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### Consumer Law As Tax Alternative

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## CONSUMER LAW AS TAX ALTERNATIVE

RORY VAN LOO\*\*

*Policymakers and scholars have in distributional conversations traditionally ignored consumer laws, defined as the set of consumer protection, antitrust, and entry barrier laws that govern consumer transactions. Tax law dominates distributional conversations partly because legal rules are seen as less efficient and partly because consumer law research speaks to narrow and siloed contexts—deceptive fees by Visa or a proposed merger between Comcast and Time Warner Cable. Even millions of dollars in reduced credit card fees seem trivial compared to the trillion-dollar growth in income inequality that has sparked concern in recent decades. This Article is the first to synthesize the fragmented empirical literature quantifying inefficiently higher consumer prices across diverse markets—called overcharge. If economists’ overcharge empirics are to be believed, the current legal framework allows businesses to overcharge consumers well over a trillion dollars, or approximately ten percent of all that consumers spend. The data available also suggests that low- and middle-income consumers likely disproportionately pay overcharge. Moreover, reducing consumer overcharge could bring the share of income earned by the top one percent of households from its current level—twenty percent of all income—to about where it was in 1980, when the top one percent earned ten percent of all income. Moreover, this massive redistribution would be driven by laws making markets more competitive, rather than tax increases that distort markets. And they would hit two types of inequality—on the spending side, and on the income side. If the empirical literature currently available is right, consumer law merits serious consideration as an alternative to tax.*

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\*\* Associate Professor of Law, Boston University; Affiliated Fellow, Yale Law School Information Society Project. For valuable input on prior drafts, I am grateful to Anne Alstott, Vivek Ashok, Ian Ayres, Joseph Bankman, Molly Brady, Chad Carr, Matt Evangelisto, Jacob Hacker, Henry Hansmann, Keith Hylton, Robert Lawless, Yair Listokin, Angela Littwin, Daniel Markovits, Michael Meurer, Edward Morrison, Morgan Ricks, Gordon Silverstein, D. Daniel Sokol, Holger Spamann, Fred Tung, Shreya Vora, David Walker, and Kathryn Zeiler for helpful comments on prior drafts, and to participants at the 2014 American Bankruptcy Institute’s Young Bankruptcy Scholars Conference, the 2017 Stanford/Yale/Harvard Junior Faculty Forum, The Future of Law & Economics and the Legacy of Guido Calabresi Conference, and the 2018 Next Generation of Antitrust Scholars Conference. Jacob Axelrod, Caroline Blake, and Phoebe Dantoin provided excellent research assistance.

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## INTRODUCTION

Each year, the tax system redistributes trillions of dollars. These transfers have received heightened bipartisan attention in recent years,<sup>1</sup> after the share of income earned by the top one percent of households doubled between 1980 and 2010.<sup>2</sup> Bipartisan leaders in academia, business, civil society, and government have identified rising inequality as a leading driver of societal risk,<sup>3</sup> and scholars have linked it to lower economic growth and political instability.<sup>4</sup> The main policy debates have focused on taxes,<sup>5</sup> in accordance with the longstanding scholarly paradigm that taxes are the best mechanism for redistribution because they are the most efficient option.<sup>6</sup>

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1. See, e.g., Damian Paletta, *Both Parties Agree the Opportunity Gap Is Widening, But the Proposed Solutions Are Starkly Different*, WALL ST. J., Jan. 8, 2014, at A2 (reporting that “the two parties point to the same economic currents—the growing income disparity between the highest-earning Americans and everyone else”); Nelson D. Schwartz, *Economists Take Aim at Wealth Inequality*, N.Y. TIMES (Jan. 3, 2016), <https://www.nytimes.com/2016/01/04/business/economy/economists-take-aim-at-wealth-inequality.html> [<https://perma.cc/2FBW-3U6D>] (reporting that the annual meeting of the 2016 American Economic Association, “a barometer of what concerns economists most,” was filled with presentations about inequality); 18th Annual Faculty Conference, FEDERALIST SOCIETY (Jan. 8, 2016) at <http://www.fed-soc.org/events/detail/18th-annual-faculty-conference> [<https://perma.cc/GR97-NKQZ>] (listing a panel on inequality as one of four topical sessions in the annual faculty conference for the Federalist Society); American Constitution Society at Yale Law School, *Law & Inequality Conference*; FACEBOOK (Oct. 16, 2015), <https://www.facebook.com/events/1476302866005591/> [<https://perma.cc/Z99H-48ZZ>] (organizing a national conference).

2. THOMAS PIKETTY, *CAPITAL IN THE 21ST CENTURY*, Table S8.2 (2014).

3. See, e.g., *The Global Risks Report 2017*, WORLD ECONOMIC FORUM 4, 6 (2017), [http://www3.weforum.org/docs/GRR17\\_Report\\_web.pdf](http://www3.weforum.org/docs/GRR17_Report_web.pdf) [<https://perma.cc/4296-NH2Y>] (surveying roughly 750 World Economic Forum stakeholders and reporting “rising income and wealth disparity” as the leading trend driving risks).

4. See STANDARD & POOR’S RATING SERVICES, *HOW INCREASING INCOME INEQUALITY IS DAMPENING U.S. ECONOMIC GROWTH, AND POSSIBLE WAYS TO CHANGE THE TIDE*, 1, 3 (2014) (concluding that inequality hinders growth, partly because low- and middle-income consumers spend a larger portion of what they earn); Alberto Alesina & Roberto Perotti, *Income Distribution, Political Instability, and Investment*, 40 *EUROP. ECON. REV.* 1203, 1204 (1996) (finding that income inequality likely leads to socio-political instability). The causal relationships between inequality and instability are complex and still in development. See, e.g., Ronald F. Inglehart & Pippa Norris, *Trump, Brexit, and the Rise of Populism: Economic Have-Nots and Cultural Backlash 2* (Harv. Kennedy Sch. Working Paper No. RWP16-026, 2016) (examining inequality and contrasting theories that seek to explain the rise of anti-establishment populist political movements).

5. See, e.g., PIKETTY, *supra* note 2, at 471 (“[T]he ideal policy for avoiding an endless inegalitarian spiral and regaining control over the dynamics of accumulation would be a progressive global tax on capital.”); Thomas B. Edsall, Opinion, *The Republican Discovery of the Poor*, N.Y. TIMES, Feb. 11, 2015, at A15 (discussing Republican proposals to address inequality through tax reform).

6. See Chris William Sanchirico, *Optimal Redistributive Instruments in Law and Economics*, in *THE OXFORD HANDBOOK OF LAW AND ECONOMICS, VOLUME 1: METHODOLOGY*

This Article looks at an alternative mechanism for redistribution: consumer overcharge. In an informal but intuitive sense, overcharge is the difference between actual prices and prices that would exist absent some act identified as anticompetitive—such as a monopolistic merger or deceptive sales practice.<sup>7</sup> The animating question of the Article is whether efficiency-improving consumer laws might provide a superior alternative to taxes for a substantial portion of redistribution. Framed as such, the inquiry is relevant for those wanting to significantly lessen inequality. But it is also relevant for those simply wishing to improve the efficiency of how we achieve the current level of distribution.

Three main questions frame the analysis. First, might reducing overcharge redistribute resources of a sufficient *magnitude* to put consumer law in conversation with tax? Second, would the *direction* of that redistribution meaningfully lessen inequality? Third, does consumer law provide a sufficient *institutional* alternative to taxes?

To be clear, each of these questions is impossible to answer definitively. But absolute certainty is not, and never has been, the standard for law and economics. Indeed, scholars and policy makers regularly draw conclusions under great uncertainty about the best means of redistribution. Their default assumption is usually that consumer law is irrelevant or inferior to tax—but that assumption is rarely interrogated in light of the evidence available. My primary aim is to move such decisions from impressionistic to empirically informed.

On the first question, the magnitude of overcharge, the literature has yet to provide a sustained and empirically based examination. This gap is problematic because policy making on distributional issues is dominated by public finance and tax analyses. Those macroeconomic inquiries consider how to transfer trillions of dollars.<sup>8</sup> In contrast, those who quantify consumer overcharge tend to analyze a small slice of the economy—how a bank deceives consumers into paying a few dollars in additional credit card fees, for example, or how a merger among bottlers leads to a price increase of a few cents on each soft drink. It is not immediately clear to someone with an instant tax lever for moving trillions of dollars of income around how a few cents of overcharge per soft drink, or even billions of dollars

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AND CONCEPTS 323 (Francesco Parisi ed., 2017) (noting that in law and economics and in public finance the belief that income taxation is superior to other redistributive instruments dominates despite a countercurrent); Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 667–68 (1994) (arguing that legal rules should seek to efficiently regulate, leaving distributional goals to the tax system).

7. Perfectly competitive prices are at marginal cost, just high enough to motivate firms to produce the equilibrium quantity and give firm owners a competitive return on investment.

8. See, e.g., Edsall, *supra* note 5, at A15.

rolled up in a given market, is worthy of attention. The observation that “law and economics” should be renamed “law and microeconomics”<sup>9</sup> is particularly apt for consumer law.

To inform the question of magnitude, the Article synthesizes currently disconnected empirical studies of overcharge. Legal scholars have begun this exercise in subsets of consumer law, concluding that consumers pay billions of dollars in higher prices due to market distortions related to financial institution sales practices (such as deceptive credit card fees),<sup>10</sup> retail goods sales practices,<sup>11</sup> antitrust,<sup>12</sup> common ownership of competing firms,<sup>13</sup> and occupational licensing.<sup>14</sup> Though academics have necessarily divided up the study of these areas for greater precision, a consumer may pay overcharge for each of these categories of overcharge on a single purchase, such as for an automobile. Moreover, a single governmental entity, most notably the Federal Trade Commission (FTC), can act on the laws driving the three major categories of overcharge—entry restriction, antitrust and consumer protection.<sup>15</sup> Making conservative assumptions based on the dispersed literature would put consumer overcharge across the

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9. Yair Listokin, *Law and Macroeconomics*, OXFORD BUS. L. BLOG (Feb. 10, 2017), <https://www.law.ox.ac.uk/business-law-blog/blog/2017/02/law-and-macroeconomics> [<https://perma.cc/D67K-H2UR>].

10. See Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 64 (2008) (arguing that “unsafe credit products reduce the overall amount of resources in a society”).

11. See Rory Van Loo, *Helping Buyers Beware: The Need for Supervision of Big Retail*, 163 U. PA. L. REV. 1311, 1311 (2015) (discussing behavioral economics overcharge by sellers of goods such as Amazon, Walmart, Unilever, and Kraft).

12. See Jonathan B. Baker & Steven C. Salop, *Antitrust, Competition Policy, and Inequality*, 104 GEO. L.J. ONLINE 1, 4 (2015) (explaining how changes to antitrust laws could lessen income inequality); Lina Khan & Sandeep Vaheesan, *Market Power and Inequality: The Antitrust Counterrevolution and its Discontents*, 11 HARV. L. & POL’Y REV. 235, 237 (2017) (“A revived antitrust movement could play an important role in reversing the dramatic rise in economic inequality.”);

13. See Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1267 (2016) (concluding that horizontal shareholding is widespread in the U.S. economy and helps explain the steep increase in income inequality)

14. Morris M. Kleiner & Alan B. Krueger, *Analyzing the Extent and Influence of Occupational Licensing on the Labor Market*, 31 J. LAB. ECON. S173, S195–96 (2013) (noting that, unlike unionized jobs, professions that require licensing as a barrier to entry have not shown to reduce wage inequality). Not only are these analyses disconnected, but also similar analyses have yet to be undertaken for significant areas of overcharge, particularly related to the recent wave of behavioral economics studies. This is a big omission because “[s]ystematic market failures and systematic redistributive problems are the bread and butter of behavioral law and economics.” Daniela Caruso, *The Baby and the Bath Water: The American Critique of European Contract Law*, 61 AM. J. COMP. L. 479, 492 (2013).

15. See, e.g., Kenneth W. Clarkson, *Constraining the Federal Trade Commission: The Case of Occupational Regulation*, 35 U. MIAMI L. REV. 77, 77, 81, 86 (1980).

economy at well over a trillion dollars, a magnitude relevant to macroeconomic distributional conversations.<sup>16</sup>

The second major question, how overcharge is distributed, has been the subject of recent debate by antitrust scholars. Professors Jonathan Baker, Steven Salop, Einer Elhauge and others have concluded that the benefits of “market power accrue primarily to shareholders and the top executives, who are wealthier on average than the median consumer.”<sup>17</sup> Others have come to the opposite conclusion, with Professor Daniel Crane arguing that “wealthy shareholders and senior corporate executives do not capture the preponderance of monopoly rents.”<sup>18</sup> Because neither side engages in any numerical analysis of the distributional implications, or any systematic review of the empirics, it remains difficult to assess precisely where each side disagrees, the scope of the disagreements, and which disagreements matter most.<sup>19</sup>

This Article extends those distributional conversations by applying the overcharge literature to national data on household spending and income. That data indicates that low- and middle-income households likely pay disproportionately more for overcharge, although there is great heterogeneity by market and type of overcharge. In terms of income, adjusting for many of Crane’s and other critics’ most important challenges and relying on conservative assumptions, it is plausible that removing overcharge would reduce the top households’ share of income from 20% closer to 15%.<sup>20</sup> Whether this figure supports Crane’s or Baker, Salop, and Elhauge’s perspective is unclear since they did not express their arguments numerically, leaving open the interpretation of words such as

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16. See *infra* Part I.

17. See Baker & Salop, *supra* note 12, at 11–12; Elhauge, *supra* note 13, at 1293 (noting that a large number of economists have concluded that anticompetitive pricing contributes to economic inequality). At least two Nobel-prize winning economists have come to similar conclusions. See JOSEPH E. STIGLITZ, *THE PRICE OF INEQUALITY* 92, 97 (2012) (arguing that corporate rents, along with corporate governance, access to health care, the tax structure, and other areas, contribute to economic inequality); Paul Krugman, Opinion, *Robots and Robber Barons*, N.Y. TIMES (Dec. 9, 2012), <http://www.nytimes.com/2012/12/10/opinion/krugman-robots-and-robber-barons.html> [<https://perma.cc/75H8-ZN3B>] (concluding that the rise of monopoly power may partly explain growing inequality).

18. Daniel A. Crane, *Antitrust and Wealth Inequality*, 101 CORNELL L. REV. 1171, 1171 (2016) (challenging arguments for more antitrust enforcement to address inequality); see N. Gregory Mankiw, *Defending the One Percent*, 27 J. ECON. PERSP. 21, 23 (2013) (arguing that “Stiglitz’s narrative relies more on exhortation and anecdote than on systematic evidence” that widespread rents occur in the economy). *But see* Elhauge, *supra* note 13, at 1293–97 (providing an extended rebuttal to Crane’s arguments).

19. Decades ago, scholars took a broader approach to estimating the distributional implications of industry concentration across the economy. Those approaches were subsequently economically discredited in recognition of the need for more market-specific analysis of overcharge. See *infra* note **Error! Bookmark not defined.** and accompanying text.

20. See *infra* Part III.C.1.

“preponderance”<sup>21</sup> and “primarily.”<sup>22</sup> Alternative scenarios that more closely map the empirical literature rather than discounting it indicate that the removal of overcharge could lower income inequality considerably further, possibly bringing the share of income earned by the top one percent to 10 percent of all income.

Those insights feed into the final, overarching, question in the analysis—an institutional comparison between consumer law and tax. The dominant paradigm generally asserts that tax law should be used to redistribute because it distorts markets less than legal rules.<sup>23</sup> Distortion avoidance is less relevant to the type of consumer laws considered in this Article which, if well-executed, remove market distortions. Several other objections could be made about using consumer law for redistribution, including the imprecision of the distributional effects; the possibility that legal rules will reach too far; the difficulty in coordinating across multiple consumer regulators; and intense political resistance to regulation. These concerns all have merit, but taxes face execution challenges ranging from fraud to an “illusion of precision.”<sup>24</sup> Institutionally comparing tax law and consumer law yields pluses and minuses on both sides, but the criterion established as the most important one for redistribution favors consumer law: market efficiency. There is thus a basis for concluding that achieving as many distributional goals as possible through consumer law would be preferable to relying solely on taxes. Stated otherwise, the failure to implement efficiency-improving consumer law requires more inefficient taxes to achieve a given distributional outcome.

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21. Crane, *supra* note 18, at 1171.

22. Baker & Salop, *supra* note 12, at 11.

23. See Kaplow & Shavell, *supra* note 6, at 667–68 (suggesting that “using legal rules to redistribute income distorts work incentives fully as much as the income tax system” and arguing that “redistribution through legal rules offers no advantage over redistribution through the income tax system and typically is less efficient”). Scholars have begun to challenge that paradigm, arguing that non-tax policies might work better for redistribution in certain contexts. See, e.g., John R. Brooks, Brian Galle, & Brendan Maher, *Cross-Subsidies: Government’s Hidden Pocketbook*, 106 GEO. L.J. (forthcoming 2018), <https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=3021&context=facpub> [<https://perma.cc/BD96-N5ZR> (dark archive)] (“[C]ross-subsidies can be more efficient than taxes, especially when they are used to redistribute wealth on grounds other than income, such as the ACA’s transfer from men to women.”); Brian Galle, *Is Local Consumer Protection Law a Better Redistributive Mechanism Than the Tax System?*, 65 N.Y.U. ANN. SURV. AM. L. 525, 526 (2010) (“My central argument is that redistributive tort rules can be more efficient at the local level than the national level, and may be more efficient than local or national redistributive taxation.”); David Gamage, *How Should Governments Promote Distributive Justice?: A Framework for Analyzing the Optimal Choice of Tax Instruments*, 68 TAX L. REV. 1, 75 (2014) (arguing that other legal instruments, such as patent law, may be worthy of consideration if they redistribute more efficiently than taxes).

24. Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609, 613 (1995).



Part I examines how much overcharge consumers pay due to information asymmetries, behavioral factors, monopoly power, and restrictive government laws. It synthesizes empirical studies that mostly estimate a percent of anticompetitive price increase in individual markets ranging from financial products to airline tickets. Those findings are applied to annual market-specific spending totals to come up with a base case for aggregate overcharge across the economy. Parts II and III then trace the flow of funds transferred by such overcharge. Part II analyzes which consumer groups pay what percent of overcharge, by applying the aggregate overcharge figures from Part I to spending data broken down by income bracket. Part III then looks at income earned from that overcharge after it enters firms. Several key inputs are determinative: how much overcharge is profitable; how much overcharge is captured internally by senior managers in the top one percent of earners; and which socioeconomic groups earn ownership income from overcharge. Depending on the assumptions for these inputs, along with the aggregate level of overcharge from Part I, several scenarios are offered for how much of the income of the top one percent today comes from overcharge—and thus how the distribution of income would change if such overcharge flowing to the top one percent were removed. Part IV compares tax and consumer law as distributional tools, in light of widespread market inefficiency.