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Recommended Citation

Alex Raskolnikov, *Distributional Arguments, In Reverse*, MINNESOTA LAW REVIEW, FORTHCOMING; COLUMBIA PUBLIC LAW RESEARCH PAPER NO. 14-671; COLUMBIA LAW & ECONOMICS WORKING PAPER NO. 627 (2020).
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DISTRIBUTIONAL ARGUMENTS, IN REVERSE

Alex Raskolnikov[†]

What should the government do about the distribution of resources and outcomes in the society? Two arguments have shaped academic debates about this question for several decades. The first argument states that economic regulation should focus on efficiency alone, leaving distributional considerations for the tax-and-transfer system. The second argument objects to government assistance for people unintentionally harmed by legal reforms. Taken together, the two arguments impose major restrictions on the range of possible distributional policies.

This Article contends that a growing body of research in the economics of trade, immigration, industrial organization, labor, and environmental regulation reveals that the core assumptions underlying the two distributional arguments do not hold. Moreover, once these assumptions are changed to reflect reality, the analytical machinery underlying the arguments goes in reverse: The conclusions become not merely indeterminate but opposite of those originally advanced. The revised distributional arguments support enacting a broad-based transitional assistance program for low-skill workers, embracing some distributionally informed legal rules, and replacing our complex, obscure, state-specific social safety net with a simpler, transparent, nationally uniform one. More generally, reversing the normative thrust of the two distributional arguments shifts the focus of the academic inquiry. Instead of debating whether the government should actively shape distributional outcomes in a variety of ways, the question becomes how should the government do so given institutional, informational, and political constraints. Finding and refining answers to this question would help policymakers to craft better policy responses to major economic shocks, whether these shocks arise from legal

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reforms, technological transformations, or a deadly pandemic.

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Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution.

Robert Lucas, Nobel Laureate in Economics¹

Marie Antoinette said, “Let them eat cake.” But history records no transfer of sugar and flour to her peasant subjects.

Paul Samuelson, Nobel Laureate in Economics²

INTRODUCTION

On November 9, 1993, less than two weeks before the pivotal congressional vote that would decide the fate of the North American Free Trade Agreement (NAFTA), Vice President Al Gore was on Larry King Live—the most watched show in CNN history.³ That night, the show had its largest audience ever. Over eleven million viewers tuned in to watch Gore debate NAFTA with the 1990’s version of a flamboyant-billionaire-turned-protectionist-presidential-aspirant H. Ross Perot.⁴ Naturally, the two debaters disagreed.

Perot warned Americans about the “giant sucking sound” that they would hear if NAFTA passed,⁵ as almost six million jobs would move south of the border.⁶ He was not alone in his concerns. Trade unions

¹ Robert E. Lucas, Jr. *The Industrial Revolution: Past and Future*, 44 ECON. ED. BULLETIN 1, 8 (2004).

² Paul A. Samuelson, *Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization*, 18 J. ECON. PERSP. 135, 144 (2004). To be fair to Lucas, he concludes the paragraph that starts with the quoted sentence by saying: “The potential for improving the lives of poor people by finding different ways of distributing current production is *nothing* compared to the apparently limitless potential of increasing production.” Lucas, *supra* note 1, at 8 (emphasis in original). Be it as it may, Marie Antoinette lost her head.

³ *Larry King Live: NAFTA Debate—Gore vs. Perot* (transcript of CNN television broadcast, Nov. 9, 1993), <https://advance.lexis.com/api/document?collection=news&id=urn:contentItem:3TD9-1900-0029-54DJ-00000-00&context=1516831> (hereinafter, *CNN Debate*). For the viewing statistics of the show, see *Larry King Live*, WIKIPEDIA, https://en.wikipedia.org/wiki/Larry_King_Live (last visited Jan 7, 2020).

⁴ *Id.*

⁵ Eduardo Porter, *Ross Perot’s Warning of a “Giant Sucking Sound” on Nafta Echoes Today*, N.Y. TIMES (July 9, 2019), <https://www.nytimes.com/2019/07/09/business/economy/ross-perot-nafta-trade.html>.

⁶ See ROSS PEROT & PAT CHOATE, SAVE YOUR JOB, SAVE OUR COUNTRY:

opposed the agreement as well, worried about large losses of American jobs.⁷

But Gore had a completely different view. Not only NAFTA would not cost American workers, he argued, it would bring 200,000 new jobs to the United States.⁸ There would not be even an initial “dip” in U.S. employment, he reassured the viewing public. Perrot and the unions were wrong.

As the NAFTA debate raged on, the non-partisan Congressional Budget Office (CBO) reviewed nineteen forecasts of the NAFTA’s economic impact. Whatever the uncertainties, the CBO concluded, the “models estimate that NAFTA would have little effect on the vast majority of major industries in the United States, and that even the largest of these effects would be surprisingly small.”⁹ Gore, it appeared, had the better argument.

Congress approved NAFTA on November 20, 1993, with more than half of the representatives of Gore’s own party voting against it.¹⁰ In the two decades that followed, congressional majorities and presidential administrations acted as if the CBO had perfect foresight. Although advocates continued to sound alarms,¹¹ policymakers remained unmoved. They offered no meaningful transitional assistance to workers affected by NAFTA and the China’s accession to the World Trade Organization (WTO) that followed a decade later with U.S. acquiescence. They did not modify the social safety net to help American workers absorb the

WHY NAFTA MUST BE STOPPED—NOW! 52-54 (1993). *See also*, White House Briefing, Sept 15, 1993, 1993 WL 366308 (explaining that Perot’s claim implies—incredibly—that by absorbing 5.9 million U.S. jobs Mexico would *double* its GNP).

⁷ *See* EDWARD ALDEN, FAILURE TO ADJUST: HOW AMERICANS GOT LEFT BEHIND IN THE GLOBAL ECONOMY 82 (2017).

⁸ *See CNN Debate, supra* note 3.

⁹ CONG. BUDGET OFFICE, ESTIMATING THE EFFECTS OF NAFTA: AN ASSESSMENT OF THE ECONOMIC MODELS AND OTHER EMPIRICAL STUDIES 61 (1993), <https://www.cbo.gov/sites/default/files/103rd-congress-1993-1994/reports/93doc154.pdf>.

¹⁰ *See* ALDEN, *supra* note 7, at 22.

¹¹ *See, e.g.*, Robert E. Scott et al., *Revisiting NAFTA: Still Not Working for North America’s Workers*, EPI Briefing Paper No.173 (Sept. 28, 2006), <https://www.epi.org/publication/bp173/>; Robert E. Scott, *Heading South, U.S.-Mexico Trade and Job Displacement After NAFTA*, EPI Briefing Paper No. 308 (May 3, 2011), https://www.epi.org/publication/heading_south_u-s-mexico_trade_and_job_displacement_after_nafta1/.

economic shocks of trade liberalization. They did not slow the pace of that liberalization to enable experts to better assess the resulting distributional impacts. And experts themselves remained uninterested in checking whether the CBO's prediction of "surprisingly small" adverse economic impacts would turn out to be true (it did not).¹²

A similar story may be told about the evolution of U.S. competition policy, immigration policy, labor policy, and environmental policy during the same period. All these policies, we are now learning, gave rise to large, unintended distributional burdens that were missed by academics and ignored by policymakers again and again.

The consequences of these decisions have upended American politics and will continue to do so in years to come. The causes of these decisions are numerous and complex. But the intellectual foundation of these decisions is clear. And it is this foundation—or at least its key elements—that are the focus on this Article.

Over the past several decades, two influential arguments have dominated academic debates about the proper scope of government distributional policies. The first argument posits that efficiency should be the *only* concern of economic regulation. This "efficiency-only argument" urges the government to ignore distributional considerations in the design of legal rules. Distribution, the argument concludes, should be addressed through the tax-and-transfer system alone.¹³

¹² This is particularly true of academic experts. On NAFTA's ten-year anniversary, the Congressional Research Service reviewed "numerous evaluations" of the economic effects of NAFTA. Not a single evaluation was performed by an academic economist or published in a peer reviewed journal. The evaluations mostly reaffirmed the 1993 consensus about the small economic impact of NAFTA, though Carnegie Foundation report did discuss the need for trade adjustment assistance and a possible need for a larger social safety net. J.F. Hornbeck, CONG. RESEARCH SERV., RS21737, *NAFTA at Ten: Lessons from Recent Studies* 2 (2017), <https://digital.library.unt.edu/ark:/67531/metadc824515/>.

¹³ The key statements of this argument are Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994) and Steven Shavell, *A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation?*, 71 AM. ECON. ASS'N PAPERS & PROC. 414 (1981). For an earlier expression of the same idea, see Aanund Hylland & Richard Zeckhauser, *Distributional Objectives Should Affect Taxes but Not Program Choice or Design*, 81 SCAND. J. ECON. 264 (1979). For a later contribution, see David A. Weisbach, *Should Legal Rules Be Used to Redistribute Income?*, 70 U. CHI. L. REV. 439 (2003). The economic model on

The second argument resists government compensation for those unintentionally harmed by new or changing government programs. Private markets do a better job of protecting people from foreseeable risks than the government ever could, this “no-compensation argument” explains.¹⁴ Besides, if the government does try to compensate unintended losers, the resulting effort is bound to be arbitrary, unfair, and ultimately unsustainable.¹⁵

Taken together, the two arguments urge a decidedly limited government involvement in the distribution of economic resources and outcomes in the society. To be clear, the arguments do not oppose all such involvement. But they do limit it to certain occasions (generally excluding losses from legal transitions) and certain forms (generally the tax-and-transfer system alone).¹⁶

This Article contends that the government should consider—rather than ignore—distributional consequences both in the design of legal rules and during legal transitions. This does not mean that the distributional effect of every legal rule should be measured and taken into account in the rule’s design. But if the likely distributional effects are unintended, large, and objectionable, if the efficiency of the legal rule is doubtful, if the compensating tax-and-transfer adjustment is not forthcoming (or has not occurred), policymakers should take distribution into account. One way of doing so is to choose among several alternative legal rules of questionable efficiency the one with better distributional consequences. Another is to slow the pace of legal change in certain cases.

Nor does the Article suggest that every transitional loss should be reimbursed. But if losses are large and unforeseeable, if private risk-mitigation mechanisms are unavailable, the government should step in. Enacting a broad-based transitional assistance program for low-skill workers and replacing our complex, obscure, state-specific social safety

which the argument rests comes from Anthony B. Atkinson & Joseph E. Stiglitz, *The Design of Tax Structure: Direct versus Indirect Taxation*, 6 J. PUB. ECON. 55 (1976).

¹⁴ The key articulation of this claim is Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 535 (1986).

¹⁵ An early—and possibly the original—explication of this point is Clair Wilcox, *Relief for Victims of Tariff Cuts*, 40 AM. ECON. REV. 884 (1950).

¹⁶ This brief summary of the two arguments presents their strong, generally recognized version. For a discussion of qualifications and caveats *see infra*, text accompanying notes 39-47; 54-60.

net with simpler, transparent, nationally uniform one would go a long way toward mitigating the losses discussed here.

This Article is not the first one to challenge the two influential distributional arguments.¹⁷ But none of the previous counters took account of the large body of emerging research in the economics of trade, labor, immigration, industrial organization, and regulation. The

¹⁷ For the counters to the efficiency-only argument, *see, e.g.*, Tomer Blumkin & Yoram Margalioth, *On the Limits of Redistributive Taxation: Establishing a Case for Equity-Informed Legal Rules*, 25 VA. TAX REV. 1, 3 (2005) (discussing the effect of administrative costs and egalitarian preferences on the choice of distributional instruments); Lee Anne Fennell & Richard H. McAdams, *The Distributive Deficit in Law and Economics*, 100 MINN. L. REV. 1051 (2014) (arguing that political impediments to offsetting distributive adjustments defeat the unequivocal prescription of the efficiency-only argument); Zachary Liscow, Note, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 YALE L.J. 2478 (2014) (arguing that legal rules may be more efficient than tax-and-transfer system in reducing inequality in certain circumstances); Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 TAX L. REV. 157, 167-68 (2003) (drawing attention to non-income sources of inequality as a reason to account for distributional consequences in designing legal rules); Richard L. Revesz, *Regulation and Distribution*, N.Y.U.L. REV. 1489 (2018) (arguing in favor of a standing interagency regulatory body to address undesirable distributional effects of legal rules); Chris W. Sanchirico, *Taxes versus Legal Rules as Instruments for Equity: A More Equitable View*, 29 J. LEG. STUD. 797, 798 (2000) (arguing that possible unobserved within-income group heterogeneity should lead to distributionally informed legal rules). For examples of objections to the no-compensation argument, *see, e.g.*, Michael Doran, *Legislative Compromise and Tax Transition Policy*, 74 U. CHI. L. REV. 545, 545 (2007) (arguing that by binding itself to either always or never compensating transitional losses the legislature reduces its ability to compromise on future legislation); Jill E. Fisch, *Retroactivity and Legal Change: An Equilibrium Approach*, 110 HARV. L. REV. 1055, 1090-91 (1997) (pointing out that market insurance may be unavailable in particular cases and that public cost of retroactive lawmaking may be unacceptably high); Daniel S. Goldberg, *Tax Subsidies: One-time vs Periodic An Economic Analysis of the Tax Policy Alternatives*, 49 TAX L. REV. 305, 328-30 (1994) (suggesting that committing to transition relief reduces investment uncertainty and administrative and operational costs of legislation); Kyle Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 MICH. L. REV. 1129 (1996) (contesting the no-compensation argument as applied to incentive subsidies while analogizing them to government contracts); Mark Ramseyer & Minoru Nakazato, *Tax Transitions and the Protection Racket: A Reply to Professors Graetz and Kaplow*, 75 VA. L. REV. 1155 (1989) (explaining why the no-compensation rule would—and does—give rise to rent-seeking).

economists' findings are so recent that, to the best of my knowledge, no one has used them to reassess the two arguments. This Article undertakes such reassessment and reaches a stark conclusion: the assumptions underlying both arguments—not just some assumptions, but key assumptions—falter when compared to actual outcomes, either in general or in a large and important set of cases. Moreover, once these assumptions are changed to reflect reality, the policy prescriptions resulting from the two arguments do not merely become indeterminate. Rather, the analytical machinery underlying the arguments goes in reverse—the policy prescriptions become the opposite of the original ones.

The efficiency-only argument assumes that distributional adjustments take place in the tax-and-transfer system, at least “in response to changes in legal rules whenever these changes resulted in a ‘sufficiently important’ shift in the distribution of income.”¹⁸ It is becoming increasingly clear that over the past several decades, a range of government policies gave rise to such distributional shifts. These policies unintentionally imposed large losses on a specific group of Americans consisting of low-skill, low-education, pre-retirement age workers. Yet the U.S. government has enacted no significant programs aimed at offsetting or mitigating these losses.¹⁹ The assumed tax-and-transfer adjustments never materialized.

Moreover, the efficiency-only argument stresses the importance of designing legal rules to achieve economic efficiency. But recent research raises serious doubts about the efficiency of actual legal rules, and even entire legal regimes. There is growing evidence of multiple market failures: monopoly power in product markets, monopsony power in labor markets, and possible anticompetitive behavior in capital markets as well.²⁰ Law-and-economics scholars are increasingly skeptical about the efficiency of the common law.²¹ If the assumption that real-world legal rules are at least roughly efficient is implausible, it becomes difficult to argue for sacrificing real-world distributional concerns for the sake of hypothetical efficiency.

¹⁸ Shavell, *supra* note 13, at 417 (quotes in original).

¹⁹ See *infra* text accompanying notes 228-231 explaining why the Affordable Care Act and the expansion of the Earned Income Tax Credit cannot be plausibly viewed as such compensating adjustments.

²⁰ For a discussion, see *infra* text accompanying notes 175-210.

²¹ For a discussion, see *infra* text accompanying note 211.

Furthermore, it is well-understood that the choice between legal rules and the tax-and-transfer system becomes complicated if there is unobserved heterogeneity among people in the same income group. So only if one assumes that such heterogeneity does not exist (or is not important) does the efficiency-only argument's ultimate prescription retain its full force. It turns out, however, that unobserved heterogeneity does exist within the group of low-skill American workers. Although less consequential than the failure of the first two assumptions, this heterogeneity adds another reason to reconsider the efficiency-only argument.

Turning to the no-compensation argument reveals a similar disconnect between assumptions and reality. The argument urges no government relief for unintended losers from changes in government policies. In its general form, this argument relies on two assumptions. First, private actors can anticipate future legal changes. Second, actors can insure against those changes either by buying private insurance or by diversifying in financial markets.

No doubt, some changes may be anticipated, private insurance may be available, and diversification may be a realistic possibility. But for those affected by the changes in U.S. trade, competition, labor, and other policies discussed in this Article, none of this is true. Economists are surprised by the magnitude and concentration of negative shocks from trade liberalization, labor market monopsonization, and other recent policies—shocks that they are discovering only now. Given that experts failed to anticipate these shocks, American workers who suffered them could hardly be expected to have had greater foresight. Financial diversification is of no help for these workers either, and no private insurance is available. Large, unanticipated, privately uninsurable and undiversifiable losses of labor income are the classic reason for social insurance, whether these losses result from legal changes or not.²² So the no-compensation argument's own logic points toward the need for government assistance for those who suffer these losses.

²² See Raj Chetty & Amy Finkelstein, *Social Insurance: Connecting Theory to Data*, in 5 HANDBOOK OF PUBLIC ECONOMICS 111, 134, 141 (Alan J. Auerbach et al. eds., 2013); MICHAEL J. GRAETZ & JERRY L. MASHAW, TRUE SECURITY: RETHINKING AMERICAN SOCIAL INSURANCE 26-27 (1999); Alan B. Krueger & Bruce D. Meyer, *Labor Supply Effects of Social Insurance*, in 4 HANDBOOK OF PUBLIC ECONOMICS 2327, 2330 (Alan J. Auerbach & Martin Feldstein eds., 2002).

A narrower version of the same argument rejects targeted government assistance even when the factual assumptions underlying the broad version do not hold. Even if government compensation is a good idea in theory, this narrower version states, it cannot be implemented in practice without relying on arbitrary distinctions.²³

This implementation critique assumes the need for arbitrary line drawing. That assumption has been plausible for decades as the only significant U.S. transitional assistance policy has been the Trade Adjustment Assistance Program (TAA).²⁴ But the TAA's reliance on distinctions is irrelevant today. Economists are discovering that it was not only U.S. trade policy that unintentionally harmed low-skill American workers. Widespread labor market monopsony resulting from weak enforcement of U.S. competition laws likely harmed these workers as well. The same is likely true of the U.S. labor policy, environmental policy, and federal government's acquiescence in proliferation of state licensing requirements and local zoning regulation. Given these findings, the targeted adjustment assistance program needed today would require much less targeting compared to the TAA. Rather than separating workers harmed by free trade from those harmed by labor market monopsony, automation, poor management, and so on, this program would target low-skill workers as a group. Such broad targeting would not suffer from the arbitrariness that bedeviled the TAA for half a century.

Considering U.S. social insurance in light of recent empirical findings brings more reasons for concern. These findings highlight a major, previously unappreciated flaw of U.S. distributional policies. It is no secret that U.S. social safety net is highly location-specific. Welfare,²⁵ unemployment insurance,²⁶ health insurance,²⁷ and nutritional

²³ See Wilcox, *supra* note 15.

²⁴ See J.F. Hornbeck, CONG. RESEARCH SERV., R41922, TRADE ADJUSTMENT ASSISTANCE (TAA) AND ITS ROLE IN U.S. TRADE POLICY 2 (2017), <https://fas.org/sgp/crs/misc/R41922.pdf>.

²⁵ See Gene Falk, CONG. RESEARCH SERV., RL32748, THE TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF) BLOCK GRANT: A PRIMER ON TANF FINANCING AND FEDERAL REQUIREMENTS 5-8 (2017), <https://fas.org/sgp/crs/misc/RL32748.pdf>; David A. Super, *Rethinking Fiscal Federalism*, 118 HARV. L. REV. 2544, 2547 (2005).

²⁶ See Julie M. Whittaker & Katelin P. Isaacs, CONG. RESEARCH SERV., RL33362, UNEMPLOYMENT INSURANCE: PROGRAMS AND BENEFITS 2-4 (2019), <https://fas.org/sgp/crs/misc/RL33362.pdf>; JONATHAN GRUBER, PUBLIC FINANCE

assistance²⁸ vary greatly from state to state. Academics have supported this variation by pointing out the benefits of experimentation, local accountability, sensitivity to variations in the cost of living, and responsiveness to taxpayers' heterogeneous preferences for amenities.²⁹

But even if the implicit assumption that all these benefits outweigh the costs of geographic variation has been plausible until recently, it has become much less plausible today. New research reveals that economic shocks resulting from trade liberalization, low-skill immigration, and labor market monopsony are highly local. Moreover, when these shocks occur, labor market adjustments are both difficult and slow. Adjustment costs that economists assumed away and politicians ignored turned out to be a major burden.

These adjustment costs are not inevitable. The federal government can reduce them in two ways. It can lower the artificial, state-imposed barriers to geographic mobility. And it can replace the current complex, obscure, state-specific income assistance programs with simpler, transparent, nationally uniform ones.

Give the Article's conclusions, neither policy experts nor policymakers should feel constrained by the standard prescriptions of the efficiency-only and no-compensation arguments. Instead, they should consider the types of policies that follow logically from replacing the unrealistic assumptions underlying both arguments with plausible ones. These takeaways are sure to give rise to objections. The Article considers three important ones.

The first objection is that distributional adjustments advocated here are uniquely challenging because measuring unintended distributional impacts of government policies is difficult. More difficult, in particular, than forecasting future changes in employment, inflation, revenues, and other key economic indicators that routinely affect government policies.

AND PUBLIC POLICY 385 (2007).

²⁷ See Alison Mitchell, CONG. RESEARCH SERV., IN FOCUS: OVERVIEW OF THE ACA MEDICAID EXPANSION (DEC. 3, 2018), <https://fas.org/sgp/crs/misc/IF10399.pdf>.

²⁸ See Randy Alison Aussenberg, CONG. RESEARCH SERV., RL42505., SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM (SNAP): A PRIMER ON ELIGIBILITY AND BENEFITS 9-12 (2018), <https://fas.org/sgp/crs/misc/R42505.pdf>.

²⁹ See Brian Galle & Joseph Leahy, *Laboratories of Democracy? Policy Innovation in Decentralized Governments*, 58 EMORY L.J. 1333, 1335-37 (2009); Super, *supra* note 25, at 2552-60.

This objection is factually correct. Distributional projections do, indeed, require more information than forecasts of the standard economic indicators. But greater informational demands do not justify inaction. Our government makes important choices lacking full information about key economic indicators all the time. These predictions have turned out to be wrong again and again. Yet Congress, the Federal Reserve, and other government actors continue to make decisions faced with uncertain projections, adjusting policy when forecasts turn out to be mistaken. Policymakers should follow the same approach when it comes to distributional adjustments.

The second objection is that distributional impacts take too long to reveal themselves. Too long, that is, for the government to be able to respond effectively as these impacts unfold.

Recent evidence appears to support this objection, yet it in fact the opposite conclusion emerges from data. Economists are discovering only now the effects of trade shocks that occurred two decades ago and the consequences of changes in the U.S. product and labor markets that took even longer to develop. But the same new research reveals that the reason for these delayed findings is that, to put it bluntly, “it took a while for academics to catch up.”³⁰ Many long-term trends were visible in the data at least a decade—and in some cases decades—ago. Paying more attention to these and similar trends going forward would allow policymakers to respond to unintended distributional impacts much more promptly.

Third, the call for lowering state-imposed barriers to entry and for a greater uniformity of federal safety net programs runs head-on into fiscal federalism concerns. The Article’s response is straightforward. We now know about large costs of geographic immobility. These costs are borne by Americans who are ill-equipped to avoid or absorb them. Whatever the balance between federal and local provision of social insurance and public assistance has been until now, new evidence surely weighs in favor of greater centralization and uniformity.

The Article’s arguments unfold in five main parts. Part II summarizes the two distributional arguments and highlights their key assumptions. Part III demonstrates that over the past several decades, numerous major

³⁰ Nelson D. Schwartz & Quoc Trung Bui, *Where Jobs Are Squeezed by Chinese Trade, Voters Seek Extremes*, N.Y. TIMES (Apr. 25, 2016), <https://nyti.ms/1Ta9XDj>.

U.S. policies likely imposed large, concentrated burdens on low-skill American workers without aiming to do so. Part IV argues that the U.S. government largely ignored these new burdens. Part V evaluates the assumptions underlying the two distributional arguments in light of the evidence discussed in Parts III and IV, finding that the assumptions are contradicted by major economic developments of the past several decades. Part VI suggests several directions for policy reform, and Part VII addresses likely counterarguments. The Conclusions emphasizes the general implications of the Article's analysis. Reversing the normative thrust of the two distributional arguments shifts the focus of the academic inquiry. Instead of debating *whether* the government should actively shape distributional outcomes in a variety of ways, the question becomes *how* should the government do so given institutional, informational, and political constraints. Finding and refining answers to this question would help policymakers craft better policy responses to economic shocks, whether these shocks arise from legal reforms, technological transformations, or a global pandemic.

II. DISTRIBUTIONAL ARGUMENTS AND THEIR ASSUMPTIONS

The close connection between general government programs and the government's distributional policies is not a recent discovery. Two millennia ago Juvenal berated Roman rulers for using bread and circuses to compensate for poor governance.³¹ More recently, law-and-economics scholars advanced two arguments about the interaction of legal rules and distributional policies. The first one limits distributional policies to the tax-and-transfer system. The second one urges policymakers to ignore losses from legal transitions. Both arguments are powerful, compelling, and highly influential.³² And both rely on assumptions, as all theories do.

³¹ See Bread and Circuses, https://en.wikipedia.org/wiki/Bread_and_circuses.

³² See, e.g., Blumkin & Margalioth, *supra* note 17, at 2 (referring to the efficiency-only argument as “the prevailing norm in the law and economics literature”); Tsilly Dagan, *The Global Market for Tax and Legal Rules*, 21 FLA. TAX REV. 148, 151-52 (2017) (describing the efficiency-only argument as a “canonical claim”); Matthew Dimick, *The Law and Economics of Redistribution*, 15 ANNUAL REV. LAW SOC. SCI. 559, 560 (2019) (calling Kaplow and Shavell's article articulating the efficiency-only argument “seminal—and, for many—debate concluding”); Zachary D. Liscow, *Are Court Orders Sticky? Evidence on Distributional Outcomes from School Finance*, 15 J. EMPIRICAL LEGAL STUD. 4, 4 (2018) (referring to the efficiency-only argument

This Part presents the two arguments and their key assumptions in order to re-examine them in light of recent evidence later on.

A. *The Efficiency-Only Argument*

In the words of its main proponents Louis Kaplow and Steven Shavell, the efficiency-only argument states that “legal rules should not be adjusted to disfavor the rich and favor the poor in order to redistribute income, because the income tax and transfer system is a more efficient means of redistribution.”³³ The argument begins by noting that in general, any given distributional objective may be accomplished by changing either legal rules (understood broadly as any rule “other than those that define the income tax and welfare system”³⁴) or tax rules (understood as all rules that do define the tax and welfare system). But any transfer from the rich to the poor distorts incentives to earn income. When this transfer is carried out through the tax-and-transfer system, this distortion gives rise to the standard deadweight loss of taxation. What the efficiency-only argument adds is the insight that if the same transfer is accomplished through a legal rule rather a tax rule, the same distortion gives rise to the same deadweight loss. But in addition, embedding redistribution in legal rules “also creates inefficiencies in the activities regulated by the legal rules.”³⁵

In other words, shifting distributional adjustments from the tax system to the legal system does nothing to reduce the efficiency cost of redistribution but adds a new costly distortion. So nothing is gained but some efficiency is lost when legal, rather than tax, rules are altered to reflect distributional concerns.

as the “traditional economic analysis of legal rules”); Logue & Avraham, *supra* note 17, at 158 (“we believe that it is safe to say that a majority of legal economists hold the ... view” that the efficiency-only argument is correct); Masur & Nash, *supra* note 62, at 394 (“For many years, the traditional law and economics literature advocated strongly against legal transition relief.”); Revesz, *supra* note 17, at 1510-11 (demonstrating the influence of the efficiency-only argument in legal academy); Sanchirico, *supra* note 17, at 798 (referring to the “broad consensus within law and economics that legal rules should be set solely on the basis of efficiency”).

³³ Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. LEG. STUD. 821, 821 (2000).

³⁴ Kaplow & Shavell, *supra* note 13, at 667 n.1.

³⁵ *Id.* at 668.

Importantly, the efficiency-only argument is *not* an argument against redistribution. Rather it is an argument against a particular form of redistribution. As Shavell noted in his original presentation of the argument,

[O]ne's attitude toward the result under discussion will depend on his expectation that the income tax would be (or could be) altered in response to changes in legal rules whenever these changes resulted in a "sufficiently important" shift in the distribution of income.³⁶

If we gloss over the difference between "would be" and "could be" in the quoted passage, Shavell conditions the normative takeaway from the efficiency-only argument on the expectation about the offsetting tax-and-transfer adjustment.³⁷ Similarly, David Weisbach explains that he supports the efficiency-only argument

not out of lack of concern for distribution or equality, [but because] there is a better method of addressing these concerns. ... We should, therefore, use the tax system rather than legal rules to address income inequality, and, correspondingly, legal rules should not systematically favor the poor.³⁸

These statements—as well as the overall logic of the efficiency-only argument—demonstrate that the assumption about the tax-and-transfer system adjustment carries a lot of weight. So much weight, in fact, that if the assumption is reversed, the conclusion must be reversed as well. If tax rules do *not* take distribution into account, or fail to do so adequately, then legal rules *should* reflect distributional considerations at least in some cases.³⁹ After all, the argument's proponents support redistributive

³⁶ Shavell, *supra* note 13 at 417 (quotes in the original).

³⁷ Glossing over this difference treats the argument charitably. Writing later jointly with Kaplow, Shavell explains that the critique of the efficiency-only argument "would be moot if the income tax system ... *could* be used freely" to redistribute. Kaplow & Shavell, *supra* note 13, at 667 (emphasis supplied). I believe that if Kaplow and Shavell knew for certain that redistribution through the tax system is possible (*could* happen) but is never done, they would not insist on ignoring distributional issues in the design of legal rules.

³⁸ Weisbach, *supra* note 13, at 439.

³⁹ Weisbach does not go quite as far, but he does conclude that "[w]ithout the tax system, [the efficiency-only argument's] conclusion would not necessarily hold and legal rules might optimally be set to redistribute." *Id.* at 439-40. Weisbach's use of "might" may be a stylistic choice rather than substantive

transfers. If these transfers cannot be carried out through the tax system, the only alternative is to redistribute through the legal system, imperfect as it may be for accomplishing distributive goals.

The efficiency-only argument's another important assumption is about the efficiency of legal rules. Various articulations of the argument differ significantly in the importance of that assumption. A weaker version states that "any regime with an inefficient legal rule can be replaced by a regime with an efficient legal rule and a modified income tax system designed so that every person is made better off."⁴⁰ This is a statement about possibilities. Hypothetical efficiency of hypothetical rules is achieved by an imaginary change in the tax system.

Other versions, however, are much more assertive. "[R]edistribution through legal rules *offers no advantage* over redistribution through the income tax system and *typically* is less efficient."⁴¹ "[L]egal rules *should not be* designed to redistribute to the poor ... [because] *there is* a better method of addressing these concerns."⁴² These statements can be fairly read as addressing actual legal and tax rules, or as calls for actual reforms of the existing regulatory architecture. And in fact, many legal scholars do interpret the arguments as policy advice.⁴³

But what if the actual legal rules are inefficient, or if there is significant uncertainty about their efficiency? And what if there is no plausible argument that the tax rules are anywhere close to optimal either?⁴⁴ Then there is no reason to prefer tax rules or legal rules as vehicles for redistribution on efficiency grounds. In fact, as is well known, changing legal rules to reflect distributional considerations in

doubt. A few sentences after the quoted sentence he asks: "Why might we want to redistribute income?" *Id.* at 440. Yet his quote in the text above leaves little doubt that he believes in redistribution.

⁴⁰ Kaplow & Shavell, *supra* note 13, at 669.

⁴¹ *Id.* at 667 (emphasis added).

⁴² Weisbach, *supra* note 13, at 439 (emphasis added).

⁴³ *See, e.g.*, Fennell & McAdams, *supra* note 17, at 1054 ("Our sense today is that both the K&S result and the policy advice have become the conventional wisdom, at least among many law professors who employ economic analysis.").

⁴⁴ This is, quite likely, the case. *See* Alex Raskolnikov, *Accepting the Limits of Tax Law and Economics*, 98 CORNELL L. REV. 523 (2013). Kaplow has shown that the logic of the efficiency-only argument holds even if income tax is not optimal. *See* Louis Kaplow, *On the Undesirability of Commodity Taxation Even When Income Taxation Is Not Optimal*, 90 J. Pub. Econ. 1235 (2006). However, the income tax in Kaplow's proof is a labor income tax that has little resemblance to the actual U.S. tax system.

these circumstances may increase—not reduce—their efficiency by introducing a distortion that offsets some other, pre-existing distortion.⁴⁵ So if the efficiency-only argument is taken as a statement that has real-world significance, the assumption about efficiency of existing legal rules becomes critical. And again, reversing this assumption reverses the argument's takeaway.

The efficiency-only argument's proponents were always clear that the argument is subject to qualifications,⁴⁶ one of which is particularly relevant for our purposes. As Kaplow and Shavell explain, tax rules may not clearly dominate legal rules as a redistributive mechanism if there is unobservable heterogeneity within income groups.⁴⁷ If such heterogeneity exists, the analysis becomes complicated. Efficiency-enhancing distributional adjustment may turn out to favor the rich or the poor depending on considerations reflecting unknown empirical facts.⁴⁸ If, however, unobservable heterogeneity is such that changing legal rules is likely to have desirable distributional effects, Kaplow and Shavell's logic supports these adjustments.

To summarize, the efficiency-only argument states that legal rules should not be used for redistribution, which should be achieved through the tax-and-transfer system. To the extent that this argument is viewed as policy-relevant, it relies on three assumptions, the first two being particularly important. First, the tax-and-transfer system actually *is*

⁴⁵ See Richard G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11 (1956) (“[I]n a situation in which there exists many constraints which prevent the fulfillment of the Pareian [sic] optimum conditions, the removal of any one constraint may affect welfare or efficiency either by raising it, by lowering it, or by leaving it unchanged.”). Half a century later, Richard Lipsey stuck to his guns. See Richard G. Lipsey, *Reflections on the General Theory of Second Best at Its Golden Jubilee*, 14 INT’L TAX & PUB. FIN. 349, 358 (2007) (“Are there general policy rules for piecemeal improvements? My answer ... is ‘no.’”).

⁴⁶ See Kaplow & Shavell, *supra* note 13, at 669, 680-81 (discussing the possibility that certain legal disputes are complements or substitutes to income-generating activities); Kaplow & Shavell, *supra* note 33, at 827-28 (pointing out that qualifications do not automatically lead to a conclusion that legal rules should reflect distributive concerns); Shavell, *supra* note 13 at 417 (making the offsetting tax system adjustment assumption).

⁴⁷ See Kaplow & Shavell, *supra* note 13, at 674 n.7; Kaplow & Shavell, *supra* note 33, at 827-32. If the heterogeneity is observable, Kaplow and Shavell point out that tax rules should be adjusted to take it into account. See *id.* at 829 n.18.

⁴⁸ See Kaplow & Shavell, *supra* note 33, at 827-33.

adjusted to reflect distributional objectives. Second, legal rules *are* (or can realistically be made) efficient. And third, there is no unobserved within-income-group heterogeneity that may be harnessed to improve distributional outcomes by adjusting a legal rule. Reversing each of these assumptions would reverse the efficiency-only argument's policy takeaway. Rather than excluding distributional considerations from the design of legal rules, the argument's logic would lead policymakers to include these considerations and, in some cases, change legal rules to reflect distributional concerns.

B. The No-Compensation Argument

The U.S. government enacts new laws and changes the existing ones all the time. These changes often create winners and losers. Yet the government generally does not expropriate the gains, nor does it compensate the losses.

The Sixteenth Amendment to the U.S. Constitution permits the government to impose an income tax, that is, to take taxpayers' money without giving anything back, at least not directly.⁴⁹ Moreover, the income tax schedule is progressive, burdening high-income taxpayers disproportionately. Congress frequently changes tax rules, including the progressivity of the tax system. Yet few would argue today that the income tax, its changes, and its progressive rate schedule are unconstitutional.⁵⁰ The Constitution also has the Takings Clause, which requires compensation for a specific taking of private property.⁵¹ Occasionally, courts find that government regulation amounts to a "regulatory taking."⁵² But the small number of such cases reinforces the general point that the government owes no compensation when its changing rules give rise to unintended economic burdens.

This is as it should be according to the no-compensation argument. The argument comes from the literature on so-called legal transitions,

⁴⁹ See U.S. CONST. amend. XVI.

⁵⁰ The most developed objection to taxes as unconstitutional uncompensated takings of property comes from Richard Epstein. See RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* 295-303 (1985).

⁵¹ See U.S. CONST. amend. V.

⁵² For a review of caselaw, see, e.g., Eduardo Moises Penalver, *Regulatory Takings*, 104 COLUM. L. REV. 2182, 2193-95 (2004) (discussing regulatory takings doctrine).

and from long-standing critiques of actual transitional assistance. The theoretical prong of the argument has been developed by Kaplow in its general form,⁵³ and its logic is straightforward.

Government changes legal rules all the time, the argument goes. These changes come in many forms—from property takings to regulation, deregulation, judicial decisions, and so on. Many of these changes produce “incidental”⁵⁴ winners and losers.⁵⁵ The possibility of incurring a loss from government action imposes risk on individuals, and risk-averse individuals would prefer to mitigate it.⁵⁶ But if the government compensates transitional losers, it would eliminate private parties’ incentives to take into account, probabilistically, all “real costs and benefits of their decisions.”⁵⁷ “The belief that market solutions to problems of risk and incentives are generally more efficient than government remedies implies that the market response to legal transitions is similarly more efficient than government transitional relief.”⁵⁸ The market solutions that Kaplow has in mind are private insurance and financial diversification.⁵⁹

Note that Kaplow’s argument emphasizes—rather than dismisses—the importance of risk spreading and insurance. His point is simply that

⁵³ Michael Graetz was first to offer reasons why the government should not compensate transitional losers, but Graetz’s analysis was limited to tax law and admitted exceptions. See Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47 (1977). Kaplow, in contrast, argued that in general, the government should ignore transitional losses resulting from government actions. See Kaplow, *supra* note 14, at 509.

⁵⁴ Kaplow, *supra* note 14, at 519. By “incidental” Kaplow meant unintended. Unfortunately, another common meaning of this term is “minor.” Merriam-Webster online dictionary, <https://www.merriam-webster.com/dictionary/incidental> (defining “incidental” as “being likely to ensue as a chance or minor consequence” and “occurring merely by chance or without intention or calculation”).

⁵⁵ For a fuller list of examples of changing rules, see Kaplow, *supra* note 14, at 517.

⁵⁶ See *id.* at 527.

⁵⁷ *Id.* at 529.

⁵⁸ *Id.* at 522. While Kaplow avoids saying that “the belief” he is describing is his own, he does point out that governmental “adoption of mechanisms to deal with all conceivable market risks would be tantamount to government displacement of the market economy.” *Id.* at 535.

⁵⁹ “If this analogy between market and government risks is accepted, transition policy should vanish as a separate concern.” *Id.* at 535.

in the context of transitional gains and losses, the best means of addressing risk are private rather than social.

The no-compensation argument also has a more practical prong. Even if the government did try to compensate transitional losers, the argument goes, the effort would fail. Imagine that the government decided to alleviate economic losses incurred by U.S. businesses and workers negatively affected by trade liberalization. Difficult questions would immediately arise.

Say a U.S. auto assembly plant moves from Ohio to Mexico after U.S. and Mexico sign a free-trade agreement. Surely the plant's laid off workers suffer a loss and they seem to be deserving of government compensation. But what about the workers at the plant's suppliers that go bankrupt in the wake of the plant's relocation—should they be compensated as well? And what about those working at a diner near the plant that loses most of its customers, a car repair shop in town that suffers a precipitous drop in business, or a childcare center that closes because laid off autoworkers stay home with their kids?⁶⁰ It is also not clear why workers laid off because their jobs moved to Mexico are more deserving of assistance than workers who lost their jobs to automation, recession, or just poor management. Even for the workers who clearly suffered from trade liberalization, measuring their loss would be no easy task. Should we assume, for instance, that these workers will never get another job? Should we account for cheaper Mexican-made goods that these workers will buy ... with whatever money they have left?

Clair Wilcox raised these concerns about trade adjustment assistance in the pages of *American Economic Review* in 1950.⁶¹ Scholars,⁶² policy experts,⁶³ and politicians⁶⁴ repeated these arguments ever since. The

⁶⁰ To verify the realism of these hypotheticals, *see, e.g.*, AMY GOLDSTEIN, *JANESVILLE: AN AMERICAN STORY* (2017).

⁶¹ *See* Wilcox, *supra* note 15, at 884-89.

⁶² *See, e.g.*, Katherine Baicker & M. Marit Rehavi, *Trade Adjustment Assistance*, 18 J. ECON. PERPS. 239, 251-52 (2004) (raising questions about who should get transition relief under TAA); Jonathan S. Masur & Jonathan Remy Nash, *The Institutional Dynamics of Transition Relief*, 85 N.Y.U.L. REV. 391, 441-42 (2010) (raising same questions about the reach of any transition assistance program).

⁶³ *See* Hornbeck, *supra* note 24; ALDEN, *supra* note 7, at 117 (describing the 1954 report of President Eisenhower's Randall Commission).

⁶⁴ *Id.* at 121 (citing President Reagan).

persistence of these objections may explain the political vulnerability of the TAA and its resulting ineffectiveness.⁶⁵

The assumptions underlying the no-compensation argument are easy to see. The argument holds only if transitional losses are foreseeable, and if private insurance and market diversification are, indeed, available. Transitional assistance programs require arbitrary distinctions only if they are narrowly targeted. If these assumptions fail to hold, the conclusions change to the opposite of those being advanced. Large, unforeseeable, uninsurable, and undiversifiable losses to people's livelihoods are the classic reason for social insurance.⁶⁶ This is as true when the losses are caused by changes in government policies as it is when they are not. And if a transitional assistance program need not rely on questionable distinctions, the arbitrariness objection loses its force.

* * * * *

One may view the two distributional arguments as pure thought experiments with little relevance to the world in which we live. Or one may think of them as strictly formal statements with a structure of "if and only if X, then Y." But the argument's proponents appear to have greater ambitions, as revealed by numerous instances when the arguments read like direct prescriptions for policymakers.⁶⁷ Perhaps more importantly, both arguments have come to be viewed as guides for actual policy reforms.⁶⁸ It is this connection to real-world policymaking that puts so

⁶⁵ See ALDEN, *supra* note 7, at 116-122. The same arguments had the same effect in the context of a proposed transitional assistance program for coal miners affected by the Clean Air Act Amendments of 1990. See Revesz, *supra* note 17, at 1546-50.

⁶⁶ See GRAETZ & MASHAW, *supra* note 22, at 26-27.

⁶⁷ See, e.g., *supra*, text accompanying notes 41, 42, 59.

⁶⁸ See, e.g., Ronen Avraham et al., *Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow & Shavell*, 89 IOWA L. REV. 1125, 1126 (2004) (explaining economists' belief "that has become the new conventional wisdom: that income (or wealth) redistribution is always better accomplished through the tax-and-transfer system than through the legal system."); Ilan Benshalom, *Rethinking International Distributive Justice: Fairness as Insurance*, 31 B.U. INT'L L.J. 267, 308 (2013) ("There is a strong case for the division-of-labor approach [implementing the efficiency-only argument] in a domestic setting" but not internationally); John Brooks et al., *Cross-Subsidies: Government's Hidden Pocketbook*, 106 GEO. L.J. 1229, 1271 (2018) (considering the efficiency-only argument in connection with the design of the Affordable Care Act); Dagan, *supra* note 32 (discussing the efficiency-

much weight on the assumptions underlying these arguments. As this Part explains, these assumptions are far from self-evident. It is time to examine how plausible they are.

III. THE UNINTENDED EFFECTS OF GOVERNMENT POLICIES

The two distributional arguments entered academic debates more than three decades ago.⁶⁹ To evaluate their continuing significance we need to understand what has happened in the U.S. economy since then.

This Part presents the latest evidence that bears on this question. The evidence shows that major government policies have produced unintended distributional burdens. It is increasingly likely that these burdens were large, unanticipated, concentrated, persistent, and fell on the same group of Americans who are not well-positioned to absorb or deflect these burdens.

A. Trade

One can go back many decades, if not centuries, in search of the origins of the economic analysis of trade.⁷⁰ But the crucial period for our purposes is the nineteen eighties and nineties. Free trade was all the rage at the time. Developing countries were unilaterally lowering their historically high trade barriers.⁷¹ They also started to enter into regional trade agreements with developed countries, including, of course, the United States.⁷² The U.S. entered into NAFTA in 1994, continued to

only argument in connection with evaluating the architecture of the international tax and legal rules); Fennell & McAdams, *supra* note 17, at 1054 (explaining how a court or any other institutional actor would resolve a dispute following the efficiency-only argument); Kyle D. Logue, *Legal Transitions, Rational Expectations, and Legal Process*, 13 J. CONTEMP. LEGAL ISSUES 211, 213 (2003) (advising policymakers to follow the logic of the no-compensation argument for corporations but not individuals).

⁶⁹ See Graetz, *supra* note 53, Hylland & Zeckhauser, *supra* note 13, Kaplow, *supra* note 14, Shavell, *supra* note 13.

⁷⁰ See generally DOUGLAS A. IRWIN, *CLASHING OVER COMMERCE: A HISTORY OF U.S. TRADE POLICY* (2017).

⁷¹ See Dani Rodrik, *The Rush to Free Trade in the Developing World: Why So Late? Why Now? Will It Last?* 1-3 (Nat'l Bureau of Econ. Research, Working Paper No. 3947, 1992), <https://www.nber.org/papers/w3947>.

⁷² See Lorenzo Caliendo & Fernando Parro, *Estimates of the Trade and Welfare Effects of NAFTA*, 82 REV. ECON. STUD. 1, 4 n.7 (2015).

renew China's most-favorite-nation trade status throughout the nineties, and negotiated the terms of China's accession to the WTO which took place in 2001.⁷³

At about the same time, trade economists became concerned that trade liberalization—something they supported almost uniformly—may be contributing to wage inequality that started to reveal itself in the data.⁷⁴ In fact, the foundational trade theory of comparative advantage, which Paul Samuelson once called the only proposition in economics that is at once true and non-trivial,⁷⁵ predicts that trade liberalization will increase inequality in the developed world. However, after a vigorous inquiry, trade economists concluded that technology rather than trade was to blame, and turned their attention to studying the effects of trade liberalization in the developing world.⁷⁶

Not every economist was equally convinced. Dani Rodrik warned about the distributive effects of free trade in an influential 1997 book.⁷⁷ He pointed out that “the basic models of trade theory [show] that the net gains [from trade] and the magnitudes of redistribution are directly linked The larger the net gains, the larger the redistribution.”⁷⁸ Others expressed concerns as well.⁷⁹ But those concerns were based on theory

⁷³ See Gregory Shaffer & Henry Gao, *China's Rise: How It Took on the U.S. at the WTO*, 2018 U. ILL. L. REV. 115, 131-32 (2018).

⁷⁴ See David H. Autor et al., *The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade*, 8 AN. REV. ECON. 205, 206 (2016) [hereinafter Autor et al., *China Shock*].

⁷⁵ See Rodrik, *supra* note 71, at 1.

⁷⁶ See Autor et al., *China Shock*, *supra* note 74, at 206 (“After vigorous inquiry, concern about the labor-market consequences of trade receded. Economists did not find trade to have had substantial adverse distributional effects in developed economies, either for low-skill workers specifically or for import-competing factors and sectors more generally.”); Pinelopi Goldberg, *Introduction*, in TRADE AND INEQUALITY 2 (2015) (“Until recently, the consensus among economists had been that trade had a relatively small effect on inequality. This consensus emerged in the late 1990s after nearly a decade of studies by both labor and trade economists As a result of [the discovered] evidence, interest in the relationship between trade and inequality in developed countries subsided.”).

⁷⁷ See DANI RODRIK, HAS GLOBALIZATION GONE TOO FAR? (1997).

⁷⁸ Dani Rodrik, *Interview*, 3 WORLD ECON. ASS'N NEWSL. 9, 11 (2013), available at <https://www.worldeconomicsassociation.org/files/newsletters/Issue3-2.pdf>.

⁷⁹ See Justino De La Cruz et al., *Econometric Estimates of the Effects of NAFTA: A Review of the Literature* (U.S. Int'l Trade Commission, Office of Econ. Working Paper No. 2013-12A, 2013).

and simulations, not on rigorous empirical evidence.⁸⁰ So distributional objections to free trade remained on the periphery of the economics profession. And the objectors—even the most prominent ones—encountered considerable opprobrium.⁸¹

It took one or two decades for trade economists to return their focus to the U.S. and other developed countries. Yet even today—and despite recent assertions that “now there is a large body of evidence ... about the economic effects of NAFTA on the three countries”⁸²—there is just one published empirical study of the distributional impact of NAFTA in the U.S.⁸³ Its main finding is that blue-collar workers in industries and locations most exposed to NAFTA (that is, where tariffs went from high to low) bore a very high cost. Their wage growth over a decade was 17 percentage points (not percent!) lower compared to industries where tariffs were already low and NAFTA changed little.⁸⁴ Even low-wage workers outside of the affected industries but living in locations where those industries were prevalent experienced substantially lower wage growth. College-educated workers, in contrast, saw no statistically significant wage changes.

The China shock has received more attention, at least in part because its empirical analysis is less vulnerable to endogeneity concerns.⁸⁵ Over the past several years, a group of leading economists has published several influential papers arguing that China’s accession to the WTO accounts for one quarter of the aggregate decline in U.S. manufacturing

⁸⁰ *See id.*

⁸¹ *See* Paul A. Samuelson, *Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization*, 18 J. ECON. PERSP. 135, 135-37, 143-45 (2004) (raising some doubts about the benefits of globalization, and concluding that “mainstream trade economists have insufficiently noticed the drastic change in mean U.S. incomes and in inequalities among different U.S. classes.”); Avinash Dixit & Gene Grossman, Comment, *The Limits of Free Trade*, 19 J. ECON. PERSP. 241-42 (2005); Paul A. Samuelson, *Response from Paul A. Samuelson*, 19 J. ECON. PERSP. 242-43 (2005).

⁸² De La Cruz et al., *supra* note 79, at 2.

⁸³ *See* Shushanik Hakobyan & John McLaren, *Looking For Local Labor Market Effects of NAFTA*, 98 REV. ECON. & STAT. 728, 728-29 (2016) (observing that “economists to date have not provided an answer to the question of whether NAFTA has indeed had the effects ascribed to it by its opponents,” who argued—without evidence at the time—that “NAFTA has destroyed millions of U.S. jobs”).

⁸⁴ *See id.* at 729.

⁸⁵ *See* Autor et al., *China Shock*, *supra* note 74, at 210.

employment⁸⁶ and a loss of between two and 2.4 million jobs overall between 1999 to 2011.⁸⁷ In addition to outright job losses, China's entry into the WTO reduced wages of those low-skill workers who managed to keep their jobs.⁸⁸ As with NAFTA, these losses were highly concentrated by industry and location. And as with NAFTA, the empirical findings are recent.⁸⁹

The disconcerting view of China's accession to the WTO is not universally accepted. Zhi Wang and colleagues argue in a recent working paper that David Autor, Daron Acemoglu, Gordon Hanson and others got the China shock backwards.⁹⁰ Accounting for what the paper calls "supply chains," Wang and colleagues conclude that trade with China has led to "a net job increase of 1.27% (as a share of working age cohort)"⁹¹ and to higher wages for 75% of the workers in an average region (average in terms of exposure to Chinese competition).⁹² Autor and co-authors disagree, arguing that upstream effects are negative while downstream effects are "small and insignificant in the aggregate."⁹³ But

⁸⁶ See David H. Autor et al., *The China Syndrome: Local Labor Market Effects of Import Competition in the United States*, 103 AM. ECON. REV. 2121, 2121 (2013) [hereinafter Autor et al., *China Syndrome*]; Autor et al., *China Shock*, *supra* note 74, at 213-214 (offering reasons why China's accession to the WTO—rather than China's economic development in general—is the likely reason for U.S. job losses); Justin R. Pierce and Peter K. Schott, *The Surprisingly Swift Decline of US Manufacturing Employment*, 106 AM. ECON. REV. 1632, 1632 (2016) (linking an 18% "plunge" in U.S. manufacturing employment between 2001 and 2007 to the U.S. grant to China of the permanent normal trade relations that became effective on China's accession to the WTO).

⁸⁷ See Daron Acemoglu et al., *Import Competition and the Great US Employment Sag of the 2000s*, 34 J. LAB. ECON. S141, S141 (2016).

⁸⁸ See Autor et al., *China Shock*, *supra* note 74, at 229.

⁸⁹ See Goldberg, *supra* note 76, at 7 (noting that Autor et al., *China Syndrome*, *supra* note 86, was the first paper to report large effects of the China Shock).

⁹⁰ See Zhi Wang et al., *Re-Examining the Effects of Trading with China on Local Labor Markets: A Supply Chain Perspective 1* (Nat'l Bureau of Econ. Research, Working Paper No. 24886, 2018), <https://www.nber.org/papers/w24886> ("incorporating a supply chain perspective ... can overturn the received wisdom in the literature" expressed in Autor et al., *China Syndrome*, *supra* note 86).

⁹¹ *Id.* at 2.

⁹² *See id.*

⁹³ Autor et al., *China Shock*, *supra* note 74, at 228 n.33, 234. In contrast, Wang and co-authors conclude that "the job gains from the downstream channel are not only statistically significant but also economically powerful enough to

importantly, Wang and colleagues agree with Autor and co-authors that the majority of workers with less-than-college education have suffered wage losses, and that these losses have been particularly large (15-25% declines) for the lowest deciles of wage distribution.⁹⁴ While this bottom-line conclusion is not unanimous,⁹⁵ most high-quality econometric research of the past several years reveals large and geographically concentrated negative effects of trade liberalization on American blue-collar workers.⁹⁶

B. Immigration

In terms of their political significance, distributional effects of U.S. trade policies rival only those of immigration. Economists have been studying how immigrants affect wages and jobs of American workers for a long time.⁹⁷ There is a vigorous debate among leading labor economists about the effect of low-skill immigration on wages of low-skill Americans. “[T]he existing literature demonstrates that it is quite difficult to isolate the impact of immigration on wages. Even more problematic, it turns out that the evidence often depends on *researcher choices* about how to frame the empirical analysis.”⁹⁸

more than offset the combined negative effects from direct competition and the upstream channel.” Wang et al., *supra* note 90, at 2.

⁹⁴ See *id.* at 25-26.

⁹⁵ Yet another recent paper argues that “the finding that the China shock is pro-rich is fragile, as it depends on how non-labor income is apportioned across groups.” Simon Galle et al., *Quantifying the Aggregate and Distributional Effects of Trade* 28 (Nat’l Bureau of Econ. Research, Working Paper No. 23737, 2017), <https://www.nber.org/papers/w23737>.

⁹⁶ Another recent paper shows that the same areas that mostly suffered from trade liberalization also benefited from it. As a result, perhaps surprisingly, repealing NAFTA would hurt workers in the same locations that suffered when NAFTA was enacted. Raphael A. Auer et al., *The Economics and Politics of Revoking NAFTA*, 68 IMF ECON. REV. 230, 232-33 (2020). The key finding for our purposes is that some workers did suffer from NAFTA, even though other workers living nearby gained from it. On the other hand, the paper’s result is difficult to reconcile with Hakobyan and McLaren who found that low-skill workers in the entire areas impacted by NAFTA were negatively affected. See Hakobyan & McLaren, *supra* note 83.

⁹⁷ See Shelby D. Gerking & John H. Mutti, *Costs and Benefits of Illegal Immigration: Key Issues for Government Policy*, 61 SOC. SCI. Q. 71, 72 (1980); Jean B. Grossman, *The Substitutability of Natives and Immigrants in Production*, 64 REV. ECON. & STAT. 596, 600-602 (1982).

⁹⁸ Jason Anastasopoulos et al., *Job Vacancies and Immigration: Evidence*

George Borjas and co-authors have produced a large body of work demonstrating that low-skill immigration depresses wages and employment of low-skill American workers.⁹⁹ This conclusion seemingly follows from the basic analysis of supply and demand.¹⁰⁰ Yet David Card and others have been arguing that the effects, if any, are small,¹⁰¹ emphasizing that Borjas' "revisionist" view of recent U.S. immigration is overly pessimistic.¹⁰²

As with trade, the warning signs came decades ago. An early red flag appeared in a 1996 study by Borjas, Richard Freeman, and Lawrence Katz (all leading economists).¹⁰³ They found "negative relations between immigration-induced changes in supply and native wages. [Moreover,] immigration contributed more to the decline in the relative earnings of high-school dropouts than trade, while both modestly reduced the earnings of high-school workers relative to college workers."¹⁰⁴

Twenty years of subsequent research have not brought a consensus among labor economists. Summarizing the literature, Eric Posner and Glen Weyl highlight the continuing disagreements:

From Pre- and Post-Mariel Miami 4 (Nat'l Bureau of Econ. Research, Working Paper 24580, 2018), <https://www.nber.org/papers/w24580> (emphasis in original).

⁹⁹ See *id.* at 5-6; George Borjas, *The Labor Demand Curve Is Downward Sloping: Reexamining the Impacts of Immigration on the Labor Market*, 118 Q.J. ECON. 1355 (2003).

¹⁰⁰ As Paul Samuelson notes, "[i]f mass immigration into the United States of similar workers to [low-skill, low-education American workers] had been permitted to actually take place, mainstream economists could not avoid predicting a substantial drop in wages of this native group" Samuelson, *supra* note 81, at 144.

¹⁰¹ See David Card & John E. DiNardo, *Do Immigrants Inflows Lead to Native Outflows*, 90 AM. ECON. REV. 360 (2000); David Card, *Immigrant Inflows, Native Outflows and the Local Labor Market Impacts of Higher Immigration*, 19 J. LABOR ECON. 22 (2001); Giovanni Peri & Vasil Yassenov, *The Labor Market Effects of a Refugee Wave: Applying the Synthetic Control Method to the Mariel Boatlift* (Nat'l Bureau of Econ. Research, Working Paper No. 21801, 2017), <https://www.nber.org/papers/w21801>; Ethan G. Lewis, *Local Open Economics Within the US: How Do Industries Respond to Immigration?* (Federal Reserve Bank of Philadelphia Working Paper No. 04-1, 2003).

¹⁰² David Card, *Is The New Immigration Really So Bad?*, 115 ECON. J. F300, F300 (2005).

¹⁰³ See George Borjas et al., *Searching for the Effect of Immigration on the Labor Market*, 86 AM. ECON. REV. 246 (1996).

¹⁰⁴ *Id.* Needless to say, the trade data studied by Borjas and co-authors did not include the effects of NAFTA or the China shock.

There is significant evidence that immigration reduces the wages of native workers whose backgrounds are similar to those of migrants. For example, illegal immigration to the United States from Mexico and Central America tends to hurt native workers with low education and weak language skills. However, the effects of migration on the broader labor markets are murkier. Some scholars believe that the native workers are in aggregate harmed, albeit only to a limited extent. Others argue that effects are negligible or even that most workers may benefit¹⁰⁵

The disagreement between the two camps is so fundamental, that Card, Borjas, and others continue to debate the consequences of a single event—the Mariel boatlift—that took place almost forty years ago. Card finds that the boatlift had virtually no impact on local wages.¹⁰⁶ Borjas finds that wages of “native” high-school dropouts fell by ten to thirty percent.¹⁰⁷

In the view of the National Academy of Sciences, the weight of evidence is shifting toward a greater concern about the effects of low-skill immigration. Revisiting its comprehensive 1997 analysis of economic and fiscal consequences of immigration, the Academy reached the following conclusion in 2017:

At that time [that is, in 1997], the authoring panel’s conclusion that ‘immigration has had a relatively small adverse impact on the wage and employment opportunities of competing native groups’ seemed to summarize well what the academic studies indicated. However, the intensive research on this topic over the past two decades ... displays a much wider variation in the estimates of the

¹⁰⁵ ERIC A. POSNER & GLEN WEYL, *RADICAL MARKETS: UPROOTING CAPITALISM AND DEMOCRACY FOR A JUST SOCIETY* 143 (2018) (citing sources). For a similar assessment see ROBERT SHILLER, *THE NEW FINANCIAL ORDER: RISK IN THE 21ST CENTURY* 159 (noting that entry of “hard-working and well-meaning people from developing countries ... would in many cases harm the interests of the indigenous population, who do have rights of citizenship that must be honored”).

¹⁰⁶ See David Card, *The Impact of the Mariel Boatlift on the Miami Labor Market*, 43 *INDUS. & LABOR REV.* 245 (1990).

¹⁰⁷ See George J. Borjas, *The Wage Impact of the Marielitos: A Reappraisal*, 70 *INDUS. & LAB. REL. REV.* 1077, 1077 (2017).

wage impact on natives who are most likely to compete with immigrants, with some studies suggesting sizable negative wage effects on native high school dropouts Thus, evidence suggests that groups comparable to immigrants in terms of their skill may experience a wage reduction as a result of immigration-induced increases in labor supply, although there are still a number of studies that suggest small to zero effects.¹⁰⁸

The latest research using the highest quality data explains why the earlier studies that found small effects may be misleading. These studies were capable of detecting only average effects, and averages masked the existence of both significant winners and significant losers.¹⁰⁹ A more granular look shows that low-skill Americans “who appear to be displaced by immigrant labor and move out of their local labor market” are the losers.¹¹⁰ So while the economic losses of low-skill Americans exposed to an influx of low-skill immigrants are still debated, they are likely and likely to be significant.

C. *Market Concentration*

Economists studying the growth of economic inequality have been focused on trade and immigration for some time. More recently, another trio of explanations has entered the distributional debates: the rise of concentration in product, labor, and capital markets.

The numbers are striking. Jan De Loecker, Jan Eeckhout, and Gabriel Unger show that since 1980, product markups (profits that firms capture by setting prices of the goods they sell in excess of costs)¹¹¹ increased

¹⁰⁸ NATIONAL ACADEMIES OF SCIENCES, ENGINEERING AND MEDICINE, THE ECONOMIC AND FISCAL CONSEQUENCES OF IMMIGRATION 247-48 (Francine D. Blau & Christopher Mackie eds., 2017).

¹⁰⁹ Joseph Price et al., *The Winners and Losers of Immigration: Evidence from Linked Historical Data* 1-3 (Nat'l Bureau of Econ. Research, Working Paper No. 27156, 2020), <https://www.nber.org/papers/w27156> (investigating novel panel comprising *individual-level* data on location, occupation, employment, and income of workers affected by impact of new immigrants during 1910's and 1920's).

¹¹⁰ *Id.* at 1.

¹¹¹ A markup is what a firm charges above its marginal cost. See Jan De Loecker et al., *The Rise of Market Power and the Macroeconomic Implications* 135 Q.J. ECON. 561, 562 (2020). In a perfectly competitive economy the markup is zero. See Suresh Naidu et al., *Antitrust Remedies for Labor Market Power*,

from 21% to 61%.¹¹² The increase suggests a dramatic rise in market power that could explain the decrease in labor and capital shares in national income, the decline of low-skill wages, and the drop in labor force participation, the authors conclude.¹¹³ Robert Hall examined markups in specific industries (rather than in the entire economy), and confirmed their rise, revealing a “substantial growth in market power,” though not as dramatic as De Loecker and co-authors suggest.¹¹⁴

Another recent blockbuster paper by Simcha Barkai argues that economists have completely missed the rise of abnormal returns to capital (economic windfalls or rents¹¹⁵) by simply assuming them away based on empirical findings from the 1980s.¹¹⁶ In the meantime, rents grew to \$14,000 per employee in 2014—almost half of median personal

132 HARV. L. REV. 536, 556 (2018) (“The markup equals the difference between the monopoly price and the competitive price, and thus serves as a natural gauge of market power”).

¹¹² See De Loecker et al., *supra* note 111, at 561.

¹¹³ See *id.* at 563, 566. Labor share of national income is “the fraction of economic output that accrues to workers as compensation in exchange for their labor,” *Estimating the U.S. Labor Share*, MONTHLY LAB. REV. (Feb. 2017), or “a share of labor income in total sales or value added,” David Autor et al., *Concentrating on the Fall of the Labor Share*, 107 AM. ECON. REV. PAPERS & PROC. 180, 185 (2017), or just labor’s share of Gross Domestic Product, *see id.* at 180. When market power increases, whether due to monopoly or monopsony power, rents (the share of total output the firms obtain because of their market power) rise, while capital share (the share of output that firms obtain due to their productive activities) and labor share fall. See Naidu et al., *supra* note 111, at 565.

¹¹⁴ Robert E. Hall, *New Evidence on the Markup of Prices over Marginal Costs and the Role of Mega-Firms in the US Economy* 14 (Nat’l Bureau of Econ. Research, Working Paper No. 24574, 2018), <https://www.nber.org/papers/w24574>.

¹¹⁵ “Economic rents are the return to a factor of production in excess of what is required to keep it in the market.... By definition, they are excessive returns to market activity that would have occurred anyway in their absence.” Jason Furman & Peter Orszag, *A Firm-Level Perspective on the Role of Rents in the Rise in Inequality*, in *TOWARD A JUST SOCIETY: JOSEPH STIGLITZ AND TWENTY-FIRST CENTURY ECONOMICS* 20 (Martin Guzman ed., 2018).

¹¹⁶ See Simcha Barkai, *Declining Labor and Capital Shares*, 75 J. FIN. 2421-2458 (2020) (“Past empirical estimates of small economic pure profits together with the potential theoretical advantage of indirectly inferring capital costs have led many researchers to prefer the assumption of zero pure profits over the direct measurement of capital costs.”). The assumption of zero rents was consistent with a broader view among economists, especially applied economists, that markets are perfectly competitive and no firms have monopoly power. See POSNER & WEYL, *supra* note 105, at 23-29.

income in the U.S.¹¹⁷ Barkai argues that decline in competition explains the rise of windfall profits.¹¹⁸

These findings are consistent with yet another recent study by Gustavo Grullon and colleagues who find that 75% of U.S. industries have experienced an increase in concentration levels over the last two decades.¹¹⁹ “To the extent industries look more like oligopolies than perfectly competitive markets, they will generate economic rents ... [eroding] the surplus that would otherwise accrue to consumers in a competitive market.”¹²⁰ Grullon and co-authors suggest that lax enforcement of antitrust laws may explain the increase. Economists in the Obama White House had similar concerns.¹²¹ Recent econometric research “has found tacit collusion to be unexpectedly prevalent.”¹²² Given the “revolution” that re-oriented antitrust law towards efficiency and away from other social objectives over the past decades, the drop of some merger reviews by the FTC and DOJ, and a sharp decline in antitrust challenges, these concerns seem well-founded.¹²³

One should not confuse concerns with consensus. Some of the papers just discussed are unpublished, and other scholars have already raised objections.¹²⁴ For example, an increase in industry concentration may

¹¹⁷ See POSNER & WEYL, *supra* note 105, at 39.

¹¹⁸ See Barkai, *supra* note 116, at 2422.

¹¹⁹ See Gustavo Grullon et al., *Are U.S. Industries Becoming More Concentrated?*, 23 REV. OF FIN. 697, 697 (2019).

¹²⁰ Furman & Orszag, *supra* note 115, at 35.

¹²¹ See COUNCIL OF ECON. ADVISERS ISSUE BRIEF, BENEFITS OF COMPETITION AND INDICATORS OF MARKET POWER I (May 2016).

¹²² Steven Berry et al., *Do Increasing Markups Matter? Lessons from Empirical Industrial Organization*, 33 J. ECON. PERSP. 44, 60 (2019).

¹²³ See John Kwoka, *Mergers, Merger Control, and Remedies: A Response to the FTC Critique* (Working Paper, March 2017); <https://ssrn.com/abstract=2947814> (describing the decline in antitrust enforcement); Thomas G. Wollman, *Stealth Consolidation: Evidence from an Amendment to the Hart-Scott-Rodino Act*, 1 AER: INSIGHTS 77, 78-79 (2019) (concluding that the 2000 amendment to the Hart-Scott-Rodino Antitrust Improvements Act that increased the threshold for premerger review led to a large increase in mergers between competitors). Inadequate enforcement may have reflected a misunderstanding of the changing markets. See POSNER & WEYL, *supra* note 105, at 177 (“Beginning in the 1970s and accelerating from the 1980s onward, antitrust authorities lost track of the ways in which capital markets reconfigured themselves to maintain monopoly power.”).

¹²⁴ See Susanto Basu, *Are Price-Cost Markups Rising in the United States? A Discussion of the Evidence*, 33 J. ECON. PERSP. 3 (2019); Berry et al., *supra* note 122; Loukas Karabarounis & Brent Neiman, *Accounting for Factorless*

reflect an increase in market power or it may not.¹²⁵ A dramatic increase in markups suggests an even greater decline of the labor share than the actual one.¹²⁶ No doubt, the debates about the monopoly power in the U.S. economy will continue.¹²⁷ But clearly, there are strong reasons to be concerned.

Turning from product to labor markets, the emerging evidence reveals a significant increase in the employers' power over workers. Examining a near-universe of online job vacancies, José Azar and co-authors find that judging by the DOJ/FTC standards (that those agencies use in product markets), 54% of U.S. labor markets are highly concentrated and another 11% are moderately concentrated.¹²⁸ These macro-effects are consistent with the evidence of anticompetitive labor market practices at the micro-level, ranging from non-poaching agreements¹²⁹ to non-compete clauses,¹³⁰ to expansive licensing requirements.¹³¹ Weak antitrust enforcement against labor market monopsony and legal obstacles to employees' challenges of employer market power have not helped.¹³² "A key worry ... is that anticompetitive practices have often

Income, 33 NBER MACROECON. ANNUAL 167 (2018); James Traina, *Is Aggregate Market Power Increasing? Production Trends Using Financial Statements*, Working Paper, <https://ssrn.com/abstract=3120849>.

¹²⁵ See Chad Syverson, *Macroeconomics and Market Power: Facts, Potential Explanations and Open Questions*, BROOKINGS ECON. STUD. 4 (Jan. 2019), <https://www.brookings.edu/research/macroeconomics-and-market-power-facts-potential-explanations-and-open-questions/>.

¹²⁶ See Basu, *supra* note 124, at 19.

¹²⁷ In fact, De Loecker and co-authors have already replied to the criticisms of their work, pointing out that some of their critics rely on an unrealistic assumption and an ill-fitting modeling framework. See De Loecker et al., *supra* note 111, at 603-05.

¹²⁸ See José Azar et al., *Concentration in U.S. Labor Markets: Evidence From Online Vacancy Data 1* (Nat'l Bureau of Econ. Research, Working Paper No. 24395, 2018), <https://www.nber.org/papers/w24395>. These numbers tend to overstate the economic significance of market concentration somewhat because many highly concentrated markets are very small. See David Berger et al., *Labor Market Power 9* (Nat'l Bureau of Econ. Research, Working Paper No. 25719, 2019), <https://www.nber.org/papers/w25719>. Still, the numbers are striking.

¹²⁹ See Naidu et al., *supra* note 111, at 571-72.

¹³⁰ See Alan B. Krueger & Eric A. Posner, *A Proposal for Protecting Low-Income Workers from Monopsony and Collusion*, THE HAMILTON PROJECT 7-8 (Feb. 2018).

¹³¹ See *infra*, text accompanying notes 240-243.

¹³² See Naidu et al., *supra* note 111, at 569-73.

targeted the most vulnerable workers: those with limited education and low skills.”¹³³

Greater employer concentration corresponds to lower wages—a relationship that is more pronounced at high levels of concentration and that has increased over time.¹³⁴ Moreover, in areas where labor market concentration has increased, low earners have seen their wages decline while high earners have experienced little change in their wages.¹³⁵ These trends are even more troubling than they appear because greater concentration also leads to employers demanding higher skills, especially from their low-skill workers.¹³⁶ So these workers’ skill-based wages should be higher, not lower when concentration increases.

Suresh Naidu, Eric Posner and Glen Weyl roughly estimate that “monopsony power in the U.S. economy reduces overall output and employment by 13%, and labor’s share of national output by 22%.”¹³⁷ New, micro-level empirical work shows that “the degree of monopsony power is substantially larger in low-wage labor markets.”¹³⁸ David Berger and colleagues disagree that labor market power has led to the decline in the labor share, but show convincingly that this oligopsony power has imposed “substantial welfare losses ... ranging from 2.9 to 8.0 percent of lifetime consumption.”¹³⁹

¹³³ *Id.* at 572.

¹³⁴ See José Azar et al., *Labor Markets Concentration* 1-2 (Nat’l Bureau of Econ. Research, Working Paper No. 24147, 2017), <https://www.nber.org/papers/w24147>; Efraim Benmelech et al., *Strong Employers and Weak Employees: How Does Employer Concentration Affect Wages?* 3 (Nat’l Bureau of Econ. Research, Working Paper No. 24307, 2018), <https://www.nber.org/papers/w24307>.

¹³⁵ See Kevin Rinz, *Labor Market Concentration, Earnings Inequality, and Earning Mobility*, Ctr. for Admin. Records Research and Applications Working Paper 2018-10 4-5, <https://www.census.gov/library/working-papers/2018/adrm/carra-wp-2018-10.html>.

¹³⁶ See Brad Hershbein & Claudia Macaluso, *Labor Market Concentration and the Demand for Skills* 5 (Working Paper, July 30, 2018), http://conference.iza.org/conference_files/DATA_2018/macaluso_c26795.pdf.

¹³⁷ Naidu et al., *supra* note 111, at 538.

¹³⁸ Ihsaan Bassier et al., *Monopsony in Movers: The Elasticity of Labor Supply to Firm Wage Policies* 5 (Nat’l Bureau of Econ. Research, Working Paper No. 27755, 2020), <https://www.nber.org/papers/w27755>.

¹³⁹ Berger et al., *supra* note 128, at 1. The welfare loss arises due to lower wages, less time spent working, and more work taking place at lower productivity firms. *Id.* at 37.

As always, there are doubts. The decline of labor share in the national income may be due to trade liberalization.¹⁴⁰ Labor markets more exposed to the China shock are also more concentrated,¹⁴¹ at least in part because some domestic firms went out of business. It is also possible that technological change gives rise to “superstar firms” with higher productivity, and these firms capture an increasingly greater market share.¹⁴² Some evidence supports this hypothesis, at least for the U.S. manufacturing.¹⁴³ So maybe it is trade and technology after all, perhaps along with the U.S. competition policy and its (lax) enforcement, that explain the increase in market concentration.

Finally, recent research suggests that the current historically high degree of common ownership of most publicly traded firms may be harmful to economic competition. BlackRock, State Street, Vanguard, and Fidelity together control more than a fifth of the value of the U.S. stock market.¹⁴⁴ The first of these three constitute the single largest shareholder in eighty eight percent of public companies in the S&P500 index.¹⁴⁵ And the consequences may be starting to show.

Airlines prices, for example, are arguably 3-7% higher due to anticompetitive power of institutional investors.¹⁴⁶ Researchers observed similar effects in the banking industry.¹⁴⁷ These results are recent, and there are already strong counterarguments.¹⁴⁸ Nonetheless, there is a real

¹⁴⁰ See Michael W.L. Elsby et al., *The Decline of the U.S. Labor Share*, Brookings Papers on Econ. Activity 1 (Fall 2013), <https://www.brookings.edu/bpea-articles/the-decline-of-the-u-s-labor-share/> (concluding that “offshoring of the labor-intensive component of the U.S. supply chain [is] a leading potential explanation of the decline in the U.S. labor share over the past 25 years.”).

¹⁴¹ See Benmelech et al., *supra* note 134, at 5.

¹⁴² See David Autor et al., *The Fall of the Labor Share and the Rise of Superstar Firms*, 135 Q.J. ECON. 645, 645 (2020) [hereinafter Autor, *Superstar Firms*].

¹⁴³ See *id.* at 665-70.

¹⁴⁴ See POSNER & WEYL, *supra* note 105, at 171.

¹⁴⁵ See Jan Fichtner et al., *Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and new Financial Risk*, 19 BUS. & POLITICS 298 (2017).

¹⁴⁶ See José Azar et al., *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1517 (2018).

¹⁴⁷ See José Azar et al., *Ultimate Ownership and Bank Competition* 1, 3 (Working Paper, July 23, 2016), available at <https://ssrn.com/abstract=2710252>.

¹⁴⁸ See Patrick Dennis et al., *Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry* (Working Paper, Feb. 5, 2018);

possibility that concentration in product and labor (and maybe even capital) markets has harmed American workers and consumers, especially those who live in the areas where employers exert significant market power over wages.

D. Labor Policy

Since at least the 1970's, membership in private sector labor unions has been declining while wage inequality has been increasing.¹⁴⁹ Are the two changes related?

Over time, scholars have offered different answers. One side has argued that the relationship between union membership and wage inequality is weak at best.¹⁵⁰ The other side has asserted that “the decline in organized labor explains a fifth to a third of the growth in [wage] inequality [between 1973 and 2007]—a major effect comparable to that of the growing stratification of wages by education.”¹⁵¹

The latest research relying on new data supports, and even magnifies, the latter view. A recent working paper overcomes a long-standing empirical challenge—absence of micro-level data on union membership prior to 1973—and finds that “unions have had a significant, equalizing effect on the income distribution over” the period of 1936 to the

<https://ssrn.com/abstract=3063465> (finding no relationship between airline ticket prices and common ownership of airlines); Erik P. Gilje et al., *Who's Paying Attention? Measuring Common Ownership and Its Impact on Managerial Incentives*, 137 J. FIN. ECON. 152, 154 (2020) (finding that accounting for possible investor inattention “cast[s] doubt on the idea that overlapping ownership structures, particularly those driven by asset manager mergers, significantly shift managers' incentive or induce anticompetitive behaviors among firms in the airline and banking industries” as suggested by Azar and co-authors); John Morley, *Too Big to Be Activist*, 92 S. CAL. L. REV. 1407, 1412-13 (2020) (explaining why exercise of market power is unlikely given the institutional structure of the major institutional investors).

¹⁴⁹ See Bruce Western & Jake Rosenfeld, *Unions, Norms, and the Rise in U.S. Wage Inequality*, 76 AM. SOC. REV. 513, 513, (2011).

¹⁵⁰ See, e.g., Daron Acemoglu et al., *Deunionization, Technical Change and Inequality*, in 55 CARNEGIE-ROCHESTER CONF. SERIES ON PUB. POL'Y 229, 230 (2001) (“Most economists, however, discount the role of unions in the increase in inequality.”).

¹⁵¹ Western & Rosenfeld, *supra* note 149, at 513, 517 (stating the conclusion and comparing it with studies finding both weak and significant relationship).

present.¹⁵² Moreover, strong unions disproportionately helped less-skilled workers, something that weak unions of today no longer do.¹⁵³

The emerging evidence of labor market concentration further highlights the importance of labor unions. Not only does greater market power of employers depress wages, but the negative correlation between wages and market power is stronger when unionization rates are low.¹⁵⁴

There is also new evidence that government regulation weakening employment protections diminishes the bargaining power of workers and reduces their wages.¹⁵⁵ “Somewhat surprisingly,” the extensive analysis of the well-known decline in labor share “has touched very little on the role of labor market regulation.”¹⁵⁶ Yet it now appears quite likely that decades of U.S. (anti-)labor policies that contributed to the decline of labor unions harmed American workers, especially low-skill ones.¹⁵⁷ And

¹⁵² Henry S. Farber et al., *Unions and Inequality Over the Twentieth Century: New Evidence from Survey Data 1* (Nat’l Bureau of Econ. Research, Working Paper No. 24587, 2018), <https://www.nber.org/papers/w24587>.

¹⁵³ *See id.* at 3.

¹⁵⁴ *See* Benmelech et al., *supra* note 134, at 4. The “it appears” qualifier in the text is there because the link between the decline in labor share and unionization is uncertain. *Compare* Michael W.L. Elsby et al., *The Decline of the U.S. Labor Share*, BROOKINGS PAPERS ON ECON. ACTIVITY 1 (Fall 2013), <https://www.brookings.edu/bpea-articles/the-decline-of-the-u-s-labor-share/> (stating that “institutional explanations based on the decline in unionization is inconclusive” in explaining the decline in the labor share) *with* Autor et al., *Superstar Firms*, *supra* note 142, at 648 (noting that “the broadly common experience of a decline in labor shares across countries with different levels and evolutions of unionization and other labor market institutions somewhat vitiates” the connection between “unions and the real value of the minimum wage.”) Yet new evidence suggests that deregulation of job protection laws in 26 countries did “contribute[] to some of the observed decline in labor shares in many advanced economies” Gabriele Ciminelli et al., *Employment Protection Deregulation and Labor Shares in Advanced Economies*, IMF WORKING PAPER WP/18/186 (2018), <https://www.imf.org/en/Publications/WP/Issues/2018/08/16/Employment-Protection-Deregulation-and-Labor-Shares-in-Advanced-Economies-46074>.

¹⁵⁵ *See id.* at 7.

¹⁵⁶ *Id.* at 8.

¹⁵⁷ *See* Farber et al., *supra* note 152, at 3 (concluding that market “forces alone cannot explain patterns in union membership over the 20th century); TIMOTHY NOAH, THE GREAT DIVERGENCE: AMERICA’S GROWING INEQUALITY CRISIS AND WHAT WE CAN DO ABOUT IT 138-43 (2012) (describing the consequences of the Taft-Hartley Act passed in 1947 and the later appointment of an anti-union head of NLRB by President Reagan); Western & Rosenfeld, *supra* note 149, at 516 (same).

because today's public sector unions are the only ones yielding economic advantages for their members,¹⁵⁸ the recent Supreme Court decision weakening these unions,¹⁵⁹ as well as public-sector unions' loss of public support and political clout in both parties,¹⁶⁰ is bound to be particularly costly for a large group of working Americans.

Drawing on many recent empirical findings discussed in the Part, Anna Stansbury and Lawrence Summers make the broadest and the boldest claim: the decline of “worker power”—and not globalization, technological transformation, or the rise of monopoly or monopsony power—is the best explanation for the “fall in the labor income share, an increase in [Tobin's] Q, corporate profitability, and measured markups, and a fall in the [non-accelerating rate of unemployment].”¹⁶¹ The magnitude of the decline is significant: the share of product market rents captured by labor declined by half, “from 12% of net value added in the nonfinancial corporate business sector in the early 1980s to 6% in the 2010s.”¹⁶² And—should we be surprised?—“the decline in labor rents was larger for non-college-educated workers than for college-educated workers.”¹⁶³ What caused the loss of worker power? Stansbury and

¹⁵⁸ See David Card et al., *Unions and Wage Inequality: The Roles of Gender, Skill and Public Sector Employment* 28 (Nat'l Bureau of Econ. Research, Working Paper No. 25313, 2018), <https://www.nber.org/papers/w25313> (finding that private sector unions reduce male wage inequality by 1.7% and female wage inequality by 0.6% while the respective numbers for public sector unions are 16.2% and 50%).

¹⁵⁹ See *Janus v. Am. Fed'n of State, Cry., & Mun. Emps.*, 138 S. Ct. 2448 (2018) (finding that mandatory collection of public union fees is unconstitutional).

¹⁶⁰ See Dorian T. Warren, *The Politics of Labor Policy Reform*, in *THE POLITICS OF MAJOR POLICY REFORM IN POSTWAR AMERICA* 103, 119 (Jeffery A. Jenkins & Sidney M. Mikis eds., 2014) (describing the deteriorating public standing of public sector unions and anti-union measures of both Republican and Democratic governors in the wake of the Great Recession).

¹⁶¹ Anna Stansbury & Lawrence H. Summers, *The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 27193, 2020), <https://www.nber.org/papers/w27193>. By worker power the authors mean power “arising from unionization or the threat of union organizing, firms being run partly in the interests of workers as stakeholders, and/or from efficiency wage effects . . .” *Id.*

¹⁶² *Id.* at 4.

¹⁶³ *Id.* at 7.

Summers offer several reasons, but changes in government labor market policies are the first on their list.¹⁶⁴

E. *Environmental Policy*

On the environmental front, decades-long extensive work on the incidence of environmental taxes, subsidies, and tradable permits has had little to say about the distributional effects of non-tax regulation.¹⁶⁵ Yet regulation—and not taxes and tradeable permits—has been Congress’ primary environmental policy tool.

Emerging research finds that regulatory mandates have significant distributional effects. Building energy codes, for example, disproportionately harm low-income home owners.¹⁶⁶ Corporate average fuel economy (CAFE) standards are not only regressive, but are more regressive than carbon taxes would be.¹⁶⁷ The same may be true of other command-and-control regulation.¹⁶⁸

¹⁶⁴ See *id.* at 2 (listing “[f]irst, institutional changes: the policy environment has become less supportive of worker power by reducing the incidence of unions and the credibility of the ‘threat effect’ of unionism or other organized labor” and the fall of minimum wage in real terms).

¹⁶⁵ A 2008 comprehensive review of environmental policy instruments devoted just one or two sentences to the subject without citing any prior research. See Lawrence H. Goulder & Ian W.H. Parry, *Instrument Choice in Environmental Policy*, 2 REV. ENVIRON. ECON. & POL’Y 152, 166 (2008); see also Don Fullerton & Erich Muehlegger, *Who Bears the Economic Costs of Environmental Regulations?*, 13 REV. ENVIRON. ECON. & POL’Y 62, 62 (2019) (making the same observation a decade later).

¹⁶⁶ See Chris Bruegge et al., *The Distributional Effects of Building Energy Codes*, 6 J. ASSOC. ENVIRON. RESOURCE ECON. S95, S99 (2019).

¹⁶⁷ See Lucas W. Davis & Christopher R. Knittel, *Are Fuel Economy Standards Regressive?*, 6 J. ASSOC. ENVIRON. RESOURCE ECON. S37, S38-39 (2019) (finding that CAFE standards are regressive when their effects on costs of both new and used vehicles are taken into account); Arik Levinson, *Energy Efficiency Standards Are More Regressive Than Energy Taxes: Theory and Evidence*, 6 J. ASSOC. ENVIRON. RESOURCE ECON. S7, S9 (2019) (2019) (finding that CAFE standards are more regressive than a carbon tax when both the type of vehicle and the miles driven are considered).

¹⁶⁸ See Fullerton & Muehlegger, *supra* note 165, at 7 (reviewing “new and emerging empirical literature on distributional effects of non-tax environmental mandates and regulations” and finding that “mandates are more regressive than a carbon tax when compared in a revenue-neutral way”).

Regulatory mandates may also lead to higher unemployment in polluting industries in areas where these industries are concentrated.¹⁶⁹ While in basic economic models of environmental regulation “jobs are a cost, not a benefit,”¹⁷⁰ there is clear evidence that the basic models are too basic. They ignore the costs of changing jobs as well as the relative job quality.¹⁷¹ Yet these costs are substantial, and no work in environmental economics (or elsewhere) “attempts to model the effect of regulation on job quality.”¹⁷² In fact, “there is a sharp disconnect between the political importance of the jobs question and the limited research on the job effects of [environmental] policy”¹⁷³

If environmental regulation replaces “good jobs” in West Virginia with “bad jobs” half way across the country, the resulting distributional burdens or overall social welfare impacts are not known. The latest models suggest that environmental mandates produce greater labor market disruptions than environmental taxes or tradable permits do.¹⁷⁴

Economic analysis of all these issues is just beginning. Given widespread use of environmental mandates, the unintended distributional effects of U.S. environmental policies are yet another cause for concern.

E. Efficiency of U.S. Markets

Until now, the discussion focused on the recent evidence of the effects of various U.S. policies on American workers. We now turn from policies to markets. It turns out that emerging evidence is changing economists’ long-settled views here as well.

Not long ago economists believed that U.S. labor, product, and capital markets are generally efficient. Trade economists, for instance, assumed that American labor force is highly mobile, that “U.S. markets are smoothly integrated across space,”¹⁷⁵ reflecting their efficiency.¹⁷⁶ This

¹⁶⁹ See Kenneth A. Castellanos & Garth Heutel, *Unemployment, Labor Mobility, and Climate Policy* 5 (Nat’l Bureau of Econ. Research, Working Paper No. 25797, 2019), <https://www.nber.org/papers/w25797>.

¹⁷⁰ Marc A.C. Hafstead & Roberton C. Williams III, *Jobs and Environmental Regulation*, 1 ENVIRON. ENERGY POL’Y & ECON. 192, 198 (2020).

¹⁷¹ See *id.* at 204-06.

¹⁷² *Id.* at 205. The only exceptions that authors cite is a highly stylized model of the effect of trade liberalization on a population of identical workers.

¹⁷³ *Id.* at 192.

¹⁷⁴ See *id.* at 29, 36-42.

¹⁷⁵ Autor et al., *China Shock*, *supra* note 74, at 235.

assumption was critical to the analysis of the distributional effects of trade liberalization. If workers move easily between firms, industries, and regions,¹⁷⁷ they will leave the industries and places disadvantaged by growing foreign imports and move to industries and places that flourish due to growing U.S. exports. In fact, this movement (“factor reallocation” in economic parlance) “is a crucial part of the mechanism through which the aggregate gains from trade are realized.”¹⁷⁸

Yet despite the critical importance of the labor mobility assumption, “[u]ntil recently, the literature had surprisingly little to say about [adjustment costs], as it was focused on steady state outcomes” when all the switching has already occurred.¹⁷⁹ When economists questioned the easy switching assumption in the past decade, they discovered that “there are substantial barriers to mobility and reallocation,”¹⁸⁰ and that “labor-market adjustment to trade shocks is stunningly slow.”¹⁸¹ Even more disturbing is a growing evidence that “low-skilled workers [are] less mobile and more sensitive to local shocks.”¹⁸² U.S. labor market turned out to be not that efficient after all.

The economic analysis of competition reveals a similar shift in economists’ views. Following a highly influential analysis by Arnold Harberger published in 1954,¹⁸³ economists assumed that market power is not an economy-wide problem in U.S. product markets.¹⁸⁴ Market

¹⁷⁶ “[G]eographical labor mobility is considered to be an efficient adjustment mechanism to macroeconomic shocks.” Marco Caliendo et al., *The Returns to Labor Market Mobility: An Evaluation of Relocation Assistance for the Unemployed*, 148 J. PUB. ECON. 136, 137 (2017).

¹⁷⁷ See Autor et al., *China Shock*, *supra* note 74, at 207-208.

¹⁷⁸ Goldberg, *supra* note 76, at 19.

¹⁷⁹ *Id.* at 20.

¹⁸⁰ *Id.*

¹⁸¹ Autor et al., *China Shock*, *supra* note 74, at 235. How slow? “[L]ocal labor force participation rates remain[] depressed and local unemployment rates remain[] elevated for a full decade or more after a shock commences.” *Id.*

¹⁸² Richard Hornbeck & Enrico Moretti. *Who Benefits From Productivity Growth? Direct and Indirect Effects of City TFP Shocks on Wages, Rents, and Inequality* 3 (Nat’l Bureau of Econ. Research, Working Paper No. 24661, 2019), <http://www.nber.org/papers/w24661>. If the shock is positive, lower mobility may help low-skill workers, as Hornbeck and Moretti show.

¹⁸³ See Arnold C. Harberger, *Monopoly and Resource Allocation*, 44 AM. ECON. REV. 77 (1954)

¹⁸⁴ See Jan De Loecker & Jan Eeckhout, *The Rise of Market Power and the Macroeconomic Implications* 1 (Nat’l Bureau of Econ. Research, Working Paper No. 23687, 2017), <http://www.nber.org/papers/w23687> (“While there was

power is indicative of monopolization—a textbook example of market failure. Its absence is a sign that product markets are competitive and efficient.

Yet “[d]espite the vital importance of market power in economics, surprisingly little is known about its systematic patterns for the aggregate economy and over time.”¹⁸⁵ When economists recently considered how product markups changed over decades, they found evidence of a dramatic increase in market power.¹⁸⁶

Or consider the well-known decline of the labor share since the beginning of this century.¹⁸⁷ As the share of national income going to workers fell, economists suggested that technological change, mechanization, capital accumulation, change in the relative price of capital, or unobserved intangible capital explained the decline.¹⁸⁸ Each explanation concluded that the decline was efficient¹⁸⁹ and even welfare-enhancing in the long run.¹⁹⁰ Notably, almost all explanations assumed that the decline in labor share necessarily meant that the capital share increased.¹⁹¹ This assumption came from empirical findings that between the 1960’s and 1980’s, the share of economic rents (windfall profits) in

a tradition to investigate the potential impact of market power on resource allocation, the analysis of Harberger (1954) concluded that profit rates across US (manufacturing) industries during the 1920s were not sufficiently dispersed to generate any meaningful aggregate outcome. This analysis, and its conclusion that market power barely impacts economy-wide outcomes, became the default view held by many economists and policy makers ever since.”); Naidu et al., *supra* note 111, at 541-42.

¹⁸⁵ De Loecker et al., *supra* note 111, at 562.

¹⁸⁶ *See id.*

¹⁸⁷ *See* Michael D. Giandrea & Shawn A. Sprague, *Estimating the U.S. Labor Share*, BUREAU OF LABOR STAT. MONTH. LABOR REV. 1, 2, 5 (2017), <https://www.bls.gov/opub/mlr/2017/article/estimating-the-us-labor-share.htm> (citing studies considering the causes of the decline). *See also* David Autor et al., *Concentrating on the Fall of the Labor Share*, 107 AM. ECON. REV. PAPERS & PROC. 108, 180 (2017) (“there is consensus that there has been a decline in the US labor share since the 1980s, particularly in the 2000s.”); De Loecker et al., *supra* note 111, at 609 (“the decline in the labor share is widely discussed”).

¹⁸⁸ *See* Barkai, *supra* note 116, at 2421, 2423.

¹⁸⁹ *See* Simcha Barkai, *Declining Labor and Capital Shares 2* (Working Paper, 2017); <https://www.london.edu/faculty-and-research/academic-research/d/declining-labor-and-capital-shares>.

¹⁹⁰ *See id.* at 5-6.

¹⁹¹ *See id.* at 4.

the U.S. economy was close to zero, as it should be if economy is competitive.¹⁹²

Even though we are now half a century removed from those decades, the zero-profit assumption has persisted until Simcha Barkai abandoned it in his recent path breaking work.¹⁹³ His stark conclusion? Not only did the normal return to capital not increase to offset the decrease in the labor share, but the capital share declined even more than the labor share did. What increased—dramatically—were windfall profits.¹⁹⁴ The cause, again, is the decline in market competition.¹⁹⁵ That this rise improves efficiency and welfare is very much in doubt, given that it causes large declines in output, wages, and investment.¹⁹⁶

One sees more of the same in other areas of economics. In the 1970's, 80's and 90's labor markets were viewed as reasonably competitive.¹⁹⁷ Labor economists believed that unions were responsible for the remaining labor market rigidity and inefficiency.¹⁹⁸ To the extent that economists tested the employers' monopsony power as an alternative explanation, the tests were indirect and their persuasiveness was limited.¹⁹⁹

Then unions faltered but inefficiencies remained, surprising labor economists.²⁰⁰ “The concurrent decline of unions and rise of labor market concentration implies that the neoliberal assumption that unions, rather

¹⁹² See Barkai, *supra* note 116, at 2457-58.

¹⁹³ See *id.* at 2459 (“To the best of my knowledge no [aggregate measure of pure profits] exists for the past three decades.”).

¹⁹⁴ See *id.* 2423.

¹⁹⁵ See *id.* at 2424.

¹⁹⁶ See *id.* at 2457.

¹⁹⁷ See Naidu et al., *supra* note 111, at 541-42, 552-53 (noting that “economists assumed that labor markets are reasonably competitive, and accordingly that labor market power was not an important social problem”).

¹⁹⁸ See Acemoglu et al., *supra* note 150, at 232 (“The standard view is one in which unions are pure rent-seeking organizations. They distort the socially optimal allocation of resources and represent and impediment to free contracting in the labor market.”); Farber et al., *supra* note 152, at 5.

¹⁹⁹ See Benmelech et al., *supra* note 134, at 5-6 (explaining that David Card and Alan Krueger inferred monopsony power as a possible explanation of employers' non-responsiveness to an increase in minimum wage, and Michael Reich and co-authors made the same inference from the workers' relatively low propensity to leave jobs after wage declines).

²⁰⁰ See Krueger & Posner, *supra* note 130, at 4 (referring to monopsonization as “a new and perhaps surprising” explanation for wage stagnation and income inequality).

than employers, are the major source of cartelization of labor markets was false.”²⁰¹

Naturally, economists have a lot of catching up to do.

The idea that even highly advanced labor markets, like that of the United States, might be better characterized as imperfectly competitive opens a host of questions about the welfare implications of industrial policies and labor market institutions Empirical work *lags particularly far behind* the theory in this domain.²⁰²

Next consider the economic analysis of environmental regulation. Until recently, most computable general equilibrium models used to estimate the effects of environmental regulation assumed full employment and perfect labor mobility across industries and regions.²⁰³ Yet evidence suggests that neither assumption is warranted. The 1990 Clean Air Act Amendments, for instance, likely “induced substantial mobility costs for affected workers.”²⁰⁴ High mobility costs undermine labor market efficiency.

Macro economists, for their part, were optimistic about the U.S. financial system. “At the onset of the [2008] crisis, the workhorse macroeconomic models assumed frictionless financial markets.”²⁰⁵ Then the crisis hit, and the prevailing models of “frictionless, perfectly competitive, complete information”²⁰⁶ markets were of little use to the Federal Reserve and other government agencies trying to contain a meltdown of the imperfect, real-world financial system. The same models looked detached from reality when it turned out that the most important benchmark in the deepest financial market turned out to have been manipulated for years, and it was not the only example of major

²⁰¹ *Id.*

²⁰² David Card et al., *Firms and Labor Market Inequality: Evidence and Some Theory*, 36 J. LABOR ECON. S1, S57 (2018) (emphasis supplied).

²⁰³ See Castellanos & Heutel, *supra* note 169, at 2; Hafstead & Williams, *supra* note 170, at 195.

²⁰⁴ Castellanos & Heutel, *supra* note 169, at 3, n.1; Reed W. Walker, *The Transitional Costs of Sectoral Reallocation: Evidence from the Clean Air Act and the Workforce*, 128 Q.J. ECON. 1787, 1797 (2013).

²⁰⁵ Mark Gertler & Simon Gilchrist, *What Happened: Financial Factors in the Great Recession*, 32 J. ECON. PERSP. 3, 3 (2018).

²⁰⁶ John C. Williams, *The Rediscovery of Financial Market Imperfections, in TOWARD A JUST SOCIETY: JOSEPH STIGLITZ AND TWENTY-FIRST CENTURY ECONOMICS 201, 201-03* (Martin Guzman ed., 2018).

financial market manipulation.²⁰⁷ Understandably, macro economists have now moved away from the naively optimistic pre-crisis assumptions and beliefs.²⁰⁸

Emerging from all these observations is an unmistakable trend. For decades, trade economists, industrial organization economists, labor economists, macro economists, and environmental economists relied on rather Panglossian assumptions about the efficiency of U.S. economy. Some of these assumptions were probably wrong all along.²⁰⁹ Some were valid when made decades ago but remained in use well past their expiration date.²¹⁰ Either way, economists increasingly recognize that these assumptions were flawed, and so were the conclusions based on these assumptions. Proceeding on parallel tracks, law-and-economics scholars have become increasingly skeptical about the claims that the common law either is efficient or is developing toward efficiency.²¹¹

* * * * *

The findings summarized in this Part reveal a sobering picture. Not only did many government policies likely gave rise to large, unintended economic losses, but these losses fell on the same group of Americans—low-skill, low-education, pre-retirement age workers. Their obvious economic vulnerability makes the recent findings especially troubling. Moreover, market failures and other inefficiencies that have been growing in various sectors of the U.S. economy diminished American

²⁰⁷ That rate is LIBOR. See Alan Krueger, *Reflections on Dwindling Worker Bargaining Power and Monetary Policy*, Address at the Jackson Hole Economic Symposium 1 (Apr. 24, 2018) (remarking that “some of the best finance economists in the world thought it inconceivable that foreign exchange markets or LIBOR could be manipulated.”), <https://www.kansascityfed.org/~media/files/publicat/sympos/2018/papersandhandouts/824180824kruegerremarks.pdf?la=en>. Both markets were proven to be rigged. *Id.*

²⁰⁸ See *supra*, Gertler & Gilchrist, at 4-9.

²⁰⁹ Assumptions about low switching costs in the economic analysis of trade and about unions as the main cause of labor market rigidity come to mind.

²¹⁰ An example is the assumption about low windfall profits.

²¹¹ See Richard Craswell, *In That Case, What Is the Question? Economics and the Demands of Contract Theory*, 112 YALE L.J. 903, 911 (2003); Anthony Niblett et al., *The Evolution of a Legal Rule*, 39 J. LEGAL STUD. 325, 330 (2010); Eric A. Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 830 (2003); D. Daniel Sokol, *Rethinking the Efficiency of the Common Law*, 95 NOTRE DAME L. Rev. 795, 797 (2019).

workers' capacity to avoid or absorb their losses. The next question is what, if anything, did the U.S. government do in response.

IV. GOVERNMENT'S DISTRIBUTIONAL (NON)ADJUSTMENTS

Congress and the President have the power to create distributional burdens, and the power to mitigate them as well. Part III reveals that a wide range of national policies likely created unintended burdens. This Part shows that the U.S. government did little to mitigate them. Its main targeted relief program has been limited and ineffective. Its general efforts to address the impacts discussed in Part III have been inadequate. To make things worse, the U.S. government's growing reliance on states in administering federal social insurance programs—as well as the U.S. government's reluctance to counter some state-specific policies—exacerbated the losses resulting from the national policies discussed in Part III. These conclusions matter greatly in assessing the two distributional arguments at the center of this Article.

A. *Targeted Assistance Programs*

The only significant federal program specifically aimed to counter the unintended distributional impacts of a major U.S. policy is the Trade Adjustment Assistance program (TAA). The TAA offers cash benefits, retraining, and relocation assistance to workers who lost their jobs to import competition.²¹² The idea for the program came from David J. McDonald in 1953. McDonald was the president of the United Steelworkers union and a member of the presidential Commission on Foreign Economic Policy.²¹³ He supported free trade and viewed adjustment assistance as a response to the possible (though at that point entirely hypothetical) dislocations resulting from trade liberalization. Championed by John F. Kennedy since his days as a junior senator from Massachusetts, the TAA began operation in 1962.

In the first six years of TAA existence, the Tariff Commission tasked with evaluating petitions for adjustment assistance denied every single one. Assistance started flowing after that, but barely. Only forty-six

²¹² See ALDEN, *supra* note 7, at 107; Baicker & Rehavi, *supra* note 62, at 239-46. TAA was also designed to help U.S. companies affected by foreign competition. See ALDEN, *supra* note 7, at 111.

²¹³ See ALDEN, *supra* note 7, at 116.

thousand workers received benefits between 1968 and 1973. Congress significantly expanded the program in 1973 with support from the Nixon administration. As a result, more than 1.3 million workers qualified for TAA benefits between 1975 and 1981. Then the Reagan administration cut the program's funding by seventy five percent. It became almost impossible to qualify for benefits,²¹⁴ and only sixteen thousand workers received them in 1981. Participation grew gradually but remained fairly low until 2002 when the George W. Bush administration reached a deal about its fast-track trade-negotiating authority with Congress. The final expansion came as part of President Obama's stimulus package in 2009. So just in the past two decades, participation in TAA went from under 100,000 in 2000, to 235,000 in 2002,²¹⁵ to more than 280,000 in 2010.²¹⁶ The 2009 expansion was temporary, however.²¹⁷ By 2017, only 94,000 workers benefited from the program.²¹⁸

These wild fluctuations are not a sign of a stable, reliable program.²¹⁹ And given that *millions* likely lost jobs from the China shock alone,²²⁰ the current level of participation reveals the program's overwhelming inadequacy. This inadequacy is obvious when one looks at the TAA's significance in the lives of affected workers. In the regions most harmed by the China shock, for example, TAA payments are "negligible relative to many other transfer programs"²²¹ that are not targeted to provide specific relief. For a program designed to assist, TAA does not offer much assistance. No other major federal program aims at relieving the unintended distributional costs of government policies adopted in the past half-century.

²¹⁴ The grant rate dropped from over 80% to just 14%, *see id.*

²¹⁵ *See id.* at 121-22.

²¹⁶ *See* EMPLOYMENT AND TRAINING ADMIN., U.S. DEP'T OF LABOR, TRADE ADJUSTMENT ASSISTANCE FOR WORKERS PROGRAM, FISCAL YEAR 2017 4 (2010).

²¹⁷ *See id.* at 2-3.

²¹⁸ *See id.* at 9.

²¹⁹ Some of these fluctuations, such as the 2009 expansion, reflect economic cycles, but many do not.

²²⁰ *See* Acemoglu et al., *supra* note 87, at S141.

²²¹ Autor et al., *China Shock*, *supra* note 74, at 230-31.

B. General Social Safety Net Programs

If the targeted congressional efforts are meager and ineffective, what about the general redistributive programs? The Earned Income Tax Credit, or EITC, is a major cash transfer program for working Americans. Enacted in 1975 and expanded on several occasions most recently in 2015,²²² it is one of the federal government's largest antipoverty programs. In 2017, it provided about \$65 billion to twenty seven million workers.²²³ Notably, Congress significantly expanded the EITC in 1993, just as the country was entering into NAFTA and gearing up for negotiations that culminated in China's entry into the WTO.²²⁴

The EITC surely helps low-income American workers. But its design undermines the claim that it was intended to—or did—serve as an effective distributional adjustment to the government-created economic shocks discussed earlier. For the lowest earners, the EITC increases as wages rise.²²⁵ So if trade liberalization, or labor market monopsony, or environmental regulation reduced wages of some workers, their EITC payments went down as well. For those earning a bit more, the EITC is a fixed dollar amount that would not counteract a decrease in wages.²²⁶ Moreover, the EITC is available in meaningful amounts only to parents caring for children (and some other dependents). So neither young single workers, nor older workers with children over nineteen, nor workers living separately from their children are eligible for benefits. Given the breakdown of marriage among low-income Americans,²²⁷ the last limitation in particular severely limits the reach of the EITC.

²²² See Margot L. Crandall-Hollick, CONG. RESEARCH SERV., R44825, THE EARNED INCOME TAX CREDIT (EITC): A BRIEF LEGISLATIVE HISTORY 1, 10 (2018), <https://fas.org/sgp/crs/misc/R44825.pdf>.

²²³ See Statistics for Tax Returns with EITC; <https://www.eitc.irs.gov/eitc-central/statistics-for-tax-returns-with-eitc/statistics-for-tax-returns-with-eitc>.

²²⁴ See Crandall-Hollick, *supra* note 222, at 6.

²²⁵ See Elaine Maag, *Who Benefits from Expanding the EITC or CTC?*, Urban Institute (Jul. 30, 2018), https://www.urban.org/sites/default/files/publication/98829/who-benefits-from-expanding-the-eitc-or-ctc_understanding-the-intersection-of-the-eitc_0.pdf. The proportionate relationship between wages and EITC exists up to earned income of \$14,290 for a family with two children. See Rev. Proc. 2018-18, 2018-10 I.R.B. 392.

²²⁶ EITC amount remains flat for earned income between \$14,290 and \$24,350 for a family with two children. See *id.*

²²⁷ See Anne Alstott, *Updating the Welfare State: Marriage, the Income Tax, and Social Security in the Age of Individualism*, 66 TAX L. REV. 695, 720-21

Patient Protection and Affordable Care Act (ACA)²²⁸ is another federal program that had the potential of relieving some of the economic hardship of low-wage stagnation and low-skill job losses. But a crucial part of the ACA—the national Medicaid expansion—was struck down by the Supreme Court.²²⁹ Twelve states have not expanded Medicaid as of September of 2020,²³⁰ including some of the states most affected by policies discussed in Part III.²³¹

Other than the EITC, the curtailed ACA, and the ill-fated TAA, there has been no significant government program that can be plausibly viewed as countering the losses discussed earlier. General anti-poverty programs like unemployment insurance, disability insurance, and Temporary Assistance for Needy Families are surely used by workers affected by free trade, labor market monopsony, and so on.²³² But a claim that any of these programs was adopted in order to mitigate the adverse distributional effects discussed here is implausible. In fact, changes to some of these programs have made things worse, as the next section explains.

There are several specific employment and training programs that are plausibly viewed as assisting low-skill workers regardless of the cause of their job losses. These programs are numerous, almost all are poorly funded and negligible in effects.²³³ Many of them do not aim to help dislocated workers.²³⁴ The largest among those that do is the Workforce

(2013).

²²⁸ See Pub. L. No. 111-148, 124 Stat. 119 (2010).

²²⁹ See Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519 (2012) (finding that the ACA's national expansion of Medicaid exceeded Congress' Constitutional powers).

²³⁰ See *Status of State Action on the Medicaid Expansion Decision*, Henry J. Kaiser Family Foundation (April 26, 2019), <https://www.kff.org/medicaid/issue-brief/status-of-state-medicaid-expansion-decisions-interactive-map/>.

²³¹ For example, the Carolinas are among the states most affected by the China Shock, see Autor, *China Shock*, *supra* note 74, at 225, and Kansas and large parts of Texas are among areas with the highest employer concentration and market power, see Azar et al., *supra* note 128, at 25. None of these states expanded Medicaid.

²³² See Autor, *China Shock*, *supra* note 74, at 230.

²³³ See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO, MULTIPLE EMPLOYMENT AND TRAINING PROGRAMS: PROVIDING INFORMATION ON COLOCATING SERVICES AND CONSOLIDATING ADMINISTRATIVE STRUCTURES COULD PROMOTE EFFICIENCIES (2011).

²³⁴ Some programs are focused on youth, on re-integration of ex-offenders, on disabled veterans, and so on. See *id.* at 47.

Investment Act / Dislocated Workers program enacted in 1998.²³⁵ In 2009, Congress spent slightly less than \$2.5 billion on this program.²³⁶ TAA disbursed about \$700,000; National Farmworker Jobs Program \$80,000.²³⁷ Compared to \$65 billion of EITC benefits, these are trivial amounts. The distressing bottom line is that although politicians have been talking about the unintended burdens of free trade, regulation, and technological change for decades, they did little to address these burdens.

C. *Making Things Worse*

The federal structure of the U.S. political system, combined with the federal government's increasing reliance on states in administering national safety net programs, has made things even worse for low-income Americans. As Part III explains, many unintended distributional losses have been geographically concentrated. Some areas have been affected by trade liberalization much more than others. The country's heartland has highly concentrated labor markets while the coasts do not. Given this concentration, geographic mobility is crucial for a fast dissipation of labor market shocks.

Yet a number of state policies likely reduced geographic mobility of low-skill workers over the past several decades. Restrictive zoning laws adopted in many economically thriving locales artificially increased housing costs.²³⁸ Because these costs consume a larger share of one's budget as income declines, pricey real estate disproportionately affected relocation opportunities of low-income Americans²³⁹

Another barrier has been the proliferation of state-imposed occupational licensing and related requirements. Over the past six decades, the share of U.S. labor force subject to these requirements grew five-fold.²⁴⁰ No longer limited to doctors and lawyers, licensing regimes

²³⁵ See Burt S. Barnow & Jeffrey Smith, *Employment and Training Programs*, in 2 ECONOMICS OF MEANS-TESTED TRANSFER PROGRAMS IN THE UNITED STATES 127, 132-33, 139 (Robert A. Moffitt ed., 2016).

²³⁶ See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 233, at 47.

²³⁷ See *id.*

²³⁸ See Peter Ganong & Daniel Shoag, *Why Has Regional Income Convergence in the U.S. Declined?*, J. URBAN ECON. 76, 76 (2017); David Schleicher, *Stuck! The Law and Economics of Residential Stagnation*, 127 YALE L.J. 78, 114 (2017); see also Furman & Orszag, *supra* note 115, at 29.

²³⁹ See Ganong & Shoag, *supra* note 238, at 78.

²⁴⁰ See Peter Q. Blair & Bobby W. Chung, *How Much of Barrier to Entry is*

cover barbers, bartenders, florists, manicurists, and many other relatively low-skill professions.²⁴¹ More than 1,100 occupations are regulated at least in one state.²⁴²

Because these licensing restrictions are state-specific, they have a negative effect on labor mobility.²⁴³ Moreover, according to the first-of-a-kind recent estimate of the welfare effects of licensing, licensing an occupation “reduces total surplus from the occupation, defined as the welfare value of trade in its labor services by about 12 percent relative to no licensing. Workers and consumers respectively bear about 70 and 30 percent of these welfare costs.”²⁴⁴ Workers with a only a high-school degree are among those most negatively affected.²⁴⁵

The federal government has done very little to counter these state-imposed restrictions. So the state-erected barriers to geographic mobility of low-skill workers have grown unabated.

The federal government’s contribution to geographic immobility goes beyond mere passivity, however. From welfare to food stamps,²⁴⁶ from Medicaid to unemployment insurance, the federal government runs its

Occupational Licensing? 57 BRIT. J. INDUS. REL. 919, 919 (2019).

²⁴¹ See DEP’T OF THE TREASURY, COUNCIL OF ECON. ADVISERS & DEP’T OF LABOR, OCCUPATIONAL LICENSING: A FRAMEWORK FOR POLICYMAKERS 17 (July 2015), https://obamawhitehouse.archives.gov/sites/default/files/docs/licensing_report_final_nonembargo.pdf.

²⁴² See *id.* at 4.

²⁴³ See Blair & Chung, *supra* note 240, at 920 (finding that “licensing reduces labor supply by an average of 17-27 per cent.”); Janna E. Johnson & Morris M. Kleiner, *Is Occupational Licensing A Barrier to Interstate Migration?*, 12 AM. ECON. J.: ECON. POL’Y 347, 350, 366-69 (2020) (finding that in general, state licensing has a negative but small effect on interstate mobility, but also discovering that for some occupations such as pest control workers and pharmacists that effects are sizeable); Schleicher, *supra* note 238, at 120-21 (summarizing the evidence).

²⁴⁴ Morris M. Kleiner & Evan J. Soltas, *A Welfare Analysis of Occupational Licensing in the U.S. States* 1 (Nat’l Bureau of Econ. Research, Working Paper No. 26383, 2019), <https://www.nber.org/papers/w26383>.

²⁴⁵ *Id.* at 3.

²⁴⁶ “Welfare” is the non-technical name for the Temporary Assistance for Needy Families and “food stamps” is the non-technical name for the Supplemental Nutritional Assistance Program. See, e.g., CONG. RESEARCH SERV., RL 32748, THE TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF) BLOCK GRANT: A PRIMER ON TANF FINANCING AND FEDERAL REQUIREMENTS (Dec. 14, 2017), <https://fas.org/sgp/crs/misc/RL32748.pdf>.

low-income assistance programs through states.²⁴⁷ The 1996 welfare reform increased federal-to-state delegation, exacerbating interstate differences in benefits, eligibility, and conditions of low-income support programs.²⁴⁸ Variation in unemployment benefits—the form of assistance of most immediate concern for displaced workers—is nothing short of staggering. Minimum earnings requirements for eligibility, for instance, range from \$130 in Hawaii to \$3,400 in Florida.²⁴⁹ The maximum weekly benefit is \$600 in Massachusetts but only \$190 in Mississippi.²⁵⁰ None of these and related variations are transparent. Complexity and heterogeneity of benefits inevitably limits interstate mobility by giving rise to uncertainty, hassle, and fear of losing some of the benefits.²⁵¹ It is far from clear that the federal government took these mobility costs into account in its decisions to increasingly delegate the administration of the federal social safety net programs to the states.²⁵²

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²⁴⁷ See Schleicher, *supra* note 238, at 125-26; see also *supra*, text accompanying notes 25-28. The EITC is a major exception—it is administered directly by the federal government. See Gene Falk, CONG. RESEARCH SERV., RL31768, THE EARNED INCOME TAX CREDIT 2 (EITC): AN OVERVIEW (Oct. 22, 2014), <https://fas.org/sgp/crs/misc/RL31768.pdf>.

²⁴⁸ See MARTIN GILENS, WHY AMERICANS HATE WELFARE: RACE, MEDIA, AND THE POLITICS OF ANTIPOVERTY POLICY 175, 183 (1999). Ryan Nunn et al., Up Front, Brookings Inst., *How Difficult Is It to Find a Job?*, https://www.brookings.edu/blog/up-front/2019/05/02/how-difficult-is-it-to-find-a-job/?utm_campaign=Economic%20Studies&utm_source=hs_email&utm_medium=email&utm_content=72429855 (reporting that duration of unemployment benefits varies from 12 weeks to 28 weeks depending on the state); Lars J. Lefgren et al., *Contemporary State Policies and Intergenerational Income Mobility* 10, 50 Tbl. 6 (Nat'l Bureau of Econ. Research, Working Paper No. 25896, 2019), <https://www.nber.org/papers/w25896> (describing large inter-state differences in the generosity of state social safety net programs), 55 J. HUMAN RESOURCES (2020) (forthcoming).

²⁴⁹ See Krueger & Meyer, *supra* note 22, at 2334.

²⁵⁰ See *id.* at 2335.

²⁵¹ See Schleicher, *supra* note 238, at 126-27. This heterogeneity, combined with state-specific licensing and restrictive zoning may well explain why interstate mobility has been lower than inter-county mobility for the past several decades. See Furman and Orszag, *supra* note 115, at 40-43, although other explanations of the same phenomenon exist, see *id.*

²⁵² As David Schleicher points out, federal tax subsidies for owner-occupied housing may also reduce geographic mobility of low-income home owners. See Schleicher, *supra* note 238, at 127-30.

Over the past several decades, the federal government put in place a number significant social programs. It enacted the ACA.²⁵³ It greatly expanded the EITC.²⁵⁴ It added prescription drug coverage to Medicare.²⁵⁵ But none of these programs targeted—or especially benefitted—low-skill American workers disproportionately disadvantaged by the U.S. trade, immigration, competition, and labor policies. The program enacted to help some of these workers—the TAA—has been singularly unsuccessful. To make things worse, Congress’ increasing delegation of social safety net programs to the states made it harder for low-skill workers to move across state lines to areas of greater economic opportunity. The federal government’s failure to intervene as states and local jurisdictions erected additional barriers to workers’ movement further exacerbated the problem. Overall, then, U.S. distributional policies did little to alleviate the unintended burdens of government decisions considered in Part III. Quite likely, some federal (as well as state and local) policies added to these burdens instead.

V. DISTRIBUTIONAL ARGUMENTS, IN REVERSE

Having reached this point in the discussion, it is easy to compare the policy takeaways from the two arguments described in Part II with the actual policies discussed in Parts III and IV. The comparison reveals that the academic arguments and the actual policies have an uncanny resemblance. Legal rules were indeed designed without regard to their distributional effects, just as the efficiency-only argument would recommend. Congress indeed ignored transitional losses, just as the no-compensation argument would advise.²⁵⁶

²⁵³ See Pub. L. No. 111-148, 124 Stat. 119 (2010).

²⁵⁴ See CONGRESSIONAL RESEARCH SERVICE, *THE EARNED INCOME TAX CREDIT (EITC): A BRIEF LEGISLATIVE HISTORY* 1, 6 (2018) (describing the 1993 expansion).

²⁵⁵ See Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, §§ 101-11, 117 Stat. 2066, 2071-76 (offering optional prescription drug coverage for Medicare enrollees).

²⁵⁶ I am not the first one to note stark similarities between major U.S. policies enacted by administrations and congressional majorities of both political parties over the past four decades and the arguments’ prescriptions. See Larry Kramer, *Beyond Neoliberalism: Rethinking Political Economy*, William & Flora Hewlett Foundation 2-3 (2018), <https://hewlett.org/wp-content/uploads/2018/04/Beyond-Neoliberalism-Public-Board-Memo.pdf>.

This comparison certainly does not amount to a claim that the academic arguments caused the actual policies. The U.S. economy and the country's political system are too complex to allow for any such causal inference. But the two arguments are important even if they merely influenced academic and policy debates. And there is plenty of reasons to think that they did.²⁵⁷ Whether such influence is merited going forward depends on the plausibility of the arguments' underlying assumptions—the question to which we now turn.

A. *The Efficiency-only argument*

1. The Tax-and-Transfer Adjustment Assumption

The first assumption underlying the efficiency-only argument is that appropriate distributional adjustments are made through the tax-and-transfer system. In the absence of unintended distributional shifts, “appropriate” simply means viewed as desirable by policymakers at the time. If, however, unintended distributional burdens do arise, and if policymakers do not view these burdens as desirable, “appropriate” adjustments are those that offset such unintended burdens.²⁵⁸

The discussion in the previous two Parts makes it very likely that large burdens did arise. It is also clear that these burdens were not intended. This conclusion follows not from a magical insight into someone's state of mind.²⁵⁹ Rather, the burdens were unintended because they were unexpected.

Until the recent wave of empirical research, policymakers had no rigorous evidence of the magnitude of the losses described in Part III, and little knowledge of some of those losses. This is not to say that there were no warnings. Debates about the costs of trade liberalization started

²⁵⁷ See sources cited *supra* notes 17, 68.

²⁵⁸ This is exactly what Shavell explained in the passage quoted *supra*, note 36.

²⁵⁹ Arguments about the futility of discovering the intent of individual policymakers and entire legislative bodies are well known. See, e.g., Ryan Doerfler, *Who Cares How Congress Really Works?*, 66 DUKE L.J. 980, 986-95 (2017); Victoria F. Nourse, *A Decision Theory of Statutory Interpretation: Legislative History by the Rules*, 122 YALE L.J. 70, 76 (2012); Peter H. Schuck, *Delegation and Democracy: Comments on David Schoebroad*, 20 CARDOZO L. Rev. 775, 777 (1999).

shortly after the end of World War II,²⁶⁰ even though the United States was close to an autarchy at the time.²⁶¹ Congress' concerns about distributional effects of market concentration go all the way back to the beginning of the twentieth century.²⁶² Protectionist restrictions on immigrants' employment are at least a century-old as well.²⁶³

But speculation and fears should not be confused with evidence. After all, the CBO reassured Congress in 1993 that losses from NAFTA would be "surprisingly small."²⁶⁴ At about the same time, the National Research Council issued a report on economic and fiscal consequences of immigration. The report concluded that "there is only a small adverse impact of immigration on the wage and employment opportunities of competing native groups."²⁶⁵ These conclusions gave policymakers little cause for concern. Two decades later it turned out that these conclusions were over-optimistic.

If one agrees that the losses from major policies discussed here were unintended, can one question whether these losses were objectionable? After all, there is no such thing as the ideal distribution of income (or wealth, or opportunities) in the economy—ideals are in the eye of the beholder. So there is no way to know if any *change* in distribution is desirable from some ideal point of view. Not knowing the baseline, how can one evaluate a change?

Whether this logic persuades one in general, it has little purchase when it comes to the evidence presented here. Geographic and industry variations are the reason. The China shock hit North Carolina but not

²⁶⁰ See Wilcox, *supra* note 15, 884-89 (marshalling arguments against the view of Secretary of State Dean Acheson that "producers who may suffer from increased imports, caused by further reductions in the American Tariff, might be compensated in some way by the government.").

²⁶¹ See Alden, *supra* note 7, at 1-2. Alden quotes Wikipedia that defines autarky as existing "whenever an entity can survive or continue its activities without external assistance or international trade." *Id.* at 1.

²⁶² See Lina Khan & Sandeep Vaheesan, *Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents*, 11 HARV. LAW & POL'Y REV. 235, 278-79 (2017).

²⁶³ See KUNAL M. PARKER, MAKING FOREIGNERS: IMMIGRATION AND CITIZENSHIP LAW IN AMERICA, 1600-200 162 (2015).

²⁶⁴ CONG. BUDGET OFFICE, ESTIMATING THE EFFECTS OF NAFTA: AN ASSESSMENT OF THE ECONOMIC MODELS AND OTHER EMPIRICAL STUDIES 61 (1993).

²⁶⁵ THE NEW AMERICANS: ECONOMIC, DEMOGRAPHIC, AND FISCAL EFFECTS OF IMMIGRATION 236 (James P. Smith & Barry Edmonston eds., 1997).

Nevada.²⁶⁶ U.S. labor markets became concentrated in the heartland but not on the coasts.²⁶⁷ There is no plausible argument that prior to the China Shock low-skill workers in North Carolina were unjustifiably better off than low-skill workers in Nevada; that before labor markets became concentrated high school dropouts were doing better in Nebraska than in California. Yet only if these disparities indeed existed can one suggest that the China Shock or the labor market monopsony have led to desirable distributional outcomes by hurting North Carolinian and Nebraskan workers who had somehow benefitted from an earlier unjustifiable advantage. The argument fails on its face.

The bottom line, then, is that large losses described in Part III were both unintended and undesirable. Given this conclusion, the major policy failure of the past several decades has not been choosing the wrong policy instrument for distributional adjustments—it has been not making sufficient adjustments of any kind. Congress simply failed to offset distributional burdens through the legal system or the tax system. The tax-and-transfer adjustment assumption failed.

This Article is not the first one to raise doubts about the realism of that assumption. Ronen Avraham, David Fortus, and Kyle Logue pointed out that policymakers aiming to implement tax-and-transfer adjustments contemplated by the efficiency-only argument “would face an enormous informational burden” making such adjustments “virtually impossible to implement.”²⁶⁸ Avraham and co-authors offer many reasons supporting their conclusion, all conceptual. Lee Fennell and Richard McAdams offered a related critique. For the efficiency-only argument to be plausible as a guide to real-world policymaking (what they call prescriptive tax superiority), it must be true either that appropriate adjustments actually happen through the tax-and-transfer system, or—if they do not—that they are equally unlikely to happen through the legal system. Fennell and McAdams offered many reasons—again, conceptual—why such “invariance” is highly unlikely.²⁶⁹ Richard Revesz pointed out that given increasing congressional gridlock, the likelihood

²⁶⁶ See Autor et al., *China Shock*, *supra* note 74, at 225.

²⁶⁷ See Azar et al., *supra* note 128, at 24.

²⁶⁸ Avraham et al., *supra* note 68, at 1130.

²⁶⁹ These reasons include political inertia, interest group politics, framing, and more. See Fennell & McAdams, *supra* note 17, at 1056.

of “continual redistributive tax reforms” implementing the adjustments assumed by the efficiency-only argument is implausible.²⁷⁰

There is some empirical evidence contradicting the tax-and-transfer adjustment assumption. Zachary Liscow studied school funding reform in Connecticut and concluded that distributional effects of court desegregation orders were not offset by changes in that state’s income tax.²⁷¹

Fennell and McAdams come closest to articulating this Article’s critique of the tax-and-transfer adjustment assumption. They argue that there is no “evidence that Congress is consistently offsetting redistributive legal rules in the real world”²⁷² To support this conclusion they observe that the “tax-and-transfer system has not generally adjusted over time to correct for changes in the national income distribution.”²⁷³ U.S. Gini coefficient, they point out, rose by 23% between 1974 and 2012 revealing a large increase in income inequality. It is likely that some of this increase is due to changes in legal rules rather than other reasons, they argue.²⁷⁴ If so, these (unspecified) legal changes created economic burdens that the tax system ignored.

The efficiency-only argument’s proponents defend the tax-and-transfer adjustment assumption. As for narrowly-targeted adjustments of the kind that Liscow finds lacking, their absence is hardly surprising, they remark.

It remains true that the legislature is not in the business of fine-tuning the tax system each time a program is enacted or repealed. ... [O]ne would not expect tax adjustments to offset the [distributive effects of legal rules] completely and precisely. Nevertheless, if one had to guess, it seems plausible that roughly, on average, and over time, changes in [legal rules] will tend to be accompanied by tax adjustments that offset changes in the distributive incidence of ... those [rules].”²⁷⁵

²⁷⁰ Revesz, *supra* note 17, at 1520, 21-25.

²⁷¹ See Liscow, *supra* note 32.

²⁷² Fennell & McAdams, *supra* note 17, at 1081.

²⁷³ *Id.* at 1079.

²⁷⁴ *Id.* at 1079-82.

²⁷⁵ Louis Kaplow, *The Optimal Supply of Public Goods and the Distortionary Cost of Taxation*, 49 NAT’L TAX J. 513, 521 (1996). For other statements in the same vein see Fennell & McAdams, *supra* note 17, at 1076-77.

As for congressional gridlock and, more generally, claims that “tax system does not, or is unlikely to, change to address distributive concerns,” Weisbach argues that these claims are “flat out contradicted by the facts.”²⁷⁶ Congress tinkers with the tax code incessantly, “most often with great focus on distributional issues,” he explains.²⁷⁷

Even if only a modest portion of these changes were distributive in nature ..., the number of [tax-and-transfer] adjustments would be high. Blanket assertions that the tax system does not respond to distributional concerns are false.²⁷⁸

There is also some evidence suggesting that distributional adjustments do take place sometime.²⁷⁹

This is the state of play in the academic debate about the practical implications of the efficiency-only argument and the realism of the tax-and-transfer adjustment assumption. Opponents raise theoretical objections, identify specific instances where the assumption proved to be false, and point to practical realities—congressional gridlock, rise of income inequality—that indirectly suggest that the assumption is implausible. Proponents counter with theoretical points of their own and make equally indirect empirical observations. At the end of the day, even the opponents conclude that “[e]mpirically, little is known about whether the distributional impacts of various institutions’ policy choices stick.”²⁸⁰

This Article, as must be clear by now, makes a reaches a very different conclusion. A lot—not a little—is known about the stickiness of distributional impacts. The Article’s emphasis is on rigorous, wide-ranging empirical evidence of specific, major distributional burdens, and on Congressional failure to implement any significant program that may be plausibly viewed as the kind of adjustment that the efficiency-only

²⁷⁶ David A. Weisbach, *Distributionally Weighted Cost-Benefit Analysis: Welfare Economics Meets Organizational Design*, 7 J. LEG. ANALYSIS 151, 174 (2015).

²⁷⁷ *Id.*

²⁷⁸ *Id.*

²⁷⁹ See Richard T. Boylan & Naci Mocan, *Intended and Unintended Consequences of Prison Reform*, 30 J.L. Econ. & Org. 558, 558 (2013) (concluding that following court orders requiring states to reduce prison overcrowding “correctional expenditure increase and welfare cash expenditures decrease ..., suggesting that the burden of improved prison conditions is borne by welfare recipients.”).

²⁸⁰ Zachary Liscow, *Is Efficiency Biased?*, 85 U. CHI. L. REV. 1648, 1666 (2018).

argument assumes.²⁸¹ The failure of the tax-and-transfer adjustment assumption, the Article shows, is both more definitive and much more dramatic than previously recognized. Over the past several decades, the U.S. tax-and-transfer system has ignored unintended losses running in the multiple billions of dollars and millions of jobs. So it may or may not be true in theory that legal rules should ignore distribution because “there is a better method of addressing these concerns.”²⁸² But in practice, that better method has not been deployed for decades. This conclusion alone is sufficient to set aside the efficiency-only argument as a source of real-world policy guidance, at least until U.S. policymakers begin to make timely and adequate tax-and-transfer adjustments that this argument assumes.²⁸³

2. The Efficient Legal Rules Assumption

U.S. markets are regulated, and increasingly so.²⁸⁴ Competition law and labor law govern product and labor markets. Securities,

²⁸¹ A working paper by James Sallee bolsters this conclusion. He shows that even for a relatively simple legal rule—a Pigouvian tax on gasoline—“it is infeasible to create a Pareto improvement from the taxation of goods [subject to the Pigouvian tax], and moreover ... plausible policies are likely to leave a large fraction of households as net losers.” James M. Sallee, *Pigou Creates Losers: On the Implausibility of Achieving Pareto Improvements from Efficiency-Enhancing Policies* 1 (Nat’l Bureau of Econ. Research, Working Paper No. 25831, 2019), <https://www.nber.org/papers/w25831>. Sallee’s analysis offers both formal and econometric support for the arguments about the severity of policymakers’ informational constraints advanced conceptually by Avraham and co-authors. See Avraham et al., *supra* note 68, at 1130.

²⁸² Weisbach, *supra* note 13, at 439.

²⁸³ Joseph Stiglitz, one of the authors of the seminal 1976 article on which the efficiency-only argument rests, Atkinson & Stiglitz, *supra* note 13, recently reached the following conclusion after observing real-world distributional effects of actual policies and policymakers’ failure to respond to these effects during four decades since the publication of his paper: The “general result in the theory of optimal taxation and expenditure [is that] when there are distributive effects that cannot be undone by commodity taxes (including type-specific factor subsidies), production efficiency is in general not desirable.” Joseph E. Stiglitz, *Addressing Climate Change Through Price and Non-Price Interventions*, 119 *EUROP. ECON. REV.* 594, 603 (2019). Translation: When the undesirable distributional effects of legal rules cannot be undone by targeted, fully-compensating transfers to the losers, the efficiency-only argument is generally not valid.

²⁸⁴ See, e.g., German Gutiérrez & Thomas Philippon, *Declining Competition and Investment in the U.S.* 55 (Nat’l Bureau of Econ. Research, Working Paper

commodities, and banking regulations control financial markets. U.S. trade, environmental, and immigration law—including their enforcement—govern their respective domains. According to the efficiency-only argument, all these regulatory regimes should ignore distributional considerations and focus on efficiency.

This prescription presumes that all the rules and regulations in question actually are efficient or may be made so. Yet as the discussion in Part III reveals, it is increasingly clear that this assumption is as implausible as the assumption about the tax-and-transfer adjustments. The prevailing view among economists appears to have undergone a full reversal. Rather than viewing U.S. markets as generally efficient (with some residual imperfections), economists now view these markets as generally inefficient (with some pockets of efficiency).

U.S. competition law, it turns out, has failed to prevent the rise of monopoly power in product markets and monopsony power in the labor market. U.S. labor law has led to the decline of unions without much improvement in labor market “rigidities” that unions were thought to have caused.²⁸⁵ U.S. financial regulation has failed to prevent not only the Great Recession, but flagrant manipulation of major financial benchmarks. When legal scholars tested whether common law evolves toward efficiency, they came away disappointed as well.²⁸⁶ And one hardly needs to comment on the efficiency of U.S. immigration law, as it is currently enforced. It is safe to say that, at the very least, the efficiency of numerous legal regimes discussed here is in serious doubt.

So what efficiency should be preserved by directing distributional adjustments away from legal rules? Why categorically ignore the likely distributional effects of these rules if their efficiency is uncertain and will remain so for the foreseeable future? To be sure, efficiency is important and pursuing it is essential for economic growth. Some legal rules are clearly wasteful and adopting them is not a good idea no matter what their distributional effects happen to be. But given the doubts among economists and the law-and-economics scholars about the efficiency of many legal rules as they exist in the real world, the efficiency-only

No. 23583, 2017), <https://www.nber.org/papers/w23583> (summarizing a steady increase in the mean number of government regulations governing many industries).

²⁸⁵ See *supra*, text accompanying notes 198-200.

²⁸⁶ See *supra* note 211.

argument offers no reason to always disregard distributional considerations in pursuit of efficiency benefits.

3. The Homogeneity Assumption

Kaplow and Shavell explain that the advantage of the tax-and-transfer system is that it treats individuals based on income—the relevant characteristic for distributional purposes. Legal rules, in contrast, are “often [] confined to the small fraction of individuals who find themselves involved in legal disputes ... [and there is often] substantial income variation within groups of plaintiffs and groups of defendants (so that much redistribution will be in the wrong direction).”²⁸⁷

But the hardships of the China shock, NAFTA, low-skill immigration (legal and illegal), and the monopsony power in labor markets are not distributed solely based on income. Heterogeneity of individuals that Kaplow and Shavell recognized²⁸⁸ and that others emphasized as a limitation on their takeaway²⁸⁹ becomes crucially important here. Geography and industry, in particular, play a major role.

A low-skill worker in New England has borne the brunt of Chinese competition; a low-skill worker in Oregon has barely noticed it.²⁹⁰ NAFTA hurt low-income workers in Carolinas much more than in Maryland or Montana.²⁹¹ An income-based tax system is not well-equipped to deal with these kinds of differences.

Heterogeneity limits the main takeaway of the efficiency-only argument only if it is unobserved. Otherwise, the tax-and-transfer system may base distribution on income plus an additional relevant observable factor.²⁹² Given that economists had no idea how the China shock would play out across the country, or that they did not look for geographically uneven effects of monopsony until the past few years, heterogeneity has been, indeed, unobserved, often for a long time.

Thus, if a worker lost a relatively well-paying job to trade liberalization and replaced it with two low-paying jobs that generate the same total income (while working many more hours), the tax system

²⁸⁷ Kaplow & Shavell, *supra* note 33, at 823.

²⁸⁸ *See id.* at 827-29.

²⁸⁹ *See* Avraham et al., *supra* note 68, at 1130-32.

²⁹⁰ *See* Autor et al., *China Shock*, *supra* note 74, at 225.

²⁹¹ *See* Hakobyan & McLaren, *supra* note 83, at 735.

²⁹² *See* Kaplow & Shavell, *supra* note 33, at 827-30. Kaplow and Shavell offer blindness as an example of such additional observable factor.

would not have recognized this worker as distributionally worse-off compared to a similar worker whose job did not move overseas. Yet the first worker's losses may have been even greater than it appears at first glance. In addition to losing a better paying job, that worker may have lost a generous—and tax-exempt—benefits package, an ability to work regular, predictable hours, and job security that came with union membership that the worker no longer has. Even beyond these costs, this worker may have experienced a loss “of a personal sense of usefulness or dignity, loss of a sense of purpose, and loss of coworker companionship.”²⁹³ Our tax system does not account for the value of any of these benefits, so it cannot adjust for the harm of losing them.

Of course, not knowing the location of unobservable distributional costs within income groups makes it difficult to adjust legal rules—not just tax rules—to take these costs into account. But in some cases, an adjustment to legal rules does have a significant advantage in addressing unobserved heterogeneity, as explained in Part V.

* * * * *

Nothing in this discussion undermines the efficiency-only argument as a matter of theory. This Article takes no position about the arguments' merits if the appropriate distributional changes are indeed made in the tax-and-transfer system, if legal rules are indeed efficient, and if there is no unobserved within-income-group heterogeneity. Nor does this Article assert that there has never been a tax-and-transfer adjustment of a kind that the efficiency-only argument recommends, that not a single actual legal rule is efficient, or that there is always heterogeneity within income groups. The Article does conclude, however, that in many cases of great economic and social importance, one, two, or all three assumptions underlying the efficiency-only argument fail to hold. So for real-world policymaking purposes, one would be wise to appreciate the argument's conceptual insights, and then immediately proceed to considering actual distributional adjustments to both legal rules and the tax-and-transfer system in light of the unintended distributional effects of major government policies.

²⁹³ Revesz, *supra* note 17, at 1518.

B. *The No-Compensation Argument*

1. The Private Risk Mitigation Assumption

In its essence, the no-compensation argument is a judgment about the advantage of private ordering over government regulation. In advancing the argument, Kaplow by no means ignores the individual's need to insure against a variety of risks present in a market economy, including the risk of changes in government policy. At the same time, the argument is sensitive to the well-known incentive problems that insurance brings—adverse selection and moral hazard.²⁹⁴ After comparing the risk of losses from legal transitions to other risks that individual face, Kaplow concludes that there is no fundamental difference between the two. “The prevailing assumption in our society that market solutions for allocating risk are preferable to government remedies is therefore equally applicable when the risks to be allocated arise from legal transitions,”²⁹⁵ he concludes. The market solutions that Kaplow has in mind are private insurance and financial diversification.²⁹⁶

Given this reasoning, one clearly sees the limits of the argument. If people do not (or cannot) anticipate the costs of future government actions, the negative ex ante incentive effects of government compensation disappear. If losses are large, concentrated, and born by low-wealth individuals, risk mitigation is particularly important.²⁹⁷ And if private insurance does not exist and financial diversification is unavailable, the government should step in.

All of these caveats apply to the distributional effects of the government policies discussed in Part III. To start, private risk mitigation is, indeed, unavailable for the risks of unemployment, wage stagnation, skill obsolescence, and poverty. Kaplow recognizes this, and he mentions government programs such as social security, unemployment insurance, and general income maintenance that protect millions of Americans from adverse market outcomes.²⁹⁸ But he explains that “such programs are the exception in the vast universe of market risks.”²⁹⁹ While this is true as far

²⁹⁴ See Kaplow, *supra* note 14, at 520.

²⁹⁵ *Id.* at 520.

²⁹⁶ See *id.* at 540-41.

²⁹⁷ See *id.* at 596.

²⁹⁸ See *id.* at 535, n.72.

²⁹⁹ *Id.* at 535. Indeed, as Kaplow says, “there is no general government compensation for new products that fail, production facilities that prove more

as it goes, risks of unemployment, wage stagnation, and skill obsolescence—and the government’s failure to mitigate them—turned out to be of first-order economic and political importance.

Not only market-based risk mitigation is unavailable for the particular *market* risks discussed here, but private insurance is not available for just about any risk of *legal* change. Shavell recently considered the question thoroughly and confirmed what others noted earlier based on weaker evidence: with some minor exceptions not relevant here, legal risks are uninsurable.³⁰⁰ Without government intervention, losses from legal change lie where they fall. But if no private insurance is available, the logic of the no-compensation argument points *toward* social insurance rather than away from it.

Kaplow himself mentions that social insurance may have an advantage over private insurance if different individuals have different ability to diversify or insure,³⁰¹ or if adjustment costs are high.³⁰² Discussing the subject briefly, he “does not explore how significant these issues are in practice, or in what contexts they are most important.”³⁰³ The context he generally considers is the effect of legal transitions on businesses and investors.³⁰⁴ Subsequent literature on legal transitions generally retains this focus.³⁰⁵

costly than anticipated, or people who earn less than they had expected due to a variety of unfortunate circumstances.” *Id.* at 535.

³⁰⁰ See Steven Shavell, *Risk Aversion and the Desirability of Attenuated Legal Change*, 16 AM. L. & ECON. REV. 366 (2014). Jonathan Masur and Jonathan Nash reached a similar conclusion and summarized earlier work. See Masur & Nash, *supra* note 62, at 406-410, 416, 421.

³⁰¹ In Kaplow’s discussion, this difference arises, for example, because “certain individuals lack the information to use such markets to diversify risks created by the possibility of changes in government policies.” Kaplow, *supra* note 14, at 550.

³⁰² See *id.* at 592 n.254.

³⁰³ *Id.* at 550.

³⁰⁴ “Of course, a substantial range of government reforms have their primary economic impact—in terms of transitions losses—on corporations and regular investors, actors presumably best able to take advantage of market arrangements.” *Id.* at 550. See also *id.* at 527, 537, 540, 548-49, 596, and elsewhere throughout the article. Even when Kaplow discusses trade liberalization he focuses on transitional losses incurred by businesses, not workers. See Louis Kaplow, *Transition Policy: A Conceptual Framework*, 13 J. CONTEMP. LEGAL ISSUES 162, 180 (2003).

³⁰⁵ See Barbara Fried, *Ex Ante/Ex Post*, 13 J. CONTEMP. LEGAL ISSUES 123, 158-59 (2003); Kyle D. Logue, *Legal Transitions, Rational Expectations, and*

Shifting attention to low-skill, low-education workers whose ability to insure their human capital or to diversify in financial markets is not just limited but altogether non-existent highlights the limits of the no-compensation argument. When markets offer no risk mitigation, it can only come from the government.

Another reason for government insurance of transition losses is the “probability misperception.”³⁰⁶ Kaplow suggests that some “less sophisticated (often, less wealthy) individual investors” may lack incentives and skills to make proper risk assessments, leading them to underinsure in private markets.³⁰⁷ Low-skill workers are even less financially sophisticated than less wealthy investors are. Risk assessments that these workers make are even less reliable. So there is an even stronger reason to mitigate transitional losses of these workers.

Kaplow views probability misperception as “the strongest case for some government response” to transitional losses,³⁰⁸ preferably in the form of compulsory government insurance.³⁰⁹ When probability is unknown rather than misperceived, when even policy experts and government agencies fail to anticipate the effects of their policies, the case for a subsequent government intervention is even stronger. And given that the government finances its social safety net programs through (compulsory) income and payroll taxes, we already have a compulsory insurance mechanism in place.³¹⁰

Finally, Kaplow recognized that “more concentrated gains or losses would present a stronger case for corrective action.”³¹¹ Michael Graetz viewed the magnitude of transitional losses as the main reason to offer relief as well.³¹² Losses discussed in this Article are both large and

Legal Process, 13 J. CONTEMP. LEGAL ISSUES 211, 213, 225-27 (2003) (distinguishing corporations from individual investors because only the latter are subject to cognitive biases); Ramseyer & Nakazato, *supra* note 17, at 1158 n.12 (“we deal only with transitional rules applicable to investments”).

³⁰⁶ Kaplow, *supra* note 14, at 548.

³⁰⁷ *See id.* at 548-49.

³⁰⁸ *Id.* at 548.

³⁰⁹ *See id.* at 549.

³¹⁰ I am not arguing that this mechanism currently reflects the appropriate premiums (whatever “appropriate” means in this context). I only point out that the mechanism itself is already in place.

³¹¹ Kaplow, *supra* note 14, at 596.

³¹² *See* Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47, 87 (1977); *see also* Michael J. Graetz, *Retroactivity Revisited*, 98 HARV. L. REV. 1820, 1826 (1985). Graetz’

concentrated. So they present a particularly compelling case for government assistance.

In sum, the theoretical argument against the government's mitigation of transitional losses does not apply to the policies discussed here on the argument's own terms. No private risk mitigation is available. Even if it were available, probability misperceptions are likely to be severe. The relevant probabilities may be unknown altogether. In sum, all key assumptions underlying the no-compensation argument do not hold for the momentous legal transitions discussed in this Article.

This conclusion about the no-compensation argument is new to the literature. In retrospect, this may seem surprising. Kaplow was well-aware that risky investments in capital include investments in human capital,³¹³ and that some losses should be insured by government because no private alternative is available.³¹⁴ Yet he did not view these issues as affecting his overall conclusion.

Kaplow's assumptions have been questioned by others. Scholars pointed out that private insurance is not available in specific markets and circumstances, such as for land takings,³¹⁵ retroactive changes to protected rights³¹⁶ and statuses,³¹⁷ and so on. The entire 2003 issue of the *Journal of Contemporary Legal Issues* was dedicated to the analysis of legal transitions.³¹⁸ Yet none of the nine contributors to the issue (ten, including Kaplow himself), nor any other scholars writing about legal transitions, raised the objections made here. What explains this omission?

reason to compensate taxpayers suffering large losses is political expediency of allowing for some compensation in order to enact otherwise desirable changes, *id.* In his most recent work Graetz argues for a broad-based transition assistance program similar to the one suggested here. See MICHAEL GRAETZ & IAN SHAPIRO, *THE WOLF AT THE DOOR: THE MENACE OF ECONOMIC INSECURITY AND HOW TO FIGHT IT* (2020).

³¹³ See Kaplow, *supra* note 14, at 516 n.7.

³¹⁴ See *id.* at 535.

³¹⁵ See Lawrence Blume and Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 CAL. L. REV. 569, 592-97 (1984).

³¹⁶ See Richard H. Fallon & Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 HARV. L. REV. 1731, 1795 (1991) (doubting availability of insurance for retroactive invalidation of police investigative techniques).

³¹⁷ See Fisch, *supra* note 17, at 1090 (questioning availability of insurance for retroactive repeals of sovereign immunity of public officials).

³¹⁸ See 13 J. CONTEMP. LEGAL ISSUES 1-311 (2003).

A book published in 2003 by a distinguished economist Robert Shiller suggests the answer. The book advocated a major reform of U.S. social insurance to address the multiplicity of new risks facing individuals in a modern capitalist economy. This multiplicity made it impossible for the government or private markets to offer insurance tailored to each specific risk, Shiller explained.³¹⁹ So a new general insurance scheme was needed.

To bolster his argument, Shiller offered a long list of possible threats to individuals' livelihoods. A country's national income, he wrote, may fall due to population growth, due to changes in monetary policy, energy prices, returns to social capital, returns to educational investment, public confidence in the economy, and so on.³²⁰ Of course, there are individual career risks as well.³²¹

Having considered this long list of risks, the closest Shiller came to mentioning the risk of adverse distributional impacts discussed in Part III were the risks of "fluctuations in the strength of cartels, or to changes in public support of labor unions."³²² He cited a 1986 article about super-game-theoretic model of price wars for the former, and evidence from the Great Depression for the latter.³²³ Shiller also discussed immigration, acknowledging that it can "frustrate the efforts [of] any ... one country to manage the distribution of income within its borders."³²⁴ He paned the U.S. immigration regime of strict laws and lax enforcement as "crazy."³²⁵ But his takeaway was a proposal for auctioning immigration rights, not a call for assisting American workers disadvantaged by the government's "crazy" immigration policy.

Shiller is a Nobel laureate in economics who is deeply interested in social insurance. His lack of awareness of the market distortions and distributional burdens discussed in Part III was the sign of time. Just seventeen years ago, one of the best economists in the world—and the one with great empathy for the plight of those struggling to succeed in

³¹⁹ See ROBERT J. SHILLER, *THE NEW FINANCIAL ORDER: RISK IN THE 21ST CENTURY* 58-59 (2003).

³²⁰ *See id.* at 60-61.

³²¹ Shiller offers an example of a risk of being drafted in the army during the war. *See id.* at 60.

³²² *Id.* at 63-65.

³²³ *See id.*

³²⁴ *Id.* at 159.

³²⁵ *Id.*

the modern U.S. economy—simply did not see the losses that the government decisions were imposing on these very people. Today these losses are impossible to ignore. And their existence surely limits the plausible scope of the no-compensation argument.³²⁶

2. The Arbitrariness Assumption

Addressing the theoretical analysis of legal transitions does not end the discussion of the no-compensation argument. Theory aside, what if the practical obstacles to compensating transitional losers are insurmountable? This is precisely what many have argued about the most significant U.S. transitional assistance program, the TAA.

These arguments have merit. The TAA does raise difficult line-drawing questions. Scholars and policy experts flagged them before the program was enacted, and these questions persisted ever since.³²⁷ It turned out to be very difficult to delineate people and companies who suffered from trade liberalization enough to justify government assistance, to determine the form of that assistance, and to decide on the program's generosity. More fundamentally, TAA's defenders never articulated a convincing explanation for why the government should help only those who suffered from free trade—and not other government decisions and private market shifts.

But all these objections to transitional assistance are largely beside the point today. As Part III reveals, it was not only U.S. trade policy that unintentionally harmed low-skill American workers. Widespread labor

³²⁶ Steven Shavell offers another reason why the no-compensation argument does not always hold. When the legal rule is of a threshold-type (also known in the law-and-economic literature as negligence, fault-based, or, in Shavell's article in question, a legal standard), and if the private parties were required to make lasting investments in order to satisfy the threshold and avoid liability, grandfathering or some other form of transition assistance is socially desirable. But if the relevant legal regime is that of strict liability, the no-compensation argument holds. See Steven Shavell, *On Optimal Legal Change, Past Behavior, and Grandfathering*, 37 J. LEGAL STUD. 37 (2008). Shavell's argument does not inform the present analysis of the transitional issues. Workers affected by free trade, for example, were not told by the government, on the pain of legal sanctions, to acquire human capital in auto or textile industry (impacted by trade liberalization) rather than nursing or primary education (that was impacted very little). So in the relevant sense, the legal regime governing the decisions of these workers is that of a strict liability type.

³²⁷ See Hornbeck, *supra* note 24, at 2; ALDEN, *supra* note 7, at 116-22; Masur & Nash, *supra* note 62, 441-42; Wilcox, *supra* note 15, at 884-89.

market monopsony resulting from weak enforcement of U.S. competition laws likely harmed these workers as well. The same is likely true of the U.S. labor policy, immigration policy, and environmental regulation. So a targeted adjustment program of the future needs much less targeting compared to the TAA. Rather than separating workers harmed by free trade from those harmed by other government decisions discussed here, this program would need to target low-skill workers as a group. Such broad targeting would not suffer from the arbitrariness embedded in the TAA, eliminating the remaining support for the no-compensation argument.

* * * * *

To be clear, the critique of the no-compensation argument offered here is broad by not boundless. The Article does not assert that the assumptions underlying this argument always fail. What the Article does claim, however, is that these assumptions proved to be implausible in an economically, socially, and politically important case of unintentional transitional losses imposed on low-skill American workers by the government policies discussed in Part III. For these workers, the logic of no-compensation argument calls for substantial government assistance.

VI. POLICY DIRECTIONS

If policymakers ever viewed the efficiency-only and no-compensation arguments as constraining actual policy choices, the discussion in the previous Part should remove these constraints. Yet if policymakers were to start considering how to reflect distribution in the design of legal rules and how to structure transition relief, questions would immediately arise. What legal rules should be tested for distributional impacts? How do distributionally-motivated adjustments to legal rules look like? And what adjustments should be made to the tax-and-transfer system to provide transition relief? This Part suggests that in principle, these questions may be answered. Details of policy design are beyond the Article's scope.

A. Attention to Distribution

If policymakers decide to pay more attention to distributional effects of their policies, they would need to determine which policies to scrutinize. This Article's discussion suggests two answers.

First, distributional concerns should loom large if the efficiency benefits of a policy are small or questionable, and if significant

distributional effects are possible. State occupational licensing requirements are a clear example of legal rules of questionable efficiency.³²⁸ Federal antitrust authorities' acquiescence (until recently) in proliferation of non-compete agreements—especially for low-skill workers—is another example.³²⁹ Land-use restrictions are also highly suspect.³³⁰

Second, policymakers should consider distributional impacts of some policies that are likely to be socially beneficial overall. If these policies do not aim to redistribute, if they have a known potential to produce significant winners and losers, and if there is great uncertainty about the magnitude and location of the resulting gains and losses, distribution should enter the analysis. Trade liberalization is an obvious example of such policy; environmental regulation may well fit the description as well. Sometimes, it may be unclear whether a particular policy fits this description. But some important policies surely do, and policymakers should monitor their distributional impacts closely both when enacting them and over time.

B. *Distributionally-Informed Legal Rules*

Having identified the types of legal rules that should be potentially adjusted on account of their distributional impacts, what kinds of adjustments should policymakers consider?

For the rules in the first category, the adjustments are straightforward. If state-specific occupational licensing, local land-use regulations, and non-compete agreements are borderline efficient (at best), policymakers should decrease the licensing coverage, eliminate some land-use restrictions, and restrict or ban non-competes. The federal government has many ways of intervening to achieve these goals. It can reform U.S.

³²⁸ See *supra*, text accompanying notes 243-245.

³²⁹ See Krueger & Posner, *supra* note 130, at 7-8. Non-compete agreements that bind low-skill workers are especially problematic for three reasons. First, they reduce geographic mobility of these workers who are already immobile due to financial demands of relocations. Second, given financial and educational constraints, low-skill workers are particularly unlikely to obtain legal advice that would inform them that many of non-competes are not legally bindings. Third, the standard justifications of these agreements as protecting employers' investments in employees and sharing of valuable information with employees do not apply for low-skill workers. *Id.*

³³⁰ See Furman & Orszag, *supra* note 328, at 26-29; Ganong & Shoag, *supra* note 238, at 76-79; Schleicher, *supra* note 238, 114-17.

competition law and enforcement,³³¹ preempt state licensing schemes, induce interstate compacts harmonizing them, or even threaten antitrust action against uncooperative states.³³² Congress can influence state and local zoning policies as well.³³³ The larger the distributional losses in question, the greater should be the burden of demonstrating the efficiency gains of policies that impose these losses.³³⁴

Changes to policies in the second category—those that generally are socially beneficial even if distributionally problematic—are not as obvious. This Article suggests that slowing down the pace of change is one possibility. A more gradual trade liberalization, or a slower relaxation of antitrust enforcement would have softened the impacts described in Part III and would have given academic and policymakers time to identify these impacts. Moreover, these kinds of adjustments to legal rules would have made later tax-and-transfer system adjustments more informed and more effective.

Note that in order to slow trade liberalization or to relax antitrust enforcement more gradually Congress only needs to recognize the *possibility* of distributional concerns. If future distributional impacts are highly uncertain (including the uncertainty about unobserved within-income-group heterogeneity), recognizing the possibility of distributional impacts is the best Congress can do for some time. In contrast, Congress cannot deploy offsetting distributional adjustments through the tax-and-transfer system until Congress has a good idea of who suffered and how much. That knowledge emerges only after a delay. So there is a clear tradeoff between possibly more efficient but delayed tax-and-transfer adjustments and possibly less efficient but timely distributional adjustments to legal rules.

In thinking about this tradeoff, it is important to keep in mind that the delayed adjustments through the tax system may be not only untimely, but impossible (or grossly inadequate). To take a stark example, what tax

³³¹ See Krueger & Posner, *supra* note 130, at 12-13 (suggesting reforms of competition law); Schleicher, *supra* note 238, 150-54

³³² See Schleicher, *supra* note 238, at 121-22, 151 (discussing federal government's ability to diminish state licensing and zoning regulation).

³³³ See *id.* at 151.

³³⁴ For instance, Barkai concludes that “the value of this increase in pure profits amounts to over \$1.2 trillion in 2014, or \$14.6 thousand for each of the approximately 81 million employees of the nonfinancial corporate sector.” Barkai, *supra* note 116, at 2423. Distributional shifts of this magnitude surely deserve Congressional attention.

or transfer program would compensate today a worker who lost his job due to the China shock fifteen years ago? What if this worker got depressed, divorced, and addicted to opioids?³³⁵ Distributional adjustment through the tax system may come so late that it would be, indeed, “too late to compensate the losers.”³³⁶

Needless to say, temporizing policy changes has its own costs. Delaying socially beneficial changes defers their benefits. It is more difficult to identify causal effects of small changes compared to large ones econometrically. Gradual changes require constant action by the government—a challenge in our system of checks and balances.³³⁷

These concerns are real, but not determinative. NAFTA tariff reductions, for instance, could have been phased in—or phased in more slowly—without any additional legislation or budget negotiations.³³⁸ The same is true of the loosening of antitrust enforcement. The executive could have varied the timing of tariff reductions across the country as well, allowing economists to measure the differential effects. These are just some examples. On the other hand, experience shows that even a dramatic change such as the China shock would not force policymakers to act if they are unwilling to do so.

Notably, Graetz, Kaplow, and Shavell all mentioned slowing down the rate of legal change as a possible response to government-induced distributional losses. Shavell suggested recently that legal change should be “attenuated,” including through a delayed or gradual implementation

³³⁵ These are not mere hypotheticals. See generally NICHOLAS EBERSTADT, *MEN WITHOUT WORK: AMERICA’S INVISIBLE CRISIS* (2016).

³³⁶ Dani Rodrik, *Too Late to Compensate Free Trade’s Losers*, PITT. POST-GAZETTE (Apr 16, 2017), <http://www.post-gazette.com/opinion/Op-Ed/2017/04/16/Too-late-to-compensate-free-trade-s-losers/stories/201704160069>.

³³⁷ Note also that compensating transitional losers by temporizing legal change affects the source of compensation. Immediate legal reform followed by compensating transitional losers from general revenues disperses the burden of paying compensation among all taxpayers. Slower legal reform places the burden of compensating the losers on putative winners whose benefits from the slower reform are delayed. See Joseph J. Cordes & Burton A. Weisbord, *When Government Programs Create Inequities: A Guide to Compensation Policies*, 4 J. POL’Y ANALYSIS & MGMT. 178, 187 (1985).

³³⁸ Some of NAFTA’s tariff elimination provisions were indeed phased in. See M. Angeles Villarreal & Ian F. Fregusson, CONG. RESEARCH SERV., R42965, *THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) 17* (2017), <https://fas.org/sgp/crs/row/R42965.pdf>.

of new laws, after concluding that private insurance against legal change does not exist.³³⁹ Graetz explained that if losses are large, “efficiency and fairness concerns may suggest that phased-in or delayed effective dates be often used to mitigate the impact.”³⁴⁰ Kaplow concluded that slowing the pace of change would be less efficient than letting private markets operate without government interference.³⁴¹ Yet he also mentioned that this conclusion may change if different individuals have different ability to diversify or insure,³⁴² or when adjustment costs are high.³⁴³

We now know that it would be difficult to overstate the significance of the concerns just mentioned for low-skill American workers. Thus, slowing down the pace of legal change is an option that should be on the table in appropriate cases. This conclusion is another example of the Article’s overarching claim. Once the assumptions underlying the two distributional arguments are changed to reflect reality, the arguments’ objections to distributionally-sensitive legal rules turn to endorsements.³⁴⁴

C. *Transitional Assistance and Uniform Social Insurance*

Changing legal rules on account of distribution may be good policy sometime, but there is little doubt that the tax-and-transfer system should do much of the work. This Article’s analysis points to two directions for reforming that system.

First, the country needs a broad-based, well-funded, federally-administered (that is, nationally uniform) transitional assistance program for low-skill workers. This is hardly a new idea. Whether offered as a

³³⁹ See Shavell, *supra* note 300, at 368, 394.

³⁴⁰ Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47, 87 (1977); see also Michael J. Graetz, *Retroactivity Revisited*, 98 HARV. L. REV. 1820, 1826 (1985) (stating that “phased-in or delayed effective dates should often be used instead of grandfathering to mitigate particularly large losses that result from changes in the law.”).

³⁴¹ See Kaplow, *supra* note 14, at 592 (discussing phase-ins).

³⁴² In Kaplow’s discussion, this difference arises, for example, because “certain individuals lack the information to use such markets to diversify risks created by the possibility of changes in government policies.” Kaplow, *supra* note 14, at 550.

³⁴³ See *id.* at 592 n.254.

³⁴⁴ For different suggestions of how to reflect distributional considerations in the design of legal rules, see Liscow, *supra* note 280, at 1698-1700.

reform of unemployment insurance,³⁴⁵ or as a stand-alone program,³⁴⁶ transitional assistance for blue collar workers has been proposed and discussed for decades.³⁴⁷ The Article's contribution is to demonstrate that given the recent developments in the U.S. economy, the no-compensation argument, including its arbitrariness prong, does not apply to such a broad-based program.

Second, if Congress decided to alleviate the hardships that it has unintentionally imposed on blue-collar American workers, it would need to reform American social insurance system in the direction that is the exact opposite of what Congress has been doing in recent decades. Rather than devolving authority to design various parts of American social safety net to the states, Congress needs to reclaim this authority and make this safety net simpler, more transparent, and nationally uniform.

There is now strong evidence that Congressional policies have led to many local labor market shocks. There is growing evidence that these shocks are large and persistent. Given that low-skill workers do not relocate to where opportunities are, facilitating geographic mobility of these workers is an obvious avenue for improvement. A system where the federal unemployment insurance scheme, to take one example, "results in essentially 53 different programs" with vastly different requirements and benefits is indefensible.³⁴⁸

All reform directions suggested here give rise to tradeoffs, and no single policy dominates the rest. So the final policy suggestion is that

³⁴⁵ See ALDEN, *supra* note 7, at 119, 122 (summarizing President Nixon's and President Obama's proposals).

³⁴⁶ For a recent proposal see GRAETZ & SHAPIRO, *supra* note 312; ISABEL SAWHILL, THE FORGOTTEN AMERICANS: AN ECONOMIC AGENDA FOR A DIVIDED NATION 108-27 (2018) (proposing a "GI Bill" for American workers).

³⁴⁷ See, e.g., U.S. DEP'T OF LABOR, REPORT OF THE SECRETARY OF LABOR'S TASK FORCE ON ECONOMIC ADJUSTMENT AND WORKER DISLOCATION (Dec. 1986) (urging new national institutions to "address the needs of dislocated workers"); *The Statement of Findings and Purpose*, S. Rep. No. 651, 87th Cong., 1st Sess. (1961), as quoted in Richard A. Givens, *The Search for an Alternative to Protection*, 30 FORDHAM L. REV. 17, 40 n.125 (1961); Ronald J. Daniels & Michael Trebilcock, *A Better Way to Help U.S. Victims of Free Trade*, Bloomberg (Dec. 2, 2016), <https://www.bloomberg.com/opinion/articles/2016-12-02/a-better-way-to-help-u-s-victims-of-free-trade> (urging better work training, rationalizing multiple federal programs, improving TAA, and greater spending for all of these purposes).

³⁴⁸ Whittaker & Isaacs, *supra* note 26.

policymakers should pursue solutions in all directions at the same time. A major benefit of this multi-prong approach is that success of one type of response will alleviate the pressure to succeed in others. If social insurance and public assistance become more generous and more nationally uniform leading to a greater geographic mobility of low-skill workers and lowering their adjustment costs, the transition assistance program and a slower legal change would become less important.³⁴⁹ If policymakers design a highly effective transition assistance program for blue-collar workers, the need to temporize legal change and to reform the general safety net would diminish.³⁵⁰ Not all suggestions made here are interconnected in this way,³⁵¹ but many are, and pursuing all of them will increase the overall chance of success.

VII. THE THREE OBJECTIONS

The policy approaches just discussed are general, and they are general by design. There are many thoughtful, detailed policy proposals consistent with the approaches suggested here, and there have been many such proposals over time.³⁵² But even this Article's general suggestions

³⁴⁹ Arguably, this approach reflects the social policy in Nordic countries. See Michael Cembalest, *Lost in Space: The Search for Democratic Socialism in the Real World, and How I Ended Up Halfway Around the Globe From Where I Began*, Eye on the Market (June 24, 2019), <https://am.jpmorgan.com/gi/getdoc/1383625713370>.

³⁵⁰ The design of such effective programs still eludes policymakers around the globe. See, e.g., Esther Duflo, *The Economic as Plumber*, 107 AM. ECON. REV. PAPERS & PROC. 1 (2017) (describing the disappointing results of a rigorous test of a well-thought-out French reform of unemployment insurance); Daynard S. Manoli et al., *Long-Term Effects of Job-Search Assistance: Experimental Evidence Using Administrative Tax Data* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 24422, 2018), <https://www.nber.org/papers/w24422> (reporting a limited success of recent a state job-search assistance program, comparing it to even smaller effects of earlier similar efforts).

³⁵¹ If, for instance, the government is choosing between two possible legal rules that it believes to be roughly equally efficient, the government should prefer the rule with better distributional consequences whatever happens to the general safety net, transitional assistance programs, and so on.

³⁵² Some examples include GRAETZ & SHAPIRO, *supra* note 312 (discussing a broad transition assistance program); GRAETZ & MASHAW, *supra* note 22 (offering detailed proposals for improving U.S. social safety net, including unemployment insurance); Revesz, *supra* note 17, at 1566-72 (arguing that incorporating distributional considerations into the analysis of environmental

to adjust legal rules and the tax-and-transfer system on account of the unintended distributional impacts of some government policies are likely to give rise to equally general objections. Without a claim to comprehensiveness, this Part takes on several of them.

A. Distributional Impacts Are Too Uncertain

The first objection is that the uncertainty about the future unintended distributional consequences of government policies is so great, and our knowledge of distributional impacts is so speculative, that no distributional adjustments are possible in practice. A shorter version of this argument is that U.S. policymakers cannot do any better in the future than they have done in the past.

Distributional changes are indeed difficult to access and even more difficult to predict. Evaluating distributional impacts simply requires more information than forecasting future economic growth, employment interest rates, revenues, and so on.

Say we want to study the distributional impact of the China Shock. First, we need to develop a model that would predict the consequences: what production (if any) moves to China; what production (if any) moves to the United States? Second, we would need to estimate this model empirically, finding the relevant magnitudes and elasticities. But these findings would not be nearly enough to determine distributional impacts.

As Autor and colleagues explain, we would also need to determine

[t]o what extent are trade-induced industry employment contractions offset by employment gains elsewhere in the U.S. economy, potentially outside of trade-impacted regions? Do trade adjustments occur on the employment margin, the wage margin, or both? ... Are the costs of trade adjustment borne disproportionately by workers employed at trade-impacted firms and residing in trade-

regulation is a reachable goal); SAWHILL, *supra* note 346, at 108-29 (suggesting transitional assistance for workers and a social security reform); PLACE-BASED POLICIES FOR SHARED ECONOMIC GROWTH, THE HAMILTON PROJECT (Jay Shambaugh & Ryan Nunn eds., 2018) (discussing place-based strategies); Krueger & Posner, *supra* note 130, at 12-13 (proposing reforms to reduce labor market monopsony).

impacted local labor markets? Or do these shocks diffuse nationally, thus moderating their concentrated effects?³⁵³

To answer these questions, we would need to find out what happens up and down the supply chains both in the industries directly affected by foreign competition and, crucially, in the industries that are relatively unaffected by that competition but benefit from cheaper inputs resulting from it. We would also need to consider the possible effects on productivity³⁵⁴ and on consumer prices.³⁵⁵ If consumers gain, we would need to compare these gains to losses resulting from disappearing jobs and stagnant wages. This is not the full list of questions that would need to be answered to determine all distributional impacts of free trade.³⁵⁶

Or consider distributional consequences of monopoly power. To understand them, researchers would first need to determine whether this power exists and to what extent—not a trivial task. But this would only begin the analysis. Market power allows firms to earn windfall returns. When the U.S. Department of Treasury makes distributional estimates, it assigns all such returns to owners of capital (shareholders).³⁵⁷ So it would seem that greater market power necessarily benefits the wealthy. But several studies suggest that European workers capture a significant share

³⁵³ Autor et al., *China Shock*, *supra* note 74, at 222-23.

³⁵⁴ In particular, would productivity be affected at all? If so, in what sectors, and through what channels? All of this is still unclear. *See id.* at 228.

³⁵⁵ Pablo Fajgelbaum and Amit Khandelwal, for example, argue that gains from trade disproportionately benefit the poor because poor consumers spend relatively more on cheap imported goods. *See* Pablo D. Fajgelbaum & Amit K. Khandelwal, *Measuring the Unequal Gains from Trade*, 131 Q.J. ECON. 1113, 1116-17 (2016).

³⁵⁶ For example, what if competition with China boosts U.S. innovation, eventually benefitting both U.S. workers and U.S. consumers? *See* Autor et al., *China Shock*, *supra* note 74, at 228-29.

³⁵⁷ *See* TREASURY'S DISTRIBUTIONAL METHODOLOGY AND RESULTS, U.S. DEPARTMENT OF THE TREASURY, OFFICE OF TAX ANALYSIS 2 (November 12, 2015) ("The share of the corporate income tax that represents a tax on supernormal returns is assumed to be borne by shareholders."), <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/Summary-of-Treasurys-Distribution-Analysis.pdf>. In fact, the Department estimates that windfall profits are mostly earned by the top one percent of earners. *See* Julie Anne Cronin et al., *Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology*, 66 NAT'L TAX J. 239, 256 (2013) ("Families in the top 1 percent of the income distribution receive 51.2 percent of corporate supernormal capital income [windfall profits], 64.3 percent of non-corporate supernormal capital income, and 45.6 percent of normal capital income.").

of corporate rents, and that U.S. workers captured some rents in the past.³⁵⁸ Granted, U.S. labor is vastly less powerful than it used to be and than it is in Europe today. But the possibility of rent-sharing remains. Indeed, the most recent analysis suggests that U.S. workers get roughly one half of significant rents captured by U.S. firms.³⁵⁹ Here too, however, high-skill workers do much better than low-skill ones.³⁶⁰

There is no doubt that distributional projections are more complex and less precise than the forecasts of the standard economic indicators. But it is a mistake to use this comparison as a justification for not making distributional adjustments. That is because the uncertainty about common economic forecasts is great as well. Great enough, that is, for the forecasters to be wrong time and again.

Start at the top, with the U.S. Congress. It has a knack for trying to regulate behavior through the tax code. In 1993, for example, it decided to deny a compensation deduction for any payment to a corporate executive in excess of one million dollars unless the payment was performance-based.³⁶¹

Congress being a collective body, it is difficult to attribute to it a single purpose for enacting the rule. One goal was to limit executive pay—a prominent issue during the 1992 presidential election.³⁶² “The committee believes that excessive compensation will be reduced if the deduction for compensation (other than performance-based compensation) paid to the top executives of publicly held corporations is

³⁵⁸ See Emmanuel Saez et al., *Payroll Taxes, Firm Behavior, and Rent Sharing: Evidence from a Young Workers' Tax Cut in Sweden*, 109 AM. ECON. REV. 1717, 1717 (2019); see also Farber et al., *supra* note, at 5 (summarizing the literature); Furman & Orszag, *supra* note 328, at 2, 37-38 (offering rent-sharing between suppliers of capital and labor as a possible explanation for rise of inequality and decline in labor mobility, citing research showing the existence of such rent sharing in the U.S. in the 1970s).

³⁵⁹ See Thibaut Lamadon et al., *Imperfect Competition, Compensating Differentials and Rent Sharing in the U.S. Labor Market* 48 (Nat'l Bureau of Econ. Research, Working Paper No. 25954, 2019), <https://www.nber.org/papers/w25954>.

³⁶⁰ See *id.* at 50.

³⁶¹ See H.R.2264, Pub. L. No. 103-66 (adding section 162(m) to the Internal Revenue Code).

³⁶² See Kevin J. Murphy, *Executive Compensation: Where We Are and How We Got There*, in 2 HANDBOOK OF THE ECONOMICS OF FINANCE 211, 277-79 (George M. Constantinides et al. eds., 2013) (reporting statements of several presidential aspirants, including Bill Clinton).

limited to \$1 million per year,” the House Report explained.³⁶³ What followed, however, was the exact opposite of what Congress intended to achieve. One million in cash became a floor—not a ceiling—for any self-respecting executive.³⁶⁴ Congress’ failure of imagination did not stop it from attempting to impose a similar restriction twenty five years later (this time on tax-exempt organizations) while expecting a different result.³⁶⁵

An alternative justification for the 1993 limitation on executive compensation was to improve corporate governance by tying executive pay, no matter how high, to the company’s performance.³⁶⁶ That, too, did not happen.³⁶⁷ Or, perhaps, the 1993 limitation aimed to give shareholders more power over corporate boards. Alas, that did not occur either.³⁶⁸

Perhaps Congress is not the best example of forecast failures. Maybe some senators and representatives knew all along that the one million restriction and “performance-based” rules would improve nothing. Maybe these legislators were happy to indulge their naïve colleagues in their confused efforts. What about the Federal Reserve—a non-partisan assembly of economic experts?

³⁶³ H.R. Rep. 103-111 at 646.

³⁶⁴ “[T]he pay trend ... makes it look as if [162(m)] were passed with the intention of accelerating, not curbing, CEO pay increases.” *CEO Compensation: Hearing Before the Senate Comm. On Commerce, Sci. & Transp.*, 108th Cong. (2003) (statement of Brian Hall). “[W]hile there is some evidence that companies paying base salaries in excess of \$1 million lowered salaries to \$1 million following the enactment of Section 162(m), many others raised salaries that were below \$1 million to exactly \$1 million.” Murphy, *supra* note 362, at 278-79 (internal references omitted).

³⁶⁵ See H.R. Rep. 115-409, at 333 (2017) (expanding the excise tax on compensation in excess of \$1 million to apply to tax-exempt organizations). The House Ways and Means Committee cited in support of the measure its belief “that excessive compensation ... diverts resources from those particular purposes” that Congress aimed to encourage by granting the tax-exempt status. *Id.* Lesson not learned.

³⁶⁶ See Executive Compensation, Hearing on S. 1198, H.R. 4727, and H.R. 5260 before the Subcomm. on Taxation of the S. Comm. on Finance, 102 Cong. (1992) (Opening Statement of Hon. David L. Boren, Senator from Oklahoma and Chairman of the Subcommittee).

³⁶⁷ See LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE 121-43 (2004) (explaining why even stock options generally viewed as performance-based compensation and treated as such by the tax code in fact bear only a weak relationship to corporate success).

³⁶⁸ See *id.* at 196-97.

Benn Steil, a monetary economist and an astute observer of the Fed, recently summarized the results of the Fed's forecasts:

The Fed started publishing the Board of Governors' and Reserve Banks' three-year forecasts in October 2007. At that time, the GDP growth forecasts among this group of 17 ranged from 2.2% to 2.7%. Actual 2010 GDP growth was 3%, outside the Fed's range.

The Fed forecasters told us that unemployment in 2010 would be in a range between 4.6% and 5%. In fact, it averaged about twice that, or 9.6%. The forecasters further predicted that both Personal Consumption Expenditures inflation (PCE, similar to CPI) and core PCE inflation would be in a range from 1.5% and 2%. The former came in at 1.3% and the latter at 1%, again outside the Fed's range. The Fed's scorecard on its 2007 three-year forecasts: 0 for 4.

In short, the Fed's premise that it can speak with authority about the future is flawed. During the two decades [ending in] 2006, its own experts were worse than outside ones in predicting one-year economic data. Since the start of the crisis in 2007, its three-year predictions have been worthless.³⁶⁹

To the Fed's credit, it is cutting back on its forecasting business. But this retrenchment took some time, dismal results notwithstanding.³⁷⁰

Or consider another non-partisan expert body—the CBO. Its success in projecting budgetary costs of various programs is decidedly mixed. Some of its projections were remarkably accurate. For instance, the CBO's forecast of the unemployment benefits under the Emergency Unemployment Compensation program was just five percent off.³⁷¹ But the CBO predictions of the revenue brought by spectrum auctions missed

³⁶⁹ Benn Steil, *Why We Can't Believe the Fed*, WALL ST. J. (Feb 22, 2012), <https://www.wsj.com/articles/SB10001424052970204652904577197010637908348>.

³⁷⁰ See Benn Steil & Benjamin Della Rocca, *The Fed Finally Unties Its Own Hands*, WALL ST. J. (Oct. 23, 2018), <https://www.wsj.com/articles/the-fed-finally-unties-its-own-hands-1540247559>.

³⁷¹ See Doug Elmendorf, *The Accuracy of CBO's Budget Projections* (Mar. 25, 2013), <https://www.cbo.gov/publication/44017>.

the mark by thirty percent—in both directions on various occasions.³⁷² The CBO was off by thirty five percent estimating the cost of Medicare Part D (the Administration’s estimates were even more flawed).³⁷³ And it understated the decline in corporate tax revenues in the wake of the 2017 tax reform by a factor of two.³⁷⁴ Needless to say, the CBO has not stopped producing estimates, and Congress has not stopped passing budgets based on them.

It is all but inevitable that distributional projections will be sometimes mistaken even if they are based on the most sophisticated econometric techniques and are constantly reviewed and revised. Yet these mistakes will be neither unique nor unfamiliar. Similar mistakes happen time and again when Congress, the Federal Reserve, other agencies, and numerous state legislatures adopt policies based on imperfect forecasts of future productivity, employment, interest rates, economic growth, and so on. And just as all those policies continue despite prior misses and even occasional failures of the underlying forecasts, so should the distributional projections and distributional adjustments become the standard part of policymakers’ toolkit.

The final point is that the implications of emphasizing distributional uncertainty are decidedly one-sided. I am not aware of a single major policy enacted in the past four decades that *over-compensated* distributional losers because the proper level of compensation was so difficult to ascertain. Instead, distributional uncertainty is inevitably used to justify *under-compensating* those who bear disproportionate costs. These asymmetric results ought to loom large in evaluating calls for inaction in light of distributional uncertainty.

B. *Distributional Impacts Take Too Long to Reveal Themselves*

Another objection emphasizes not uncertainty but time. Distributional impacts take so long to reveal themselves in the data, the objection goes,

³⁷² See *id.*

³⁷³ See *id.*

³⁷⁴ See Brian Faler, *Big Business Paying Even less Than Expected Under GOP Tax Law*, POLITICO (June 13, 2019) (reporting that corporate tax revenue in 2018 experienced “almost twice the decline official budget forecasters had predicted”), <https://www.politico.com/story/2019/06/13/big-businesses-pay-less-tax-law-1364591>.

that the government would be reacting to yesterday's (or, more precisely, years'-old) news if it tries to respond to distributional impacts when it discovers them.

This objection doubles as an explanation for the U.S. government's failure to address the unintended distributional burdens of its policies for decades. But as recent research shows, the troubling distributional effects of the policies discussed in Part III—or at least major red flags suggesting these effects—could have been discovered a decade or two ago.

Consider labor mobility once again. The key assumption of trade economists in the 1990's was that distributional effects of trade are minor because U.S. workers are highly mobile. Labor mobility is also key for the analysis of the monopsony power in labor markets. If workers can pick up and leave any place that has only a few employers trying to hold down wages, wages will equilibrate nationwide and no employer would be able to exert market power. A similar analysis applies to the geographically concentrated costs of environmental regulation. Clearly, labor mobility is very important for distributional outcomes.

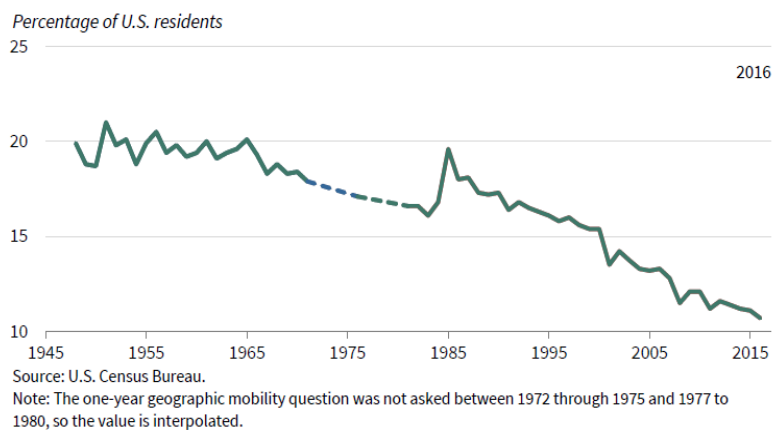


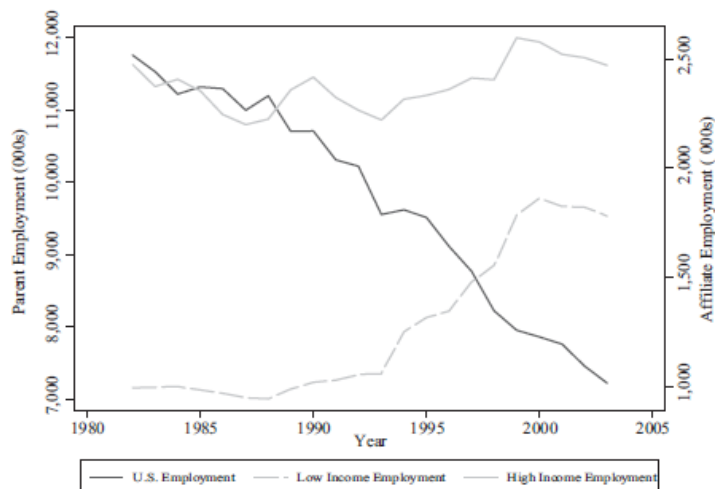
Figure 1. Share of U.S. residents who moved during the past year, 1947-2016.³⁷⁵

Figure 1 shows how Americans moved in the past seven decades. The decline is dramatic. Between 1945 and 1965 about twenty percent of U.S. residents moved during any previous year. By 2015 that share

³⁷⁵ The figure appears in ADDRESSING AMERICA'S RESKILLING CHALLENGE, COUNCIL OF ECON. ADVISERS 5 (2018).

dropped almost by half. As importantly for our purposes, this decline is not recent. It started in 1960s, briefly reversed in mid-1980s, and continued without interruption since then.³⁷⁶ Maybe economists looking at Figure 1 in early 1990s would not have seen a cause for concern. But by 2000 the decline would have been impossible to ignore. Economists, it appears, simply did not look for some time.

Now consider the evidence of offshoring—American jobs leaving abroad. Figure 2 shows the trends in employment of U.S. and foreign workers by multinational firms. Note that these trends do not show all offshoring job losses. If GM moved a plant from Michigan to its Mexican subsidiary, Figure 2 reflects the change. But if Magnavox' U.S. TV manufacturing simply disappeared while Samsung's South Korean production revved up, the resulting American job losses would be *in addition* to those depicted in Figure 2.



Authors' calculations based on the most comprehensive available data, and based on firm-level surveys on U.S. direct investment abroad, collected each year by the Bureau of Economic Analysis of the U.S. Department of Commerce. Using these data, we compute the number of employees hired abroad by country and year and then aggregate employment by low (high) income country according to World Bank income classifications.

Figure 2. Trends in domestic and affiliate employment among multinational firms.³⁷⁷

³⁷⁶ See Benmelech et al., *supra* note 134, at 2; De Loecker & Eeckhout, *supra* note 184, at 27-28.

³⁷⁷ Figure 2 appears in Avraham Ebenstein et al., *Estimating the Impact of Trade and Offshoring on American Workers Using the Current Population Surveys*, 96 REV. ECON. STAT. 581, 586 (2014).

One does not need a Ph.D. in economics to see that by mid-1990s the trend was as clear as it was disturbing. Yet first empirical work investigating the distributional consequences of NAFTA and the China shock did not appear until 2010.³⁷⁸ (Note that “low-income employment”—the rising line in Figure 2—refers to employment in low-income countries, not U.S. employment of low-income workers.)

The point is certainly not that trade economists missed some obvious changes in the economy. There are many ways to slice the data and look at employment. Just in 2016, Justin Pierce and Peter Schott published an article in the leading economics journal focused on the “surprisingly swift decline of U.S. manufacturing employment” *after 2000*.³⁷⁹ Yet the U.S. manufacturing employment at multinational firms has been declining for a long time, as is clear from Figure 2. If that figure could be produced in 2010,³⁸⁰ a similar figure could have been produced in 1998. And if it were produced then, alarm bells would have probably started ringing twenty years ago.

One could have looked at import exposure of U.S. manufacturing industries as well, as German Gutiérrez and Thomas Philippon recently did.³⁸¹ Again, the trend depicted in Figure 3 was clear by 2000, even if not as dramatic as it became afterwards.

³⁷⁸ The sole working paper revealing distributional effects of NAFTA that was later published as Hakobyan & McLaren, *supra* note 83, was available at least as early as 2010. See John McLaren & Shushanik Hakobyan, *Looking for Local Labor Market Effects of NAFTA* (Nat'l Bureau of Econ. Research, Working Paper No. 16535, 2010), <https://www.nber.org/papers/w16535>. An early draft of the *China Syndrome*, *supra* note 86, was available at least as early as 2011, <http://economics.mit.edu/files/7723>. *China Syndrome* was the first study showing the impact of the China Shock. See Goldberg, *supra* note 76, at 7.

³⁷⁹ Pierce & Schott, *supra* note 86.

³⁸⁰ The draft version of this article was available at least as early as 2010. See Autor et al., *China Syndrome*, *supra* note 86, at 2167 (citing the 2010 working paper later published as Ebenstein et al., *supra* note 377).

³⁸¹ See Gutiérrez & Philippon, *supra* note 284, at 15.

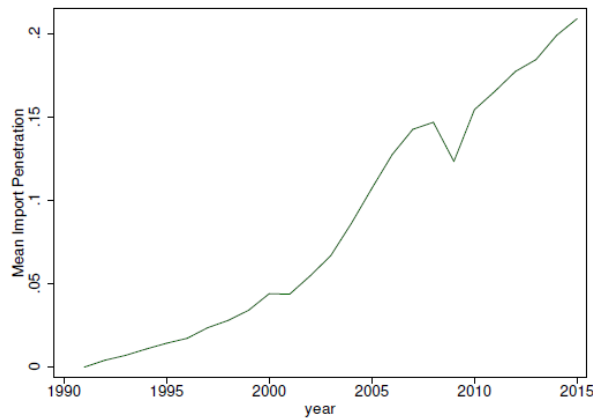


Figure 3. Import exposure for manufacturing industries.

Turning to the growing evidence of product market concentration, Figure 4 shows the rise in markups during the past several decades. If economists looked at this data in 1990, they probably would have taken notice. By 2000 they would have seen a clear red flag. The paper reporting this data is published in 2020.

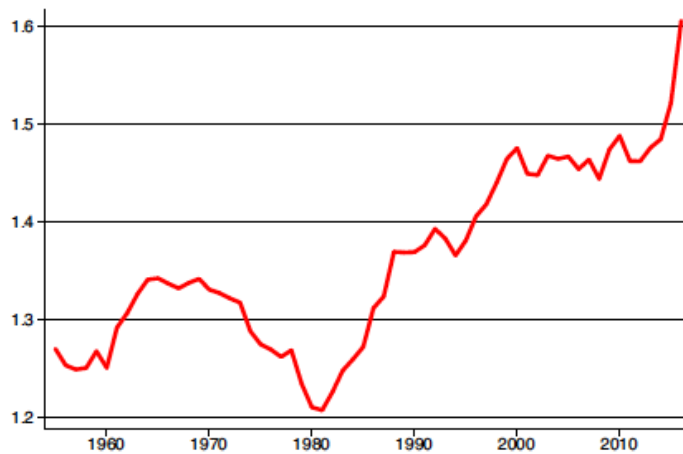


FIGURE I
Average Markups

Figure 4. The evolution of average markups from 1955 to 2016.³⁸²

Now consider the rise of monopsony power in labor markets caused by the small number of employers in American heartland. As is clear

³⁸² The figure comes from De Loecker et al., *supra* note 111, at 575.

from Figure 5, here too the alarming trend has emerged by early 2000's. Here too the trend remained undetected until now.

This figure plots trends in the employment-weighted average of the Herfindahl-Hirschman Index (HHI) of employment by firms computed at the county-three-digit industry-year level. The computed HHI is averaged across county-three-digit industry-year cells within each of the five-year periods (the last period includes eight years, 2002-2009) using the number of employees in each cell as the weight. Thus, the average HHI represents the degree of employer concentration the average worker faces in the labor market.

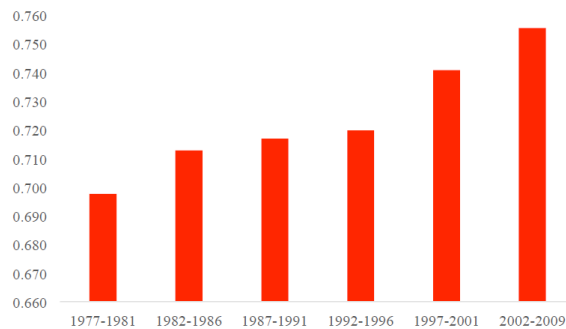


Figure 5. Trends in average local-level employment concentration, 1977-2009.³⁸³

Observing the timing of all these trends, one has to agree with one of the leading trade economists, Gordon Hanson. Explaining to the New York Times corresponded who was trying to understand why voters supporting candidate Donald Trump's protectionist policies seemed to have discovered the devastating effects of trade liberalization before the economists did, Hanson confessed that "it took a while for academics to catch up."³⁸⁴ Now that economists have done so, policymakers will have much more timely data about distributional impacts, enabling them to respond with policy adjustments if they choose to do so.³⁸⁵

C. *Fiscal Federalism*

This Article urges greater national uniformity to alleviate the geographically uneven burdens of free trade, labor market concentration, environmental regulation, and so on. Greater national uniformity stands in obvious tension with local experimentation. As various scholars

³⁸³ Figure 6 comes from Benmelech et al., *supra* note 134, at 28.

³⁸⁴ Nelson D. Schwartz & Quoc Trung Bui, *Where Jobs Are Squeezed by Chinese Trade, Voters Seek Extremes*, N.Y. TIMES (Apr. 25, 2016), <https://nyti.ms/1Ta9XDj>. Hanson was commenting on the effects of the China shock on the U.S. economy.

³⁸⁵ Indeed, a flurry of research findings discussed in the Conclusion offers strongly supports this conjecture.

pointed out, this experimentation may lead to more efficient local government that emerges from inter-governmental competition to attract more (and more affluent) residents, greater ability of residents to choose among various packages of local amenities, fewer governmental intrusions into operation of the markets, greater accountability of local officials, and may serve as a check on abuse of power at the federal level.³⁸⁶

All these arguments have counterarguments, and this Article does not attempt to resolve the long-standing debates about federalism in general and fiscal federalism in particular. The Article's contribution to this debate, however, is to highlight a growing body of empirical research that points strongly in the same direction. Highly variable social safety net as well as high and growing state-created barriers to entry exacerbate and prolong the economic suffering resulting from major federal policies discussed in this Article. This evidence should weigh heavily in policymakers' balancing of costs and benefits of greater national uniformity.

CONCLUSION

Along with the rest of the world, the United States is facing two profound challenges. First, the country needs to find a medical solution to a global pandemic. Second, and as important, the country needs to find an economic solution to the pandemic's consequences.

Sadly, but not surprisingly, the emerging evidence reveals that these consequences have much in common with those described in this Article. Again, it is low-skill, low-wage workers who are bearing the brunt of the economic contraction caused by the spread of COVID-19.³⁸⁷ Again, the

³⁸⁶ For a discussion of these arguments and references to a large literature, see, e.g., Galle & Leahy, *supra* note 29, at 1335-37; Wallace E. Oates, *Toward A Second-Generation Theory of Fiscal Federalism*, 12 INT'L TAX & PUB. FIN. 349, 350-51 (2005); Super, *supra* note 29, at 2556-60.

³⁸⁷ "Workers in occupations that are more likely to be affected by social distancing policies are workers [who are] more economically vulnerable." Simon Mongey et al., *Which Workers Bear the Burden of Social Distancing Policies?* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 27085, 2020), <http://www.nber.org/papers/w27085>. See also Alexander W. Bartik et al., *Measuring the Labor Market at the Onset of the COVID-19 Crisis* 15-16 (Brookings Papers on Economic Activity 2020), available at <https://www.brookings.edu/wp-content/uploads/2020/06/Bartik-et-al->

burdens are concentrated geographically, making low mobility of low-skill workers particularly costly.³⁸⁸ Given these similarities, the policies advocated in this Article—broad-based transitional assistance, stronger and nationally uniform social safety net, and some distributionally-informed legal rules—are precisely the ones needed to help vulnerable Americans (and the country as a whole) to recover from the economic devastation of the pandemic.³⁸⁹

Yet it is by no means clear that the government will pursue these programs after the emergency cash infusions into the economy inevitably come to an end. Nor is it the case that academics have developed widely shared views about how to design, implement, evaluate, and improve distributional policies.

The two distributional arguments may well be part of the reason for this unfortunate state of affairs. Global pandemics happen rarely, as do major financial crises like the Great Depression or the Great Recession. In contrast, legal rules change more often, including the major changes like those described in this Article. These relatively frequent changes,

conference-draft.pdf (finding that economic contraction caused by COVID-19 disproportionately affected low-wage, low-education workers); Tomaz Cajner et al., *The U.S. Labor Market During the Beginning of the Pandemic Recession* 11-12 (Nat'l Bureau of Econ. Research, Working Paper No. 27159, 2020), <https://www.nber.org/papers/w27159> (finding that the “employment losses during the Pandemic Recession are disproportionately concentrated among low wage workers”); Raj Chetty et al., *How Did COVID-19 and Stabilization Policies Affect Spending and Employment? A New Real-Time Economic Tracker Based on Private Sector Data* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 27431, 2020), <https://www.nber.org/papers/w27431> (finding that low-wage hourly workers were especially likely to lose jobs and that job postings fell more sharply for low-skill positions).

³⁸⁸ See Jose Maria Barrero et al., *COVID-19 Is Also a Reallocation Shock*, 3, 24-25 (Nat'l Bureau of Econ. Research, Working Paper No. 27137, 2020), <https://www.nber.org/papers/w27137> (suggesting that occupational licensing restrictions that significantly “impede mobility across occupations and states” are likely to be among major reasons likely to “retard ... responses to the pandemic-induced reallocation shock”); Chetty et al., *supra* note 387, at 3-4 (finding that while fewer than 30% of workers employed by small businesses were laid off in lowest-rent ZIP codes, that number exceeded 65% in the highest-rent ZIP codes, and emphasizing that “prior work shows that geography plays a central role in the impacts of economic shocks due to low rates of migration”).

³⁸⁹ Others agree. See, e.g., Chetty et al., *supra* note 387, at 5-6 (emphasizing the need for stronger social insurance and targeted assistance for low-income individuals in areas that have suffered the largest losses).

and the new economic burdens they bring, offer scholars plenty of chances to focus on designing and refining the types of programs that this Article advocates. No doubt, some of that work was being done all along.³⁹⁰ But it is easy to imagine that more would have been done if scholars working on these issues did not feel compelled to articulate reasons why *any* distributional adjustments should be made in the first place before considering what these adjustments should be.³⁹¹ If the two distributional arguments were not viewed as the default guides for practical policymaking, perhaps academics would have been more prepared today to offer concrete policy solutions as a global pandemic made the need for these solutions both obvious and urgent.

This Article shows that the core assumptions of the efficiency-only and no-compensation arguments are implausible. Evidence for this conclusion comes not from a few isolated reforms or several modest distributional shifts. Rather, major changes in U.S. economy facilitated by many government policies likely produced distributional burdens that the arguments either dismiss or assume away. As general guides for real-world governance, the two distributional argument do not survive a reality check.

If so, perhaps the conversation should move on. We should keep in mind the powerful logic of the two distributional arguments, and we should take seriously the arguments' well-known implications where appropriate. But as a general matter, we should remember that the core assumptions of the two arguments do not hold and their standard policy prescriptions do not follow. So those who have relied on the two arguments to support a view favoring limited government involvement in distributional outcomes should now look elsewhere for analytical support. And those who viewed the two arguments as conceptual obstacles to a more distributionally-sensitive and egalitarian social and economic agenda should realize that when the two arguments are retrofitted with realistic assumptions, they support this agenda, not oppose it.

³⁹⁰ See *supra*, note 352.

³⁹¹ As recently as in 2018, Richard Revesz felt that he had to devote a substantial part of his article to explaining why the efficiency-only argument does not hold for environmental, health, and safety regulation. See Revesz, *supra* note 17, at 1511-25.