LAW, TAXES, INEQUALITY, AND SURPLUS

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ABSTRACT

In this contribution to the Boston University Law Review *Symposium on Law, Markets, and Distribution, I introduce an important new exception to the presumption that the tax system is superior to the legal system as a tool to redistribute wealth. When legal rules are used to divvy up a surplus, there is no* a priori *reason to prefer the tax-and-transfer system over the legal system to address inequality. This is the "surplus-sharing exception."*

This surplus-sharing exception is noteworthy for two reasons. First, because surplus is ubiquitous, the surplus-sharing exception represents a major caveat to the presumption that the tax system is superior to the legal system as a tool to redistribute wealth. Second, and more specifically, surplus-sharing laws that regulate market transactions are a particularly useful pathway through which the legal regime can divvy up surplus, and so laws that regulate market activity are often superior to the tax-and-transfer system as a way to address inequality.

The discussion begins with a concrete example illustrating why a tax-and-transfer approach is not presumptively more efficient than legal rules as a way to address inequality when the task involves divvying up a surplus.

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INTRODUCTION

Calls to use market regulation to address inequality invariably face a question about the relative efficacy of law as compared to tax policy as the best means to achieve equitable ends. A central tenet of law and economics scholarship, the double-distortion presumption, holds that it is better to address redistributive goals through the tax-and-transfer system than the legal system.[1]

The logic justifying this presumption favoring the tax-and-transfer system over legal rules as a way to address income inequality is simple: choosing to enact legal rules to address income inequality causes two distortions. First, the legal rules so adopted will be less efficient than rules exclusively designed to maximize efficiency.[2] Second, legal rules that address income inequality create a disincentive to earn income. This second effect is the same disincentive that results from implementing redistributive tax policies directly. A tax on income (whether explicit or implicit) taxes labor but does not tax leisure.[3] The double-distortion presumption posits that the same redistributive benefits that might be provided by an inefficient law adopted to address income inequality could be achieved more efficiently by combining a slightly higher redistributive tax with a more efficient law.

If the double-distortion presumption is correct, then it is a mistake to turn to the law, including legal regulation of the marketplace, to address inequality. Thus far the double-distortion presumption has proven quite resilient.[4]

This Essay identifies for the first time an important situation where the double-distortion presumption does not apply. In myriad ways, the law is used to address what I have coined the "surplus problem."[5] A surplus presents opportunities and challenges. Opportunities arise out of the possibility of providing resources to those who are needy or deserving without making others worse off. Challenges arise from the fact that competition for surplus is both hard to prevent and inherently wasteful.[6]

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[1] *See infra* Part II.

[2] *See* Chris William Sanchirico, *Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View*, 29 J. LEGAL STUD. 797, 797 (2000).

[3] *See* Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. LEGAL STUD. 821, 825-26 (2000) [hereinafter Kaplow & Shavell, *Should Legal Rules Favor the Poor?*] ("Because the income tax applies to income but not to leisure, the effect of the income tax is . . . to distort the labor-leisure choice in the direction of too much leisure.").

[4] *See infra* Part II. For a discussion of three previously identified caveats to the double-distortion presumption, see *infra* Section II.B. For those who view the double-distortion presumption as otherwise deeply flawed, those parts of this Essay that focus attention on refuting the double-distortion presumption in the context of surplus-sharing laws will be of less interest.

[5] *See infra* Part III. For the coinage of the surplus problem terminology, see Michael D. Guttentag, *Law and Surplus: Opportunities Missed*, 2019 UTAH L. REV. 607, 610 [hereinafter Guttentag, *Opportunities Missed*].

[6] *See* Guttentag, *Opportunities Missed*, *supra* note 5, at 612.

My claim is that there is no reason to presume that laws designed to address a surplus problem are inferior to a tax-and-transfer system as a way to address inequality. The double-distortion presumption is based on the implicit assumption that the function of private law is to encourage parties to act in an efficient manner. For example, tort damage rules are viewed as a tool to encourage parties to adopt an efficient level of care.[7] The goal of surplus-sharing law is different: to avoid wasteful competition and maximize distributional equity in allocating a surplus. There is no reason to assume that the tax system will be superior to the law in achieving these dual goals. This is the "surplus-sharing exception."[8]

The insight that laws allocating surplus are not subject to the double-distortion presumption has important policy ramifications. For one, surplus is ubiquitous in a market economy.[9] As a result, using legal rules to divvy up surplus may be as effective or more effective than a tax-and-transfer approach to addressing inequality over a large swath of economic activity.[10] Calls to use legal regulation of the marketplace to address inequality should not be treated as a mere second-best approach to achieve a fairer distribution of resources.

I. AN EXAMPLE ILLUSTRATING THE SURPLUS-SHARING EXCEPTION

A simple hypothetical scenario can illuminate the basic intuition as to why the double-distortion presumption does not apply with equal force when legal rules are used to address a surplus problem. Let us imagine that we live in an alternate world much like our own except for the fact that everybody owns a similarly sized piece of land and meteorites containing quite valuable minerals regularly fall from the sky (in ways that fortunately never cause any harm). When these meteorites hit the ground, they roll forward for a bit. As a result, these meteorites cross over several people's property in readily identifiable ways before they come to their ultimate resting spot.

Consider two different legal rules that might be used to determine ownership of each of these meteorites. First, the legal rule might be that the meteorite belongs to whomever owns the land on which the meteorite ultimately comes to rest. Let us call this the "ownership where it stops" rule. This would be the laissez-faire approach to the allocation of meteorite property rights. Second, the legal rule might be that ownership of the meteorite depends on a comparison of the income of each of the individuals whose property the meteorite rolled over as it came to a stop. This second legal rule would then be that among these

[7] STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 178-82 (2004).

[8] *See infra* Part IV.

[9] *See* Guttentag, *Opportunities Missed*, *supra* note 5, at 608.

[10] *See infra* Part V.

landowners, the one with the lowest income would be granted ownership of the meteorite. Let us call this the "ownership to the poorest" rule.[11]

If we want to provide resources to those who have less income, then the second law, the "ownership to the poorest" rule, is clearly preferable to the first law, the "ownership where it stops" rule. In choosing the "ownership to the poorest" rule we are choosing a legal rule based on the distributional consequences of that law. What about the claim based on the double-distortion presumption that the tax-and-transfer system would inherently be more efficient than a legal rule when the goal is to address income inequality? Does it really make sense to ignore entirely the potential distributional benefits of the "ownership to the poorest" rule?

Several observations are in order. First, notwithstanding the potential redistributive benefits of the "ownership to the poorest" rule, implementing this rule will have one of the distortionary effects that the double-distortion presumption is designed to address. Implementing the "ownership to the poorest" rule will create a disincentive to earn income. Under this rule, earning more income will make it less likely that one will benefit from the meteorite windfall. Thus, the "ownership to the poorest" rule will distort the labor-leisure tradeoff (creating a socially inefficient incentive to choose leisure over labor) in precisely the manner identified by proponents of the double-distortion presumption.[12]

The second distortionary effect of concern to those who argue for the double-distortion presumption is, however, not present in this scenario. The choice of how to allocate this meteorite windfall does not have an obvious effect on the incentives of the parties affected. The potential distortionary effects of adopting an inefficient law, the central concern justifying the adoption of the double-distortion presumption, is not a problem in this situation. Neither method of allocating meteorites provides an incentive to deviate from socially optimal behavior beyond the incentive created for leisure over labor.[13] The presumption that laws based on considerations of equity are inferior to a tax-and-transfer system as a way to redress inequality does not exist here.

What does this mean for the right choice of law in this hypothetical world? In this world it is almost certainly less expensive to implement the "ownership where it stops" rule than to implement the "ownership to the poorest" rule. The

[11] There is a third rule one might explore. We could imagine a regime in which a central taxing authority takes ownership of all the meteorites and transfers the value generated by the meteorites to those deemed deserving. Whether this central government approach is superior to the "ownership to the poorest" law discussed in the text is going to turn largely on administrative cost considerations. This Essay does not separately consider this third approach here because the goal here is to communicate the basic intuition about why distributional effects are relevant when deciding how to allocate surplus. The taxing authority scenario is considered *infra* Section IV.A.

[12] Guttentag, *Opportunities Missed*, *supra* note 5, at 650-51.

[13] I am assuming that there is no way to invest resources to increase your chances of securing a meteorite.

"ownership to the poorest" rule would require identifying whose land the meteorite rolled through on its way to stopping and then comparing the income of the affected landowners. However, the added cost of implementing the "ownership to the poorest" does not mean that the best way to address inequality is to implement the "ownership where it stops" rule combined with a tax-and-transfer system. We need to compare the costs of implementing the "ownership to the poorest" rule with the costs of a system where the "ownership where it stops" rule is in place and a tax-and-transfer system is relied upon to achieve desirable levels of redistribution.[14] The "ownership to the poorest" rule may be a less expensive way to achieve desirable levels of redistribution. Most importantly, there is no reason to make a first-order presumption against law as a tool for redistribution in this context.

This meteorite hypothetical illustrates that when there is a surplus to be divvied up, perhaps because wealth is literally falling like manna from heaven, one can ignore considerations about incentive effects that might otherwise complicate the analysis of the costs of the distortionary effects of legal rules. In such a situation, use of the legal system to address inequality is not systematically disadvantaged as compared to the tax-and-transfer system.

These valuable but harmless meteorites are not as much of an impossibility as they might seem. Surplus in the economy is ubiquitous.[15] The law is used to determine how to divvy up surplus fairly and efficiently in a variety of contexts.[16] Whether the tax-and-transfer system or the legal system will do a better job of divvying up the value of surplus in ways that address both fairness and efficiency concerns is an open empirical question. There is no reason to presume the tax-and-transfer system will be superior.

II. THE DOUBLE-DISTORTION PRESUMPTION

The double-distortion presumption is a claim made about when and how the legal system should be used to address inequality.[17] The double-distortion presumption provides the following simple and sweeping answer to the question of how much weight should be given to the ability of a law to benefit those who are less well-off: none! The sole objective of legal rules, according to this line of analysis, should be to address efficiency goals, not distributive goals.[18] The canonical statement of this claim appears in the aptly titled 1994 article by Louis

[14] See *infra* Section IV.A for a numeric example of this comparison.

[15] *See infra* Section III.A.

[16] *See infra* Section III.C.

[17] Guttentag, *Opportunities Missed*, *supra* note 5, at 650.

[18] *See* Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 677 (1994) [hereinafter Kaplow & Shavell, *Less Efficient*] ("[I]t is appropriate for economic analysis of legal rules to focus on efficiency and to ignore the distribution of income in offering normative judgments.").

Kaplow and Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, as described more fully below.[19]

A. *The Kaplow and Shavell Argument*

Scholars now customarily refer to the argument Kaplow and Shavell presented in their seminal article as the "double-distortion argument," following Chris Sanchirico.[20] I would add that it is helpful to view their claim as one about the correct presumption to be made when presented with an argument for favoring one law over another based on considerations of redistributive benefits. Therefore, I use the term "double-distortion presumption" to describe the Kaplow and Shavell claim.

According to the double-distortion presumption, the choice to favor one law over another based on considerations of redistributive benefits causes two distortions. First, a legal rule adopted because of its equitable benefits will be less efficient than the more efficient alternative that would otherwise have been selected.[21] Second, there will be a loss of efficiency from adopting this more equitable rule because the adopted rule will create a disincentive to earn income.[22] This second effect is the same disincentive that results from implementing redistributive tax policies: implementing a redistributive tax or enacting a redistributive law creates a subsidy for leisure as compared to labor because leisure is not taxed. The presumption is that the better approach is likely to be the combination of a slightly higher redistributive tax with the more efficient law, because such an approach would not incur the additional cost of implementing an inefficient law.[23]

The implication of the double-distortion presumption for policy analysis is that the redistributive benefits of a legal intervention should not be analyzed as if legal intervention is the only way to achieve redistributive benefits. Quite the opposite. Instead, the redistributive gains from legal intervention should be compared with implementing a more efficient law and achieving redistribution through the tax-and-transfer system.

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[19] *See id.*; *see also* RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE: A STUDY IN PUBLIC ECONOMY 18 (1959) (describing competing concerns when considering government interference in allocation); Kaplow & Shavell, *Should Legal Rules Favor the Poor?*, *supra* note 3, at 821 (reaffirming prior conclusion that "legal rules should not be adjusted to favor the poor in order to further redistributive objectives"); Steven Shavell, *A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation?*, 71 AM. ECON. REV. 414, 414 (1981).

[20] Sanchirico, *supra* note 2, at 799.

[21] *See id.* at 798 ("[E]ven in the presence of an optimally redistributive tax system, legal rules would be adjusted away from the configuration dictated by pure efficiency in an effort to create positive redistributional effects.").

[22] *Id.* at 801 (asserting that in a world concerned only with efficiency, marginal tax rates would be zero, "[g]iven their distortionary effects on work incentives").

[23] *See* Kaplow & Shavell, *Less Efficient*, *supra* note 18, at 669.

The double-distortion presumption is a claim about means, how best to address inequality, not about ends, whether or to what extent the law should address inequality. The double-distortion presumption derives its compelling logic from a simple idea: it does not make sense to do indirectly what can be achieved more effectively by taking direct action.[24] The income tax system provides a mechanism to address income inequality directly.[25] There is a cost to an income tax: such a system creates a disincentive to generate income at the socially optimal level.[26] However, the unfortunate reality is that there is no viable cost-free alternative to transfer income from high-earners to low-earners.[27] The possibility that a legal rule can carry out this redistribution more effectively is illusory.

Many scholars accept as valid the double-distortion presumption. Fennel and McAdams observe, "Our sense today is that both the [Kaplow and Shavell] result and the policy advice have become the conventional wisdom, at least among many law professors who employ economic analysis."[28]

B. *Three Caveats to the Double-Distortion Presumption*

Subsequent research has identified three noteworthy caveats to the double-distortion presumption. These three caveats, as discussed more fully below, are (1) that Kaplow and Shavell rely on too simplistic an analytic model, (2) that the double-distortion presumption fails to address the legal foundations of property rights, and (3) that the double-distortion presumption ignores administrability costs.

The first caveat to the double-distortion presumption has to do with the assumptions in the mathematical model Kaplow and Shavell use to formalize their claim.[29] In that model, Kaplow and Shavell make simplifying assumptions about people's preferences[30] that are almost certainly false. Sanchirico argues that the policy ramifications of correcting these simplifying assumptions are significant, whereas Kaplow and Shavell argue that the policy implications of introducing more heterogeneity and complexity into their model are of minimal importance.[31] It remains disputed how significant an impact replacing these

[24] Kaplow & Shavell, *Should Legal Rules Favor the Poor?*, *supra* note 3, at 821-22.

[25] *Id.*

[26] Sanchirico, *supra* note 2, at 801.

[27] *See* Kaplow & Shavell, *Less Efficient*, *supra* note 18, at 677 (asserting that while distribution through both taxation and legal rules impose costs, doing so through taxation is more efficient).

[28] Lee Anne Fennell & Richard H. McAdams, *The Distributive Deficit in Law and Economics*, 100 MINN. L. REV. 1051, 1062 (2016).

[29] Kaplow & Shavell, *Less Efficient*, *supra* note 18, at 679.

[30] *Id.*

[31] *Id.*; Sanchirico, *supra* note 2, at 814-15; Chris William Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 CORNELL L. REV. 1003, 1008-09 (2001) (presenting several

simplifying assumptions with a more realistic model might have on the double-distortion presumption.

A second caveat to the double-distortion presumption has to do with property rights. David Blankfein-Tabachnick and Kevin Kordana observe that the double-distortion presumption takes as a given the preexisting assignment of property rights.[32] Blankfein-Tabachnick and Kordana argue that taking property rights as a given is deeply problematic for the double-distortion presumption because property rights themselves are a creation of the legal system. Moreover, property rights have significant effects on the distribution of income and wealth. Blankfein-Tabachnick and Kordana do not, however, offer guidance as to how property rules should be modified in ways that could address equity concerns more effectively than does the tax-and-transfer system. The significance or practical importance of the failure of the double-distortion presumption to grapple with the law's role in creating property rights remains uncertain.

A third caveat to the double-distortion presumption is based on practical considerations rather than theoretical concerns. Various scholars, including Lee Fennel and Richard McAdams, Christine Jolls, and Zachary Liscow, have raised the concern that the double-distortion presumption does not adequately account for practical considerations.[33] These critics of the double-distortion presumption argue that Kaplow and Shavell's preference for tax-and-transfer over legal rules as a means to redistribute income fails to take into account the various administrative and other costs of implementing either approach as a tool for redistribution. According to these scholars, once we include transaction costs, political action costs, behavioral biases, and other real-world costs, the unabashed superiority of the tax-and-transfer system over the legal system as a way to address inequality disappears.[34]

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challenges to double-distortion argument for focusing exclusively on the efficiency effects of private law rules).

[32] David Blankfein-Tabachnick & Kevin A. Kordana, *Kaplow and Shavell and the Priority of Income Taxation and Transfer*, 69 HASTINGS L.J. 1, 8-9 (2017) (arguing against claim that for the purpose of meeting egalitarian goals taxation is superior to changes in initial assignment of property rights).

[33] Fennell & McAdams, *supra* note 28, at 1053; Christine Jolls, *Behavioral Economics Analysis of Redistributive Legal Rules*, 51 VAND. L. REV 1653, 1657 (1998); Zachary Liscow, Note, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 YALE L.J. 2478, 2482 (2014) [hereinafter Liscow, *Reducing Inequality*]; Zachary Liscow, *Is Efficiency Biased?*, 85 U. CHI. L. REV. 1649, 1652 (2018); Zachary Liscow, *Redistribution for Realists*, 107 IOWA L. REV. 495, 509-11 (2022); *see also* Edward J. McCaffery & Jonathan Baron, *The Political Psychology of Redistribution*, 52 UCLA L. REV. 1745, 1748-50 (2005) (arguing that public is more likely to reject welfare-improving reforms).

[34] *See, e.g.*, Liscow, *Reducing Inequality*, *supra* note 33, at 2014 (examining effect of taking transaction costs into consideration when weighing tax-and-transfer system against legal system as way to reduce inequality); Fennell & McAdams, *supra* note 28, at 1052-53 (taking into account political action costs when it comes to weighing welfare-maximizing

The critique offered by these scholars is not meant as a challenge to the double-distortion presumption in theory. Fennel and McAdams, for example, state that they "do not take issue with . . . [the Kaplow and Shavell] formal result that for any increment of redistribution that a society might wish to achieve, the tax-and-transfer system can achieve it at a lower cost in behavioral distortion than can a legal rule."[35] Liscow similarly writes that "the orthodoxy [that we should redistribute solely through tax and transfer policies because those are the most efficient] holds in theory," although he adds that "it fails in practice because of the public's psychology about redistribution."[36]

Whether and to what degree these three concerns (that Kaplow and Shavell rely on too simplistic an analytic model, that the double-distortion presumption fails to address the legal foundations of property rights, and that the double-distortion presumption ignores administrability costs) undermine the importance of the double-distortion presumption remains an open and contested issue.[37] While these caveats introduce legitimate concerns about the double-distortion presumption, many scholars probably still believe that "it is a safe bet that a majority of legal economists hold the following view: Whatever amount of redistribution is deemed appropriate or desirable, the exclusive policy tool for redistributing to reduce income or wealth inequality should always be the tax-and-transfer system."[38] Matthew Dimick similarly concludes in an article reviewing the double-distortion presumption that "[responses to the double-distortion argument] have had only limited success in challenging the [double-distortion argument's] sturdy reputation."[39]

The new insight added by the analysis provided below is that there is an important class of legal rules for which the double-distortion presumption clearly does not even hold in theory: laws involving the sharing of surplus resources. The nature of surplus and law's role as a tool to share surplus resources is reviewed next.

redistributive methods); Jolls, *supra* note 33, at 1676-77 (suggesting that clear-cut neoclassical economic answers regarding redistribution methods become less clear-cut once behavioral economics is taken into account).

[35] Fennell & McAdams, *supra* note 28, at 1057.

[36] Liscow, *Redistribution for Realists*, *supra* note 33, at 495.

[37] For excellent surveys of the debate and arguments as to how valid the conclusions remain, see Matthew Dimick, *The Law and Economics of Redistribution*, 15 ANN. REV. L. & SOC. SCI. 559 (2019); Rory Van Loo, *Broadening Consumer Law: Competition, Protection, and Distribution*, 95 NOTRE DAME L. REV. 211, 217 (2019); Ramsi A. Woodcock, Antimonopolism as a Symptom of American Political Dysfunction 37-48 (Dec. 6, 2021) (unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3864585).

[38] Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 TAX L. REV. 157, 158 (2003).

[39] Dimick, *supra* note 37, at 560.

III. LAW AND SURPLUS ANALYSIS

The law has a rich and underappreciated history as a tool to divvy up surplus resources as summarized more fully below.

A. *About Surplus*

The first step in exploring law's role in divvying up surplus is to describe what constitutes a surplus. In simplest terms, a surplus exists wherever the value of something exceeds its cost.[40] Surplus so defined can arise in a variety of ways, including when the quality of a particular piece of land exceeds the quality of the marginal land available for purchase, when resources are combined to create something of greater value than the cost of those resources, or when a trade is made where one party to the transaction is willing to pay more than the price at which the other party is willing to sell. Many economists use the term "rent" to refer to surplus so defined, following the pioneering work of David Ricardo, but for reasons I have discussed elsewhere I prefer the surplus terminology.[41]

While it is difficult to estimate with precision the amount of surplus in the economy at any given point in time, preliminary estimates suggest that the amounts involved are quite large. Two methods for estimating the magnitude of surplus created just from market transactions in the U.S. economy suggest that the amounts involved are at a bare minimum in the range of trillions of dollars on an annual basis.[42]

Where does all of this surplus come from? One source of surplus is heterogeneity, or differences, both between and among buyers and sellers.[43] For example, Ricardo explained how a person who owns higher quality land earns rent (or surplus in my terminology) because the fecundity of her land exceeds that of the marginal land farmed, and the market price for renting land is determined by the productivity of the marginal land rented.[44] Differences

[40] *See* Guttentag, *Opportunities Missed*, *supra* note 5, at 608.

[41] Alfred Marshall also uses the term "surplus" to describe the area below the demand curve and above the supply curve. ALFRED MARSHALL, PRINCIPLES OF ECONOMICS 124-28 (8th ed. 1920). For use of the term "rent," see DAVID RICARDO, ON THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION 38-39 (Georgetown, D.C., Joseph Milligan 1819) ("It is only then because land is of different qualities with respect to its productive powers . . . that rent is ever paid for the use of it. . . . [T]he amount of that rent will depend on the difference in the quality of these two portions of land."). For an explanation of my preference for the surplus terminology, see Guttentag, *Opportunities Missed*, *supra* note 5, at 623 n.79. For a discussion suggesting the difficulties in making a precise determination of what constitutes a surplus, see Philippe Van Parijs, *Free-Riding Versus Rent-Sharing: Should Even David Gauthier Support an Unconditional Basic Income?*, *in* ETHICS, RATIONALITY, AND ECONOMIC BEHAVIOUR 159, 170-74 (Francesco Farina, Frank Hahn & Stefano Vannucci eds., 1996).

[42] *See* Guttentag, *Opportunities Missed*, *supra* note 5, at 629.

[43] Woodcock, *supra* note 37 (manuscript at 12-14).

[44] RICARDO, *supra* note 41, at 35-56.

between and among buyers and sellers are likely to be sustained and pronounced.[45]

Inequality may contribute to the heterogeneity that is the source of much surplus in a market economy.[46] Consider the following hypothetical example: a rich person and a poor person would enjoy equally an ice cream cone on a warm sunny day. However, the rich person is willing to pay $10 for the ice cream cone while the poor person is only willing to pay $2 for the same ice cream cone. Despite identical preferences, differences in their marginal utility of money will result in a quite different willingness to pay for the same delicious ice cream.[47]

Moreover, wealth differences are not only a source of surplus but a source of surplus that is problematic from a social welfare perspective.[48] If the price for that ice cream cone is $1, then the poor person will receive a surplus of $1 ($2 minus $1), whereas the rich person will receive a surplus of $9 ($10 minus $1), even though both enjoy the ice cream equally, and both are paying the same price. Liam Murphy and Thomas Nagel correctly observe that a "competitive market in private goods therefore automatically creates a large surplus—the difference between actual price and reserve price—for people who have lots of money."[49]

A final observation about surplus in the economy is that the fight for surplus is entering a new and more competitive phase.[50] More than a century ago, the introduction and adoption of price tags in retail stores led to something of a truce in the battle for surplus between buyers and sellers at least at the retail level.[51] However, this truce is breaking down.[52] New technologies allow firms to modify prices quickly and base prices on whomever the purchaser is.[53] These technologies enable sellers to capture a greater share of the surplus than when prices were more costly to change or personalize.[54] Consumers are fighting back

[45] For an analysis as to why surplus is likely to be ubiquitous and persistent in a modern capitalist economy, see Woodcock, *supra* note 37 (manuscript at 12-18).

[46] Guttentag, *Opportunities Missed*, *supra* note 5, at 625.

[47] For a discussion of differences in the marginal value of money between rich and poor, see Piotr Dworczak ® Scott Duke Kominers ® Mohammad Akbarpour, *Redistribution Through Markets*, 89 ECONOMETRICA 1665, 1669-70 (2021).

For a discussion of the use of the ® notation, see generally Debraj Ray ® Arthur Robson, *Certified Random: A New Order for Coauthorship*, 108 AM. ECON. REV. 489 (2018).

[48] Liam Murphy & Thomas Nagel, *Taxes, Redistribution, and Public Provision*, 30 PHIL. & PUB. AFFS. 53, 61-65 (2001).

[49] *Id.* at 60.

[50] Guttentag, *Opportunities Missed*, *supra* note 5, at 629.

[51] *Id.*

[52] *Id.* at 630.

[53] *Id.*

[54] *Id.* (citing Adam Tanner, *Different Customers, Different Prices, Thanks to Big Data*, FORBES (Mar. 26, 2014, 6:00 AM), https://www.forbes.com/sites/adamtanner/2014/03/26/different-customers-different-prices-thanks-to-big-data/).

with price comparison technologies.[55] The result is that the battle between purchasers and sellers for surplus is escalating anew.[56]

B. *The Surplus Problem*

The ubiquity of surplus is important to the design of a legal system because wherever there is a surplus, there are both opportunities and challenges.[57] The opportunities arise out of the possibility of providing resources to the deserving or needy without making others worse off.[58] The challenges arise from the fact that competition for surplus is both hard to prevent and inherently wasteful.[59] Therefore, the goal when divvying up a surplus should be to do so in a way that maximizes distributional benefits while minimizing wasteful competition.[60] Determining how to achieve this result requires solving what I have coined the "surplus problem."[61]

The surplus problem can be separated into three elements. The first element involves determining how to avoid wasteful competition.[62] In competition for surplus, one person's gain is simply another person's loss, and so any resources expended to claim surplus for oneself instead of someone else are wasted to the extent that there is a less expensive way than outright competition to allocate these surplus resources.[63]

A simple example of the problem of wasteful competition comes from the competition for foreknowledge in securities markets. When foreknowledge has no effect on the productive use of resources, as modeled by Jack Hirshleifer in *The Private and Social Value of Information and the Reward to Inventive Activity*, the socially optimal level of investment in acquiring foreknowledge is zero.[64] Yet the private benefits from acquiring foreknowledge in securities markets are likely to be substantial, and so there is an extreme mismatch between private and social benefits.[65] This example also illustrates why leaving the

[55] *Id.* at 630-31.

[56] See *id.* at 631 for a more detailed discussion of the nature of this historic truce and its recent demise.

[57] *Id.* at 660.

[58] *Id.*

[59] *Id.* at 661.

[60] *Id.* at 615 ("The goal in sharing a surplus is to do so in a fair and efficient manner.").

[61] *See id.*

[62] *See, e.g.*, Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224, 228 (1967) (explaining how wasteful competition for surplus results from everyday government decisions).

[63] Guttentag, *Opportunities Missed*, *supra* note 5, at 615 (citing ARTHUR C. PIGOU, THE ECONOMICS OF WELFARE 196 (1920)).

[64] Jack Hirshleifer, *The Private and Social Value of Information and the Reward to Inventive Activity*, 61 AM. ECON. REV. 561, 567 (1971) ("When private information fails to lead to improved productive alignments . . . it is evident that the individual's source of gain can only be at the expense of his fellows.").

[65] *Id.*

allocation of surplus to market forces might not lead to desirable levels of investment and innovation.[66] Private returns realized by investing to capture greater amounts of surplus far exceed the social gains from these investments.[67]

The second element of the surplus problem is determining what criteria to use when deciding how to divvy up the surplus among the interested parties.[68] Philosophers have grappled with this fundamental question of distributive justice for millenia.[69] Robert Nozick and John Rawls, for example, take diametrically opposed positions.[70] While Nozick argues that the rule should essentially be "finders keepers," Rawls recommends all surplus be pooled and distributed to those most in need.[71]

The third element of the surplus problem involves addressing tradeoffs between these first two elements of the surplus problem—avoiding wasteful competition, on the one hand, and equitably distributing resources, on the other hand—when such tradeoffs need to be made.[72] What should be done if the efficiency benefits of avoiding wasteful competition point in a different direction than the equity considerations of how to distribute resources to those who are most needy or deserving? For example, allocating surplus resources to the wealthiest may be the best way to avoid wasteful competition for surplus but the least desirable outcome in terms of addressing inequality.[73] I have previously argued that research on the so-called social welfare function provides a robust

[66] *See id.*

[67] *See generally* Terry L. Anderson & Peter J. Hill, *The Race for Property Rights*, 33 J.L. & ECON. 177 (1990) (considering aspects of property law that can be understood as efforts to minimize the waste that might otherwise arise from competition for surplus); Dean Lueck, *The Rule of First Possession and the Design of the Law*, 38 J.L. & ECON. 393 (1995) (explaining how different types of first possession rules can help to minimize rent dissipation).

For the implications of this insight on the design of insider trading law, see Michael D. Guttentag, *Avoiding Wasteful Competition: Why Trading on Inside Information Should Be Illegal*, 86 BROOKLYN L. REV. 895, 947-54 (2021) [hereinafter Guttentag, *Trading on Inside Information*]; and John P. Anderson, *Guttentag's Response to My Post Concerning His Article on Insider Trading as Wasteful Competition*, BUS. L. PROF BLOG (Mar. 22, 2022), https://lawprofessors.typepad.com/business_law/2022/03/guttentags-response-to-my-post-concerning-his-article-on-insider-trading-as-wasteful-competition.html [https://perma.cc/8KSE-KKZ5].

[68] Guttentag, *Opportunities Missed*, *supra* note 5, at 652.

[69] *See generally* DAVID GAUTHIER, MORALS BY AGREEMENT (1986) (portraying different views of distributive justice).

[70] *Id.* at 276 (analyzing both philosophers' perspectives on distributive justice).

[71] *See id.* at 276 ("Nozick would treat the right to [surplus] as a component of liberty, [while] John Rawls would not only demand its confiscation, but its redistribution so that, in effect, the surplus . . . would be enjoyed by those lacking . . . .").

[72] Liscow, *Redistribution for Realists*, *supra* note 33, at 552-57.

[73] MATTHEW D. ADLER, WELL-BEING AND FAIR DISTRIBUTION: BEYOND COST-BENEFIT ANALYSIS 114-34 (2012).

toolkit for making choices where these kinds of equity versus efficiency tradeoffs need to be evaluated.[74]

C. *Law as a Solution to the Surplus Problem*

There are many situations where the law proves to be a helpful tool when attempting to share surplus resources in ways that are fair and efficient. Much of property law, for example, can be understood as an effort to address the surplus problem.[75] Well-defined property rights can help to protect resources from wasteful competition, a problem made emblematic by the so-called "tragedy of the commons."[76] According to this line of analysis, in the absence of well-defined property rights, everyone will rush to capture surplus and in doing so fail to realize the costs their competitive efforts impose on others.

Conversely and less widely recognized, the denial of property rights can also be used as a way to address the wasteful competition aspects of the surplus problem. Richard Posner offers the rule of salvage in admiralty law as an example of this phenomenon.[77] The rule of salvage dictates that "persons by whose voluntary assistance a ship at sea or her cargo or both have been saved in whole" receives if the rescue is successful, an amount somewhat greater than the cost of rescue but not necessarily the full value of the goods rescued.[78] If there is value remaining after the salvager is compensated, that value goes back to the original owner of the property.[79] Posner's insight is that the rewards to the successful salvager need to be reduced lest "an expected gain be translated into costs through competitive efforts."[80] Posner concludes "the denial of a property right can be as much an economizing device as the creation of one."[81]

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[74] *See* Guttentag, *Opportunities Missed*, *supra* note 5, at 652. A social welfare function first "conceptualizes the status quo and each policy alternative as a pattern of *well-being* across the population of concern." Matthew D. Adler, A Better Calculus for Regulators: From Cost-Benefit Analysis to the Social Welfare Function 2 (Feb. 2017) (unpublished manuscript) (on file with author). These patterns of "*well-being* across the population of concern" are then converted into aggregate well-being levels based on an agreed-upon social welfare function. *Id.*; *see also* ADLER, *supra* note 73, at xiii (analyzing different ways social welfare function can be used to "evaluat[e] governmental policies and other large-scale choices").

[75] *See* Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243, 1244 (1968).

[76] *Id.* ("Each man is locked into a system that compels him to increase his herd without limit—in a world that is limited.").

[77] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 46 (8th ed. 2011).

[78] 3A BENEDICT ON ADMIRALTY § 2, 1-3 (Martin J. Norris 7th ed., rev. 2005) (citations omitted).

[79] GRANT GILMORE & CHARLES L. BLACK, JR., THE LAW OF ADMIRALTY 566-70 (2d ed. 1975).

[80] POSNER, *supra* note 77, at 45 n.4.

[81] *Id.* at 47 (emphasis omitted).

Other examples of actual or proposed legal rules that address the surplus problem include laws that place limits on price discrimination,[82] proposals to tax securities market transactions,[83] proposals to restrict the enforceability of consumer boilerplate,[84] and the prohibition against trading on inside information.[85]

D. *The Surplus Problem and the Double-Distortion Presumption*

The third element of the surplus problem—determining what should be done if the efficiency benefits of avoiding wasteful competition point in a different direction than the equity benefits of providing surplus to the needy or deserving—is the element of the surplus problem that is in direct tension with the double-distortion presumption. If the double-distortion presumption is applicable in this context, then addressing a surplus problem should only require solving the first element of the surplus problem—namely determining how to minimize wasteful competition for surplus.[86] The double-distortion presumption would imply that there is no need to consider the potential redistributive benefits of allocating surplus to those who are less well-off.[87] In the meteorite illustration this would mean the "ownership where it stops" rule is always superior to the "ownership to the poorest" rule, because the "ownership where it stops" rule will always be less expensive to implement.[88]

I will next show that this conclusion about the claimed irrelevance of the redistributional benefits of legal solutions to the surplus problem is incorrect because surplus-sharing represents an exception to the double-distortion presumption. When faced with a surplus problem, the best approach is to use social welfare analysis to address the tradeoffs, if any, between avoiding wasteful competition and achieving equitable distribution, while remaining cognizant of the fact that redistribution can also be carried out through the tax-and-transfer system—although not necessarily more efficiently.

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[82] *See* Ramsi A. Woodcock, *Big Data, Price Discrimination, and Antitrust*, 68 HASTINGS L.J. 1371, 1415-16 (2017) (arguing for adoption of price regulation over deconcentration to achieve distribution of wealth between consumers and firms); Ramsi A. Woodcock, *Personalized Pricing as Monopolization*, 51 CONN. L. REV. 311, 317-21 (2019); Guttentag, *Opportunities Missed*, *supra* note 5, at 638-40.

[83] *See* James Tobin, *A Proposal for International Monetary Reform*, 4 E. ECON. J. 153, 155 (1978); Lawrence H. Summers & Victoria P. Summers, *When Financial Markets Work Too Well: A Cautious Case for a Securities Transactions Tax*, 3 J. FIN. SERVS. RSCH. 261, 281-84 (1989).

[84] Michael Guttentag, *Hidden Markups, Inframarginal Transfers, and the Case Against Enforcing Consumer Boilerplate*, *in* THE INFRAMARGINAL REVOLUTION: MARKETS AS WEALTH DISTRIBUTORS (Ramsi Woodcock ed., forthcoming 2023) (manuscript at 3-4) (on file with *Boston University Law Review*).

[85] Guttentag, *Trading on Inside Information*, *supra* note 67, at 954-95.

[86] *See infra* Section III.B.

[87] *See infra* Section III.B.

[88] *See supra* Part I; *infra* Section IV.A.

IV. LEGAL RULES VERSUS TAX POLICY TO SOLVE A SURPLUS PROBLEM AND ADDRESS INEQUALITY

The stage is set. On the one hand, there is the double-distortion presumption which posits that considerations of inequality are inapposite when deciding on the optimal legal rule. On the other hand, there is research on legal solutions to the surplus problem which calls for balancing efficiency and equity considerations when deciding on the optimal legal rule. This Part will show the problem lies with the double-distortion presumption and that legal solutions to the surplus problem provide a concrete and important exception to the double-distortion presumption.

The discussion begins with a numeric example to show why it would be a mistake to follow the dictate of the double-distortion presumption and ignore consideration of inequality when addressing a surplus problem. The crucial insight from this numeric example is that the double-distortion presumption fails to consider the ways in which legal intervention can facilitate well-being beyond just encouraging behavior that is efficient on the margin.

The second Section of this Part considers how this surplus-sharing exception relates to earlier critiques of the double-distortion presumption. Finally, the third Section considers why the proponents of the double-distortion presumption have failed thus far to note that when law is used to divvy up surplus the double-distortion presumption does not apply.

A. *Numerical Example Comparing Law and Tax-and-Transfer as the Solution to a Surplus Problem*

In Part I of this Essay, I described a hypothetical scenario involving valuable but harmless meteorites to illustrate that when it comes to using the law to share surplus resources there does not appear to be a good reason to ignore redistributive benefits. That meteorite hypothetical can be used as the basis for a numerical example that further illustrates the failure of the double-distortion presumption in the context of law used as a tool to address a surplus-sharing challenge.

In the hypothetical introduced in Part I, we considered two legal rules as alternative ways to allocate the wealth provided by these meteorites. One legal rule was the "ownership where it stops" rule wherein the meteorite belongs to whomever owns the land on which the meteorite ultimately comes to rest. The second rule allocates ownership of the meteorite based on a comparison of the income of each of the individuals whose property the meteorite rolls over as it comes to a stop. This was the "ownership to the poorest" rule.

This meteorite hypothetical can be refined to include likely costs and benefits of applying each of the legal rules described above. To make the analysis concrete, let us assume that a given meteorite is worth $100. Next, I consider a scenario where we are also in the hypothetical world suggested by the work of

Ronald Coase in which there are no transaction costs.[89] The question of interest is whether to use a legal rule or the tax-and-transfer system to achieve redistributional ends. If we were to use a tax-and-transfer system, the government would tax the meteorite as income and then redistribute the proceeds from that tax in a manner deemed to be equitable. The alternative means to redistribute income would be to implement the "ownership to the poorest" rule. In the world of zero transaction costs our only concern is whether the "ownership to the poorest" rule can match the equitable efficiency of the tax-and-transfer system. Both approaches will create an incentive for leisure over labor, and there will be no other costs. This conclusion harkens back to the observation by Stewart Schwab that if there were no transaction costs then legal rules could focus exclusively on distributive concerns because private ordering regardless of legal entitlements would eliminate inefficiencies.[90]

This conclusion, that taxation and legal design are perfect substitutes in a world without administrative or transaction costs when it comes to allocating a surplus, is already a sufficient basis for rejecting the double-distortion presumption. The double-distortion presumption holds that before considering administrative and transaction costs the tax system should be favored over the legal system to carry out redistribution. Yet in determining how to allocate the wealth produced by these meteorites, whether by law or by tax, there is no reason to favor the tax approach over the legal approach in this setting.

The failure of the double-distortion presumption in this context remains even after we add a bit more realism about transaction and administrative costs into the scenario. The first step in making the scenario more realistic is to include some measure of the disincentive to earn income created by either a tax on income or a law that redistributes resources based on income. Let us assume the social cost of this disincentive to engage in income-generating activities is $5 under either approach.

The next step is to estimate the social benefits of redistributing the resource value of the meteorite to the less well-off. It seems fair to assume that a tax system does a better job of distributing resources to those who are most in need. The "ownership to the poorest" rule has the obvious limitation of allowing redistribution only to those whose property the meteorite rolled over as it came to a stop. Let us assume the social welfare benefit of redistribution through the tax-and-transfer system is $18, and the social welfare benefit of redistribution from implementing the "ownership to the poorest" rule is $15.

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[89] R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 2 (1960); Richard A. Epstein, *Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase*, 36 J.L. & ECON. 553, 555 (1993) ("The world of zero transactions costs is one in which all obstacles vanish from the path of one seeking the efficient allocation of resources.").

[90] Stewart Schwab, *Coase Defends Coase: Why Lawyers Listen and Economists Do Not*, 87 MICH. L. REV. 1171, 1173 (1989) (reviewing R.H. COASE, THE FIRM, THE MARKET, AND THE LAW (1988)).

Next, consider the likely costs of administering either approach. Using a tax-and-transfer approach to redistribute wealth from the meteorites would involve administrative costs related to the development and maintenance of the centralized technology necessary to implement a tax. There would also need to be monitoring done to assure that the value of the meteorites and the property where they came to rest were properly accounted for. Finally, a determination would need to be made as to who should receive the benefit from the surplus collected by the central taxing authority. Let us assume that the administrative cost of capturing and distributing the funds through the tax system is $15.

Implementing the "ownership to the poorest" rule would have a different set of administrative costs. The determination would need to be made among the landowners as to whom among them had the lowest income and, therefore, was entitled to own the meteorite. If the meteorite came to a stop on the property of the landowner with the lowest income then no more costs would be incurred. However, if it landed elsewhere, either the meteorite would need to be transferred back to the land of the poorest among those whose land the meteorite touched or perhaps an efficacious arrangement could be made so that the value of the meteorite was realized in the most efficient manner possible and the net proceeds were transferred to that individual. Let us assume that the cost of distributing the value of the meteorite under the "ownership to the poorest" rule is $8.

We can now calculate whether a tax-and-transfer system or the "ownership to the poorest" rule is the most efficacious way to distribute the value of the meteorite to those who are less well-off:

	Tax-and-Transfer of Meteorite Value	**"Ownership to the Poorest" Meteorite Value**
Disincentive to Earn Income	$(5)	$(5)
Redistribution Gains	$18	$15
Administrative Costs	$(15)	$(8)
Net Social Welfare of Redistribution	**$(2)**	**$2**

The conclusion from this numeric simulation is that not only is the "ownership to the poorest" rule the more socially efficient way to redistribute wealth (a $2 gain as compared to a $2 loss), but, in fact, redistribution is only welfare enhancing if the "ownership to the poorest" rule can be put in place. The net social welfare effect of the tax-and-transfer system is negative. In this example,

it would certainly be a mistake to ignore the redistributive benefits of enacting an "ownership to the poorest" rule.

This calculation is, of course, merely illustrative as is the hypothetical world where valuable meteorites fall upon us without ever doing any harm. The insight is quite real, however. Nowhere in the calculation does the second distortion that motivates the preference for tax-and-transfer over legal rules that is essential to the double-distortion presumption appear. The reason for the absence of this second distortion is that the legal rule analyzed here is not used to discourage inefficient behavior but rather to divvy up a surplus fairly and efficiently. When serving this end, legal rules are a perfectly reasonable substitute for the tax-and-transfer system as a way to achieve redistributive objectives.

B. *How the Surplus-Sharing Exception Relates to Earlier Caveats About the Double-Distortion Presumption*

This Section considers the ways in which recognizing that there is a surplus-sharing exception to the double-distortion presumption relates to caveats to the double-distortion presumption previously identified by other scholars. Above I identified three caveats other scholars have identified with respect to the double-distortion presumption.[91] First, I noted that the original Kaplow and Shavell article presented an analytic model that was overly simplistic. Scholars, most notably Sanchirico, argued that adding more realistic assumptions to that model greatly weakens the case for the double-distortion presumption. Second, I described the Blankfein-Tabachnick and Kordana argument that Kaplow and Shavell's failure to consider the origins of property rights limited the legitimacy of the double-distortion presumption. Third, I discussed the possibility explored by several scholars that Kaplow and Shavell did not undertake a sufficiently robust analysis of the practical obstacles to achieving desired levels of redistribution through the tax-and-transfer system alone, and that once practical considerations are included the inevitable inferiority of law as compared to the tax system as a way to address inequality disappears.

The discussion of the relationship between the surplus-sharing exception and each of these caveats proceeds in turn. First, with respect to problems related to the simplicity of the assumptions in the Kaplow and Shavell analytic model, there is little that identifying the surplus-sharing exception adds to the conversation.

Second, with respect to problems for the double-distortion presumption arising out of treating property rights as a given, surplus can be usefully thought of as unclaimed property. Therefore, the surplus-sharing exception provides a concrete example of a situation where failing to address the origins of property rights leads to a mistaken faith in the universality of the double-distortion presumption.

[91] *See supra* Section II.B.

Third, the observation that the double-distortion presumption needs to be leavened with practical considerations is certainly correct. This observation, as illustrated by the numeric example above, is also true when making the decision of whether to use law or tax to divvy up surplus in the fairest and most efficient manner possible.[92] What is different in the context of the surplus-sharing exception is that there is no need when applying the surplus-sharing exception to include a penalty for the inefficiency, or second distortion, that Kaplow and Shavell consider of paramount importance.

C. *Why Many Scholars Have Ignored the Surplus-Sharing Exception to the Double-Distortion Presumption*

This Section considers why law and economic scholars have thus far ignored the surplus-sharing exception to the double-distortion presumption.

This failure to make note of the surplus-sharing exception to the double-distortion presumption is emblematic of a more general failing among those who study law and markets.[93] These scholars often fail to acknowledge that markets do not work equally well at addressing two related but distinct challenges.[94] The first challenge involves efficiently allocating scarce resources.[95] At the price where supply equals demand, wonderful properties abound, including the much-heralded workings of Adam Smith's "invisible hand."[96] In the best case, assets are efficiently allocated throughout society.[97] The role of legal rules in this context is clear.[98] Legal rules can address market failures that might otherwise result from information asymmetries, the presence of externalities, or the abuse of monopoly power.[99]

However, if the question is how to facilitate the sharing of a rent or a surplus in a fair and efficient manner, then insights from Smith about how markets allocate assets efficiently through the price mechanism are not germane.[100] Unregulated competition for a surplus is inherently problematic because competitors have little or no incentive to consider the negative impact their

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[92] *See supra* Section IV.A.

[93] Guttentag, *Opportunities Missed*, *supra* note 5, at 615-16.

[94] *See id.*

[95] *Id.* at 615.

[96] ADAM SMITH, THE WEALTH OF NATIONS 242-43 (Shine Classics 2014) (1776); *see also id.* at 10 ("It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.").

[97] ROBERT H. FRANK, MICROECONOMICS AND BEHAVIOR 359 (10th ed. 2021) ("[I]n long-run competitive equilibrium, there are no possibilities for additional gains from exchange. The value to buyers of the last unit of output is exactly the same as the market value of the resources required to produce it.").

[98] *See* Guttentag, *Opportunities Missed*, *supra* note 5, at 615.

[99] *Id.*

[100] *See* SMITH, *supra* note 96, at 18.

competitive efforts will have on the fate of other competitors.[101] The "invisible hand" is as likely to destroy value as it is to create value when one party's gain is another party's loss.[102] This market failure is unlikely to be rectified by facilitating more or better competition.[103] Rather, instilling cooperation in place of competition is more likely to be the best approach.[104]

If the law is used as a tool to replace competition with cooperation, then the distortionary effects that are central to the double-distortion presumption are not germane to the analysis. As Ricardo observed, "the laws which regulate the progress of rent[] are widely different from those which regulate the progress of profits."[105] Leaving the fight for surplus to private parties must rest on different analytical foundations than does a choice to rely on markets to allocate resources efficiently.[106] Failing to realize that the role of law in sharing a surplus is different from the role of law in facilitating allocative efficiency can lead to the mistaken presumption that a legal response to the surplus problem will be subject to the same double-distortion presumption as other legal endeavors.

V. THE CASE FOR LEGAL REGULATION OF MARKET TRANSACTIONS TO ADDRESS INEQUALITY

The discussion above shows that when laws are used as a means to divvy up surplus resources the presumption that tax policy is superior to the law as a tool to redistribute resources does not apply. This Part considers the ramifications of this insight for the legal regulation of marketplace transactions.

For laws that are used to divvy up surplus in a market transaction, the same general rule developed above about the surplus-sharing exception to the double-distortion presumption applies: there is no reason to presume that the tax-and-transfer system is superior to the legal system as a way to address inequality. The next logical question is whether and to what degree laws that regulate market transactions either directly or indirectly allocate or redistribute surplus. The likely reality is that no law works purely as a tool to redistribute surplus in market transactions without secondary effects. Subject to this caveat, there are many examples of laws regulating market transactions that at least have a significant effect on surplus allocation.

Price controls are one example of a type of market regulation that will effect surplus allocation. Perhaps the most extensively researched price controls are laws that establish a minimum wage. One of the effects of minimum wage laws

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[101] SHAVELL, *supra* note 7, at 138-50; Dale T. Mortensen, *Property Rights and Efficiency in Mating, Racing, and Related Games*, 72 AM. ECON. REV. 968, 969 (1982).

[102] Guttentag, *Opportunities Missed*, *supra* note 5, at 615.

[103] *Id.* at 657-58.

[104] Michael Guttentag, *Evolutionary Psychology and the Study of Law as a Tool to Share Resources*, EVOLUTION & HUM. BEHAV. (forthcoming 2022) (manuscript at 2-4) (on file with *Boston University Law Review*).

[105] RICARDO, *supra* note 41, at 37.

[106] Guttentag, *Opportunities Missed*, *supra* note 5, at 616.

is to shift surplus from those who are likely better off—the owners of firms and consumers generally—to those who are likely to be less well-off—those who are willing to work at minimum wage jobs. In a model analyzing the social welfare effects of minimum wage laws, David Lee and Emmanuel Saez find that minimum wage laws can be more effective at redistributing wealth than the tax-and-transfer system.[107] This finding is consistent with the conclusion above that laws that alter surplus or inframarginal allocations are not inherently inferior to the tax-and-transfer system as a way to address inequality. Even when a tax-and-transfer system is a viable alternative, it is is a mistake to assume that the surplus-sharing benefits of price controls could be more efficiently realized through the tax-and-transfer system.

Recognizing that surplus-sharing rules are an exception to the double-distortion presumption should also heighten interest in other types of market design innovations that have the effect of redistributing resources from rich to poor. For example, Piotr Dworczak, Scott Duke Kominers, and Mohammad Akbarpour identify several creative mechanisms by which the regulation of market transactions can shift resources to those who are less well-off.[108] More specifically, Dworczak, Kominers, and Akbarpour find that:

> [W]hen there is inequality across sides of the market, the optimal design uses a tax-like mechanism, introducing a wedge between the buyer and seller prices, and redistributing the resulting surplus to the poorer side of the market via lump-sum payments. When there is significant same-side inequality that can be uncovered by market behavior, it may be optimal to impose price controls even though doing so induces rationing.[109]

Dworczak, Kominers, and Akbarpour do not make any claim about the relative efficacy of their market design mechanisms to address inequality as compared to a tax-and-transfer approach.[110] If the double-distortion presumption were correct in this context, then proposals to adopt the kinds of market design mechanisms explored by Dworczak, Kominers, and Akbarpour would probably be ill-advised where a viable tax-and-transfer system exists. However, the insight developed here is that there is a surplus-sharing exception to the double-distortion presumption, and this means that to the degree these market interventions address a surplus problem the market design mechanisms explored by Dworczak, Kominers, and Akbarpour might also provide the basis for sound policy initiatives.

Dismissing the importance of engaging with fairness concerns when considering how legal rules can address inequity in market transactions fails to

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[107] David Lee & Emmanuel Saez, *Optimal Minimum Wage Policy in Competitive Labor Markets*, 96 J. PUB. ECON. 739, 747 (2012).

[108] Dworczak ® Kominers ® Akbarpour, *supra* note 47, at 1665.

[109] *Id.*

[110] *Id.* at 1668 ("We emphasize that it is *not* the point of this paper to argue that markets are a superior tool for redistribution relative to more standard approaches that work through the tax system.").

recognize that there may be many legal interventions in the market context where legal solutions are not inferior to tax policy to address inequality.

CONCLUSION

One of the reasons scholars offer for ignoring the effects on inequality of legal rules that regulate market activity is the presumption that the tax-and-transfer system is an inherently superior way to address inequality. This Essay shows that when the law is used to divvy up surplus, this rationale for ignoring the equity effects of legal rules is not valid. Laws that divvy up surplus resources can and should be treated as a viable and potentially preferred method to achieve equitable ends rather than just a second-best method to redistribute wealth.