The Uneasy Liberal Case Against Income and Wealth Transfer Taxation: A Response to Professor McCaffery

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I. INTRODUCTION

In two recent articles, Professor Edward McCaffery argues that the United States should repeal its federal income and estate taxes and replace them with a progressive tax on consumption. The basic proposal is familiar: The progressive consumption tax has a long and distinguished academic lineage, and consumption taxation in a variety of forms currently is enjoying renewed political popularity. Professor McCaffery's novel claim is that his proposal is grounded in liberal

* Professor of Law, Yale Law School. I would like to thank Bruce Ackerman, Marvin Chirelstein, Michael Graetz, Dan Shaviro and Larry Zelenak for their helpful comments on earlier drafts. I also received helpful comments from participants in the NYU Tax Law Review Colloquium on Wealth Transfer Taxation held in May 1996.

1 Edward J. McCaffery, The Uneasy Case for Wealth Transfer Taxation, 104 Yale L.J. 283 (1994) [hereinafter Uneasy Case]; Edward J. McCaffery, The Political Liberal Case Against the Estate Tax, 23 Phil. & Pub. Aff. 281 (1994) [hereinafter Liberal Case]; see also Edward J. McCaffery, Rethinking the Estate Tax, 67 Tax Notes 1678 (June 19, 1995) (testifying in favor of proposal to increase gift and estate tax exemption from $600,000 to $750,000).

2 Like Professor McCaffery, I use the terms "estate tax," "gift and estate tax" and "wealth transfer tax" interchangeably. See McCaffery, Uneasy Case, note 1, at 286 n.7. The argument here goes to the desirability of some kind of tax on inherited wealth and does not consider the relative merits of a tax on bequests (imposed on the donor's estate) as compared to a tax on inheritance (imposed on heirs).


egalitarian political theory, particularly that of John Rawls. In this Article, I argue that Professor McCaffery's argument, although provocative and interesting, is not persuasive. Professor McCaffery's articles make an important contribution because they seek to apply liberal egalitarian political theory to taxation. Professor McCaffery's particular recommendations, however, rest on normative claims that are in tension with basic liberal principles and on empirical predictions that rely on a strained reading of the available economic evidence.

To understand the nature of Professor McCaffery's surprising claim, one must understand both the traditional liberal justification for the estate and income taxes and the nature of consumption taxation. Traditionally, Rawls and other liberal egalitarians have considered an estate tax and, under some conditions, a progressive income tax, to be central to a liberal regime. In Rawls' theory, the estate tax is an important means of correcting disparities in the distribution of wealth and power that tend to undermine important principles of justice—the fair value of political liberty and fair equality of opportunity. Rawls also argues that progressive income taxation may be appropriate under conditions of extreme and continuing economic inequality, a condition that arguably is met in the United States today. Professor McCaffery, in contrast, argues that neither an estate tax nor an income tax is a prerequisite for distributive justice in a liberal egalitarian regime. Instead, he contends, a progressive consumption tax would best promote liberal objectives.

The defining characteristic of a consumption tax is that it removes from the tax base income that is saved or invested (for example, in financial investments like stocks or bonds or in real investments like plant and equipment). A consumption tax, by definition, taxes only income spent on current, personal consumption (for example, on cars, food and travel). By deferring tax on saved income until the money is spent, a proportional consumption tax essentially exempts the earnings on the investment from taxation. A progressive consumption tax of the kind Professor McCaffery advocates would offer significant

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5 See John Rawls, A Theory of Justice (1971) [hereinafter Theory]. Like Professor McCaffery, I use the terms "liberal egalitarian" and "liberal" interchangeably; thus, the liberal principles considered here exclude, among other things, libertarian theories.

6 See id. at 277-78.

7 See id. at 278-79 (advocating a consumption tax and an estate tax, and noting that if economic inequalities are severe, stronger measures, including progressive income taxation, are appropriate). For data on inequality of income and wealth, see note 20.

8 See McCaffery, Uneasy Case, note 1, at 289-97.

9 See id. at 335-58.

10 See Alvin C. Warren, Jr., Fairness and a Consumption-Type or Cash Flow Personal Income Tax, 89 Harv. L. Rev. 931, 938-41 (1975).
tax benefits to savers while penalizing those with high levels of consumption spending.\textsuperscript{11} In contrast, an income tax encompasses both consumed and saved income, and an estate tax taxes all inherited wealth, whether saved or consumed.\textsuperscript{12}

Professor McCaffery’s argument differs significantly from prior scholarship advocating a consumption tax. Many previous proposals for consumption taxation have been framed in explicitly utilitarian terms: Economists, in particular, have long argued that a consumption tax, relative to an income tax, would promote aggregate well-being by increasing economic efficiency.\textsuperscript{13} Other advocates have argued

\textsuperscript{11} A proportional consumption tax exempts from tax the income from savings. Although amounts withdrawn from savings are nominally taxed when consumed, the apparent tax on investment income is actually offset by the earlier exclusion accorded to savings. See generally Graetz, Implementing, note 3, at 1598-600 (describing “immediate-deduction/yield-exemption equivalence” and the conditions under which it holds). This familiar “yield exemption” result holds only if tax rates are constant, however, and under a progressive consumption tax, the exclusion may save tax at a rate that is higher or lower than the subsequent tax rate paid on consumption. Assuming that the progressive rate schedule itself remains unchanged, the applicable marginal tax rate for excluded savings or taxable withdrawals from savings is determined by the consumption levels in the year of saving and in the year of consumption, and because savings can be transferred across generations without tax, the saver and the consumer may be different people. Thus, depending on the circumstances, the progressive consumption tax may create a positive rate of tax on income from savings, a negative tax rate or a zero tax rate. In general, the tax rate on investment income will be positive where the saver faces a lower marginal tax rate than the consumer, negative where the saver faces a higher marginal tax rate than the consumer and zero where the two marginal rates are equal.

\textsuperscript{12} Several scholars have suggested an important, additional refinement to the conventional analysis of the difference between an income and a (proportional) consumption tax, explained in the preceding note. Given certain assumptions, it can be shown that the only economic difference between the two taxes is that an income tax taxes the risk-free return to capital, while a proportional consumption tax exempts the risk-free yield. Both types of taxes tax returns in excess of the risk-free rate or, under an alternative analysis that sees the government’s nominal “tax” collection as simply the return on its initial co-investment, both types of taxes fail to tax the return in excess of the risk-free rate. See David F. Bradford, Consumption Taxes: Some Fundamental Transition Issues, in Frontiers of Tax Reform 123, 129 (Michael J. Boskin ed., 1996). Professor Bradford suggests that the risk-free rate historically has been quite close to zero. See id. at 11. This is an intriguing point, because it suggests that the economic impact of adopting a consumption tax may be quite limited, and that the main differences relate to administration and issues of transition. The issue warrants further examination to take into account the differences between real world taxes and the model, in particular the nonrefundability of losses, the deviations in the income tax from the Haig-Simons accrual ideal and the possibility of progressive marginal tax rates in either type of tax. See Joseph Bankman & Thomas Griffith, Is the Debate Between an Income Tax and a Consumption Tax a Debate About Risk? Does It Matter?, 47 Tax L. Rev. 377, 397-402 (1992). This Article does not consider these issues further, except to note that this line of analysis raises serious questions about the magnitude of the economic impact of a consumption tax.

\textsuperscript{13} See, e.g., Dale W. Jorgenson, The Economic Impact of Taxing Consumption, 96 TNT 62-36, Mar. 28, 1996, available in LEXIS, Fedtax Library, TNT File (arguing that a consumption tax would increase GDP, savings, labor supply and real investment); see also Edward J. McCaffery, Tax Policy Under a Hybrid Income-Consumption Tax, 70 Tex. L.
that the consumption tax would avoid the considerable administrative challenge of measuring income from capital.\textsuperscript{14} Some prominent proponents of consumption taxation have recommended an additional tax on wealth, for instance, an estate tax, in order to preclude an undue advantage for the rich, who own a disproportionate share of capital and income from capital.\textsuperscript{15} In contrast, Professor McCaffery's case for a progressive consumption tax does not rely on utilitarian norms, but instead on the principles of liberal egalitarian political theory, and his argument rejects not only the income tax but also the estate tax.

In this Article, I argue that Professor McCaffery's argument is untenable at three key points. First, Professor McCaffery contends that traditional liberal theory has ignored an important distinction between the possession and the use of wealth, and that it is primarily the use, or consumption, of wealth that is objectionable on grounds of equality of opportunity or political liberty. Thus, he concludes, a tax on consumed income is ideally suited to a liberal tax regime.\textsuperscript{16} A closer examination shows that Professor McCaffery's argument discounts the significant political, economic and social power that possession of wealth confers. His claim ultimately turns on an ethically unconvincing characterization of private savings and investment as liberal values. In attempting to reconcile private power with public benefit, Professor McCaffery advances institutional innovations that are both unworkable and in tension with the premises of his argument.

Professor McCaffery's second argument concerns the economic effects of the estate and income taxes. He argues that liberal society appropriately values work and savings, which a consumption tax would encourage but which income and estate taxation discourage. In addition, he claims, the economic gains created by repeal of the income and estate taxes would tend to increase, rather than reduce, economic equality.\textsuperscript{17} Professor McCaffery's economic case rests on an overly optimistic account of the relevant empirical evidence and relies

\textsuperscript{14} See Andrews, Cash Flow Tax, note 3, at 1149.
\textsuperscript{15} See id. at 1172. For an argument that Professor Andrews' advocacy of a wealth tax is inconsistent with the premises of a consumption tax, and his response, see Warren, note 10, at 942-43; William D. Andrews, Fairness and the Personal Income Tax: A Reply to Professor Warren, 88 Harv. L. Rev. 947, 956-58 (1975).
\textsuperscript{16} See McCaffery, Uneasy Case, note 1, at 312-13.
\textsuperscript{17} See id. at 322-24.
on comparisons of an idealized consumption tax with the flawed, real-world income and estate taxes.

Finally, Professor McCaffery defends his interpretation of liberal egalitarian principles by reference to current social practices. He argues that liberal political theory has inappropriately ignored public opposition to the estate tax and contends that, in this case, public opinion is an appropriate guide to liberal egalitarian ideals. Social interpretation is, however, a tricky business, and Professor McCaffery's overly simple reading of public opinion and political rhetoric comes dangerously close to equating illiberal sentiments with liberal principles.

Although this Article challenges Professor McCaffery's conclusions, his work is important and well worth attention because it appropriately pushes us to consider how to fill in the significant institutional gaps in Rawlsian theory. Rawls provides a basic normative framework for thinking about just institutions but intentionally (and wisely) leaves unanswered many concrete questions about the nature of taxation in a liberal regime. Rawls' initial institutional recommendations regarding taxation are sketched in a few brief pages, and in a later work, Rawls acknowledges that matters of equitable distribution "rest on complicated inferences and intuitive judgments that require us to assess complex social and economic information about topics poorly understood." Assessing these complicated issues is a difficult task, but those who study tax policy and public finance and who are committed to liberal goals have a responsibility to bring to bear the best available information, to use it critically and to apply it responsibly to craft a taxing regime that best serves liberal goals.

These fundamental issues of justice in taxation are particularly important today, when already-large inequalities in income and wealth in the United States continue to grow and there is renewed debate in political circles about the propriety and economic costs of redistributive taxation and transfers. Although Professor McCaffery appar-

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18 See Rawls, Theory, note 5, at 274-84.
20 See, e.g., Edward N. Wolff, Top Heavy: A Study of the Increasing Inequality of Wealth in America (1995); Keith Bradsher, Gap in Wealth in U.S. Called Widest in West, N.Y. Times, Apr. 17, 1995, at A1; Edward M. Gramlich, Richard Kasten & Frank Sammartino, Growing Inequality in the 1980s: The Role of Federal Taxes and Cash Transfers, in Uneven Tides: Rising Inequality in America (Sheldon Danziger & Peter Gottschalk eds., 1993) (concluding that income inequality increased in the 1980's and that tax and transfer policy in the aggregate worsened income disparities, largely because of the decline in the relative importance of transfers, the share of transfers received by the high income elderly and increasing social security taxes).
21 The flat tax was a major issue in the 1996 Republican Presidential primary, and the 1996 changes in the former Aid to Families with Dependent Children program (including new time limits, work requirements and behavioral sanctions) were hotly contended. For
ently does not intend a general attack on redistribution from richer to poorer, his moral and economic arguments bear an uncomfortable resemblance to familiar claims made by opponents of redistribution. Left unanswered, Professor McCaffery's arguments could offer unwarranted (though unintended) theoretical support for an illiberal political agenda. Although liberal egalitarian principles may be, as a practical matter, a thin defense against the powerful currents of politics, they provide important reasons for tempering prevalent concerns about aggregate economic output with a modicum of distributional fairness.

Professor McCaffery's articles are long and complex, and I cannot respond to every argument in this limited space. This Article does not attempt to defeat all possible arguments for a progressive consumption tax, and, in particular, does not address arguments that are based on utilitarian norms or administrative considerations. Further, although this Article defends, as a matter of liberal principle, the imposition of redistributive taxes on income and wealth, it does not attempt a complete defense of the current estate and income taxes. Finally, although I question Professor McCaffery's conclusions, his work raises some important general questions about the nature of taxation in a liberal regime. The Conclusion highlights some of the important issues that Professor McCaffery's work presents and suggests alternative ways to pursue those questions.

II. Uneasy Normative Claims: The Liberal Value of Savings

Inheritance and the private accumulation of wealth create a classic dilemma for liberal theory. Liberal theory typically values liberty, equality of opportunity, and fairness in distribution, but these goals are not always mutually consistent. Permitting inheritance and the accumulation of wealth serves the goal of liberty by allowing people to reap the rewards of their efforts and to dispose of their wealth as they choose. Inheritance can, however, erect barriers to fair equality of opportunity and political liberty by giving some people an unearned head start in life. More generally, great disparities in wealth (whether through inheritance or lifetime accumulation) may interfere with political liberty and equal opportunity, and they also permit morally arbitrary differences among people (for example, innate intelligence, social background or a talent for producing highly marketable goods

or services) to determine their opportunities and well-being. Thus, there is an inevitable tension between the goal of maximizing individual liberty—including the liberty to accumulate wealth and to pass it on to one’s heirs—and the goal of preserving equal starting points for everyone.

Rawls’ principles of justice provide one method of setting priorities among these competing goals. The two principles of justice include a commitment to equal basic liberties and to fair equality of opportunity, and they also incorporate the “difference principle,” which provides that social and economic inequalities are acceptable only if they work to the greatest benefit of the least advantaged. Although Rawls provides relatively little guidance on concrete institutions to carry out these principles, he does sketch a tax and transfer system that includes an estate or inheritance tax, in combination with other institutions, including a flat-rate consumption tax or, in some circumstances, a progressive income tax. The current estate and income taxes do not dovetail completely with Rawls’ recommendations but reasonably might be said to strike a roughly similar balance between allowing workers to keep a substantial portion of their earnings and mitigating disparities in wealth that arise from morally arbitrary sources.

Professor McCaffery adopts these liberal goals but argues that traditional liberal policies strike the wrong balance among them. He argues that the income and estate taxes discourage work and savings, which a liberal society appropriately values. An initial problem with Professor McCaffery’s statements about work and savings is that they seem simply to recreate the classic liberal dilemma. Replacing the income and estate taxes with a progressive consumption tax would allow workers and their heirs to keep more of their earnings (at least if they save rather than consume them) and might encourage more work and savings (an empirical proposition that Section III considers). But liberal principles suggest strongly that one instead might “value work and savings” in a more meaningful sense by attempting to ensure fair equality of opportunity and political liberty for all workers, and by limiting the economic advantages that attend particular kinds of work that the market values highly. Thus, the challenge for Profes-

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22 See generally Rawls, Theory, note 5, at 75-80 (describing moral arbitrariness of natural endowments and how the difference principle addresses that problem).
23 See generally Bruce Ackerman, Social Justice in the Liberal State 201-06 (1989).
24 See id. at 302-03 (setting forth the two principles of justice and the priorities between them).
25 See id. at 277-78; see generally Mark L. Ascher, Curtailing Inherited Wealth, 89 Mich. L. Rev. 69, 81-84 (1990) (noting the tension between the rights of donors to dispose of their property as they choose and egalitarian arguments for limiting inheritance).
26 See McCaffery, Uneasy Case, note 1, at 296.
sor McCaffery is to explain why promoting work and savings is important enough to override competing liberal concerns.

Professor McCaffery offers a variety of normative arguments in support of this position. In this Section, I examine four principal shortcomings in Professor McCaffery's basic case.

As an initial matter, it is useful to clarify that, although Professor McCaffery often speaks of "work and savings" in a single breath, in fact, he is most concerned with savings. He argues, for example, that a progressive consumption tax does "not deter work or savings per se, except to the extent that the worker or saver insists on spending all of her wealth at once or in large units, in which case she loses a good deal of our sympathies and may even begin to generate ethical harms." If this were really a statement about the value of work, it would be rather peculiar: Under this view, a hard day's work is socially valuable not because of the diligence it requires or the social product it creates but only to the extent that the worker saves her wages. The best way to make sense of this position is to understand that Professor McCaffery does not value labor for itself but only when it adds to savings.

A. The Untenable Distinction Between Possession and Use

One key component of Professor McCaffery's argument is that traditional liberal theory has overlooked a crucial distinction between the possession and use of wealth. Professor McCaffery contends that "large-scale use may distort the allocation of resources and interfere with the fair value of prior liberties; it is the use and not the mere concentration of wealth that threatens reasonable liberal values." In the same vein, he argues that "mere possession" of wealth should not...
be objectionable, because savings contribute to the "common pool" and benefit society as a whole. Conversely, he claims, the consumption of wealth depletes the common pool and gives wealthy consumers an advantage over others in society. Thus, Professor McCaffery concludes, the fairest tax would be a progressive consumption tax, which exempts savings from taxation and imposes a progressively higher tax on greater consumption.

The first problem with this argument is that the distinction between possession and use of wealth simply will not bear the normative and analytic weight Professor McCaffery places on it. The boundaries between "possession" and "use" are not well-defined, and, contrary to Professor McCaffery's claim, the "mere possession" of wealth is quite rightly a subject of liberal concern. The unavoidable difficulty is that private wealth remains a source of current social, economic and political power that goes beyond the potential use of wealth for consumption. In addition to the social and political influence that wealth creates, the possession of wealth confers significant economic security; one need not consume wealth to bask in its benefits. The result is that Professor McCaffery's proposal would leave significant leeway for the exercise of economic privilege by the rich.

For example, Professor McCaffery repeatedly invokes the case of Ross Perot, the billionaire who spent enormous sums as a presidential candidate in 1992. The Perot example certainly illustrates the political dangers of large-scale political spending attributable to private wealth but does not support Professor McCaffery's further claim that the "mere possession" of private wealth is not similarly an obstacle to the exercise of political liberty by others. It is not at all clear that society would be more sanguine about the integrity of the political process if Perot simply held onto his money and exercised the indirect influence that the possession of wealth confers. For example, he might exercise significant political pull through his stock holdings. Instead of spending money on direct mail and television infomercials, he might influence politicians by promising to continue to invest in companies that do business in a particular jurisdiction, or by threatening to change investments or relocate plants. As long as Perot did not directly spend his money on consumption items, he could wield this sort of influence without incurring tax under Professor McCaffery's proposal. Such influence nevertheless is at least as destructive of the

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31 See id. at 295-96.
32 See id. at 324.
33 See, e.g., Ascher, note 25, at 93-96 (arguing that inherited wealth confers political power).
political process as outright campaigning. Arguably, it is more so, because it can occur with far less publicity.

Consider the more recent case of Steve Forbes, the heir to the Forbes publishing fortune, who spent large amounts of his own inherited wealth on an unsuccessful primary campaign for the 1996 Republican presidential nomination. In one sense, the Forbes example cuts in favor of Professor McCaffery's argument by illustrating that the current estate and income taxes did not foreclose the significant economic and political advantages of inheritance and that a progressive consumption tax might penalize Forbes' use of his inherited wealth in a political campaign. But ultimately, the Forbes case also demonstrates that the mere possession as well as the use of wealth is a matter of liberal concern. The concern that the current income and estate taxes did too little to curb Forbes' inherited financial power is an argument for a stronger estate tax, or for some other type of wealth tax, and not for a consumption tax. Now that the hype of the presidential primary is over, Forbes continues to wield the considerable political and social advantages that unspent wealth confers, which, in his case, includes editorial and financial control over a major business magazine.

Professor McCaffery anticipates the criticism that private possession of wealth can confer political and economic power even when it is not actually spent. In response, he suggests one intriguing substantive change in property law, but he describes it in a single paragraph and overlooks both its institutional complexity and its inconsistency with the rest of his normative argument. He argues that the power conferred by possession of wealth could be curbed by requiring private


35 A progressive consumption tax might have some symbolic advantage over an income tax in a Perot or Forbes case, because the tax would be imposed on the (visible) act of spending. Perhaps this symbolism would make society feel that it had raised the public cost of consumption power by the rich, whether in the political arena or elsewhere. This is not a particularly good argument for Professor McCaffery's proposal, however. First, the elimination of the income and estate taxes might leave Perot or Forbes with more to spend, even after paying the progressive consumption tax, depending on rates and the length of time wealth was saved. Thus, the timing of the tax, although perhaps symbolically appealing, might not curb actual spending power compared to current law. Second, if one liked the symbolic appeal and timing of a kind of "luxury tax" on very high consumption, one might favor imposing a progressive consumption tax, with a high exemption level, in addition to the income tax. Third, as Eric Rakowski points out, it is not at all clear that taxing conspicuous consumption is a liberal goal. See Eric Rakowski, Transferring Wealth Liberally, 51 Tax L. Rev. 419, 433-35 (1996).
savers to save through blind trusts or other limited savings vehicles.\textsuperscript{36} He argues that such arrangements would "preserve the efficiency of decentralized decisions while checking abuse, much as the loose form of government oversight of the current pension and charitable activity sectors now does."\textsuperscript{37}

Far from resolving the issue, this proposal simply highlights the difficulty of channeling privately-held wealth into truly public projects. The proposal is fascinating, because it suggests the potential for the creation of a new kind of quasi-public form of property ownership, but it raises a host of serious institutional and normative questions that Professor McCaffery does not consider. For example, creating a huge and influential new class of powerful financial intermediaries raises significant issues about the exercise of financial power by the managers of these trusts, who might assume for themselves the power that wealth confers. Corporate law scholars have long been concerned that the analogous separation of ownership and control that takes place in publicly-held corporations allows managers to divert shareholders' funds to their own personal use.\textsuperscript{38} Quasi-public blind trusts would appear to raise exactly the same issues and to extend these problems of agency arrangements to arenas where they do not now operate.\textsuperscript{39}

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\textsuperscript{36} See McCaffery, Uneasy Case, note 1, at 349. Professor McCaffery acknowledges that "one might consume or exercise power directly through investment; this is possession \textit{qua} use." Id.

\textsuperscript{37} Id.

\textsuperscript{38} See Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property (1932). There is a large literature attempting to explore ways of minimizing the "agency costs" that result from the separation of ownership and control. In the 1980's, some corporate law scholars viewed takeovers as a means of disciplining managers; more recently, scholars have sought more active monitoring of management by large shareholders. See Roberta Romano, Public Pension Fund Activism in Corporate Governance Reconsidered, 93 Colum. L. Rev. 795, 795-96 (1993).

\textsuperscript{39} The blind trusts would create in some respects an entirely new agency problem by creating a huge pool of private capital that is managed entirely by professionals, with little effective external oversight. The lack of oversight would come from two sources. First, the same measures that would prevent owners of the blind trusts from exercising investment control also presumably would preclude active oversight of investment decisions apart from basic claims for fraud and misappropriation.

In contrast, mutual funds and defined contribution pension funds typically offer beneficiaries a relatively high degree of control over investment choice, if only through the power to withdraw and reinvest capital in alternative funds. Second, unlike charities and defined benefit pension plans, the blind trusts would have no competing claimant who could help monitor the use of funds. Unlike charitable organizations, the blind trusts presumably would be operated with the goal of increasing private owners' wealth rather than for any explicitly public-regarding ends. Although the efficacy of public and private remedies to enforce the charitable use of charitable funds may be imperfect, it is at least a potential means of forcing managers to meet external goals. The blind trusts appear to resemble more closely defined benefit pension plans that manage beneficiaries' funds without allowing any management powers to beneficiaries. Even this analogy is quite imperfect,
Heavy regulation of the new funds might curb managers’ abuse of power (given a perhaps heroic assumption that the new regulatory regime would avoid bureaucratic paralysis or capture by fund managers), but that route creates yet another set of problems. Regulation of the blind trusts not only could preclude managers’ assertion of personal power but also could render such agents unduly timid or constrained in their investment choices, with the result that they make investments that are inefficient for their principals and for the economy as a whole. Corporate law scholarship has demonstrated that legal regulation of large financial intermediaries, like pension funds, mutual funds and banks, may prevent them from taking the kind of active role in corporate management that would be productive for corporations and for society.40 This scholarship also raises political questions that are relevant to Professor McCaffery’s proposal: Concern about the concentration of economic power could lead to over-regulation of the new trusts, and the trusts themselves might be constrained by political considerations in ways that would reduce the economic productivity of their investments.41 At the very least, these issues deserve more careful study.

Most significantly, the blind trust proposal is also incompatible with Professor McCaffery’s own objectives. Such arrangements may discourage work and savings by the wealthy, and (as the next Section describes), Professor McCaffery is particularly eager to promote work and savings by just this class of people. He argues that accumulating money to leave to one’s heirs provides a significant motive for work and savings and that the blind trust proposal (combined with elimina-

40 See, e.g., Mark J. Roe, A Political Theory of American Corporate Finance, 91 Colum. L. Rev. 10, 11 (1991) (arguing that American law and politics diminished the power of financial institutions to take large stock positions that would permit them to monitor corporate management). Thus, it is not necessarily a good defense of the blind trust proposal to point out that (to some extent) pension funds, charities, public corporations and even mutual funds now operate with a separation between ownership and control that is analogous to the blind trust proposal. Recent scholarship has raised significant questions about the management problems and other costs of this sort of organization, and these issues should be addressed before extending a similar and broader regime to virtually all private capital. See note 39 (arguing that the blind trusts would create potential problems of oversight that are more serious than those of pension funds, charities or mutual funds).

41 See Roe, note 40, at 32-36 (demonstrating that regulation of financial intermediaries’ role as corporate shareholders was motivated in part by populist suspicion of concentrated economic power); Romano, note 38, at 796 (noting that public pension funds face political constraints on their ability to take an activist stance in disciplining corporate managers).
tion of the estate tax) would preserve the ability to do so. That argument ignores another important motive for work and savings. The blind trust device, by definition, would deprive investors of the power to direct and manage their investments and to play a personal role in adding to their accumulated wealth. Surely that deprivation would tend to discourage work and savings by breaking the linkage between work and reward. The blind trust device would constrain investors to be only passive holders of wealth and (presumably) would allow them to take an active role only in enterprises in which they hold no significant stake. The magnitude of the empirical effect is uncertain, of course, but no more so than other economic effects about which Professor McCaffery is concerned. Would Ross Perot have worked as hard, or bargained as strategically, if his accumulated wealth would inure to a blind trust? Would Malcolm Forbes (Steve’s father) have built a major publishing empire if he could not have reinvested his own funds in the enterprise and have assured that, as owner, he also would control editorial content?

Thus, the blind trust proposal raises more problems than it solves. If owners of wealth view control over reinvestment as an important incident of wealth, the blind trust is a “tax” on wealth of exactly the kind that Professor McCaffery finds troubling. The current tax system strikes a distinctive compromise among liberal goals by constraining lifetime accumulation through the income tax and modestly curbing inheritance through the estate tax. Professor McCaffery’s consumption tax and blind trust proposal simply substitutes another form of interference with lifetime consumption and accumulation but repeals any limit on inheritance.

B. The Murky Depths of the “Common Pool”

The second problem with Professor McCaffery’s argument is that it mistakenly treats private savings as a liberal value. Professor McCaffery lionizes the “frugal capitalist,” who contributes to the “common pool” of savings, and he disparages the “decadent consumer” who depletes that pool. Professor McCaffery argues that “[i]t is use that takes away from others . . . and diverts resources to private prefer-

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42 See Section III.

43 Once again, corporate law scholarship on agency costs suggests that business managers perform best when compensation is tied to performance. See generally Robert C. Clark, Corporate Law 201 (1986).

44 McCaffery, Uneasy Case, note 1, at 347.

45 Id. at 341.
The common pool is a favorite metaphor among consumption tax advocates, who typically argue that savings benefit society as a whole. The problem with Professor McCaffery's use of this argument, however, is that the common pool idea is grounded in utilitarian, rather than liberal norms. Liberal egalitarian theory provides no rationale for preferring savings over consumption but instead seeks to allow the greatest possible leeway for individuals to pursue their own visions of the good—whether those life plans involve savings or consumption. Thus, although contributions to overall social well-being may carry greater weight in a utilitarian scheme, which might value highly any contribution to overall economic output, the common pool metaphor is not a convincing liberal justification for a moral judgment in favor of savings over consumption, particularly when such a judgment would ignore the inequalities of opportunity and political power that wealth creates and preserves.

The common pool metaphor also significantly overstates the unique public benefits of savings. Professor McCaffery invokes the concept of "public good" several times in describing the benefits of the common pool, but private investment is certainly not a public good in the conventional, economic sense of a commodity that can be used by some without diminishing its availability for others. Even accepting a looser use of the term "public good," it is not at all clear why private consumption is an "imposition" on the "collective" when private investment is not. An equally appealing metaphor would treat private investment, which directs resources to privately-valued ends, as also a withdrawal from the common pool for the benefit of identifiable individuals.

For example, it is difficult to view the investment of funds in the development of, say, the Ultra Slim Fast diet shake as public-spirited investment, even though those investments have clearly benefitted

46 Id.
48 For text accompanying note 56.
49 For example, he argues that "if the capital stock has elements of a public good, the good may be enhanced by the nominally private ownership of capital." McCaffery, Uneasy Case, note 1, at 311.
their investors and may have contributed to economic growth. I am clearly making a negative and frankly paternalistic judgment here about the social utility of investments in Ultra Slim Fast, and many people who value the chance to lose weight might disagree. But my point is not that people should not be able to invest their savings in the production of diet drinks if they choose. A liberal society seeks to give people considerable freedom to pursue their own visions of the good, and liberal theory recognizes that there are considerable advantages to using market transactions to allocate resources efficiently. My point is only that one can and should distinguish between investments that serve the rather narrow, private interests of consumers and producers and competing uses of social resources that arguably would do more to promote the public interest. If, like Professor McCaffery, one seeks to adhere to liberal principles, one should not adopt the utilitarian calculus that treats any utility-enhancing market transaction as a valuable social achievement. Liberal principles are quite compatible, of course, with allowing the markets to perform a wide range of allocative tasks, but they do require keeping in mind the principles of justice that, in some cases, warrant interference with those allocations in the service of other goals.

Even if one agrees that private savings and investment may have long-term social benefits, Professor McCaffery does not explain how private savings create a unique benefit for the collective. Savings and investment may produce social benefits by, for example, creating jobs, improving productivity through advances in technology or preserving and improving the infrastructure for future generations. On the other hand, savings is not the only kind of private activity that benefits others: Labor in the market and the family, charitable activities and even consumption certainly benefit others. Both savings and consumption, for example, involve (presumably) mutually beneficial trades between savers and borrowers, in the former case, and consumers and producers, in the latter. Consumption of a restaurant meal, for example, benefits the consumer as well as the restaurant’s owners, workers and suppliers. Some kinds of consumption expenditures have more general social benefits as well. Spending on health care and welfare improve not only the lives of the poor but also those who care about them and those who might employ a better-nourished and healthier workforce. The purchase of art and music may not simply gratify private tastes but may ensure the continuation of shared culture. This list might be extended indefinitely, but the basic question is why the “common pool” does not encompass these socially useful activities as well.
A defender of the common pool metaphor might respond that these activities all have some component of "investment" and so are properly understood as contributing to the common pool.\footnote{Many scholars have pointed out that the boundaries between consumption and investment are not always clear. See generally Michael J. Graetz \& Deborah H. Schenk, Federal Income Taxation, Principles and Policies 30-43 (3d ed. 1995). The tax treatment of human capital and families has been particularly troublesome. See generally Lawrence Zelenak, The Reification of Metaphor: Income Taxes, Consumption Taxes and Human Capital, 51 Tax L. Rev. 1 (1995); Louis Kaplow, Response, The Income Tax Versus the Consumption Tax and the Tax Treatment of Human Capital, 51 Tax L. Rev. 35 (1995). The law has developed in pragmatic ways to include in "consumption" a variety of personal expenditures. See generally Graetz \& Schenk, supra, at 30-43, 233-301. There is nothing magical about the conventional definition of consumption, however, and the point in the text is to question the moral basis for a distinction between consumption and investment as conventionally defined.} One might, without stretching too far, view health care or welfare expenditures as a form of investment in human capital. More generally, virtually any consumption expenditure that benefits people (food, clothing, education, leisure) could be treated as an investment in the human capital of workers or potential workers or citizens. Even the purchase of a CD could be seen as, at least in part, an investment in cultural vitality. The problem is that such an expansive interpretation of the common pool no longer would be a particularly good justification for a consumption tax. A tax base that excluded all socially-beneficial expenditures (broadly defined) might be ethically appealing but probably would not raise much revenue and certainly would not closely resemble the consumption tax that Professor McCaffery advocates, which is based on the traditional distinction between capital investments and other kinds of activities.\footnote{One might argue that the charitable deduction rules should provide the exclusive means for excluding socially-valuable activities from the income or consumption tax base. However much that argument might appeal on pragmatic or descriptive grounds, it is surely mistaken as an ethical matter: The charitable deduction represents a pragmatic compromise between the goals of encouraging (some) socially valuable activities while continuing to raise revenue and insisting on a degree of verifiability for deductions. It would be extremely difficult to argue that private gifts to a poor individual, for example, are not socially valuable just because they are not deductible.}

Thus, the basic problem is that Professor McCaffery's argument overstates the liberal value of savings. Liberal theory provides no moral rationale for privileging private savings over consumption, and there is no particular reason to believe that savings is a unique social good. Although liberal theory acknowledges the advantages of the market in allocating resources to provide goods that people want, it requires that the market operate within the confines of just background institutions that mitigate disparities in wealth.\footnote{See Rawls, Theory, note 5, at 73-74; cf. Michael J. Graetz, To Praise the Estate Tax, Not to Bury It, 93 Yale L.J. 259, 275 (1983) [hereinafter Praise] (arguing that market distributions are not inherently just because they depend on luck and on the public's tastes,}
C. The Uncertain Liberal Implications of the Thrifty-Spendthrift Parable

A third component of Professor McCaffery's case for rewarding savings and taxing high levels of consumption is based on a hypothetical story involving two individuals, Thrifty and Spendthrift. Both begin life with the same opportunities and capabilities, but—as their names imply—the former lives frugally, saves her earnings and passes on her wealth to the next generation, while the latter lives the high life and leaves her heirs to fend for themselves. Professor McCaffery uses this story to suggest that, at some intuitive level, people like savings and dislike (conspicuous) consumption. The important question, however, is whether that intuition has any grounding in liberal egalitarian theory, and a closer look suggests that it does not.

In general, liberal egalitarian theory places a high value on letting people pursue their own visions of the good, and—as Professor Rakowski points out—there is nothing in this version of liberal theory that would privilege savings over spending. Both spenders and savers should be equally entitled to pursue their own private plans, provided that the basic conditions of justice have been satisfied. Thus, there is no liberal reason to favor Thrifty over Spendthrift by penalizing large-scale consumption.

A more serious question is whether liberal theory provides any rationale for penalizing Thrifty's savings. A familiar argument for consumption taxation is that an income tax imposes a higher tax burden on the lifetime consumption of savers than on consumers; the familiar claim is that an income tax taxes saved income twice, while a (proportional) consumption tax taxes consumption equally, whether it occurs right away or is postponed. The answer to that question, in liberal

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often reflect joint production and almost always reflect the influence of social institutions). I recognize that Rawls and other liberal scholars also have adopted the common pool metaphor, but I respectfully suggest that, without a more compelling justification, the asserted moral distinction between savings and consumption remains unconvincing.

54 See id. at 342-44.
56 I added this Subsection in response to discussions at the Tax Law Review Colloquium, which were sparked by Professor Rakowski's article. See Rakowski, note 35.
57 See David F. Bradford, Untangling the Income Tax 315 (1986) [hereinafter Untangling] (arguing that an accrual income tax's "extra discrimination against savers" relative to a consumption tax is "a disadvantage in equity terms"); Andrews, note 3, at 1167-68 (arguing that "the lesser burden of a deferred tax is more appropriate because it ultimately imposes a more uniform burden on consumption, whenever it may occur, than does an accretion-type tax"). This argument does not completely fit Professor McCaffery's plan, because only a proportional consumption tax ensures no greater tax burden (in present value terms) on deferred consumption than on current consumption, but this argument appears to be part of Professor McCaffery's appeal to intuition, at least in Uneasy Case. In
terms, is that liberal institutions must balance competing goals. If one could be absolutely certain that all spenders and savers entered the world with equal abilities and opportunities, and if savings were nothing more than deferred consumption, there would be no liberal reason for disfavoring future over current consumption. As suggested above, however, the liberal dilemma arises because taxation of savings may be necessary to ensure equality of opportunity, and because economic returns to work or to investment often arise from morally arbitrary sources as well as from the different choices of equally-endowed individuals. Thus, Professor McCaffery's simple parable ultimately fails, because it abstracts from the complex, real-world circumstances that require mitigating institutions.

D. Accommodating Inevitable Imperfections in Liberal Institutions

Finally, a fourth element of Professor McCaffery's argument concerns the imperfection of liberal institutions. Professor McCaffery begins by noting, quite correctly, that fair equality of opportunity and just social institutions are not achieved (and may not even be achievable) in the real world. Rawls and many other scholars have recognized that fair equality of opportunity may not be feasible, but the traditional liberal response has been that, despite these imperfections, society should use the limited available measures (for example, tax and transfer policy) to mitigate disparities in equality of opportunity.

Professor McCaffery, in contrast, invokes the imperfection of real-world institutions to argue for abandoning altogether efforts to mitigate inequalities in inherited wealth. He points out that the estate tax does not address lifetime inequalities in wealth attributable to market outcomes and may even exacerbate lifetime inequalities in consumption, because estate taxation may encourage the wealthy to spend during their lifetimes. He concludes that a consumption tax is appropriate, because "[i]t now becomes possible that inequality in use is more offensive, even to prior liberal values such as the fair equality of opportunity, than is inequality in possession."
This is a peculiar conclusion, for three reasons. First, the argument once again relies on the possession-use distinction, which I have already questioned. Second, although it is troubling in liberal terms that the current estate and income taxes do relatively little to curb the lifetime influence of wealthy individuals, it is not at all clear that a recognition of persistent inequalities should lead to dismantling redistributive institutions rather than to strengthening them. Rawls, for example, initially recommends a consumption tax on the assumption that income is fairly earned but then suggests that stronger efforts at redistribution (for instance, through a progressive income tax) are the appropriate response to persistent injustice in institutions. Third, even if one agreed with Professor McCaffery that large-scale, lifetime consumption is particularly objectionable, the appropriate remedy would seem to be the imposition of a progressive consumption tax on wealthy consumers in addition to—not instead of—the income and estate taxes. The income tax already taxes both consumed and saved income, but it would be possible to levy an additional consumption tax (perhaps at progressive rates with a very high exemption level) to discourage the worst displays of conspicuous consumption.

Professor McCaffery also recognizes that one response to the limitations of the current income and estate taxes would be to strengthen them, but he rejects that possibility for reasons of economic incentives and political feasibility. I discuss Professor McCaffery’s economic arguments in Section III. The political argument is that there is no public appetite for higher estate taxes. As a descriptive matter, this may or may not be true, but, at a minimum, this is a rather one-sided claim: Professor McCaffery dismisses the possibility of improvements in the current income and estate taxes but overlooks the political factors that could distort or constrain a consumption tax as well. Neither the United States nor any major industrialized country has

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63 See Rawls, Theory, note 5, at 278-79. Rawls initially recommended a proportionate consumption tax but argued that “[i]t does not follow that, given the injustice of existing institutions, even steeply progressive income taxes are not justified when all things are considered.” Id. at 279; see also Rawls, Liberalism, note 19, at 268 (“The basic structure comprises first the institutions that define the social background and includes as well those operations that continually adjust and compensate for the inevitable tendencies away from background fairness, for example, such operations as income and inheritance taxation designed to even out the ownership of property.”).

64 See McCaffery, Uneasy Case, note 1, at 339-40.


66 See McCaffery, Uneasy Case, note 1, at 321, 327-28.

67 See id. at 326-35.
experience with the kind of progressive consumption tax Professor McCaffery favors, and it is likely that the same antitax forces that have weakened the estate and income taxes also would be brought to bear in minimizing the impact of a progressive consumption tax on the most powerful consumers.\textsuperscript{68} Recent flat-tax and consumption tax proposals already begin to demonstrate the immense complexity of the transition to a consumption tax and the kinds of political compromises that are virtually certain to be made.\textsuperscript{69}

Professor McCaffery also suggests another solution, arguing that the progressive consumption tax might incorporate a higher rate of tax on consumption funded from inherited wealth.\textsuperscript{70} This is an important proposal, because it could reintroduce a degree of taxation of inherited wealth, but it raises several questions. Although Professor McCaffery sets aside issues of implementation,\textsuperscript{71} in fact, these practical problems highlight some significant and inevitable tensions between the proposal and Professor McCaffery's main argument.\textsuperscript{72} The key issue is when consumption is deemed to come from inherited wealth. A taxpayer-favorable stacking rule, which deemed consumption to be made first from other sources of wealth, could render the surtax merely symbolic. A government-favorable stacking rule, which treated consumption as made first from inheritance, could replicate the effects of an inheritance tax, thus recreating the issues of fairness and incentives which Professor McCaffery works hard to avoid. Although Professor McCaffery might coherently argue for such a tax as a compromise between his objectives and the objective of taxing inheritance, the argument at a minimum should acknowledge the significant tension with the primary argument in the rest of the articles—that \textit{any} tax on inheritance inappropriately penalizes savings relative to consumption.

\textsuperscript{68} See generally Graetz, Implementing, note 11, at 1634 (noting that Congress may persist in according special preferences for particular types of investments in a consumption tax system, just as it has done in the income tax). Professor McCaffery appears to approve certain potentially significant erosions of the consumption tax base, for example, deductions for medical and educational expenses. See McCaffery, Uneasy Case, note 1, at 354.

\textsuperscript{69} For discussions of the administrative complexity of consumption tax proposals and the potential "loopholes" available, see Alan L. Feld, Living with the Flat Tax, 48 Nat'l Tax J. 603 (1995); Martin D. Ginsburg, Life Under a Personal Consumption Tax: Some Thoughts on Working, Saving, and Consuming in Nunn-Domenici's Tax World, 48 Nat'l Tax J. 585 (1995); see also Bradford, Untangling, note 57, at 94-99 (discussing issues of transition to a consumption tax).

\textsuperscript{70} See McCaffery, Uneasy Case, note 1, at 349-50.

\textsuperscript{71} See id. at 350, 352.

\textsuperscript{72} See also Comment of Carlyn McCaffery at Tax Law Review Colloquium, May, 1996 (arguing that creating a special tax regime to track spending out of inheritance, in effect, would recreate the worst administrative problems of the estate tax).
III. Uneasy Economic Claims: The Costs of Redistribution

Another key component of Professor McCaffery's argument concerns the economic effects of the income and estate taxes. Liberal theorists have long struggled with a second classic dilemma: Taxes on income and wealth may facilitate redistribution but, by discouraging work and savings, could ultimately work to the detriment of even the least advantaged. Well aware of this tradeoff, liberal egalitarians have traditionally sought to balance the ethical claims for redistribution against its economic costs. Rawls' difference principle, for example, permits economic inequalities to the extent that (by facilitating economic activity by the better off) they ultimately benefit the least advantaged.

Professor McCaffery's surprising claim is that his proposal can circumvent this classic dilemma of redistribution. Replacing the income and estate taxes with a progressive consumption tax, Professor McCaffery argues, would both increase economic output and promote economic equality. In effect, Professor McCaffery's argument is that

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73 At the Tax Law Review Colloquium, Professor McCaffery argued that his argument is not a "narrowly consequentialist one" and "does not turn on empirical effects." Professor McCaffery's earlier articles, however, devote considerable attention to empirical questions. See McCaffery, Uneasy Case, note 1, at 297 (describing five central arguments; of the five, one is an empirical argument that the estate tax is "ineffective" and "counterproductive," and one is a statement that no stronger tax is "popular or practical"); id. at 304 (discussing capital stock effects, and arguing that although capital stock is not the "trump," that "capital formation is relevant, even if not decisive, for all but the most purely rights-oriented liberal egalitarians"); id. at 313-21 (considering the behavioral incentives created by the income and estate taxes). Although the second article devotes less space to empirical arguments, it also seems to include consequentialist claims as an integral part of the argument. See McCaffery, Liberal Case, note 1, at 286-89 (arguing that the current estate tax creates incentives to make gifts, encourages consumption and discourages work and savings); id. at 289 (assuming that the incentives described have significant consequences and asking whether these consequences are "good results" on liberal grounds). My understanding of the role of consequentialist claims in Professor McCaffery's argument proceeds in part from the apparent grounding of the argument in liberal egalitarian theory, which is concerned with consequences, at least in part. Any Rawlsian argument for or against the income and estate taxes, for example, should consider the effects of social and economic inequalities (such as those that might attend the repeal of the income and estate taxes) for the least advantaged.

74 To use a well-known metaphor, redistribution is not a pure transfer of resources from richer to poorer but a "leaky bucket": The "leak" is the reduction in economic output that redistributive measures cause. See Arthur Okun, Equality and Efficiency: The Big Tradeoff, 91-100 (1975).

75 For an analysis of these issues in the context of the estate tax, see Graetz, Praise, note 53, at 264, 274-86 (recognizing the tension between the desire for structural tax reform and tax provisions designed to stimulate capital formation and arguing that the estate tax's contribution to progressivity in taxation outweighs its putative effects on capital formation).

76 See Rawls, Theory, note 5, at 78; see also id. at 277-78 (noting that inheritance is subject to the difference principle).

77 See McCaffery, Uneasy Case, note 1, at 345-50.
the conventional liberal economic wisdom is wrong and that taxes simultaneously can promote work and savings, enhance equality of opportunity and mitigate unfair disparities in wealth.\textsuperscript{78} A closer examination reveals, however, that Professor McCaffery's analysis overstates the likely economic costs of income and estate taxation and fails to consider some economic costs of consumption taxation. Thus, it is questionable whether his proposal would produce even the aggregate economic gains he claims. Even more troubling in liberal terms, he fails to establish that his proposal would produce a distribution of economic gains that would benefit the least advantaged.

It is useful to clarify the stakes here. The current estate tax taxes the wealthiest 1\% of decedents\textsuperscript{79} and raises about $17 billion per year,\textsuperscript{80} which (potentially, at least) is available for redistribution to the least advantaged.\textsuperscript{81} The income tax also imposes a significant tax on the capital income of the wealthy,\textsuperscript{82} and both the estate and income taxes encourage the rich to direct additional resources to the least advantaged through charitable contributions that reduce their estate tax liability. To make a convincing case for repeal of the estate tax on liberal egalitarian grounds, Professor McCaffery must show not only that replacing the estate and income taxes with a consumption tax would promote economic growth, but also that such growth would insure to the benefit of domestic residents who are among the least ad-

\textsuperscript{78} See generally id.

\textsuperscript{79} See id. at 298.

\textsuperscript{80} See Budget of the United States Government: Fiscal Year 1998, at 41 (1997) [hereinafter 1998 Budget] (the actual receipts in 1996 for estate and gift taxes were $17.189 billion).

\textsuperscript{81} This is not a large sum compared to total GDP of $7 trillion and a federal government budget of $1.6 trillion but neither is it entirely trivial at a time when federal spending on welfare payments to families, for example, is only $17 billion. See Stat. Abstract of the United States 451 tbl. 699 (1995) (showing 1994 GDP of $6.7384 trillion); 1998 Budget, note 80, at 20, 1191 (showing total 1996 outlays of $1.56 trillion and estimated outlays on Temporary Assistance to Needy Families of $16.67 billion).

\textsuperscript{82} Despite their relatively small revenue yield, the estate and gift taxes can contribute significantly to the progressivity of the federal income tax. In a 1983 article, Professor Michael Graetz estimated that, in 1970, the estate and gift tax contributed "nearly one-third as much to the progressivity of our tax structure" as progressive marginal income tax rates did. Graetz, Praise, note 53, at 271-72. Professor Graetz noted that 1981 changes in the estate tax were likely to reduce the progressivity-enhancing effect of the estate tax, see id. at 272, and a recalculation based on recent data confirms that fact. In 1992, the revenue raised by the estate and gift taxes ($11 billion) represented only 14\% of the revenue raised by progressive marginal income tax rates in excess of the average tax rate ($79 billion). See Budget of the United States Government: Fiscal Year 1994, at 11 (1993); IRS, SOI Bull., Winter 1994-95, at 206. Professor McCaffery discounts the progressivity argument, responding that progressive taxation of income and wealth conflicts with his alternative account of liberal distributive justice; that conventional measures of progressivity fail to take into account the effects of the estate tax on lifetime gifts and consumption; and that the estate tax burdens only the rich who fail to plan adequately. See McCaffery, Uneasy Case, note 1, at 331-32.
vantaged and that such benefits are likely to exceed those of the current income and estate taxes. This is a considerable task, and Professor McCaffery's empirical argument does not accomplish it.

A. The Uncertain Effects of Taxation on Work and Savings

The foundation of Professor McCaffery's case is the proposition that taxation has significant effects on work and savings.83 Professor McCaffery argues strongly that there is a consensus that high income tax rates are "inefficient and ultimately wasteful" because they lead high earners to reduce work effort significantly.84 In fact, the effects of income taxes on labor supply are highly uncertain. Economic theory teaches that an income tax both discourages work (through a "substitution effect" that makes work less attractive than leisure) and encourages work (through an "income effect" that leads people to work harder to make up the lost income).85 Empirical estimates of the effect of income taxes on work effort vary widely, and there is no consensus that the income tax has dramatically reduced aggregate labor supply.86

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83 See McCaffery, Uneasy Case, note 1, at 318-20; see generally Joel Slemrod, Do Taxes Matter? Lessons from the 1980s, 82 Am. Econ. Rev. 250, 250 (1992) [hereinafter Do Taxes Matter?] (noting that first Keynesians and then supply-side economists in the 1980's insisted that taxation significantly affects economic activity but concluding that "we were fooled again").

84 See McCaffery, Uneasy Case, note 1, at 319, 320.


86 Compare Martin Feldstein & Daniel Feenberg, Higher Tax Rates With Little Revenue Gain: An Analysis of the Clinton Tax Plan, 58 Tax Notes 1653 (Mar. 22, 1993) (arguing that behavioral responses that reduce taxable income will largely offset the revenue gain produced by tax rate increases), with Jane G. Gravelle, Behavioral Responses to Proposed High-Income Tax Rate Increases: An Evaluation of the Feldstein-Feenberg Study, 59 Tax Notes 1097, 1097-101 (May 24, 1993) [hereinafter Behavioral Responses] (arguing that Feldstein's and Feenberg's prediction greatly overstates the behavioral responses to higher tax rates and that labor supply responses to tax rate changes are small); see also Thomas Macurdy, Work Disincentive Effects of Taxes: A Reexamination of Some Evidence, 82 Am. Econ. Rev. 243, 246 (1992) (noting conflicting empirical evidence on magnitudes of labor supply effects of income taxes and concluding that "raising upper-bracket tax rates is likely to induce relatively minor adjustments in men's hours of work"); see generally M.A. Akhtar & Ethan S. Harris, The Supply Side Consequences of U.S. Fiscal Policy in the 1980s, Fed. Reserve Bank N.Y. Q. Rev., Spring 1992, at 12-13, 16 (noting difficulty of determining effects of tax policy during 1980's on labor supply and concluding that reductions in tax rates probably made a "significant, though modest, contribution to labor supply and potential output"); Gary Burtless & Robert Haveman, Taxes, Transfers, and Labor Supply: The Evolving Views of U.S. Economists, in The Relevance of Public Finance for Policy-Making 127, 135-41 (Hans M. van de Kar & Barbara L. Wolfe eds., 1987) (arguing against the "alarmist" view that taxes and transfers have reduced aggregate U.S. labor supply dramatically). In discussing the effects of taxation on labor supply and on savings, Professor McCaffery appears to be concerned with uncompensated or total elasticities, rather than the compensated elasticities that are relevant to an efficiency analysis. In other words, I understand his concern with "work effort" and "savings" to be about
Professor McCaffery claims that the estate tax also discourages work, but again both the theoretical prediction and the empirical evidence are uncertain. The estate tax might reduce work, if bequests are an important motivation for work, but once again the competing income effect might lead workers to work even harder in order to leave the same after-tax bequest. In addition, taxing inheritance might increase work effort among heirs. Professor McCaffery provides little empirical evidence to support his claim, and the actual effect of the estate tax on work effort remains uncertain.

Professor McCaffery's argument about taxation and work virtually omits mention of the significant fact that a consumption tax also may discourage work—and, by discouraging work, may lower the supply of savings. Although the magnitude of the consumption tax's effect on work effort is unclear, the potential effects of the tax are inconsistent with the welfare loss caused by tax distortions.

See Rosen, note 85, at 497. Professor McCaffery cites one study that suggests that receipt of sizeable inheritances undermines work effort, see McCaffery, Uneasy Case, note 1, at 320-21 & n.141, but rejects this argument on the ground that a "complete confiscation . . . would surely impact incentives at the donor level." Id. at 321. Why Professor McCaffery chooses to consider only confiscation of wealth, rather than estate taxation at current rates, is unclear. Even on this issue, intuitions differ; Professor Ascher, for example, argues that even virtual confiscation of inherited wealth is unlikely to discourage work. See Ascher, note 25, at 100-01. There is potentially another competing effect at work in the case of heirs. Professor McCaffery argues that the estate tax may discourage work by heirs if inter vivos gifts increase and if children who receive large transfers early in life are likely to work less than do heirs who receive inheritances later in life. See McCaffery, Uneasy Case, note 1, at 320.

See McCaffery, Uneasy Case, note 1, at 320.

See David F. Bradford, The Economics of Tax Policy Towards Savings, in The Government and Capital Formation 11, 28-29 (George M. Von Furstenberg ed., 1980) [hereinafter Tax Policy]. Professor McCaffery clearly understands the consumption tax's potential effects on work, see McCaffery, Uneasy Case, note 1, at 340-41, but he does not offer a clear exposition of the issue. Several discussions of the consumption tax in the article omit mention of the consumption tax's effect on work, even where that effect would seem to be highly relevant to the analysis.

See, e.g., McCaffery, Uneasy Case, note 1, at 330 (arguing that "[t]he adverse effects on work and savings incentives constrain the income tax rate structure, whereas it is primarily the adverse effect on consumption incentives that constrains rates under a consumption tax"); id. at 336-37 (focusing only on savings in comparing the relative efficiency of the income and consumption taxes); id. at 353-55 (providing reasons why the progressive consumption tax does not have the "chilling effect" on work or savings that the current tax system does; these reasons relate only to savings and do not address the work-leisure tradeoff directly).

Although it sometimes is said that a consumption tax creates a larger labor-leisure distortion than an income tax, because marginal tax rates must be higher to collect the same revenue from a smaller tax base, that statement is not necessarily correct. A tax on consumption or on income tends to make work (or, put another way, the consumption that earnings can buy) less attractive relative to leisure (compared to the hypothetical no-tax
with Professor McCaffery's apparent goal of encouraging work. Pro-
fessor McCaffery argues that "[i]f parties capable of high earnings in-
sist on spending all of their earnings, society faces a choice between
the good of work effort and the bad of excessive private, preclusive
use; society must draw lines. All practical tax systems come down to
some more or less arbitrary choices."92 This dismissal of the issue
seems a bit abrupt, however: Why is an "arbitrary choice" to tolerate
the work disincentives of the consumption tax acceptable, when, in
Professor McCaffery's view, such disincentives are among the key
shortcomings of the income and estate taxes?

Professor McCaffery also argues that the income and estate taxes
reduce savings,93 but this proposition too is controversial. There is no
consensus on which to base a strong empirical claim about the effects
of the income tax on savings, and indeed, one might describe recent
literature as producing an "emerging consensus" that changes in in-
come tax rates have no effect on savings.94 There is even less evidence

92 McCaffery, Uneasy Case, note 1, at 341.
93 See id. at 319-20, 327, 334-35.
94 See Lynn A. Karoly, Trends in Income Inequality: The Impact of, and Implications
for, Tax Policy, in Tax Progressivity and Income Inequality 126 (Joel Slemrod ed., 1994)
(noting the "emerging consensus" that "behavioral effects of taxes are in fact smaller than
previously estimated" and arguing that these results give greater leeway for redistribution);
shows that savings is not highly responsive to the rate of return and that earlier studies,
from the 1970's and 1980's, which found higher elasticities, now are thought to be mis-
taken. In theory, income taxes might increase or decrease savings. Taxing income from
capital lowers the return to capital, and this "substitution effect" makes savings less attrac-
tive. At the same time, however, the "income effect" may lead people to save more in
order to achieve the same (after-tax) amount of savings. See Jane G. Gravelle, The Eco-
nomic Effects of Taxing Capital Income 24-25 (1994) [hereinafter Economic Effects].
Some studies conclude that, for the population as a whole, the income and substitution
effects more or less cancel each other out. See Rosen, note 85, at 418 (citing a study by
Hausman and Poterba and concluding that "the difficulties involved in estimating the im-
pact of the level of taxation on saving have defied the efforts of economists to reach a firm
consensus"). Jane Gravelle concludes that "[t]he empirical evidence is mixed and inade-
quate to justify any certainty about the direction—or magnitude—of effects. ... [R]esearch
does not provide evidence of a strong savings response to a reduction of taxes on capital
income." Gravelle, supra, at 28; see also Joel B. Slemrod, The Simplification Potential of
Alternatives to the Income Tax, 66 Tax Notes 1331 (Feb. 27, 1995) (describing research
finding that the current tax rate on capital income is already close to zero, with the result
that adoption of a value-added tax might not stimulate aggregate investment). Professor
McCaffery acknowledges this basic uncertainty only in footnote citations. See McCaffery,
Uneasy Case, note 1, at 306 n.89.
on the effects of the estate tax on savings. In theory, the estate tax, like the income tax, may discourage saving by reducing the return on savings, but again there is a competing income effect that might lead savers to save more in response to taxes. Although it seems likely that people save for a variety of reasons—to provide for old age, to insure against economic calamity and to provide for one's heirs—at the moment, there is no economic consensus on the relative importance of the bequest motivation for savings or on the actual magnitude of the estate tax's impact on savings.

What is clear, however, is that other fiscal and monetary policies directly influence savings, and that their effects may dwarf those of the income and estate taxes. The federal budget deficit, for example, has been estimated to account for a large proportion of the decline in net national savings, and many commentators argue that reducing the deficit is the best way to increase aggregate savings.

See Graetz, Praise, note 53, 278-83 (noting significant empirical uncertainties about the effects of the estate tax on savings and capital formation).

See, e.g., id. at 281 (noting three competing models of savings behavior—life cycle, short-horizon and multigeneration models); McCaffery, Tax Policy, note 13, at 1208 n.308 (noting that “[t]he actual elasticity of bequest savings is an empirical matter that requires further study. However, compared to life cycle and precautionary savings, there are strong intuitive reasons to believe that bequest savings are relatively elastic because of their 'left-over' nature.”); Edward N. Wolff, Changing Inequality of Wealth, 82 Am. Econ. Rev. 552, 557 (1992) (noting that “[d]ebate has raged on the relative importance of bequests versus life-cycle savings in the accumulation of household wealth”), citing Denis Kessler & André Masson, Bequests and Wealth Accumulation: Are Some Pieces of the Puzzle Missing?, J. Econ. Persp., Summer 1989, at 141 (reviewing literature on the debate over savings motivations).

See Graetz, Praise, note 53, at 283 (“[T]he economic evidence available to date simply fails to make a case for the elimination or reduction of estate and gift taxes on the grounds that increased savings will result.”); McCaffery, Tax Policy, note 13, at 1208 n.309 (citing studies that reach different results on the question of the importance of intergenerational transfers in wealth accumulation). Henry Aaron and Alicia Munnell note that the importance of inherited wealth in the capital stock is highly contested, and they state their own findings in tentative terms. See Henry J. Aaron & Alicia H. Munnell, Reassessing the Role for Wealth Transfer Taxes, 45 Nat'l Tax J. 119, 130-32 (1992) (noting that “the role of bequests in wealth accumulation is clearly controversial and unresolved . . . [T]he central finding is that intergenerational wealth transfers are of sufficient size to establish a potential role for wealth transfer taxes to affect the distribution of wealth.”). They use this finding to argue for stronger wealth transfer taxes. See id. at 139. Professor McCaffery construes their findings as supporting the importance of bequest motivations in savings. See McCaffery, Uneasy Case, note 1, at 308-10. This evidence is minimal, at best, however, and leaves important issued unresolved. For example, the existence of a large stock of inherited wealth does not necessarily refute the “fortuitous leftovers” or life cycle view of savings, particularly if people are risk-averse and so accumulate large amounts of precautionary savings. Further, even if inherited wealth constitutes a significant part of the total capital stock, that fact conveys no information about the degree to which the current estate tax (or a stronger estate tax) would reduce the capital stock; that is a question of elasticity.

See, e.g., Akhtar & Harris, note 86, at 3; Graetz, Praise, note 53, at 282-83; Gravelle, Economic Effects, note 94, at 28 (arguing that a more direct route to increasing savings is to increase government savings); Eric Toder, Comments on Proposals for Fundamental Tax
Professor McCaffery notes that the estate tax also may reduce aggregate savings by transferring wealth from rich donors, with a higher propensity to save, to the government or to recipients of transfer payments, with a lower propensity to save. Any redistribution from richer to poorer presumably has this effect. Once again, however, the magnitude of this effect is unknown and depends on the nature of the transfers in question. (A priori, one would expect the marginal propensity to save from Social Security payments to be greater than from welfare payments, for example.) In addition, this argument adopts, without defending, an unduly narrow conception of government “savings.” A broader view might appropriately count as “savings” the long-term benefits of government investment spending (on education or infrastructure, for example). Even government “consumption” spending through transfer payments can have significant long-term, liberal benefits that might rival those of “savings” in the traditional sense: Government transfers to the poor, for example, ideally could improve long-term health, enhance equality of opportunity and even political liberty.

The broader point is—once again—that there is nothing intrinsically good about savings or bad about consumption, without specifying in more detail how savings serve liberal norms like liberty, equality of opportunity or security for the least advantaged. Although savings may promote long-term investment and economic growth, the question of the “right” rate of savings is notoriously difficult when taken seriously. Rawls, for example, struggles with the question of intergenerational justice and fails to reach a definitive answer to the question of the appropriate rate of savings. Professor McCaffery Reform, 66 Tax Notes 2003, 2008 (Mar. 27, 1995) (arguing that deficit reduction is the most direct way to increase national savings).

99 See McCaffery, Uneasy Case, note 1, at 311.

100 Professor McCaffery notes this fact but rejects the argument that “all ethically appropriate redistributions take from the rich and give to the poor.” Id. at 348. He turns again to the distinction between the possession and use of wealth, arguing, in effect, that ethically appropriate redistributions may redistribute from high consumers to low consumers, regardless of wealth. See id. The validity of this response turns on the possession-use distinction, which I questioned in Section II.

101 See Akhtar & Harris, note 86, at 8-10 (examining the economic impact of changes during the 1980's in government spending on education, public capital formation and research and development).


103 Rawls argues that just savings are to be determined in the original position, with due regard for maintaining just institutions and for the well-being of future generations. Although that principle suggests that current generations should not plunder the economy without thought for the future, it does not offer a definitive standard for judging whether current levels of savings are too low and explicitly does not require that each generation
acknowledges briefly that the question of the right amount of savings is morally complicated, but he then offers the familiar claim that there is a "consensus" that the U.S.' capital stock and savings rates are too low.\textsuperscript{104} Despite the popularity of this claim, it is an extremely weak justification for concern about absolute levels of savings, because it credits economic experts with what is fundamentally a normative judgment.

Finally, at several points, Professor McCaffery argues that the estate tax is objectionable because it encourages the rich to engage in inter vivos giving and lifetime consumption, which Professor McCaffery characterizes as "illiberal" effects.\textsuperscript{105} Although this argument provides an interesting elaboration of some of the potential tradeoffs inherent in an estate tax, it is not a particularly effective critique. First, the argument simply describes some additional goals that may be in tension with one another but offers no reason for choosing one over another. On liberal grounds, it is not immediately clear why unlimited inheritance should be permitted in order to avoid encouraging lifetime gifts or conspicuous consumption. Second, once again it is important to remember that potential incentives do not necessarily translate into behavioral changes of any significant magnitude; Congress surely would not repeal the estate tax in order to avoid minimal increases in lifetime gifts or consumption. Professor McCaffery argues that gifts and consumption patterns are "undoubtedly sensitive" to tax rules but offers little in the way of empirical evidence.\textsuperscript{106} One might expect the rich to respond to tax incentives, but many people would be reluctant to save taxes by giving away or consuming the social and economic power that their wealth confers (including considerable power within the family, which might be particularly important to an aging donor). Finally, the asserted tradeoff also assumes the impossibility or undesirability of reform; for example, inter vivos gifts might be discouraged if the gift tax rates were made tax-inclusive or if the advantages of estate freezes could be curbed.

\textsuperscript{104} See McCaffery, Uneasy Case, note 1, at 305.

\textsuperscript{105} See id. at 313.

\textsuperscript{106} See id. at 316-18. Evidence that large gifts are made does not tell us what the magnitudes would be without the tax. Professor McCaffery acknowledges that "causality is difficult to establish." Id. at 318.
B. Distribution and the Limited Predictive Capacity of the Stiglitz Hypothesis

The second component of Professor McCaffery’s economic argument concerns the impact of the estate tax on the distribution of income and wealth. Relying on a 1978 paper by Joseph Stiglitz, Professor McCaffery argues that, by reducing the U.S. capital stock, the estate tax may actually increase inequalities in the distribution of wealth by increasing capital’s share (and reducing labor’s share) of total income. This claim is intriguing, to put it mildly, but a closer look reveals several serious questions about the empirical significance of Professor Stiglitz’s hypothesis and its normative role in Professor McCaffery’s argument.

First, Professor Stiglitz’s argument originally was posed as a theoretical possibility, not an empirical finding. His argument rests, in part, on the assumption that the estate tax reduces savings. For the reasons discussed above, this is a controversial assumption, and Professor Stiglitz’s brief theoretical analysis does not purport to resolve the matter. Other economists also have raised questions about Professor Stiglitz’s model, arguing that alternative (and equally plausible) models of behavior indicate that the estate tax does in fact reduce inequality. Even if we accept Professor Stiglitz’s theoretical model,

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107 See id. at 306 (“[W]hatever one thinks of the complicated social question of the optimal savings rates and capital stock, more savings would help reduce the cost of capital and increase productivity, ultimately resulting in higher wages.”)


109 See McCaffery, Uneasy Case, note 1, at 322-24.

110 Professor Stiglitz argues that the estate tax may increase inequality of consumption even if public policy offsets the decline in savings. See Stiglitz, note 108, at S146-49. This result follows from the observation that bequests typically increase equality of consumption, if parents tend to leave bequests to children who otherwise would consume less than their parents. In such a simply modelled world, assessing a “prohibitive tax” on bequests increases inequality of consumption. See id. at S148.

111 Professor Stiglitz argues that the reduction in savings comes about through two mechanisms: (1) a transfer from those with a higher propensity to save to those with a lower propensity to save, and (2) incentive effects. On the question of incentives, he notes the competing income and substitution effects for donors but ignores potential income effects for donees (in other words, reductions in bequests might lead donees to work harder or save more). He concludes, without empirical support, that “it does not seem likely” that the potential income effect, which leads people to increase savings to maintain a net after-tax bequest, will overcome the transfer effect. See id. at S138.

112 See Chris Sanchirico, Reassessing the Effect of Estate and Gift Taxes on Capital Accumulation and the Distribution of Wealth 3, 64 (mimeo, Yale University 1991) (arguing that “the pessimistic results obtained in existing models stem from their highly specific structure and are not robust to reasonable, indeed desirable modeling variations” and that “transfer taxes are as likely to increase as to decrease savings”). Sanchirico specifies alter-
the important—and unresolved—empirical question is whether the equality-enhancing features of the tax or the countervailing capital stock effects are larger.\(^{113}\)

Second, Professor Stiglitz’s simple model was not intended principally to mount a serious challenge to the estate tax but, instead, to argue for a change in economic methodology for evaluating the incidence of taxation.\(^{114}\) Professor Stiglitz shows that, if the government takes action through other fiscal policy or through monetary policy to offset the reduction in capital stock, the estate tax will increase equality of income and wealth.\(^{115}\) Professor Stiglitz’s primary point raises significant questions about Professor McCaffery’s policy conclusions.\(^{116}\) Even if the estate tax does reduce the capital stock, the government might adopt other policies to increase savings and counteract that result. Thus, repealing the estate tax is not the only, or even the obvious, route to increasing the capital stock. Other plausible policies include, for example, savings subsidies that could encourage increased life-cycle savings to offset reductions in bequest savings. Monetary policy or increases in government savings also might recoup savings lost through the estate tax.\(^{117}\) These alternative policies could increase savings in ways that benefit a larger class of savers or at least do not have the deleterious side effect of preserving disproportionate benefits for inherited wealth. Thus, a conscious governmental policy might choose to tax inherited wealth, as a liberally-disfavored source of savings, and to make up the economic differential elsewhere by encouraging savings distributed in a more egalitarian way.\(^{118}\) These alternative models of behavior, including an “overlapping generations” model that explicitly considers bequest motives; he finds that changes in the estate tax do not necessarily reduce savings, and that an increase in the estate tax probably increases equality in the distribution of wealth. See id. at 11-48; see also Rosen, note 85, at 499 (noting that “[w]hile Stiglitz’s observations may be correct theoretically, from an empirical point of view they may not be very important.”).

\(^{113}\) See Rosen, note 85, at 516 (“Ultimately . . . the important question is whether the equality-increasing or equality-decreasing effect dominates empirically.”).

\(^{114}\) He constructed his argument to show that, under certain conditions, the burden of the estate tax may be shifted to labor, and to argue that “to evaluate the incidence of a tax in a growth context, one should compare policy changes which leave the aggregate capital labor ratio unchanged.” Stiglitz, note 108, at S137.

\(^{115}\) See id. at S137, S145.

\(^{116}\) Professor McCaffery notes Professor Stiglitz’s point in a footnote but fails to pursue its implications for his own proposals. See McCaffery, Uneasy Case, note 1, at 305 n.86.

\(^{117}\) See Stiglitz, note 108, at S139.

\(^{118}\) Of course, the relative efficacy of these alternative savings subsidies is also an empirical question. If, for example, the estate tax reduces savings by a large amount but other savings subsidies have only small effects, it might require a large net subsidy by the government (and thus higher tax rates generally) to begin to make up the lost savings. The important point here is that there are a range of options that liberal policies might pursue, and, without further study, there is no particular reason to think that repealing the estate tax is the best option.
ternative policies raise a host of empirical questions, but, at the very least, they deserve closer attention in a liberal program for encouraging savings.

Third, even if repeal of the estate tax increased U.S. savings, the new savings may not result in benefits that inure to U.S. workers. Professor McCaffery acknowledges this point in a footnote and correctly notes that "there is an interesting but seldom-asked normative question of whether we should be concerned solely with American prosperity." Unfortunately, Professor McCaffery fails to consider this important question. Left unaddressed, the problem of national boundaries is a significant shortcoming of his argument. One might seek to extend liberal principles beyond national boundaries, but Rawls, for example, hesitates to do so. This issue requires further consideration; any strong assertion that national boundaries do not matter, at the very least, would fit uneasily with Professor McCaffery's methodology of deriving liberal values from "our" social practices. If national borders do not matter, then whose values and commitments are relevant?

A final ambiguity in Professor McCaffery's use of the Stiglitz theory relates to the distribution of gains among workers. Even if repealing the estate tax would increase the capital stock and raise U.S. workers' wages, Professor McCaffery does not consider how the aggregate increase in labor's aggregate share of national income would be allocated among different classes of workers. Professor Stiglitz's conclusion that the estate tax reduces equality is based on the observation that labor income is more equally distributed than capital income, but "equality" as used here is dangerously underspecified. Which workers would benefit from an increase in the capital stock? For example, suppose that repeal of the estate tax would increase the incomes of the richest 10% of the population while reducing the incomes of the richest 1%. That sort of change is equality-enhancing in a narrow quantitative sense but is not normatively compelling in liberal terms, because it may do little to enhance equality of opportunity

119 See, e.g., Rosen, note 85, at 417-18 (noting that tax policy designed to stimulate saving may not lead to more domestic investment in an open economy); Bradford, Tax Policy, note 90, at 37 (emphasizing that the taxation of domestic wealth holders is irrelevant to the size of the domestic capital stock in an open economy).
120 See McCaffery, Uneasy Case, note 1, at 306 n.87.
121 Id. (emphasis in original).
123 I describe and address this argument in Section IV.
124 See Stiglitz, note 108, at S157; see also McCaffery, Uneasy Case, note 1, at 324 n.153 (noting that "[o]n a trivial level, most wealth transfers are equality enhancing, because the parent-transferors are wealthier than the children-transferees").
or to improve the circumstances of the least advantaged. These are questions, not answers, but they are fundamental issues that Professor McCaffery’s proposal should take into account.

C. A Leap of Faith

Thus, Professor McCaffery’s economic case against the estate tax is built on a shaky empirical foundation. Taking into account these substantial empirical uncertainties, Professor McCaffery’s real claim is that potential reductions in savings brought about by the income and estate taxes are sufficient to warrant repeal of all forms of taxation on capital and income from capital. The available evidence suggests that Professor McCaffery’s conclusion rests as much on intuition as on empirical fact.125

Professor McCaffery acknowledges that it is “difficult and perhaps impossible to ascertain” the truth about the economic effects of the estate tax126 but concludes:

A happy invocation of a priori insights cannot allow us simply to dismiss what evidence we do have, nor can we ignore the possibility of significantly counterproductive results. We should, at the very least, engage in a more careful risk-of-error analysis. Which consequences seem worst, and for what reasons? ... What are the worst-case scenarios that can emerge from any particular reform option?127

Although Professor McCaffery is quite right to call for reasoned discussion of the probable and possible consequences of alternative tax policies, it is not at all clear that the outcome of such a debate would

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125 For example, although Professor McCaffery acknowledges some uncertainty in the empirical evidence on savings, principally in footnotes 2 and 89 in Uneasy Case, he nevertheless concludes boldly that “capital will likely decrease due to behavioral effects on work and consumption decisions at the donor level ... it is initially hard to believe that high tax rates do not have disincentive effects, at least once we move beyond the life-cycle/fortuitous leftover view of large bequests.” McCaffery, Uneasy Case, note 1, at 310. Later, he characterizes the evidence in even starker terms, stating that the estate tax “almost certainly negatively affects the capital stock.” Id. at 312. This economic leap of faith is reminiscent of supply-side economics, which considers tax cuts to be the engine of economic growth. In fact, recent evidence suggests that supply-side economics did not work. See Akhtar & Harris, note 86, at 1, 16 (concluding that the favorable effects of reductions in marginal tax rates on potential output appear to have been smaller than the adverse consequences of large and persistent budget deficits).
126 McCaffery, Uneasy Case, note 1, at 361. He also notes, correctly, that “[i]n the particular case of wealth transfer taxation, many of the important economic variables, such as the relevant elasticities, are difficult to uncover; estimates of labor supply and savings elasticities vary widely.” Id. at 362.
127 Id. at 362-63.
favor his proposal. Replacing the income and estate taxes with a progressive consumption tax has the clear potential to increase inequalities of income and wealth, to perpetuate for generations even greater inequalities of opportunity, and to exempt wealthy investors from their obligation to help finance the cost of government. Professor McCaffery is eager to take action: He argues “The Case Against Doing Nothing” by urging, “Is not this—or something—worth a try?” On this evidence, I think the answer is “no.” Repealing the income and estate taxes could indeed “do something” quite serious by eliminating important redistributive institutions. The “a priori insights” that Professor McCaffery questions are, in fact, central tenets of liberal egalitarian theory, and they should not be set aside without more compelling empirical evidence than Professor McCaffery presents.

The existence of empirical uncertainty should not prod us into action for action’s sake: Trading uncertain benefits for likely harm is not a wise course.

IV. Uneasy Social Interpretation: The Dangers of Populism

Professor McCaffery structures his argument against the estate tax as a response to an initial “puzzle”: Despite its secure place in liberal theory, the estate tax has not garnered popular support in the United States or elsewhere, and existing wealth transfer tax regimes are limited in scope. Professor McCaffery argues that the solution to the puzzle is that liberal political theorists have misconstrued their own principles: “The people are not illiberal; their liberal leaders have failed them.” Professor McCaffery justifies his concern with public opinion by characterizing his theory as “political and interpretive.”

A “political” theory of tax is one that “takes seriously the idea that legal and economic rights and institutions are human-made; that tax rules are, so to speak, up for grabs,” and an “interpretive” theory “looks for norms in society’s actual practices and beliefs.”

Although Professor McCaffery is surely right that any sensible and appealing version of liberalism must pay close attention to society’s values, in this case, Professor McCaffery’s social interpretation is not

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128 Id. at 358, 363.
129 Liam Murphy and Eric Rakowski disagree on whether the estate tax is required as a matter of liberal principle. See Murphy, note 58; Rakowski, note 35. This is a subtle but important debate, but the larger point is that, although liberals may disagree about whether inheritance is a particular subject of liberal concern, inequalities of wealth and the attendant inequalities of liberty, opportunity and welfare clearly are a continuing liberal concern.
130 McCaffery, Uneasy Case, note 1, at 364; see also id. at 361.
131 Id. at 286.
132 Id.
careful enough. While practices may indeed reflect deep normative judgments, social interpretation is a delicate task, and the interpreter of social practices also must be an alert critic. An overly simple reading of current practices may elevate unthinking prejudices or narrow self-interest to the level of principles of justice.\textsuperscript{133} This Section outlines some important, unanswered questions about Professor McCaffery's approach to social interpretation, which accepts too readily casual public opinion as an authoritative source of liberal values.

The first problem lies in determining what "the public" believes. Public opinion polls provide one source of information, and Professor McCaffery cites the results of several polls that indicate public opposition to estate taxes.\textsuperscript{134} Public opinion polls are a questionable source of data, however. It is well known that poll results depend critically on the precise question that is asked. The classic example is that a majority consistently supports "aid to the poor," but a majority also opposes "welfare."\textsuperscript{135} The reported unpopularity of the estate tax may be similarly malleable: The public may reflexively reject a "tax" of any kind, but the answers might well differ if the question asked about compelling the richest 1% of society to contribute a fraction of their wealth to the cost of important government services.

Further, even if the poll results are accurate, uneducated public opinion may not be a reliable source of ethical guidance. Professor McCaffery considers but rejects the idea that the public is "too ill informed for our implicit practices to mean much of anything at all."\textsuperscript{136} He argues that "[t]here is nothing particularly confusing or confused about the people's opposition to the very idea of estate taxation, or about the absence of any popular clamor for more revenue on account of estate taxes."\textsuperscript{137} This is an assertion, not an argument, however, and does little more than reiterate the convenient match between public opinion and Professor McCaffery's proposal. The deeper problem is that there is no particular reason to think that public opinion necessarily reflects liberal values. Majority opinions may obscure or

\textsuperscript{133} See Susan M. Okin, Justice, Gender, and the Family 42-43 (1989) (arguing that communitarian appeals to "our traditions' and the 'shared understandings' . . . are both incapable of dealing with problem of the effects of social domination on beliefs and understandings") (emphasis in original); Michael Walzer, Interpretation and Social Criticism 21-22 (1987) (embracing a critical, interpretive approach to moral reasoning but cautioning that "the capacity for criticism always extends beyond the 'needs' of the social structure itself and its dominant groups. . . . Morality is always potentially subversive of class and power.").

\textsuperscript{134} See McCaffery, Uneasy Case, note 1, at 327-28.


\textsuperscript{136} McCaffery, Uneasy Case, note 1, at 287-88.

\textsuperscript{137} Id. at 288.
give too little weight to the valid concerns of minorities, and in any event, real-world opinions developed in the context of practical politics are virtually by definition not a good guide to what people would decide in the original position.138

Setting aside public opinion polls as a questionable source of information about society's deepest beliefs, one might look instead, as Professor McCaffery does, to the content of the tax laws. Professor McCaffery argues that "our actual tax systems are at best only weakly progressive, and at worst not progressive at all" and concludes that "[p]ractical liberal politics have gotten our objective social values wrong."139 Once again, however, social interpretation is considerably more complex than Professor McCaffery acknowledges. In fact, the law sends severely mixed messages. While the current income and estate taxes are not as comprehensive as they might be, they have remained in the law for many years and have exhibited greater and lesser degrees of progressivity.140 Although current law certainly contains elements of a consumption tax, including the realization requirement and the tax treatment of qualified pension plans, in recent years, Congress has adopted numerous reforms intended to strengthen the income taxation of various forms of income from capital.141 Further, despite the hybrid character of the current income tax system, a formal consumption tax, although vigorously promoted by some policymakers and scholars, has not yet been enacted, and recent proposals

139 McCaffery, Uneasy Case, note 1, at 364.
140 See, e.g., Graetz, Praise, note 53, at 260-63. Professor Graetz characterizes Congress' attitude toward the estate tax during this period as "schizophrenic." Id. at 263; see also Harry L. Gutman, Reforming Federal Wealth Transfer Taxes After ERTA, 69 Va. L. Rev. 1183, 1183-84 (1983) (discussing 1976 Act reversed by ERTA).
141 Many scholars have pointed out that the current income tax contains elements of a consumption tax. See Andrews, Cash Flow Tax, note 3, at 1128-40; McCaffery, Tax Policy, note 13, at 1152-55. Although that point is clearly true, the system is not a particularly coherent hybrid. See Bradford, Tax Policy, note 90, at 62 (arguing that "[w]hat we actually have is not a position between two poles [of income and consumption taxation] in any very pure sense, but rather different rules applicable to transactions that are virtually identical economically"). In addition, there also have been in recent years a number of attempts to strengthen the income tax features of the current hybrid system, notably efforts in the 1980's to shut down tax shelters and to improve the income taxation of complex financial instruments. See, e.g., IRC § 469 (passive activity losses), §§ 1271-1276 (original issue discount and market discount). For proposals to improve the income taxation of financial instruments, see generally David F. Bradford, Fixing Realization Accounting: Symmetry, Consistency and Correctness in the Taxation of Financial Instruments, 50 Tax L. Rev. 731 (1995); Deborah H. Schenk, Taxation of Equity Derivatives: A Partial Integration Proposal, 50 Tax L. Rev. 571 (1995); David A. Weisbach, Tax Responses to Financial Contract Innovation, 50 Tax L. Rev. 491 (1995); but cf. Jeff Strnad, Taxing New Financial Products: A Conceptual Framework, 46 Stan. L. Rev. 569 (1994).
appear to face fairly vocal opposition.\textsuperscript{142} Indeed, the United States, unlike many other countries, has no federal consumption tax, although many states have sales taxes. The fate of recent proposals for consumption taxation is still uncertain, and it is not at all clear that the public understands that many current “flat tax” proposals are in fact consumption taxes. This state of affairs suggests strongly that the country seems to like at least the symbolism, and some considerable part of the substance, of taxing income from capital and inherited wealth. At the very least, there is no clearly identifiable social consensus that opposes the taxation of wealth and capital income.

Another problem in social interpretation is to accord the proper weight to even clear statements of public values. For example, it is easy enough to find political speeches that extol work and savings as American values, but, once again, accepting these statements at face value and characterizing them as necessarily “liberal” is surely naive. Public statements about the value of work and savings often support illiberal policies or obscure a complex political agenda. Welfare reform, a perennial feature of national politics, provides a familiar example. For many years, proposals to encourage or require welfare recipients to work have been justified by rhetoric extolling the moral value of work.\textsuperscript{143} Claims about work in this context are, however, immensely complex, and the kinds of activities that count as “work” and the classes of people who are expected to work have shifted rather dramatically over time.\textsuperscript{144} Many scholars have suggested that claims about welfare and work reflect a combination of motives, including social control of the poor and near-poor, racism and sexism.\textsuperscript{145} The liberal rhetoric of work thus too often has been used to support illiberal policies. A wide spectrum of liberal egalitarian theory suggests that society ought to provide a social minimum,\textsuperscript{146} but current proposals could undercut even the precarious social minimum the American welfare state traditionally has provided.

Debates about capital gains taxation and tax subsidies to stimulate investment provide another example of seemingly straightforward rhetoric that camouflages complex social agendas. Proposals to cut


\textsuperscript{144} See generally Handler & Hasenfeld, note 143, at 44-169 (noting changing expectations about work by mothers and the elderly).

\textsuperscript{145} See id. at 201-09.

\textsuperscript{146} See note 102.
the capital gains tax or to increase accelerated depreciation inevitably are framed by their proponents as policies to increase savings and economic growth,\(^{147}\) but there is considerable empirical uncertainty about the effectiveness of these policies.\(^{148}\) There is less empirical uncertainty about the distributional effects of these policies, which disproportionately benefit the rich.\(^{149}\)

Professor McCaffery anticipates criticism based on the Madisonian concern that "the people will be predictably base and self-interested."\(^ {150}\) He argues that "Madison's fear has not come to pass. . . . Neither envy nor any 'soak the rich' populism can explain the [estate] tax's unpopularity and its practical evisceration, here and in other democratic societies."\(^ {151}\) What Professor McCaffery ignores, however, is that populism need not take the form of soak-the-rich "class warfare." Another kind of populism that is even more dangerous to liberal egalitarian ends may now be politically ascendant: A distinctly American, anti-tax, "soak-the-poor" populism that seeks to evade the costs of government, denigrate its achievements and blame poverty on the poor and on anti-poverty programs. Generalized anti-tax sentiment clearly proceeds, at least in part, from self-interest, even if it occasionally leads to opposition to taxes, like the estate tax, which might safely be imposed only on a minority. Opposition to taxation also may reflect the strong libertarian strain in American politics, which may or may not be defensible but which certainly is in tension with liberal egalitarian norms. At its very worst, the lionization of work and savings is the self-serving rhetoric of the uneasy middle class, which seeks to assuage its economic anxiety by asserting social control over the least advantaged.

V. Conclusion

Although Professor McCaffery's case for a progressive consumption tax is not persuasive, his arguments raise some fundamental issues that merit continued study. First, Professor McCaffery's work squarely poses the difficult question of how to set tax policy—or other social policy—when empirical information about the effects of taxa-


\(^{150}\) McCaffery, Uneasy Case, note 1, at 287.

\(^{151}\) Id. at 287.
tion on behavior remains uncertain. Although economic studies have improved understanding of the issues, they often provide conflicting or ambiguous answers. I have argued above that Professor McCaffery's current policy proposals reflect an unduly sanguine interpretation of the existing evidence and a willingness to take significant risks with potentially illiberal outcomes. It would be difficult, but also extremely useful for Professor McCaffery's project, to consider more systematically how to approach the problem of empirical uncertainty. Working within a liberal framework, one might ask, for example, whether people in the original position would favor a risk-averse approach to policymaking under conditions of empirical uncertainty, or a more adventurous one, and why.\footnote{Rawls and others have debated the question of risk aversion in the original position as it relates to the difference principle, and it would be interesting to consider whether those debates suggest any principled approach to this practical and important problem. See generally Rawls, Theory, note 5, at 164-66, 175-79; Jeremy Waldron, John Rawls and the Social Minimum, 3 J. Applied Phil. 21, 25-29 (1986) (discussing Rawls' characterization of risk-taking in the original position and arguing that people in the original position might choose a social minimum rather than the difference principle). Compare Ackerman, note 23, at 257-62 (discussing tax incentive arguments for special advantages (like inheritance rights), which may be claimed to work to the general advantage, noting the inevitably contested nature of competing empirical claims as well as the value questions that may be at stake, and advocating an ongoing liberal dialogue, in which the "collective sense of the contestability of special advantage" is a "permanent value that must be preserved at all cost"). This essay and Professor McCaffery's work perhaps can be viewed as one effort to conduct the kind of liberal dialogue that Professor Ackerman envisions. Framed in these terms, my argument is that Professor McCaffery's proposals rely on a flawed general advantage argument and would inappropriately eliminate the sense of contestability of special advantages accruing to inheritance and the possession of wealth more generally.}

Second, Professor McCaffery's work usefully calls attention to economic and political barriers to the creation and sustenance of liberal institutions. Although I have argued above that Professor McCaffery gives undue weight to public opinion and dismisses too readily the potential for reform of the income and estate taxes, his work (and that of others) usefully reminds us of important constraints on the redistributive agenda of liberal egalitarian theory. For example, the United States and other countries are facing economic conditions that may impose severe constraints on redistribution. The international mobility of capital may sharply limit countries' ability to tax wealth and capital income.\footnote{See Sven Steinmo, The End of Redistribution? International Pressures and Domestic Tax Policy Choices, Challenge 9-17 (Nov.-Dec. 1994).} In addition, the increasing importance of human capital and intellectual opportunities in determining earnings highlights the limitations of a transfer tax regime that generally fails to tax intergenerational wealth transfers in the form of education and
intangible human capital. Long-term demographic and economic trends also may create a significant challenge for traditional wealth transfer taxation. Professor John Langbein points out that wealth is increasingly held in the form of pension annuities that do not survive the decedent and in the form of human capital. These trends so far have not affected significantly the extremely wealthy class targeted by the current estate tax, but they do raise questions about the capacity of a wealth tax imposed on financial assets held at death to attack important disparities in wealth.

These limitations underscore the challenge of inventing or revising institutions to meet modern conditions, but they do not support Professor McCaffery's proposal. Although the contours of liberal institutions are not carved in stone, and it is worth exploring the merits of alternative arrangements, any convincing liberal alternative must comport with liberal egalitarian commitments to equal liberty, equal opportunity and an appropriate regard for the least advantaged. Professor McCaffery's proposal does not meet these criteria. It would limit redistributive possibilities from the revenue side, and his arguments relating to work, savings, public opinion and the capital stock emphasize the costs of redistribution while downplaying the liberal egalitarian case for mitigating disparities in opportunities and economic power. Although I applaud Professor McCaffery's willingness to take on serious issues of justice in taxation, and I admire his

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154 See McCaffery, Uneasy Case, note 1, at 329 (noting that wealth transmission occurs in the form of "hard-to-police opportunities and the passing on of knowledge"); Stiglitz, note 108, at 1748-49 (arguing that the estate tax may distort forms of transfer and lead to overinvestment in human capital relative to physical capital).


156 See id. at 724.

157 See Karoly, note 94, at 126-27 (summarizing studies that simulate higher income tax rates combined with an increase in the earned income tax credit and conclude that these changes have only a modest effect on inequality as measured by the Gini coefficient). The Gini measure is not necessarily a reliable guide to policy, however. See David M. Cutler, Comments, in Tax Progressivity and Income Inequality, at 130, 133-34 (noting that the Gini co-efficient underweights changes in the tails of the income distribution and arguing that, although taxes required to offset increased inequality between the wealthy and the middle class are too large to undertake, tax policy for the very poor might be worthwhile). These issues highlight the importance of avoiding unduly narrow definitions of inequality and defining more clearly the normative issues at stake.

158 Professor McCaffery anticipates the criticism that his arguments are anti-redistributive but turns it aside with the possession-use distinction that I question in Section II:

[This argument] reflects a failure to think through the normative distinction between the possession and use of wealth. If we progressively tax the use of wealth, we will not necessarily chill its private accumulation. . . . [A] progressive consumption tax is a way of protecting a "frugal capitalist class" while penalizing only the "self-indulgent aristocracy."

McCaffery, Uneasy Case, note 1, at 312.
articles' ability to integrate political and economic theory with the technical literature on public finance, his proposals ultimately are unpersuasive as a liberal approach to taxation.