawls and Ronald Dworkin to illustrate the application of liberal egalitarian political theory to taxation, and concluded that those theories are not consistent with the optimal tax model's ideal tax.

Where does the analysis of fair taxation go from here? Proponents of equal opportunity may find more promising avenues outside taxation, through educational investment or entitlement shares.²¹⁷ But even the best intervention on those terms would likely fall short of truly equalizing opportunity. The tax system may have a greater role to play at a later stage, where it can transfer some of the rewards from those with greater endowments to public programs and redistribution—an after-the-fact adjustment for differences in opportunity that could not be identified and equalized *ex ante*.

Rather than demanding some mechanism for equalizing potentials, as an endowment tax would, distributive justice may be more concerned about guaranteeing minimums. Murphy and Nagel endorse a basic minimum²¹⁸ and Rawls assumes that it exists before designing institutions.²¹⁹ The intuition that favors redistribution to individuals with very low levels of income, wealth, or consumption may derive from concern with whether their destitution makes them unable to participate in civil society. In a particular social environment, some systems of taxation may better foster participation in civil society.

In an earlier article, I argued that political theories generally do not mandate specific systems of taxation,²²⁰ and I continue to maintain that view. There is no one ideally just tax scheme because justice in taxation is intertwined with market outcomes, public provision of goods and services, and political institutions. Against the backdrop of particular institutional arrangements, one type of tax may be clearly superior to another. In an economic system with little inequality, a

²¹⁷ See Bruce Ackerman & Anne Alstott, *The Stakeholder Society* 4-5 (1999) (proposing a grant for every citizen reaching adulthood).

²¹⁸ Murphy & Nagel, note 34, at 45.

²¹⁹ Robert Taylor reads Rawls to require “a degree of fulfillment of needs and material wants” because “the [p]riority of [l]iberty would be meaningless in a society that could not even establish the basic liberties themselves due to social and economic conditions.” Taylor, note 75, at 262–63.

²²⁰ See Sugin, note 139.

significant welfare state, and developed institutions for education, child care, and health, a tax with limited redistributive potential²²¹ might adequately fund economic opportunity and security for all citizens. However, a society with great wealth and income inequality, and inadequate public education, social services, and medical care would require a more redistributive tax system as a tool of economic justice.²²²

The further a society finds itself from equality, the more work a tax system must do to contribute to justice. The design of a just tax system is contingent on outside factors. While there might be internal tax norms that maintain the coherence of the system, there is no avoiding the interaction of taxation with other social policies. Justice in taxation must ultimately be accountable on the same terms as other government institutions. Despite the continued allegiance of tax policy theorists to internal norms of taxation, those norms must be evaluated according to the broader criteria applied to the exercise of coercive government power.

The role of political theory in tax justice is generally contingent since it cannot definitively mandate particular rate schedules or tax bases, and many diverse systems of taxation would be acceptable within most political theories. Standing alone, political theory cannot recommend specific tax schemes, but it can operate as a trump on schemes that arise in the political process. In my prior article, I considered the work of John Rawls, and argued that looking for a particular system of taxation required by his theory was misguided.²²³ Instead, I argued that those interested in tax justice should look to political theories for limits on acceptable forms of taxation, since different theories may prohibit particular systems; tax scholars need to shift their focus from a search for requirements to identifying those limitations.²²⁴ The one prohibited tax scheme I identified was one based on an individual's ability to earn.²²⁵

²²¹ A proportional consumption tax would be an example of such a tax. See Neal Boortz & John Linder, *The FairTax Book 75-76* (2005) (proposing abolishing the current U.S. tax system and replacing it with a flat 23% personal consumption tax).

²²² For example, given the current distribution of income and wealth combined with existing government policies of economic regulation, one may argue that a progressive income tax is the most just. Repetti, note 11, at 1131-32 (arguing for a tax system "designed to achieve equal opportunity for self-realization" by keeping the burden on disadvantaged taxpayers low enough to avoid harming opportunities while keeping the burden on advantaged taxpayers high enough to allow for the reduced burden on the disadvantaged).

²²³ Sugin, note 139, at 1992-93.

²²⁴ *Id.* at 1993-94.

²²⁵ *Id.* at 2006-08.

This Article has been an attempt to comprehensively analyze that limitation and its implications for the optimal tax model. It explains why the intuition that most people have about ability taxation is right—that endowment taxation is fundamentally at odds with fairness principles. It has identified the nature of the objections to endowment taxation more specifically than vague notions of autonomy and liberty that have previously appeared in the literature, and has exposed some of the underlying assumptions and biases in the discussion to date. The arguments against endowment taxation do not necessarily map onto arguments for another base, but the concerns analyzed here must be part of the evaluation of any system of taxation that purports to be just.

