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THEORIES OF DISTRIBUTIVE JUSTICE AND LIMITATIONS ON TAXATION: WHAT RAWLS DEMANDS FROM TAX SYSTEMS

Linda Sugin*

INTRODUCTION

Liam Murphy and Thomas Nagel, at the beginning of their important book, *The Myth of Ownership: Taxes and Justice* (“*The Myth of Ownership*”), describe a “dominant theme” of their analysis as follows:

[T]he tax system cannot be evaluated by looking at its impact on private property, conceived as something that has independent existence and validity. Taxes must be evaluated as part of the overall system of 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.¹

The book contains a devastating critique of traditional tax policy analysis. It describes theories of vertical equity as “false” accounts of governmental justice,² and demolishes the principle of equal sacrifice—a bulwark of fairness discussions in taxation—as “myopi[c],” for “treat[ing] the justice of tax burdens as if [they] could be separated from the justice of the pattern of government expenditure.”³ *The Myth of Ownership* carefully erases the baseline so often employed in tax policy scholarship—pre-tax income and its implications of entitlement.⁴

To students of tax policy, *The Myth of Ownership* could be quite disheartening. One could read the book as an argument for the demise of all tax policy analysis, since it maintains that the tax system’s fairness cannot be measured in a vacuum apart from all other

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1. Liam Murphy & Thomas Nagel, *The Myth of Ownership: Taxes and Justice* 8 (2002).

2. *Id.* at 14.

3. *Id.* at 25.

4. In the authors’ view, pre-tax income has no moral significance, and therefore it is inappropriate for it to be accorded a presumption of entitlement in determining the justice of any taxing scheme, which necessarily takes some part of pre-tax income from the individual. *Id.* at 19.

public institutions, and that taxes themselves affect markets and the definition of private property. The authors claim that the tax system "is among the conditions that *create* a set of property holdings, whose legitimacy can be assessed only by evaluating the justice of the whole system, taxes included."⁵ If they are right, there may be nothing to say about justice and taxation at all; perhaps we can only evaluate more comprehensive policies that consider all aspects of economic life.

If Murphy and Nagel are calling for the integration of tax policy with everything else that might be considered government economic policy,⁶ the task they give policymakers is daunting. In such an integration, it would be necessary to consider the entire scheme of government protection of property rights and markets, government provision of goods and services, along with taxation, to have any coherent ideas about economic justice in society. There is too much law on both the tax side and the expenditure side of the budget, not to mention the regulation of all manner of economic life, to expect that policymakers can constantly adjust the overall picture in accordance with an ideal of distributive justice as they make every legal change. It would be a Herculean task to consider any legal rule.

To those for whom taxation is a vitally important piece in what is clearly a larger scheme of economic justice, the lesson from *The Myth of Ownership* may be less dire. Given the extensive discussion of individual issues in taxation,⁷ Murphy and Nagel themselves seem to cling to the belief that it is possible to discuss justice in taxation, even if it is not possible to achieve justice *only* through taxation. In fact, their denial of any moral presumption of entitlement to pre-tax income invites significantly higher levels of taxation than we currently have, and a potentially more central role for taxation in achieving economic justice through the political process.

Thus, rather than rejecting all tax policy analysis, *The Myth of Ownership* requires a reassessment of traditional tax policy approaches and an evaluation of the practical role of tax policy in achieving distributive justice. I believe that the lessons of *The Myth of Ownership* demand that we be less specific than we might hope about the connection between taxes and justice. What follows from Murphy

5. *Id.* at 37.

6. Economists have long considered government expenditures together with taxation, recognizing government transfer payments as both increased income for individuals receiving them and also negative taxes from a fiscal perspective. See Richard A. Musgrave & Peggy B. Musgrave, *Public Finance in Theory and Practice* 216, 295 (5th ed. 1989). Murphy and Nagel seem to go beyond this relatively narrow universe by expanding the relevant economic categories to all institutions that affect property holdings. See, e.g., Murphy & Nagel, *supra* note 1, at 37.

7. The book contains considerable discussion of some of the most controversial and current issues in tax policy: the tax base, progressivity, and estate taxation. See Murphy & Nagel, *supra* note 1, at 96-129 (the tax base), 130-41 (progressivity), and 142-61 (estate taxation).

and Nagel's argument is that no tax system, by itself, is capable of carrying out a conception of economic justice, and fairness in government cannot be determined by isolating elements of any tax system. We need to ask less of tax policy analysis, but not abandon it altogether.

Previously, tax policy analysts may have asked whether a theory of distributive justice requires a particular tax policy, such as progressive rates or a particular tax base. But progressive rates or a particular tax base may not tell us much about the ultimate distribution of resources, opportunities, income, or welfare in society.⁸ Only in conjunction with the myriad other rules and policies in place in any system can we determine whether a society operates in an economically just manner. Regardless of the progressivity of the tax or its base, the broad combination of taxes, transfers, public goods, educational opportunities, avenues for redress of economic harms, market regulation, and the like are all part of the determination of whether, for example, the poorest members of society are provided a basic minimum that a just or even a decent society would provide.⁹ Neither a progressive rate structure nor an income base can guarantee that minimum, despite their general association with redistributive policies. The tax system itself can never give us enough information to determine whether any ideal is, in fact, being met.

Murphy and Nagel's critique prevents endorsement of specific tax policies in the name of justice, but invites a different, narrower inquiry: whether a particular tax system (or even tax provision) *precludes* a just economic arrangement in society. For example, if the tax system consisted of confiscating all the property of the poorest 20% of the population, no set of remaining government policies could provide an overall economic distribution that liberal egalitarians would consider just. Similarly, the injustice in a tax system that required only black people to pay income taxes could not be cured by any other combination of government institutions.

This Essay attempts to map out how such an inquiry would be conducted in light of Rawls. Rather than searching in theories of justice for required precepts of taxation, we might more fruitfully ask

8. Different theories of distributive justice would consider these various metrics appropriate. *See, e.g.*, Will Kymlicka, *Contemporary Political Philosophy: An Introduction* 81-85 (1990) (describing the interpretation of equality as the fundamental argument in contemporary political theory); Murphy & Nagel, *supra* note 1, at 40-75; Amartya K. Sen, *Inequality Reexamined* 12 (1992) (“[E]very normative theory of social arrangement that has at all stood the test of time seems to demand equality of something The theories involved are diverse and frequently at war with each other”).

9. I use this example simply because it is a principle that Murphy and Nagel themselves seem to adopt. *See* Murphy & Nagel, *supra* note 1, at 134-35. Rawls does as well. *See* John Rawls, *Justice as Fairness: A Restatement* 162 (Erin Kelly ed., 2001).

what constraints, if any, a particular theory of justice imposes on the tax system. Application of such an approach to Rawls's theory of justice may explain his apparent preference for a flat consumption-based tax.¹⁰ This preference is otherwise quite puzzling in light of much of what Rawls wrote about economic justice, and might lead us to expect him to endorse a progressive income tax. If Rawls's discussion of economic justice is treated as offering limitations rather than mandates for taxation, then a variety of tax systems may be part of a just Rawlsian society, including a flat consumption-based tax. Extension of this approach to other political theories might produce a shorter list of acceptable taxes, depending on the extent to which the chosen theory is likely to constrain government action.

I. RAWLS AND THE FLAT CONSUMPTION TAX

Rawls wrote a great deal about economic justice generally, but very little about taxation in particular, and what he did say is puzzling.¹¹ He preferred a consumption tax to an income tax,¹² and he suggested that such a tax could have flat rates.¹³ This is surprising because Rawls's broader conception of economic justice—e.g., the famous difference principle—manifests great concern for the least advantaged in society, and a flat, consumption-based tax is quite generous to the rich, as compared to alternatives such as a progressive income or wealth tax.¹⁴ The architect of the difference principle, which demands that inequalities must be justifiable on the ground that they benefit the least well-off, may seem to be aligned, in matters of taxation, with Steve Forbes and Dick Armey.¹⁵ Does this make sense? I suggest that it does if we understand Rawls's theory to allow a variety of tax systems, depending on the other institutions of society and the operation of non-tax policies. Under certain circumstances, a flat consumption tax is perfectly consistent with Rawls's theory.

Barbara Fried examines the flat aspect of Rawls's suggested tax scheme, and argues that a proportional (i.e., flat) tax seems clearly

10. See John Rawls, *A Theory of Justice* 246 (rev. ed. 1999) (explaining why a proportional expenditure tax is preferable to an income tax).

11. Barbara Fried notes Rawls's "inexplicable enthusiasm" for a flat, consumption-based tax. Barbara H. Fried, *The Puzzling Case for Proportionate Taxation*, 2 Chap. L. Rev. 157, 195 (1999).

12. Rawls, *A Theory of Justice*, *supra* note 10, at 246-47.

13. *Id.*; see also Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 161.

14. Both the flat rate and the consumption base potentially relieve the tax burden on the most well-off group compared to a progressive income tax because (1) under a consumption tax, investment returns are effectively exempt, while wages are taxed in full, and (2) the same flat rate applies to all taxed amounts, regardless of quantity.

15. See Dick Armey, *The Flat Tax: A Citizen's Guide to the Facts on what It Will Do for You, Your Country, and Your Pocketbook* (1996); Neil A. Lewis, *The Forbes Pitch for a Flat Tax*, N.Y. Times, Mar. 6, 1996, at B8 (describing Steve Forbes's flat tax proposal).

misplaced in Rawls's theory.¹⁶ She claims that Rawls's preference for a flat tax on account of its treating everyone in a uniform way "stands as an island of deontological rights swamped by a sea of redistribution," and is undermined by Rawls's own approval of a degressive tax, which is, in fact, progressive to some extent.¹⁷ She maintains that a flat rate makes no logical sense in Rawlsian theory, given the larger aims of the theory, and Rawls's view that income earned on account of talents is not deserved.¹⁸

Liberal egalitarians seem generally to favor progressive systems—i.e., systems in which tax liability increases as a share of the base as the base size increases.¹⁹ Murphy and Nagel ultimately endorse the principle of progressivity on egalitarian, welfare-based grounds, although they do not necessarily favor graduated rates.²⁰ Ronald Dworkin's tax scheme, based on a hypothetical insurance model derived from his theory of equality of resources, is also progressive.²¹ Utilitarians have also argued for progressivity on the theory that society's utility could be maximized by taxing the rich (whose marginal utility of income is low) more than the poor (whose marginal

16. Fried, *supra* note 11, at 185-86.

17. *Id.* at 185. A degressive tax is one in which rates are flat but exemptions or demogrants are allowed, creating progressivity as a matter of overall effective rates of tax. For example, a degressive tax could impose tax at a rate of 20%, but allow everyone a personal exemption of \$100. The taxpayer with \$200 income would pay \$20 in tax, for an average rate of 10% tax, while the taxpayer with \$2,100 income would pay \$400 in tax, for an average rate of 19%. Alternatively, the government could transfer \$20 to each taxpayer. In that case, the taxpayer with \$400 income would pay \$40 tax but receive the \$20 demogrant, for a net of \$20. The taxpayer with \$2,100 income would pay \$420 tax but receive \$20, for a net tax of \$400, producing the same result as the exemption. Because average rates increase as income increases, the system is progressive, even though the rate is flat. Rawls's description of his flat tax allows for "an appropriate social minimum" which could be either in the form of exemption or demogrant, and adjusted up or down as necessary to satisfy the difference principle. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 161-62.

18. Fried, *supra* note 11, at 186.

19. See, e.g., Anne L. Alstott, *The Uneasy Liberal Case Against Income and Wealth Transfer Taxation: A Response to Professor McCaffery*, 51 *Tax L. Rev.* 363 (1996). This definition of progressivity indicates that the rate question is wholly independent of the base question. Consumption taxes, as well as income taxes, can be designed with progressive rates.

20. Murphy & Nagel, *supra* note 1, at 140-41. Following the optimal tax model, Murphy and Nagel favor demogrants, which are cash transfers that operate to adjust the effects of the tax system most dramatically at the lowest levels. Demogrants can operate to provide significant levels of overall progressivity, including negative average rates, even where the statutory rate of tax is proportional. See Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 *Cal. L. Rev.* 1905 (1987). Despite the appeal of demogrants in the academic literature, they are considered politically impossible. See Lawrence Zelenak & Kemper Moreland, *Can the Graduated Income Tax Survive Optimal Tax Analysis?*, 53 *Tax L. Rev.* 51, 60-62 (1999).

21. Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10 *Phil. & Pub. Aff.* 283 (1981), *reprinted in* Ronald Dworkin, *Sovereign Virtue* 65 (2000).

utility of income is presumably higher).²² Even Edward McCaffery, an enthusiastic consumption tax proponent, argues that a progressive tax is the most consistent with Rawls's principles.²³

Nevertheless, a flat tax can be redistributive or not, depending on the distribution of the base and the government's use of revenues. For example, assuming equal government benefits to all, a flat tax on wealth would be highly redistributive because the truly poor would have no base to tax, and a person with modest wealth would pay a much smaller tax than would a person of great wealth.²⁴ Flat taxes are not redistributive where the tax base is equal across taxpayers. For example, a flat tax on everybody's grocery budget would not be nearly as redistributive as the flat wealth tax because the rich spend more on food than do the poor, but probably not a thousand times more (assuming wealth was a thousand times as great).²⁵ Thus, from the perspective of limitations, isolating the flat component yields little information. A flat tax can be consistent with a redistributive theory of economic justice.

What about a consumption base? Putting flat rates together with a consumption base is less redistributive than a flat wealth tax. But it might still be redistributive. A consumption base can be very flexible in allocating tax burdens, and, therefore, is not controlling in determining an overall level of redistribution in society.²⁶ A progressive consumption tax²⁷ could easily be designed to impose a

22. Of course, a proportional tax does collect more money from a rich person than from a poor person. The utilitarian case for progressive taxation depends on some questionable assumptions. In addition to the assumption stated in the text about relative marginal utilities, the case for progressivity depends on a very steep utility curve. See F.A. Hayek, *The Constitution of Liberty* 315-16 (1960); Richard A. Musgrave, *The Theory of Public Finance: A Study in Public Economy* 154-59 (1959); Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. Chi. L. Rev. 417 (1952); Fried, *supra* note 11, at 189 n.89.

23. Edward J. McCaffery, *The Fair Timing of Tax* 28 (Sept. 2003) (unpublished manuscript, on file with author), available at <http://ssrn.com/abstract=441344>.

24. If a 3% wealth tax were levied on everyone in a society in which *A* has zero wealth, *B* has 100, and *C* has 1,000,000, *A* would pay nothing, *B* would pay 3, and *C* would pay 3000. Government benefits could be significantly skewed toward *C* and still allow this tax to be redistributive.

25. For example, if a poor family making \$25,000 a year spends \$2,600 a year (\$50 a week) on groceries, it is difficult to imagine that even a family making \$25 million a year would spend \$2.6 million (\$50,000 a week) on groceries.

26. The redistributive limitations often associated with consumption taxes are political, rather than inherent.

27. There is nothing inherent in a consumption tax base that requires that it be proportional. Some of the most serious proposals for consumption taxation have contained progressive rates. See USA Tax Act of 1995, S. 722, 104th Cong. (1995); David F. Bradford, *Taxation, Wealth, and Saving* 47, 69-70 (2000); Edward J. McCaffery, *Fair Not Flat: How to Make the Tax System Better and Simpler* 101 tbl.6.1 (2002) (displaying progressive rate schedule for consumption tax proposal). Senators Nunn and Domenici's proposed USA Tax had graduated rates of 19-27-40% being reduced over five years to 8-19-40%. S. 722 § 15(a)(1)-(5). Even Hall and Rabushka's Flat Tax is degressive in nature, and Representative Armev's proposal

greater burden on the rich compared to the poor than would an income tax with less progressive rates. Even a flat consumption-based tax raises more revenue from the rich than the poor because rich people can generally be counted on to consume more total goods and services than poor people consume. Certainly, a consumption tax would not preclude satisfaction of the difference principle in a society in which all economic institutions were coordinated. The base question seems even less central to Rawls's theory than the rate structure because the base is at least as amenable as the rates to variation in distribution, depending on other institutions and circumstances. Rawls uses the tax system as a means of achieving distributive justice, rather than as a requirement of justice itself—the features of a tax system are not constitutional essentials.²⁸

Thus, a consumption-based tax could form part of an integrated governmental scheme that used revenues in a redistributive manner so as to guarantee opportunity and improve the prospects of the least well-off. If the proceeds of taxes collected are redistributed to provide the greatest benefit to the least well-off—through whatever mechanism, whether direct transfers, schools, health care, or other programs that open opportunity and improve the prospects of the poorest—then it matters little what the tax itself looks like because the spending side of the budget corrects or adjusts the distributional consequences overall.²⁹ In Murphy and Nagel's terms, the entire fiscal picture could inure to the benefit of the worst-off segment of society and protect the basic liberties even if the tax system in isolation is regressive as to income and wealth. The mechanism chosen on the spending side is a question of effectiveness. From an efficiency perspective, direct transfers may be the most desirable mechanism of redistribution, but any integrated approach could achieve the overall distributional goals of the society.

It might not even be necessary to explain how a flat consumption tax could fit in a Rawlsian society because Rawls's "enthusiasm" for a flat consumption tax may be overstated. His specific comments about taxation are considerably more tentative than his general discussion of distributive justice, and he could have easily offered a stronger endorsement of flat consumption taxes than he did. His mention in *A Theory of Justice* is offered thus: "Leaving aside many complications, it is worth noting that a proportional expenditure tax may be part of

based on it contained an exemption of \$10,700 for individual returns (\$21,400 for joint and surviving spouse returns). Freedom and Fairness Restoration Act of 1995, H.R. 2060, 104th Cong. § 101 (1995); see also Armev, *supra* note 15; Robert E. Hall & Alvin Rabushka, *The Flat Tax* (2d ed. 1995).

28. John Rawls, *Political Liberalism* 227-28 (1993) (stating that the fair equality of opportunity and difference principles are not "constitutional essentials").

29. Fried, *supra* note 11, at 183-84; Murphy & Nagel, *supra* note 1, at 164; Musgrave & Musgrave, *supra* note 6, at 245.

the best tax scheme."³⁰ A few sentences later, he allows exemptions for dependents, which creates progressivity, even if rates are nominally flat.³¹ Then he continues: "It may be better . . . to use progressive rates only when they are necessary to preserve the justice of the basic structure . . ."³² and concedes that if existing institutions are unjust, then "steeply progressive income taxes" may be "justified when all things are considered."³³

In his later work, Rawls's penchant for a flat consumption tax weakened. In *Justice as Fairness*, he consistently tempered his discussions with statements such as: "the following remarks indicate some of the kinds of taxation by which economic and social background justice might be preserved,"³⁴ and "the progressive principle of taxation might not be applied,"³⁵ and "income taxation might be avoided altogether and a proportional expenditure tax adopted instead."³⁶ So, it seems that Rawls fell short of endorsing any particular base or rate schedule, subordinating both the base question and the progressivity question to larger questions of institutional adequacy. Taxes are the mechanism by which the government raises revenue, so that it can be spent in guaranteeing basic liberties and satisfying the requirements of democratic equality, including the difference principle.³⁷

II. THEORY AS LIMITATION: THE DIFFERENCE PRINCIPLE

Perhaps Rawls did not endorse or commit to the tax proposals that he did mention because his analysis of philosophical principles does not require commitment to any particular tax system at all. Numerous tax systems could conceivably satisfy Rawls's principles of justice. Looked at through the lens of *The Myth of Ownership*, the particular design of the tax system is not Rawls's concern at the level of political

30. Rawls, *A Theory of Justice*, *supra* note 10, at 246.

31. *Id.* To illustrate the point, consider two people in a hypothetical flat consumption tax with exemptions. *A* consumes \$100, *B* consumes \$30. If exemptions are each worth \$5 and they each have 4 exemptions, and the flat rate of tax is 20%, *A* will pay tax of \$16 (\$100 consumption - \$20 exemptions = \$80 taxable consumption x 20% = \$16 tax), while *B* will pay tax of \$2 (\$30 consumption - \$20 exemptions = \$10 taxable consumption x 20% = 2). While the statutory rate is a flat 20%, *A* pays tax at an effective (average) rate of 16%, while *B* pays at an effective rate of only 6.6%. Because *A* pays a greater proportion of consumption in tax than does *B*, the hypothetical flat tax is actually progressive.

32. *Id.*

33. *Id.* at 246-47.

34. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 160.

35. *Id.* at 161.

36. *Id.*

37. See Rawls, *A Theory of Justice*, *supra* note 10, at 247 ("Proportional expenditure (or income) taxes are to provide revenue for public goods, the transfer branch and the establishment of fair equality of opportunity in education, and the like, so as to carry out the second principle.").

philosophy, as *A Theory of Justice* seems to be suggesting by not committing his theory to the specific design of a tax system.

Ironically, in applying the perspective of limitations in designing a tax system, Rawls's first principle of justice, which concerns equal political liberties, is more important than his second principle, which concerns economic arrangements. The second principle, which demands that economic inequalities are justifiable only if they benefit the least advantaged, can be satisfied through the combination of a wide variety of institutions, of which the tax system is only one. Inequalities in taxation that fail to benefit the most disadvantaged may be outweighed by other economic arrangements and provisions that benefit those who are worst-off. Only a tax system that burdens exclusively the poorest group would be foreclosed on account of the difference principle, because that scheme of public finance would necessarily entail some redistribution, in the form of public goods at least, from the worst-off to the better-off. The only major limitation on a tax system demanded by the difference principle seems to arise from the revenue needs of the basic structure as a whole; it would preclude a system of taxation that collected insufficient total revenue to support the public institutions that are necessary for fair equality of opportunity, such as education and economic regulation.³⁸ The government must raise sufficient resources to provide a social minimum.³⁹ In isolation, Rawls does not apply the difference principle to appraise any particular rate or base.⁴⁰

Perhaps justice as fairness is more concerned with sufficient taxation than with the particular distribution of tax burdens.⁴¹ From that perspective, the demands of justice on tax design are minimal, or at least do not necessarily entail any particular arrangement. A proportional tax could certainly raise enough revenue to provide for substantial redistribution, both directly in the form of transfer payments to the neediest members of society, and indirectly, through the provision of public goods that disproportionately benefit the least well-off.

38. *Id.* at 243.

39. *See, e.g., id.* at 244-45.

40. This conclusion may contradict Rawls's own statement in *Justice as Fairness* that "[t]he difference principle might, then, roughly be satisfied by raising and lowering [the exemption for a social] minimum and adjusting the constant marginal [flat] rate of taxation." Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 161. This suggests that the tax system, by itself, can roughly satisfy the difference principle. *Id.* at 161-62.

41. This might be the most important point of contention concerning taxation between Rawls and his critics. For example, the institutions which would be necessary in the minimal state that Robert Nozick proposes would be considerably more modest than those required in a Rawlsian state, and, therefore, require considerably less revenue. Nozick argues that redistributive taxation is only legitimate for the narrow purpose of providing protective services to everyone. *See* Robert Nozick, *Anarchy, State and Utopia* 52, 149 (1974).

Focusing on sufficient taxation, even a lump-sum tax, which levies an equal dollar charge on all individuals, could potentially satisfy Rawls's requirements of justice as fairness. Sufficient taxation depends on the operation of many institutions in society, and Rawls imagined a system in which minimal taxation might be adequate. In *Justice as Fairness*, he describes an economic system of property-owning democracy, in which the background institutions of society "work to disperse the ownership of wealth and capital, and thus to prevent a small part of society from controlling the economy."⁴² In its ideal form, a property-owning democracy would not produce wide disparities of income and wealth and a few privileged members of society controlling most of the economic and social resources. "Under these conditions[,] we hope that an underclass will not exist"⁴³

A property-owning democracy that manages to achieve the level of cooperation and mutuality that Rawls envisioned requires little state revenue for guaranteeing basic needs through redistribution. If the existing institutions of society are just and operate to produce benefits throughout the economic strata, government would need to fund the institutions required to guarantee equality of opportunity. But there would be no need for large-scale transfers to the least well-off, who would presumably benefit from the operations of the economic system that rewarded everyone for "doing their full share on terms recognized by all as mutually advantageous and consistent with everyone's self-respect."⁴⁴

Under such circumstances, a small head tax might be acceptable. If the proceeds of the tax were used to benefit the least well-off—with the understanding that the disparity between the two is narrow—it could satisfy the difference principle. The entire scheme might be just, even if the tax portion, when isolated, seems quite unfair, which it presumably would to someone who understands equality as Rawls does.⁴⁵

42. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 139. In *Justice as Fairness*, Rawls contrasted a "property-owning democracy" with "welfare-state capitalism," the latter being less desirable because it allows greater concentration of wealth and income and leaves an underclass outside the political culture. *Id.* at 139-40. In *A Theory of Justice*, Rawls was less specific about economic institutions and allowed that both socialism and property-owning democracy would be acceptable systems, given his principles. See Rawls, *A Theory of Justice*, *supra* note 10, at 234-42.

43. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 140.

44. *Id.* at 139.

45. It is possible to argue that a head tax satisfies some conception of equality. It levies an equal tax, in dollars, though clearly not an equal burden on individuals in different economic circumstances. Most people who reject progressive taxation on equality grounds opt for proportional taxation, rather than a head tax. See Blum & Kalven, *supra* note 22, at 506-16. Jeffrey Schoenblum is the exception. He argues for a head tax from a philosophical perspective, albeit not a Rawlsian one. See 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 (1995).

These observations reconciling various regressive tax schemes with Rawls's principles may indicate something about Rawls's theory, but little about the taxes considered.⁴⁶ Rather than supporting a particular tax base or rate structure, Rawls's theory of justice as fairness (and other theories of economic justice) might be better interpreted as providing limits to certain tax schemes. Rawls may prohibit the state from raising revenue in a way that precludes satisfaction of the difference principle, regardless of later redistribution. But it may do no more than that. Scholars have differed about which tax would satisfy Rawlsian principles precisely because a wide variety of taxes could all be consistent with those principles. This approach to taxation and theories of distributive justice, though less determinate, provides a better analytical framework than attempting to infer specific tax institutions from a general political theory.

In keeping with this conference, this Essay focuses on Rawls, but the same approach would be fruitful with respect to other theories of distributive justice as well. Depending on the theory, the result would not always be as inclusive as described here for Rawls. For example, a libertarian theory, such as that described by Robert Nozick in *Anarchy, State and Utopia*,⁴⁷ would preclude most tax systems. Nozick's principles of justice would not allow the state to interfere with the private market, unless the state's action operated to correct some past injustice in either acquisition or transfer.⁴⁸ Because Nozick's theory severely curtails the role of the state, the revenue it needs is minimal, and any tax system that raised it by coercion would be suspect. Consent would be necessary, making a voluntary tax most consistent and a benefits-based tax arguably acceptable.⁴⁹

An example of this approach for Rawls is helpful. If a tax system imposed a levy only on the poorest segments of the population, it would be ruled out in a Rawlsian world because it would be impossible for the overall scheme of government distribution to satisfy the difference principle.⁵⁰ By definition, in such a tax, there is

46. Barbara Fried's puzzlement at Rawls's embracing of a flat tax led her to conclude that there must be a "powerful instinct" connected with proportionality. Fried, *supra* note 11, at 186. That, of course, is another sympathetic reading of Rawls's discussion of taxation.

47. Nozick, *supra* note 41.

48. *Id.* at 151.

49. *Id.* at 169-72 (explaining why taxation is equivalent to forced labor); see Murphy & Nagel, *supra* note 1, at 16-19; Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 Mich. L. Rev. 465, 491-97 (1987).

50. It might be possible, however, for a highly regressive tax to be part of a larger institutional structure that is just if there are other taxes or fees that provide net benefits to the worst-off class. This simply means that it is incomplete to isolate a single tax, such as the federal income tax, and consider its distributional effects

redistribution from the worst-off to all better-off groups because the worst-off finance all public goods. Any transfer payments that come from the pool collected from the lowest income group might constitute redistribution between individuals, but would fail to constitute redistribution between groups.⁵¹ Rawls's focus on groups is a familiar approach in tax analysis, and important in applying the limitations approach.⁵² If income (or wealth or consumption) is the relevant criterion, then the focus on groups effectively isolates that characteristic and treats all other characteristics of people as evenly distributed across income groups.⁵³ The difference principle could not be satisfied with such a tax system, regardless of other government programs, because the scheme could not be designed to benefit the least advantaged group.

Extending this example, the difference principle might also preclude a highly regressive tax,⁵⁴ depending on the operation of markets and other institutions in society. For example, consider a highly regressive tax pursuant to which the lowest income taxpayers paid tax at an average rate of 50%, while the highest income taxpayers paid an average rate of 2%. Such a tax could raise more dollars from the rich than the poor, depending on the income distribution prior to the tax. The greater the inequality in market returns, the more tax would be paid by the rich compared to the poor in this system. Could the overall scheme of economic distribution and regulation benefit the least well-off members of society despite a tax system, which, in isolation, exhibits a pattern that is opposite Rawls's ideal? It depends on the distribution of government benefits, and how that distribution interacts with the tax system.

If we assume that other institutions provide significant benefits to all, then high-income taxpayers would get considerable benefits from

without considering other taxes that are imposed by the same authority, such as the federal payroll or estate tax.

51. This is an illustration in which Rawls's use of representatives, rather than particular individuals, produces results that differ from one another, and it is clear, in this case, that the focus on groups goes considerably further in establishing economic justice for the society.

52. The IRS and economists often organize taxpayers into quintiles or deciles of income. We have lately heard a fair amount about the top 1% or 2% and even the top few. *See, e.g.*, David Cay Johnston, *Perfectly Legal: The Covert Campaign to Rig Our Tax System to Benefit the Super Rich—and Cheat Everybody Else* 30-44 (2003); Joel Slemrod, Office of Tax Policy Research, *The Fortunate 400* (July 17, 2003), at <http://www.otpr.org/fortunate400.pdf>.

53. Of course, some characteristics are, in fact, highly correlated with income. For example, the lowest income group is likely to be made up disproportionately of single women of color, while the top earners are historically 100% white. *See* Joseph Bankman & Barbara H. Fried, *Winners and Losers in the Shift to a Consumption Tax*, 86 *Geo. L.J.* 539, 559 (1998).

54. A regressive tax is one in which the average rate of tax declines as the base (such as income) grows.

the government and the tax system.⁵⁵ The combination of widely shared or evenly dispersed government benefits and highly regressive taxes could be suspect in a Rawlsian conception. Under the difference principle, benefits to high-income taxpayers are acceptable, but only if the benefits flow down also, and where significant benefits from government are enjoyed by the rich, the overall distribution of benefits might not be sufficient to compensate the worst-off for the heavy tax burden that they bear. On the other hand, if the benefits of government are considered more modest, or have minimal value,⁵⁶ then a regressive scheme might provide an overall distribution of economic benefits that inures to the benefit of the worst-off. Thus, even within the modest approach of looking for limitations, those limitations depend on empirical determinations and moral judgments about the non-tax institutions of society. Ironically, it may turn out that the greater pre-tax income inequality that a society has, assuming fair background institutions and markets, the more likely that a regressive rate structure will satisfy the difference principle.⁵⁷ This might explain why the difference principle is only a limited part of the analysis of tax systems under Rawls's theory.⁵⁸

In assessing tax systems under this integrated approach, there are a few issues that need to be resolved. For example, all taxes must be aggregated because a highly regressive tax could be complemented by a highly progressive tax, providing government revenue in a generally proportional manner. The net total tax scheme would need to be examined to determine whether a theory of justice limits the scheme as a whole. This requirement applies Murphy and Nagel's comprehensive perspective to the narrower question of limitations.

In addition, taxes and government benefits would need to be identified if something less than all accrued gains (from whatever source) are to be included in the analysis under the difference

55. This is the view of society endorsed by Murphy and Nagel. See Murphy & Nagel, *supra* note 1, at 16-19.

56. John Stuart Mill seemed to be of this view when he described the benefits of government as being highest for slaves. See John Stuart Mill, *Principles of Political Economy* 171 (Jonathan Riley ed., Oxford Univ. Press 1994) (1848).

57. Consider this example: A society with fair background institutions and markets produces pre-tax incomes of \$1,000 for *A* and \$10 for *B*. If *B* pays tax at 10%, he pays \$1 in tax. If *A* pays tax at 5%, he pays \$20 in tax. If the tax revenues are used to provide government benefits that are equal for to all citizens, then the tax scheme satisfies the difference principle because it redistributes from *A* to *B* to the extent of \$9.50. On the other hand, if pre-tax incomes are \$20 for *A* and \$10 for *B*, then the same tax rates produce \$1 of tax for each. If the taxes finance equal government benefits, then the same schedule of rates fails to improve the position of the least well-off. One objection to this example is that the levels of inequality in the first example necessarily evidence a less fair institutional structure than the second, in which incomes are more equal.

58. See *infra* text accompanying notes 65-91 for a discussion of the first principle. It is a matter of some controversy how stringent or permissive the difference principle is; I shall not enter that debate here.

principle. If all gains are included, then the implication is that all returns, regardless of source, are provided by the government.⁵⁹ But if some inequalities in market returns are acceptable in a just society—and Rawls believed that they are⁶⁰—then in judging institutions of government, we need to separate out socially created advantages from those arising out of individual effort. The socially created advantages must count in determining overall benefits and burdens from government, and the calculus under the difference principle must account for them, but the benefits from individual effort appropriately produce inequalities in income and wealth, and should not require adjustment under the difference principle. Only by defining the universe of social benefits can we analyze whether the taxing scheme permits a fair distribution of government benefits and burdens overall. Although this definition may be a difficult task, there will be some systems that veer so far from justice in background institutions that the analysis is clear, and inequalities from markets arise from monopoly or inequality in opportunities. Since Rawls is willing to accept some inequality in economic outcomes if certain conditions are satisfied, the implication is that there are some legitimate returns that are outside the category of public justice and, therefore, outside the tax and transfer scheme.

Some cases will be hard. For example, social security (“FICA”) can be described as an insurance scheme that contains some redistributive elements. Over a lifetime, it redistributes from richer workers to poorer workers, although richer workers contribute more into the system and receive more out of the system in dollar terms.⁶¹ But it can also be described as a pure tax in which today’s workers subsidize today’s retirees; no actual fund is created for individual workers and the system pays out amounts as they are received.⁶² As a tax, FICA is highly regressive because it is imposed on a worker’s first dollar and contains an earnings cap.⁶³ Average tax rates are flat from \$1 in wages until the cap is reached, and then decline as wages exceed the cap. On the insurance model, FICA breezes through the difference principle,

59. This is a point on which philosophers differ. It is essentially the baseline issue discussed by Murphy and Nagel. The position stated in the text, which makes everything the government’s before anything is yours, reflects the opposite extreme from what many people understand as desert. *The Myth of Ownership* criticizes the fulsome approach to desert, but stops short of turning it entirely on its head. See Murphy & Nagel, *supra* note 1, at 35-37.

60. Rawls describes “open and workably competitive markets” as fair. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 131; see also *id.* at 151. In *A Theory of Justice*, he writes, a “significant advantage of a market system is that, given the requisite background institutions, it is consistent with equal liberties and fair equality of opportunity.” Rawls, *A Theory of Justice*, *supra* note 10, at 240-41.

61. Daniel Shaviro, *Making Sense of Social Security Reform 69-71* (2000).

62. *Id.* at 88-89.

63. It is a wage tax, so non-wage income is exempt by design, exacerbating the regressivity as to income. See *id.* at 12.

but on the tax model, additional taxes or institutions are necessary to determine whether the regressivity of the tax is isolated or present throughout the system. FICA is a much more troublesome institution.

Thus, the analyses of constraints on the tax system that arise from the difference principle are largely dependent on factors arising outside the tax system. There are virtually no absolute judgments that can be made about the tax system from the requirements of the difference principle. In fact, if background institutions were just and markets operated to produce universal equality in income and wealth, the difference principle would not require any tax for its achievement. In a society “beyond justice,”⁶⁴ taxation would only be about providing government financing for public goods and operations; redistribution simply would be unnecessary.

III. LIMITATIONS ON THE TAX STRUCTURE FROM RAWLS’S FIRST PRINCIPLE

The most significant limitations on the tax structure come from Rawls’s first principle of justice, which guarantees political liberties and has priority over the second principle’s promise of economic justice. While tax scholars have searched the difference principle for a framework, they are most successful where it is supplemented by another model into which the difference principle can be incorporated for measurement.⁶⁵ A more compelling influence on the broad design of a tax structure comes from the first principle.

The first principle may impose significant limitations on systems of taxation because it demands that every individual have equal basic liberties. Based on this limitation, justice as fairness would preclude an endowment tax, which taxes people according to their abilities to earn, regardless of the actual choices they make to earn. Protection of individual autonomy, not economic justice, drives the limitation. In addition, the first principle precludes any tax system that allows economic inequalities to interfere with the integrity of the political system. Thus, where concentrations of wealth produce concentrations of political power, the first principle would require the tax system to break up politically threatening concentrations of wealth so that equal liberties of citizenship are possible.⁶⁶

In *Justice as Fairness*, Rawls stated the first principle as: “Each person has the same infeasible claim to a fully adequate scheme of

64. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 177.

65. See Bankman & Griffith, *supra* note 20, at 1955 (applying Rawls’s leximin within the optimal tax model).

66. Similarly, the first principle would support campaign finance regulation in furtherance of a principle of equal participation. See Rawls, *Political Liberalism*, *supra* note 28, at 359-63 (criticizing *Buckley v. Valeo*, 424 U.S. 1 (1976)).

equal basic liberties, which scheme is compatible with the same scheme of liberties for all”⁶⁷ The basic liberties consist of:

freedom of thought and liberty of conscience; political liberties (for example, the right to vote and 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.⁶⁸

The priority of these basic liberties, which can be threatened by economic power, provides significant and specific demands on the tax system. The tax system must protect the scheme of basic liberties in two ways: (1) taxation itself may not violate any of the basic liberties, and (2) the tax system may not allow other institutions with which it interacts, such as the market, to violate any basic liberties.

From these principles, it becomes clear that any tax that itself compromises political rights, personal integrity, or freedom of thought is off limits. Thus, a tax on people with particular political or moral views would be prohibited, as would a poll tax that disenfranchised the poor. But Rawls’s first principle also precludes tax systems that are less transparently hostile to the basic liberties, and an endowment tax, even though it does not target the basic liberties, would nevertheless be incompatible with a Rawlsian conception. In addition, any society in which the wealth of some individuals threatens any of the basic liberties of others may require taxation to protect the threatened individuals. Thus, it is clear that an inheritance tax might be necessary in a society in which economic power constrains political participation or personal integrity.

Economists like endowment taxes because, unlike income and consumption taxes, endowment taxes would not distort the labor/leisure choice.⁶⁹ Endowment taxation adopts an ex ante perspective, compared to most forms of taxation currently in use, which take an ex post perspective.⁷⁰ To a welfarist, any ex ante tax might be problematic because it ignores outcomes. But ex ante taxes

67. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 42.

68. *Id.* at 44.

69. David F. Bradford & U.S. Treasury Tax Policy Staff, *Blueprints for Basic Tax Reform* 36-37 (2d ed. 1984) [hereinafter Bradford, *Blueprints*]; David F. Bradford, *Untangling the Income Tax* 154-56 (1986); Musgrave & Musgrave, *supra* note 6, at 291-93; Louis Kaplow, *Human Capital Under an Ideal Income Tax*, 80 Va. L. Rev. 1477, 1498-99 (1994). Murphy and Nagel reject an endowment tax for different reasons than those discussed in the text. They argue that an endowment tax is not about fairness at all, but about utility and wealth maximization. Murphy & Nagel, *supra* note 1, at 23.

70. Different consumption tax proposals vary on the perspective. Cash flow consumption taxes are ex post. Wage taxes, which are equivalent to cash flow consumption taxes under certain moderately unrealistic assumptions, are ex ante. It has been argued an income tax, which appears ex post, actually operates as an ex ante tax. See Noël B. Cunningham, *The Taxation of Capital Income and the Choice of Tax Base*, 52 Tax L. Rev. 17, 34-35 (1996).

would not necessarily be problematic in a Rawlsian society because the background institutions of society are designed to provide continuous procedural justice, rather than equality of welfare.⁷¹

Nevertheless, an endowment tax is problematic from the standpoint of Rawls's conception of justice because of the obligations that it places on individuals to earn enough money to pay the tax. Particularly well-endowed individuals would be deprived of the opportunity to choose their own life plans if those plans would provide insufficient funds to pay their tax liability. In *Some Reasons for the Maximin Criterion*, Rawls discusses a "head tax on natural assets,"⁷² by which he clearly means an endowment tax. He writes:

[G]reater natural talents are not a collective asset in the sense that society should compel those who have them to put them to work for the less favored. This would be a drastic infringement upon freedom. But society can say that the better endowed may improve their situations only on terms that help others. This way inequalities are permitted in ways consistent with everyone's self-respect.⁷³

Similarly, in his *Reply to Alexander and Musgrave*,⁷⁴ Rawls rejects endowment taxation, explaining:

It seems doubtful, in fact, whether natural abilities even exist in a form that could be measured, even theoretically, for purposes of lump sum taxation. . . . [P]otential earning capacity is not something independent from the social forms and the particular contingencies over the course of life, and the idea of a lump sum tax does not apply.⁷⁵

Finally, in *Justice as Fairness*, he offers his most precise objection:

[An endowment tax] would violate the priority of liberty. It would force the more able into those occupations in which earnings were high enough for them to pay off the tax in the required period of time; it would interfere with their liberty to conduct their life within the scope of the principles of justice. . . . The point is clear and brings out a further aspect in which our native endowments are ours

71. Rawls's index of primary goods is not a measure of welfare. See John Rawls, *Reply to Alexander and Musgrave*, 88. Q.J. Econ. 633 (1974), reprinted in John Rawls, *Collected Papers* 232 (Samuel Freeman ed., 1999) [hereinafter Rawls, *Reply*]. Ex ante taxes might be suspect under the difference principle, which considers outcomes. In addition, Rawls would assure a decent social minimum covering basic needs, which also concerns outcomes. See Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 162.

72. John Rawls, *Some Reasons for the Maximin Criterion*, 64 Am. Econ. Rev. 141 (1974), reprinted in John Rawls, *Collected Papers* 225, 231 (Samuel Freeman ed., 1999) [hereinafter Rawls, *Reasons*]. In *Justice as Fairness*, Rawls also refers to a "head tax" but it is evident that he means an endowment-based tax rather than a lump-sum equal tax for everyone, which is what the tax literature generally calls a head tax. See Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 157-58.

73. Rawls, *Reasons*, *supra* note 72, at 231.

74. Rawls, *Reply*, *supra* note 71.

75. *Id.* at 253.

and not society's: namely, that we cannot be subject to [an endowment tax] to equalize the advantages our endowments might confer. That would violate our basic liberties.⁷⁶

Thus, it is clear that Rawls's theory precludes the adoption of an endowment tax because of the dangers to liberty that it poses.⁷⁷ Some philosophers would extend this reasoning to all taxation,⁷⁸ but Rawls's approach is more moderate, and prohibits only taxes that interfere with the basic liberties.⁷⁹ Although an endowment tax might not be arbitrary, it is unacceptably intrusive and burdensome precisely where Rawls requires that society allow individuals to form their own plans and control their own actions.

In addition to prohibiting an endowment tax, Rawls's first principle might suggest other limitations on taxation, depending upon other institutions of society and the existing pattern of income and wealth. For example, given the current, actual distribution of income and wealth,⁸⁰ a tax system consisting solely of a consumption tax threatens to encroach on the first principle. This is because a consumption tax allows unlimited accumulations of wealth.⁸¹ Rawls allows only a limited gain to the most favored group "on the assumption that, even if the difference principle would allow it, there would be unjust effects on the political system and the like excluded by the priority of liberty."⁸² Thus, a general consumption tax might need to be supplemented to safeguard the first principle and prevent the power

76. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 158.

77. After explaining his practical and theoretical objections to an endowment tax, Rawls writes, "All this is bad enough, but the situation is even worse if we ask at what time of life the tax is to be assessed." Rawls, *Reply*, *supra* note 71, at 253. The implication of this terse statement is that any injustice in attempting to measure natural abilities and tax them is increased by doing so prior to the time at which individuals turn these contingencies into actual measurable benefits. In *Justice as Fairness*, Rawls identifies another objection connected to timing and practical application of such a tax: "[P]eople will have a strong incentive to conceal their endowments, as well as a strong incentive not to realize them until after the age at which the tax is imposed." Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 158. This sort of objection to an endowment tax is the more traditional, practical objection. Rawls's most compelling objections seem to go further.

78. Robert Nozick views all taxation of labor as enslavement. Nozick, *supra* note 41, at 169.

79. He stresses this point in *Reply to Musgrave and Alexander*. Rawls, *Reply*, *supra* note 71, at 252.

80. See Robert Greenstein & Isaac Shapiro, *Ctr. on Budget and Policy Priorities, The New, Definitive CBO Data on Income and Tax Trends 6* (Sept. 23, 2003) (reporting that the "2.8 million people who made up the top one percent of the population received more after-tax income in 2000 than did the 110 million Americans in the bottom 40 percent of the population"), at <http://www.cbpp.org/9-23-03tax.pdf>.

81. While an income tax allows significant accumulation of wealth as well, it has been recognized to operate as a tax on wealth. See Cunningham, *supra* note 70, at 17; Alvin Warren, *Would a Consumption Tax Be Fairer than an Income Tax?*, 89 *Yale L.J.* 1081, 1097-101 (1980).

82. Rawls, *A Theory of Justice*, *supra* note 10, at 70.

associated with money from interfering with the basic liberties. Some form of a wealth tax would likely be necessary.⁸³

Unlike the prohibition of an endowment tax, which I argue is absolute in a Rawlsian conception, the necessity for a wealth tax is contingent on the existing arrangements in society. If accumulations of wealth do not develop, or if accumulations do not threaten the basic liberties, there is no need for a wealth tax. Rawls imagines a world in which wealth and income inequality is not as large as currently observed. In such a society, there is less need for any redistributive taxation because “[p]roperty-owning democracy . . . ensur[es] the widespread ownership of productive assets and human capital (that is, education and trained skills).”⁸⁴ But Rawls recognizes that “background institutions must work to keep property and wealth evenly enough shared over time to preserve the fair value of the political liberties[,] . . . [and] devices such as taxes[] [are necessary] to prevent excessive concentrations of private power.”⁸⁵

Specifically, Rawls endorses an accessions tax,⁸⁶ which levies a tax on recipients of bequests, not for the purpose of raising government revenue, “but solely to prevent accumulations of wealth that are judged to be inimical to background justice.”⁸⁷ His focus on recipients, rather than donors, who are the focus in an estate tax, may fairly be connected to the content of background justice, in particular, equal opportunity, and to the problem of justice between generations. Equal opportunity is an element of both of Rawls’s principles of justice: The opportunity to participate in the political system, and achieve power in that system, is part of the first principle, while economic opportunity is a component of the second principle.⁸⁸ Because equal opportunity must be renewed at every generation, an accessions tax may be preferable to an estate tax because it is sensitive to the concentrations of individual wealth going forward. If the allocations of resources that develop over time produce concentrations of wealth that prevent equal opportunities across generations, then taxation would be necessary to readjust those opportunities at every generation.⁸⁹

Contingent on the operation of the institutions in society, a wealth

83. Edward McCaffery has argued that a consumption tax, without a wealth tax, would be the best institutional embodiment of Rawls’s principles. *See, e.g.*, Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 Yale L.J. 283 (1994).

84. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 139.

85. *Id.* at 51 (citation omitted).

86. Any form of wealth tax would probably satisfy Rawls’s policies. The text discusses his particular references, but a periodic wealth tax, which breaks up dangerous accumulations regularly during a person’s lifetime, might be most effective in achieving the goals of a wealth tax.

87. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 160-61.

88. *See, e.g.*, *id.* at 149.

89. *Id.* at 51-52.

tax might not need to collect any revenue; it can operate as insurance against the potential dangers of unequal concentrations of wealth. If inequalities in wealth accumulation over time do not interfere with the fairness of background institutions, then inheritance taxation might not be necessary.⁹⁰ A single society might need such a tax at different periods in its history. Because a just society can have significant disparities in wealth and income,⁹¹ those disparities only trigger the requirement of a tax where they threaten the basic institutions. Inequalities in wealth and welfare among individuals within generations is not unjust, as long as those inequalities do not result from flaws in the basic structure that allow unfair advantages to some individuals. Thus, taxation may have its most compelling role as a mechanism to adjust institutions across generations.

IV. CHOOSING AMONG TAX STRUCTURES

If we start with the perspective of limitations and recognize that many different structures of taxation might be acceptable from the standpoint of Rawls's conception, how do we decide which tax structure to choose as a matter of legislative prerogative? It should be clear from the preceding analysis that it is largely contingent on the economic structure of society, the levels of inequality of wealth and income, and the relationship between inequalities in wealth and income and opportunity in both the public and private spheres.

Given the inequalities that currently exist in the real world and the way that markets actually function, the constraints that Rawls's principles of justice impose on the tax system may be substantial. If markets operate to increase inequalities, and the prospects of the least advantaged are not chain-connected⁹² to the prospects of the most advantaged, then the tax system carries a particularly large burden among the institutions of society to correct economic injustices. While the perspective of limitations seems to impose few requirements for a tax system, it demands more as the other institutions of society are treated as fixed. Justice as fairness begins to preclude more tax structures as society becomes more determined. The further we move from the original position, and the more imperfect the economic and social institutions actually are, the more limitations the tax system faces from Rawls's theory.

In *Justice as Fairness*, the economic system described as property-owning democracy is sufficiently ideal that no taxation at all may be necessary to adjust the distribution of income and wealth.⁹³ In a

90. See *id.* at 53.

91. Rawls is entirely clear about this. He writes that a guarantee of equal income and wealth is "irrational." *Id.* at 151.

92. See Rawls, *A Theory of Justice*, *supra* note 10, at 70-73 (discussing concepts of "chain connection" and "close-knitness").

93. Rawls, *Justice as Fairness: A Restatement*, *supra* note 9, at 139.

perfectly operating society, the institutions of cooperation would distribute income and wealth in a manner that allowed greater gains to some, but some gains to all, as a matter of course. This is because “the background institutions . . . work to disperse the ownership of wealth and capital, and thus to prevent a small part of society from controlling the economy, and indirectly, political life as well.”⁹⁴ The difference principle could be satisfied in a market economy in which the least well-off are able to invest their human capital in productive ways so that they are entitled in the market to the benefits of society’s productivity along with the most advantaged. In such a society, “reciprocity is owed”⁹⁵ to the least advantaged, and their prospects improve along with everyone else’s. In such a society, taxation as a tool of distributive justice is much diminished because it is not necessary to achieve equality of opportunity or satisfy the difference principle. Taxation may serve only as a revenue-raising tool.

But in the real world, wealth and capital are not widely dispersed, and reciprocity is rarely to the least advantaged, so Rawls’s broader principles might lead to a more distributive tax system. In particular, Rawls’s assumption of “chain connection” and “close-knitness”⁹⁶ minimize the task of the policymaker. Where there is chain connection, and where “expectations are close-knit,” improving the expectations of the least advantaged would improve the expectations of everyone else as well.⁹⁷ If chain connection held and expectations really were close-knit, then we could reach the same policy recommendations by alternatively focusing on the most advantaged, and inferring that their enrichment would likewise enrich the worst-off as well. Economic benefits would necessarily be distributed across the income spectrum. As a matter of fact, there is no evidence that chain connection actually operates,⁹⁸ and tax benefits enjoyed by the rich do not seem to improve the lot of the poor.⁹⁹ Therefore, in

94. *Id.*

95. *Id.*

96. Rawls, *A Theory of Justice*, *supra* note 10, at 71. Expectations are close-knit where there are no discontinuities between the expectations of different representative men. Where expectations are close-knit, as expectations improve for one group, they also improve for other groups. In the curves that Rawls drew of the expectations of the least and next-least favored representative men, “[a]t each point both curves are either rising or falling.” *Id.*

97. *Id.* at 70.

98. Press Release, Ctr. on Budget & Policy Priorities, *Two Decades of Extraordinary Gains for Affluent Americans Yield Widest Income Gaps Since 1929, New Data Indicate 2* (Sept. 23, 2003) (reporting that between 1979 and 2000, the average after-tax income of the top 1% rose 201%, while the lowest fifth rose less than 9%), at <http://www.cbpp.org/9-23-03tax-pr.pdf>.

99. Greenstein & Shapiro, *supra* note 80, at 13 tbl.6 (reporting that the 2001 and 2003 tax cuts resulted in a 5.4% increase in the after-tax income of millionaires, as opposed to an increase of only 0.2% for the bottom quintile).

Rawls's view, the least well-off must explicitly be given the greatest consideration.¹⁰⁰

Another problem in applying Rawlsian principles to the real world arises from Rawls's assumptions about the "common pool."¹⁰¹ Professors Murphy and Nagel question the intellectual origins as well as the wisdom of the common pool argument,¹⁰² and the common pool as a descriptive matter seems largely untenable today. In small communities, the common pool argument may have resonated, but in a global economy, it seems far-fetched to suggest that the resources an individual invests (in any way) translate into specific benefits for identifiable others. Nevertheless, the common pool argument is quite powerful in the real world of tax law. The last decade has seen a subtle and gradual, but undeniable shift away from taxing investment; savings for all sorts of purposes have disappeared from the base, privileging investment income compared to wage income, a hallmark of consumption taxation as compared to wage.¹⁰³

One of the fundamental problems with the common pool in Rawls's theory is that it allows a benefit to accrue to the most advantaged, and relies on the market to distribute those benefits to everyone else. The most recent tax legislation provides a good illustration of how the

100. Rawls, *A Theory of Justice*, *supra* note 10, at 69-70.

101. This assumption is that invested savings inure to the benefit of others, as well as the owner of those investments. An income tax taxes everything earned, whether saved or spent, while a consumption tax only taxes amounts spent on private, preclusive consumption, so a belief in the value of the common pool supports a preference for consumption taxation. Only personal, preclusive consumption—which benefits only the consumer—need be taxed. The common pool is a venerable notion that traces its origin to Hobbes, and has proved persuasive to many consumption tax proponents including John Stuart Mill, Nicholas Kaldor, and some influential thinkers in the Treasury Department. See Bradford, *Blueprints*, *supra* note 69, at 47 (noting that moving to a consumption base would "remove a distortion that discourages capital formation . . . [and lead] to a higher U.S. growth rate in the short run, and a permanently higher capital/output ratio in the long run"); Nicholas Kaldor, *An Expenditure Tax* 53 (1993) (noting that a consumption tax "would tax people according to the amount which they take out of the common pool" because "[i]t is only by spending, not by earning or saving, that an individual imposes a burden on the rest of the community in attaining his own ends"); Mill, *supra* note 56, at 180 (concluding that by investing, the rich "divert their income from the supply of their own wants, to a productive investment, through which . . . it is distributed in wages among the poor"). The belief that taxes should be levied according to one's standard of living is an outgrowth of the common pool argument.

102. Murphy & Nagel, *supra* note 1, at 109-12.

103. Under current law, savings may grow free of tax if they are in retirement accounts (sections 401, 403, and 408A of the Internal Revenue Code), or accounts dedicated to education (sections 529 and 530) or medical expenses (section 220), and investments in machinery and equipment are now subject to a negative rate of tax (yes, that means the government will pay you!). See Calvin H. Johnson, *Depreciation Policy During Carnival: The New 50 Percent Bonus Depreciation*, 100 *Tax Notes* 713, 714 (2003) (describing how the bonus depreciation allowance enacted in the Tax Relief Act of 2003 provides a negative tax, or direct subsidy, of 27% for debt-financed investments in equipment).

market often fails to do that. It primarily reduced the rate of tax on dividends and capital gains as part of a proclaimed effort to create jobs for people who were not the direct beneficiaries of the legislation.¹⁰⁴ These tax cuts only translate into benefits for poor and middle-income people if the tax savings are invested in domestic jobs and industries that serve poor and middle-income people, and it is not clear that the recent cuts are creating secondary beneficiaries.¹⁰⁵

In addition, there is only a net improvement in the well being of the least well-off if tax-savings induced jobs and programs provide greater benefits than government programs could have provided with the lost tax revenue. A central flaw of the common pool argument in current application is that it seems to ignore the alternative of the public sector. While high-income taxpayers might invest their savings overseas, the government could have targeted those funds more precisely through direct appropriations. Thus, the legislative application of the common pool idea, as illustrated in the 2003 Act, is inconsistent with Rawls's second principle of justice. By actively increasing the benefits to the most advantaged, and leaving the least advantaged at the mercy of the market, the policies carrying out the common pool idea fail to consider the actual consequences of government actions on the least well-off. Without chain connection and secondary market beneficiaries, in practice, any Rawlsian support for a flat, consumption tax becomes significantly weaker.

CONCLUSION

This focus on limitations rather than mandates should not suggest that all potentially acceptable tax systems would be equally effective in achieving a particular vision of distributive justice. I have tried to show how Rawls's theory presents different constraints on the design of a tax system, depending on other background institutions. A society with a progressive income tax may need fewer total government programs to achieve an acceptable level of economic inequality in a Rawlsian conception. The less that government is able to integrate separate programs in an overall distributive scheme effectively, the greater redistributive burden the tax system must bear.

In theory, the particular design of the tax system might not matter much in determining whether there is a just overall societal distribution. But, in fact, it matters a great deal. For better or for worse, the tax law is the major tool of redistribution we have. Tax policy debate is one of very few areas of the law in which discussions

104. President Bush described his tax cuts as a program of "job creation." Patti Mohr, *Bush Takes on Tax Cut Critics, Predicts Economic Recovery*, 100 Tax Notes 610, 610 (2003); Daniel Altman, *Recession Is Over; Jobs Aren't Trickling Down*, N.Y. Times, July 18, 2003, at C1. The 2003 tax cut was on top of the 2001 tax cut, which cut marginal rates, and repealed the estate tax, which, by definition, only affects the rich.

105. See Altman, *supra* note 104.

of distributive justice are considered appropriate. The political reality is that most other economic regulation is oriented towards maximization of wealth, rather than its distribution.¹⁰⁶ The tax law comes in after productivity is maximized, and it should—to some extent at least—rearrange the results produced by markets that operate to concentrate wealth and opportunity.¹⁰⁷

Murphy and Nagel clearly recognize the centrality of taxes to the real-world question of distributive justice.¹⁰⁸ On the one hand, their insistence that pre-tax market outcomes provide individuals with no presumptive ownership claims¹⁰⁹ lowers the bar for arguments in favor of taxation of all kinds. Without such a presumption in the way, we only need to make arguments about the desirability of a tax according to whatever theory we believe most persuasive, whether it be Rawlsian, utilitarian, or even religious.¹¹⁰ But, at the same time, the demands of their analysis to treat the tax system as one component in a larger, integrated scheme of distributive justice subordinates the tax system and weakens its institutional role, as the application of their approach to Rawls's theory illustrates. The irony of Murphy and Nagel's argument is that in their concern for distributive justice, they possibly discount the one real-world tool that is regularly employed toward achieving it. As they recognize in the beginning of their book, anyone who cares about distributive justice in the real world needs to pay close attention to taxation. It remains the most likely mechanism to address rising income inequality, wealth concentration, and the dangers to basic liberties that those economic patterns present.

106. For example, the securities laws' focus on disclosure is directed toward maximization of market results.

107. This is appropriate according to utilitarians. See Louis Kaplow, *A Fundamental Objection to Tax Equity Norms: A Call for Utilitarianism*, 48 Nat'l Tax J. 497 (1995).

108. Murphy & Nagel, *supra* note 1, at 3-7.

109. This is the myth of ownership to which the book's title refers. See *id.*

110. Susan Pace Hamill makes such an argument for progressivity, which was apparently important in the recent Alabama referendum on tax reform (alas, voted down). See Susan Pace Hamill, *An Argument for Tax Reform Based on Judeo-Christian Ethics*, 54 Ala. L. Rev. 1 (2002); David M. Halbfinger, *G.O.P. Chief's Idea for Raising Alabama: Taxes*, N.Y. Times, June 4, 2003, at A26 (quoting the governor of Alabama as saying that “[h]aving a regressive tax structure is one thing,” but that “when it starts at \$4,600 for a family of four, that’s immoral”).