

THE RENT TAX IS TOO DAMN LOW

JUSTICE, PRODUCTIVITY, AND THE TAX BASE

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TAXATION is the means by which society finances its public initiatives. It is the area of public policy where the topic of distributive justice plays its largest role, for it determines who will bear the burdens of paying for society's collective aims. The current economic and public policy literature poses the tax debate as one involving trade-offs between economic considerations and moral values. In particular, optimal tax theorists are concerned with optimizing across competing considerations of equity and efficiency.¹ Such an approach assumes an inherent antagonism between these two normative aims. A similar antagonism also persists in the philosophical literature, where taxation itself is often perceived as being at odds with principles of distributive justice, especially the principle of labor ownership.²

My contention is that these antagonisms are not inherent to all forms of taxation, but rather they exist because tax theorists and policy makers tend to focus on a narrow range of options for the tax base. The tax base, both in theory and practice, is traditionally confined to certain kinds of economic gains, such as earned income, gains from capital, and consumption. When economists and philosophers evaluate taxes, they tend to do so in the context of thinking about this prevailing tax base.³ I begin by discussing the two major drawbacks of the prevailing tax base: (1) the equity-efficiency tradeoff and (2) the diminishment of labor ownership. I then diagnose the common cause responsible for these moral and economic drawbacks. Next, I discuss an alternative tax base that

- 1 This has been true since Mirrlees's foundational paper. See Mirrlees, "An Exploration in the Theory of Optimum Income Taxation."
- 2 Such as seen in Locke, *Second Treatise of Government*, 12–18; George, *Progress and Poverty*, 122–24; Nozick, *Anarchy State and Utopia*, 175; Dworkin, "What Is Equality?"; Vallentyne, "Self-Ownership and Equality"; and Otsuka, "Self-Ownership and Equality." A more moderate expression of that antagonism can be found in Russell, "Self-Ownership, Labor, and Licensing," 194–95; and Brennan, "Striving for the Middle Ground," 5–14.
- 3 See Halliday "Justice and Taxation," 1114–16.

avoids this common cause and consequently does not possess these two major drawbacks. I conclude by offering some illustrative, though tentative, examples of the alternative tax base, knowing that further investigation is necessary.

This is not a comprehensive tax-and-spend proposal. I make no claims regarding the scope of government, the size of spending, or tax rates and schedules. My concern here is only on *what kinds of things* we tax, not the extent to which we should tax them.⁴ Further, the proposal herein is general, not absolute. The proposed tax base may not be suitable in some circumstances. I only argue that, as a general matter, it will likely be better to replace the prevailing tax base with a proposed alternative tax base.

Before proceeding, it is worth noting that the tax base I endorse would in some sense be more familiar to the classical political economists and philosophers of the early modern period than to contemporary theorists. Thinkers of this period, notably Adam Smith, David Ricardo, and John Stuart Mill, often distinguished economic activities on the basis of their origin and normative legitimacy.⁵ By contrast, the tendency in modern economics is to treat all economic gains the same, with the implicit assumption being “if there is money being paid, there is value being generated.” Throughout this piece I will challenge this assumption and make distinctions between economic gains on the basis of wealth generation or lack thereof. One way of viewing this project is as a modernization and evolution of the classical conception of rental taxation in a way that is consistent with the standards of contemporary economic and philosophical thought.⁶

1. TWO OBJECTIONABLE FEATURES OF THE PREVAILING TAX-BASE REGIME

Countries in the developed world have tax-policy differences; however, their tax-base regimes are more alike than they are different. In most developed countries the majority of the tax burden falls on workers in the form of taxes on earned income such as wages or salaries, and also in the form of payroll taxes

- 4 Some scholars ask whether it “make[s] sense to evaluate the tax system independently of what the tax revenue is used for” (Brennan and Tsai, “Tax Ethics,” 399). I am agnostic about such a claim, except to note that if it is permissible to raise general funds for some legitimate governmental purpose, then this paper is an investigation into the moral considerations of what the *sources* of such funds ought to look like.
- 5 See Smith, *The Wealth of Nations*, 1130–32; Ricardo, *Principles of Political Economy and Taxation*, 167–69; and for an overview of Mill’s views on taxation see Halliday, *Inheritance of Wealth*, 47–57.
- 6 The contemporary assumptions I am referring to include using (i) standard marginalist analysis, (ii) a subjective (utility) theory of value, (iii) an emphasis on broadly egalitarian desiderata and, (iv) an updating of the concept of labor ownership.

or other social insurance levies.⁷ The second-largest source of tax revenue in most developed countries is consumption taxes, either in the form of sales or value-added taxes.⁸ The burden of these taxes falls predominantly on consumers. Typically, the third-largest source of tax revenue by country is corporate income and capital gains taxes. The burden of this tax is often thought to be shared among consumers, workers, and firms.⁹ In most developed countries these three tax sources constitute the vast majority of tax revenue, with other sources of tax revenue being meager by comparison. These taxes pose serious drawbacks, the first of which is the equity-efficiency tradeoff.

1.1. The Equity-Efficiency Tradeoff

The approach that dominates the economic literature on optimal taxation characterizes the primary tax problem as a trade-off between economic efficiency and distributive equality.¹⁰ Recent practitioners are now using a broader array of normative considerations, but the central focus of optimal tax theory remains balancing equity and efficiency.¹¹ To solve this problem optimal tax theorists typically employ a social welfare optimization approach, where the aim is “keeping tax distortions to a minimum, subject to restrictions by the need to raise revenue and maintain an equitable tax burden.”¹² I first describe the efficiency costs of taxation and then discuss how trying to minimize these costs comes at the expense of equity. I then highlight how optimal tax theorists have traditionally sought to curtail the effect of this equity-efficiency trade-off and then gesture toward an alternative way of avoiding the trade-off altogether.

All taxes have income effects, that is, they decrease the amount of money that the taxed individual has available to them. However, not all taxes are *distortionary*. The fundamental problem with most forms of taxation is that they artificially change the relative price of a given bundle of economic offerings (goods, services, labor, etc.) from its market baseline price. Under standard assumptions, the market baseline price is efficient because in a competitive

7 Enache “Sources of Government Revenue in the OECD.”

8 Enache “Sources of Government Revenue in the OECD.”

9 Arulampalam, Devereux, and Maffini, “The Direct Incidence of Corporate Income Tax on Wages.”

10 Mirrlees, “An Exploration in the Theory of Optimum Income Taxation,” 175; and Mankiw, Weinzierl, and Yagan, “Optimal Taxation in Theory and Practice,” 5.

11 Notable papers that broaden the list of normative considerations include Saez and Stantcheva, “Generalized Social Marginal Welfare Weights for Optimal Tax Theory,” 25; and Fleurbaey and Maniquet, “Optimal Income Taxation Theory and Principles of Fairness.”

12 Auerbach and Hines, “Taxation, and Economic Efficiency,” 1347.

environment the price of a given bundle approximates its marginal cost.¹³ Taxes change the relative prices between various bundles and consequently agents choose new bundles that are inferior to the bundles that they would have chosen absent the tax.¹⁴ To illustrate, imagine that, in some competitive market, the price of an apple is \$1.00. If a \$0.50 tax is levied on each apple, then those who would have bought an apple between \$1.00 and \$1.50 no longer make that purchase and those exchanges are foregone. Those consumers will instead use their \$1.00 to purchase goods or services that are less valuable to them than the apple would have been. Economists call this a *distortion*, since the individuals are choosing less preferable alternative consumption bundles than they would choose absent the tax. The difference in surplus between the optimal bundle and the inferior bundle is the *deadweight loss* and represents the value that society loses as a result of the tax.¹⁵ Taxes on consumption, capital, and earned income all distort people's economic decisions and incur deadweight loss.

The other major concern that looms large for tax theorists is equality. Optimal tax theorists are not preoccupied with ensuring that distributions are equal, but they do assume that more equal distributions of wealth are better than less equal distributions, subject to efficiency concerns. Egalitarian desiderata are typically justified with reference to diminishing marginal utility or Rawlsian concerns over the welfare of the least advantaged.¹⁶ However, one does not need to be a Rawlsian to see how it would be a pyrrhic victory for tax justice if increasing the total size of the economic pie comes at the expense of diminishing the size of the slices available to most people. Most arguments against egalitarianism do not challenge the principle that more equal distributions are favorable to less equal distributions, *ceteris paribus*; rather, they challenge giving priority to egalitarian aims *at the expense* of other important criteria, such as efficiency, fairness, or desert. As I hope will become clear by the end of this paper, equality and these other desiderata tend to run together, if only we would select the correct tax base.

Since Mirrlees's 1971 paper, the fundamental problem of optimal tax theory has been the equity-efficiency tradeoff.¹⁷ The basic notion is that marginal tax

13 Mankiw, Weinzierl, and Yagan, "Optimal Taxation in Theory and Practice," 4.

14 Slemrod, "Optimal Taxation and Optimal Tax Systems," 159.

15 Feldstein, "The Effect of Taxes on Efficiency and Growth," 4.

16 For the Rawlsian influence see Fleurbaey and Maniquet, "Optimal Income Taxation Theory and Principles of Fairness," as well as Stiglitz, "Pareto Efficient and Optimal Taxation and the New Welfare Economics." For diminishing marginal utility see Mirrlees, "An Exploration in the Theory of Optimum Income Taxation."

17 See Mirrlees, "An Exploration in the Theory of Optimum Income Taxation"; and Saez, "Using Elasticities to Derive Optimal Income Tax Rates," 205.

rates distort a person's production or consumption behavior and the size of the distortion increases as the rate of income or consumption rises.¹⁸ To see why, compare a tax on a person's first earned dollar to a tax on a person's hundred-thousandth earned dollar. The tax on the first dollar earned is unlikely to disincentivize someone from working. This is because, at lower income levels, the income effect is much more operative than the substitution effect. People are less willing to substitute leisure for work when their basic needs and interests are not satisfied. By contrast, at higher levels of income, the substitution effect plays a larger role. People are more willing to substitute work for leisure when giving up work only comes at the expense of fewer luxury goods. The consequence is that taxes at lower levels of income result in less distortions than taxes at higher levels of income. The same reasoning applies to consumption. Hence, a tax on a person's first earned dollar has much less deadweight loss than a tax on their hundred-thousandth earned dollar. This is the equity-efficiency trade-off.

The paramount problem for optimal tax theory is how to minimize the equity-efficiency tradeoff. Imagine that making the economic pie larger also shrinks the size of the median pie slice. Optimal tax theorists are trying to keep the economic pie from shrinking while also making the size of the median pie slice as large as possible. Most inefficiency occurs when a tax discourages work or consumption at the margin. To solve this problem, tax theorists have tried to optimize tax rate schedules within the prevailing tax regime by trying to determine the shape of the ability distribution.¹⁹ Distinguishing between high and low income ability means that it becomes possible to set tax rates such that "few individuals would be affected at the margin and many would be affected inframarginally."²⁰ The idea is to structure tax rates such that they are greatest below the earnings potential of high-ability individuals while also remaining *above* the earnings potential of low-ability individuals.²¹ The motivation behind determining the distribution of ability is to extract tax revenue through the most inelastic portion of a person's earnings schedule.

Consistent with the example described above, the general strategy for optimal tax theorists has been to remain within the prevailing tax regime and try to either (a) exploit commodity inelasticities, or (b) exploit income inelasticities.²² One problem with this approach is informational. It is extremely difficult

18 Stiglitz, "The Origins of Inequality and Policies to Contain It," 583–86.

19 Mankiw, Weinzierl, and Yagan, "Optimal Taxation in Theory and Practice," 6.

20 Mankiw, Weinzierl, and Yagan, "Optimal Taxation in Theory and Practice," 6.

21 Brewer, Saez, and Shephard, "Means-Testing and Tax Rates on Earnings," 91

22 See Saez, "The Desirability of Commodity Taxation under Non-linear Income Taxation and Heterogeneous Tastes," 228, and "Using Elasticities to Derive Optimal Income Tax Rates."

to determine where the inelasticities are, especially given the enormous heterogeneity of preferences within a population of workers or consumers.²³ Another problem with this approach is that it tries to optimize *given* the trade-off, instead of trying to find a way *out* of the trade-off altogether.

An alternative approach is to search for a tax base where the equity-efficiency trade-off is not present, or if it is sometimes present it is at least greatly diminished.²⁴ One way of doing this may involve shifting our thinking about *who* or *what* we tax. For example, the prevailing tax-base regime centers taxation on the *economic agent*, i.e., the person responsible for making production and consumption decisions. The fundamental challenge with taxing economic agents is that they are *agents*—they make decisions in response to changes in the environment. The source of economic distortion is the fact that taxes alter trade-offs and so the agent will *substitute away* from the optimal bundle to a less optimal bundle. But what if instead of taxing economic agents, we sought other forms of taxation that did not alter the trade-offs of economic agents?

What if instead of focusing on a tax base consisting of economic agents, we searched for a tax base that consisted more of economic *patients*. To borrow the agent-patient distinction from moral philosophy, an *economic patient* is not themselves an economic decision maker in a particular context, but is someone who nevertheless is affected by economic choices or circumstances.²⁵ Taxing an economic agent changes their relevant trade-offs, hence introducing the possibility of economic distortion. By contrast, taxing an economic patient *cannot* change their relevant trade-offs, because in the given context, they are not making any economic decisions. Since the equity-efficiency tradeoff is a consequence of a tax base replete with economic distortions, it may be a worthwhile strategy to search for a tax base less susceptible to distortions, or at least less susceptible to *bad distortions*. As a brief prelude to my general strategy, I recommend searching for a tax base that consists of either (a) economic agents whose decisions we *want* to distort or (b) economic patients who have no relevant decisions to distort. I will elucidate this strategy in sections 3 and 4.

1.2. Diminishing Labor Ownership

The concept of labor ownership is firmly embedded within the prevailing economic and social structure. While the idea has ancient roots, it was first introduced

23 See Dahan and Strawczynski, "Optimal Income Taxation"; and Sandmo, "Optimal Redistribution when Tastes Differ."

24 "It is indeed worth emphasizing that ethical principles may be relevant not only to the design of the income tax, but also to the selection of the tax base" (Fleurbaey and Maniquet, "Optimal Income Taxation Theory and Principles of Fairness," 1032).

25 For the original agent-patient distinction, see McPherson, "The Moral Patient."

in the modern era by Locke's famous labor-mixing argument.²⁶ However, Locke's argument was the formal articulation of an already existing norm rather than the generation of an entirely new idea. The principle of labor ownership can be expressed in myriad ways, but essentially the idea is that *the person (or people) who create or produce a thing have some bundle of property rights in that thing that others do not possess*. This typically includes the right to use, gift, trade, sell, and, more controversially, destroy, their creation. The "thing" created may be the performance of certain activities, e.g., labor, or a product, service, or even string of words or set of ideas. The principle of labor ownership is not identical to the concept of property, but serves as the normative basis for many property claims in that it is a method of determining who has original title to property.

Many thinkers have sought to justify the principle of labor ownership in various ways. The preeminent economic justification is that the principle of labor ownership gives people enormous incentives to engage in productive activity, which makes both themselves and society wealthier.²⁷ Moral justifications for labor ownership have been more varied. One common justification is derived from individual sovereignty. An early example is found in Henry George: "Is it not primarily the right of a man to himself to the use of his own powers to the enjoyment of the fruits of his own exertions?... As a man belongs to himself, so his labor when put in concrete form belongs to him."²⁸ According to this argument, labor ownership is a logical extension of the sovereignty that one has over one's own body and activities. Modern variations of the individual sovereignty argument for labor ownership remain popular with prominent theorists, including Vallentyne, Otsuka, and Steiner.²⁹ Another recent conception of labor ownership deploys this familiar concept of self-sovereignty but constrains it within the limits of social reciprocity.³⁰ Daniel Russell contends that "property in one's labor ... [should be] understood as a social institution for balancing two freedoms: freedom to act even if it interferes with someone else, and freedom from interference."³¹ Under this conception, labor ownership ought to be protected on the condition that such protections create "reciprocal benefits" within the community.³²

26 Locke, *Second Treatise of Government*, 12–18.

27 See Demsetz, "Toward a Theory of Property Rights," 348.

28 George, *Progress and Poverty*, 122.

29 See Vallentyne, "Self-Ownership and Equality"; Otsuka, "Self-Ownership and Equality"; Steiner, "Left Libertarianism and the Ownership of Natural Resources"; and Delmotte and Verplaetse, "What Is Wrong with Endowment Taxation?"

30 See Russell, "Self-Ownership, Labor, and Licensing."

31 Russell, "Self-Ownership, Labor, and Licensing," 174.

32 Russell, "Self-Ownership, Labor, and Licensing," 187.

Other moral arguments for labor ownership are derived from differential sacrifice between persons. For instance, Dworkin argues that a version of labor ownership can be justified by morally relevant differences in choice under certain conditions of equality:

If he earns enough by working hard, or by working at work that no one else wants to do, to satisfy all his expensive tastes, then his choice for his own life costs the rest of the community no more than if his tastes were simpler and industry less. . . . The choice should be indifferent under equality of resources, so long as no one envies the total package of work plus consumption that he chooses. So long as no one envies, that is, his life as a whole.³³

Dworkin is not alone in thinking that differential sacrifice in the form of hard work or other features can confer labor ownership. In public political culture, “hard work,” “risk,” and “sacrifice” are commonly offered reasons for justifying moral claims to one’s property or position of differential advantage. Regardless of whether or not any of these arguments succeed, labor ownership is currently a widely accepted foundational economic norm that people follow, that market participants presume, and that courts uphold. This alone does not justify the practice, but makes the principle a plausible starting point.

Supposing temporarily that we accept the principle of labor ownership, what then is the implication for taxation? At first glance, it appears that labor ownership is completely at odds with any form of taxation assessed against returns on human labor, that is, *earned income*, which includes wages, salaries, bonuses, commissions, and profits. Proponents of this view, most notably Nozick, radically suggests that taxation on earned income is “on a par with forced labor.”³⁴ Similarly, the political slogan “taxation is theft” reflects this absolutist conception of labor ownership, where any deviation amounts to a rights violation.³⁵ Yet, there are serious difficulties with this absolutist approach to labor ownership.³⁶ Commentators as diverse as Buchanan, Murphy, and Nagel have argued that upholding labor ownership claims in the first place likely requires a system of public infrastructure and hence some system of

33 Dworkin, “What Is Equality?” 306.

34 Nozick, *Anarchy State and Utopia*, 169.

35 See Kearl, “Do Entitlements Imply that Taxation Is Theft?”; and Mack, “Non-absolute Rights and Libertarian Taxation.”

36 Although Nozick’s conception of labor ownership is derived from Locke’s, it is construed in absolute terms, whereas Locke’s conception was conditional on obligations of assistance embedded in an original natural-law understanding of the provisos. See Lamb, *Property*, 58–62.

tax collection.³⁷ Consequently, it becomes problematic to claim that one has absolute entitlement to pretax earnings on the basis of labor ownership, since those pretax earnings require the joint production of the wider community.³⁸ This entanglement of productive causes has led some skeptics of labor ownership to discard the concept altogether, notably Rawls.³⁹ Subsequent theorists, such as Murphy, Nagel, and Lindsay, argue that property claims can only be upheld when they are the consequence of a legitimate social and legal structure. For example, Lindsay contends that “ownership is a social fact, and as such derives its legitimacy from the extent to which people living under it give it their uncoerced consent.”⁴⁰ The upshot of these legal constructivist accounts is that there are no “pre-political” claims to property on the basis of labor ownership; hence pretax earnings are an illegitimate benchmark and have no moral relevance to the topic of tax justice whatsoever.⁴¹ It is worth noting that some scholars have pointed out that the Rawlsian critique of a joint product does not necessarily entail a conventionalist view of pretax earnings or other property claims.⁴² Regardless, the core of the dispute raised by Nagel and Murphy remains. Do labor ownership claims on pretax earnings have any independent normative significance given that they are reliant on the preexisting legal and social system?

I want to challenge the notion that the moral relevance of labor ownership claims on pretax earnings is predicated on being causally independent of the social-legal structure. There can be strong reasons for endorsing the independent normative significance of labor ownership claims, *even if* the existence of those claims is dependent on the social and legal structure. To see how, let us consider an alternative way of thinking about labor ownership and its connection to tax justice by considering a concept I call *effective control*.

People have more effective control over their lives the closer their own decisions are tightly connected to the outcomes they experience. The less that their

37 Buchanan, “The Ethical Limits of Taxation”; Murphy and Nagel, *The Myth of Ownership*.

38 Controversy over this idea played out in public political culture over the interpretation of President Obama’s “you didn’t build that” comment. See Blake, “Obama’s ‘You Didn’t Build That’ Problem.”

39 See Rawls, *A Theory of Justice*, 10–11, 240–42.

40 Lindsay, “Ownership by Agreement,” 935.

41 See Murphy and Nagel, *The Myth of Ownership*, 74.

42 Notably, Geoffrey Brennan argues that the moral relevance of pretax earnings is consistent with a Rawlsian constitutional approach, and Jorgen Pedersen argues that a Rawlsian commitment to independence and self-respect entails a thin conception of private property. See Brennan, “Striving for the Middle Ground,” ch. 3; and Pedersen, *Distributive Justice and Taxation*, 151–52.

decisions are connected to those outcomes, the less effective control they possess. To illustrate, consider the following. A 1 percent tax on a person's earned income is likely to have little effect on a person's ability to control their own lives; for most people it is unnoticeable. By contrast, a fully enforced 100 percent tax on earned income will completely deprive someone of their ability to control their economic situation; without assistance, they will die. The upshot is that as the tax rate on earned income increases, the effective control that people have over their economic situation decreases. For example, consider an effective 25 percent tax rate on earned income. Someone earning \$20 per hour and working forty hours per week would have pretax earnings of \$800, with post-tax earnings of \$600. To make up the \$200 difference, an individual would have to work more than thirteen additional hours every week. Hence, taxes on earned income reduce the *effectiveness* of each labor hour and thus stymie the relationship between an individual's actions and their economic outcomes.⁴³ The effectiveness of economic decisions, such as working, saving, investing, obtaining additional skills, and changing careers, are all reduced by the extent to which earned income is taxed. Preserving labor ownership bolsters effective control by maintaining a tight relationship between what a person puts in (e.g., labor, skill learning, creativity, risk taking) and what a person gets out (e.g., wages, salaries, benefits, or other economic gains). Thus, preserving labor ownership by lowering the tax rate on earned income, or other economic gains from human labor, is desirable because it enables people to have more effective control over their economic situation. The upshot is that if we can find an alternative tax base that does not diminish labor ownership, then this would be a powerful reason that would count in favor of adopting that tax base.

I am *not* making the claim that preserving labor ownership is the only useful economic norm for giving people effective control over their lives, simply that preserving labor ownership significantly aids in this cause. The argument from effective control shows that we need not be wedded to either extremes regarding the principle of labor ownership. We do not need to choose between the Nozickean account where property claims are inviolable side constraints and the legal constructivist account where there are "no property rights antecedent to the tax structure."⁴⁴ Instead, we can hold that adhering to the principle of labor ownership enables individuals better effective control over their lives, without positing that the principle is absolute or that it requires recognizing some pre-political natural right. Furthermore, this approach is consistent with the more moderate expressions of labor ownership offered and defended by

43 This is why taxes on earned income have a disincentive effect.

44 Murphy and Nagel, *The Myth of Ownership*, 74.

contemporary theorists.⁴⁵ Notably, this conclusion about labor ownership does not imply that we should never tax earned income. The advantages from a particular spending program might outweigh the disadvantages from taxing earned income to fund such a program. However, the point is that taxing earned income comes with a moral cost—it diminishes the effective control that people have over their own economic lives.

The argument that I will make in the remaining sections does not rest upon accepting the principle of labor ownership. Some theorists may prefer different criteria altogether. To the extent that someone finds any version of labor ownership attractive, they will also find any tax base that does not diminish labor ownership attractive relative to one that does diminish it.

2. TYPES OF ECONOMIC GAINS

2.1. *Productive vs. Unproductive Economic Gains*

The previous section described how the prevailing tax regime suffers from two drawbacks, but it did not describe their common cause. To explain the origin of the two problems, I distinguish between productive and unproductive economic gains.

An economic gain refers to money, property, or any other economic asset. Economic gains are *productive* in situations where the gain is instrumental in the creation of wealth, that is, any kind of valuable social surplus.⁴⁶ This occurs whenever the economic gain motivates an agent to engage in productive activity. Notably, the motive need not be selfish, as for example when individuals work in order to produce for their families or contribute to charitable causes. As an illustration, if I produce apples in exchange for money, the apples are the “wealth” and the money is the “economic gain.” This is a productive economic gain, since the money was instrumental in the creation of the apples.

Recall that the prevailing tax regime includes taxes assessed on earned income, gains from capital, and consumption. These gains either constitute wealth itself, such as in the case of consumption, or are instrumental in the creation of wealth, such as in the case of earned income or gains from capital. Without the prospect of earning income or obtaining profits, the activities

45 See Russell, “Self-Ownership, Labor, and Licensing,” 175; and Brennan, “Striving for the Middle Ground,” 5.

46 Wealth is anything valuable or useful to human beings; it includes everything from automobiles and food catering to insurance.

responsible for generating wealth would vastly diminish.⁴⁷ Thus, the prevailing tax regime is composed of taxes levied on productive economic gains. What's more, the reason that taxing these economic gains is inefficient is *because* they are instrumental in the creation of wealth or social surplus. Taxing these gains affects the trade-offs of economic agents in a way that *distorts* their production and consumption decisions and consequently reduces the total supply of wealth. Taxing productive economic gains also diminishes labor ownership, because the person or people who produce a thing retain less of the benefit of that production. The fact that the prevailing tax regime possesses both of these drawbacks is not incidental. It is a consequence of most taxes in the prevailing tax-base regime being levied against productive economic gains.

So, if taxes on productive economic gains possess these two drawbacks, what other economic gains can be taxed that lack these drawbacks? Some economic gains *are not* instrumental in the creation of wealth—they are *unproductive* economic gains. Money obtained from theft and fraud are examples, as these are the result of the coercive taking of preexisting wealth. For obvious reasons, these cannot possibly serve as a tax base. However, there is a class of unproductive economic gains that are not intrinsically immoral, and hence may be legally permitted and could serve as the foundation of a tax base. Economists call these type of unproductive economic gains “rents.” Rents are typically defined as “those benefits to an agent that are in excess of the minimum necessary for the agent to accept the transaction.”⁴⁸ This definition is consistent with the original meaning, but is unnecessarily narrow. The use of the word “transaction” implies that rents are generated through exchange, but there is no reason to suppose that all rents accrue as a consequence of exchange. For example, when a landowner's property doubles in value because of the nearby development of parks and schools, it is not because she is party to some exchange or engages in any transaction. Yet, this example is consistent with what economists would generally regard as rents because the accrued gain does not contribute to supplying the land.⁴⁹ The fact that a person's land value is increased by proximate economic development is not instrumental to said development; it is a side effect. The landowner gains a value because of the productive activity of others. Thus, in order to allow for a wider consideration of the tax base, and to not unnecessarily prejudice ourselves against forms of

47 Earning money is not the only reason people engage in productive activities, but it is contributory, if not necessary, otherwise “working” would be indistinguishable from “volunteering.”

48 Schwerhoff, Edenhofer, and Fleurbaey, “Taxation of Economic Rents,” 400.

49 For the traditional definition, see Varian, *Intermediate Microeconomics*, 412.

rent that are “exchanges,” I will continue using the broader account of unproductive economic gains.

3. THE ARGUMENT IN THE ABSTRACT

Before discussing specific nominees for rental taxation, I want to give the general form of the argument. My first goal is to demonstrate, in the abstract, how taxing rents avoids the two aforementioned drawbacks and hence makes for a promising tax base. I begin with the equity-efficiency tradeoff.

3.1. *Does Rental Taxation Possess the Equity-Efficiency Tradeoff?*

As defined, rents are a form of unproductive economic gains. That is, the gains accrued from rents do not play a role in the creation of wealth because they do not induce any productive economic activity.⁵⁰ Consequently, a tax on an economic gain that does not produce wealth cannot create a disincentive to create wealth because no wealth is being created in the first place.⁵¹ If the tax does not reduce the creation of wealth, then the tax would have no efficiency costs. That is, the same amount of wealth would exist before and after the tax. Consequently, a tax without efficiency costs would not pose an equity-efficiency tradeoff.⁵²

To illustrate, suppose Bob gains \$200 of economic rent. Whether the government taxes Bob's gain at a rate of 0, 50, or 100 percent, there is no equity-efficiency tradeoff, because the efficiency cost is always the same: zero. The tax rate determines how much Bob and the government split the \$200, but the rate does not change the amount of wealth in existence; it just determines the distribution of the economic gain. It is important to clarify that the equity-efficiency tradeoff is *not* the same as tax progressivity, but it determines how progressive a tax can be, subject to the efficiency constraint. Economists look for taxes that do not have an equity-efficiency tradeoff because they can make the rates as progressive as desired without causing any efficiency loss.⁵³

A tax on rents may not only have no efficiency cost, but may actually encourage the creation of wealth depending on the type of rent that is taxed. *Windfall rents* occur when someone receives a rent that they did not pursue, but still

50 Mulligan, “Do People Deserve Their Economic Rents?” 183.

51 Schwerhoff, Edenhofer, and Fleurbaey, “Taxation of Economic Rents,” 410.

52 In a non-competitive market it is possible for a tax on rents to pose an efficiency cost at the margin. I discuss these noncompetitive market rents in section 6.

53 Schwerhoff, Edenhofer, and Fleurbaey, “Taxation of Economic Rents,” 389.

accrue, simply because they are the beneficiary of an economic spillover.⁵⁴ In the context of windfall rents, the beneficiary is an economic patient, because no action or decision that they could undertake would affect the total supply of an economic good.⁵⁵ In the case of windfall rents, as for example when a person's property values increase because of nearby economic development, a tax on the windfall will not induce any behavioral change and so there will be no efficiency loss.⁵⁶ On the other hand, if a rent is generated because of *rent-seeking behavior*, then a tax on rent-seeking activity will alter the trade-offs of the rent seeker. Specifically, a tax on rents will increase the attractiveness of productive economic behavior at the margin relative to rent-seeking behavior. This is simply because a tax makes the opportunity cost of rent-seeking behavior higher relative to productive behavior.⁵⁷ Thus, a tax on rents of this kind would not only be costless, but would actually generate additional wealth.⁵⁸

Whether a tax on rents simply has no efficiency loss or has a *negative efficiency loss*, i.e., it positively generates wealth, depends on whether the rent is levied on the windfalls of economic patients or on the rental gains made by active rent seekers. The upshot is that taxes on competitive market rents have no equity-efficiency trade-off and, in the case of taxing rent seekers, may actually be hyperefficient.⁵⁹

There are situations where rents are generated by rent-seeking behavior, but the beneficiary of the rent is not the same as the rent seeker. In these cases, taxing the rental beneficiary will not result in efficient outcomes because those imposing the rent do not themselves face the altered trade-offs directly.⁶⁰ I discuss these cases of noncompetitive market rents in section 5.

3.2. Does Rental Taxation Diminish Labor Ownership?

Recall that the principle of labor ownership says that the person (or people) who creates or produces a thing has some bundle of property rights in that

54 Alterman, "Land Use Regulations and Property Values," 1–5.

55 Medda, "Land Value Capture Finance for Transport Accessibility," 156.

56 Medda, "Land Value Capture Finance for Transport Accessibility," 157.

57 Sobel and Garret, "On the Measurement of Rent Seeking and Its Social Opportunity Cost," 117.

58 Stiglitz, "The Origins of Inequality and Policies to Contain It," 433.

59 "The tax shifts investment towards reproducible stocks, alleviating their undersupply and leading to higher output and aggregate consumption" (Edenhofer, Mattauch, and Siegmeier, "Hypergeorgism," 476).

60 This occurs in the case regulatory capture, where rule makers create, administer, or authorize rules that generate rents for other parties such as in the case of labor rents or monopoly rents. See Aidt, "Rent Seeking and the Economics of Corruption, 147–51.

thing that others do not possess. As previously mentioned, the “thing” created may be the performance of certain activities, e.g., labor, or a product, service, or even a string of words or set of ideas, over which the owner has the right to sell, trade, use, or otherwise dispense. A condition of having a labor-ownership claim seems to be that something was produced or instantiated (in the case of labor) to have a claim over. However, rents are economic gains that do not contribute to the creation of wealth. If no wealth, however broadly defined, was generated by the rentier, how could they have a labor-ownership claim to the economic gains accrued from wealth that others created? If the rentier engages in no productive activity, it is hard to see how their property claims could be grounded in the principle of labor ownership.

One response might be that perhaps the creation of wealth is not required to confer labor ownership, just that the rentier is engaged in some activity that can be construed as labor in which they reallocate wealth from others to themselves. Earlier, we distinguished between rents generated by windfalls and rents generated by rent-seeking behavior. In the case of windfall rents, the person receiving the rent performs no activity that can be construed as labor; rather, the economic gain they receive is merely a side effect of the actions of others. For this reason, windfall rents can be disqualified from having any grounding in the principle of labor ownership. By contrast, rent-seeking behavior arguably involves the performance of some kind of labor. However, the so-called labor under consideration is not useful, at least in the sense that it does not produce any additional wealth or social value. The labor of rent-seeking behavior merely reallocates already existing wealth from others to themselves.⁶¹ Rent-seeking behavior has this feature in common with stealing, but nobody would justify burglary on grounds that the thief put in some work. Thus, it cannot be on grounds of effort alone that labor ownership is justified.

Traditional accounts of labor ownership, whether they be Lockean, Geor-gist, Nozickian, or Dworkinian, imply that it is the creation of something *new or valuable* that entitles a person to property, or at the very least that others not be made *worse off* in the process.⁶² This also corresponds to the justificatory language people use in economic contexts where they reference the “product” or “fruits” of their labor.⁶³ People do not typically justify their holdings by referencing the “takings” or “appropriations” of their labor. Whether through some

61 What Stiglitz calls “exploitation rents” (“The Origins of Inequality and Policies to Contain It,” 432–34).

62 See Locke, *Second Treatise of Government*, ch. 5; George, *Progress and Poverty*, 122; Nozick, *Anarchy State and Utopia*, 175; and Dworkin, “What Is Equality?” 287.

63 This language is also common in the literature, see Otsuk, “Self-Ownership and Equality,” 74; and Steiner, “Left Libertarianism and the Ownership of Natural Resources,” 5.

process of labor mixing, differential sacrifice, or self-sovereignty, labor-ownership claims are conferred when there is an act of creation or production, or some form of contribution generated by the labor owner. Yet, rent seeking is not act of creation; it adds nothing to the social surplus. On the contrary, rent-seeking behavior appropriates wealth from others without generating any value, thereby making others worse off. Further, rent-seeking behavior cannot be justified on grounds that it enables the individual to have greater effective control over their lives. This would imply that my ability to effectively control my life comes at your expense and vice versa. It is only on grounds that others not be made worse off that such a principle can be justified, and the gains from rent seeking fail to satisfy this common standard.⁶⁴ Consequently, property claims in rent cannot be justified on grounds of labor ownership, thus taxing rents does not diminish labor ownership.

It is important *not* to overstate the implications of this argument. Denying that economic rents are grounded in the principle of labor ownership does not imply that there are no legitimate property claims in rent. Property claims in rent could plausibly be justified on other grounds.⁶⁵ Enacting institutional rules of any kind will likely generate property claims in rents of one form or another, but that is acceptable if we have good reasons for adopting those rules. The upshot of my argument is not to deny that we can have property claims in rent. Rather, the upshot is that taxing rents does not diminish the principle of labor ownership. This is an advantage to taxing rents over and above taxing productive economic gains for reasons discussed in section 2. Namely, preserving labor ownership creates good incentives, promotes individual sovereignty, aligns with established economic norms, and allows individuals greater effective control over their economic lives.

4. POTENTIAL NOMINEES FOR RENTAL TAXATION

I have argued that taxing rents lacks the drawbacks that afflict taxing productive gains, but have not yet specified what rental taxation would look like in practice. It is beyond the scope of this paper to offer policy prescriptions, though it may be instructive to provide some sense of what a tax base composed of rents may look like. The subsequent examples are only intended to demonstrate some

64 This common standard includes the Pareto principle, Locke's proviso, Nozick's proviso, and George's principles of acquisition. Also see Stiglitz and Rosengard, *Economics of the Public Sector*, 63–65; Locke, *Second Treatise of Government*, 12–18; Nozick, *Anarchy State and Utopia*, 172–82; George, *Progress and Poverty*, 122–24; and Russell, "Self-Ownership, Labor, and Licensing", 186.

65 For example, "first possession" rules. See Schmidtz, "The Institution of Property," 5–9.

possible avenues of rental taxation. Whether these tax nominees are desirable bases of taxation requires further investigation and research. I offer these examples to be illustrative, knowing that they are not definitive.

4.1. Land Rents

Land offers the paradigmatic example of rental taxation. Indeed, the term rents, originally coined by the eighteenth-century physiocrats, refers to the rental value of land.⁶⁶ A given piece of property or real estate has two sources of value: the value of the land itself and the value of improvements made by the owner. The economic gains accrued from the land-ownership portion alone (distinct from property improvements made by the land owner) can be regarded as a rent because it has no origin in the landowner's productive activities but rather is a consequence of the land's natural features as well as surrounding improvements.⁶⁷ For instance, much of a property's value is a consequence of its proximity to desirable features, such as schools, parks, restaurants, commercial activity, or beautiful scenery. As development increases in an area, landowners gain a significant windfall based on the improvements made by others, i.e., proximate improvers.⁶⁸

A land value tax is designed only to tax the value derived from the land-holding portion of the property and *not* to tax the value derived from physical structures or other human improvements. As the land's value increases due to proximate development, and the landowner receives a windfall, a tax is levied on that windfall and returned to the community.⁶⁹ The tax is generally regarded as being efficient because it does not distort the behavior of the landowner.⁷⁰ The landowner is, in our terminology, an economic patient, because they do not supply the land or its proximate development; they merely capture positive spillovers from neighbors.⁷¹ The landowner's behavior is not distorted by the tax because the supply of land is fixed, i.e., more land cannot be produced.⁷² The extreme inelasticity of the supply of land means that a tax will not distort the behavior of the landowner and hence a tax on land's rental value generally has no efficiency costs; it can only redistribute the gains from land ownership. Hence,

66 Lackman, "The Classical Base of Modern Rent Theory," 287.

67 Schwerhoff, Edenhofer, and Fleurbaey, "Taxation of Economic Rents," 411–12.

68 Medda, "Land Value Capture Finance for Transport Accessibility."

69 For a survey of the different instruments used for achieving this, see Alterman, "Land Use Regulations and Property Values."

70 Mattauch, *Rent and Redistribution*, 11–13.

71 Mclean, "The Politics of Land Value Taxation," 11.

72 Oates and Schwab, "The Impact of Urban Land Taxation," 17–19.

a tax on land rents has no equity-efficiency tradeoff.⁷³ This desirable feature of land as a source of taxation has been recognized by many economists, notably Henry George, William Vickrey, Milton Friedman, and Joseph Stiglitz.⁷⁴

Taxing the land's rental value is efficient, but does it diminish labor ownership? Since the land itself has been supplied by nature and increases to the land's marginal value are supplied by the activities of proximate improvers, the principle of labor ownership cannot apply to the landowner.⁷⁵ Labor ownership arguments on behalf of the landowner would only apply to improvements on the land or of its use, but not the land itself.⁷⁶ This point was first made prominent by Thomas Paine, who held that "the earth ... [is] the common property of the human race" and "that it is the value of improvement only, and not the earth itself, that is individual property."⁷⁷ Indeed, if anyone has a claim on grounds of labor ownership to the rental value of the land it is the members of the local community responsible for the surrounding improvements that increase the land's marginal value, not the landowner. Labor ownership may imply that the proximate improvers would have claim to the portion of the surplus of the land's rental value that their improvements generated. Knowledge problems would likely make it impossible to disentangle whose contribution was responsible for each marginal improvement in the value of the land. From a labor-ownership standpoint, returning the surplus value of these positive spillovers back to the community in the form of tax revenue is better than allowing it to be captured by landowners, especially if these levies replace taxes on other economic gains accrued through labor ownership.

Some have raised concerns regarding implementation of a land value tax, most notably related to the problem of "unrealized value."⁷⁸ Specifically, while the landowner benefits from surrounding improvements, they may not mon-

73 This is not meant to imply that a land tax will always be progressive—the distributional benefits will depend on the particular land value tax policy and the distribution of land holdings—rather, it indicates that the tax rate can be made progressive without creating distortions.

74 See George, *Progress and Poverty*, 156; Vickrey, "Site Value Taxes and the Optimal Pricing of Public Services"; Stiglitz, "The Theory of Local Public Goods Twenty-Five Years after Tiebout," 14; "An Interview with Milton Friedman."

75 See Vallentyne, Steiner, and Otsuka, "Why Left-Libertarianism Is Not Incoherent, Indeterminate, or Irrelevant," 202.

76 "While the finiteness of land makes all claims to perpetual possession inconsistent with Locke's proviso, some claims to the use of land are consistent with it" (Tideman, "Takings, Moral Evolution, and Justice," 1724).

77 Paine, *Agrarian Justice*, 4.

78 For problems of unrealized value in connection to wealth taxation, see Fleischer, "Not So Fast," 265–66 and 288.

etize these benefits until they sell the land. A natural question then becomes whether the tax should be assessed as a point-of-sale tax on the land's value or as an annualized land-rental tax. A point-of-sale land value tax would consist of a single large tax payment assessed against the total rental value accrued from the point of purchase to the point of sale, while the annualized version consists of a continuous stream of annual payments assessed against each year's portion of the land rent. Determining the proper implementation of the tax depends on a number of empirical and conceptual considerations. The point-of-sale route allows greater flexibility to the taxpayer because it foregoes any liquidity concerns for those who are "land rich and cash poor."⁷⁹ However, from a public revenue standpoint, a series of smaller payments made by all landowners every year is preferable to large but infrequent payments where some landowners may only pay the tax every several decades. The annualized version of the tax is more consistent with conceptualizing the land tax as an annual fee that the owner pays in compensation for removing the land from "the commons" and thus giving the landowner exclusive right of use for as long as they continue to pay the rental portion back to the community.⁸⁰ In general, the annualized version is likely a more preferable tax instrument, but the details of land-tax policy ought to be construed in a way that accommodates liquidity concerns related to unrealized value, such as allowing payment deferrals or implementing modest tax-exemption thresholds on low-value land plots.⁸¹

4.2. Incidental Inheritance

The economic literature discusses many types of inheritance, but for our purposes these can be broken down into two types: deliberate bequests and incidental bequests.⁸² A deliberate bequest is one in which the donor changes (or would have changed) their productive activity to ensure a specific recipient or group of recipients receives an economic gain following their death. For example, a person may want to help their adult children get a solid start or ensure that a disabled child has enough saved in trust for their entire life span,

79 Mclean, "The Politics of Land Value Taxation," 14.

80 George, *Progress and Poverty*, 158.

81 For an outline of proposals, see Mclean, "The Politics of Land Value Taxation," 11–14.

82 Roughly speaking, what is known in the literature as "accidental bequests" and "capitalist bequests" (or "wealth-loving bequests") qualifies as incidental bequests, while "voluntary" or "planned" bequests qualify as deliberate bequests. I adopt new terminology in this context because it better captures the difference between productive gains and economic rent. For the traditional terminology listed above, see Masson and Pierre, "Bequests Motives and Models of Inheritance," 54–88; and Piketty and Saez, "A Theory of Optimal Inheritance Taxation," 1866.

or they may have a specific charitable purpose in mind. Deliberate bequests are characterized by the fact that a donor had a goal for their bequest *and as a consequence* their economic activity was in part formed around that purpose.⁸³ By contrast, an incidental bequest occurs when the bequest was not instrumental in motivating the donor to engage in productive economic activity.⁸⁴ For example, this might occur when the donor's retirement savings exceeds their life span due to uncertainty regarding the donor's longevity or when the productive decisions of the donor end up being more profitable than their original expectations.⁸⁵ This would include the gains that the children of the ultra-wealthy (e.g., mega-millionaires and billionaires), receive upon their parents' death. The greater portion of these bequests are unproductive economic gains since it is unlikely that the billionth inherited dollar was instrumental in motivating the productive activities of the donor in the first place.⁸⁶

The implication of this distinction is that deliberate inheritances are productive economic gains while incidental inheritances are rents. Taxing deliberate inheritance will alter the trade-offs of the donor because knowing that the bequest will be taxed will change their economic decisions. By contrast, incidental inheritances were not produced *for* the recipient, though the donor may have wanted the recipient to receive them in the event of the donor's death.⁸⁷ For example, we may want our children to have our excess accruals, but this does not mean we produced or saved those gains *for* that purpose. Taxing incidental inheritance will not alter the production and consumption decisions of the donor and is therefore efficient.⁸⁸

As it concerns labor ownership, an inheritance tax cannot diminish the labor ownership of the inheritor, because the inheritor did not produce the inheritance.⁸⁹ A common right-libertarian argument against inheritance taxation argues that it diminishes the labor ownership of the donor, since it reduces

83 Deliberate bequests encompass "voluntary bequests," "planned bequests," and "altruistic bequests." See Masson and Pierre, "Bequests Motives and Models of Inheritance," 57; and Batchelder, "Leveling the Playing Field between Inherited Income and Income from Work through an Inheritance Tax," 70–71.

84 Piketty and Saez, "A Theory of Optimal Inheritance Taxation," 1866–67.

85 For accidental bequests in the case of life-span uncertainty see Hurd, "Mortality Risk and Bequests." For capitalist bequests see Masson and Pierre, "Bequests Motives and Models of Inheritance," 71.

86 See Batchelder, "Leveling the Playing Field between Inherited Income and Income from Work through an Inheritance Tax," 50–51; and Francis, "Wealth and the Capitalist Spirit."

87 Kopczuk, "Taxation of Intergenerational Transfers and Wealth," 10.

88 Batchelder, "Leveling the Playing Field between Inherited Income and Income from Work through an Inheritance Tax," 50–51.

89 A point recognized first by John Stuart Mill. See Pedersen, "Just Inheritance Taxation," 5.

their effectiveness in transferring their wealth to others.⁹⁰ Daniel Halliday challenges this argument by pointing out that the inheritance tax is considerably less coercive than other forms of taxation because it tends to pose fewer opportunity costs to the labor owner.⁹¹ Essentially, the labor owner can fully make use of their wealth while they are alive, but only incurs a tax at the time of transfer—when they are dead—whereas all other taxes diminish the wealth of the labor owner while they are alive.⁹² Further, by targeting incidental inheritance for taxation as opposed to deliberate inheritance, the tax base would be drawn from sources that do not interfere with the purposes for which donors generated these economic gains in the first place. Compared to either a generic inheritance tax or other forms of taxation, taxing incidental inheritance better preserves labor ownership and is non-distortionary.

Drawing a conceptual distinction between deliberate and incidental inheritance means that in theory it is possible to tax inheritance rents, but this does not itself assist the tax administrator in determining how to tax inheritance, since the actions and motivations of bequesters are unknown to them. Traditional explanations for what motivates inheritance include altruism toward progeny, precautionary savings as a kind of lifelong insurance, and promissory payments to adult children in exchange for elder care.⁹³ However, identifying a common bequest motive across large heterogeneous populations is notoriously elusive.⁹⁴ Given the mixed motivations of bequesters and the inability for any tax administrator to know the circumstances in each case, how could it be possible to create a tax that distinguishes the rental portions of inheritance from its productive portion? Of course, no administrable tax system can perfectly target a given tax base, but nonetheless a sound tax system should have a reasonable degree of accuracy.⁹⁵ There are at least two possibilities for practically separating incidental inheritance from deliberate inheritance. I briefly

90 For a brief overview of this type of argument see Halliday, “Is Inheritance Morally Distinctive?” 621–24.

91 Halliday, “Is Inheritance Morally Distinctive?” 627–31.

92 “Other taxes generally aren’t like this. Taxes imposed before death generally have a greater impact on the value of the various options open to an individual at the time the tax is imposed” (Halliday, “Is Inheritance Morally Distinctive?” 632).

93 See Fried, “Who Gets Utility from Bequests?” 646–56; Blumkin and Sadka, “Estate Taxation with Intended and Accidental Bequests,” 2–3.

94 “Any attempt to explain intergenerational transfers by a single motive seems hopelessly oversimplified” (Fried, “Who Gets Utility from Bequests?” 653).

95 Halliday remarks, “It should be conceded that most tax schemes are going to be heuristics that will generate a number of false positives and negatives” (*Inheritance of Wealth*, 187). Also see Fried, “Compared to What?” 385.

discuss two such possibilities in turn: (a) the “Rignano scheme” and (b) the pre-commitment strategy.⁹⁶

The presence of inheritance can be a consequence of a single generation or the result of a continuous chain of multigenerational wealth. One proposal that sees periodic consideration in the philosophical literature involves treating single-generation versus multigeneration inheritance differently.⁹⁷ The Rignano scheme involves treating the presence of newly created inherited wealth at a fairly low tax rate while levying a high tax rate on the presence of wealth that is passed on to subsequent generations.⁹⁸ Under a Rignano scheme, if Alice earns and bequeaths a million dollars to her son, Bill, the tax on that inheritance is extremely minimal. Suppose in the next generation Bill passes on one-and-a-half million to his daughter, Karen. The first million would now be taxed at a very high rate of taxation since this wealth is carried over from the first generation, but the subsequent half million that Bill earns and passes on would be taxed at a low rate. The idea is consistent with maintaining incentives for donors to be productive across successive generations, as well as the idea that the originators of wealth should have the ability to transfer their wealth as they see fit, but that subsequent rentiers have less of a claim to transfer wealth free from taxation. The Rignano scheme’s treatment of multigenerational transfers tends to capture a strong portion of incidental inheritance, since the taxed wealth was not even produced by its donor. However, the Rignano scheme’s treatment of first-generation transfers is overly generous, as a significant portion of these transfers are likely to be incidental inheritance as a consequence of precautionary savings or unanticipated economic success. A Rignano scheme with perhaps a steeper initial progressive tax curve on first-generation transfers could be a decent approximating tool for taxing incidental inheritance while minimizing deliberate inheritance taxation.

Another possibility for taxing inheritance rents is to create a tax system with a precommitment device that incentivizes donors to reveal their preferences and thus create a separating equilibrium between incidental and deliberate inheritance. For example, governments could allow for tax-advantaged accounts up to some limit, but the donor would not be permitted to withdraw funds from the account and instead those funds would be placed in a trust for the recipient upon the donor’s death. Alternatively, withdrawal from the tax-advantaged trust could be allowed, but only after paying an extremely high rate to serve as a penalty for failing to commit. Any inheritance or gift transferred

96 For the Rignano scheme, see Halliday, *Inheritance of Wealth*, 54–72 and 195–96.

97 See Halliday, *Inheritance of Wealth*, 54–72; Pedersen, “Just Inheritance Taxation,” 6.

98 Halliday, *Inheritance of Wealth*, 54–72, 195–96.

outside this system would be subject to taxation at progressive a rate as desired. The consequence is that a properly designed combination of tax advantaged trusts with a significant withdrawal penalty could create a separating equilibrium between deliberate and incidental inheritance.

4.3. Zero-Sum Financial Transactions

Market transactions generally create value because participants receive something more valuable to them in exchange for giving up something less valuable to them. Some transactions initially appear to be zero sum, meaning that the amount of wealth that exists at the beginning of the transaction is the same that exists at the end of the transaction. Insurance is a notable example of being zero sum on paper, but actually increases the expected value for participants since it secures them against the possibility of greater losses. However, there is increasing skepticism that many zero-sum financial transactions have a socially beneficial function. For example, Posner and Weyl make the case that many of these transactions are merely a form of “financial gambling” and are “welfare reducing and contribute to systemic risk.”⁹⁹ I make no claims regarding particular financial transactions but seek to demonstrate the plausibility of this hypothesis with a simple example.

Poker is a zero-sum game on paper. If it were not for the enjoyment of the participants in playing the game, poker would not produce any social surplus. Imagine that the participants in the poker game were not human beings enjoying themselves, but computer algorithms programmed by their creators to try and maximize their earnings from online poker games. If there are six poker programmers, then we know that five of them will be sorely disappointed with the outcome of the game. The consequence of the joyless poker game will be that five players will be worse off and one player will be significantly better off. The gains accrued by the victor of our joyless poker game produce no additional wealth; they just redistribute already existing holdings.

Taxing the gains from joyless poker games will not reduce efficiency, but curiously it would alter the trade-offs of the participants. This is because, unlike land rents and incidental inheritance, these rents are not windfalls but a consequence of rent-seeking activity. Taxing rent-seeking activity will alter the trade-offs of our poker programmers, but in a socially beneficial way. As discussed in section 3.1, taxing the gains from rent seeking will not only have zero efficiency costs, but will also create an incentive at the margin to engage in more productive activity. As the tax rate increases on these gains, the poker programmers have greater incentive to abandon rent seeking in pursuit of more profitable

99 Posner and Weyl, “An FDA for Financial Innovation,” 1317.

and, likely, more productive activities. Furthermore, justifications from labor ownership are absent; no good was created nor any service rendered. It is on grounds of consent to participate in a game, not on grounds of labor ownership, that the gains from the joyless poker game are justified.

Is the joyless poker game merely an interesting contrivance or an accurate approximation of some of the zero-sum securities markets, including options, derivatives, futures, foreign currency, cryptocurrency, and sports gambling?¹⁰⁰ Such an answer is likely to be nuanced and requires further investigation, but many well-informed commentators question whether many of these zero-sum financial transactions actually create wealth.¹⁰¹ If there are types of financial transactions that are akin to a joyless poker game, then these transactions are ripe possibilities for rental taxation.

4.4. *Negative Externalities*

One of the primary justifications for a competitive market system is that an offering's price tends to approximate its marginal social cost. The assumption of this justification is that the marginal cost endured by the firm is equivalent to the social cost endured by society. Negative externalities describe the situation when this condition not met—when the price of an offering underrepresents its marginal cost. Negative externalities are peculiar because most activities that produce negative externalities *also* generate wealth. For example, burning fossil fuels creates pollution but also powers modern industry. The problem is that because the supplier or the demander of the productive activity does not bear its full costs, the activity is oversupplied. Hence, for negative externalities it is the *level* at which the productive activity is supplied that is the problem, as opposed to the activity itself being intrinsically unproductive. This means that for some *portion* of the activity (and *not* the activity considered on net), more wealth is being destroyed than being created. Thus, there are economic gains being accrued on a portion of the activity that is not only unproductive, but actively destructive. The gains accrued from portion of the activity that generates negative externalities can properly be considered rents since they are

100 The justification offered here for taxes assessed on gambling is on the basis of their possibly constituting economic rents, and not on paternalistic grounds. Using taxation for paternalistic reasons is an intriguing idea since raising cost of bad habits may reduce their prevalence. However, such a strategy can also be self-defeating. If the tax does not alter the person's behavior, all that has been accomplished is to make their bad habit even more expensive, which makes them worse off.

101 See Posner and Weyl, "An FDA for Financial Innovation"; Stiglitz, "The Origins of Inequality and Policies to Contain It," 432–34; Mazzucato, "Financing Innovation," 858; and Buiter, "Useless Finance, Harmful Finance, and Useful Finance."

gains that are not instrumental in the creation of wealth—in fact they destroy wealth, *at the margin*.¹⁰²

Since we often do not want to prohibit the activity as a whole, but rather temper it, a commonly proposed solution to negative externalities is the “Pigouvian tax,” a levy designed to internalize all costs of production so that firms produce the optimal amount of the offering.¹⁰³ The idea is that such a tax internalizes social costs and pushes the price toward the equilibrium point so that the price of the offering either approximates, or nears approximating, its marginal cost. While taxation on negative externalities is attractive for efficiency reasons, it operates differently than the other taxes on rents we have discussed. In the case of land, incidental inheritance, and zero-sum transfers, these rents could theoretically be taxed at 100 percent and remain efficient. This is because there is no portion of these rents that generates wealth. By contrast, in the case of activities that generate negative externalities, there is a specific price point (or range) at which the production of the offering is efficient. This means that, while Pigouvian taxation can be efficient, it does not necessarily avoid the equity-efficiency tradeoff in a way that is characteristic of the other forms of rental taxation. Pigouvian taxation may still be very attractive because it can increase efficiency, but because the tax is constrained by the goal of finding the optimal price range, it lacks the rate flexibility that the other forms of rental taxation possess. Still, Pigouvian taxation is likely to be progressive, since those who bear negative externalities tend to be poorer than those who benefit from not paying the costs of those externalities. However, Pigouvian taxation is considerably less flexible than the other rental taxes discussed.

Do levies on negative externalities diminish labor ownership? A Pigouvian tax that only discourages the destructive portion of the activity would not diminish labor ownership, so long as we assume that labor ownership is reasonably constrained by some account of harm or individual rights. This is a widely accepted condition placed upon freedom more generally and labor ownership in particular. Such a stipulation is reflected in Mill’s harm principle and Locke’s proviso.¹⁰⁴ However, the constraint on labor ownership only applies when the Pigouvian tax is properly designed and does not overly restrict the activity in question so as to diminish its wealth-generating portion.

102 Schwerhoff, Edenhofer, and Fleurbaey, “Taxation of Economic Rents,” 401.

103 Mankiw, “Smart Taxes.”

104 See Locke, *Second Treatise of Government*, 12–14; and Robson, *Collected Works of John Stuart Mill*, 223

5. COMPETITIVE MARKET RENTS VS. NONCOMPETITIVE MARKET RENTS

The aforementioned examples are potentially promising nominees for rental taxation. Yet, not all rents may be suitable targets for taxation and some rents may be better handled by adjusting the system of rules. The contemporary economic literature tends to focus on rents that are a consequence of regulatory capture.¹⁰⁵ Occupational licensing rules may protect consumers in situations of low information and intellectual property law can create incentives for research and discovery. Yet, the presence of these rule systems can also be leveraged or co-opted by rent-seeking firms, professional associations, or political lobbyists. When the rules governing economic suppliers (either firms or workers) are abused or co-opted in a way that artificially restricts some suppliers in favor of other suppliers, the subsequent gains are economic rent. Prime examples of these include monopoly/oligopoly rents and labor rents. There are many causes for an artificial scarcity of suppliers, including guilds, cartels, overly restrictive intellectual property law, excessively demanding licensing rules, or principal-agent problems.¹⁰⁶ The economic gains that accrue to permitted suppliers are artificially inflated because other legitimate suppliers are being prevented from participating, such as competing firms in the cases of monopoly/oligopoly rents and competing workers in the case of labor rents. The portion of gains attributable to decreased competition is unproductive because it does not stimulate wealth generation but merely transfers consumer surplus to producer surplus in the form of higher prices to consumers and higher wages/profits to permitted suppliers.¹⁰⁷

In addition to being inefficient, these artificial restrictions also violate the labor ownership of those suppliers who are unfairly excluded. Suppose for example that obtaining a medical license is so onerous and challenging that it not only excludes unqualified medical practitioners, but also excludes a large portion of qualified medical practitioners. Qualified candidates that are excluded from medical practice are unfairly not being allowed to pursue promising careers and thus have a diminished potential to exercise their abilities in a way that allows them to control their own economic situation. Dan Russell argues that restrictive licensing constitutes “takings of property in labor” and

105 See Dal Bó, “Regulatory Capture”; and McChesney, “Rent Extraction and Rent Creation in the Economic Theory of Regulation.”

106 See Aidt, “Rent Seeking and the Economics of Corruption,” 147–51.

107 Labor rents may also occur as a result of principal-agent problems. See Kräkel and Anja, “Internal Labor Markets and Worker Rents.” For example, CEOs and other executives likely receive labor rents as a consequence of their partial associations with their boards of directors. See Moriarty, “Do CEOs Get Paid Too Much?” 260–62.

therefore faces a justificatory burden.¹⁰⁸ That justificatory burden is rooted in a conception of reciprocity.¹⁰⁹ Specifically, he contends that “the justification for taking is that even those from whom property is taken are better off in the greater scheme of things for living in the sort of community that such a power to take property makes possible.”¹¹⁰ Notably, this conception of labor ownership is not absolutist. It would justify restrictions on labor where doing so would make those subject to those restrictions better off in the greater scheme of things, such as in the case of prohibiting unqualified doctors from practicing medicine. Yet, a restriction on labor does not satisfy this justificatory burden when it “does not allow positive sum transfers,” such as in the case of prohibiting market entry of qualified medical applicants.¹¹¹ Accordingly, the rules that create supplier rents also diminish labor ownership by unfairly restricting liberty in cases where it is reciprocally beneficial.

Are supplier rents a promising target for taxation? Supplier rents are notably different from our previous examples of economic rent. In the other four cases we have discussed, the rents exist within, or alongside, competitive markets. None of the previous cases involved a market where competition was artificially restricted. By contrast, within the context of noncompetitive markets, the ensuing supplier rents are not a result of windfalls, nor of distortions, created by the market participants acting within the rules of the game, but rather as a result of *rules that distort the game*. Unlike our previous examples, it is the rule makers, *not* the market participants that are the relevant decision makers, i.e., economic agents, when it comes to the existence of these rents. Thus, it is the trade-offs that face rule makers that are most relevant in these cases. For example, an overly restrictive system of medical licensing that creates an artificial scarcity of doctors is a consequence of political lobbying on the part of medical associations or affiliated interest groups; it is not a result of practicing medicine. Thus, taxing doctors for their labor rents would not affect the trade-offs of the relevant economic agent in the right way, but rather would exacerbate the existing artificial scarcity of medical care. A proper rental tax in this case would involve discouraging behavior at the level of political lobbying, not at the level of medical supply. The problem with these labor rents is not the fact that some doctors are practicing medicine, but, instead, that other qualified would-be doctors are *prevented* from practicing medicine. Generalized, supplier rents accrue to *some* suppliers but are not the consequence of the activity of supplying. Instead,

108 Russell, “Self-Ownership, Labor, and Licensing,” 174.

109 Russell, “Self-Ownership, Labor, and Licensing,” 179.

110 Russell, “Self-Ownership, Labor, and Licensing,” 180.

111 Russell, “Self-Ownership, Labor, and Licensing,” 186.

supplier rents are the result of rule makers creating, administering, or enforcing rules that diminish the labor ownership of other economic suppliers.

Rental taxation could theoretically be effective in the case of supplier rents if applied at the proper level. The rental tax would have to be levied on rent-seeking behavior at the level of political decision making. While such a tax on rule-maker rents is intriguing, what would it look like in practice? Imaginations could run wild regarding the details of such a tax. It could be applied in the form of a large fixed fee for all political lobbying efforts, or as a penalty to firms that lose lawsuits that judges deem to be frivolous attempts to corner the market by leveraging the courts. The problems with such proposals are myriad. Systems of taxation virtually always apply to economic participants (including economic agents and economic patients), and I can recall no instance of taxation being applied to rule makers or at the level of political decision making itself. There are likely a host of good reasons for this, including deep knowledge problems concerning the optimal amount, context, and application of the tax; agency problems; and enormous constitutional concerns. Future proposals of rental-tax design might reflect on whether such a "rule-maker tax" is possible and/or desirable. However, given the size and scope of these challenges, rents that exist because of noncompetitive markets are likely better resolved by properly updating the rule systems than by trying to tax these rents. Rents that exist in the context of competitive markets are more promising targets of taxation, since there is either (a) no altered trade-offs, as in the case of windfall rents, or (b) in the case of rents from rent seeking, there is no disambiguation between the rental beneficiary and the rent seeker.

6. CONCLUDING REMARKS ON TAX-BASE SELECTION

There are different levels of disagreement that one could have with this project, not all of which are antithetical to that project's purpose. Someone might disagree that the tax nominees I have proposed constitute proper rents and may think that there are alternative rental nominees better suited for taxation. This level of disagreement is completely consistent with the greater aims of the project. Distinguishing which economic gains are rents from those that are genuinely productive requires further research. Yet, someone voicing this disagreement still accepts the central claim that we ought to replace taxes on productive economic gains with taxes on rents.

There are other levels of disagreement antithetical to the core project. Someone might deny that economic rents exist at all. Given the preponderance of evidence presented and absent a strong argument that all economic gains are productive, this standpoint is not credible. A more plausible objection contends

that it will be difficult to find a general class of taxable objects that always count as rents and not as productive economic gains. I have offered some potential nominees to illustrate that there are such general classes. One rebuttal might be to find exceptions with these nominees themselves and to argue that even these are not always rents. However, the appropriate standard does not lie in finding the platonic ideal of a tax base; instead it is a matter of choosing the best tax base among all relevant alternatives. Thus, if there are exceptions within a class of objects that generally constitute rents, we need only ask, "What are the alternatives?" For those skeptical that pure rents exist as a class, the thesis can be modified: "It is better to tax things that are more rent-like than things that are more consistently productive economic gains." Unless we think all classes of taxable objects are equivalently productive, an implausible proposition, we should want to tax classes of objects that are more rent-like instead of the class of objects that tends to be more productive.

Finally, the largest fundamental disagreement one could have with this project would be to claim that it is better to tax productive economic gains than rents. Given the drawbacks we have discussed, it is hard to imagine how someone might make this argument. Perhaps they would point to alternative normative features, ones that we did not consider within the scope of this paper. Yet, this avenue of objection looks increasingly dubious once we actually consider the other plausible normative features. Consider economic growth. It is widely established that taxing productive economic gains, especially gains from capital, have deleterious effects on growth.¹¹² By contrast, rental taxation is thought to have minimal effects on growth, and may even *increase* economic growth.¹¹³ What about other moral features, such as desert? For those holding that desert should play a justificatory role in economic outcomes, it is typically on grounds of social contribution or productive activity that desert claims to economic gains are justified. Yet, as discussed, these are precisely the kinds of characteristics that rental economic gains lack and that productive economic gains possess.¹¹⁴ Indeed, people generally object to individuals accruing large economic gains when they are "unconnected to underlying productive capacity," such as occurs in the case of rents.¹¹⁵ By contrast, desert claims to economic gains are most justifiable when the gain is a consequence of creating social or economic value to society, such as occurs with productive economic gains.¹¹⁶ Looking at

112 Mankiw, Weinzierl, and Yagan. "Optimal Taxation in Theory and Practice," 20–22.

113 Murphy, Shleifer, and Vishny, "Why Is Rent-Seeking so Costly to Growth?"

114 See Lamont, "Incentive Income, Deserved Income, and Economic Rents," 45.

115 Mulligan, "Do People Deserve Their Economic Rents?" 183.

116 Mulligan, "Do People Deserve Their Economic Rents?" 184.

other plausible normative considerations, such as incentives, social reciprocity, or differentiating gains from luck and choice, none of these seem likely to overturn the attractiveness of rental taxation compared to the alternative.¹¹⁷ If anything, these features seem to strengthen and not weaken the case for rental taxation. There does not seem to be any plausible normative criteria that might lead us to favor taxing productive gains instead of rents, let alone one that would tilt the holistic balance of reasons in that direction.

The upshot of my central argument is as follows: to the largest extent possible, we ought to replace levies on productive economic gains with taxes on economic rents. Yet, given the amount of funding that modern governments require, is such a tax base large enough? It is an empirical matter whether full replacement of the tax base is possible, but even a degree of partial replacement would create enormous improvements. Since “deadweight loss increases with the square of the tax rate,” even small reductions on the tax rates of productive gains can have outsized economic effects.¹¹⁸ A parallel argument applies for labor ownership. Pushing the tax rate down a few percentage points can have a significant impact on the effective control that people have over their lives. This is especially true at lower rates of income, where even marginal tax reductions can be the difference between retaining control over one’s economic situation or being at the mercy of external circumstances.

The fundamental ethos of this approach to taxation is that we should try to avoid taxing people’s propensity to create, produce, or consume wealth, but rather tax their propensity to co-opt, exploit, or diminish it. Future research in this rental-taxation program will likely revolve around two major topics. First, what are the best nominees for rental taxation and how do we design tax rules and mechanisms so as to separate the rental portion of economic gains from the productive portion of those gains? We have already discussed several plausible nominees but considerably more investigation into alternative rental tax bases is needed. Second, what are the political and public choice barriers that have so far prevented the widespread use of rental taxation and how do we overcome those barriers? The widely cited Mirrlees Review comments “the economic case for a land value tax is simple, and almost undeniable. Why, then, do we not have one already? Why, indeed, is the possibility of such a tax barely part of the mainstream political debate, with proponents considered marginal and unconventional?”¹¹⁹ Given its obvious normative benefits, the same question

117 For rental taxation in the context of luck egalitarianism, see Vallentyne, “Self-Ownership and Equality,” 331.

118 Stiglitz, *Economics of the Public Sector*, 584.

119 Mirrlees and Adam, *Dimensions of Tax Design*, 373.

can be applied to rental taxation at large: Why has it gained so little traction? The answer likely stems from political influence and opposition by embedded interest groups. Political philosophy can play a further role in the tax debate by emphasizing the normative difference between justifications rooted in private interest from those justifications based on publicly recognizable moral considerations.¹²⁰

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