

INEQUALITY AS MARKET FAILURE

by

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ABSTRACT

This Article explores economic, philosophical, and legal relationships between economic inequality and market failure, and it draws on these linkages to develop an innovative normative justification and alternative constitutional basis for a levy on wealth.

The Article's central analytic result is that several general mechanisms responsible for common market failures can also systematically produce economic inequalities whenever preferences against extreme inequality are fairly widespread. Because these mechanisms satisfy both the 'process-based' and 'outcome-based' criteria of market failure, redistributive transfers designed to reduce these inequalities would be normatively justified under the widely accepted market failure theory of government action. On this view, the remediation of market failure is generally a sufficient condition for government intervention in the economic sphere.

The institutional and constitutional implications of this 'market failure theory of inequality' are then elicited. At the level of policy, this Article advocates for a bifurcated tax-and-transfer system, in which (i) a levy on wealth is employed to reduce inequalities attributable to (both 'local' and 'global') market failures, while (ii) income or consumption taxes are utilized to address inequalities that are not the product of market failure.

If this institutional division of labor were adopted, the Commerce Clause of the U.S. Constitution would then license the enactment of a 'market-failure-correcting wealth exaction,' as Congress's commerce power accords it broad authority to legislate to remedy market failures. This fiscal imposition could be characterized in a way that avoids the constitutional prohibition on unapportioned 'direct taxes,' widely believed to be fatal to the implementation of a wealth tax. In this way, the total quantity of constitutionally permissible redistribution would be maximized.

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INTRODUCTION

According to orthodox public economics, taxation has the following primary functions:²

1. **Fiscal:** raise revenue to fund government provision of public goods.³
2. **Pigouvian:** force the internalization of externalities by market actors.⁴
3. **Distributive:** tax and transfer to produce a fair (or just) distribution of resources.

Traditionally, it has been believed that the fiscal⁵ and Pigouvian⁶ functions of taxation correct market failures, while the distributive function does not. Therefore, so the argument goes, the former derive legitimation from the *market failure theory of government action*, which holds that rectifying market failure is generally a legitimate justification for state intervention into the

² See e.g., HARVEY S. ROSEN & TED GAYER, PUBLIC FINANCE 63, 84, 261-66 (9th ed. 2010); ANTHONY ATKINSON & JOSEPH STIGLITZ, LECTURES ON PUBLIC ECONOMICS 5-7 (updated ed. 2015); ROBIN W. BOADWAY & NEIL BRUCE, WELFARE ECONOMICS 130 (1984).

³ *Public goods* are goods that are both non-excludable and non-rivalrous. E.g., ROSEN & GAYER, *supra* note 2, at 54. A good is *non-excludable* if persons within some area cannot be prevented from consuming it or enjoying its benefits. *Id.* A good is *non-rivalrous* if one person's consumption or enjoyment does not reduce others' consumption or enjoyment. *Id.* By contrast, *private goods* are goods that are both excludable and rivalrous. *Id.* Classic examples of public goods are national defense, police, the legal system, clean air, publicly accessible structures such as roads, and common areas like parks. The fountainhead of the modern theory of public goods is Paul Samuelson, *Pure Theory of Public Expenditure*, J. ECON. & STAT. (1954).

⁴ *Externalities* are costs or benefits imposed on third parties who are not privy to the economic arrangements that produce these costs/benefits. As a consequence, these costs/benefits are not priced into market transactions. E.g., ROSEN & GAYER, *supra* note 2, at 73.

⁵ Most economists believe that public goods must be funded through taxation since private provision of these goods gives rise to *collective action problems*. To illustrate, suppose that a number of individuals are deciding whether to contribute to funding some public good—say, national defense. Because the good is non-excludable, each realizes that if the good is ultimately provided, then anyone can enjoy it, regardless of whether that person had financially contributed to its provision or not. Therefore, each person, to the extent that they are self-interested and rational, has an incentive to *free ride*: that is, to consume the good without paying their fair share. E.g., *id.* at 62. Because all (or at least a significant proportion) of the group's members reason this way, an insufficient number financially contribute to the good's provision. As a result, the good is not provided (at least at its socially optimal level). To escape this predicament, the state must tax people to pay their fair share of public goods from which they derive benefit. Otherwise, these critical goods would not be provided at all, or would be provided at an inefficiently low level. *Id.*

⁶ In the presence of externalities, market transactions frequently beget inefficient outcomes. E.g., *id.* at 77. That's because efficiency, understood as wealth maximization, requires parties to bear the full costs and benefits of their actions. If A and B derive certain benefits from their economic arrangement, but do not take into account further costs or benefits that their arrangement imposes on C, then A and B will opt for a level of economic activity that is either higher or lower than the social optimum.

One way to induce market participants to choose the efficient level of activity is to impose a tax on behavior that produces negative externalities, or conversely to subsidize behavior that creates positive externalities. If the tax is equal to the costs or benefits imposed on third parties, this will force A and B to *internalize* the externalities of their behavior: i.e., to take account of these costs/benefits in their private economic decisions. A and B will then opt for the socially optimal level of activity. This tax scheme is referred to as *Pigouvian taxation (and subsidization)*. *Id.* at 47.

See classically, ARTHUR PIGOU, THE ECONOMICS OF WELFARE (1920). For recent discussions by law professors applying the Pigouvian framework to regulatory and constitutional issues, respectively, see Jonathan S. Masur & Eric A. Posner, *Toward a Pigouvian State*, 164 U. PA. L. REV. 93, (2015); Peter N. Salib, *The Pigouvian Constitution* 88 U. CHI. L. REV. 1981 (2021). An epistemic critique of Pigouvian taxation, emphasizing the difficulty of quantifying externalities, is presented by Victor Fleischer, *Curb Your Enthusiasm for Pigouvian Taxes*, 58 VAND. L. REV. 1673 (2015).

economic sphere. This view enjoys widespread support among scholars of law-and-economics,⁷ classical political economists,⁸ welfare and public finance economists,⁹ liberal egalitarian philosophers,¹⁰ and even certain libertarian and conservative scholars (albeit subject to caveats).¹¹ Accordingly, the fiscal and Pigouvian functions of taxation have proved quite uncontroversial from the standpoint of public policy, while the distributive function has been far more contentious.

In recent years, this traditional view has been questioned by a small band of renegade scholars, who challenge the complete independence of these functions of taxation. In certain instances, the dissidents argue, these functions can bleed into each other. Notably, in their seminal treatise on taxation and justice, the legal philosophers Liam Murphy and Thomas Nagel contend that redistribution to provide a decent social minimum can serve as a public good that cannot be efficiently provided by the market¹² and highlight further interdependencies between the fiscal and redistributive functions of taxation.¹³ Generalizing the former thought, the economist Thomas Piketty has explored at length the concept of *efficient redistribution*, which denotes transfers that simultaneously correct for inequitable distributive effects of market imperfections while also producing a Pareto efficient outcome.¹⁴

Both Murphy-Nagel's and Piketty's analyses make (at least tacit) use of the idea of an *inequality-generating market failure* (or 'IGMF'), which can be defined as a market failure that commits the dual sins of producing an inefficient outcome while also increasing economic inequality. The existence of IGMFs would validate what I'll refer to as the:

Convergence Thesis: In circumstances where market failure results in (i) an economically inefficient outcome, as well as (ii) increased economic inequality, the distributive and market-failure-correcting functions of taxation coincide.¹⁵

⁷ See Masur & Posner, *supra* note 6, at 100 ("Government intervention in the market is generally assumed to be justified when the market fails").

⁸ See ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS Bk. 5, ch.1 (1776); DAVID HUME, A TREATISE OF HUMAN NATURE, Bk 3, Pt 2, ch.7 (1739). For discussion of Smith's and Hume's views, see Jonathan Anomaly, *Public Goods and Government Action*, reprinted in PHILOSOPHY, POLITICS, AND ECONOMICS: AN ANTHOLOGY 200-01 (2016).

⁹ See BOADWAY & BRUCE, *supra* note 2, at 130; ATKINSON & STIGLITZ, *supra* note 2, at 3-8 (adopting the theory as an organizing framework, while cautioning that attempts to correct market failures can still be foiled by government failure).

¹⁰ See LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: JUSTICE AND TAXES 46 (2002).

¹¹ See DAVID SCHMIDTZ, THE LIMITS OF GOVERNMENT: AN ESSAY ON THE PUBLIC GOODS ARGUMENT (1991). Some of the typical caveats are as follows. First, libertarians frequently hold that there are fewer true market failures than is typically believed and that many purported market failures can be solved by sufficiently clever market mechanisms. See DAVID D. FRIEDMAN, PRICE THEORY: AN INTERMEDIATE TEXT Ch. 18 (1986). Second, if the state's efforts to correct market failure are likely to result in government failure more severe than the targeted market failure, then the government intervention is not warranted. As an auxiliary premise, it is often asserted that government failure is both more prevalent and significant than market failure. DAVID D. FRIEDMAN, THE MACHINERY OF FREEDOM 261 (3rd ed. 2015).

¹² See MURPHY & NAGEL, *supra* note 10, at 87. See *infra* at Part III for further discussion.

¹³ *Id.* at Ch. 4. In general, they observe that "[a]ny distributive aim will depend for its implementation on some form of public-private provision division, and any public-private division can be justified only against the background of some distributive assumption." *Id.* at 78.

¹⁴ THOMAS PIKETTY, THE ECONOMICS OF INEQUALITY 3 (1997/2015) [hereinafter, "PIKETTY, ECONOMICS OF INEQUALITY"].

¹⁵ The convergence thesis is the denial of the '*separability thesis*' that these functions never overlap.

And where do these IGMFs rear their ugly heads? In his early career masterwork, *The Economics of Inequality*, Piketty surveys a host of impairments in specific markets that tend to increase inequality in the distribution of wealth.¹⁶ Among these are defects in the markets for credit rationing and capital,¹⁷ education,¹⁸ labor (in the presence of monopsonistic¹⁹ and discriminatory employers²⁰), and insurance.²¹ Because these are imperfections in particular markets, which arise by dint of their distinctive structural characteristics, I refer to them as ‘*local*’ IGMFs. One may then wonder: are there *generic* IGMF mechanisms that can afflict markets of all stripes?

The goal of this Article is to establish that there are such mechanisms and that this fact has significant legal, economic, and philosophical implications for tax law and policy. At a more granular level, this Article builds on foundational work by Murphy-Nagel, Piketty, philosopher G.A. Cohen, economist Mancur Olson, among others, to develop the following dimensions of a *market failure theory of inequality*:

(1) Global IGMFs: Several highly general mechanisms responsible for classic market failures can also systematically produce economic inequality whenever preferences against extreme economic inequality are fairly prevalent. As such, nearly all markets are potentially subject to these ‘*global*’ IGMFs.²² In developing this general component of the market failure theory of inequality, I survey, synthesize, and build upon ideas from a number of classic works in political economy and philosophy, as well as recent work by a few other tax law scholars. This integrated theory is defended from objections and its normative and legal implications are duly elicited.

(2) Market-Failure-Correcting (‘MFC’) Redistributive Taxation: A redistributive tax designed to reduce economic inequalities attributable to global and local IGMFs should be uncontroversial from the standpoint of public policy since it is justified under the market failure theory of government action. Indeed, a central normative objective of this Article is to establish that even those who typically reject the distributive function of taxation (e.g., libertarians, classical liberals, other laissez-faire enthusiasts) are internally committed to embracing such a tax to the extent that they accept other market-failure-correcting functions of taxation, such as the fiscal and Pigouvian functions. To borrow a term from the discipline of logic, my argument is dialectically *ad hominem*: that is, I grant my interlocutors their own favored normative presuppositions²³ and proceed to show how those very assumptions ultimately require them to accept my policy conclusions on pain of internal inconsistency.

(3) Wealth Tax Function and Constitutionality: While a market-failure-correcting redistributive tax could in principle take many forms, I argue that a *wealth tax*²⁴ would be particularly well-suited

¹⁶ In his subsequent landmark work, Piketty argued that even markets operating at close to a state of perfect competition have the tendency to produce snowball inequality over time, since the returns to capital exceed returns to labor as well as the general growth rate of the economy. THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* 25, 571 (2014). In this Article, I shall focus on developing the ‘general component’ of the market failure theory of inequality immanent in Piketty’s earlier work.

¹⁷ PIKETTY, *ECONOMICS OF INEQUALITY*, *supra* note 14, at 64-65.

¹⁸ *Id.* at 79-80.

¹⁹ *Id.* at 94.

²⁰ *Id.* at 86-88.

²¹ *Id.* at 115-17.

²² In future work, I hope to show that, on reasonable empirical assumptions, local and global IGMFs can jointly account for a nontrivial portion of economic inequality.

²³ I.e., the distributive function’s purported illegitimacy and the market-failure-correcting functions’ conceded legitimacy.

²⁴ As explained in Part V.B, this fiscal imposition would be properly characterized for constitutional purposes as a “wealth exaction,” rather than as a “wealth tax,” since it primarily functions as a regulation aimed at rectifying market

to this task. Under my proposed institutional scheme, a market-failure-correcting levy on wealth would play a similar but inverse role to that of a universal basic income (UBI). While the latter serves as a floor on low-end inequality, the former functions as a ceiling on high-end inequality. In between these poles, progressive income or consumption taxes could be employed to reduce more politically and normatively contentious inequalities, which are not the product of market failure.

If this division of labor were effectuated, the market failure theory of inequality would provide an alternative constitutional basis for such a levy on wealth based on authorization under the Commerce Clause of the U.S. Constitution, which accords Congress broad power to legislate to rectify market failures. This fiscal imposition could be characterized in a way that avoids the constitutional prohibition on unapportioned “direct taxes,” widely believed to be fatal to the implementation of a wealth tax. In this way, the total quantity of constitutionally permissible redistribution would be maximized.

This constitutional argument is briefly introduced in this Article to demonstrate the critical legal ramifications of the market failure theory of inequality and will be elaborated upon in greater detail in subsequent work. In light of the spiraling growth of economic inequality in recent decades and continued legal uncertainty regarding the constitutionality of wealth taxation in the wake of the Supreme Court’s recent decision in *Moore v. United States*,²⁵ this project has become increasingly urgent.

The development of these distinct dimensions of the market failure theory of inequality represents this Article’s respective analytic, normative, institutional, and legal contributions. Before advancing these theses, however, I must first provide background on the economic theory of market failure, which serves as the scaffolding on which my own analysis is built. In the following Part I, I set the stage by explaining the orthodox conceptual analysis of market failure and canvassing a number of classic market failure mechanisms. In this Article’s subsequent parts, I demonstrate how these very same mechanisms can systematically produce economic inequality whenever preferences against extreme economic inequality are fairly widespread, and I establish that these outcomes qualify as market failures under (an appropriately refined version of) this orthodox conception. Accordingly, their remediation via redistributive taxes and transfers should enjoy the imprimatur of the market failure theory of government action.

I. ORTHODOX ANALYSIS OF MARKET FAILURE

The starting point for the orthodox conceptual analysis of market failure is the *fundamental theorem of welfare economics*. The centerpiece of neoclassical economic theory, the fundamental theorem is essentially a mathematical formalization of Adam Smith’s famed invisible hand argument. In *The Wealth of Nations*, which laid the groundwork for the modern discipline of economics, Smith endeavored to show that competitive markets, in which each individual pursues

failure. I use the term “wealth tax” throughout the Article prior to Part V in the interest of expositional simplicity and to contextualize my own contribution to the tax policy literature, despite being at odds with my subsequent constitutional analysis. With this disclaimer issued, it shall be no objection to my constitutional theory that I herein employ the label “wealth tax” for pragmatic reasons!

²⁵ 602 U.S. 572, 598-600 (2024) (“[T]he Government further acknowledges that the constitutionality of a hypothetical unapportioned tax on appreciation may depend on, among other things, whether realization is a constitutional requirement for an income tax . . . Those are potential issues for another day, and we do not address or resolve any of those issues here.”)

his own self-interest, nevertheless lead to collectively efficient allocations of resources.²⁶ Similarly, the fundamental theorem holds that market competition satisfying certain formal conditions (*‘perfect competition’*) is guaranteed to yield a Pareto efficient outcome in which no parties can be made better off without making at least one party worse off.²⁷ According to its orthodox conceptual analysis, *market failure* is defined negatively by contrast to this baseline case of perfect competition.²⁸ In particular, market failure has both (i) process-based and (ii) outcome-based criteria.²⁹

The *process-based criterion* is present whenever a market fails to exhibit one or more of the required structural characteristics of perfect competition. These necessary conditions include:³⁰

- (C1) Perfect Information: All market participants know the prices for all commodities traded on the market, as well as the utilities that each would derive from each such commodity.
- (C2) Excludability: Market participants have well-defined property rights in all commodities traded on the market and may fully exclude others from deriving benefits from these goods.
- (C3) No Externalities: Market participants fully internalize the costs and benefits of their economic activity, such that no costs or benefits are imposed on third parties who are not in contractual privity with these market actors.
- (C4) No Market Power: There are a large number of small buyers and sellers, such that each market participant is a ‘price-taker’ and exerts no tangible influence on price levels.
- (C5) No Transaction Costs: Buyers and sellers do not incur transaction costs to partake in market transactions.

The *outcome-based criterion* of market failure is present whenever the operation of a market produces a *Pareto inefficient* (or *Pareto suboptimal*) outcome: in other words, there are feasible Pareto improvements that would make one or more parties better off relative to the market outcome, while making none worse off.

Pareto inefficiency is the typical consequence of the failure of one or more structural requirements of perfect competition. However, it is not an inevitable consequence. That’s because it is theoretically possible for different market failures, or distinct instances of a single type of market failure, to fortuitously offset each other,³¹ thereby producing a Pareto optimal state of affairs by happenstance. For this reason, the process-based and outcome-based criteria are not conceptually or extensionally equivalent. To qualify as a true market failure, *both* must be present—each is a necessary condition.

²⁶ See generally SMITH, *supra* note 8.

²⁷ E.g., BOADWAY & BRUCE, *supra* note 2, at 64.

²⁸ See ATKINSON & STIGLITZ, *supra* note 2, at 5, 285.

²⁹ This bipartite analysis, I claim, is at least implicit in most of canonical discussions of the theory of market failure. See e.g., *id.* at 103-36; Francis M. Bator, *The Anatomy of Market Failure*, reprinted in TYLER COWEN (ed.), *THE THEORY OF MARKET FAILURE: A CRITICAL EXAMINATION* 35-40 (1988).

³⁰ See e.g., BOADWAY & BRUCE, *supra* note 2, at 104; Tyler Cowen, *Public Goods and Externalities: Old and New Perspectives*, in COWEN, *supra* note 29, at 1-23.

³¹ R.G. Lipsey & K. J. Lancaster, *The General Theory of Second Best*, REV. ECON. STUD. (1956).

Nonfulfillment of conditions (C1-C5) of perfect competition can give rise to the following classic *market failure mechanisms*,³² which (as just explained) normally yield Pareto inefficient outcomes:

- C1: Failure of perfect information may result in adverse selection, moral hazard, or other transactions that ex post do not increase the subjective utility of all parties to an exchange.
- C2: Failure of excludability may result in free riding, tragedy of the commons, and the underproduction of public goods.
- C3: Failure of no externalities may result in inefficiently high or low levels of economic activities for which costs are not fully internalized.
- C4: Failure of no market power may result in monopoly, oligopoly, or monopsony.
- C5: Failure of no transaction costs may deter transactions that would otherwise produce Pareto improvements between the relevant parties.

Each of these market failures, it is widely held, provides warrant for appropriate *government interventions* aimed at remedying the underlying structural imperfection. If judicious, these remedial measures can yield Pareto improvements relative to the market outcomes that otherwise would have obtained. Some of the standard interventions for these classic market failures are enumerated below.³³

* * *

This completes my background discussion of the orthodox conceptual analysis of market failure. With these prerequisites fulfilled, the stage has been set for my development of the market failure theory of inequality and exploration of its economic, philosophical, and legal ramifications. The remainder of this Article is organized as follows.

Part II.A explicates a notion central to my argument: that of an egalitarian ‘*distributive preference*,’ which is essentially a preference against significant inequality in the distribution of wealth or welfare. Empirical evidence is cited for the prevalence of these preferences among the general population.

Part II.B demonstrates that whenever egalitarian distributive preferences are fairly widespread, economic inequality will be systematically produced by mechanisms responsible for classic market failures. In particular, inequality will be generated by (i) *imperfect information*, (ii) *non-excludability*, and (iii) *negative externalities*. Due to these structural defects in the market process, the process-based criterion for market failure is firmly satisfied in the envisaged circumstances.

Part III takes up the question of whether the outcome-based criterion of market failure is also satisfied in these cases. This discussion is framed by a challenge, purporting to show that while these scenarios are *Kaldor-Hicks inefficient* (i.e., total economic surplus is not maximized due to

³² See e.g., BOADWAY & BRUCE, *supra* note 2, at 103-129; Cowen, *supra* note 30, at 1-23.

³³ Standard interventions for the market failures delineated above include: (i) mandatory information disclosure, as well as risk-pooling techniques, to address adverse selection and moral hazard; (ii) coercive taxation and public financing to address free riding and underproduction of public goods; (iii) the toolkit of antitrust law to address monopoly and market power; (iv) Pigouvian taxes/subsidies, command-and-control regulation, tradeable permits, and a reduction of transaction costs facilitating Coasean bargaining, to address externalities; and (v) adoption of liability rules over property rules, elimination of legal frictions on economic transacting, and subsidization of technologies that increase the efficiency of search, negotiation, contracting, and other market processes, to address transaction costs.

frustration of widespread egalitarian distributive preferences), they are nevertheless *Pareto efficient*, since a Pareto improvement is not possible for reasons to be explained. Responding to this challenge, I pursue three distinct lines of reasoning suggesting that an appropriate outcome-based criterion of market failure can nevertheless be satisfied in the cases delineated in Part II.

Part IV then considers several objections to the argument developed in Parts II and III and offers replies and refinements to my preceding analysis. In the Appendix, I also address the fundamental objection that, contra my own contention, distributive preferences ought not to be accorded weight in normative economic analysis. I have chosen to append this discussion since a rigorous defense of this critical assumption requires appropriately nuanced engagement with the philosophical and welfare economic literature.

Part V describes an institutional vision consonant with the market failure theory of inequality, in which a levy on wealth is utilized to eliminate economic inequalities attributable to both local and global IGMFs, while other forms of taxation (e.g., progressive income or consumption taxes) are employed to address the broader class of inequalities that do not emanate from market failure. To conclude the Article, I draw on the inequality theory of market failure to sketch an alternative constitutional basis for a levy on wealth. My legal strategy would permit this instrument to circumvent the constitutional prohibition on unapportioned “direct taxes,” widely believed to encompass wealth taxes.

II. SOURCES OF INEQUALITY-GENERATING MARKET FAILURE

A. Distributive Preferences

Let me undertake my development of the market failure theory of inequality by first defining some key terminology. A *distributive preference* is a preference, ceteris paribus, for a certain distribution of wealth (or welfare) to obtain within the population of concern.³⁴ A central assumption of the arguments developed below³⁵ is that a significant proportion of individuals hold distributive preferences against (at least) very dramatic high-end inequality. That is, ceteris paribus, many people disfavor distributions where a small fraction of the population enjoys a very large portion of total societal wealth (or welfare). I’ll refer to these as *moderately egalitarian* distributive preferences.

The concept of a distributive preference is a close cousin to what the preeminent legal economists Louis Kaplow and Steven Shavell (KS) call “*tastes for notions of fairness*” in *Fairness Versus Welfare*, their seminal defense of welfare economic analysis of law.³⁶ There, KS suggest that many people possess such preferences as a consequence of the socialization process,³⁷ which inculcates norms of fairness yielding beneficial social consequences when widely internalized and acted upon. While close enough that much of KS’s analysis should remain apt, my notion of a distributive preference appears to diverge from their tastes for notions of fairness in at least two important respects.

³⁴ See PER-OLOV JOHANSSON, AN INTRODUCTION TO MODERN WELFARE ECONOMICS 4, 100 (1991). The admissibility of preferences for distributive outcomes, which are not rooted in hostility, is given a brief defense in the context of optimal tax theory by Lawrence Zelenak & Kemper Moreland, *Can the Graduated Income Tax Survive Optimal Tax Analysis?*, TAX L. REV. 74 (1999).

³⁵ See *infra* at Part II.B.

³⁶ LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 21, 78, 431 (2002).

³⁷ *Id.* at 78.

First, KS's tastes for notions of fairness seem to concern specific forms of fair *treatment*, which are frequently tied up with intuitions about promissory morality,³⁸ retributive justice,³⁹ and other non-consequentialist moral notions. Distributive preferences, on the other hand, are preferences for *outcomes*, characterized by particular distributions of wealth or well-being.

Second, KS's tastes for notions of fairness seem to be preferences for fair treatment *as such*. Distributive preferences, as I shall employ the term, may be held for a number of reasons. They may be rooted in attitudes about the *intrinsic (ethical) desirability* of certain outcomes; or they might look to the *instrumental effects* of particular distributions.⁴⁰ They may be motivated by *altruism*,⁴¹ an *impartial sense of justice*,⁴² or (*enlightened*) *self-interest*.⁴³ These distinctions generate two axes for classifying distributive preferences, giving rise to the following six-part typology:

Table 1: Types of Distributive Preferences

	Intrinsic Desirability	Instrumental Effects
Altruism	Type 1	Type 2
Impartial Sense of Justice	Type 3	Type 4
(Enlightened) Self-Interest	Type 5	Type 6

In addition, distributive preferences can sometimes be held for illiberal or morally objectionable reasons. These are addressed in the Appendix to this Article.

Some substantive reasons for holding egalitarian distributive preferences, which shed light on why egalitarian outcomes may satisfy one's altruism, impartiality, or self-interest, include the following:⁴⁴

- Equality has sundry salutary social consequences that can be characterized as public goods or positive externalities: e.g., less crime, more educated citizenry, less political division.⁴⁵
- Status is a relative good: the amount of status that one derives from a given level of material holdings frequently depends on how much wealth others possess. In a more egalitarian

³⁸ See *id.* at 78 n. 117.

³⁹ See *id.* at 21.

⁴⁰ The distinction between intrinsic and instrumental desirability dates back at least to ARISTOTLE, *NICOMACHEAN ETHICS*.

⁴¹ See JOHANSSON, *supra* note 34, at 66. If distributive preferences are motivated by altruism, they may indicate an *interdependent utility function*, in which an individual gains utility from improvements in the welfare of others. It is less clear whether distributive preferences grounded in an impartial sense of justice signify an interdependent utility function, since it's conceptually possible (and indeed, psychologically plausible) that individuals can harbor such preferences for moral reasons without deriving personal utility from them.

As the converse of altruism, distributive preferences can also be motivated by *envy*, among other malevolent attitudes. See *id.* Some theorists have argued that 'other-regarding' preferences rooted in envy or malice should not be given weight in social welfare analysis. See John C. Harsanyi, *Morality and the Theory of Rational Behavior*, in AMARTYA SEN & BERNARD WILLIAMS (eds.), *UTILITARIANISM AND BEYOND* 39, 56 (1982). I address such arguments in the Appendix to this Article.

⁴² See John Harsanyi, *Cardinal Welfare, Individualistic Ethics and Interpersonal Comparisons of Utility*, J. POL. ECON. (1955); BOADWAY & BRUCE, *supra* note 2, at 179.

⁴³ For a classification scheme exhibiting some overlap with this one, see BRIAN BARRY, *POLITICAL ARGUMENT* 297-98 (1965).

⁴⁴ Most of these reasons, among others, are discussed by T.M. SCANLON, *WHY DOES INEQUALITY MATTER?* (2018), which builds on his influential essay, *The Varieties of Objections to Inequality*, THE LINDLEY LECTURE (1996).

⁴⁵ See MURPHY & NAGEL, *supra* note 10, at 87.

society, one may therefore derive greater status, and with it more well-being, from a given level of wealth.⁴⁶

- In an inequalitarian society, a small number of affluent individuals may exert disproportionate influence over political outcomes, permitting them to appropriate an unfair portion of the social surplus.⁴⁷
- In an egalitarian society, a greater number of individuals may enjoy fair equality of opportunity and greater social mobility.⁴⁸
- In a highly unequal society, a large number of individuals may lack the ability to meet their basic needs.
- A highly unequal distribution of wealth is unlikely to maximize aggregate utility due to the declining marginal utility of wealth.⁴⁹
- A highly unequal society accords undue weight to the welfare of those who are better-off, which is less morally urgent than the welfare of those who are worse-off.⁵⁰

For purposes of the arguments developed below in Part II.B, it will not matter precisely *why* people harbor moderately egalitarian distributive preferences.⁵¹ My analysis merely presupposes that, as an empirical matter, preferences against dramatic levels of high-end inequality are fairly widespread.⁵² There is ample evidence to substantiate this assumption.⁵³

⁴⁶ See SCANLON, *supra* note 44, at 26-39; JOHN RAWLS, A THEORY OF JUSTICE 155-57 (revised ed. 1999) (discussing distributive justice and the social bases of self-respect).

⁴⁷ See ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY. Downs's model is discussed *infra* at Part II.B. See also SCANLON, *supra* note 44, at 74-94; MICHAEL WALZER, SPHERES OF JUSTICE 120 (1983).

⁴⁸ See SCANLON, *supra* note 44, at 53-73; RAWLS, *supra* note 46, at 63.

⁴⁹ See e.g., ROSEN & GAYER, *supra* note 2, at 262.

⁵⁰ See MATTHEW D. ADLER, WELL-BEING AND FAIR DISTRIBUTION: BEYOND COST-BENEFIT ANALYSIS (2011); MATTHEW D. ADLER, MEASURING SOCIAL WELFARE: AN INTRODUCTION (2019).

⁵¹ Subject to certain qualifications pertaining to the admissibility of morally noxious other-regarding preferences to normative economic analysis, which are discussed in the Appendix to this Article.

⁵² An important distinction must be drawn here. As stated above, as I shall understand the notion, distributive preferences may be held for self-interested reasons. Nevertheless, we must be careful to distinguish:

- (i) A distributive preference *for one's society to exhibit a certain pattern* of wealth holdings or welfare levels, which is held for self-interested reasons; and
- (ii) A preference for more wealth (or welfare) *for oneself*, regardless of whether this would have the effect of bringing about some broader distributional pattern.

I shall *not* regard the latter as a true distributive preference. While most people undoubtedly harbor preferences of this sort, they are not the sort of preferences with which I am concerned, nor do they factor into my argument.

⁵³ In the most thorough recent empirical study of Americans' attitudes regarding economic equality, the political scientists Benjamin Page and Lawrence Jacobs find that "72% of Americans agree that 'differences in income in America are too large.'" BENJAMIN I. PAGE & LAWRENCE R. JACOBS, CLASS WAR: WHAT AMERICANS REALLY THINK ABOUT ECONOMIC INEQUALITY 40 (2009). Correlatively, "68% reject the idea that the current distribution of money and wealth is 'fair.' Instead, this large majority says that 'the money and wealth in this country should be more evenly distributed among a larger percentage of the people.'" *Id.* at 41.

Nor are these attitudes confined to the most likely suspects. Rather, the belief that "extreme inequality of income and wealth is bad and should be dealt with" is shared by "Americans from widely different backgrounds." *Id.* at 43. Indeed, this coalition comprises

. . . low-income groups struggling to make ends meet and Democrats committed to a philosophy of social justice. But supporters of reducing inequality also include most Republicans, most citizens who consider themselves 'middle class,' and most higher-income people . . . solid majorities of Republicans (56 percent) and of high-income earners (60 percent) agree that income differences are 'too large' in the United States. Remarkably, then, majorities of those who are often assumed to be *least* concerned about inequality believe that income differences

Moreover, in the event that this supposition failed to prevail within a given society at a given moment in time, my analysis could simply be restated in conditional form: *whenever* the assumption of fairly widespread moderately egalitarian distributive preferences prevails within a society, the implications are those to be spelled out in Part II.B. As many significant contributions to economic theory have taken the form of conditional proofs,⁵⁴ I believe that this demonstration is independently valuable, even apart from its empirical pertinence to a given society.

In addition to this assumption of prevalent moderately egalitarian preferences, a further normative premise of my argument is that the satisfaction of distributive preferences should be accorded weight in economic procedures for ranking the social desirability of different states of affairs, such as cost-benefit and social welfare analysis. As validating this normative postulate demands nuanced engagement with the philosophical and welfare economic literature, a rigorous defense is reserved for the Appendix to this Article. For now, I shall simply emphasize that the fulfillment of distributive preferences is frequently an authentic source of satisfaction and ought to therefore be regarded as increasing the holder's well-being (like the gratification of any other preference meeting this desideratum). Distributive preferences should thus be accorded at least presumptive weight in normative economic analysis.⁵⁵ For such reasons, the admissibility of distributive (and related) preferences to social choice calculi is a principled and common, if not entirely unanimous, supposition of welfare economics.⁵⁶

B. Mechanisms of Inequality-Generating Market Failure

In this Part II.B, which lies at the heart of this Article, I show that if egalitarian distributive preferences against (at least) dramatic high-end inequality are fairly widespread, then certain economic inequalities produced by market transactions will be traceable to mechanisms responsible for classic market failures. In particular, these inequalities may be attributable to: (i) imperfect information, (ii) non-excludability, and (iii) negative externalities.⁵⁷ Each of these mechanisms is examined in turn.

in the United States are too large. They also favor doing something about. Majorities of Republicans (52 percent) and of the affluent (51 percent) favor more evenly distributing money and wealth. *Id.* at 43-44

Nor are such results confined to recent memory. Au contraire, “about six out of ten Americans have consistently favored having money and wealth ‘more evenly distributed’ and have rejected the proposition that it was already fairly distributed. This remarkable finding comes from eleven surveys conducted between 1984 and 2007.” *Id.* at 41. While Page and Jacob’s 2007 survey detected a “twenty year high point in support for a more even distribution of money and wealth” (*Id.*), this is plausibly explained by the fact that inequality has also been steadily on the rise in recent decades, reaching unrivaled elephantine proportions as of the time of this Article.

For additional research corroborating the prevalence of (at least moderately) egalitarian distributive preferences, see also Michael I. Norton & Dan Ariely, *Building a Better America—One Wealth Quintile at a Time*, 6(1) PERSPECTIVES ON PSYCHOLOGICAL SCIENCE 9, 10-11 (2011) (“All groups—even the wealthiest respondents—desired a more equal distribution of wealth than what they estimated the current United States level to be . . . all groups agreed that such redistribution should take the form of moving wealth from the top quintile to the bottom three quintiles.”)

⁵⁴ E.g., Arrow’s Impossibility Theorem, Coase’s Theorem, etc.

⁵⁵ Kaplow and Shavell stress similar points regarding their related concept of “tastes for notions of fairness.” KAPLOW & SHAVELL, *supra* note 36, at 21, 78, 431.

⁵⁶ See *id.*; JOHANSSON, *supra* note 34, at 4, 100.

⁵⁷ See *infra* at Part I for discussion.

i. Market Failure 1: Imperfect Information

My first argument is that given fairly widespread moderately egalitarian distributive preferences, imperfect information in the operation of markets will systematically produce economic inequality. This argument builds on the political philosopher G.A. Cohen's critique of Robert Nozick's libertarian account of justice. According to Nozick's '*entitlement theory*,'⁵⁸ given an initial state of affairs in which all individuals enjoy legitimate claims to their property holdings, voluntary economic transactions will necessarily be justice-preserving. Because the baseline is assumed to be just *ex hypothesi*, and all individuals enjoy rights to exchange their legitimately owned property and personal labor, the outcome will perforce be just.

In rejoinder, Cohen observes that "a just situation could be transformed into an unjust one because of the way a mass of uncoordinated transactions" *unforeseeably combines*.⁵⁹ From at least the time of Adam Smith, it has been recognized that markets can "lead to aggregate results that the individual neither intends," nor is even "aware of, results that sometimes have no recognizable counterpart at the level of the individual."⁶⁰ These collective consequences sometimes prove fortuitous, as with the spontaneous emergence of a market order that facilitates the coordination of individual plans and expectations.⁶¹ In other cases, however, an unforeseen outcome may prove odious, such that its unwitting architects rue their inadvertent contributions.⁶²

In the latter circumstances, says Cohen, ostensibly voluntary transactions may not actually be justice-preserving. That is because these transactions may fail a test of fully informed consent:

[O]f each person who agrees to a transaction we may ask: *would he have agreed to it had he known* what its outcome would be? Since the answer may be negative, it is far from evident that transactional justice, as described, transmits justice to its results.⁶³

While Cohen's response to Nozick's rights-based libertarianism is framed in terms of fully informed (hypothetical) consent, the basic idea can readily be adapted to the framework of welfare economics and its accompanying market failure paradigm. We have been assuming that many individuals harbor distributive preferences against (at least) high-end inequality. When they participate in transactions that inadvertently contribute to the production or exacerbation of high-end inequality, their distributive preferences will be frustrated. Depending on the intensity of those preferences, and upon the availability of alternative transactions that do not contribute (as much) to high-end inequality, it will sometimes be the case that the market participants would have forgone their actual dealings in favor of such alternative transactions.⁶⁴ By the principle of revealed

⁵⁸ ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 150-51 (1974).

⁵⁹ G.A. COHEN, SELF-OWNERSHIP, FREEDOM, AND EQUALITY 34 (1995).

⁶⁰ THOMAS SCHELLING, MICROMOTIVES AND MACROBEHAVIORS 140 (1978).

⁶¹ See generally F.A. HAYEK, INDIVIDUALISM AND ECONOMIC ORDER (1948).

⁶² For instance, the Nobel laureate economist Thomas Schelling famously demonstrated that morally noxious patterns of neighborhood segregation can emerge from individuals acting on a "moderate urge to avoid small-minority status" in the area of their residence. SCHELLING, *supra* note 60, at 154. These decisions can even cause a "nearly integrated [housing] pattern to unravel, and highly segregated neighborhoods to form." *Id.*

⁶³ COHEN, *supra* note 59, at 23, 50 [emphasis mine].

⁶⁴ In correspondence, Lawrence Zelenak objects that many individuals are aware that their consumption choices accrue to the benefit of prominent billionaires, such as Elon Musk, Jeff Bezos, and Mark Zuckerberg, but follow through with these transactions anyway. This undermines my contention that in other cases, where the ultimate distributive consequences of one's commercial dealings are not as predictable, individuals would avoid transactions

preference,⁶⁵ participation in these alternative transactions would have been a *more efficient* outcome, as such dealings would have produced a greater economic surplus as measured by the satisfaction of preferences.

The cause of this inefficiency, as Cohen's remarks imply, is *imperfect information*—a classic source of market failure. Recall that one of the necessary conditions of perfect competition is that *all* market participants know the prices for *all* commodities exchanged on the market, as well as the *utilities* that each would derive from each such commodity. With recourse to one further conceptual tool, we can demonstrate that this perfect information condition will routinely be violated in the circumstances contemplated by Cohen.

The basic idea is that every commodity market is also a market for distributive influence. Whenever A agrees to pay \$x to B for a widget, A receives not just a widget in consideration for his \$x: in addition, A *also* receives the opportunity to causally contribute to a particular distributive outcome. For instance, A's payment of \$x to B may contribute to making B far richer than any of B's compatriots. Or it may have the opposite effect and contribute to a levelling of the playing field by raising B up to an income commensurate with his peers. In either event, a *part of what A receives* for his \$x is the opportunity to contribute to a distributive outcome—in particular, the one that ultimately eventuates.

Let us refer to these as '*shadow markets*' for *distributive influence*. Every garden variety commodity market *doubles as* (or is *affixed to*) a market for influence over distributive outcomes: that is the commodity market's shadow market. To my knowledge, economists have not hitherto

that exacerbate high-end inequality if they became aware of these distributive ramifications. In response, I emphasize three points.

First, I do not claim that individuals would *never* engage in transactions that exacerbate high-end inequality if they had knowledge of those outcomes. Rather, I advance the more modest thesis that given widespread moderately egalitarian distributive preferences and perfect information about ultimate distributive outcomes, economic actors would opt for alternate transactions that do not contribute (as much) to high-end inequality in at least a significant number of cases. Accordingly, some substantial portion of high-end wealth will be attributable to market failures stemming from imperfect information.

Second, even if this more modest claim were false for a given society, it would surely be vindicated somewhere where egalitarian distributive preferences are more prevalent or intense. This conditional demonstration holds independent theoretical value, apart from its applicability to any particular population.

Third and most importantly, one may question the interpretive import of the observational data cited by Zelenak. While individuals seem to assent to benefitting the aforementioned moguls, these appearances may be deceiving. Due to *collective action problems* of the type described infra in Part II.B.ii, it could be that consumers are incapable of coordinating their purchases to achieve mutually favored egalitarian outcomes through alternate transactions. If this coordination were possible, they might opt for these alternatives in favor of their actually chosen transactions. In other words, even when people know that their commercial dealings will benefit the ultra-wealthy, they may be powerless to coordinate on preferable alternatives.

Due to the prevalence of collective action problems, the consumer behavior adduced by Zelenak may not reveal actual preferences or assent—the latter cannot be confidently inferred from the former. Furthermore, because coordination failures provide a satisfying explanation for why some individuals express concern about inequality in empirical studies while continuing to engage in transactions that they know will benefit the ultra-wealthy, this skeptical conjecture is buoyed by its explanatory power. This discussion also illustrates how the imperfect information and non-excludability arguments developed in this Part II work together synergistically in certain circumstances.

⁶⁵ The *principle of revealed preference* seeks to reverse engineer an individual's preferences from her pattern of consumption choices. Thus when an individual chooses option X over option Y, a preference for X over Y is revealed (at least in the absence of confounding market imperfections of the sort described in the prior note). In its metaphysically strong (behaviorist) version, preferences are even identified with such choices. See e.g., JULIAN REISS, PHILOSOPHY OF ECONOMICS: A CONTEMPORARY INTRODUCTION 33 (2013).

appreciated that distributive effects are not mere byproducts of primary market activity, but rather are one of the commodities embedded in and effectively traded in every transaction. These shadow markets operate in parallel with primary markets, giving rise to their own dynamics.

With this tool in hand, we can now establish the routine failure of the perfect information condition. Because every commodity market doubles as (or is affixed to) a shadow market for distributive influence, it follows from the perfect information condition that, for perfect competition to prevail, all market participants must know the utilities that each would derive from his own contribution to the ultimate distributive outcome. That's because this distributive influence is one of the commodities effectively being traded, and perfect information requires that market participants know the utilities of *all* commodities subject to exchange.

In turn, knowledge of the utility that one would derive from one's own contribution requires foreknowledge of the eventual distributive outcome, as well as of counterfactual alternatives. Therefore, if such knowledge is *not* available, then the perfect information condition will go unfulfilled. Consequently, whenever all market participants lack foreknowledge of ultimate distributive outcomes, the situation is ripe for market failure. Because this is the standard epistemic predicament of market actors, inequality-generating market failures of this sort are ubiquitous.⁶⁶

What is the explanation for economic agents' general inability to deduce the combinatorial effects of their interactions? In prior work, I have argued that very precise economic (and social

⁶⁶ In conversation, Leslie Francis objects that because parties to an agreement never have perfect foreknowledge of subsequent events, my imperfect information argument may prove too much. For it implies that no contract should ever be binding. In response, I offer two lines of reply.

First, my thesis is not that a contract should be *legally unenforceable* whenever its parties lack comprehensive foresight into the future. Rather, it is that some such agreements will eventuate in inefficient (and inequalitarian) outcomes, and that corrective ex post *redistributive transfers* would therefore be justified on efficiency grounds. Such transactions will be inefficient whenever (i) one or more parties to an agreement are ignorant of certain (future) events E, such as the distributive consequences of their commercial dealings, and (ii) antecedent knowledge of E would have led them to forgo their actual arrangement in favor of alternatives. (If one or more parties are ignorant of E but knowledge of E would not have impacted their decision to enter into the agreement, then the transaction is not inefficient.)

Second, while I do not advance the stronger thesis that these agreements should be legally unenforceable, a plausible case could nevertheless be marshaled for this more extreme view. Indeed, black letter contract law already recognizes defenses based on considerations of this sort. For instance, when one or more parties to a contract are mistaken as to a basic assumption on which the agreement is predicated, the contract will not be enforceable in some circumstances. See RESTATEMENT (SECOND) OF CONTRACTS §§ 152-153 (1981). Similarly, if unforeseen future events conspire to frustrate the fundamental purpose of a transaction, or to render performance impracticable, some courts will not enforce the agreement. See RESTATEMENT (SECOND) OF CONTRACTS §§ 261, 265 (1981).

These defenses rest on a sound economic foundation, since at least one of the central functions of contract law is to facilitate exchanges that produce Pareto improvements. In cases covered by the aforementioned defenses of mistake and changed circumstances, Pareto improvements are not assured. (Indeed, many other defenses to contract enforcement similarly involve circumstances where apparent mutual assent to a bargain does not guarantee that each party will in fact be made better off: e.g., fraud, duress, unconscionability, lack of capacity, intoxication, etc.)

According to contract law doctrine, the defenses of mistake and changed circumstances must implicate a basic assumption or fundamental aspect of the bargain itself. However, the logic of Pareto efficiency does not dictate that their boundaries be artificially circumscribed in this manner. Whenever (i) one or more of the parties to an agreement are ignorant of certain events E and (ii) knowledge of E would have led them to forgo the transaction, the very same economic considerations that undergird these defense will apply. Nevertheless, additional countervailing considerations, such as concern for contractual certainty and stability, may pull in the opposite direction and militate in favor of enforcement. For such reasons, this Article confines itself to the more modest thesis stated above, pertaining to ex post redistributive transfers, rather than advancing the stronger thesis, pertaining to legal unenforceability.

scientific) prediction is typically not feasible for an array of principled reasons,⁶⁷ and I would encourage the reader to consult that in-depth discussion. In addition to these obstacles, however, two further factors⁶⁸ explain why private economic actors embedded in a market economy, in particular, can seldom foresee the distributive ramifications of the complex of transactions in which they participate. These further epistemic impediments are the (i) dispersion of local knowledge and (ii) impersonality of the market.

While these themes have been expounded upon by leading laissez-faire economists, their implications for market failure emanating from imperfect information have largely gone unexplored. In the following two sections, I draw on these discussions to shed further light on the aforementioned epistemic plight of market actors, thereby bolstering our economic reconstruction and elaboration of Cohen's argument. Perhaps to the surprise of their expositors, these epistemic constraints support, rather than rule out, certain forms of redistribution.

Dispersion of Local Knowledge

The first such factor is the *dispersion of local knowledge*. In his seminal article, *The Use of Knowledge in Society*,⁶⁹ Friedrich Hayek observed that if an economic agent possessed complete information about the present allocation of resources, property rights, prices, preferences, and all other pertinent causal relations, then economic decision making would be a purely deductive exercise. However, this epistemically idealized environment is a far cry from the reality we inhabit. In the actual world, "data from which the economic calculus starts are never . . . given to a single mind which could work out the implications, and can never be so given."⁷⁰ Rather, individuals necessarily possess "dispersed bits of incomplete and frequently contradictory knowledge"⁷¹ concerning "*particular circumstances of time and place*."⁷²

Market actors acquire such '*local knowledge*,' as I will refer to it, in virtue of their unique spatiotemporal locations and orientations within the network of economic (and other pertinent causal) relations. This knowledge of "people, of local conditions, and of special circumstances"⁷³ provides an individual with some advantage in the marketplace over others who lack this local knowledge—although, of course, this advantage may be offset by other market participants' own unique local knowledge.

⁶⁷ Erick J. Sam, *Distribution Through Taxation Versus Legal Rules, and the Epistemic Limits of Law and Economics*, 2024 UTAH L. REV. 1047 (2024). These epistemic obstacles include the: (i) false assumptions of rational choice theory, certain economic models, and standard econometric methods; (ii) unobservability of mental states, such as expectations and preferences, that serve as inputs to economic theories/models; (iii) economic domain's lack of causal closure; (iv) existence of multiple equilibria or optima in many economic systems; (v) indeterminacy in the optimality conditions for evidence gathering; (vi) potential existence of libertarian free will; (vii) reflexivity of economic and social scientific theories; (viii) logical impossibility of predicting technological development and intellectual novelty; (ix) inherent unpredictability and pervasive impact of 'black swan' events; (x) chaotic nature of many economic systems, meaning that small variations in their boundary conditions are amplified into large differences in observable outcomes. For discussion and references, see *id.* at 1089-1092, 1109-1129.

⁶⁸ Which I had neglected to discuss in that prior work.

⁶⁹ F.A. HAYEK, *The Use of Knowledge in Society*, 33 AM. ECON. REV. 519 (1945), reprinted in INDIVIDUALISM AND ECONOMIC ORDER, *supra* note 61, at 77-91.

⁷⁰ *Id.* at 77.

⁷¹ *Id.*

⁷² *Id.* at 80. For a book-length elaboration of Hayek's central idea, see THOMAS SOWELL, KNOWLEDGE AND DECISIONS (1980).

⁷³ HAYEK, *supra* note 69, at 80.

By trading on local knowledge, information about matters far and wide is progressively incorporated into market prices. While any particular individual may not—indeed, could not—be aware of all information embodied in a commodity’s price, he can nevertheless rely on prices to plan his own economic affairs. In this way, prices function as *informational signals*,⁷⁴ which facilitate coordination among market actors with distinct ends and local knowledge.⁷⁵

Despite the gifts of the market, its *dynamic nature*⁷⁶—that is, the fact that it is a discrete process taking place in time, which never integrates *all* relevant information into the price signal at a single moment—ensures that market outcomes can never be forecast with precision. While such prediction would be possible in a world of perfect information, in which economic consequences are logically deduced from the conjunction of boundary conditions and relevant laws, the fact of dispersed local knowledge ensures that no actual individual (or government entity, Hayek would so contend) can do so.

Hayek’s primary policy conclusion is that *centrally planned economies* are epistemically infeasible, and that decentralized markets are required for the socially efficient aggregation and utilization of local knowledge.⁷⁷ For the most part, welfare economists and political theorists⁷⁸ have conceded the force of Hayek’s critique of central planning.⁷⁹ Nevertheless, many dispute the argument’s decisiveness with respect to a *mixed economy*, understood as the union of decentralized markets and redistributive taxes (or other measures) aimed at modifying the first-order distributive results of market processes.⁸⁰

The idea is to rely on (i) decentralized markets to aggregate local knowledge into the price signal, thereby facilitating individual planning, coordination, and directing capital to its efficient usages; while using (ii) taxation (or other redistributive measures) to increase distributive fairness *ex post*. Although these measures result in some distortion in the use of local knowledge, and thereby pose efficiency costs, these costs are far less significant than those incurred by centralized economic planning. If such measures significantly improve the fairness of outcomes, then bearing these efficiency costs can be justified by distributionally sensitive cost-benefit or social welfare analysis. That is, they may reflect a favorable efficiency-equity tradeoff.⁸¹

⁷⁴ *Id.* at 86-87

⁷⁵ *Id.* at 85. See also F.A. HAYEK, *Economics and Knowledge*, ECONOMICA (1937), reprinted in INDIVIDUALISM AND ECONOMIC ORDER, *supra* note 61, at 33-56 (arguing that plan coordination constitutes an appropriate equilibrium concept for dynamic market processes).

⁷⁶ See F.A. HAYEK, *The Meaning of Competition*, reprinted in INDIVIDUALISM AND ECONOMIC ORDER, *supra* note 61, at 92-106; GERALD P. O’ DRISCOLL, JR. & MARIO J. RIZZO, *AUSTRIAN ECONOMICS RE-EXAMINED: THE ECONOMICS OF TIME AND IGNORANCE* 105-118 (2015 ed.).

⁷⁷ HAYEK, *supra* note 69, at 84. As Thomas Sowell frames the matter in *KNOWLEDGE AND DECISIONS*, force distorts knowledge. See SOWELL, *supra* note 72, at 167, 213-223. Hayek employs his theory of dispersed local knowledge to wage a full scale assault on centrally planned economies in *Socialist Calculation: Parts I, II and III*, reprinted in INDIVIDUALISM AND ECONOMIC ORDER, *supra* note 61, at 119-208.

⁷⁸ See G.A. COHEN, *WHY NOT SOCIALISM?* 60 (2009); PHILLIPE VAN PARIJS, *REAL FREEDOM FOR ALL: WHAT IF ANYTHING CAN JUSTIFY CAPITALISM?* 192 (1995).

⁷⁹ Nevertheless, there have been several prominent holdouts. See Abba P. Lerner, *Economic Theory and Socialist Economy*, 2 REV. ECON. STUD. 51 (1934); FRED TAYLOR & OSKAR LANGE, *ON THE ECONOMIC THEORY OF SOCIALISM* (1938).

⁸⁰ For a brief survey of such schemes, see COHEN, *WHY NOT SOCIALISM?*, *supra* note 78, at 63-79. Two carefully developed accounts are due to JOSEPH CARENS, *EQUALITY, MORAL INCENTIVES, AND THE MARKET: AN ESSAY IN UTOPIAN POLITICO-ECONOMIC THEORY* (1981); JOHN E. ROEMER, *A FUTURE FOR SOCIALISM* (1994).

⁸¹ Hayek himself considers this possibility and is unable to reject it for methodological reasons. Because he rejects the conceptual coherence of aggregating individual utilities into social welfare, he is unable to determine whether this

Let us return now to the topic of IGMFs stemming from imperfect information. Not only is Hayek's local knowledge argument indecisive against the mixed economy model of politico-economic organization—it actually *lends support* to the type of redistributive measures defended by this Article. That is because the dispersion of local knowledge⁸² ensures that predicting the distributive consequences of an agglomerate of market transactions will normally be infeasible. Per our economic reconstruction of Cohen's argument, this means that distributive preferences will routinely be frustrated, thereby leading to inefficiently inequalitarian outcomes. Indeed, the more dispersed and fragmented local knowledge is, the less able economic actors are to foresee the combinatorial impact of their market transactions, and to act on so as to satisfy their distributive preferences.

Hayekians therefore find themselves in the following uncomfortable position: the greater the empirical verisimilitude of their theory, the more robust the support it lends for our Cohenian argument for market-failure-correcting redistributive measures. So long as the costs of redistributing wealth⁸³ are less than the gains derived from the increased satisfaction of distributive preferences, redistribution to rectify inequalities attributable to imperfect information will constitute an unambiguous improvement from the standpoint of economic efficiency.

Impersonality of the Market

A second factor that sheds light on market actors' frequent inability to foresee the distributive consequences of their interactions is the *impersonality of the market*. This idea is explicated by Milton Friedman in his classic monograph, *Capitalism and Freedom*. There Friedman extols the market's opacity as a source of security for dissidents who might otherwise be subject to persecution at the hands of an intolerant majority. Acting on prejudice is far more difficult in the market realm, since

... [n]o one who buys bread knows whether the wheat from which it is made was grown by a Communist or a Republican, by a constitutionalist or a Fascist . . . This illustrates how an impersonal market separates economic activities from political views and protects men from being discriminated against in their economic activities for reasons that are irrelevant to their productivity—whether these reasons are associated with their views or their color.⁸⁴

While an astute observation, Friedman remains blind to the dark side of the market's impersonality. The other half of the picture is filled in by the reputed socialist economist John Roemer, who characterizes the opaqueness of many market transactions as an obstacle to the identification of the capitalist class.⁸⁵ In a capitalist system, “firms are owned, not by their managers, but by stockholders who are quite *invisible* to the worker . . . although many people own some stock, they are not capitalists,”⁸⁶ who are traditionally defined as persons wealthy enough to subsist without the sale of their own labor. Rather, “the big stockholders are often

is a justified trade off—the states of affairs are strictly commensurable. See HAYEK, *INDIVIDUALISM AND THE ECONOMIC ORDER*, *supra* note 61, at 146–47.

⁸² And necessarily, the incomplete integration of this information into the price signal, owing to the dynamic nature of the process.

⁸³ These costs are posed by diminished work incentives and distortions in the use of knowledge.

⁸⁴ MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 26–27 (1962).

⁸⁵ JOHN E. ROEMER, *FREE TO LOSE: AN INTRODUCTION TO MARXIST ECONOMIC PHILOSOPHY* 34 (1988).

⁸⁶ *Id.*

financial institutions, and . . . the [ultimate] identity of capitalists is difficult to trace.”⁸⁷ Roemer decries this anonymity as a noxious shroud that obfuscates the true nature of economic relations.⁸⁸ In particular, it obscures the fact that members of the capitalist class are frequently able to derive excess returns by exploiting workers,⁸⁹ who can only endure by selling their labor on inequitable terms.

The important point, for our purposes, is that the market’s impersonality functions as a further impediment to portending the cumulative effect of commercial transactions on (in)equality. To foresee this impact, the ultimate recipients of the profits of an agglomeration of transactions, and these recipients’ economic attributes, would have to be identifiable. But as Friedman and Roemer observe, this is frequently infeasible: the market is often a black box, which cannot be pierced by even the most penetrating of glances. This is particularly true of large liquid markets that otherwise satisfy the criteria of perfect competition: the larger the number of buyers and sellers, and the greater the layers of the supply chain and financial intermediaries, the more difficult tracing and identification become.

In turn, this opacity gives rise to several types of *asymmetric information*, which compromise the ability of economic agents to act on their distributive preferences. If A transacts with B . . . Z, but the latter are unaware of (i) A’s very identity, (ii) A’s present wealth, (iii) A’s profits from the exchanges, (iv) the fact that the remainder of B . . . Z are also contracting with A, among other pertinent economic attributes, then B . . . Z will be unable to deduce the sum effects of their exchanges on A’s holdings, as well as upon the overall wealth distribution. These are each bits of knowledge that *A possesses but which B . . . Z lack*, and which bear on one of the commodities effectively being traded: influence on distributive outcomes.⁹⁰ Without symmetric knowledge of these matters, the ultimate impact of one’s dealings on economic (in)equality cannot be reliably envisaged. To determine whether paying \$x to A for some commodity will improve or exacerbate preexisting inequality, B . . . Z must know each of the aforementioned facts. But they frequently do not; and indeed they cannot.

As a species of imperfect information, asymmetric information is a classic source of market failure.⁹¹ Due to the impersonality of the market, it can (along with the dispersion of local knowledge) lead to the frustration of egalitarian distributive preferences and with it inefficient inequality.

ii. Market Failure 2: Non-Excludability

Our prior *Cohenian argument* demonstrated that inefficient inequalities can derive from imperfect information. Because people frequently cannot predict the combinatorial effects of their market

⁸⁷ *Id.*

⁸⁸ For Roemer, the impersonality of the market derives from the characteristic division of labor under capitalism: viz., the bifurcation of the citizenry into those who contribute capital and those who contribute labor to industrial processes. In an alternative system of worker cooperatives, in which firms were managed and owned by the very same individuals, the recipients of a firm’s profits would be readily identifiable, and the nature of economic relations more transparent.

⁸⁹ Somewhat more precisely, this division of labor makes it difficult for workers to identify capitalists’ appropriation of the workers’ *surplus labor value*, which is equal to the difference between (i) the amount of labor expended on the job and (ii) the amount of labor that is socially necessary to produce those goods that the workers are able to purchase with their wages. *Id.* at 34, 39. This concept is originally due to KARL MARX, CAPITAL, VOLUME I (1867).

⁹⁰ See discussion of shadow markets for distributive influence *supra* at Part II.B.i.

⁹¹ See George Akerlof, *The Market for ‘Lemons’*, 84 Q. J. ECON. 488 (1970).

exchanges, and therefore whether such outcomes will frustrate their distributive preferences, they enter into certain arrangements that they otherwise would have avoided. Let us now consider a second market failure mechanism that systematically produces inequality whenever moderately egalitarian distributive preferences are fairly prevalent. This second argument highlights a failure of *excludability*,⁹² which refers to the ability of market participants to prevent others from deriving benefits from one's property. As discussed in Part I, excludability is another necessary condition of perfect competition.

Non-excludability frequently begets *collective action problems*: that is, failure of a group's members to coordinate their behavior to act in the group's collective interest. In turn, collective action problems can stymie the private provision of *public goods*, which are defined as goods that are (at least partially) *non-excludable*, in the aforementioned sense, as well as (at least partially) *non-rivalrous*, meaning that one person's enjoyment of the good's benefits does not compromise another person's enjoyment.⁹³

To illustrate the basic predicament, imagine that people comprising a group are deciding whether to contribute to financing some public good—say, a national defense force. Each individual realizes that if the good is ultimately provided, then any member of the group can enjoy it, regardless of whether that person has financially contributed to its provision or not. Therefore, each individual—to the extent that they are rational and self-interested—has an incentive to *free ride*: to consume the good without paying his fair share. Because all (or at least a large proportion of) the group's members reason this way, an insufficient number of individuals end up contributing to the good's provision. As a consequence, the good is not provided, or at least not at its socially optimal level.

This is the essence of a collective action problem: while it is in the group's collective interest to cooperate to provide the public good, it is in each individual's self-interest to forgo paying for it while still reaping its benefits. Accordingly, collective rationality is foiled by individual rationality.⁹⁴ Due to both their ubiquity and noxiousness, the political theorist Russell Hardin has colorfully referred to collective action problems as the “back” of Smith's invisible hand of the market.⁹⁵

To escape this dilemma, so the standard argument goes, the state must coerce people to pay their fair share of the cost of public goods from which they derive benefit.⁹⁶ Otherwise, the group will end up in a situation where these critical goods are not provided. This is the *fiscal function* of taxation—to compel contribution to the provision of socially necessary public goods. In this way, (almost) everyone is made better off: (at least nearly) all individuals are better off in a society with

⁹² More technically, this would be non-excludability of consumption; market failures can also result from non-excludability in production. See BOADWAY & BRUCE, *supra* note 2, at 112-13.

⁹³ E.g., MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 14-15, 14 n. 21 (1965); ROSEN & GAYER, *supra* note 2, at 54. Private and public goods fall along a continuum, and can be classified by the extent to which they possess these characteristics. Although public goods are generally defined as commodities that exhibit some degree of both non-excludability and non-rivalry, the types of free rider and collective action problems discussed below also arise for “*common pool resources*,” which are non-excludable but rivalrous. See generally ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION (1990). Thus, it is non-excludability that is the primary culprit for this variety of market failure.

⁹⁴ E.g., OLSON, *supra* note 93, at 2; NEIL S. SIEGEL, THE COLLECTIVE-ACTION CONSTITUTION 60 (2024).

⁹⁵ RUSSELL HARDIN, COLLECTIVE ACTION 6 (1982).

⁹⁶ OLSON, *supra* note 93, at 13-14.

national defense, police, courts, and public infrastructure such as roads, than in a state of nature scenario where these goods and services are absent.⁹⁷

The kernel of this predicament was intuited by classical visionaries of political theory such as Smith, Hume, and Mill, leading them to hold that the provision of public goods is a legitimate function of government. Jumping ahead a century or two, the theory of public goods received its first modern formulation at the hands of Paul Samuelson, the father of mathematical economics.⁹⁸ Shortly thereafter, it was accorded its seminal treatment by Mancur Olson in *The Logic of Collective Action*,⁹⁹ which I adopt as my analytic starting point.

Olson's Logic of Collective Action

In that work, Olson's central finding is that *small groups* are more likely to overcome collective action problems than larger groups, for several reasons.¹⁰⁰

First, a public good can successfully be provided if any single member of the group derives sufficiently great benefit that it would be worthwhile for that individual to pay the entire cost himself. In that case, even if the rest of the group's members were to free ride, it would still be in such an individual's interest to fully finance the good's provision. Groups for which this is the case are called "*privileged*"¹⁰¹ in Olson's lexicon. Privileged status is more likely to obtain for small groups since the benefits from public goods are less diffuse than in larger groups.¹⁰² The opportunities for free riding are also greater in larger groups with a more sizeable number of potential contributors.¹⁰³

Second, even if a group is not privileged, if it is small enough, it may still be feasible for its members to *monitor* each other for free riding.¹⁰⁴ Monitoring for defection becomes exponentially more difficult and costly as a group grows in size.¹⁰⁵ Therefore, a non-privileged but sufficiently tight knit group may still be able to circumvent problems of collective action.

Third, the larger the group, the more substantial the *organization costs* of developing institutional mechanisms aimed at overcoming collective action problems,¹⁰⁶ such as the use of "*selective incentives*."¹⁰⁷ Unlike public goods, whose benefits are non-excludable and therefore give rise to free rider problems, selective incentives constitute excludable private benefits (or

⁹⁷ This is an instance of what I refer to in prior work as an 'invisible hand' Pareto argument. Sam, *supra* note 67, at 1080-84 (2024).

⁹⁸ Samuelson, *supra* note 3.

⁹⁹ OLSON, *supra* note 93.

¹⁰⁰ *Id.* at 33-36, 48.

¹⁰¹ If C are the costs of provision, V_i are gross benefits, and A_i are net benefits, then $A_i = V_i - C$. The group is then privileged if $A_i > 0$ for some member i , and will likely succeed. Conversely, if $A_i < 0$ for all members i , then the group is "*latent*," and will fail to provide good unless some other success condition obtains. This simplified algebraic formulation is due to HARDIN, *supra* note 95, at 20.

¹⁰² OLSON, *supra* note 93, at 34.

¹⁰³ *Id.* at 35

¹⁰⁴ The Nobel laureate Elinor Ostrom observes that monitoring is itself a public good: because it helps to solve a collective action problem, non-excludable benefits accrue to the group at large. For this reason, the provision of monitoring gives rise to a *second-order collective action problem*. Therefore, Ostrom argues that a monitoring strategy will generally only be feasible when monitoring is incidental to consumption of the first-order public good: e.g., fishing in the common waters. OSTROM, *supra* note 93, at 45.

¹⁰⁵ See OLSON, *supra* note 93, at 45, 45 n.67.

¹⁰⁶ *Id.* at 48.

¹⁰⁷ *Id.* at 51, 60-64.

sanctions) directed at particular members of a group to induce those individuals to cooperate.¹⁰⁸ These targeted incentives¹⁰⁹ may be either economic in nature (e.g., union benefits)¹¹⁰ or social (e.g., tribal exclusion).¹¹¹

Olson's theory has vital implications for public policy and has played an integral role in the development of *public choice economics*, which employs economic methods to study political governance. His most important insights for our purposes surface at the tail end of his treatise. In its final pages, Olson observes that certain unorganized collectives that "have no lobbies and exert no pressure, are among the largest groups in the nation, and . . . have some of the most vital common interests."¹¹² These groups "fit the main argument of this book best of all," as they are the most susceptible to the ruthless and unrelenting logic of collective action.¹¹³ Among such sprawling, disjoint, and vulnerable collectives are the "*taxpayers* . . . a vast group with an obvious common interest, but [who] in an important sense . . . have yet to obtain representation."¹¹⁴ By a similar token, "*consumers* are at least as numerous as any other group in society, but they have no organization to countervail the power of an organized or monopolistic producer."¹¹⁵ Consequently, producers are frequently able to exploit consumers and capture a greater portion of the social surplus from their transactions.

Generalizing, Olson concludes that a "rational individual in [a] large [unorganized] group in a socio-political context will not be willing to make any sacrifice to achieve the objectives he shares with others."¹¹⁶ For instance, a rational actor in the "economic system does not curtail his spending to prevent inflation . . . because he knows, first that his own efforts would not have a noticeable effect, and second, that he would get the benefits of any price stability that others achieved in any case."¹¹⁷

Collective Action and Economic Inequality

On my reading, Olson seems primarily concerned with the inability of large, disorganized groups to advance their mutual interests through coordinated participation in the political system. However, his reasoning is readily translated to the realm of market transactions. Employing Olson's logic, we can show that some quantum of economic inequality created by market exchanges is due to collective action problems of the very same sort. Ensuing inequalitarian outcomes will therefore be inefficient and succumb to the process-based criterion for market failure.

¹⁰⁸ *Id.* Of course, the ability to condition such benefits or sanctions on cooperation depends on the group's ability to monitor for defection.

¹⁰⁹ *Id.* at 60-64.

¹¹⁰ *Id.* at 72.

¹¹¹ *Id.* at 60.

¹¹² *Id.* at 165.

¹¹³ *Id.*

¹¹⁴ *Id.* at 165-166. Due to their smaller size, which permit for effective organization and lobbying efforts, special interest groups are frequently able to win "tax loopholes, favorable tariffs, special tax rulings, general regulatory policies, and the like." *Id.* at 148. Nevertheless, Olson concedes that the "business community as a whole," perhaps due to its greater size, "has been unsuccessful in its attempts to stop the trend toward social-welfare legislation and progressive taxation." *Id.*

¹¹⁵ *Id.* at 166.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

As before, let us presume that a non-trivial proportion of individuals harbor distributive preferences against (at least) severe high-end inequality. Let us further define ‘*transaction-specific surplus*’ as consumer or seller surplus¹¹⁸ that a market participant realizes from a transaction, without regard to the (dis)satisfaction he derives from the distributive outcome produced by an agglomeration of related exchanges (for instance, exchanges between a multitude of buyers and a common seller).

With these pieces in place, our second *Olsonian argument* runs as follows. Even if I were able to predict the cumulative effects of an aggregate of transactions, I lack assurance that others with similarly egalitarian distributive preferences would ‘cooperate’ and forego exchanges that combine to produce a mutually disfavored distributive outcome. Why? Because each such individual may reason as follows.

In a large economy, my own impact on the ultimate distribution of wealth or welfare is quite small. Therefore, if I ‘defect’ and partake in just those dealings that maximize my own transaction-specific surplus, I can still enjoy the benefits of an egalitarian distribution of wealth insofar as others ‘cooperate’ and opt for exchanges that provide them with a smaller transaction-specific surplus but which yield a more favorable distributive outcome. Conversely, if others defect and seek to maximize their own transaction-specific surplus, then I do best to defect as well in order to avoid my own exploitation.

Since all (or at least most) parties are self-interested¹¹⁹ and rational, they reason the same way. As a consequence, all (or at least most) parties partake in just those exchanges that maximize their own transaction-specific surplus. As the group of market actors involved is very large and amorphous, it certainly does not constitute a privileged group able to transcend this collective action problem. While the group would jointly prefer an alternate outcome, where each person sacrifices some transaction-specific surplus for a more egalitarian distribution of wealth, individual rationality blocks this collectively favored result.

Because this predicament may arise even given perfect information about how various transactions would combine to produce a certain distributive outcome, and about the utilities one would garner from these outcomes, imperfect information is not the ultimate source of market failure in these cases.¹²⁰ Rather, this market imperfection reflects a *failure of excludability*: if A has financed the provision of an egalitarian outcome O by forgoing some transaction-specific surplus, A has no way of excluding others who have not similarly contributed to O from obtaining the benefits that flow from O.

To concretize this reasoning, let us consider a stylized example. Imagine that you are the denizen of a small city—say Scranton, Pennsylvania. You are deliberating about whether to purchase a copy of Franz Kafka’s *Metamorphosis* from a small local bookstore, Dunder Mifflin Books, or from Amazon. Amazon offers a better price than the local vendor: \$10 rather than \$15. But you and a majority of Scranton residents prefer the proliferation of your local book shops to the concentration of industry and profits in the hands of Mr. Bezos.

¹¹⁸ In economic theory, *consumer surplus* is defined as the difference between (i) the highest price that a consumer would be willing to pay for some commodity, and (ii) the actual sales price. Conversely, *seller surplus* is equal to the difference between (i) the actual sales price, and (ii) the lowest price at which the seller would be willing to sell.

¹¹⁹ Here, I am using self-interest in the broad sense that one seeks the fulfillment of all of one’s preferences, including distributive preferences held for self-regarding, altruistic, or impartial fairness-based reasons.

¹²⁰ Although, as discussed *supra* at note 64, the arguments from imperfect information and non-excludability can work together in some circumstances.

Now if you knew that a sufficient number of your neighbors would spring for \$15 to sustain the local vendor, then you too would purchase from Dunder Mifflin Books. But unfortunately you lack such assurances. If your fellow Scrantonians all purchase from Amazon, then it is likely that Dunder Mifflin will go out of business anyway. After all, you are but a single patron, unable to sustain the venerable local institution through your own modest purchases. Conversely, if your fellow Scrantonians all pay \$5 more to support Dunder Mifflin, then your own purchase from Amazon would not single-handedly spell doom for the local vendor.

You therefore recognize that, whomever your fellow Scrantonians decide to patronize, it is individually rational to maximize your own transaction-specific surplus and to buy from Amazon for \$10 rather than from Dunder Mifflin for \$15. Because all (or at least most) of your fellow Scrantonians reason similarly, they too purchase from Amazon. Dunder Mifflin is soon put out of business and Amazon reigns supreme. Because Scrantonian consumers of classic literature are a large unorganized group—and therefore ‘unprivileged’ in Olson’s lexicon—it could not have been otherwise.

iii. Market Failure 3: Negative Externalities

Let us now consider a third inequality-generating market failure for which there has been somewhat greater appreciation. For the time being, let us suppose that the parties to some agglomeration of transactions—let’s call them the As and Bs—judge themselves all-things-considered better off as a consequence of these dealings. That is, they regard their respective positions to be improved, even accounting for their exchanges’ sum distributive effects.

Nevertheless, these transactions might make *third parties* (the Cs) worse off due to their aggregate consequences.¹²¹ If such transactions create or exacerbate high-end inequality, then these third parties’ egalitarian distributive preferences may be frustrated. And if the disappointment of the Cs’ distributive preferences exceeds the economic surplus reaped by the As and Bs¹²²—or, more precisely, exceeds the *excess surplus* reaped by the As and Bs, relative to the surplus that they would have derived from an alternate set of transactions that yields a more egalitarian outcome¹²³—then the actual outcome will again be an inefficient one. In this case, the inefficiency stems from the presence of *negative externalities*, yet another classic source of market failure.

Externalities refer to costs and benefits that are not priced into market transactions¹²⁴ because they are imposed on third parties who are not privy to those exchanges.¹²⁵ If A and B enter into a

¹²¹ See COHEN, *supra* note 59, at 26-27. Although he does not develop the point within the framework of welfare economics, or employ the technical notion of externalities, Cohen comes to a similar realization in his response to Robert Nozick’s ‘Wilt Chamberlain Argument.’ Cohen observes that a “person’s effective share depends on what he can do with what he has, and that depends not only on how much he has but on what others have and on how what others have is distributed. If it is distributed equally among them he will often be better placed than if some have especially large shares. Third parties . . . may therefore have an interest against” contracts of others that give rise to significant economic inequality. *Id.*

¹²² This *economic surplus* would be equal to the sum of consumer and seller surplus, net of any satisfaction/dissatisfaction of distributive preferences attributable to the parties’ respective contributions to the ensuing distributive outcome.

¹²³ This *excess surplus* would be equal to the economic surplus referred to in the immediately preceding note, minus the economic surplus produced by an appropriately chosen comparison transaction yielding a more egalitarian distributive outcome.

¹²⁴ E.g., ROSEN & GAYER, *supra* note 2, at 73.

¹²⁵ E.g., Masur & Posner, *supra* note 6, at 100.

contract, and their arrangement imposes *costs* on C who is not privy to their agreement, then these costs are called negative externalities.¹²⁶ The classic example of negative externalities is a privately owned factory that releases pollution into the environment, thereby degrading the air quality of the surrounding town.¹²⁷ Conversely, if A and B's arrangement creates *benefits* that neither of them fully capture, but which redound to a third party C, then the arrangement is said to generate positive externalities. A plausible example of positive externalities is research and development into clean energy technologies that permits a reduction in pollution throughout society.

A key insight from the economic analysis of law is that efficiency (here understood as the maximization of wealth or economic surplus) requires people to bear (or '*internalize*') the full costs and benefits of their actions. If A and B derive certain benefits from their arrangement, but they do not take into account the full costs (or benefits) that they impose on C, then A and B will opt for a level of economic activity that is too high (or low) relative to the social optimum.¹²⁸

One way to induce economic agents to choose the efficient level of activity is to impose a *tax* on behavior that produces negative externalities and conversely to subsidize activities that create positive externalities. If this tax/subsidy is set equal to the costs/benefits imposed on third parties, then this will force the economic agents to take account of these costs/benefits in their private calculations. They will then opt for the socially efficient level of the relevant activity.¹²⁹ This regime is referred to as *Pigouvian taxation (and subsidization)* in honor of its pioneer, Arthur Pigou.¹³⁰

Let us return to our third *Pigouvian argument* for inequality-generating market failure. Why might third parties judge themselves worse off as a consequence of a distributive outcome produced by transactions to which they were not privy? The answer is: for any of those reasons one might hold distributive preferences, which were surveyed above at Part II.A. In a classic article¹³¹ recently expanded into a book,¹³² the political philosopher T.M. Scanlon explores no less than six qualitatively distinct types of harms stemming from economic inequality, which he observes in passing may be regarded as negative externalities.¹³³ In contrast to Scanlon,¹³⁴ for purposes of my economic argument, I do not regard these social consequences of inequality *as such* to be externalities; rather, I take them to be reasons why one might hold egalitarian distributive preferences, the frustration of which constitute negative externalities from the standpoint of cost-benefit analysis or preference-based welfarism.

One reason why third parties may take a concerted interest in distributive outcomes, which a few other tax law scholars¹³⁵ have recently honed in on and on which I shall therefore focus, is

¹²⁶ *Id.*
¹²⁷ *Id.*¹²⁸ *Id.*¹²⁹ *Id.* at 101.¹³⁰ See PIGOU, *supra* note 6.¹³¹ Scanlon, *supra* note 44.¹³² SCANLON, *supra* note 44.¹³³ *Id.* at 113.¹³⁴ As well as those tax law scholars cited *infra* at note 135.¹³⁵ Externality-based rationales for redistributive taxation largely focusing on the externality of undue political influence are suggested by Daniel N. Shaviro, *The Economics of Tax Law*, in FRANCESCO PARISI (ed.), OXFORD HANDBOOK OF LAW AND ECONOMICS 8 (2014); David Hasen, *Accretion-Based Progressive Wealth Taxation*, FLORIDA TAX REV. 294-96 (2017); Ari Glogower, *Taxing Inequality*, N.Y.U. LAW REV. 1441-42 (2018). Hasen also discusses other systemic repercussions of inequality, such as decreased growth, increased crime, and reduced happiness. Hasen, *supra*, at 295-96. Hasen attributes an earlier externality-based justification for a wealth tax to the economist William

that high-end economic inequality can lead to a rarefied cadre of affluent individuals commandeering the political process. This machinating cohort might then employ the political process to implement policies that deliver them an outsized proportion of the benefits of social cooperation, but which set back the interests of the vast majority of the population. Such harms are properly regarded as negative externalities of those market transactions that produced the underlying inequality. David Hasen has referred to this as the “*externality of undue influence*.”¹³⁶

This sort of argument was developed by the economist Anthony Downs in his classic 1957 study, *An Economic Theory of Democracy*¹³⁷—another seminal work in the field of public choice economics. As Downs’s discussion is among the earliest and most comprehensive, and because it is integrated into a broader rational choice framework for explaining and predicting government behavior, I shall focus on his presentation.

Building on the work of Joseph Schumpeter,¹³⁸ Downs conceptualizes the democratic political process as a market in which political parties compete for votes and governmental power. Contra traditional public economics, the government is *not* presumed to be a perfectly benevolent monolith that directly aims to maximize social welfare. Rather, like any other organization, it is composed of largely self-interested and rational individuals who seek to maximize their own personal utility. Political parties and administrations strive to maximize votes to either gain office or extend their tenure. While the government may adopt policies that promote social welfare, this goal is not sought for its own sake. Instead, it is viewed as a mere means to achieving or sustaining electoral success.

This rational choice model of government action is connected to the income distribution in the following way. Downs observes that “[s]ince the pretax distribution of income in almost every society gives large incomes to a few persons and relatively small incomes to many persons,”¹³⁹ a party or administration concerned with maximizing its votes will often find redistribution toward equality politically advantageous, since the lower and middle classes outnumber the upper class in this regard. For this reason, the “equality of franchise in a democratic society creates a tendency for government action to equalize incomes by redistributing them from a few wealthy persons to many less wealthy ones.”¹⁴⁰

M. Dugger, *The Wealth Tax: A Policy Proposal*, 24 J. ECON. ISSUES 133 (1990), although it is not clear to me that this characterization of Dugger’s reasoning is apt. Hasen, *supra*, at 294 n. 70.

In a recent article, Charles Delmotte also constructs a somewhat analogous public choice argument from a libertarian perspective. While he does not employ the language of externalities, Delmotte proposes elimination of inequalities attributable to political rent seeking as a classical liberal alternative to redistributive taxation. This is best achieved, he argues, by embracing a benefits tax regime, under which tax burdens would be proportionate to benefits received from the government. Charles Delmotte, *Predistribution Against Rent-Seeking: the Benefit Principles Alternative to Redistributive Taxation*, SOC. PHIL. & POL. (2022).

However, Delmotte fails to follow the logic of his argument to where it leads. Per my discussion *infra* of Anthony Downs’s public choice model of government behavior, great economic inequalities *permit* special interests groups and affluent citizens to effectively lobby the government to depart from a benefits tax regime. For this reason, the long run elimination of rent seeking requires reduction of these underlying economic inequalities, the bulk of which would be left standing under a benefits tax. Accordingly, Delmotte’s proposal fails the test of dynamic stability and is self-defeating: a benefits tax regime would be under perpetual attack from the very rent seeking behavior it’s designed to prevent, because it leaves underlying wealth concentrations in place.

¹³⁶ Hasen, *supra* note 135, at 294 n. 70.

¹³⁷ ANTHONY DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* (1957).

¹³⁸ JOSEPH SCHUMPETER, *CAPITALISM, SOCIALISM, AND DEMOCRACY* (1942).

¹³⁹ DOWNS, *supra* note 137, at 198.

¹⁴⁰ *Id.*

However, once we transition to a more realistic setting in which there is imperfect information, the affluent are able to turn the tables in their own favor.”¹⁴¹ In an idealized world of perfect information, the effects of government policies are known by all individuals with exactitude. In a world of imperfect information, by contrast, voters must become informed or persuaded of these effects. It is normally the case then that “voters with the highest incomes . . . have the most political power, since in an uncertain world they can use their financial resources to create influence for themselves.”

There are two primary mechanisms by which economic advantage is parlayed into political power. First, superior finances can be used to persuade or propagandize other citizens to vote for the affluent’s favored policies. Second, superior finances can be used to obtain influence directly from government actors. Given uncertainty, the government too “needs resources to convince people that its policies are good ones” and to “defend itself from the attacks of opposition parties and interest groups.”¹⁴² In order to “acquire the money for these tasks, it can sell favors to men who need government action and are willing to pay for it.”¹⁴³ While this can take the form of outright bribes, it is more typical for the rich to make “campaign contributions in return for favorable dispositions or attitudes by the party.”¹⁴⁴

In this way, “[u]ncertainty and costliness of information redistribute political power so as to offset the economic levelling tendency of democracy.”¹⁴⁵ Downs concludes that in a world of uncertainty, rationality leads government “to construct policies often aimed more at the good of a few voters than at the good of all, or even a majority.”¹⁴⁶ For the government to “act otherwise would be irrational.”¹⁴⁷

We conclude that, on Downs’s model, those transactions that produce the inequalitarian distribution of wealth eventuating in this political outcome, and the corresponding frustration of third parties’ distributive preferences, represent market failures. (In addition, to the extent that the parties privy to these transactions failed to foresee this political outcome or were unable to avert it due to collective action problems, and that they regard themselves as worse off as a consequence, we find ourselves back in the province of the Cohenian and Olsonian arguments explored above.)

While I have concentrated on Downs’s public choice framework, similar negative externality reasoning would apply *mutatis mutandis* to the frustration of third party distributive preferences held for other reasons, such as those surveyed above at Part II.A. As with Pigouvian taxation generally, a market-failure-correcting redistributive tax equal to the magnitude of these negative externalities could be wielded to force the internalization of such costs and eliminate the inefficient and inequitable effects of the IGMF.

With this conclusion, we draw our analysis of inequality-generating market failure mechanisms to a close.

¹⁴¹ *Id.* at 201.

¹⁴² *Id.* at 92.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 202.

¹⁴⁶ *Id.* at 93.

¹⁴⁷ *Id.*

III. OUTCOMES OF INEQUALITY-GENERATING MARKET FAILURE

A. A Puzzle Pertaining to Distribution and Efficiency

Let us return to the orthodox conceptual analysis of market failure and take stock.

As discussed in Part I, the concept of market failure has two criteria, or necessary conditions. First, its *process-based criterion* is satisfied whenever there is a structural deficiency in market processes corresponding to the nonfulfillment of one or more requirements of perfect competition. Second, its *outcome-based criterion* is satisfied whenever market processes yield a *Pareto inefficient (or Pareto suboptimal) outcome*. In these circumstances, market transactions fail to exhaust all possible mutually beneficial gains from trade. Therefore, judicious government intervention aimed at rectifying the underlying structural imperfection can frequently yield a Pareto improvement.¹⁴⁸ It is important to distinguish these two criteria of market failure, since the nonfulfillment of one or more requirements of perfect competition does *not necessarily* yield a Pareto inefficient outcome (although this is the typical result).¹⁴⁹

So far, we have been concerned with the process-based criterion. In Part II, I showed that several general mechanisms responsible for classic market failures can systematically produce economic inequality whenever moderately egalitarian distributive preferences are fairly prevalent. These mechanisms included (i) imperfect information, (ii) non-excludability, and (iii) negative externalities. Such imperfections can arise in (at least nearly) *any* market, and are therefore *global* inequality-generating market failures, as compared to those *local* (or market-specific) IGMFs surveyed by Piketty. In the cases I have described, the process-based criterion of market failure is firmly satisfied.

In this Part III, I turn to the second component of market failure. To establish that the mechanisms explicated in Part II give rise to true market failures, for which government intervention is (at least presumptively) justified, it must be shown that the outcome-based criterion is also satisfied. This discussion is framed by the following challenge.

Due to imperfect information, non-excludability, and negative externalities, the market outcomes described in Part II.B are *Kaldor-Hicks inefficient*. That is to say, those transactions actually entered into by market participants fail to maximize aggregate wealth or economic surplus, as measured by willingness-to-pay for the satisfaction of preferences.¹⁵⁰

Therefore, a *Kaldor-Hicks improvement*¹⁵¹ could be achieved through judicious redistributive measures. By redistributing from the wealthy, the state could realize the distributive outcomes that market participants *would have* contracted to achieve *but for* the market imperfections described

¹⁴⁸ A policy produces a *Pareto improvement* if it makes one or more parties better off relative to a specified baseline, while making no parties worse off.

¹⁴⁹ As explained *supra* in Part I, one reason that this may be the case is that multiple market failures, or distinct instances of a single type of market failure, fortuitously offset each other, thereby producing an efficient result. This coincidental efficiency is permitted by the economic ‘*theory of second best*.’ See Lipsey & Lancaster, *supra* note 31; BOADWAY & BRUCE, *supra* note 2, at 131-135.

¹⁵⁰ Including both transaction-specific preferences and distributive preferences.

¹⁵¹ A legal or policy regime P1 represents a *Kaldor-Hicks improvement* with respect to another regime P2 just in case those who gain from the adoption of P1 could, in principle, compensate all individuals who would have been better off under P2, thereby leaving all parties at least as well off under P1 as under P2, and some better off. Sam, *supra* note 67, at 1054; RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 14 (9th ed. 2014). For this reason, Kaldor-Hicks improvements are sometimes referred to as ‘potential-Pareto’ improvements.

above. From the standpoint of maximizing aggregate social wealth or economic surplus, these measures would constitute unambiguous improvements.

Nevertheless, the cases that I have described are unusual in that a *Pareto improvement* does *not* appear to be possible. Why is that? The standard technique for producing a Pareto improvement via policies that initially create winners and losers involves a two-step procedure,¹⁵² whereby the state first:

(Step 1) Adopts law or policy P that is Kaldor-Hicks efficient (i.e., which maximizes aggregate wealth or economic surplus); and then

(Step 2) Taxes the ‘winners’ (i.e., those who gain from the adoption of P) to provide any ‘losers’ (those who are harmed from P) with compensatory side payments, which make those losers at least as well off as they would have been but for P’s adoption.

Put slightly differently: first maximize total wealth via P, then use some of the gains to fully compensate those who are initially harmed by P, so as to make them at least as well off as they otherwise would have been. In this way, the positions of all parties are either improved or maintained.

In the cases described in Part II, however, Pareto improvements cannot be achieved via this standard technique. That’s because the state cannot:

(Step 1) Redistribute from the 1% to satisfy the distributive preferences of the 99%, thereby maximizing economic surplus as measured in terms of aggregate willingness-to-pay,¹⁵³ and then

(Step 2) Provide compensatory side payments to the 1% to indemnify them for the loss suffered in the prior step.

Clearly, the compensatory side payments doled out in step (2) would *undo* the distributive measures taken in step (1), thereby reintroducing the very same inequality that the first step’s redistribution was designed to eliminate.

Therefore, we have a theoretically curious case in which Kaldor-Hicks improvements that increase total wealth or economic surplus are possible, while Pareto improvements are not, even as a matter of principle.¹⁵⁴ Let’s call this the ‘*distribution-efficiency puzzle*.’ The explanation for the standard technique’s failure in this context is that the Kaldor-Hicks efficient policy P adopted in the first step is *itself a distribution of wealth*, which is impacted by the compensatory side payments implemented in the second step.

The question we now confront is whether this means that the outcome-based criterion for market failure cannot be satisfied. Because no Pareto improvement is possible, even in principle, the cases described in Part II are *Pareto efficient*. By definition, a Pareto efficient state of affairs is one where a Pareto improvement is not possible. In light of the distribution-efficiency puzzle,

¹⁵² Perhaps the most dramatic and influential application of this technique is Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994). There, Kaplow and Shavell argue that because the tax-and-transfer system creates fewer behavioral distortions than redistributive non-tax laws and policies, all redistribution should be effectuated through the former. By employing the two-step technique described below, Pareto improvements can be achieved relative to a regime of distributively fair legal rules. But for a general epistemic critique of this ‘transfer-based’ Pareto procedure, see Sam, *supra* note 67.

¹⁵³ In our schema above, this would be policy P.

¹⁵⁴ If units of utility (‘*utils*’) could be transferred among individuals, then it would theoretically be possible to redistribute utility from the 99% to the 1%, leaving all parties better off in terms of subjective welfare. Unfortunately, this is not feasible at present—and barring dramatic technological developments that presently fall within realm of science fiction, neither will it be possible in the future. Those who deny the logical coherence or normative import of interpersonal comparisons of welfares will also gainsay the principled possibility of such utility transfers.

this is putatively the situation that we find ourselves in with respect to Part II's cases. Since these contemplated scenarios are Pareto efficient, it would appear that the outcome-based criterion of market failure, as specified by the orthodox analysis in Part I, is left unfulfilled.

In response to this challenge, I shall pursue three distinct lines of reasoning, which suggest for different reasons that an appropriate outcome-based criterion of market failure can nevertheless be satisfied by the cases laid out in Part II.

First, I consider the possibility that the rich receive 'in-kind compensation' from redistributive measures that makes them strictly better off. That would mean that Pareto improvements are possible after all (and that the original market outcomes are therefore Pareto inefficient).

Second, I suggest that the outcome-based criterion for market failure should be framed in terms of approximate, rather than strict, Pareto (in)efficiency; and furthermore, that the elimination of high-end inequality can meet this duly relaxed Pareto standard.

Third, I argue in the alternative that Pareto efficiency should be dispensed with altogether as the outcome-based criterion of market failure and that the cases described in Part II can meet a more appropriate consequentialist standard.

B. Reduction in Inequality as Public Good

The first possibility to consider is whether the wealthy receive *in-kind compensation*¹⁵⁵ from redistributive measures, which makes them strictly better off. If so, then notwithstanding the distribution-efficiency puzzle, Pareto improvements can be achieved indirectly through redistributive taxes and transfers. In turn, that would mean that the outcomes described in Part II are Pareto inefficient after all and thereby satisfy the outcome-based criterion for market failure.

This proposal is tacit in Liam Murphy and Thomas Nagel's classic philosophical exploration of tax policy, *The Myth of Ownership: Taxes and Justice*. There, Murphy and Nagel argue that the reduction of poverty (and low-end inequality) can itself be regarded as a public good, which delivers benefits to all members of society. It is worth quoting the good philosophers at length:

"[T]here is . . . a case [based on public goods reasoning] for traditional social welfare policies guaranteeing a *decent minimum* standard of living, or decent minimum earnings, for everyone in society. Such programs are usually regarded as redistributive, but the alternative to a decent social minimum is a society with real poverty, which often results in higher rates of crime, drug addiction, and single motherhood, all of which impose their own costs not only on the poor but on everyone. To be grim about it, the costs of subsidizing wages for unskilled labor to make them sufficient to support a family might well be balanced by savings in the costs of prisons and law enforcement that such a change would produce, not to mention the value to everyone of the change in the social environment.

Again, such programs would not be redistributive in the usual sense of benefitting some at the expense of others. The poor would benefit but only to the extent that the rich would also. The size of the benefit to the poor would depend on what would equalize marginal benefit to the rich from among competing categories of expenditures . . .

The reduction of social and economic inequality is in this way seen as a *public good*, paid for according to its monetary value to different individual taxpayers. This case differs from that of national defense, for example, in that it makes no sense to tax the poor for some of the cost of raising their spendable income. But it is still driven by efficiency, not fairness—a direct appeal to the interests of each, with no sacrifice being imposed on anyone."¹⁵⁶

¹⁵⁵ For discussion of this general concept in the context of U.S. constitutional law, see RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* Ch. 14 (1985).

¹⁵⁶ MURPHY & NAGEL, *supra* note 10, at 87 [emphasis mine].

Implicit in Murphy and Nagel's remarks is that the elimination of (at least extreme) poverty produces a Pareto improvement: all members of society, *including* citizens who finance these anti-poverty measures, are made better off from the receipt of in-kind compensation. That is, at least insofar as the bar for a decent minimum is set low enough that (i) the costs to citizens who foot the bill are modest in relation to (ii) the gravity of social evils thereby averted.

While Murphy and Nagel speak to the efficient abatement of low-end inequality, one may wonder whether similar reasoning applies to the reduction of *high-end* inequality as well. Might it be the case that the 1% receive full in-kind compensation from redistributive taxation, in the form of salutary social effects flowing from a more egalitarian wealth distribution? This surely is possible in some instances. Nevertheless, I shall not presume it to always (or even generally) be the case, for two reasons.

The first is that the nature and significance of benefits redounding to the rich are less clear here than with respect to poverty reduction. While there are many social benefits of an egalitarian wealth distribution, it is simply not obvious that these specifically accrue, on net, to the targets of redistributive taxes, rather than to the vast remainder of the citizenry. To assume otherwise in the absence of compelling empirical evidence would constitute an unwarranted dialectic dispensation.

The second reason is methodological. Whenever the 1% receive sufficient in-kind compensation for redistributive taxation to improve their overall positions, this should—to the extent that they are rational—*already be reflected in their own distributive preferences*. Therefore, to presume that full in-kind compensation is always received would be to evade the distribution-efficiency puzzle posed above, rather than to confront it head on. If this were always the case, then transfer payments from the 1% to the 99% would not actually be redistributive in character: on the contrary, they would serve to promote the satisfaction of the 1%'s own rationally held distributive preferences.

I conclude that the Murphy-Nagel strategy is not as viable when applied to the reduction of high-end inequality as to the mitigation of low-end inequality and poverty. To overcome the challenge posed by the distribution-efficiency puzzle and to establish that the outcome-based criterion of market failure is fulfilled by the cases set forth in Part II, we must opt for a different approach.

C. Reduction in High-End Inequality as Approximate Pareto-Improvement

As an alternative response to the distribution-efficiency puzzle, I shall now argue that reduction in high-end inequality can satisfy the strongest version of the Pareto standard realistically applicable to law and policymaking.

The reason is simple: true Pareto efficiency is largely a chimera—a theoretical fantasia dreamt up by Platonist economists¹⁵⁷ to simplify normative economic analysis. By positing unanimous improvements in subjective welfare, the policymaker deftly circumvents the need to assess interpersonal comparisons of welfare, as well as the subsequent task weighing social tradeoffs.

In the actual world, strict Pareto improvements are few and far between: in almost every instance, a policy or legal change will produce at least a smattering of losers.¹⁵⁸ The same point applies *mutatis mutandis* to public goods: almost no commodities or services are *pure* public goods from which every last member of society can reap benefits without fear of exclusion or rivalrous

¹⁵⁷ See NASSIM NICHOLAS TALEB, *THE BLACK SWAN* xxix, 180 (2007).

¹⁵⁸ E.g., JOHANSSON, *supra* note 34, at 22.

consumption.¹⁵⁹ In reality, almost all ostensible Pareto improvements are *approximate*; nearly all public goods are *impure*.

Our expectations so tempered, and our sights set to a reasonable altitude on the horizon, we discern that reductions of high-end inequality can meet this appropriately slackened Pareto standard. It is true that redistribution from the 1% to the 99% retards the interests of the former to satisfy the distributive preferences of the latter. *But almost all purported Pareto improvements result in similar setbacks to 1% (or other suitably small fraction) of the population*, under the banner of conferring benefits to the lion's share of the citizenry. Thus there is nothing uniquely objectionable about redistributive taxation aimed at eliminating high-end inequality.

Furthermore, suppose that an initial empirical estimate of this suitably small fraction (e.g., 1%) was off track. If classic public goods, such as national defense, courts, roads, clean air and the like, were detrimental to some smaller subset of the population (say, the 0.25%), then the wealth threshold at which redistributive taxation becomes permissible could always be lowered accordingly (i.e., to the top 0.25% of wealth holders). This flexibility ensures that redistributive measures can be tailored to satisfy the most demanding version of the Pareto standard realistically applicable in the actual world.¹⁶⁰

This places an opponent of our proposed redistributive measures in a bind. If they reject our proposal, then they owe us an explanation for why *other* approximate Pareto improvements (such as impure public goods) are owed a leniency that the reduction of high-end inequality is not granted. Insofar as they seek to be internally consistent, they will find themselves unable to accept the justification for the former without acceding to the latter.

An important consequence of this reasoning is that not *all* (or even *most*) economic inequalities will qualify as true market failures, which can be Pareto improved. For instance, redistribution from the top 30% to the remaining 70% would set back the interests of far too many individuals to qualify as even an approximate Pareto improvement. This limits the scope of the prescriptive argument advanced in this Article: it is only the reduction of *high-end inequality*¹⁶¹ that can likely be justified under the market failure theory of government action.

As I will discuss in Part V, this limitation supports a particular division of labor within the tax system. For this reason (among others), I propose that wealth taxes should be devoted to the elimination of inequalities attributable to market failure, while progressive income (or consumption) taxes should be devoted to achieving more politically contentious redistributive goals. Under this bifurcated institutional scheme, the market-failure-correcting wealth tax demarcates the upper boundary of permissible wealth holdings, which may be levelled down further by additional redistributive measures sanctioned by the democratic will. These institutional implications, I'll argue below, represent a feature, rather than a bug, of the argument pursued

¹⁵⁹ E.g., Cowen, *supra* note 30, at 4.

¹⁶⁰ In prior work, I considered this sort of 'near-Pareto' strategy in relation to my epistemic critique of Louis Kaplow and Steven Shavell's influential argument that all redistribution should be effectuated through the tax-and-transfer system, and never through legal rules. See Sam, *supra* note 67, at 1099-1100. The analysis above provides one plausible answer to the question posed there of 'how close' to a strict Pareto-improvement some change from a baseline distribution must be in order to be normatively acceptable. At least for purposes of refining the outcome-based criterion of market failure, the answer suggested here is that a change must be as close to a strict-Pareto improvement as is realistically achievable through the public financing of these classic public goods. For further discussion of how my own approach is more epistemically modest than Kaplow and Shavell's, see discussion of the 'epistemic objection' *infra* at Part IV.

¹⁶¹ And per Murphy and Nagel's reasoning, extreme poverty.

herein. In part, that is because this division of labor maximizes the total quantity of constitutionally permissible redistribution for legal reasons to be explained in due time.

D. Alternative Outcome-Based Criteria of Market Failure

Consider now a third response to the challenge posed by the distribution-efficiency puzzle. Contrary to the orthodox conception of market failure laid out in Part I, Pareto inefficiency might reasonably be rejected as the appropriate outcome-based measure of market failure, at least in the types of cases that we have been considering. In other words, the traditional account of market failure must be amended.

The fundamental insight that ultimately yields this revisionary conclusion is that the Pareto criterion cannot be used to choose among feasible *Pareto non-comparable equilibria*.¹⁶² Two states of affairs A and B are Pareto non-comparable if (and only if) neither is Pareto-superior to the other: that is, it is not possible to transition from A to B without making at least one individual in A worse off as a consequence; and vice versa for B to A.

The feasibility of distinct Pareto non-comparable equilibria is the primary lesson of the *second fundamental theorem of welfare economics*, which holds that *any* Pareto optimal outcome can be achieved by appropriately altering the initial assignment of property rights and then letting a perfectly competitive market economy run its course.¹⁶³ Because the Pareto criterion is silent on the question of which of these feasible Pareto non-comparable equilibria the government should seek to produce, some other distributive or efficiency criterion—let's call it ' ϕ '—must be relied upon to select among these Pareto non-comparable end states.¹⁶⁴

For this reason, I contend, it would be reasonable to simply cut out the middle man and adopt ϕ as the outcome-based criterion of market failure, at least in circumstances where the Pareto criterion and ϕ cannot be concurrently satisfied. After all, if both Pareto and ϕ must normally be utilized to select among feasible Pareto non-comparable equilibria in circumstances where the two criteria are mutually compatible, then there would seem to be no principled reason for preferring Pareto to ϕ in situations where the two criteria are mutually exclusive. Rather, it would be equally reasonable to prefer ϕ to Pareto. Call this the '*normative underdetermination*' argument.

Now those cases laid out in Part II are of precisely this sort: i.e., situations where both Pareto and an appropriate ϕ (in particular, wealth maximization or preference-based social welfare maximization) cannot both be satisfied. Therefore, on this reasoning, it would be reasonable in these circumstances to cut out Pareto and adopt ϕ as our outcome-based criterion of market failure.

To skirt this argument, one might consider rejecting the use of some ϕ to choose among vying Pareto non-comparable equilibria. Biting the bullet, one might hold that any Pareto efficient state of affairs is just as good as any other.

This temptation should be resisted, however, as abandoning the use of a tie breaking device for Pareto non-comparable equilibria would come at a price that few welfare economists should be willing to pay.¹⁶⁵ The cost of this bullet is that the unadorned Pareto criterion sanctions a litany of

¹⁶² See e.g., JOHANSSON, *supra* note 34, at 25.

¹⁶³ E.g., BOADWAY & BRUCE, *supra* note 2, at 64, 83.

¹⁶⁴ E.g., JOHANSSON, *supra* note 34, at 21, 27. See also BOADWAY & BRUCE, *supra* note 2, at 83 ("If we go beyond the Pareto criterion and exclude states with extreme disparity in utility, we cannot be sure that the competitive general equilibrium will correspond to a state within the desirable subset of Pareto optimal states.").

¹⁶⁵ At least insofar as they are convinced of the possibility of (even rough) interpersonal comparisons of well-being.

highly counterintuitive results, a few of which are described below.¹⁶⁶ These unattractive implications undermine its claim to constituting the sole and final word on matters of social choice rankings. Such counterexamples will come as no surprise to veterans of welfare economics. Simply put, one cannot abandon the use of some ϕ for adjudicating among Pareto non-comparable equilibria without accepting a veritable parade of horrors. As an aptly chosen ϕ nimbly averts many of these repugnancies, the prudent welfare economist is committed to its employment.

Given this inevitability, one would (pursuant to the logic above) at least be reasonable, and plausibly most justified, in jettisoning Pareto and retaining one's favored ϕ (in its negated form) as the operative outcome-based criterion of market failure, at least in circumstances where satisfaction of Pareto and ϕ are mutually exclusive, such as those cases laid out in Part II. Because those cases also satisfy a number of plausible candidates for (negated) ϕ , such as wealth and social welfare maximization, they can meet this alternate outcome-based criterion of market failure.¹⁶⁷

* * *

Consolidating the lessons garnered from our responses to the distribution-efficiency puzzle, we conclude that inegalitarian outcomes rectifiable by redistribution from the 1% to 99% can satisfy both (i) approximate Pareto, as well as (ii) an appropriately chosen ϕ (such as wealth or social welfare maximization), and so can meet a reasonable outcome-based criterion of market failure. If one sticks with the Pareto criterion, its approximate version is the most demanding rendition applicable in the real world. On the other hand, one reasonably could (and probably should) embrace an alternative outcome-based measure of market failure, at least in circumstances where Pareto and one's favored ϕ are mutually exclusive. As the cases delineated in Part II satisfy both the process-based and outcome-based criteria, these cases constitute bona fide market failures whose remediation is justified by the market failure theory of government action.

¹⁶⁶ To take a fairly standard case, consider a zero sum setting in which A has \$100M to his name, while B . . . Z each have \$0. Because any transfer from A to B . . . Z would worsen A's lot, this state of affairs is Pareto optimal (no Pareto improvement is possible). Yet intuitively this lopsided allotment of wealth is not fair. Nor is it likely to be welfare maximizing in light of the standard assumption of the declining marginal utility of wealth. As most plausible consequentialist theories (e.g., Utilitarianism, Egalitarianism, Prioritarianism, Leximin) would recommend transfers from A to B . . . Z, use of an appropriately chosen ϕ avoids this unsavory result.

Another textbook example: in zero sum settings, a distribution in which A has \$1 and each of B . . . Z have \$0 is just as good, by the lights of Pareto, as one where A . . . Z each have \$100M. Pareto non-comparability does not admit to special pleadings for either wealth or utility maximization!

¹⁶⁷ In his recent monograph employing collective action reasoning to elucidate the structure of American constitutional law, Neil Siegel comes to a somewhat related legal (rather than normative) conclusion. In particular, Siegel argues that Congress should enjoy the legal authority to take measures that solve not only collective action problems yielding Pareto inefficient outcomes, but also "cost-benefit collective-action problems." The latter do not produce Pareto inefficient outcomes, but rather outcomes where aggregate national wealth is not maximized. SIEGEL, *supra* note 94, at 89-93. In effect, Siegel advocates for an alternate outcome-based criterion for determining the existence of collective action problems (which, as we have seen by this point, are implicated in certain market failures). In contrast to Siegel, my own argument in this section has proceeded on a purely analytic and normative, rather than legal, basis. To that extent, it hopefully provides fodder for Siegel's legal thesis pertaining to the constitutional authority of the legislature.

IV. OBJECTIONS, REPLIES, AND REFINEMENTS

In this Part IV, I consider a number of objections to the line of reasoning pursued in Parts II and III. In the course of answering these objections, several strands of my account are clarified and deepened. A few additional objections have also been addressed in preceding notes.¹⁶⁸

(O1) Inadmissible Preferences Objection: Perhaps the most fundamental objection to this Article’s central argument is that distributive preferences are a type of ‘other-regarding’ or ‘external’ preference, which ought not to be paid heed in normative economic analysis. Because these are preferences for the “assignment of goods or opportunities to *others*,” rather than to *oneself*,¹⁶⁹ their satisfaction should not be granted weight in economic procedures for ranking the social desirability of different states of affairs, such as cost-benefit and social welfare computations.

Because a rigorous defense of the admissibility of distributive preferences to these procedures requires a detailed and somewhat lengthy engagement with the philosophical and welfare economic literature, I reserve this discussion for the Appendix to this Article. Readers who would like to see justification for this important premise before proceeding forward may skip to that material now; while those who prioritize maintaining continuity in our central narrative may progress to the end of the Article before engaging with this Appendix. For the time being, I shall merely reiterate that the admissibility of distributive preferences to social choice calculi is a common, though not entirely unanimous, assumption of welfare economics.¹⁷⁰

(O2) Limited Redistribution Objection: A strident egalitarian may object that my arguments only justify significant redistribution from the wealthy to the middle class, rather than to the poor. That’s because the middle class, in virtue of its greater aggregate income, wealth, and consumption, are more frequently parties to the types of commercial transactions I’ve characterized as market failures.

Reply: I do not claim that global IGMFs account for *all* morally or politically objectionable economic inequality. I claim only that, together with local IGMFs, they can account for a non-trivial proportion of inequality; and that elimination of this portion should command unanimous normative assent, including from those who typically scorn the distributive function of taxation as illegitimate.

With that said, all three of the arguments developed in Part II.B could support redistribution to the poor to the extent that the middle class’s distributive preferences are held for altruistic reasons, or out of an impartial sense of justice, rather than from (enlightened) self-interest. If middle class individuals exhibit altruistic concern for improvement in the lot of the worst-off, or impartially desire a fair distribution of wealth (or welfare), then satisfaction of such preferences will frequently require redistributive transfers from the rich to the poor. In addition, my third ‘Pigouvian argument’¹⁷¹ could also support extensive redistribution to the poor. That’s because, even if most

¹⁶⁸ See *supra* at notes 64 and 66.

¹⁶⁹ RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 275, 234-35 (1977).

¹⁷⁰ See JOHANSSON, *supra* note 34, at 4, 100; KAPLOW & SHAVELL, *supra* note 36, at 21, 78, 423-436. Kaplow and Shavell argue that other-regarding preferences in general, as well “tastes for notions of fairness” more specifically, ought to be granted weight in normative economic analysis.

¹⁷¹ See Part II.B.3.

market exchanges are undertaken between the upper and middle classes, the poor may still bear the brunt of these transactions' externalities.

(O3) Private Provision Objection: A committed free marketer might object that if people harbor egalitarian distributive preferences, they could demand that *rebate clauses* be added to their contracts. These clauses would specify that if party A ends up with more than \$x or y% of the population's total wealth after some period of time, or after so many transactions, then A must issue rebates to his contractual counterparties B . . . Z sufficient to bring A below the specified wealth threshold. Therefore, our laissez-faire enthusiast concludes, there is no need for intrusive government intercession: the market can handle the ostensible failures described above in Part II.

Reply: To have rebate clauses incorporated into their agreements with A, parties B . . . Z would have to pay A a higher price. However, this would give rise to an Olsonian collective action problem of the sort described in Part II.B. Lacking assurances that others would pay a premium to have these provisions included in their contracts in order to realize a more egalitarian distribution of wealth, parties B . . . Z would seek to avoid their own potential exploitation and contract with A*, who does not offer a rebate clause but accepts a lower contract price. Even given such assurances, some of B . . . Z may still contract with A* to free ride on the others' sacrifices. As a consequence, it is unlikely that such rebate clauses would be widely adopted.

(O4) Inegalitarian Preferences Objection: A seasoned Socratic may query: what if people held distributive preferences for a highly *unequal* distribution of wealth? Would a relatively equal outcome then constitute a market failure to the extent that these inegalitarian preferences are frustrated?

Reply: This is a bullet that I am inclined to bite: *if* a large enough proportion of the members of a society held that, ceteris paribus, it would be good for a highly unequal distribution of wealth in society to obtain, then an egalitarian outcome could indeed constitute a market failure. However, this is a highly unrealistic counterfactual with little pertinence to the actual world—the sort of thought experiment that utilitarians routinely write off as irrelevantly fantastical. In the reality we inhabit, egalitarian preferences are far more common than the inegalitarian variety.¹⁷²

One might wonder why this empirical generalization holds. Three reasons come to mind, though I make no claim to their exhaustiveness. First, where distributive preferences are correctly¹⁷³ held for self-interested reasons, egalitarian preferences will *necessarily* outnumber the inegalitarian variety.¹⁷⁴ The proof of this arithmetical tautology is left as an exercise for the reader. Second, where distributive preferences stem from one's views on impartiality or fairness, egalitarian preferences are likely to outnumber inegalitarian preferences since few, if any, plausible normative theories of justice (or their underlying intuitions) place a value on inequality *as such*.¹⁷⁵

¹⁷² See discussion of PAGE & JACOBS, *supra* note 53, and Norton & Ariely, *supra* note 53.

¹⁷³ That is, such preferences are based on the true belief that a certain distribution would redound to one's own benefit.

¹⁷⁴ At least when quantified by number, rather than weighted by corresponding willingness-to-pay.

¹⁷⁵ Under some accounts of justice, such as libertarian and luck egalitarian theories, distributive outcomes are normatively irrelevant, while the fairness of those historical processes giving rise to such outcomes is emphasized. Adherents to such theories may hold that the distribution of wealth ought to be governed by process-based considerations that tend to yield inequalities (e.g., respect for property rights, rewards for ability, effort, etc.). However, preferences for outcomes to be determined by such procedural factors are not preferences for inequality *per se*. For purposes of this Article, I make no claim that such preferences (which are more aptly characterized as Kaplow and Shavell's "tastes for notions of fairness") ought not be included in the social choice calculus.

Finally, where distributive preferences arise from altruism, egalitarian preferences are likely to outnumber inegalitarian preferences since satisfaction of the former benefit a larger number of individuals who are the potential objects of altruistic impulse.

In light of these considerations, I am quite comfortable staking my arguments' empirical pertinence on the comparatively greater prevalence of egalitarian than (per se) inegalitarian preferences.

(O5) Triviality Objection: Granting their admissibility,¹⁷⁶ the satisfaction of egalitarian distributive preferences increases individual and social welfare, just like any other preference. Therefore, a steadfast stickler may object: isn't it just obvious that the government should take measures to ensure these preferences' fulfillment, if they are as prevalent as I claim?

Reply: This conclusion is far from trivial. To justify government intervention in the private sphere, it must also be shown that individuals are unable to effectively *act on so as to satisfy* their (distributive) preferences because of imperfections in market processes. According to the market failure theory of government action, it is *only* in these circumstances that state intercession into the economic arena is warranted. Where individuals are capable of acting on their (distributive or other) preferences, government meddling lacks warrant. One of this Article's primary contributions has been to supply this further essential premise: that is, to have demonstrated that individuals are frequently unable to satisfy their distributive preferences through private action as a consequence of market failures.¹⁷⁷

(O6) Epistemic Objection: Parts II and III offered a demonstration from first principles that some quantum of inequality is attributable to global IGMFs. However, an epistemic skeptic may inquire: how could one ever hope to determine the *amount* of inequality produced by these market failures? And if policymakers are unable to quantify this inequality, how might a market-failure-correcting redistributive tax be rationally constructed?

Reply: Along with the inadmissible preference objection, I take this to be the most fundamental challenge of the lot. Indeed, it is the very sort of charge that in prior work I have leveled against other ambitious law-and-economic theories.¹⁷⁸ For that reason, it is one that I take very seriously.

Let me begin then by taking an inventory of the market-failure-correcting redistributive tax's epistemic inputs: what information would be required for the design of such a tax? To quantify the amount of inequality attributable to global IGMFs, policymakers would need to know: (i) the prevalence and strength of distributive preferences, as well as be able to use this information to identify (ii) the transactions that market participants would have entered into had global IGMFs not impeded them from acting on these preferences. How feasible it is to acquire these distinct bits of knowledge?

¹⁷⁶ See Appendix for discussion.

¹⁷⁷ Recall that my analysis has presumed the market failure theory of government action in order to demonstrate that significant redistributive transfers are warranted *even on* such a restrictive normative account. Bracketing this dialectic strategy, this Article's conclusions are also significant on more permissive views of state intervention, which nevertheless reject excessive government interference in the economic sphere on grounds of undue paternalism or resulting economic inefficiencies. Even social welfare frameworks do not typically recommend that government *directly* seeks to satisfy all preferences. Rather, in most circumstances, establishing background rules and institutions that permit individuals to satisfy their own preferences through private action would indirectly maximize social welfare.

¹⁷⁸ Sam, *supra* note 67.

As to the first, it certainly seems possible to estimate the statistical distribution of distributive preferences through the use of surveys, psychological experiments, observation of revealed preferences, potentially among other devices. Indeed, political scientists, psychologists, and economists have already begun to undertake these exercises.¹⁷⁹

The second step likely poses greater difficulties. Knowledge of (ii) is required because the market-failure-correcting redistributive tax's objective is to reproduce the economically efficient distribution that would have prevailed under this counterfactual baseline. How might policymakers ascertain the set of alternate transactions that market participants *would have* entered into with perfect foreknowledge of the combinatorial effects of their interactions; or given an ability to cooperate in the face of collective action problems; or in the absence of distributive externalities? While I am open to be proven wrong, it seems unlikely that these counterfactuals could generally be identified with precision. Therefore, it is doubtful that policymakers could quantify the exact quantum of inequality attributable to global IGMFs.¹⁸⁰

But this is no reason to throw the baby out with the bathwater and to rashly conclude that our analysis of global IGMFs therefore lacks concrete implications for public policy. Rather, it presents an opportunity to confront the limits of our epistemic prowess with candor, and to embrace a level-headed methodological realism and pragmatism. As I see it, we find ourselves at the following crossroads.

The prevalence of moderately egalitarian distributive preferences permits us to deduce from first principles that global IGMFs are pervasive in markets, at least to some extent. In turn, this demonstration provides sufficient warrant for imposing a tax aimed at rectifying inequalities attributable to such market failures at intuitively reasonable and expressively significant amounts. That is because the alternative would be to fail to address the consequences of global IGMFs altogether. Faced with a choice between these two prongs of the dilemma, the former is preferable to the latter.

That is at least insofar as the cure is not worse than the disease. Given the limits of our knowledge, prudence dictates that we err on the side of conservatism and set tax rates too low, or demarcate the tax base too narrowly, rather than overshoot and risk introducing emergent inefficiencies attributable to ham-fisted governmental intervention. That way, at least some inroads can be made towards addressing the inefficient and inequitable consequences of global IGMFs, while reducing the odds of overreach. The parameters of recent wealth tax proposals (for instance, a 2% tax on wealth above \$50 million¹⁸¹) strike me as falling within the province of reasonableness, although such values are surely up for debate.

To narrow this range and serve as an empirical check, a population's *aggregate willingness-to-pay for a reduction in inequality* could also be used as a reasonable proxy for the counterfactual baseline described above in (ii). Even if it is epistemically infeasible to determine the distribution would have resulted from conditions of perfect competition, in which individuals are capable of acting on to satisfy their distributive preferences, as second best, policymakers could apply

¹⁷⁹ PAGE & JACOBS, *supra* note 53; Norton & Ariely, *supra* note 53.

¹⁸⁰ In prior work, I have argued that economic and social science is generally incapable of predicting precise distributions of wealth or welfare (and counterfactual distributions are particularly challenging). Realistically, these sciences are only fit to deliver more modest predictions pertaining to the directional effects of economic variables, or other course-grained properties of outcomes. Sam, *supra* note 67. Because quantifying inequality attributable to global IGMFs presents a special case of this more general epistemic liability on the part of many economic theories, this Article's argument is not in particularly bad shape relative to other theoretical models in economics.

¹⁸¹ See Elizabeth Warren's 'ultra-millionaire's tax' proposal, accessed at <https://elizabethwarren.com/plans/ultra-millionaire-tax> (Jan 19, 2025).

standard techniques of *cost-benefit analysis* to the design of a market-failure-correcting redistributive tax. This tax would be constructed to reduce inequality by a population's aggregate willingness-to-pay for such diminution, as quantified by the Gini coefficient, for instance, or other appropriate metrics.

By proceeding conservatively and making use of standard cost-benefit techniques, risk of overshooting the mark can be reduced, though not eliminated. As inaction is itself a policy decision with concrete ramifications, these sorts of heuristics, approximations, and compromises must inevitably be resorted to in light of the epistemic limits of law-and-economics.¹⁸²

Moreover, qualitatively distinct normative considerations justify the assumption of any such residual risk. It is plausible that in the face of significant epistemic uncertainty, the *expressive function of law* takes on far greater importance than in more informationally rich decision-theoretic contexts. That's because substantial uncertainty circumscribes both the feasibility and utility of consequentialist modes of analysis.¹⁸³ Unless the moral impulse is simply to be abandoned in epistemically impoverished environments, and collateral losses are to lie where they fall, our remaining option will often be to adopt rules that identify the motivating values and ambitions of public policy.

A modest market-failure-correcting redistributive tax, subject to the guidelines above, would succeed on these fronts: i.e., it would make inroads to addressing global IGMFs demonstrable from first principles and express the underlying values at play, all while minimizing the odds of excessive intervention. In the next part of this Article, I shall say more about the design of such a tax, as well as the broader system of taxation in which it might be embedded.

V. INSTITUTIONAL VISION AND CONSTITUTIONAL RAMIFICATIONS

This final part continues to explore practical ramifications of the market failure theory of inequality explicated and defended above. Its goals are twofold: first, to briefly sketch an institutional scheme of taxation congruent with the theory; and second, to elicit the theory's legal implications for the constitutional viability of a wealth tax. This latter question of constitutional significance demands far greater attention than I am able to devote to it here, and I therefore intend to devote a full-length future work to its doctrinal elaboration and development. For purposes of the present Article, I pursue the modest goal of introducing this constitutional strategy to highlight the market failure theory of inequality's crucial legal implications for a topic of current interest and great importance.

A. Institutional Vision: Market-Failure-Correcting Wealth Exaction

Begin with the institutional question. When one reflects on the market failure theory of inequality, the following division of labor naturally recommends itself:

¹⁸² Market-failure-correcting redistributive taxation does not fare as badly as the target of my own prior epistemic critique: Louis Kaplow and Steven Shavell's argument that all redistribution should be effectuated through the tax-and-transfer system, and never through legal rules, which should always be chosen exclusively on the basis of efficiency. That is because their argument expressly relies on producing a strict Pareto improvement, which (for reasons explained in my prior article) requires precise predictions of counterfactual distributions. *See generally* Sam, *supra* note 67. By contrast, the desirability of my market-failure-correcting redistributive tax will not stand or fall on its ability to produce true Pareto improvements, at least insofar as an alternate outcome-based criterion of market failure is adopted, as Part III.D argues that it should be.

¹⁸³ *See* Sam, *supra* note 67, at Part II.B.2 for discussion and citations.

(1) A levy on wealth should be devoted to addressing economic inequalities attributable to IGMFs of both (a) the global variety described in this work, as well as (b) the local variety surveyed by Piketty.¹⁸⁴ Let's call this instrument the '*market-failure-correcting (MFC) wealth exaction*.'¹⁸⁵

(2) Other forms of taxation, such as progressive income or consumption taxes, should be employed to mitigate economic inequalities that are not ultimately traceable to market failure.

How would an MFC wealth exaction tasked with addressing both local and global IGMFs be constructed? For reasons discussed above,¹⁸⁶ it is likely that Piketty's local IGMFs are more readily quantified than the global IGMFs explored in this Article. Therefore, to design a MFC wealth exaction, the base and rate schedule should first be set to eliminate local IGMFs as precisely as possible. Next, to make inroads into global IGMFs, this tentative base and rate schedule should be adjusted upward by an intuitively reasonable and expressively significant amount, while erring on the side of conservatism to minimize the chances of overshooting, and/or employing cost-benefit analysis as a reasonable approximating technique.¹⁸⁷

The primary justification for this bifurcated system of forced-payments-and-transfers is as follows. Because rectifying inequalities attributable to market failure should command unanimous normative assent under the market failure theory of government action, while the reduction of other inequalities is more tendentious, it is analytically and politically advantageous to employ distinct instruments for these respective tasks. With the fiscal system so partitioned, each instrument can then be altered independently of the other as changes in circumstance call for calibration. For example, if it were determined that inequality attributable to market failure was on the rise, the MFC wealth exaction's base could be expanded or its rates increased, all while maintaining prevailing levels of income/consumption taxation. Conversely, should political headwinds shift regarding the appropriate quantity of general redistribution, the MFC wealth exaction's machinery could remain stationary, while the income/consumption tax regime could be updated accordingly.

Admittedly, it should be possible in principle to employ a single instrument to address both types of inequalities by surgically altering its base and rate structure to track changes in just one of these desiderata. In practice, however, such fine-toothed adjustments would be difficult to achieve with the requisite precision.

Functional aggregation into a single levy would also invite confusion and political manipulation. To illustrate, if inequality attributable to market failure were to swell, its beneficiaries might seek to muddy the political waters by characterizing an offsetting tax increase as 'class warfare,' or by levelling similarly timeworn accusations of unjustified redistribution. With an exaction specifically devoted to remediating inequalities caused by market failure, rhetorical ploys of this sort would prove much more difficult to pull off.

¹⁸⁴ As explained in Part V.B, to receive constitutional authorization the MFC wealth exaction would also have been designed to address IGMFs bearing an appropriate relation to interstate or foreign commerce. Given the tightly intertwined nature of the national and global economies, however, this should not be a particularly large constraint.

¹⁸⁵ 'Exaction' is the conceptually neutral term for a mandatory payment to the government, which may be either a tax or regulatory penalty. The choice of this terminology will become clear in Part V.B.

¹⁸⁶ See *supra* at Part IV.

¹⁸⁷ See *supra* at Part IV.

In addition to providing this political insulation, our bifurcated regime would also fulfill an important expressive function, related to our earlier discussion in Part IV. Under its purview, the MFC wealth exaction would demarcate the *upper limits* of permissible wealth holdings, which may be ‘levelled down’ further via additional redistributive measures duly sanctioned by the democratic will. The MFC wealth exaction would then play a role inverse to that of a *universal basic income* (UBI). As characterized by its main philosophical proponents, a UBI would set the *lower limits* of permissible income levels, which can be ‘levelled up’ by earned income or additional government transfers.¹⁸⁸

Within this institutional framework, the MFC wealth exaction and UBI would constitute opposing poles that set nonnegotiable bounds for material holdings. These boundaries would express the judgement that certain distributive principles are so normatively uncontroversial that they ought not be held hostage to the whims of majoritarian impulse. In the case of the UBI, this is plausibly the distributive sufficiency principle, potentially *inter alia*.¹⁸⁹ For the MFC wealth exaction, it is the market failure theory of government action. It is only in between these bookends that adjustments to entitlements ought to be determined by democratic deliberation among members of a pluralistic society harboring disparate but reasonable conceptions of distributive justice.¹⁹⁰

One may be seduced by the logic of this bifurcated regime and yet wonder why a wealth exaction should be devoted to correcting market failures, while income or consumption taxes should be recruited to address residual inequalities—why not the other way around? One pragmatic reason is that it would involve fewer transition costs to keep the scaffolding of the existing progressive income tax in place for its present purposes, while adopting a new fiscal instrument to fulfil a novel policy function. In addition, there is a crucial legal rationale for this suggested division of labor: within the arena of American constitutional law, this partition would maximize the quantity of constitutionally permissible redistribution for the reasons now to be discussed.

B. Constitutional Ramifications: Commerce Clause Authority for a Market-Failure-Correcting Wealth Exaction

It is time to make good on my earlier promise and to explain how the market failure theory of inequality offers a viable alternative constitutional basis for a levy on wealth, permitting it to avert the constitutional prohibition on unapportioned “direct taxes.” While I intend to develop this line of argument at greater lengths in future work, it behooves me to provide a rough sketch here to illustrate the legal ramifications of our preceding analysis.

First things first: what is the constitutional predicament? Put succinctly, under the U.S. Constitution, federal “*direct taxes*” must be apportioned among states based on their respective populations.¹⁹¹ In other words, direct tax rates must be set to collect proportionately more revenue from more populous states and proportionately less revenue from less populous states.

¹⁸⁸ VAN PARIJS, *supra* note 78, at 35; PHILIPPE VAN PARIJS & YANNICK VANDERBORGHT, BASIC INCOME: A RADICAL PROPOSAL FOR A FREE SOCIETY AND A SANE ECONOMY 10, 12, 27 (2017). Existing anti-poverty programs have similar objectives, although eligibility for their benefits typically depends on fulfilling certain work requirements. For this reason, such programs does not create a truly *unconditional* lower bound on income.

¹⁸⁹ For surveys of the various normative justifications that have been offered for a UBI, *see* VAN PARIJS & VANDERBORGHT, *supra* note 188, at Ch. 5; MATT ZWOLINSKI & MIRANDA PERRY FLEISCHER, UNIVERSAL BASIC INCOME: WHAT EVERYONE NEEDS TO KNOW 18-22 (2023).

¹⁹⁰ *See* JOHN RAWLS, POLITICAL LIBERALISM (1993).

¹⁹¹ U.S. Const. art I. §§ 2 and 9.

Furthermore, it is a matter of ongoing contention whether wealth taxes constitute direct taxes.¹⁹² The Constitution offers no definition of “direct taxes” and the historical record suggests incertitude among the framers on this score.¹⁹³ The only taxes that have been uncontroversially recognized as direct taxes are head taxes (lump sum taxes of a uniform amount imposed on all individuals) and taxes on the value of real property. Because an ad valorem tax on real property is a tax on one component of wealth, it has been argued—quite persuasively, in my estimation—that a general wealth tax on the value of a person’s total assets would be properly characterized as a direct tax as well.

If a wealth tax were so regarded, however, the apportionment requirement would then warp it beyond repair. That is because there is no necessary connection (or even particularly strong empirical correlation) between (i) a state’s population and (ii) its per capita wealth or number of affluent residents whose wealth exceeds a taxability threshold (e.g., \$50 million). As Bruce Ackerman explains in his classic article *Taxation and the Constitution*, if a wealth tax were subject to the apportionment requirement, then “the citizens of a poor state such as Alabama—whose per capita levels of income and consumption are relatively low—would have to pay a *higher* . . . tax [rate] than citizens of a rich state such as Oregon. Only in this way could each state contribute a share of the tax revenues that was proportional to its share of the national population. But this would be absurd,”¹⁹⁴ as it would defeat the tax’s egalitarian motivations. By subjecting poorer citizens to higher tax rates, inequality among citizens would be exacerbated rather than mitigated.

With the spiraling growth of economic inequality in recent decades,¹⁹⁵ tax scholars and constitutional lawyers have been scrambling to develop constitutional strategies for skirting the icy reach of the direct tax apportionment requirement.¹⁹⁶ Suffice it to say, however, that none has achieved (even near) consensus pertaining to their success. For purposes of this Article, I take no definite stance on the viability of these preceding approaches—I merely take it that none are without controversy. Accordingly, there remains a dire need for alternative constitutional bases for wealth taxation, if only to supplement existing approaches in the face of significant legal uncertainty. The market failure theory of inequality offers just such an alternative. In its bare bones, the legal theory is as follows.

In light of the constitutional jurisprudence of regulatory taxation,¹⁹⁷ a market-failure-correcting wealth exaction would best be characterized as a *regulatory penalty* for constitutional purposes, rather than as a *tax*.¹⁹⁸ Under the most principled test for drawing the distinction between a tax and a penalty, an exaction¹⁹⁹ (or forced monetary payment) should constitute a tax if its primary

¹⁹² *Moore v. United States*, 602 U.S. 572 (2024).

¹⁹³ See Bruce Ackerman, *Taxation and the Constitution*, 99 COLUMBIA L. REV. 1, 11 (1999).

¹⁹⁴ *Id.* at 2.

¹⁹⁵ See generally PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY, *supra* note 16.

¹⁹⁶ E.g., Ackerman, *supra* note 193; Ari Glogower, *A Constitutional Wealth Tax*, 118 MICH. L. REV. 717 (2020); John R. Brooks & David Gamage, *Taxation and the Constitution, Reconsidered*, 76 TAX L. REV. 75 (2022).

¹⁹⁷ For an in-depth historical overview of the major cases up to the mid-twentieth century, see R. ALSTON LEE, A HISTORY OF REGULATORY TAXATION (1973).

¹⁹⁸ As explained *supra* at note 24, for this reason my use of the word “tax” throughout this Article (prior to Part V) has been technically incorrect. This language was employed in the interest of expository simplicity and in order to contextualize my own contribution to the tax policy literature, despite being at odds with my subsequent constitutional analysis.

¹⁹⁹ ‘Exaction’ is the conceptually neutral term for a mandatory payment to the government, which may be either a tax or regulatory penalty.

purpose is to raise revenue for general purposes and a regulatory penalty otherwise.²⁰⁰ Furthermore, the paradigmatic case of a regulation is a law or policy intended to correct market failure.²⁰¹ Because the primary purpose of the MFC wealth exaction is the remediation of IGMFs,²⁰² this forced payment should thus be characterized as a regulatory penalty²⁰³ so long as its revenues are used to rectify market failures rather than for general purposes.

As a regulatory penalty, a wealth exaction engineered to mitigate local and global IGMFs with an appropriate interstate or foreign dimension would enjoy authorization under the Commerce Clause of the U.S. Constitution, which grants Congress broad authority to regulate interstate and foreign commerce.²⁰⁴ Indeed, the rectification of market failures is the paradigmatic use of this power.²⁰⁵ Due to the profoundly interconnected nature of the modern national and global economies, designing the MFC wealth exaction to address IGMFs bearing an appropriate relation to interstate or foreign commerce would not dramatically restrict its scope.

Winding down the argument, because a MFC wealth exaction ought not be regarded as a “tax” for constitutional purposes, a fortiori it should not be deemed a “direct tax” subject to the apportionment requirement.²⁰⁶ *For a forced payment to be a “direct tax,” it must first be a “tax”*

²⁰⁰ This view is defended by Reuven S. Avi-Yonah & Yosef M. Edrey, *Constitutional Review of Federal Tax Legislation*, 1 UNIV. ILL. L. REV. 3 (2023); Kyle D. Logue, *NFIB v. Sebelius and the Individual Mandate: Thoughts on the Tax/Regulation Distinction*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 173 (2016).

²⁰¹ See MICHAEL CONANT, THE CONSTITUTION AND ECONOMIC REGULATION: OBJECTIVE THEORY AND CRITICAL COMMENTARY, Ch. 4. (2008) (surveying Commerce Clause jurisprudence and demonstrating that many of its leading cases involve government action to rectify market failures).

²⁰² Although it is typically necessary to raise (and redistribute) revenue to achieve this outcome, these steps are merely of *instrumental* importance: the *ultimate objective* is the rectification of IGMFs. This reasoning will be elaborated upon in future work.

²⁰³ Under an alternative approach developed by Robert Cooter and Neil Siegel, and apparently employed by the Supreme Court in *NFIB v. Sebelius*, the distinction between a tax and a regulatory penalty turns on several factors, including: (i) successful deterrence of the targeted behavior, (ii) heaviness of the exaction, (iii) collection of significant revenue, (iii) a scienter requirement for liability, (v) expression of condemnation. See generally Neil S. Siegel & Robert D. Cooter, *Not the Power to Destroy: An Effects Theory of the Tax Power*, 98 VA. L. REV. 1195 (2012); *NFIB v. Sebelius*, 567 U.S. 519 (2012). For reasons that it would take more ink to explain than I presently have available, Siegel & Cooter’s theory is ultimately unsatisfactory and so this narrow aspect of the *NFIB* opinion should be abandoned. Nevertheless, an appropriately constructed MFC wealth exaction could still qualify as a regulation under their approach, although this result would take some work to establish. I therefore must defer these discussions to future work.

²⁰⁴ The Supreme Court’s contemporary Commerce Clause jurisprudence is articulated in the landmark cases *United States v. Alfonso D. Lopez, Jr.*, 514 U.S. 549 (1995); *United States v. Morrison*, 529 U.S. 598 (2000); *NFIB v. Sebelius*, 567 U.S. 519 (2012). The basic rule that emerges from this modern lineage of cases is that Congress enjoys the authority to regulate the channels and instrumentalities of interstate commerce, persons or things in interstate commerce, and activities that significantly affect interstate commerce.

²⁰⁵ CONANT, *supra* note 201, at Ch 4. See also SIEGEL, *supra* note 167, at 89-93, 171-205. Siegel argues that many classic commerce power cases involved legislation aimed at solving *collective action problems* and that this objective is a sufficient justification for Congressional action. As the notion of a collective action problem bears an intimate relationship to that of market failure, and the former frequently give rise to the latter, Siegel’s view lends support for Commerce Clause authority to enact a MFC wealth exaction.

²⁰⁶ A similar point is made by Libin Zhang, *Moore Implications From Forgetting the Foreign Commerce Clause*, TAX NOTES INTERNATIONAL 723 (Feb. 5, 2024). Drawing on analysis from a 1961 Treasury Department Memorandum concerning the Subpart F rules of U.S. international taxation, Zhang contends that “taxes justified by the commerce clause are not subject to the same constitutional limitations . . . that apply to taxes justified by other constitutional clauses.” For this reason, he continues, the mandatory repatriation tax (MRT) that was specifically at issue in *Moore*, and potentially even a broader wealth tax tied to foreign commerce (*Id.* at 730), could sidestep constitutional limitations on the taxing power, such as the apportionment requirement.

simpliciter.²⁰⁷ Through this maneuver, the MFC wealth exaction nimbly averts the direct tax apportionment requirement's baleful gaze.

To be sure, this strategy could not be employed to legitimate a broader wealth exaction that addresses inequalities that are not ultimately attributable to market failure. However, under the institutional vision sketched above in Part V.A, progressive income or consumption taxes should be relied on to address this distinct class of inequalities. The recommended institutional division

While an earlier draft of my own Article had been written and presented to colleagues by fall of 2023, I attribute credit to Zhang for independently converging on similar constitutional insight. Nevertheless, Zhang's position diverges from my own in several critical respects and lacks most of the major structural features of my account.

First and most fundamentally, Zhang does not link commerce clause authority for a levy on wealth to the remediation of *market failures* or explicate the notion (critical to my own view) of *inequality-generating market failure*. For this reason, his proposal lacks a limiting principle on commerce clause authority and is vulnerable to objections predicated on legislative overreach. While the commerce power is broad, it's generally recognized that it cannot be boundless. *See e.g.*, Neil Siegel, *Collective Action Federalism and its Discontents*, 91 TEX. L. REV. 1937, 1941-42, 1949, 1967 (2013). The market failure criterion provides an attractive limiting principle that derives strong support from the history of the Commerce Clause. To that end, it also provides inbuilt protections against rapacious usurpations or interstate fiscal discrimination on the part of Congress, thereby addressing traditional justifications for the constitutional prohibition on unapportioned direct taxes. These features of my account will be developed in future work.

Second, Zhang solely focuses on Congress's power to regulate *foreign* commerce and does not consider whether a wealth exaction bearing an appropriate relation to domestic interstate commerce would be constitutional. His proposal thus exhibits a narrower scope than my own.

Third, Zhang does not engage with the broader constitutional literature on the *tax/penalty distinction* to cull general criteria for characterizing an exaction as one such category or the other. *See* Libin Zhang, *Commerce Clause and Constitutional Analysis*, TAX NOTES INTERNATIONAL 1701, 1704 (March 18, 2024) (offering a cursory nod to case law on the tax/penalty distinction without seeking to excavate or formulate a universal test of demarcation).

Fourth, as a consequence of this omission, Zhang does not build a case for why a wealth exaction connected to foreign commerce, which he discusses in passing, should be *exclusively* characterized as a regulatory penalty and not *also* as a tax subject to the apportionment requirement. As Professor Erik M. Jensen presses in a short rejoinder to Zhang, if an exaction were *both* a regulation and tax, as Zhang seems to contemplate (he frequently uses the word "tax"), it is not clear why commerce clause authorization should obviate limitations on the taxing power. *See* Erik M. Jensen, *The Commerce Clause Doesn't Override Rules Governing the Taxing Power*, TAX NOTES INTERNATIONAL, 1169, 1171-72 (Feb. 26, 2024). Why shouldn't an instrument subsumed under both powers be subject to the limitations of each?

With respect to my own MFC wealth exaction, one reply to Jensen is that, for reasons sketched above and to be elaborated upon in the future, this levy would be best characterized as a regulatory penalty and would *not* be appropriately regarded as a tax. The possibility of dual classification is further undermined by the fact that Supreme Court has never recognized a mixed exaction constituting both regulatory penalty and tax as a matter of constitutional classification. In all high court precedents, an exaction has always been *either* a penalty or a tax, which appear to be mutually exclusive constitutional categories. Robert Pushaw, *The Paradox of the Obamacare Decision*, FLA. L. REV. 1993, 2031-32 (2013). Because a MFC wealth exaction would not even constitute a "tax," a fortiori it could not be a "direct tax" subject to the apportionment requirement. Limitations on the taxing power would not enter into the equation.

In sum, my own framework offers a critical limiting principle on commerce clause authority for a wealth exaction; enjoys broader scope in virtue of legitimating a domestic MFC wealth exaction with no linkage to foreign commerce; and fills numerous fatal gaps in the constitutional logic of Zhang's argument. My account shall be developed at length in future work and integrated with pertinent case law and constitutional scholarship.

²⁰⁷ Even if the MFC wealth exaction were regarded as *both* a regulation and a tax, it should still pass constitutional muster. In cases of conflict between constitutional clauses, the "court must create solutions on the basis of the *total structure* of constitutional law." CONANT, *supra* note 201, at 38. In light of the direct tax provisions' semantic obscurity, peripherality, and ignominious origins in the Three-Fifths Compromise (Ackerman, *supra* note 193), and the far greater centrality of the Commerce Clause in the overall constitutional scheme of economic governance, the former should give way to the latter in the face of such conflict.

of labor therefore *maximizes the total amount of constitutionally permissible redistribution*: levies on wealth, which might otherwise meet their demise at the hands of the direct tax apportionment requirement, are able to survive if constructed to address inequality attributable to local and global IGMFs; while progressive income or consumption taxes, which face no challenge to their constitutionality, may be employed to mitigate other species of inequality.

CONCLUSION

This Article has developed the analytic, normative, institutional, and legal dimensions of the market failure theory of inequality. My recapitulation of these distinct contributions shall proceed down the line.

Analytically: I have demonstrated that highly general market failure mechanisms, involving (i) imperfect information, (ii) non-excludability, and (iii) negative externalities, can produce economic inequality in (nearly any) market where moderately egalitarian distributive preferences are fairly prevalent. In addition to satisfying the process-based criterion of market failure, these cases also satisfy an appropriate outcome-based criterion. These ‘global’ IGMFs represent the ‘general component’ of the market failure theory of inequality, complementing Piketty’s analysis of ‘local’ IGMFs, which afflict particular markets in virtue of their idiosyncratic structural characteristics.

Normatively: Because the cases I’ve described should be regarded as bona fide market failures, a market-failure-correcting (MFC) redistributive exaction aimed at reducing their attendant inequalities would be justified under the market failure theory of government action. Such a levy should therefore be normatively uncontroversial and command broad assent. Indeed, even those who typically reject the distributive function of taxation are internally committed to accepting this instrument to the extent that they accept other market-failure-correcting functions of taxation (such as the fiscal and Pigouvian functions).

Institutionally: The market failure theory of inequality recommends a bifurcated system of forced payments and transfers in which a wealth exaction is employed to mitigate economic inequalities attributable to local and global IGMFs, while other forms of taxation, such as progressive income or consumption taxes, are utilized to address economic inequalities not caused by market failure. Under this division of labor, each instrument could be altered independently of the other as evolutions in circumstances call for calibration, resulting in greater analytic clarity, as well as insulation from rhetorical and political challenges. In this scheme, a MFC wealth exaction would fulfill the expressive function of demarcating the upper limits of socially permissible wealth holdings, thereby playing an inverse role to that of a universal basic income, which sets the lower bounds of acceptable income levels.

Legally: By implementing this bifurcated system of forced payments and transfers, policymakers could maximize the total quantity of constitutionally permissible redistribution. Levies on wealth that might otherwise run afoul of the direct tax apportionment requirement would pass constitutional muster if constructed to address inequalities attributable to market failures. Such MFC wealth exactions would be best characterized as regulatory penalties rather than as “taxes,” thereby enjoying authorization under the Commerce Clause and evading the “direct tax” apportionment requirement.

APPENDIX: ADMISSIBILITY OF DISTRIBUTIVE PREFERENCES IN NORMATIVE ECONOMIC ANALYSIS

Perhaps the most fundamental objection to the line of reasoning pursued in this Article is that distributive preferences are a type of ‘other-regarding’ preference, which ought not be taken into account in normative economic analysis. This objection gainsays a critical assumption of my argument, which I had promised to eventually defend at length.²⁰⁸ It is time to make good on that rain check. Before doing so, however, I must unpack this challenge by explaining its terminology and implicit premises.

In welfare economics and moral philosophy, the distinction is sometimes drawn between ‘self-regarding’ and ‘other-regarding’ preferences. Although commentators have not converged on totally uniform definitions for these notions, their intuitive core is readily conveyed. On one plausible explication, due to Ronald Dworkin, *self-regarding* (or ‘*personal*’) preferences are preferences for the “assignment of goods or opportunities to [oneself].” Conversely, *other-regarding* (or ‘*external*’) preferences are preferences for the “assignment of goods or opportunities to others.”²⁰⁹ As this definition exhibits the clearest relationship to my notion of distributive preferences, I shall adopt Dworkin’s formulation going forward. That said, the following discussion should apply similarly to other conceptual renderings.²¹⁰

With this lexicon established, it becomes apparent that the present objection takes two premises in its properly elongated form:

(P1) Other-regarding preferences are never to be given consideration in normative economics, such as cost-benefit and social welfare analysis. In other words, they are deemed ‘inadmissible’ inputs to such procedures for generating rankings of the social desirability of distinct states of affairs.

(P2) All distributive preferences are a type of other-regarding preference.

Therefore, as a lemma, all distributive preferences must be deemed inadmissible to normative economic analysis.²¹¹ But if so, the objection now concludes, my thesis that those cases described in Part II are inefficient is directly undercut, as my analysis there hinged on the presupposition that the satisfaction of egalitarian distributive preferences is to be accorded due weight in the consequentialist calculi of cost-benefit or preference-based social welfare analysis.

²⁰⁸ See *infra* at Part IV.

²⁰⁹ DWORKIN, *supra* note 169, at 275, 234-35. See also ERIC RAKOWSKI, EQUAL JUSTICE 26 (1991).

²¹⁰ While recognizing the slipperiness of these concepts, Kaplow and Shavell tentatively define other-regarding preferences as preferences that “concern or involve the *activity or thoughts* of other individuals.” KAPLOW & SHAVELL, *supra* note 36, at 424. The political philosopher Brian Barry defines the putatively synonymous “privately-oriented wants” as wants involving objects that *materially impinge* on one’s life. BRIAN BARRY, POLITICAL ARGUMENT 63 (1965).

²¹¹ In the social welfare framework, this exclusion would amount to the following. Recall that a social welfare function (SWF) is a rule for ranking the social desirability of different states of affairs based on the patterns of individual well-being levels in those scenarios. While the SWF approach is compatible with different conceptions of individual well-being, economists typically equate individual welfare with subjective preference satisfaction. If distributive preferences were deemed inadmissible, then (di)satisfaction of these preferences would not be taken as inputs to the SWF for purposes of generating this social ranking. Similarly, under cost-benefit analysis, a person’s willingness-to-pay for the satisfaction of such preferences would be paid no heed in the process of computing and comparing aggregate willingness-to-pay for competing policies.

To engage with and ultimately rebut this critique, I must first consider reasons *why* a critic might seek to exclude other-regarding preferences from normative economic analysis, per this elongated objection's first premise (P1). To that end, I will address three arguments offered by prominent philosophers and welfare economists for the inadmissibility of external preferences, which I'll refer to as the arguments from: (i) remoteness, (ii) double counting, and (iii) illiberal influence.

It will be shown that none of these arguments is ultimately successful, at least as they pertain to the egalitarian distributive preferences at issue. With its support pulled out from under its legs, P1 may be rejected in good conscience. Along the way, I will also establish P2's falsity: that is, I shall demonstrate at least some distributive preferences are *not* other-regarding preferences. Having defused both of its premises, the inadmissible preference objection will be left in shambles. By defending the admissibility of certain distributive preferences to normative economics analysis, this Article's central argument is reinforced and sharpened. With this plan in mind, let me dive in and consider the case for the exclusion of external preferences, taking the three aforementioned arguments in turn.

Arguments for the Exclusion of External Preferences

Argument from Remoteness

The moral philosopher Derek Parfit offers perhaps the most basic argument for the exclusion of other-regarding preferences: namely, that they are frequently *too remote* to actually bear on an individual's well-being. Parfit motivates this claim with the following charmed fable: during the course of a train ride, you meet a stranger and learn that he is suffering from a grave malady. After an exchange of pleasantries, you part ways and form a preference that the stranger be cured of his ailment. Unbeknownst to you, the stranger is later healed of his affliction. Parfit now inquires: have you been made better off from the satisfaction of this preference?

Parfit says that no, you have not (and conversely, if the stranger's illness had continued unabated, neither would you be worse off).²¹² The reason, he implies, is that the preference is simply too remote to bear on your own well-being.²¹³ As it does not "materially impinge" on your own life affairs, to use the philosopher Brian Barry's language,²¹⁴ it has no impact on your own welfare. And so it goes for (at least many) other-regarding preferences. Finally, this argument concludes, if such preferences have no effect on individual well-being, then a fortiori neither can they bear on social welfare, as social welfare is standardly taken to be a function of individual well-being levels.

²¹² DEREK PARFIT, REASONS AND PERSONS 494 (1987). *See also* ADLER, MEASURING SOCIAL WELFARE, *supra* note 50, at 49 (discussing Parfit's insight in relation to welfare economics).

²¹³ *See* PARFIT, *supra* note 212 at 494-95.

²¹⁴ BARRY, *supra* note 210, at 63. However, Parfit considers some cases where satisfaction of a preference does not seem to "materially impinge" on one's life affairs, but is still intuitively 'close' enough to bear on the person's well-being—e.g., satisfaction of a preference that the lives of one's children go well, even if one never learns of this fact because one is in exile. *See* PARFIT, *supra* note 212, at 495.

Argument from Double Counting

Consider now a second argument for the exclusion of other-regarding preferences in normative economic analysis, referred to as the *double counting argument*. Many hold that the primary aim of law and public policy should be to increase social welfare. However, in the pursuit of this fundamental objective, Ronald Dworkin argues that it is essential that other-regarding preferences be excluded from the consequentialist calculus, as their inclusion would inappropriately double count the interests of some individuals. That is, certain persons (let's call them the As) would have their welfare counted via the inclusion of: (i) their own self-regarding preferences, *as well as* (ii) others individuals' (call them the Bs) external preferences regarding the As' welfare.²¹⁵ Dworkin illustrates with the following example:

Suppose many citizens, who themselves do not swim, prefer the pool to the theater because they approve of sports and admire athletes . . . If [these] altruistic [other-regarding] preferences are counted, so as to reinforce the personal preferences of swimmers, the result will be a form of *double counting*: each swimmer will have the benefit not only of his own preference, but also of the preference of someone else who takes pleasure in his success.²¹⁶

External preferences therefore “present great difficulty for utilitarianism,” as that normative theory

. . . owes much of its popularity to the assumption that it embodies the right of citizens to be *treated as equals*. But if external preferences are counted in overall preferences, then this assumption is directly jeopardized.²¹⁷

The idea is that utilitarianism, as well as related forms of consequentialism, lay claim to constituting an impartial conception of justice by weighting the interests of all individuals equally. If some individuals' interests were weighted twice, as the double counting argument asserts, the theory would forfeit much of its intuitive appeal. Dworkin thus concludes that any attractive formulation of utilitarianism (and by implication, other forms of preference-based consequentialism) must be “reconstituted so as to count *only personal preferences*,” at least to the extent that this task is feasible.²¹⁸

Argument from Illiberal Influence

Dworkin develops a third argument for the exclusion of other-regarding preferences, which can be construed as the prior argument's complement. In addition to double counting the welfare interests of some, inclusion of external preferences rooted in malice, prejudice, moralism, or envy would

²¹⁵ E.g., DWORKIN, *supra* note 169, at 235; KAPLOW & SHAVELL, *supra* note 36, at 425 n. 54; John C. Harsanyi, *Problems with Act-Utilitarianism and with Malevolent Preferences*, in HARE AND CRITICS, *ESSAYS ON MORAL THINKING* (Douglas Seanor & N. Fotion, eds. 1988); JAMES GRIFFIN, *WELL-BEING: ITS MEANING, MEASUREMENT AND MORAL IMPORTANCE* 24 (1986) (“Those who not only want their own welfare but also, luckily for them, have others wanting it too count more heavily than those who do not . . .”).

²¹⁶ DWORKIN, *supra* note 169, at 235.

²¹⁷ *Id.* at 236 [emphasis mine].

²¹⁸ *Id.* at 235. Dworkin goes on to note that it is not always possible to do so directly, as personal and external preferences are frequently intertwined. *Id.* However, as discussed below, Dworkin develops an institutional strategy, which makes use of the assignment of rights, for doing so indirectly.

permit the holders of such preferences to exert *illiberal influence* over the lives of others.²¹⁹ Let us call such preferences, ‘*noxious*’ other-regarding preferences.

To illustrate, let us now suppose that the As harbor animus towards modern theater, regarding the institution as morally depraved.²²⁰ On this basis, the As develop preferences for the prohibition of such performances, despite the fact that modern theater does not materially impinge on their own life affairs. If the As’ other-regarding preferences were included in the social welfare calculus used to determine the theater’s regulation (or lack thereof), the As could exert illiberal influence over the thespian Bs. As Dworkin explains:

If the moralistic [other-regarding] preferences are counted . . . [the] actors and audience will suffer because their preferences are held in lower respect by citizens whose personal preferences are not themselves [implicated by construction of the theater].”²²¹

In general, he goes on to explain:

“[i]f . . . external preferences are counted, so as to justify a constraint on liberty, then those constrained suffer, not simply because their personal preferences have lost in a competition for scarce resources with the personal preferences of others, but precisely because their conception of a proper or desirable form of life is despised by others.”²²²

The lesson to be drawn, says Dworkin, is that exclusion of other-regarding preferences finds motivation in both a rationally constructed consequentialism, which equally weights the interests of all individuals, as well as *liberalism*, which privileges the individual’s right to pursue his own conception of the good in the face of conflict with majoritarian opinion.²²³

Defense of the Admissibility of Distributive Preferences

What are we to make of these three arguments? I will now argue that none of these arguments for the exclusion of external preferences is ultimately successful, at least as they pertain the egalitarian distributive preferences at issue. In so doing, the inadmissible preference objection’s first premise will be undermined. Along the way, I shall also controvert the inadmissible preference objection’s second premise (that all distributive preferences are a type of other-regarding preference).

Reply to Argument from Remoteness

We may readily accede, per Parfit’s parable of the stranger, that *some*—perhaps many—other-regarding preferences are indeed too remote to bear on their holder’s well-being. Nevertheless, this conclusion does not extend to *all* such preferences. As even Dworkin acknowledges, there are external preferences that are “no less genuine, nor less a source of pleasure when satisfied and

²¹⁹ *Id.* at 275-76. See also BARRY, *supra* note 210, at 63, 295-96; Amartya Sen, *The Impossibility of a Paretian Liberal*, J. POL. ECON. (1972).

²²⁰ See DWORKIN, *supra* note 169, at 235.

²²¹ *Id.* at 235.

²²² *Id.* at 276.

²²³ See *id.* at 236, 276.

displeasure when ignored, than purely personal preferences.”²²⁴ Obvious and incontrovertible examples include due concern for the well-being of close friends and family. Given that *some* external preferences are sufficiently ‘close’ to bear on an individual’s welfare, the trick is to find some mechanism for discriminating between those that are and those that are not.

Luckily, one plausible litmus test is already operative in the machinery of law-and-economics. As the legal scholar Neil Siegel explains in his recent tour de force on the economic analysis of constitutional law, “the tradition of cost-benefit analysis neither excludes nor includes [external preferences]”²²⁵ categorically.”²²⁶ Rather, such preferences “are credited only if there is demonstrated willingness to pay to vindicate one’s expression of sympathy for others. Cheap talk does not suffice.”²²⁷

This *willingness-to-pay test* provides a rather clean solution to Parfit’s problem of remoteness: if an individual is ready to put his money where his mouth is, and to expend scarce resources from his budget constraint to see that a stranger’s malady is cured, then this provides strong (if not dispositive) evidence that the preference is ‘close enough’ to the holder’s quarters to bear on his own well-being, and ought therefore be recognized in the consequentialist calculus. Why is that the case? As fiscal expenditures always involve opportunity costs, willingness to pay for the satisfaction of some preference X indicates a willingness to forgo satisfaction of another preference Y. If Y is itself close enough to bear on the individual’s well-being, then—taking on board certain standard assumptions about agential rationality and information—it follows that X must bear on his well-being as well.

This approach smoothly dovetails with Part II’s analysis. That is because inequality-generating market failures only arise in the circumstances described therein when distributive preferences are backed by a willingness-to-pay. If economic actors are unwilling to pay for the satisfaction of their distributive preferences, it will not be the case that they would have entered into alternative transactions to fulfill these preferences given an absence of market imperfections. When this counterfactual fails to hold, the principle of revealed preference cannot be used to indict the actual outcome as inefficient. Both for this reason, and because it provides a theoretically plausible and readily operationalized resolution to Parfit’s remoteness problem, we may adopt the willingness-to-pay test as an integral component of the inequality theory of market failure.

Reply to Argument from Illiberal Influence

So much for remoteness—what of the arguments that admitting external preferences gives rise to illiberal influence and double counting? While I shall endeavor to address these two arguments in order, because they are mirror images portions of my responses will necessarily bleed into each other.

Per Dworkin’s analysis, the problem illiberal influence primarily stems from other-regarding preferences rooted in morally illicit psychological motivations, such as malice, prejudice,

²²⁴ *Id.* at 276. While Dworkin frames the point in hedonic terms, which take experiential satisfaction and dissatisfaction as the currency of welfare, his observation should generalize to other conceptions of individual well-being.

²²⁵ Siegel refers to the (dis)satisfaction of external preferences as “psychological externalities.” SIEGEL, *supra* note 167, at 163.

²²⁶ *Id.* at 164.

²²⁷ *Id.*

unfounded sanctimony, or envy.²²⁸ Some economists simply bite the bullet here and adopt the ‘hardline’ welfarist view that even these noxious external preferences should be admissible to normative economic analysis, at least in principle. Why is that? As Kaplow and Shavell contend in their seminal treatise on the welfare economic analysis of law, “any actual preference is given weight because it reflects an individual’s actual well-being; there is no a priori basis under welfare economics for ignoring certain preferences.”²²⁹

Nevertheless, Kaplow and Shavell offer an olive branch to the liberal, who rejects welfare maximization as the sole and final word on matters of law and policy. Following David Hume, they conjecture that widespread beliefs that certain other-regarding preferences are objectionable (e.g., the sadist’s preference for harm to befall others) are normally predicated upon the net adverse social consequences of such preferences.²³⁰ Therefore, even this hardline form of welfare economic analysis “will not ordinarily lead one to favor policies that satisfy such preferences.”²³¹ That is because “the detrimental effects [of counting these noxious preferences]—reductions in other individuals’ well-being and often, in the long run, the well-being of those with the objectionable preferences—will tend to outweigh the benefits of satisfying such preferences.”²³²

Without taking a firm stance for purposes of this Article, I am inclined to side with Dworkin in this debate and to hold that the admission of external preferences animated by morally illicit sentiment is objectionable per se, even at the level of principle.²³³ Nevertheless, as I also suspect that Kaplow and Shavell are correct in their ‘Humean conjecture’ (i.e., that the satisfaction of noxious preferences normally yields a net social detriment), less probably hinges on this dispute than may initially appear, at least as a practical matter. Therefore, I contend that regardless of whether one takes a liberal Dworkinian tack, or opts for the hardline welfarist view defended by Kaplow and Shavell, the following two-fold institutional response to the problem of illiberal influence commends itself.

First, adopting the willingness-to pay test would significantly mitigate the problem of illiberal influence. To have one’s noxious external preferences accorded weight in the consequentialist calculus, one must be prepared to sacrifice. Lightly held moralistic or spiteful attitudes, which float atop the psyche untethered to one’s budget constraint, shall be paid no heed. However, as there surely are some resolutely malicious individuals, who stand ready to put their money where their mouth is, this strategy is unlikely to suffice on its own.

Therefore second, to further address the problem of illiberal influence, we should embrace Dworkin’s own institutional response: namely, to assign *rights* in domains where noxious external preferences are particularly prevalent in order to effectively neutralize them. By what route does Dworkin arrive at this ultimate destination?

He begins by noting the inauspicious prospects of *directly* excluding external preferences, as this task confronts the epistemic roadblock of first identifying these preferences. Unfortunately, votes cast in democratic political procedures cannot be readily distinguished based on whether

²²⁸ In a smaller number of cases, well-intentioned paternalism or moralism may also be deemed objectionable.

²²⁹ KAPLOW & SHAVELL, *supra* note 36, at 427.

²³⁰ On this score, Kaplow and Shavell follow the great philosopher David Hume’s theory of ‘artificial’ virtues and vices. See HUME, *supra* note 8.

²³¹ KAPLOW & SHAVELL *supra* note 36, at 427.

²³² *Id.*

²³³ Furthermore, I suspect that Kaplow and Shavell (and their welfare economist comrades) harbor this same intuition. Otherwise, if they did not find the inclusion of noxious preferences per se problematic, they would not feel the need to reassure their readers that their hardline position would not generally lead to the adoption of policies that favor such preferences. In other words, “the lady doth protest too much.”

they are induced by self-regarding or other-regarding preferences.²³⁴ Given the Herculean task of discriminating between the two, Dworkin argues that the most effective way of counteracting such preferences is an *indirect approach*. In particular, by assigning individuals rights to act freely in certain areas of life and law, the state can prophylactically neutralize the impact of including external preferences in its consequentialist policy computations.²³⁵ These rights serve as ‘*trumps*’ on countervailing welfarist justifications, which give weight to external preferences, for regulation of these domains. The function of rights is to create spheres of autonomy in realms that are frequently the subject of noxious other-regarding preferences.²³⁶

And what realms are these, one may query? Dworkin contends that as a sociological generalization people tend to have far more noxious external preferences regarding the scope and form of others’ social, political, and cultural association, than their economic association.²³⁷ Typically, preferences pertaining to others’ economic association are motivated by the downstream effects that such association have on the preference holders’ own well-being or the welfare of individuals who are the object of the preference holder’s altruistic impulse; or are rooted in views about distributive justice.²³⁸ This both explains and justifies modern (i.e., post-*Lochner*) constitutional jurisprudence, which recognizes (i) myriad fundamental rights in the social, political, and cultural arenas, but (ii) relatively few in the economic realm, thereby enfranchising the state to undertake regulation and taxation for the general welfare. By adopting Dworkin’s rights-based strategy, the problem of illiberal influence posed by noxious external preferences can be substantially ameliorated. At the same time, policymakers should be empowered to account for distributive preferences *not* predicated upon malignant psychological intent in their design of the tax-and-transfer system.

Reply to Argument from Double Counting

With this twofold response to the problem of illiberal influence in mind, let us return finally to the argument from double-counting. (As promised earlier, however, my answer here will also bear at points on the argument from illiberal influence.)

Even if noxious external preferences were substantially neutralized,²³⁹ that would still leave a large swath of distributive preferences rooted in (i) altruism, (ii) an impartial sense of justice, and (iii) (enlightened) self-interest.²⁴⁰ The question at hand is whether admission of these preferences gives rise to an objectionable double counting of interests. My basic position is that distributive preferences rooted in altruism *should count twice*; while those motivated by an impartial sense of justice or self-interest are, despite first appearances, *not actually external preferences at all*. Let me elaborate on this stance by taking these points in turn.

²³⁴ DWORKIN, *supra* note 169, at 276-77.

²³⁵ For discussion, see ERICK J. SAM, THE RIGHT OF EXIT: EMIGRATION, SECESSION AND THE STRUCTURE OF INTERNATIONAL TAXATION 28 (Ph.D. Dissertation, Duke University, 2021).

²³⁶ See DWORKIN, *supra* note 169, at 277-78.

²³⁷ See *id.* at 277-78; Sam, *supra* note 235, at 28-29.

²³⁸ Sam, *supra* note 235, at 29.

²³⁹ Either directly through the willingness-to-pay test, or indirectly through the assignment of counteracting rights.

²⁴⁰ See *infra* at Part II.A.

Altruism. First consider distributive (or other external) preferences motivated by altruism. There are several reasons why such preferences ought to be admitted to normative economic analysis. The first is brute inevitability. As the philosopher James Griffin observes, it is frequently

... impossible to separate self-regarding and other-regarding desires. Each of us wants certain pure states of himself (e.g., to be free from pain); but we also want our lives to have some point, and this desired state can be hard to separate from the states of others.²⁴¹

As constitutively social creatures,²⁴² our perceptions of ourselves, as well as objective metaphysical features of our identities,²⁴³ frequently depend upon our place within a web of social relations. Given that many of our goals and values make ineluctable reference to the lives of others, extrication of self-regarding and other-regarding preferences is frequently a fool's errand.²⁴⁴

Furthermore, even if it were possible to identify and weed out altruistic preferences from social choice procedures, this would not be appropriate. For to do so would

... sever the connection between [socially recognized] utility and happiness. A father's happiness can be at stake in his child's happiness—two persons' welfare riding on one person's fate. Allowing that is no violation of everybody's counting for one; it merely allows the father, like everyone else, also to count for one.²⁴⁵

In other words, given the psychological fact of interdependent utility functions, double counting the well-being of some (the child in this example) is simply the price that must be paid for counting well-being of those who hold external preferences (the father here) *even once*. Contra Dworkin's contention, then, it appears that a rationally constructed consequentialism must double count (at least) altruistic other-regarding preferences.

Indeed, in light of our species' social nature, it is simply not clear why other-regarding preferences evincing a wholly appropriate concern for one's family, friends, or society at large ought not count twice. Banishing such preferences “seems tantamount to endorsing the view that people should have preferences only for other things and not for other people—a particularly *narrow sort of materialism*.”²⁴⁶ This materialism is inherently perverse—even ‘fetishistic’ in Marx's sense²⁴⁷—and would likely foster antisocial dispositions likely to cash out in further undesirable consequences down the line.^{248,249}

²⁴¹ GRIFFIN, *supra* note 215, at 24. See also DWORKIN, *supra* note 169, at 276-77.

²⁴² See ARISTOTLE, *supra* note 40; ARISTOTLE, *POLITICS*.

²⁴³ See MICHAEL SANDEL, *LIBERALISM AND THE LIMITS OF JUSTICE* (1982).

²⁴⁴ The only realistic prospect of neutralizing altruistic preferences is provided by Dworkin's indirect approach. However, its application here would involve assigning rights to create spheres of autonomy that neutralize others' altruism, rather than their malice. This would only be sensible in the narrow set of circumstances involving unwarranted paternalism or moralism that is nevertheless predicated upon genuine concern.

²⁴⁵ GRIFFIN, *supra* note 215, at 24.

²⁴⁶ KAPLOW & SHAVELL, *supra* note 36, at 424 n.54.

²⁴⁷ See MARX, *supra* note 89.

²⁴⁸ By contrast, cultivating altruistic preferences by paying them heed in policymaking is likely to yield positive social externalities. Such preferences tend “to be socially valuable because [their holders] are more likely to help and less likely to hurt others and because a given amount of resources will do more to enhance social welfare.” KAPLOW & SHAVELL, *supra* note 36, at 430 n.64.

²⁴⁹ Kaplow and Shavell consider one further response to the double counting argument that warrants consideration. They observe that “if one were consistently to ignore types of preferences,” such as altruistic preferences, “on the ground that respecting them advantages some individuals over others [i.e., those whose interests are double-counted],” then “many [self-regarding] preferences would [also] have to be trumped.” *Id.* at 425 n.55. For instance, suppose that

Impartial Sense of Justice. So much for altruism; let us move to consider distributive preferences based on an impartial sense of justice, which I will sometimes refer to as ‘justice-based distributive preferences’.²⁵⁰ These are preferences for some distribution of wealth or welfare to obtain because such distribution reflects one’s impartially held conception of justice or fairness. The thesis to be advanced is that, in spite of first appearances, such preferences are *not actually other-regarding preferences*, properly understood, and therefore do not fall within the scope of the double counting argument.

To see why, consider preferences for a particular person Alice to have some amount of wealth or welfare, and another particular person Bob to have some other amount. These are true other-regarding preferences, as they take the lives of other determinate individuals (i.e., Alice and Bob) as their subject matter. By contrast, justice-based distributive preferences are preferences for a state of affairs with a certain abstract property to obtain—namely, the property of distributive fairness. Critically, it is of no concern which particular individuals populate this patterned outcome, so long as the morally relevant properties of its inhabitants remain constant.

This point can be made more precise by employing the following conceptual distinction, which I’ve drawn in earlier work:²⁵¹

- An *identifying (or identity-sensitive) distribution* specifies individual wealth holdings, as well as the identities of the holders. For example: Alice has \$5, Bob has \$10, and Cathy has \$15.
- An *anonymous (or identity-insensitive) distribution* specifies a pattern of wealth holdings, without regard to the identities of the holders. For example: someone has \$15, a second person has \$10, and a third person has \$5.

Having made this cut, we see that justice-based distributive preferences are generally preferences for anonymous distributions to obtain. Some abstract pattern of holdings is desired in virtue of its fairness, without regard to which determinate individuals occupy the scene. However, it is only preferences for identifying distributions that are true other-regarding preferences, as they take the lives of specific persons as their objects.

As such, the former are not proper other-regarding preferences and fall outside the scope of the double counting objection. While counting A’s justice-based distributive preferences may have the *incidental effect* of advantaging B, B’s interests, *qua his interests*, are not weighted twice. If B’s interests, *as such*, are not taken into account twice in the social welfare calculus, then there is no objectionable double weighting.

If it were otherwise, and the test of a preference’s excludability was that its satisfaction incidentally advantaged others, then all sorts of paradigmatic self-regarding preferences would also have to be banished.²⁵² For example, the thespian’s preference for the construction of a theater

the state is deciding whether to expend public funds to build a theatre or sports stadium. In that case, giving weight to preferences for the theatre confers an advantage on those with dramatic talent, as construction of the theater would permit such individuals to earn greater remuneration and status by acting in the theater’s productions. This does not seem to be a legitimate reason to discount their preference.

²⁵⁰ See BARRY, *supra* note 210, at 295-96 (explicating and discussing the similar concept of “ideal desires” that embody one’s moral principles).

²⁵¹ The following closely follows Sam, *supra* note 67, at 1075.

²⁵² See KAPLOW & SHAVELL, *supra* note 36, at 425 n.55.

in lieu of a sports stadium would be deemed inadmissible if its satisfaction incidentally advantaged the actor's devoted following.

Finally, even if one were not persuaded by this technical argument, it is clear that justice-based distributive preferences should still be granted weight in normative economic analysis for similar reasons as altruistic preferences: viz., self-regarding and other-regarding components of distributive preferences are frequently entangled; excluding them would sever the connection between subjective satisfaction and socially recognized utility; it is appropriate to give weight to such preferences in light of humans' moral and social nature; and the fetishistic materialist implications of their exclusion should be averted.

Self-Interest. To complete our inventory, we come finally to distributive preferences predicated upon (enlightened) self-interest. Like distributive preferences motivated by an impartial sense of justice—though even more patently—these preferences are not true external preferences.

To illustrate, suppose that Cathy has a preference to live in a society with a fairly egalitarian distribution of wealth, either because of a distinctive character she finds agreeable (e.g., greater comradery, less exploitation), or because of downstream effects that she believes will ultimately redound to her benefit (e.g., less crime, greater education levels, and accompanying positive externalities). At the surface level, this preference is ostensibly concerned with a patterned assignment of goods and opportunities to others. Lest we be too quick to judge on the basis of superficial appearances, however, this distribution is ultimately deemed desirable in virtue of certain emanating benefits believed to accrue to the holder of the preference. Upon this deeper analysis, we see that preferences resting upon perceived self-interest are not other-regarding, and are therefore straightforwardly admissible.

Summary

Summarizing our findings: unless distributive preferences are borne of morally illicit motivations, they should be included in cost-benefit or social welfare accounting insofar as they are backed by a willingness-to-pay for their satisfaction.

The most effective method of neutralizing noxious external preferences, and of thereby taming the problem of illiberal influence, is to assign rights in areas where these preferences are particularly prevalent. Such rights serve as trumps on countervailing consequentialist justifications for illiberal regulation of these domains. Because noxious other-regarding preferences are more common with respect to social, cultural, and political association than with respect to economic association, there is ample justification for the modern jurisprudential trend of recognizing myriad fundamental constitutional rights in the former spheres, while acknowledging relatively few in the latter. Policymakers should be enfranchised to account for distributive preferences *not* predicated upon morally noxious psychological motivations in their design of the tax-and-transfer system.

In particular, in crafting a market-failure-correcting redistributive tax: (i) altruistic distributive preferences ought to count twice; while (ii) distributive preferences based on either an impartial sense of justice or (enlightened) self-interest are, upon closer inspection, not true external preferences and should therefore also be admissible.