CHAPTER 1

Introduction

Governments tax their citizens and spend the resources they raise through taxation to meet a wide variety of goals.[1] Governments regulate the conduct of their citizens as well, establishing duties (conventionally described as affirmative duties) to do things the citizen would not choose to do in the absence of regulation or duties (often called negative duties) to forbear from doing things that they would otherwise spontaneously choose to do.[2] The ends that might be met through spending programs could generally be met as well through appropriately tailored regulations. At the same time, governments could almost invariably choose to spend the money raised through taxation to achieve the same goals regulatory schemes are designed to accomplish. Furthermore, citizens subject to regulation will generally have no private motive to differentiate a regulation from a tax. Their net income in a world without the regulation or the tax would be higher, so that they will experience the cost of regulatory compliance as indistinguishable from the cost of paying an explicit tax.[3]

1. The state's broad sorts of goals can readily be differentiated. Public finance economists traditionally speak of programs that provide public goods, correct for the misallocation of goods that occur in private markets, subsidize goods the state feels people should want (merit goods), and redistribute resources. See Richard Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959), 3–22, for the classic account.

2. That the line between affirmative and negative duties may well be either unworkably blurry or just plain unhelpful in resolving questions about the propriety of imposing the duty, even if it could be drawn, is beside the point for now. Thus, whether regulations designed to protect ecosystems are described as forbidding harmful conduct or as demanding affirmative steps to preserve the environment is not, for the moment, of any concern.

3. One could classify the tax effect of regulations in a variety of ways, but I do not think the distinctions among the varieties of regulations ultimately matter to any of the arguments I explore.

A regulation may affect regulated owners' income streams either because it increases costs or because it reduces revenues. Owners may bear higher costs because they must provide costly in-kind goods on their property, expending funds out-of-pocket to comply with the regulations (e.g., an up-to-code building, workplace safety devices, a store with ramps accessible to disabled patrons). Regulations may also increase production costs without leading owners to expend funds out-of-pocket to comply with some particular mandate (e.g., a regulatory requirement to make the workplace safer might be met by slowing the production line

At times, this interchangeability or substitutability of taxation and regulation is quite transparent, and it is debated publicly whether certain regulatory mandates ought to be thought of as new taxes. Thus, for example, governments could mandate that employers purchase health insurance for some otherwise-uncovered set of employees (a regulatory mandate) or could purchase health insurance or health care for those same persons, using tax revenue (including tax revenue that might be gathered from increases in taxes on these employers). Politicians, sensitive to whether they have increased taxes or increased the deficit, might seek to characterize the employer mandate as a regulatory scheme to keep it off-budget.[4]

down). Owners may bear higher costs because regulations require providing goods in-kind off property (e.g., developer exactions to build sidewalks or parks) or buying costly goods for some particular third party or parties (e.g., mandates that employers purchase health insurance for their workers). A regulation may force an owner to forgo revenue rather than increase costs. Thus, for example, regulations that require that a small grocery store owner provide access for the disabled may not just increase out-of-pocket expenditures (e.g., the money spent building ramps) but may require him to widen aisles and carry fewer items, thus reducing sales revenue. Similarly, a zoning regulation might preclude the building of a taller or bulkier building with more rentable units; laws that prohibit selling liquor to the inebriated or cigarettes or liquor to minors deprive owners of revenue they would otherwise earn.

4. Thus, critics of President Clinton's Health Security Act of 1993, which required employers to provide coverage for all full- and part-time employees and to pay 80 percent of premium costs, subject to certain caps for small employers, deemed the employer mandates a tax. See, e.g., Jonathan Barry Forman, "The Emperor Has No Clothes: The Naked Truth Is That Health Care 'Premiums' Are Bad Taxes," *Tax Notes* 62 (1994): 1199; Paul G. Merski, "Pricing Health Care: CBO Data Show Clinton Wants $400 Billion Tax," *Wall Street Journal,* Feb. 9, 1994, A14; Meegan M. Reilly, "Employer Mandate Contested at Ways and Means Hearing," *Tax Notes* 62 (1994): 655. The Clinton administration had said that the health insurance costs would not go on budget because funds do not flow from the Treasury and are clearly earmarked for health care. See, e.g., Amy S. Cohen, "Employers' Payroll Contribution for Health Care Not a Tax, Says Gore," *Tax Notes* 61 (1993): 868. Whether the mandates constitute a tax is of no obvious moment for functionalists, but its symbolic meaning appeared enormous: as one commentator noted, "Whether the employer/employee mandate is considered as a payroll tax or a premium contribution, however, has less to do with the consequences for the federal budget and more to do with perceptions about the role and size of government" (Alexander Polinsky, "The Health Insurance Mandate: A Tax by Any Other Name?" *Tax Notes* 61 [1993]: 395).

A tax-and-spend program might involve government provision of in-kind services (the government might act as provider of health care for the medically uninsured, either by operating municipal hospitals and clinics or by contracting with for-profit or nonprofit private hospitals and clinics to provide free or below-cost care for the uninsured); government provision of cash-equivalent grants good for use in the relevant market only (the government might give vouchers to purchase health care or health insurance, as it frequently does in the food or housing markets); or government rebates for those who spend money in the relevant market. Such rebates could be awarded either through unlimited refundable tax credits or through more limited rebates for those whose tax liability is sufficient to make nonrefundable tax credits or deductions serve as cash-rebate equivalents. Thus, the government might allow

Similarly, plaintiffs in regulatory takings cases typically urge that the court direct the relevant governmental unit to accomplish its aim by substituting a tax-and-spending program that compensates the plaintiffs for the losses they will suffer if regulated. The court should not, the plaintiffs say, permit the state simply to ban development of property; instead, the court should direct the state entity to purchase a nondevelopment equitable servitude out of general funds. Similarly, plaintiffs argue that the state should not be permitted to limit the prices the plaintiffs can charge needy customers; instead, the court should force the state to give the needy customers vouchers or cash that permit them to pay market prices for the good whose price would otherwise be controlled.

At other times, this functional interchangeability may be less transparent but no less real. Regulations requiring that providers of services charge all consumers the same prices, even though the costs of providing services to some subset of consumers is higher, could be replaced by a tax-and-spend program granting direct government subsidies for those consumers who would face higher than community-rated prices in an unregulated market that sorted buyers by cost of service.[5] Conversely, many

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all or some portion and variety of health care costs to be deductible, which would reduce purchasers' taxes by the premium price times the marginal tax rate. The government could also establish a nonrefundable tax credit at some chosen percentage of spending on the targeted good, which could be used to reduce taxes until they reached zero, or a refundable credit, which would be applied first to reducing taxes and then result in a cash rebate. The federal government helps pay for child care expenditures largely through nonrefundable tax credits, but it obviously could adopt, in whole or in part, a direct-provision method (either establishing its own free or subsidized centers or paying private businesses to operate free or below-cost centers), a regulatory method (mandating that employers provide free or subsidized day care for their employees), or a more direct cash-grant method (giving vouchers to parents to use at child care facilities).

5. See Richard Posner, "Taxation by Regulation," *Bell J. of Econ. and Mgmt. Sci.* 2 (1971): 22, for a discussion. Thus, cost-based price discrimination is often forbidden to protect some favored group (see, e.g., the protection of farmers from railroad tariffs that reflected higher marginal costs or statutes that protect smaller retailers by mandating uniform pricing by suppliers even when bulk discounts for larger retailers reflect cost differentials). But farmers could simply be paid enough to permit them to ship at unregulated prices, or smaller retailers could receive tax rebates or direct dollar subsidies to compensate for their cost disadvantage.

It is also possible to move from a regulatory system to a tax-and-spend system that benefits a broader group than those who would otherwise face higher-than-average prices. See Mark Kelman, "Health Care Rights: Distinct Claims, Distinct Justifications," *Stanford L. and Policy Rev.* 2 (1991): 90, 96–97 (discussing the advantages of levying an explicit excise tax on health insurance and redistributing the proceeds to a broad range of medically underserved citizens over proposals that would establish mandatory community rating systems for health insurance purchasers; in a mandatory community-rating system, everyone able to

traditional governmental functions now achieved through tax-and-spend methods could be replaced by regulations. Municipalities that sweep the streets and sidewalks or collect all the trash could instead require store owners to keep the areas outside their establishments clean or require property owners to take (some or all) of the garbage they generate to dumps or simply limit the amount of trash that a property owner could legally generate. Governments can vaccinate the young or require that their parents and guardians do so; the federal government can pay volunteer soldiers market-clearing wages or draft them; fire department budgets could be lowered if governments required builders to use more fire-retardant materials and/or install sprinklers and smoke alarms.

The government can also charge citizens user fees for many of the services now publicly provided (for free or at subsidized rates) or allow private parties simply to bear losses (or insure against them privately) rather than expend funds to prevent them. Once more, such choices can be transparent (adult-education courses can be provided free of charge or at cost) or more opaque (one would expect that any municipality's decision to lower spending by cutting back on the police force available to deal with residential burglaries will typically lead private homeowners to increase their own spending on precautionary protections and/or to bear, privately, higher loss levels).[6] While not identical to substituting regulatory for public tax-and-spend programs, user fees and deliberate inaction also represent alternative solutions to public policy problems.

The broad point is that there are invariably a variety of ways to meet social goals or respond to perceived social problems. Each responsive technique may generate a distinct pattern of gains and losses (and, some would argue, different levels of net gains or losses as well, at least in some cases), but alternative forms of policy responses are always available. As one illustration, take the problem of flooding. If this is a problem that some relevant governmental unit might address, it may be solved through some mixture of (a) publicly funded flood-control projects and insurance for flood victims; (b) regulations that forbid certain activities that increase

afford health insurance could purchase it at prices that reflect only their pro rata share of projected health costs, even if the insurer knew they were atypically risky and would thus, in an unregulated market, either refuse to serve them or demand a premium to account for additional risk).

6. For a discussion of the degree to which crime might more cost-effectively be prevented by private precautions by citizen-victims than by state punishment of offenders, see, e.g., Louis Michael Seidman, "Soldiers, Martyrs, and Criminals: Utilitarian Theory and the Problem of Crime Control," *Yale L. J.* 94 (1984): 315, 342–46.

flood risk (e.g., soil eroding conduct) or require that those in floodplains purchase private insurance at least sufficient to restore flooded property to a condition that is not detrimental to others in the community; (c) publicly operated flood-control projects paid for largely or entirely by people in the floodplains (user-fee equivalents); or (d) inaction, allowing flood loss levels to be determined by private action and flood losses dominantly to impact those who chose to build in the floodplain. There are, of course, familiar debates about the degree to which each of the alternative methods generates different levels of loss. Some claim, for instance, that public insurance leads to overbuilding in floodplains. Still others might argue that regulations generate too few benefits compared to costs, while regulatory proponents respond that they may well prescribe a more socially rational technique of net cost reduction than private parties would adopt on their own even if forced to internalize all losses because private efforts might fall prey to collective action problems leading to underinvestment in socially rational control programs. At a minimum, the different methods distribute both the costs of flooding (damage plus precautionary expenditures) and the gains from tolerating flood damage (building in floodplains) differently.

I will explore two broad questions in this book. First, in chapters 2 and 3, I consider whether and when the Constitution does (or should) limit the use of regulatory techniques and force governmental entities to substitute tax-and-spend programs for regulatory taxes.[7] More particularly, I ask when, if ever, parties subject to regulation should receive compensation, funded out of general tax revenues, for the losses engendered by the regulations.

In chapters 4 and 5, I address a second issue. Even if there are few (or no) appropriate constitutional limits on the use of regulatory taxation, what is the appropriate way to think about the practical virtues and pitfalls of regulatory taxation? It is obviously the case that not all that is constitutional is prudent. In this essay, I tend to emphasize some of the advantages regulatory strategies may have over tax-and-spend programs in certain set-

7. In addressing this question, I will also attempt to answer a question that litigants do not appear to have asked: might taxpayers have a valid constitutional complaint against the use of tax-and-spend programs that would permit taxpayers to demand that the relevant government entity substitute a regulatory scheme, a user fee, or inaction (letting losses lie) for taxing and spending? I will argue that the fact that taxpayers clearly do not have such a complaint under current jurisprudential standards bears on but hardly settles the question of whether plaintiffs ought to be able to force governments to move toward tax-and-spend programs.

tings, though I will try not to slight the more widely heard arguments against the practice.[8] I do so largely because the affirmative case for regulatory taxation has been, in my view, understated.

In keeping with this book's basic conceptual organizing theme—that regulatory taxation closely resembles taxing and spending—I will divide the discussion of the virtues and flaws of regulatory taxation into two broad parts. I will look at arguments emphasizing why regulatory taxation might in some circumstances be a superior and in some circumstances an inferior form of taxation (implicit revenue raising). I will also discuss why regulatory taxation might in some circumstances be an effective and in others an ineffective method of service provision (implicit spending).

In chapter 5, I also address political-process arguments that legislatures will make better decisions if forced to raise and allocate funds more explicitly. In discussing process, I express considerable skepticism about the argument most frequently articulated by those wary of the use of regulation—that the aggregate costs and the identity of the beneficiaries of regulation are unduly hidden. Instead, my chief worry is that the beneficiaries of regulation have illegitimately sheltered these programs from cost-benefit scrutiny on the grounds that regulation, conventionally, is thought to be designed solely to prevent rights infringements rather than to (implicitly) tax and deliver services more efficaciously and on the grounds that there is a duty not to calculate the costs and benefits of avoiding such infringements.

8. I by no means believe that regulation is typically superior to explicit tax-and-transfer programs: on the contrary, I have frequently chastised attempts to distribute income to particular favored beneficiary classes through antidiscrimination regulations rather than to distribute through tax-and-spend programs to those defined in terms of their individual need rather than their group status. In a wide array of situations, I believe that progressive taxation followed by explicit legislative budgeting of funds is superior to regulatory options. See, e.g., Mark Kelman and Gillian Lester, *Jumping the Queue: An Inquiry into the Legal Treatment of Students with Learning Disabilities* (Cambridge: Harvard University Press, 1997), chap. 8; Mark Kelman, "Alternative Concepts of Discrimination in 'General Ability' Job Testing," *Harvard L. Rev.* 104 (1991): 1158, 1183–94; Mark Kelman, "Health Care Rights."