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Quasi-Public Spending

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JOHN R. BROOKS*

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In November 2014, video surfaced of one of the architects of the Affordable Care Act (ACA), economist Jonathan Gruber, saying that the ACA—which, among other things, required individuals without health insurance to purchase insurance and provided income-based subsidies to help do so—“was written in a tortured way to make sure [the Congressional Budget Office (CBO)] did not
score the mandate as taxes. If CBO scored the mandate as taxes, the bill dies.1

Perhaps primed by the recent Supreme Court decision in National Federation of Independent Business v. Sebelius (NFIB),2 some commentators quickly took this to be a confession that the bill drafters had deliberately obfuscated in calling the penalty for failure to buy health insurance3 a penalty rather than a tax.4 After all, the basis of the NFIB decision, which upheld the ACA, was that the penalty was actually a tax and therefore fell within Congress’s constitutional taxing power.5

The commentators were shocked—shocked—that the drafters had misled us, and they treated this ostensible confession as inflammatory. (It probably didn’t help that Gruber also referred to “the stupidity of the American voter” in the same video.)6 The claim was presumably that the American voters would not have accepted the ACA if they knew the penalty was actually a tax.7

The commentators were wrong, however. Gruber was not talking about the penalty. He was actually saying something much bigger and potentially much more inflammatory.

Gruber was actually saying that it was the insurance premiums—the direct payments from individuals to health insurance companies—that were at risk of being called “taxes.” The penalties for failure to buy insurance were expected to raise only $4 billion per year in the first few years of the ACA8 and in any event

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3. The ACA backed up its requirement to purchase insurance with a penalty called a “shared responsibility payment” for those who did not. I.R.C. § 5000A(b) (2012).
5. NFIB, 132 S. Ct. at 2595–97.
7. The ACA votes were almost entirely on party lines. The bill passed the House with no Republican votes. After the death of Senator Ted Kennedy and the subsequent election of Senator Scott Brown, the House bill would not have withstood a filibuster in the Senate, and so congressional Democrats instead used a process called “reconciliation” to pass a bill in the Senate with a simple majority. See Emily Smith, Timeline of the Health Care Law, CNN (June 28, 2012, 10:42 AM), http://www.cnn.com/2012/06/28/politics/supreme-court-health-timeline [http://perma.cc/N8W9-MRK9]. This illustrates that passage was narrow and nearly failed, and so some commentators believed that even small obfuscations could have made a material difference.
were always scored\(^9\) by CBO as government revenue\(^{10}\)—not a lot of political risk there. In contrast, the mandated premium payments through the exchanges are currently running around $51 billion per year\(^{11}\) and are likely to get bigger\(^{12}\)—if that were seen as a tax increase, the bill would have been in serious jeopardy.

But this would require treating direct payments from individuals to insurance companies as taxes—was there really much risk that CBO would do that? Quite a lot, actually, because that is precisely what CBO did in scoring the similar 1993 Clinton health-reform bill.\(^{13}\) And, indeed, it was reasonable to do so. The mere fact that payment goes from an individual to a provider of a good or service, rather than first running through government—that is, calling a payment a “price” rather than a “tax”—does not make it any less public spending if the payment is mandated and especially if the payment is income-based like our income taxes. Indeed, this Article claims that this structure—mandated or strongly encouraged payments directly from individuals to good or service providers, rather than to the government—may actually be the future of American public spending.

This Article introduces the concept of “quasi-public spending” to describe this type of policy, whereby public provision of goods and services is effected not through direct, tax-funded government programs, as is common in continental Europe, but rather through a mixture of individuals’ direct expenditures driven by government subsidies and mandates, smaller scale taxes to make distributional adjustments, and heavy public regulation of the private market. Thus, rather than pay a tax to the government in exchange for the good or service, individuals are encouraged (or required) to purchase the good or service


\(^{11}\) My estimate is based on 11.7 million people enrolled through the state or federal exchanges paying an average monthly pre-tax premium of $364, which is the average premium for the thirty-seven states using the healthcare.gov platform. See Dep’t of Health & Human Servs., Health Insurance Marketplaces 2015 Open Enrollment Period: March Enrollment Report 5 tbl.1, 51 tbl.B7 (2015). I use the pretax premium amount because that is, essentially, the cost of the good. The premium assistance tax credits are additional government spending (in the form of tax expenditures) to make distributional adjustments to help individuals afford the good.

\(^{12}\) See infra notes 49–52 and accompanying text.

directly, but with government subsidies (raised from lower taxes) to address distributional issues, and regulations to ensure that the good or service is provided consistent with public programmatic goals. The result is financing of a good or service in a similar manner as from a direct public spending program but accomplished through a combination of private and public spending. To be clear, the emphasis is on financing—the discussion here is focused on different ways to pay for a good publicly. The good itself may be provided by either public or private entities.14

Though the legal literature sometimes imagines a sharp line between the private and the public,15 there is, in reality, a continuum between private and public spending with varying degrees of government money and involvement. For example, there is a great deal of government-subsidized private spending, such as with housing, and also private spending on public goods, such as with charitable contributions. This is well understood. I aim in this Article, however, to describe a space on that continuum that has been underexplored and undertheorized in the literature, namely where private spending on goods for individual consumption takes on such an overlay of regulation and cross-subsidization16 as to be far on the “public” end of the continuum—where payment for the good moves from being government-subsidized private spending to being, in effect, a substitute for direct public spending. This Article thus sets out to describe and analyze quasi-public spending as a policy alternative to direct public spending and to provide recommendations for when and how policymakers should consider using quasi-public spending to achieve public policy goals.

The primary examples this Article uses for existing quasi-public spending programs are post-ACA health insurance and federal loan–financed higher education. As this Article will describe, both of these programs are structured around private payments directly from individuals to providers, but with a set of distributional adjustments (and, in the case of health insurance, mandates) that make the financing of the programs collective and progressive in a manner similar to direct public spending.17 As a result, this Article argues that we should think of these programs as financially comparable to direct public spending and analyze them accordingly.

14. For example, I compare income-driven student loans to direct government tuition payments, but in both cases flowing to an existing set of higher education institutions (public and private). A full government takeover of all higher education, however, would be a very different policy (though still financially comparable).


16. By cross-subsidization, I mean any system whereby the price for a good paid by one person goes in part to subsidize the price paid by another person, especially because of legal rules or institutional structures. For example, healthy people cross-subsidize the sick in group-rated health insurance plans and urban stamp-buyers cross-subsidize rural postal delivery.

17. See infra Part I.
That comparison yields several important differences between direct public spending and quasi-public spending. First, with quasi-public spending, much of the spending on the good or service is “off-budget”—because individual spending goes directly to the provider of the good, rather than to the government first, it does not add to the nominal size of the public sector nor increase nominal taxes. There may still be direct costs for the government, but much fewer than if the government supplied the good or service directly. This is the most important difference because, as this Article will discuss, government budgets may have a political ceiling that would otherwise limit the ability of policymakers to achieve public policy goals.

Second, quasi-public spending is likely to be more complex and opaque to individuals than a comparable direct public spending program. A number of scholars and commentators have criticized similar forms of hidden government spending. At least as far back as the 1960s and ’70s, scholars have criticized tax expenditures as disguised public spending, and more recently there has been a surge of academic work describing the “submerged state,” the “delegated welfare state,” the ““hidden welfare state,” and even “kludgeocracy.” These critiques focus in varying degrees on concerns that complexity and opacity can lead to upward redistribution and declining political involvement, that social programs are increasingly administered by private actors with private incentives, and that complexity in general is inefficient and can hide rent-seeking and other antipublic behaviors, among other criticisms.

Although these are valid and important criticisms, this Article aims to complicate the discussion for several reasons. For example, complexity is not unique to quasi-public spending, nor is it necessary. Direct government activity can also be complex and opaque and thereby more conducive to interest group politics, rent-seeking, and even corruption—just consider the Pentagon’s budget. In principle, a quasi-public spending program could be designed in a simple and open way.

Moreover, quasi-public spending may actually reveal a connection between payment and benefit that is opaque in direct public spending. A health insurance premium, even a subsidized one, is more clearly connected to the delivery of health care than a general income tax payment would be. This could potentially lead to more civic engagement and political involvement, at least with respect to the given policy, if not government more broadly.\textsuperscript{26} Social Security, for example, has achieved an impressive level of political strength in part through a similar structure.\textsuperscript{27} Furthermore, although using institutions other than government to deliver the good may lead to complexity and opacity, there may be offsetting public choice benefits from having more diffusion of power and budgetary control. For these and other reasons, complexity may not always cut against quasi-public spending as a policy tool.

The third key feature of a quasi-public spending program is that quasi-public spending overlays upon existing markets and institutions, both public and private, rather than replacing them. The cases of health insurance and higher education show that quasi-public spending can be achieved through a set of iterative changes to existing institutions rather than the creation of new institutions. Indeed, in both cases, synthesizing a system similar to direct public spending was not the explicit goal of the reforms—even though, as I argue here, it was ultimately the effect. Quasi-public spending can thus arise accidentally or as a byproduct of other changes. Furthermore, the efficacy of a quasi-public spending program may be limited by the existing institutional landscape.

Finally, because the revenue for the program is not necessarily raised through the tax system, policymakers may have a broader set of policy instruments at their disposal to manage allocational and distributional issues. For example, with loan-financed higher education, distributional adjustments are made through the loan repayment schedule rather than through the tax system. That flexibility can be a useful tool in policy design, but it means that a quasi-public spending program may have different distributional effects than a comparable tax-funded direct public spending program.

With these key differences in mind, the question then becomes: should policymakers deliberately use quasi-public spending, and if so, how? Contrary to some existing scholarship,\textsuperscript{28} this Article finds that, in some situations, quasi-public spending may be effective, particularly when political or otherwise artificial budget constraints limit the ability to use direct public spending. But the complexity of quasi-public spending and its reliance on existing institutions, among other limitations, mean that in some situations it will fail to achieve its goals.\textsuperscript{29} Policymakers must therefore step carefully, because, as noted above,

\begin{footnotesize}
\begin{enumerate}
\item \textit{See infra} Section IV.B.2.
\item \textit{See supra} notes 18–24.
\item \textit{See infra} Sections IV.B–C.
\end{enumerate}
\end{footnotesize}
quasi-public spending may arise as the by-product of other iterative reforms, rather than as a deliberate goal.

In describing programs such as post-ACA health insurance and income-driven student loan repayment as quasi-public spending, this Article aims to expand the boundaries of tax-policy analysis beyond the traditional “tax” and “spend” categories. The Article thus contributes to the literature on tax expenditures, which has also worked to explode these distinctions.\(^\text{30}\) Under tax-expenditure analysis, credits, deductions, exclusions, and similar tax provisions that deviate from some normative tax baseline are conceptualized not as tax cuts but rather as disguised public spending.\(^\text{31}\) For example, tax-expenditure analysis considers the exclusion of employer-provided health insurance and health care from the definition of gross income to be not a proper adjustment in measuring a person’s income, but rather to be disguised public spending of around $157 billion per year toward health care.\(^\text{32}\) But that money appears as lower taxes, rather than higher spending, and furthermore does not go through the typical budget appropriations process.\(^\text{33}\)

What this Article reveals is that tax-expenditure analysis is too limited and that there are a number of other situations with the same effect—disguised, off-budget public spending—that do not qualify as tax expenditures, simply because they are not accomplished through the Tax Code.\(^\text{34}\) Income-driven student loan repayment, for example, operates as a quasi-public spending program in my view yet involves few tax law provisions.\(^\text{35}\) But the spending is nonetheless disguised because of how budget rules treat federal loans.\(^\text{36}\) Thus, an important contribution of this Article is to expand the tools of tax-expenditure analysis to other nontax situations.


\(^{32}\) Id. at 31.


\(^{34}\) There are also a number of tax expenditures that would not qualify as quasi-public spending in my view because they are simply transfers or have some other policy goals: accelerated depreciation, the mortgage interest deduction, and the deferral of income for controlled foreign corporations, for example.

\(^{35}\) Although there are tax deductions and credits for higher education, they are largely irrelevant to the progressivity built into the student loan program, which is my focus. See infra Section I.B. Furthermore, they may not even be that effective. See, e.g., George B. Bulman & Caroline M. Hoxby, The Returns to the Federal Tax Credits for Higher Education 1 (Nat’l Bureau of Econ. Research, Working Paper No. 20833, 2015), http://www.nber.org/papers/w20833 [http://perma.cc/4EF4-JQ44] (finding that the tax credits have “negligible causal effects” on attendance).

\(^{36}\) See infra note 60 and accompanying text.
A second, and related, contribution of this Article is to make explicit that the size of the public sector—even including the tax-expenditure budget—is an incomplete measure of a nation’s collective public activity. As an illustration of this, consider that the U.S. public sector today is about 37% of GDP, compared to 50% or higher for much of Europe.37 But if we include just the U.S. quasi-public spending programs for health care and higher education, the U.S. total comes close to 50% of GDP.38 Although there are still large differences in European and U.S. approaches to public finance, the differences today are more about institutional design than about deeper issues of social welfare.

This Article also contributes to the literature on disguised government action generally. Historians and scholars of government have argued that the United States has a pattern of regulating and governing “out of sight,” often by delegating its power to other actors.39 Tax expenditures are therefore just one example of a broader trend that historians have traced back even to the colonial period—contrary to the myth, especially pervasive in the legal literature, of the United States’ laissez-faire origins. Quasi-public spending can thus be viewed as the latest iteration of this broader historical tendency. Furthermore, because this approach to American governance appears to be the norm rather than the exception, we should expect future examples of, or opportunities for, quasi-public spending to arise. It is thus imperative for scholars and policymakers to think through the ramifications, and another important contribution of this Article is a suggested framework for doing so.

Finally, this Article also relates to the literature on government mandates and cross-subsidization. It is well-known that the government often substitutes mandated private spending for public spending. A minimum-wage law, for example, is a rough substitute for a government wage subsidy, and rent-control and affordable-housing laws are substitutes for public housing or rent subsidies. There is a large economics literature analyzing these issues, some of which this Article will discuss.40 The important qualification with quasi-public spending, however, is that the direct public spending (whether mandated or not) is by the person who is receiving the good rather than the person supplying it. Minimum-wage and rent-control laws, for example, are entirely transfers from one group to another; quasi-public spending, by contrast, is more focused on provision of a

40. See infra Section IV.D.
good, with distributional adjustments playing a secondary role. Although this may not substantially change the economic analysis, it is still a distinct approach to policymaking and institutional design.

Before proceeding, a few important caveats. First, as noted above, “public” and “private” are not discrete categories, but operate on a continuum, and there are thus gray areas and judgment calls. Reasonable minds will differ on when a system of regulation and cross-subsidization moves from being mostly private to mostly public. I do not intend to provide a strict bright-line definition of what is and is not quasi-public spending; rather, I intend the concept to be an analytic tool in understanding the effect of a subset of government policies. Furthermore, I intend the concept to be a guide to future policymakers considering different instruments to accomplish public policy goals, particularly in the face of budget constraints.

Second, this Article is not suggesting that quasi-public spending is a first- (or even second-) best approach to provision of public goods and management of distributional issues. Welfare economics, and optimal tax theory in particular, have much to say on that point, and the general conclusion is that cross-subsidization as a way to finance public goods is inferior to income taxation and that distributional issues affecting individuals’ abilities to purchase optimal amounts of goods are better addressed through cash grants than with subsidies or in-kind transfers. There are important first-order qualifications to these conclusions, but ultimately a main purpose of this Article is descriptive—the United States is already using quasi-public spending to collectively pay for goods, and it is vital that we understand it as a policy instrument. We also need to understand that the realities of U.S. policymaking will drive policymakers to use quasi-public spending in the future, and so it is also vital that we provide some guidance for doing so. This Article is not arguing that we necessarily ought to be using quasi-public spending, but that if we are going to use it, we should understand when it will work and when it will not.

41. In other words, this is an exercise in nonideal theory; that is, this is a theory for a way to improve the normative results of public-finance policy making in a world of only partial compliance with broader principles of justice. See, e.g., Liam B. Murphy, Moral Demands in Nonideal Theory 5–8 (2000); Laura Valentini, Ideal v. Non-ideal Theory: A Conceptual Map, 7 Phil. Compass 654, 655–56 (2012); cf. John Rawls, A Theory of Justice 245–46 (1971); Amartya Sen, The Idea of Justice 90 (2009). In a Rawlsian framework, for example, the first-best solution to the high costs and distributional problems might be a guaranteed minimum income or large demogrant, which could make moot nearly all the suggestions here. But the political and economic realities of our world—not the least of which is the difficulty of taxing wealth in a world of sovereign nation-states and global capital mobility—make such a proposal nearly impossible. That said, a reasonable criticism of this proposal is that embedding distributional instruments within individual programs that could persist and become sticky could make it more difficult to achieve a broader solution to distributional problems. See generally R. G. Lipsey & Kelvin Lancaster, The General Theory of Second Best, 24 Rev. Econ. Stud. 11 (1956).

42. See, e.g., Louis Kaplow, The Theory of Taxation and Public Economics 127–35 (2008) (discussing the theoretical superiority of income taxation over differential commodity taxation, of which cross-subsidization is one form); id. at 175–78 (discussing cash versus in-kind grants).
This Article proceeds as follows. Part I reviews the ACA and income-driven student loan repayment, describing how each program operates as a substitute for direct public spending. Part II presents some of the reasons for high and growing government budgets because the political ceiling on the size of government is a key motivator for policymakers to take advantage of quasi-public spending. Part III discusses the structure of quasi-public spending in more detail and contrasts it with some similar forms of government intervention. Part IV examines in detail the unique features of quasi-public spending as compared to direct public spending. This Part emphasizes that much of the spending is off-budget and that a quasi-public spending program is likely to be complex. Although both of these features have given some commentators pause, I provide a qualified defense of each. I also note that quasi-public spending can take advantage of existing institutions and provide more design flexibility, which can be used to minimize some of the costs of traditional taxation. Part V uses the preceding analysis to derive a framework for helping policymakers to determine whether quasi-public spending is feasible and reasonable. Because of its particular features, quasi-public spending will not be suitable to all settings, even where policymakers might have worthwhile goals. Part VI applies that framework preliminarily to several other policy areas.

I. Health Care and Higher Education: The New Public Spending

This Article proceeds first from the observation that two of the biggest public programs of recent years from a public-finance perspective—the ACA for health insurance and income-driven repayment for federal student loans—suggest a new model for public spending. Through these programs, health care and higher education are financed in a way similar in effect to tax-funded direct public spending but with many of the payments running directly from individuals to providers rather than to the government. While the government’s role is thus nominally limited to distributional adjustments and market regulation, it still asserts itself strongly over the provision of the good itself—but it does so indirectly, through mandates and other forms of encouragement. To inform the discussion that follows in the Article, I first describe these programs in more detail.

A. Health Care

A full treatment of the complex and diverse health care system is beyond the scope of this Article, as is an examination of all of the effects and provisions of the ACA. But from a public-finance perspective, some broad observations are instructive.

Looking first at just the ACA, the financing structure is roughly as follows. Individuals without other health insurance coverage are required to buy insurance on the private market through insurance exchanges, but with income-based subsidies for low-income individuals (including premium assistance tax credits
and the effective 100% subsidy through expanded Medicaid) and additional revenue to pay for the subsidies from high-income individuals (all high-income individuals, not just those purchasing on the insurance exchanges). That additional revenue comes from several tax instruments, especially the Medicare surtax,43 the tax on net investment income,44 a higher floor on deductible medical expenses,45 and the excise tax on “Cadillac” health plans.46 These distributional adjustments cause the net payments (or transfers) for health insurance to be generally income-based and progressive.

From a budgetary perspective, the government’s costs come (largely) from the premium assistance tax credits and the expansion of Medicaid, and the revenue comes from these more limited taxes. Contrast this with the health care system in the United Kingdom or Canada, where the budget costs would include the full cost of health care and the revenue would be the much higher income and other taxes needed to pay those costs. What’s the difference? The insurance premium portion. The portion making up the private insurance premium payment in the United States would instead be a tax payment in the United Kingdom or Canada. But if the premium payment is mandated by the government, is it so different from a tax? Either way, the money starts with an individual and ends up in the hands of a provider. Thus, the combination of mandated premium payments and the government’s distributional adjustments provide a financing structure not so different in effect from the United Kingdom and Canada, to a first approximation.

The health care system in the United States is not limited to the ACA, however. Most health insurance in the United States continues to be provided through the pre-ACA system—a combination of employer-provided health insurance, Medicare, and Medicaid. The provision of insurance by employers is encouraged through tax subsidies, in the form of an exclusion of employer-provided health insurance from gross income for tax purposes47 and by a mandate on some employers. The subsidies are regressive in effect, however, because they are a function of marginal tax rates—Stanley Surrey’s classic “upside-down” subsidy.48 Thus, with respect to the employer portion, the system lacks some of the distributional effects of a direct public spending program.

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43. I.R.C. § 1401(b)(2)(A) (2012) (imposing an additional Medicare tax of 0.9% on self-employment income); § 3101(b)(2) (imposing an additional Medicare tax of 0.9% on wages).
44. Id. § 1411 (imposing a 3.8% tax on income from “interest, dividends, annuities, royalties,” rents, and capital gains to the extent that they exceed a threshold amount).
45. Id. § 213(a), (c)(1) (allowing a deduction for medical expenses that exceed 10% of adjusted gross income (AGI), as opposed to the earlier floor of 7.5% of AGI prior to 2012).
46. See id. § 4980I(a).
47. See id. §§ 105(a), 106(a).
48. A subsidy in the form of a tax deduction or exclusion (such as the exclusion for employer-provided health insurance) provides a transfer equal to the expenditure amount times the taxpayer’s marginal tax rate. Thus, those in higher brackets get a larger subsidy as a percentage of the expenditure—hence “upside-down” subsidy. See Surrey, supra note 18, at 37–38.
The ACA financing structure is undoubtedly complex, and its interaction with the old employer-provided system compounds the complexity. How the two systems will interact remains to be seen, but for many individuals, the net cost of exchange-purchased insurance may be less than the net cost of employer-provided insurance. 49 Furthermore, because the premium assistance tax credits are likely to grow faster than incomes, 50 the group of individuals that would be better off on the exchanges is likely to grow over time. Currently, an individual is not eligible for exchange subsidies if his employer offers health insurance, 51 but it may be relatively easy for employers to avoid this mandate. 52 Thus, we should expect that more and more individuals will gradually shift away from the employer-provided system and toward the exchanges over time, which would cause the two systems to converge toward individual subsidized purchases on the insurance exchanges. This would suggest that quasi-public spending will become the dominant form of health care spending outside of Medicare and Medicaid.

Although the ACA may describe the long-term structure of our health insurance system—and its passage was, of course, a huge political battle—it was still an iterative change to the existing health insurance system, with its existing set of mandates, private spending, direct public spending, and tax expenditures. The ACA was intended to work alongside the existing institutions. Contrast that with, for example, a wholesale nationalization of health care, or the creation of a single-payer insurance company, either of which would have replaced a good swath of the existing institutions. As I discuss below, the ability to use existing institutions is an important feature of quasi-public spending. 53

B. HIGHER EDUCATION

As I have written elsewhere, the new income-driven repayment student loan programs allow for a form of collective and progressive funding for higher education but with much of the spending kept nominally off-budget and instead

49. See David Gamage, Perverse Incentives Arising from the Tax Provisions of Healthcare Reform: Why Further Reforms Are Needed to Prevent Avoidable Costs to Low- and Moderate-Income Workers, 65 TAX L. REV. 669, 690–91 (2012) (showing that the exchange subsidies and tax credits are more valuable than the tax exclusion for a family of four with income up to 400% of the federal poverty line).
50. The percentages of income at which net premium payments are capped by the premium assistance tax credits are indexed to grow to the extent that the rate of premium growth exceeds the combined rate of growth for income and inflation (as it likely will). See I.R.C. § 36B(b)(3)(A)(ii) (2012).
51. See id. § 36B(c)(2)(B) (denying eligibility for a given month if the applicable taxpayer has minimum essential coverage under, inter alia, an employer-sponsored plan).
53. See infra Section IV.C.
appearing similar to individual expenditures. Any student can borrow money from the federal government to pay for higher education, and thus a large portion of tuition is paid for with government funds, even though it is structured as a “loan.”

I say “loan” because the repayment terms for federal student loans differ in dramatic ways from a traditional bank loan. Under the current Pay As You Earn (PAYE) plan, any federal loan borrower’s monthly payments are no greater than 10% of her discretionary income, and any outstanding balance after a maximum of twenty years is forgiven. Thus, for some borrowers, the government effectively pays their tuition, and the borrowers simply pay 10% of discretionary income—effectively a 10% income surtax. This is not so different—again, to a first approximation—from a world where tuition is free, financed by higher income tax rates.

Moreover, even though the funds flow through the government (and potentially out to a government entity, if the student attends a public university), most of the payments are nominally off-budget. This is because of the loan structure—the vast majority of the federal outlays on higher education come in the form of a loan to the student rather than a direct outlay. Under budget rules, the government records only the expected difference between outlays and receipts on the loan as a budgetary cost, which is only a small fraction of the nominal amount of money actually loaned to pay tuitions. This makes the budgetary cost, at most, a few billion dollars per year rather than $100 billion.

There is no mandate comparable to the mandates in health insurance; the government does not require everyone to attend college or to take out a loan to do so. But there is what we could call a “social mandate,” that is, a softer form of requirement, because for certain careers higher education is essentially mandated. This is in contrast to health care, where the lack of insurance is not a barrier to many forms of health care. Furthermore, loans are increasingly necessary to pay high tuition costs, and the federal government now issues 90%
of all student loans. So, though not mandated, federal-loan-financed higher education is the norm.

The complex structure of PAYE raises a number of practical design considerations, such as managing adverse selection, avoiding unconstrained price increases by schools, and the question of how much of the burden should be placed on high-income students (via higher loan payments) or on taxpayers generally. I explore these at length in my article on income-driven student loan repayment. But they suggest a need for government regulation, which is already beginning to appear.

Adoption of PAYE is still relatively light, though rapidly growing. It has been available for new loans since roughly 2012, but a form of income-driven repayment for older loans will become available July 1, 2016, under the new Revised Pay As You Earn (REPAYE) program. And if tuitions continue to rise, we should expect more and more students to take advantage of the program. If so, much of higher education tuition spending may become simply a function of the student’s future income.

Although I have argued that this is a huge change in the way we publicly finance higher education, the structure of the change itself was small—simply changing the repayment terms for a student loan and adding a forgiveness provision. Thus, again, the quasi-public spending program comes about through an iterative change to existing institutions and law, and it continues to work largely within the landscape of existing institutions. Contrast this with nationalizing higher education institutions or making the government the direct payer of tuition.


64. See Brooks, supra note 54, at 263–70.


67. See 34 C.F.R. § 685.209(c).

68. Brooks, supra note 54.
C. SUMMARY

The ACA and PAYE are both still in their infancy, and both still account for a relatively small portion of spending on health insurance and higher education, respectively. But each is growing and may become the dominant financing vehicle for their respective goods, absent other policy changes.

The ACA combines mandated payments from individuals directly to providers with tax-funded distributional adjustments from the government to individuals. The net cost of the two for a given individual will be, in part, a function of income, just as an income-tax payment would. That financing structure, coupled with the heavy public regulation of providers, is thus comparable to tax-funded direct public spending on health care.

Income-driven repayment, and PAYE in particular, provide for nominal payment of tuition by individuals to schools, but with the cash to finance it coming from the government in the form of a loan. Because the student is only required to pay back the loan as a function of income, with possible loan forgiveness, the net cost for a given individual will also be, in part, a function of income, just as an income-tax payment would. That financing structure, coupled with existing and potential future regulation of providers, is thus comparable to tax-funded direct public spending on higher education.

These are not minor policies. Health care and higher education are two massive and growing portions of our economy, addressing central parts of our lives and our individual and collective well-being. Understanding them fully not only helps to explain important parts of our public finance system and our economy, but may also provide some guidance for how policy will be made in the future, particularly in an era of growing government spending and tight government budget constraints. These two programs, therefore, point toward a model of quasi-public spending, which Parts III and IV discuss in detail.

II. BUDGET CONSTRAINTS AND THE GROWING PUBLIC SECTOR

Before turning to a fuller analysis of quasi-public spending, it is worth understanding the motivations of policymakers, at least in the area of health care and higher education, to use quasi-public spending as a policy tool. I discuss some of the key differences between quasi-public spending and direct public spending in Part IV, and likely all of those factors play a role. But because the primary feature of quasi-public spending is off-budget spending, policymakers are likely to be motivated especially by large and growing government budgets and the political ceiling they impose on direct public spending. Therefore, this Part briefly sketches out some of the reasons for why government budgets are large and growing, and the political effect this has.

As evidenced by the ACA anecdote that began this Article, there are real political constraints on public spending. The nominal amounts of taxes and

69. See supra note 1 and accompanying text.
spending and the nominal size of the public sector have enormous political salience to the degree that our political process has become consumed by budget battles, supercommittees, shutdowns, and default threats, driven in part by a concern that the government is simply spending too much money.\(^\text{70}\) Some in Congress have also tried, either in legislation or in budget negotiations, to lock in public spending as a fixed percentage of GDP.\(^\text{71}\) Thus, it seems plausible that voters may tolerate only so large a nominal public sector.\(^\text{72}\) And this is not unreasonable. Involving the public sector raises issues of public choice, liberty, subsidiarity, administrative efficiency, and all the other issues that arise in considering public versus private action.\(^\text{73}\) Thus, there are real costs to moving the provision of a good into the public sector.

Yet at the same time, these political budget constraints are somewhat artificial in the sense that they are based on rough heuristics about how big government should be and not on reasoned conclusions about whether the public sector should be engaging (or not) in particular activities. Statements like government is spending “too much” or “not enough” tell us very little. Indeed, surveys tend to show that voters are actually in favor of many specific government programs, even while they may object to taxes or “government” in general.\(^\text{74}\)

The problem with this is that we can clearly observe that the public sector in modern, developed welfare states is quite large and growing.\(^\text{75}\) Although there are certainly places for cost-cutting and reform, there are also good reasons why the public sector is and will remain big—namely, that it disproportionately


\(^{72}\) See, e.g., KENWORTHY, supra note 37, at 150–52 (summarizing surveys on American adults’ views on how much the federal government should spend).

\(^{73}\) For a good discussion of whether to prioritize government’s potentially positive effects as a provider of public goods or its potentially negative effects on liberty, see generally JAMES M. BUCHANAN & RICHARD A. MUSGRAVE, PUBLIC FINANCE AND PUBLIC CHOICE: TWO CONTRASTING VISIONS OF THE STATE (1999).

\(^{74}\) See infra note 107 and accompanying text.

\(^{75}\) See infra note 86 and accompanying text.
covers goods with high and growing costs, such as health care, education, child care, housing, and retirement income. There are different and overlapping possible reasons why costs for these goods and services are high, and I review them here. In particular, I discuss below the cost pressures from scarcity of goods, an aging population, and low labor productivity growth, as well as the particular constellation of cost issues around health care. The purpose of this is not to provide a definitive answer for why, for example, health care is expensive. Rather, the purpose is to say that, for at least one set of possible reasons, the explanations are based on underlying economic forces that may be largely beyond our control.

A. SCARCE GOODS

The simplest reason for high prices is that demand is growing faster than supply. This is especially true, for example, with housing, at least in certain regions where the desirable area to live has limits, physical or political, on density. In such places, governments may intervene to keep some housing affordable for low-income individuals, such as by owning public housing, subsidizing (or mandating) low-income and affordable housing, providing tax abatements to developers, requiring rent control and stabilization, and so on. For those actions, like ownership and subsidization, that have a budgetary cost, the cost is likely to be high and rising in high-cost areas. Indeed, because it is precisely high costs that lead to government intervention, the two would tend to go together.

That said, there may often be supply-side reforms that can bring down costs, such as re-zoning to encourage greater density or development of highways and mass transit to increase the desirable residential area. Thus, in some cases, expanding public spending on the scarce good in question may not be the only policy tool available. Nonetheless, supply-side reforms take time, and so in the short term scarcity may drive up government budgets.

B. AN AGING POPULATION

Elderly people disproportionately rely on government spending and transfers, whether in the form of Social Security, Medicare and other health care, disability insurance, subsidized housing, or otherwise. Because of improvements in health care, delayed childbirth, and other demographic shifts, the elderly make up a growing share of the population in the United States and other developed countries, and thus spending on these programs is likely to rise relative to other parts of the economy. Furthermore, many elderly are outside of the labor force, meaning they are not producing income that could correspondingly raise GDP; their consumption of goods and services comes disproportionately from transfers, rather than earned income.

76. See infra Sections II.A–D.
Although there may be some policy responses to this, such as increased immigration and pronatalist policies, there is likely little that we can do to stop the trend in the near term. That means an increase in public spending as a share of GDP even if we keep relative benefits fixed.\footnote{77. See, e.g., BENEDICT CLEMENTS ET AL., INT’L MONETARY FUND, THE FISCAL CONSEQUENCES OF SHRINKING POPULATIONS 4 (2015), http://www.imf.org/external/pubs/cat/longres.aspx?sk=43345 [http://perma.cc/3765-SQDX] (finding that “spending on age-related programs (pensions and health)... would increase by 9 percentage points of GDP” without further reforms and that the “fiscal consequences [of that increase] are potentially dire”).}

C. LOW LABOR PRODUCTIVITY GROWTH

Because of a phenomenon sometimes called “Baumol’s cost disease,” goods and services with low labor productivity growth often see their prices rise faster than the average price growth in the economy. General economic theory holds that labor productivity growth leads to wage growth because a given worker can produce more, and therefore the value of the worker’s labor has gone up. But this affects wages throughout the labor market, including in those industries that have not seen comparable productivity growth.\footnote{78. See ROBERT B. ARCHIBALD & DAVID H. FELDMAN, WHY DOES COLLEGE COST SO MUCH? 36–37 (2011); WILLIAM J. BAUMOL, THE COST DISEASE: WHY COMPUTERS GET CHEAPER AND HEALTH CARE DOESN’T 21 (2012) (“In the long run, wages for all workers throughout a country’s economy tend to go up and down together.”).}

Although a company with high productivity growth can afford to pay its workers more without raising prices (and maybe even while lowering prices), a company with low productivity growth has to either raise prices or lower output (or, often, both).

The classic example from William Baumol and William Bowen is the performing arts. “The output per man-hour of the violinist playing a Schubert quartet in a standard concert hall is relatively fixed, and it is fairly difficult to reduce the number of actors necessary for a performance of Henry IV, Part II.”\footnote{79. W. J. Baumol & W. G. Bowen, ON THE PERFORMING ARTS: THE ANATOMY OF THEIR ECONOMIC PROBLEMS, 55 AM. ECON. REV. 495, 500 (1965).} But because real wages for actors have clearly risen since the sixteenth century, so has the cost of seeing a Shakespeare play, which puts strain on performing arts companies.\footnote{80. An anecdote: An opera director I know told me that to cover his opera company’s costs just from ticket sales would require prices of $600 or more per ticket. In fact, only about 10% of the opera company’s revenue came from ticket sales, with the rest from grants and endowment income (and furthermore, the once-prominent company has since declared bankruptcy and closed).}

Many government activities are also labor-intensive, such as teaching, policing, social work, sanitation, postal services, and care of the indigent. (Health care is sometimes also on this list, though the dynamics of the health care market are more complicated, as discussed below.)\footnote{81. See infra Section II.D.} As such, government is likely to be particularly burdened by the cost disease and see prices rise faster...
than average.\textsuperscript{82} To be clear, the cost disease is distinct from good scarcity. Here, the concern is not that labor costs are high because of a lack of supply, as is often the case with housing costs. Rather, the concern is that a given unit of labor cannot produce enough to offset rising wages. That said, supply-and-demand dynamics are central to the cost disease—for wages to rise with productivity, the labor market must be somewhat competitive.

Importantly, the cost disease is not necessarily an economic problem, because the lower prices in the high-productivity industries free up resources to pay the higher prices in the low-productivity industries. We spend less on cars and toasters, and more on police and teachers, and it all works out. But the cost disease is a political problem if the public sector is disproportionately burdened by it. In that case, public spending will naturally grow as a share of GDP, even if the overall basket of goods does not change. As Baumol has said, this phenomenon could create “a looming crisis for public choice” as the GDP share of public spending grows ever-larger.\textsuperscript{83}

\section*{D. Health Care}

A major driver of recent and projected growth in government spending is health care,\textsuperscript{84} and so it deserves special mention, even though it is really a constellation of issues, including the three mentioned above. There is, of course, much debate about the causes of cost growth in health care, and a huge set of policies aimed at trying to slow growth or “bend the cost curve.” A handful of the possible suspects behind high costs include: the increase in the number and efficacy of treatments worth spending money on; labor intensity and cost disease forces; end-of-life care; informational asymmetries and supply-driven demand; rent-seeking by physicians, hospitals, and pharmaceutical companies; and medical malpractice compensation. Likely, there is a bit of each of these factors at work but, to be clear, they are not all problems; some are features, not bugs. For example, it is a good thing that there are ever more and better treatments, and we should not see expanded spending for that reason as inherently problematic. Similarly, high costs due to labor intensity are not a problem to the extent that they are caused by productivity improvements elsewhere in the economy.

Analyzing more fully the causes of health care spending growth is well beyond the scope of this Article. For my purposes, it is enough to say that

\footnote{82. This is not to say that any of these goods and services cannot see improvements in labor productivity. There may be some amazing technology in the future to stop crime or pick up trash that would make extensive labor in those areas much less necessary. Should that happen, the government sector could eventually shrink as a share of GDP. But there are no signs of such technology as of this writing.}

\footnote{83. William J. Baumol, \textit{Health Care, Education and the Cost Disease: A Looming Crisis for Public Choice}, 77 PUB. CHOICE 17, 17 (1993).}

governments spend a lot on health care, and they are projected to spend even more in the future.85

E. SUMMARY

Because of these (and other) factors, government spending has been growing steadily for a long time. U.S. government spending has gone from less than 10% of GDP around 1910 to about 37% by 2007.86 Much of this comes from the creation and expansion of social insurance programs like Medicare, Medicaid, and Social Security—and the centrality of health care, aging, and wage growth to these programs is telling.

Barring huge productivity improvements or other changes, costs are likely to stay high, and thus so will public spending—unless governments simply choose to get out of the business of paying for these goods and services and push them back onto the private sector. This Article is agnostic as to whether any particular good ought to be purchased by the public or private sectors—that is ultimately a political question. That said, two brief comments are worth making. First, the standard set of goods for which governments pay all or much of the cost is fairly consistent across the developed economies: health care, education, housing, policing, arts and culture, care of the indigent, social insurance, and so on. There are likely good reasons why this is the case.

Second, the high costs described above are precisely one of those reasons for public spending, when the good itself has some particular social value or significance.87 If society wants wide provision of a cheap good, it may not need to do much more than provide a private market. (Consider clothing, for example.) But if the social good is expensive, low-income individuals may not be

85. See id.
86. See Kenworthy, supra note 37, at 10, 11 fig.1.1, 82, 83 fig.4.5. The figures include federal, state, and local government.
87. The questions of why a government or society might choose to publicly provide a good, and whether it ought to, are deep and complex. This Article is agnostic as to whether any particular good should be publicly provided and instead takes as a given that society has decided to and now must answer the question of how to pay for it. But, importantly, the list of such goods should not be confined to pure public goods, nor to those with high spillovers. These are the goods that standard public finance imagines that governments will provide, see, e.g., Harvey S. Rosen & Ted Gayer, Public Finance 62–64, 75 (10th ed. 2014), but this is not a particularly helpful guide in practice. First, the list of pure, nonexcludable, nonrivalrous public goods is small. Second, the existence of spillovers does not help, because nearly all goods have some spillovers. See Peter O. Steiner, Public Expenditure Budgeting, in The Economics of Public Finance 241, 247 (The Brookings Inst. 1974) (“Does any good which produces an externality become a public good no matter how incidental the externality? Few goods do not meet this test and thus this definition fails to provide guidance as to which goods ought to be candidates for public provision . . . .”). In practice, societies publicly provide goods for a host of other reasons that are not strictly related to simple economic models and instead reflect broad normative conclusions. See, e.g., Richard A. Musgrave & Peggy B. Musgrave, Public Finance in Theory and Practice 78 (4th ed. 1984) (discussing “merit goods,” which are simply those “which society (as distinct from the preferences of the individual consumer) wishes to encourage” and thus subsidizes, even though the goods may be rival or excludable and thus technically “private”); Steiner, supra, at 247 (“Collective goods arise whenever some segment of the public collectively wants and is prepared to pay for a bundle of goods and services other than what the unhampered market will produce.”).
able to afford the good, and even middle-income individuals may react adversely to the good becoming a larger share of their budgets. 88 And the more expensive the good, the greater that effect.

The traditional choice, therefore, is either to accept an ever-larger public sector or to simply not pay for the goods publicly—to privatize them (and thus exacerbate the distributional problems) or simply stop providing them altogether. 89 Neither choice is pleasant. Quasi-public spending presents a third way, where goods may still be supplied consistent with public goals and in a progressive manner but are not as bounded by the political budget constraints that arise in part from heuristics about the proper size of government.

III. QUASI-PUBLIC SPENDING

When the government—for whatever reason—decides that a particular good should be paid for publicly, it has a choice. The standard answer is that the government should simply pay for the good, in whole or in part, raising the revenue to do so in a progressive way through the tax system, thus ensuring universal access and affordability. But the examples of the ACA and income-driven student loan repayment provide an alternative. Instead of simply shifting the spending on the good fully onto the government in order to pay for the good collectively, the government can synthesize a similar allocational and distributional effect through a combination of direct payments from individuals to providers and distributional adjustments from the government. This is what this Article terms quasi-public spending.

In essence, quasi-public spending cuts out the government middleman as the purchaser of a good and instead has individuals purchase the good directly in such a way as to mimic the progressivity and universality of a direct public spending program. An individual might be required or strongly encouraged to purchase the good for a market price, but then the government provides subsidies and limited taxes or other charges to shift the distributional burden of paying for the good. Thus, the net cost to some individuals is similar to what their net cost would be if the government simply raised taxes to pay for the

88. For example, if a household follows the flawed yet standard advice to follow a budget that allocates spending across consumption categories, it may see cost growth in one category—such as education or health care—as evidence of over-spending rather than changes in relative prices. Thus, rather than accept that the high costs are affordable or worthwhile, they may instead seek to cut back consumption of the good. How much this actually occurs is an empirical question, of course.

89. Full privatization could, in theory, be accompanied by a greater focus on redistribution through the tax system so as to make sure that individuals have sufficient income to afford the private market prices. This is another way of stating the general view of welfare economics that cash transfers produce higher welfare than in-kind transfers. Although that may be theoretically true, the political constraints on increasing redistribution through the tax system are real. Furthermore, as Baumol points out, the cost pressures discussed above do not disappear and thus could create a different sort of political problem as individuals directly face the rising prices. See Baumol, supra note 83, at 26–27. Politicians could be pressured to respond with other measures, like price caps, which would just recreate some of the same problems. Id. Thus, privatization carries significant risks.
good directly. The difference is that much of that cost takes the form of a price rather than a tax, and thus much of the total spending for the good occurs off the government’s budget.

A. ELEMENTS OF QUASI-PUBLIC SPENDING

A direct tax-funded public spending program requires a relatively simple financing structure—simply raise revenue from taxes and then use that revenue to pay for a good. To get a similar effect from quasi-public spending, however, requires using a more complex basket of policy instruments. In particular, it requires some combination of mandates (or other encouragement), subsidies (with perhaps some direct government activity in the form of smaller scale backstopping and taxes), and regulation. I discuss the role of each below. I should note, however, that I don’t claim any particular novelty in listing these as features of government programs—indeed, they describe huge portions of government economic intervention. The novelty is rather in the particular combination of them to synthesize an effect similar to direct public spending.

1. Mandates

A mandate plays two roles. First, it mimics the mandatory nature of the tax system. Rather than using the tax law to force everyone to make a payment to the government, which is then used to purchase the good, the government could instead require everyone to purchase the good directly, simply cutting out the government middleman. Second, a mandate ensures widespread adoption of the good, similar to government provision. Thus, mandates are particularly appropriate for goods that ought to be universally or near-universally consumed, such as health care and K–12 education. In Richard Musgrave’s classic formulation, the mandate mimics the Allocation Branch of government—it is what provides the good.90

Mandates raise important liberty concerns, however, and have proven to be politically and legally difficult (though not impossible) to implement.91 The set of goods that could politically tolerate a mandate may be relatively small.92 But one could take a carrot, rather than stick, approach, through the use of subsidies and other forms of encouragement.93 Economically, subsidies and mandates may not be that different,94 but using subsidies to drive uptake complicates their

92. Some mandates may be “social” in the sense that society mandates the purchase of the good, even if government does not. For example, this is somewhat the case for higher education, which acts as a gateway to particular jobs and professions. See supra Section I.B.
93. Note, however, that mandates have varying degrees of force behind them—from mere disapproval up to criminal sanctions. Thus, at the margin, the difference between a weak mandate and another form of encouragement may be slight.
94. As frequently noted during debates around the ACA, we could get the same effect as the penalty if we instead raised everyone’s taxes but then provided a credit equal to the penalty for those who
role in a quasi-public spending program and also the relationship between the quasi-public program and the central public finance system.

First, as discussed below, subsidies are more directly used for altering the distributional effects of the spending.\(^\text{95}\) If the subsidy is also playing an allocative role, by encouraging uptake, the subsidy design question becomes substantially more complex. Second, if the subsidy is being used to make the product somewhat cheaper for \textit{everyone}, not merely those who cannot afford to pay a market price, then the quasi-public spending program would need to have some net support from the central public finance system and general tax revenue. The argument that penalties and subsidies are economically equivalent requires some offsetting increase in taxes,\(^\text{96}\) so it is not surprising that general taxes would need to go up in this case—but that would mute somewhat the effect of keeping the program off-budget.

2. Subsidies and Taxes

Subsidizing (at the low end) and taxing or levying other charges (at the high end) would mimic Musgrave’s Distribution Branch of government.\(^\text{97}\) It would allow the relative burdens of paying for the good to be distributed in a progressive way, as if the good were financed using general revenue. This is particularly important for services that suffer from high costs, because the problem is precisely that many people cannot afford to pay the true cost of the service, even if the average person could. This sort of a structure should distinguish quasi-public spending from a typical voucher-type program where the voucher or subsidy is a fixed lump-sum amount.

Subsidies cost money, of course, and in the absence of any additional taxes, that money would presumably come from general revenues. But the quasi-
public spending program could also include limited taxes in order to raise revenue and increase the progressivity of the distributional aspects of the program. Thus, the ACA includes the Medicare surtax and the tax on net investment income, and I have suggested that a higher rate of interest on student debt could play a similar role with respect to higher education funding. That said, there is some interplay with the role of the mandate discussed above. If the purchase of the good is mandated, then a tax at the high end of the distribution could be implemented without adverse selection problems; that is less likely to be possible where the program relies on subsidies or other encouragement to drive voluntary uptake.

In some cases, a government backstop might be necessary to provide the good or service directly in cases where the private market would continue to fail to do so even under a quasi-public model, especially at the low end. We see this, for example, with Medicaid. However, the backstop is essentially a 100% subsidy, so it is still not necessary that the government become the direct provider of the backstop—indeed, at least six states have been permitted to use Medicaid subsidies under the ACA to pay for private health insurance plans.

These subsidies and taxes would have a direct governmental budget effect, and so a quasi-public spending program may not be completely off-budget. But the budget effects are much smaller than if the good or service were provided directly. Furthermore, they would, in theory, reflect only the distributional element of the program, not the allocative provisioning of the good.

3. Regulation

If the government provided or directly purchased the good or service, it could decide what features it would have. If the good or service is nominally provided by the private sector, however, the government would likely need to use regulation in order to ensure that the contours of the good or service line up with public objectives. Otherwise, the quasi-public spending program could turn into privatization with a heavy dose of rent-seeking. For example, mandating the purchase of a good without some regulation of the content and pricing of the

98. See supra notes 43–44 and accompanying text.
99. See Brooks, supra note 54, at 279–81.
good would be counterproductive.101 Hence, the ACA includes rules such as requiring group-rated insurance premiums and forbidding denial of coverage based on pre-existing conditions.102 The government also uses its authority under Title IV of the Higher Education Act to monitor the schools receiving federal student loan funds.103

B. DISTINGUISHING QUASI-PUBLIC SPENDING FROM SIMILAR PROGRAMS

There are many gray areas in trying to describe different types of government intervention in the economy, and this Article does not aim to provide a bright-line definition of what is and is not a quasi-public spending program. Furthermore, even programs close to the public end of the public-private continuum will have varying degrees of public-ness. As an example, consider that the health insurance system mandates purchase of health insurance, either by individuals or employers, while there is no similar governmental mandate operating for income-driven student loan repayment. To aid in clarifying the prior discussion of what sorts of situations should be considered quasi-public spending, I now distinguish quasi-public spending from similar forms of government action.

Because quasi-public spending is ultimately about the financing of the good, and not who provides the good, it should be distinguished from private contracting. Hiring private security contractors to replace soldiers or a private company to operate a prison does not change the fact that the government pays for the good or service out of tax revenue. Furthermore, a quasi-public spending program could involve exclusively public agencies—for example, federal student loan-financed tuition spending at public universities. The focus is not on whether the provider of the good or service is a private entity or a public agency, but rather on whether the payment is made via traditional government or not.

Quasi-public spending also does not encompass all government subsidization of private spending. The government subsidizes many things, including food, housing, charitable spending, transportation, and finance, for public policy reasons. The simplest explanation for these subsidies (other than rent-seeking) is that they are (roughly) Pigouvian subsidies to account for positive externalities.104 Thus, the government is simply altering the private market price in order

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101. Otherwise, there is no oversight of what the individuals are actually buying and whether it serves the policy’s goals. And the mandate to purchase the good would increase the ability of providers to extract rents in the absence of any price regulation.
103. See 20 U.S.C. § 1070a (2012). For example, institutions that use Title IV funds must provide employment statistics, § 1094(a)(8), and cannot offer incentive compensation based on enrollments to employees engaged in recruiting students or awarding financial aid, § 1094(a)(20).
104. In cases where there is some public externality (positive or negative) from a good, the market would likely overproduce (for a negative externality) or underproduce (for a positive externality) the good because the market price would not be taking into account that externality. A Pigouvian tax (or subsidy) adds to (or subtracts from) the market price the marginal social cost (or benefit) of the good.
to aid markets in reaching the efficient outcome. Quasi-public spending, by
contrast, is a tool for public spending on goods. Quasi-public spending can also be
distinguished from simple subsidies by the size and scope of the program in relation to the good. For example, housing and agricultural subsidies are important government programs, but they do not dominate their spaces in the same way that government-subsidized health insurance and federal student loans dominate their respective spaces.105 That said, there is a continuum for these programs and a lot of gray area. The shift from private spending to quasi-public spending for health care and higher education, for example, has been gradual and incremental over time.

IV. COMPARING QUASI-PUBLIC SPENDING AND DIRECT PUBLIC SPENDING

The examination of health insurance and higher education financing in Part I
and the analysis in Part III on the component pieces of quasi-public spending lead to several observations about the key differences between quasi-public spending and direct public spending. This Part explores these differences in detail in order to better understand the nature of the policy tool and under what circumstances (if any) it will operate well.

In this Part, I focus in particular on how quasi-public spending will generally be off-budget—because it involves direct payments from individuals to providers—and more complex than other forms of spending. These are both often treated as strikes against this sort of “hidden” spending,106 but here I argue that the case is not so simple and that there can be advantages to both features given the constraints under which policymakers operate. Furthermore, quasi-public spending also offers the ability to take advantage of existing markets and institutions and provides more design flexibility to policymakers. These are, in essence, the flip sides of the first two features but cut more strongly in favor of quasi-public spending. For these reasons, I argue that quasi-public spending should be a serious part of a policymaker’s tool kit—in some situations, a quasi-public solution may be the best policy.

that would not otherwise be in the market price, and thus would shift output closer to the social optimum. See ROSEN & GAYER, supra note 87, at 84–87.

105. Nearly all health care is purchased with insurance, and all health insurance is subsidized in one way or another, most prominently through the exclusion of employer-provided health insurance from gross income for tax purposes. See supra note 32. Similarly, for the 2011–2012 academic year, 64.3% of students had received a federal student loan. Nat’l Ctr. for Educ. Statistics, Digest of Education Statistics tbl.331.95 (2014), https://nces.ed.gov/programs/digest/d14/tables/dt14_331.95.asp [https://perma.cc/7M8N-YQ7J] (showing the “[p]ercentage of undergraduate students ages 18 to 24 in their 4th (senior) year or above who ever received federal loans, nonfederal loans, or Parent Loans for Undergraduate Students (PLUS), and average cumulative amount borrowed, by selected student characteristics and control and level of institution: 1989–90, 1999–2000, and 2011–12”). The role of the government in housing and agriculture is not nearly as ubiquitous.

106. See supra notes 18–24 and accompanying text.
A. OFF-BUDGET SPENDING

By using direct payments from recipients to providers, a quasi-public spending program can operate largely off-budget, meaning that it may not raise the nominal size of the public sector. This is true even though direct payments from individuals to providers may be mandated in the same way as tax payments, and the net payments may be income-based and progressive in the same way as tax payments. This is the most obvious and most important difference between quasi-public spending and direct public spending, and it implicates several different issues.

1. Exceeding Budget Constraints

As discussed in Part II, the nominal size of the public sector likely acts as a constraint on public spending independent of the basis for spending (or not) on any particular program, and recent history implies that we are currently operating at or near that political ceiling. That two of our most recent large public spending programs—the ACA and income-driven student loan repayment—both operate in a quasi-public way shows that keeping public spending off-budget may be the most feasible way to enact such spending.

In some cases, policymakers may be reasonably and justifiably concluding that this political budget constraint should not be a barrier to enacting policy. But in describing such constraints as “political” or “artificial,” I do not mean that they are not important or reflective of serious policy conclusions. The constraints may not represent how many resources an economy has to purchase goods and services collectively, but they do roughly represent broad conclusions about the role of government, the public/private divide, public choice, and so on. For example, many Americans object on surveys to “big government,” but there is much less objection to specific programs, even when individuals are called upon to pay for them.107 Thus, the big-government objection may be more about fears of an overly powerful state than it is about social programs per se, even collective ones. I discuss these factors in more detail in the next section, but I also mention them here to emphasize that being able to exceed these budget constraints does not come without a cost.

The tax-expenditure literature has faced a similar debate between, on the one hand, those who believe that a transparent and procedurally fair budget appropriations process should be paramount and that policymakers should be forced to make choices among different forms of spending on the same footing, and, on the other hand, those who believe that, if the choice is between a tax expenditure and no expenditure at all, the tax expenditure wins.108 The difference with quasi-public spending is that we have a tax-expenditure budget, but we do not

107. See Kenworthy, supra note 37, at 150–52; Michelmore, supra note 27, at 2 (citing survey data).
have an equivalent quasi-public spending budget. Although some elements of quasi-public spending, such as government subsidies, might appear on a tax-expenditure budget—or even on the primary budget—the direct payments from individuals to providers (such as health insurance premiums and loan-financed tuition payments) do not.

Quasi-public spending is thus particularly opaque, at least as a budgetary matter. As I discuss in the next section, there can be some offsetting clarity, but off-budget spending nonetheless may carry significant risks that stem from a lack of budgetary oversight. This is especially important because, as discussed below, the characterization of payments as something other than taxes does not immunize them from having the distortionary effects of tax payments. But it will be particularly hard for analysts to study those effects without a firm grasp on the magnitude of the payments themselves.

2. Fiscal Illusion(s)

The above point—that the off-budget nature of much quasi-public spending is particularly relevant in a world of high public spending and political budget constraints—is an application of the broader point that quasi-public spending involves a degree of fiscal illusion. The central point of this Article’s analysis is that a price paid for a good by an individual to a provider ought to be considered equivalent to a tax under certain circumstances. But that fact will be invisible to a large number of people. Thus, government is, in some cases, deliberately obfuscating the true nature of the program.

But there are other types of fiscal illusion that may cut the other way. Caring about the nominal size of government is itself a form of fiscal illusion. If government disproportionately pays for goods with high-price growth, it will appear to be getting bigger and bigger, even though the overall bundle of goods may not change. Furthermore, much of government spending is social insurance and thus is simply responding to other cyclical economic effects. For example, government spending increases in a recession because of automatic stabilizers built into Unemployment Insurance, Social Security, Medicaid, and other programs, and private spending decreases because of demand shocks or job losses, but this tells us little about whether government is crowding out individuals’ economic activity or liberty.

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110. See supra Part II.
How these two illusions interact will vary depending on the details of the program. In the case of health care, the ACA drafters, according to Gruber, cared deeply about hiding the nature of the mandated insurance premium payments. But other aspects of the ACA had clear budgetary and political effects, and the experience of the Clinton reform plan showed that the fiscal illusion around the size of government was a powerful force against reform. So this may be a case in which using one illusion against another was justified—though time will tell.

On the other hand, income-driven student loan repayment is almost entirely off-budget, and although students surely know that the federal government is the lender (and the government does do relatively detailed accounting of its loan programs), students are likely a long way from seeing the repayment of the loan as equivalent to a graduate surtax. Even with income-driven repayment, many otherwise well-informed commentators and policymakers continue to treat the nominal size of a student’s debt as a central policy concern, even though the payments are by definition affordable and students may never have to pay back a good portion of the loan. Should PAYE become more widely adopted, greater understanding may evolve, but we currently seem to be a long way away. In this case the illusions about the nature of income-driven repayment may actually be impeding informed discussion about student loans and higher education finance.

3. Budget Scoring and Procedure

In addition to the political and optical effects of spending off-budget, there are also specific structural and procedural hurdles that relate directly to the Congressional scoring of a bill—the measurement of its costs to government. For example, the reconciliation process in Congress, which provides a smoother process for passage of budget bills, can, under the so-called Byrd Rule, only be used in situations that do not increase the deficit for fiscal years outside of the period covered by the reconciliation bill. Keeping the direct government outlays related to the program smaller can therefore make reconciliation—and thus passage—more likely, leaving aside any of the political optics.

111. See supra note 1 and accompanying text.
112. See supra note 13 and accompanying text.
115. See supra note 9.
As an example of both the political and structural hurdles related to the nominal size of a program, consider the 1993 Clinton health care plan. Like the ACA, the plan included a mandate that individuals buy health insurance. However, unlike the Obamacare exchanges, which act as marketplaces for private insurance, the Clinton proposal would have established regional health alliances that would have directly collected the premium payments and then distributed them to providers. Because of that more direct role for the alliances, CBO ruled that the alliances were not private entities, but agents of the government, and therefore that payments to the alliances would be considered federal receipts (though not technically taxes).

As a result of that ruling, spending on health care under the Clinton plan would have become part of the nominal public sector, which would have caused a 20% increase in nominal government outlays. That created a formidable political obstacle. Moreover, the proposal then became subject to the more difficult procedural rules under the Congressional Budget Act of 1974. The health care plan died shortly thereafter.

This was not necessarily CBO’s preferred outcome, however, and it went out of its way to help the drafters of the ACA avoid a similar fate. In 2009, it issued a detailed report on its methodology in determining the budget impact of health care reform, which was effectively a map for the bill drafters to avoid the same budget treatment as the Clinton plan. That said, it is not obvious in principle that the costs should be off-budget. CBO’s reasoning in 1994 was that:

[When the federal government specifies not only an outcome but also how the outcome is to be achieved, limits the ways in which the activity can be financed, makes a substantial financial contribution, and calls for the creation

118. See id. at 18–21. Large employers could have set up their own corporate alliances, but most spending would have run through an alliance of one sort or another. Id.
119. Id. at 44–49.
120. Id. at 50 tbl. 3-1.
122. The Clinton Administration had hoped to use budget reconciliation, much like the Obama Administration would later do for the ACA, to pass the 1993 health care proposal, but Senator Robert Byrd opposed this as stories began to emerge about its potential high costs. See, e.g., Paul Starr, The Hillarycare Mythology, Am. Prospect (Sept. 13, 2007), http://prospect.org/article/hillarycare-mythology [http://perma.cc/4FGN-TL3X]. Reconciliation would have been possible in part because the administration estimated that the bill actually lowered the deficit. See Cong. Budget Office, supra note 13, at 35–36. Under CBO’s methodology, however, the deficit would have increased by $74 billion over the next six years. Id. This effectively put reconciliation off the table and required that any bill would have to follow regular order and thus be subject to a potential Senate filibuster. See supra note 116 and accompanying text.
of new institutions to carry out the activity, CBO concludes that the boundaries of regulation have been crossed.124

CBO partly reiterated this view in its 2009 report, stating that, with regard to mandated insurance purchases:

[T]he key consideration is whether the proposal would be making health insurance an essentially governmental program, tightly controlled by the federal government with little choice available to those who offer and buy health insurance—or whether the system would provide significant flexibility in terms of the types, prices, and number of private-sector sellers of insurance available to people.125

CBO’s test gave the ACA bill drafters a way out because the test focused on the degree of control by the government and the degree of choice and flexibility for consumers. These are certainly important considerations in policy design, but note that they do not relate to the method of financing the purchase of the good, which is the central focus of this Article. One could imagine a program involving the same institutional landscape and the same degree of consumer choice but where consumers paid for health care with taxes rather than prices. For example, suppose each person were given a voucher that was income-based to help purchase health insurance from exchanges. Suppose furthermore that the money to pay for the vouchers was raised from income taxes, such that the net cost for each person would be the same as under the ACA. There is no question that CBO would have scored those as “taxes” and the spending on vouchers as “spending.” Thus, it seems that the degree of control and choice, although important from a public choice standpoint, is not in fact determinative of whether spending should be considered public or not. But because control and choice were CBO’s touchstones, the ACA drafters could create a program that effectively operated like public spending without causing much of that spending to be scored as government revenue.

B. COMPLEXITY AND OPACITY

As discussed above, the design of a quasi-public spending program necessarily involves using a basket of policy instruments to achieve a similar result as simple tax-and-spend.126 Quasi-public spending will thus naturally tend to be a more complex system. Furthermore, the off-budget nature of quasi-public spending generates one form of opacity—namely, disguising what are essentially tax-like payments for a good as prices.

124. CONG. BUDGET OFFICE, supra note 13, at 46.
125. CONG. BUDGET OFFICE, supra note 123, at 4.
126. See supra Section III.A.
It has not gone unnoticed that government programs have increasingly taken on this sort of hidden structure. Scholars on the left and right have criticized the complexity and opacity that sometimes accompany such programs. On the left, some scholars complain that involving private actors and making the government role indirect could lead to a disconnect between the role of the programs and the role of government in general.\footnote{See, e.g., \textit{Hacker}, supra note 21; \textit{Mettler}, supra note 19; \textit{Morgan \& Campbell}, supra note 20.} (We might call this the “keep government’s hands off my Medicare”\footnote{See Paul Krugman, \textit{Health Care Realities}, N.Y. Times (July 30, 2009), http://www.nytimes.com/2009/07/31/opinion/31krugman.html [https://perma.cc/3NF5-HCG7] (discussing how an attendee at a town hall meeting during the health care debates told Representative Bob Inglis to “keep your government hands off my Medicare”).} problem.) Similarly, left-leaning scholars worry that opacity and the involvement of private actors could lead to rent-seeking and upward redistribution. Consider the mortgage interest deduction, the benefits of which skew toward wealthy homeowners and their banks, or how certain privatization programs essentially redistribute tax money from the beneficiaries of the program to the shareholders of the government contractor providing the program.\footnote{See \textit{Mettler}, supra note 19, at 18.}

On the right, scholars are also concerned about the inefficiencies that accompany complexity and collective provision, but more because keeping such bloat off-budget makes the government look leaner than it really is and allows for a silently expanding state.\footnote{See, e.g., \textit{Teles}, supra note 24, at 102.} They also worry about behavioral distortions by the beneficiaries of the subsidies and other programs in addition to the providers.\footnote{\textit{Id.} at 105–06.}

These are all serious and important concerns that policymakers should consider. However, I also think that the issue is more nuanced than prior commentary paints it. For the reasons that follow, I believe that the complexity of quasi-public spending should not necessarily disqualify it as a reasonable policy choice.

1. Direct Public Spending Can Also Be Complex

Although a quasi-public spending program may tend to be more complex, complexity is certainly not a necessary result. It is perfectly possible, in theory, to design a quasi-public program that is relatively simple and clear, at least to the general public.\footnote{A straightforward program may still require some serious legal and technical expertise to operate effectively, even if the effects of the program are clear.} Imagine, for example, that instead of the ACA’s complex system of state-based health care exchanges, the federal government simply chartered a single insurance company that charged income-based premiums.\footnote{Below I discuss how quasi-public spending tends to work with existing institutions rather than replace them. \textit{See infra} Section IV.C. This stylized proposal would, of course, replace existing insurance companies and upend a lot of the medical finance system. That may be a major reason why it was not pursued. However, it would not necessarily upend the health care delivery system—hospitals, medical practices, etc., would still exist as before.}
Similarly, there is no guarantee that direct public programs will be simple. The Tax Code alone is a good place to start to see the complexity that can be associated with direct government activity. Alternatively, consider the complexities of administrative procedure and rulemaking, or the Pentagon’s budget. Lane Kenworthy argues that complexity is actually a result of our structure of government, with multiple veto points and layers of government. If so, it may be that we are stuck with complexity regardless of whether we choose the public or quasi-public path.

Furthermore, many of the complaints about complexity are focused on its effects rather than complexity in and of itself. For example, Suzanne Mettler describes the pre-2010 student loan program as a prime example of what she calls the “submerged state.” Students received loans nominally from private lenders without understanding that the loans would likely be more expensive without government guarantees, while the lenders also extracted many of those benefits for themselves. She thus described the end of subsidies and the expansion of federal direct loans as a “victory” and a “claw back [of] a significant portion of the submerged state.” However, in my view, this same legislation actually made the student loan program more of a quasi-public spending program, by expanding income-driven repayment. Thus, it is not the quasi-public structure itself that forms the basis of this type of objection, but rather the hidden rent-seeking.

That said, one way to make any social program simpler is to make the benefits more universal and less dependent on income. Much of the administrative work in social programs comes in means-testing—consider the difficulties associated with rolling out the health care exchanges in 2013, or the high rate of Earned Income Tax Credit (EITC) audits. It is not the quasi-public structure itself that forms the basis of this type of objection, but rather the hidden rent-seeking.

134. See Kenworthy, supra note 37, at 109.
135. See generally Mettler, supra note 19.
136. See id. at 9–11.
137. Id. at 86.
138. IBR was greatly expanded by the same bill, but Mettler does not mention IBR in her discussion of the bill and its effects.
141. The IRS estimates that the improper payments rate as a percentage of total payments was 21–25% in 2012. Treasury Inspector Gen. for Tax Admin., The Internal Revenue Service Was Not in Compliance with All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012, at 5 (2013). The audit rate for individual tax returns claiming the EITC is about twice the rate for all individual tax returns. See Steven T. Miller et al., IRS, Internal Revenue Service Data Book 2012, at 22 (2013).
Social Security is a prime example, with its universal benefit and its low administrative costs.\textsuperscript{142} Although the Social Security benefit formula is progressive,\textsuperscript{143} everyone gets a benefit, and it is simply a function of past wages rather than current income, so there is little need for individual oversight. Some have suggested a similar approach for higher education funding,\textsuperscript{144} though others say the benefits from a more paternalistic approach are often worth the costs.\textsuperscript{145}

A fuller discussion of the relative benefits of universal versus means-tested programs is beyond the scope of this Article.\textsuperscript{146} However, it is worth noting that universal does not mean regressive; a system can still be progressive—that is, have higher costs, lower benefits, or both as a percentage of income as income rises—even while providing a uniform benefit to everyone. This is because, first, the benefit will still decrease as a share of income as income rises,\textsuperscript{147} and second, revenue for the program can still be disproportionately raised from those with higher income.\textsuperscript{148} However, to add more progressivity beyond that would require limiting the benefits received by high-income individuals.\textsuperscript{149}

2. Opacity and Clarity

There is, however, another dimension to complexity, which we might call second-order complexity or opacity.\textsuperscript{150} For example, everyone knows that the Tax Code and the Pentagon’s budget are aspects of government and that they are complex. But quasi-public spending programs may be so opaque as to not even appear to be government programs and thus could lead people to misunderstand the role of government in their lives. This leads to my second response: in some circumstances, having a more direct connection between the good and the payment could actually increase awareness, understanding, and civic engagement, at least with respect to the program in question. When all taxes seem to go into a giant pool, and when the complexities of government make it hard to identify the individual benefits flowing from that pool, taxpayers may become more cynical. It is easy to fall into the fallacy of believing that people can be

\textsuperscript{142} Social Security administrative expenses have been equal to or less than 1% of total expenditures from the combined OASI and DI trust funds in every year from 1989 to 2012. See Social Security Administrative Expenses, Soc. Security Admin., https://www.ssa.gov/oact/STATS/admin.html [http://perma.cc/W44H-LJUH] (last visited Feb. 24, 2016).


\textsuperscript{144} See, e.g., Archibald & Feldman, supra note 78, at 215.

\textsuperscript{145} See, e.g., Kenworthy, supra note 37, at 145–46.

\textsuperscript{146} For a fuller discussion, see, for example, Graetz & Mashaw, supra note 139.

\textsuperscript{147} A flat-amount benefit becomes a smaller fraction of income as income rises.

\textsuperscript{148} See Kenworthy, supra note 37, at 80.

\textsuperscript{149} See, e.g., Richard A. Musgrave, Fiscal Tasks, in Public Finance and Public Choice: Two Contrasting Visions of the State, supra note 73, at 72, 79.

\textsuperscript{150} This is similar to the distinction between transactional complexity and rule complexity. See John R. Brooks, Doing Too Much: The Standard Deduction and the Conflict Between Progressivity and Simplification, 2 Colum. J. Tax L. 203, 237–38 (2011). I am grateful to Larry Solum for this suggestion.
categorized as “makers” and “takers,” or “taxpayers” and “tax eaters,” when the benefits of government are so diffuse. In contrast, when taxpayers can identify the benefits that flow from the payment, they may become more invested in the program itself and supportive of the funding structure. For example, this was the explicit purpose of keeping Social Security separate from general revenues and funding it with a dedicated tax. By clearly tying the retirement benefit to the taxation structure, Social Security has achieved an impressive level of political strength (though almost no one actually understands the complex benefit formula).

On the other hand, highlighting the redistributive element, rather than the benefit element, in a quasi-public spending program may have a different sort of effect on civic engagement, at least with respect to that good. Health care and higher education, for example, are sometimes mythologized as being individualist enterprises—fee-for-service, in effect—when in fact they have long been loci of collective activity, with heavy government subsidization and regulation. Thus, paying back a student loan—even a public, subsidized one—may appear to be a mere contractual payment from one party to another (despite the active involvement of government in facilitating and subsidizing that transaction). But introducing a progressive income-driven element, as the PAYE program has, makes it appear more tax-like. And paying a tax is more clearly a collective enterprise—“buying civilization,” as it were.

These two features—a direct connection to individual benefit and a broader connection to social benefit—are somewhat in tension. Too tight a connection to individual benefit reduces the ability to manage distribution, whereas too much redistribution decouples the connection between the payment and the benefit. A person calling on the government to keep its hands off his Medicare is probably not saying, literally, that Medicare is not government; rather, the person likely is using “government” to mean redistribution to someone else. Balancing these competing effects will be a challenge to policymakers making use of quasi-public spending.

3. Choice, Liberty, and Subsidiarity

For those on the right who fear a silently expanding state without pushback from voters, the complexity of a quasi-public spending program may be offset by more diffusion of power than under a direct public spending program. Concerns about bureaucratic overreach by imperial agencies are lessened if the money being spent goes directly to the provider of a good rather than being

151. See Michelmore, supra note 27, at 38–46.
152. See, e.g., id. at 5–6.
153. Justice Oliver Wendell Holmes, Jr. is said to have stated: “I like to pay taxes. With them I buy civilization.” See Felix Frankfurter, Mr. Justice Holmes and the Supreme Court 71 (2d ed. 1961); see also Yair Listokin & David M. Schizer, I Like to Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System, 66 Tax L. Rev. 179, 179 (2013).
154. This ties in with my discussion on the distortionary effects of taxation. See infra Section IV.D.
funneled through an agency’s budget. Thus, for example, we have many private
health insurance companies competing on exchanges rather than a single govern-
ment health service and a robust market of both public and private institutions
of higher education rather than a centralized education agency.\footnote{155}

Some have argued that the mandates involved in the ACA are an intrusion on
liberty,\footnote{156} but it is likely far less of an intrusion than nationalization of the entire
health care sector would be. Indeed, the first major proposal for ACA-style
mandated health insurance, in 1991, made precisely this point—that such a
program would avoid the dangers of a “monolithic, government-run system”
that would “make matters worse,” while still providing for progressive prices in
order to address the distributional problems of price growth.\footnote{157}

Above, I criticized CBO’s methodology in scoring the ACA for focusing on
issues of government control and consumer choice rather than financing.\footnote{158} But,
as I stated there, power and choice are still extremely important in policy
design, and in some cases quasi-public spending may allow for somewhat less
centralized government power and somewhat more consumer choice—particu-
larly if policymakers are following CBO’s methodology to avoid a budget
score.

Thus, although a strictly mandated program involving purchase of highly
regulated goods from entities with heavy government oversight may be indistin-
guishable from direct public spending, the more likely scenario is like the
American landscape for health care and higher education—a vast number of
entities, public and private, providing a differentiated set of goods at prices that
are at least somewhat market-based, and, ultimately, with at least some ability
for individuals to opt out (even if at a cost). Quasi-public spending therefore has
the potential to preserve a degree of individual choice, localism, and subsidiar-
ity,\footnote{159} at least as compared to direct public spending.\footnote{160}

That said, a different landscape of providers could lead to a different conclu-
sion. Arguably, concentration of wealth and power in large corporate form is

\footnotetext[155]{Cf. Daniel Halperin, A Charitable Contribution of Appreciated Property and the Realization of
Built-In Gains, 56 TAX L. REV. 1, 7 (2002) (“[T]he [charitable] deduction allows individuals to direct
federal funds, as opposed to leaving the choice up to the majority of the Congress, whose support might
be accompanied by an increase in government supervision.”).}

\footnotetext[156]{See, e.g., Barnett, supra note 94, at 605 (arguing that the government forcing individuals to
spend money with a private company is more constitutionally suspect than simply taxing them).}

\footnotetext[157]{Mark V. Pauly et al., A Plan for ‘Responsible National Health Insurance,’ 10 HEALTH AFF. 5, 6,
8 (1991).}

\footnotetext[158]{See supra Section IV.A.3.}

\footnotetext[159]{By “subsidiarity,” I mean organizing a political system with decentralized power so that social
problems are dealt with by officials closest to the problem, partly as a way to increase civic
engagement. See, e.g., George A. Bermann, Taking Subsidiarity Seriously: Federalism in the European
Community and the United States, 94 COLUM. L. REV. 331, 339 (1994).}

\footnotetext[160]{These points overlap with the familiar argument for federalism, and so a criticism of this
argument could be that instead of substituting federal mandates and subsidies for federal taxation, we
could instead devolve more of these duties to the states. For similar issues regarding the federal subsidy
for charities in a federal system, see Brian Galle, The Role of Charity in a Federal System, 53 WM. &
MARY L. REV. 777 (2012).}
more damaging to democracy than a similar concentration of wealth and power in government. Suppose, for example, that government simply contracted out all national defense to a single private company and mandated that citizens pay an income-based fee directly to that company—I could imagine almost nothing scarier. Thus, a large number of competing providers, each with relatively little political power, would make the complexity of a quasi-public program more palatable.

4. A Historical Trend

Complex and opaque policies may not be ideal, but they may also simply be how the United States does policy. There is a large literature explaining how the United States has, throughout its history, often taken a hidden or disguised approach to government spending and government power in general, particularly at the federal level, often by delegating that power to other actors. In this view, the federal government was more active than conventionally thought in the early years of the republic, but its actions were often obscured or otherwise out of sight (and furthermore, many state governments heavily regulated for the general welfare).

Scholars such as Brian Balogh have argued that the laissez-faire and “economic freedom” ideas embodied in, for example, the Supreme Court’s Lochner decision, did not derive from a historical understanding of America’s legal origins. Rather, laissez faire only became dominant in the relatively short period between the end of Reconstruction in 1877 and the Panic of 1893. The more explicitly active federal government that thereafter emerged in the Progressive Era and, especially, the New Deal may have appeared to be something new, but it was actually consistent with earlier government intervention and regulation—it was just the manner of intervention that was different. The difference was that the federal government began doing more of what the states and localities had once done, and it did it more directly rather than indirectly.

162. See, e.g., BALOGH, supra note 39; Clemens, supra note 22.
163. The government action also focused on issues like internal improvement; regulation of borders and territories; financial, economic, and market regulation; and morality. Thus, although the state was always active, it was fiscally light because it focused more on regulation of private behavior than on direct provision of goods. See, e.g., BALOGH, supra note 39, at 151–218 (discussing borders and territories); LARSON, supra note 39, at 3–7; NOVAK, supra note 39, at 83–113, 149–89 (discussing market regulation and morality regulation).
164. See, e.g., NOVAK, supra note 39 (showing that a well-regulated society was a central concern of colonial and early state governments).
167. See, e.g., NOVAK, supra note 39, at 42–50 (discussing the state common law roots of the “well-regulated society”).
168. See, e.g., BALOGH, supra note 39, at 384–92. States differed in the degree of regulation, of course. Robin Einhorn notes a pattern in that northern non-slaveholding states tended to produce...
But the American approach to more out-of-sight regulation, particularly on
distributional issues, continued. Much of the New Deal itself was designed to
mask the degree of redistribution in programs such as Social Security.\textsuperscript{169} In the
post-war period, after the income tax became a mass tax, social welfare
spending through the Tax Code in the form of tax expenditures became more
important.\textsuperscript{170} And even early Progressive Era reformers emphasized a coopera-
tive approach, involving state and local governments as well as private organiza-
tions rather than simply top-down federal regulation.\textsuperscript{171}

Quasi-public spending could be viewed as the latest iteration of this Ameri-
can approach to hidden government regulation. It differs from some earlier
versions of hidden government action in that quasi-public spending, as I de-
scribe it, is focused on provision of goods and not primarily about broader
economic regulation or redistribution. The earlier forms of out-of-sight regu-
lation that historians and scholars of government have focused on thus far relate
more to market regulation, state power, and risk-sharing and risk-shifting,\textsuperscript{172} for
example, than to paying for goods and services.

But despite these differences, quasi-public spending may be consistent with
the broader historical trend toward out-of-sight governing. This is not necessar-
ily a theoretical defense of quasi-public spending—its complex and opaque
nature may still make it theoretically inferior to direct public spending in many
cases. But progressives and others who support government spending should
consider whether they ought to make the perfect the enemy of the good. As
Brian Balogh has written:

\begin{quote}
[G]overnance out of sight “works” in the sense that Americans accept it.
Indeed, they demand it. That is why I urge progressives to embrace this
historical tendency, rather than fight it. Progressives must concentrate on the
ends—redistributive, just, representative—rather than bogging down in battles
over the means—“statist,” conspicuous, and centralizing.\textsuperscript{173}
\end{quote}

\section*{C. EXISTING MARKETS AND INSTITUTIONS}

Both the ACA and income-driven student loans are iterative changes to an
existing set of health care and higher education institutions, respectively. These

\begin{flushright}
\textsuperscript{169} See Balogh, supra note 39, at 392–94; Michelmore, supra note 27, at 5–7.
\textsuperscript{170} See, e.g., Howard, Hidden Welfare State, supra note 23, at 11–12 (noting that the size and
scope of tax expenditures derive in part from underlying changes in tax rates and other policies); id. at
34–39 (discussing growth over time); Michelmore, supra note 27, at 152–60.
\textsuperscript{171} See Balogh, supra note 39, at 353, 384; Michelmore, supra note 27, at 37–39.
\textsuperscript{172} On the role of government in risk-sharing and risk-shifting, see David A. Moss, When All Else
Fails: Government as the Ultimate Risk Manager (2002).
\textsuperscript{173} Balogh, supra note 39, at 397.
\end{flushright}
institutions include not only the provider entities themselves, but also the legal
and economic structures and especially the existing markets. Both programs
overlay upon these existing markets and institutions and use them to synthesize
an effect similar to direct public spending. This is in contrast to, say, full
nationalization, but it is also in contrast to direct public spending. Even if the
providers remained the same, the market would be drastically different if the
government became the direct purchaser of the good.174

Although we certainly would not describe these markets—either before these
policies or after—as purely competitive, they still have many of the benefits of
competitive markets. It is well understood that markets are generally more able
than a central planner to determine prices and the information that goes into
prices. There are many reasons for this, but particularly relevant are theories of
regulatory design that emphasize the difficulties government agencies have with
processing the information required to price or otherwise configure regulatory
instruments. For example, a government agency tasked with determining the
appropriate amount of money to direct toward a university is unlikely to be able
to process the amount of information needed to correctly answer the question. A
market-price-setting mechanism is far more able to accurately price the good.175

These points are boilerplate in considering public versus private activity. How
much market efficiency do we sacrifice in turning to the public sector? Do
market failures or distributional concerns justify that sacrifice? Quasi-public
spending shows, however, that it need not be a binary choice between the public
sector and private markets. If designed well, a quasi-public spending program
can maintain some of the price-setting benefits of private markets even while
addressing broader public goals.

An additional aspect of using existing markets and institutions is that the
quasi-public program needs to take them into account, and the existing institu-
tional structure may not be well suited for quasi-public spending. It may be that
quasi-public spending works best as an overlay on largely private markets and
institutions176 but may not work as well as an adjustment to some largely public
structures.177 As I discuss below, I find that a quasi-public spending model
would not work well for K–12 education because of its current decentralized

174. Above, I compared a tax-funded voucher program with quasi-public spending and suggested
that the only real difference is the financing mechanism, not the degree of government power or
consumer choice. See supra Section IV.A.3. If a voucher program were implemented that had the same
effect as the ACA, it likely would take advantage of the existing market in the same way the ACA does.
175. See Charles F. Sabel & William H. Simon, Minimalism and Experimentalism in the Administra-
176. See James M. Poterba, Government Intervention in the Markets for Education and Health
Care: How and Why?, in INDIVIDUAL AND SOCIAL RESPONSIBILITY: CHILD CARE, EDUCATION, MEDICAL CARE,
a well-functioning private market for the mandated good or service if they are to succeed”).
177. This takes into account, again, that institutions exist on a public-private continuum. See supra
note 15 and accompanying text.
nature and reliance on local property taxes for funding.\textsuperscript{178}

D. FLEXIBLE STRUCTURE

A direct public spending program normally raises money through the tax system and then spends the money on the provision of a good or service. That relatively simple structure, especially on the revenue side, means that in many cases the distributional effect will be just the incidence of the benefit offset by any cost of the tax.\textsuperscript{179} Quasi-public spending, by contrast, requires the use of several different instruments to get the same effect. Although this leads to some of the complexity discussed in section IV.B above, it also allows policymakers a wider range of possible distributional adjustments. They could choose to have more or less redistribution than a tax-funded direct public spending program—which would also mean that the program could be more or less distortionary than a direct public spending program.

To start, consider that paying a market price for a good or service is not distortionary or inefficient in the way that a tax payment is. This is because the person receives a good or service of equal or greater value for the payment, and thus the person’s labor is not devalued in terms of consumption choices—a person gets something in exchange for paying a price, but not necessarily for paying a tax. Similarly, financing the public purchase of a good with individual taxes equal to, or less than, the benefit to a given individual would also not be distortionary because the combination of the tax and the good would leave that person no worse off and perhaps better off.\textsuperscript{180} Any distortion would come only from the degree of redistribution—taxing or charging some individuals more than their benefit in order to finance subsidies to other individuals.\textsuperscript{181} Thus, if the distributional adjustment in a quasi-public spending program had the effect of raising effective marginal tax rates in the same way that a purely tax-funded program would, we would “obtain the standard distortionary result” as from

\textsuperscript{178} See infra Section VI.A.

\textsuperscript{179} More complex structures are possible, particularly if the direct public spending program uses a dedicated tax, has a complicated means-tested benefit formula, or both.

\textsuperscript{180} See Louis Kaplow, The Optimal Supply of Public Goods and the Distortionary Cost of Taxation, 49 Nat’l Tax J. 513, 520 (1996); Poterba, supra note 176, at 291–92. If the good was already in the individual’s consumption bundle before being publicly provided, then the consumption bundle and budget constraint would be basically unchanged—the money that went to the good now goes to taxes, but the rest of the consumption bundle is the same. If the good is a new one, then at worst the individual receives no utility from it, but the tax is essentially a lump-sum tax and therefore has no substitution effect—it does not affect work incentives. See Lawrence H. Summers, Some Simple Economics of Mandated Benefits, 79 Am. Econ. Rev. 177, 181 (1989) (comparing mandated benefits to lump-sum taxes); Poterba, supra note 176, at 291 (same). The better case is that there is at least some offsetting utility from the good, such that an individual would be better off shifting at least some of his prior consumption toward the taxes for the good.

\textsuperscript{181} Summers, supra note 180, at 180–81 (“In terms of their allocational effects on employment, mandated benefits represent a tax at a rate equal to the difference between the employer[’]s cost of providing the benefit and the employee’s valuation of it, not at a rate equal to the cost to the employer of providing the benefit.” (emphasis in original)).
typical taxation. But, importantly, the effective marginal tax rates could be lower—or higher.

In practice, it seems likely that the net redistribution will be lower under a quasi-public spending program than under a direct public spending program, and this is precisely because the program makes little sense if cost and benefit are not somewhat tied together for most individuals. If the core of the program is having individuals purchase the good for its price, in part out of a desire to retain existing markets and institutions and to hide the government’s direct involvement, then making someone’s net cost exactly equal to their net tax-and-transfer payments would defeat those purposes. More likely is that the subsidies will be just enough to make the good affordable to those at the lower end of the income distribution, and any high-end taxes will be just enough to offset that cost.

For example, income-driven student loan repayment could operate much like a tax on college graduates—indeed, the only core difference is that a graduate tax would be mandated, whereas loans are opt-in. But PAYE asks borrowers to pay using essentially two payment brackets—0% for income less than 150% of the relevant poverty line and 10% for income that exceeds that threshold. Contrast that with the statutory income tax rate schedule, with rates rising up to 39.6% (and higher when other taxes and phase-outs are included). Furthermore, the benefit of a student loan is essentially uniform to everyone, in contrast to many means-tested transfer programs. There is thus far less net redistribution under PAYE than there would likely be under tax-funded direct public spending on higher education. But future programs could differ and ultimately have more redistribution.

Another aspect of design flexibility is that policymakers can focus the program on the users of the good or service rather than all taxpayers. This further helps to keep a tight connection between the cost and the benefit, as opposed to raising money in part from individuals who do not receive any direct benefit from the good. Similarly, using a price mechanism helps to keep some of the subsidies directed at inframarginal purchasers of the good rather than all purchasers. If government instead provided the good to everyone, it might distort the behavior of individuals who were already purchasing a large amount of the good. By forcing them to purchase that additional desired amount for a higher price, quasi-public spending can avoid over-subsidizing those in this

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182. Kaplow, supra note 180, at 516.
183. See Summers, supra note 180, at 181 (“Without close links between taxes and benefits, that tend to be lacking in public programs, large distortions can result.”).
184. See supra Section I.B.
186. That is, all borrowers receive the higher education. Under a means-tested transfer program, everyone pays higher taxes but only qualifying individuals receive the benefit.
187. See Poterba, supra note 176, at 291 (“[O]pen-ended mandates avoid distorting the behavior of higher-consumption households.”); Summers, supra note 180, at 180–81.
group. To be clear, however, this does not mean that there would not still be potential distortions from the degree of redistribution.188

Countering this is the view in the economics literature on optimal taxation that commodities should be taxed uniformly when an income tax is available to handle distributional adjustments.189 To the degree that a quasi-public spending program includes cross-subsidies from some purchasers of the good to other purchasers, that can act as a differential commodity tax, contrary to the Atkinson-Stiglitz result.190 Thus, quasi-public spending will often not be the first-best policy option to enable public spending on particular goals or to address the distributional issues that may affect some individuals' abilities to purchase those goods. In many cases, cash grants through the tax system would lead to higher overall welfare—though, importantly, not in all cases.191

An additional feature that could affect the degree of economic distortion in a quasi-public spending program is salience, that is, the degree to which an individual is aware of and responsive to the particular instrument. If the distributional adjustments embedded in a quasi-public spending program are less salient than in an equivalent tax, then there may be less effect on behavior for the same degree of redistribution.192 For example, I have argued that a higher interest rate on student loans using income-driven repayment could provide some redistribution to fund the subsidies for lower-income borrowers.193 If those higher interest rates are less salient than taxes, then income-driven repayment could fund higher education subsidies with less distortion than tax-funded grants.

V. A FRAMEWORK FOR QUASI-PUBLIC SPENDING

Having described quasi-public spending and isolated some of its key features and its key differences from direct public spending, I now turn to specifying a

188. See Poterba, supra note 176, at 291 n.12 (“‘Mandates can avoid the distortions associated with providing a given level of a good or service to all individuals, but they cannot avoid the distortions that follow from attempts to redistribute resources across households.’”).

189. See, e.g., ROBIN BOADWAY, FROM OPTIMAL TAX THEORY TO TAX POLICY: RETROSPECTIVE AND PROSPECTIVE VIEWS 58–60 (2012); KAPLOW, supra note 42, at 127–33.

190. See A.B. Atkinson & J.E. Stiglitz, The Design of Tax Structure: Direct Versus Indirect Taxation, 6 J. PUB. ECON. 55, 74 (1976) (presenting a theoretical result that an income tax is more economically efficient than a differential commodity tax because it would distort only labor markets as opposed to distorting both labor and product markets).

191. See, e.g., KAPLOW, supra note 42, at 175–77 (discussing reasons why in-kind transfers may be preferred over cash transfers, including myopia on the part of beneficiary groups, externalities surrounding particular goods, correction of suboptimal parenting choices, and encouragement of goods complementary to labor to offset work disincentives from taxation generally).

192. See generally Gamage, supra note 49; Deborah H. Schenk, Exploiting the Salience Bias in Designing Taxes, 28 YALE J. ON REG. 253 (2011). The deadweight loss, or excess burden, of taxation is a function of both the tax rate and the compensated price elasticity of demand. See ROSEN & GAYER, supra note 87, at 332. If the tax or other adjustment is less salient, that may lower the magnitude of the elasticity, leading in turn to less deadweight loss than another instrument, even if the effective tax rate is the same.

theory and framework for when policymakers should consider employing a quasi-public spending model. My purpose here is to help policymakers think about and design quasi-public spending in a principled way, focusing on the possible benefits of the system rather than simply the political optics. This is, of course, merely a first step, and I hope others will correct, complicate, and extend these ideas.

Stated simply, when policymakers wish to pay for a good in a public manner, a quasi-public model may be a viable alternative to direct public spending, provided certain criteria are satisfied. First, the good or service and its approximate value should be clearly identifiable. Second, the identified private benefit should be large relative to the diffuse public benefits. Third, the pool of potential consumers should be large and diverse, especially across income groups. Finally, there should be an existing set of institutions, public or private, already providing the good.

These same criteria will also often apply when simple tax expenditures may be effective. As discussed above, some tax expenditures are a subset of quasi-public spending, but they are not the only form of hidden government spending. This Part concludes with a brief comparison to tax expenditures to clarify when non–tax expenditure forms of quasi-public spending may be most appropriate.

A. IDENTIFIABLE AND DISCRETE MARKET GOODS

A central feature of a quasi-public spending program is the separation of the purchase of the good from the distributional adjustments through subsidies and taxes. Thus, there must be at least somewhat of a market-price-setting mechanism for the good, so the existence of a market is a necessary condition.

But more fundamentally, we need to clearly identify and separate the good itself because ultimately the quasi-public spending program will tell individuals to go out and buy the good. Classic public goods, by contrast, are far too diffuse to be captured and described as single goods with prices—they are not separable into individual consumption items. Clean air, national defense, a monetary system—to try to isolate these as marketable goods is incoherent. We can certainly decide through the political process how much to value them and therefore how much tax revenue government should spend on their maintenance (and also how progressively that revenue should be raised)—but it would be absurd to say that we should provide for them by mandating that individuals go into the market to purchase their allocable shares of each.

This is not to say, however, that the goods have to be strictly and limitedly defined like items on a store’s shelves. The two key examples I use in this Article are health care and higher education. Each of these is in fact a complex bundle of goods, with many different variations in the bundles depending on individual preferences and market demand. The elements of the bundles have varied cost structures, positive (and negative) externalities, capital and labor intensities, rates of inflation, and so on. But our market system has, more or less, been able to put a single, reasonably accurate price on these bundles of
goods—health insurance premiums and tuition, respectively. This is sufficient to make them candidates for quasi-public spending.

B. LARGE PRIVATE BENEFIT

Related to the prior point is the idea that the goods should have large private benefits relative to public benefits. This is, in part, why there is at least a somewhat functioning market for the good in the first place. If most of the value of a good comes from its benefits to the broader public, rather than the individual purchaser, then the market would likely fail without a substantial Pigouvian subsidy.¹⁹⁴ That is an alternative—and noncontradictory—form of public intervention, but it serves a different purpose than quasi-public spending. Quasi-public spending is a form of public payment for a good, not the correction of a market price.

When the private benefit is relatively high, there is little question that most individuals would get substantial value from the good relative to its cost. Higher education, despite its costs, continues to be a good investment, for example.¹⁹⁵ And the insurance value of health insurance is substantial. Therefore, the mandate or strong push to purchase the good is unlikely to result in a loss to an individual or a large transfer *ex ante* from one group to another.¹⁹⁶ In many cases the only thing that is stopping some individuals from purchasing the good is simply a lack of money (or access to credit) or perhaps an error in calculating the value of the good.¹⁹⁷ In these cases, quasi-public spending would reflect a decision that a distributional adjustment is justified in order to enable such people to purchase the good, but it would not necessarily be questioning the underlying pricing and value.

Second, a large private benefit allows for separation of the provision of the good from the central public finance system. Where an individual’s benefits are her allocable share of diffuse public benefits, there is no real logic for trying to break out the purchase and provision of the good from any other public good—we would have to, for example, come up with a way to allocate the benefits of pure public goods. For those goods, the metaphor of a single tax as the price of civilization is stronger. But in situations where the government is

¹⁹⁴. See supra note 104.
¹⁹⁵. See Brooks, supra note 54, at 235–39.
¹⁹⁶. See supra note 183 and accompanying text. Insurance, of course, does result in a transfer *ex post*—after the insured events have come to pass. But *ex ante*, people pay roughly an actuarially fair risk-adjusted premium. In contrast, classic welfare transfers, which still have some insurance element, see John R. Brooks, Fiscal Federalism as Risk-Sharing: The Insurance Role of Redistributive Taxation, 68 TAX L. REV. 89, 94–101 (2014), are also in large part *ex ante* transfers because the qualifying event—low income—has already occurred at the time of transfer. A high-income person knows *ex ante* that part of her tax payment will be redistributive and thus will not provide her as much direct private benefit.
¹⁹⁷. On the relevance of myopia to the decision of whether to provide goods in kind, see, for example, Kaplow, supra note 42, at 175–76; Summers, supra note 180, at 178 (noting the similarities between paternalism and Musgrave’s notion of “merit good[s]”).
simply a purchasing agent for a discrete good, the total social benefit of which is largely the sum of individuals’ direct private benefits, there is no need to agglomerate the good with other government-purchased goods. This is not to say, however, that it is superior to create a separate financing mechanism—only that it is practicable.

C. BROAD AND DIVERSE PARTICIPANT POOL

In order for the program to fulfill the quasi-public character, there must be a broad enough pool of participants for sufficient redistribution and social insurance. First, for redistribution, one needs both the poor—or else why bother?—and the rich—or else where will the money come from? Many types of social programs would fail this test, of course. Consider traditional welfare payments, for example. Even if it were possible to determine a market price for the services, asking the participants themselves to fund the program would defeat the purpose. This is why purely redistributive transfers belong within the central public finance system. Although quasi-public spending contains distributional adjustments, its goal should primarily be good provision, not redistribution.

Second, social insurance and risk-pooling are key features. Because quasi-public spending, like direct public spending, is particularly appropriate where the cost of a particular good to an individual is high relative to his income, risk of low income can be a major factor, and much of what a quasi-public spending program accomplishes is the pooling of income risk. Thus, for quasi-public spending to be effective in cases where there is income volatility, we need, first, a large enough group to shrink the overall variance, and second, risks of low (and high) income to be mostly uncorrelated across individuals.198 If the pool has these features, then collective, progressive provision of the good or service can be effective. Health care satisfies this condition easily because it covers literally every person. And though the group of higher education recipients is smaller than the group of health care recipients, it also skews toward higher income recipients, which means lower risk and sufficient resources to spread what risk there is at a reasonable cost.

Pushing against this are the typical forces of adverse selection and moral hazard, which could act to undermine the risk pool. Thus, quasi-public spending may only be appropriate in cases where those forces can be managed or where tools like mandates can ensure that the good risks do not opt out entirely.199

D. DIVERSE NETWORK OF PROVIDERS

Finally, in addition to having a market price for the good, there ought to be an existing diverse network of providers of the good, public and private. First, this

198. On the connection between taxation and social insurance, see Brooks, supra note 196, at 94–102.
199. There is a tension here with the liberty benefits discussed supra Section IV.B.3. Ultimately, it is a political judgment as to how to balance these factors.
is a corollary to the previous point that there ought to be an identifiable good with a (more or less) market price. That implies a somewhat competitive market, rather than a monopoly or oligopoly (or no market at all), and thus a relatively reliable price-setting mechanism.

Second, we see in the cases of health insurance and higher education that quasi-public spending relies on an existing institutional structure and network of providers. If new types of entities and institutions have to be created from scratch, then the program is no longer an iterative change to existing institutions, but is instead a wholly formed, new institution. Without the economic and legislative efficiencies that come from using existing institutions, the case for quasi-public spending is substantially weaker. Third, creating or encouraging new entities to provide the good risks triggering the problems CBO identified in 1994—if the providers owe their existence entirely to government, they may be better perceived as government agents and therefore less likely to compete on price and quality.200

Finally, recall that a possible advantage of quasi-public spending compared to direct public spending is that the money is spread among the government, providers, and individuals, rather than captured entirely by the government through taxes. That is arguably more conducive to liberty, but not if there are very few providers, even if they are nongovernmental. Effectively making a single, large private entity into a tax collector would be dangerous to democracy. Unless the resources can be spread among diverse and competitive providers, it may be better for the government to keep them.

E. QUASI-PUBLIC SPENDING VERSUS TAX EXPENDITURES

The set of features described above flows from the fact that quasi-public spending works best—and perhaps only—when it is overlaid on an existing, functioning market.201 In this sense, quasi-public spending is essentially a “top off” to fill a gap in the existing market. Tax expenditures can do the same but in a more limited way.

For example, a tax expenditure generally operates as a deduction against taxable income—that is, a particular expenditure is deducted from the income tax base before calculating tax. This means that the subsidy rate is essentially fixed by the marginal tax rate, which is unrelated to the subsidy itself or the desired degree of redistribution. A tax credit may provide more flexibility, however—and many subsidies are nominally structured as tax credits, such as the premium assistance tax credits under the ACA202—but tax credits can also

200. For example, there does not appear to be much market benefit from contracting out prison services to private prison companies. See, e.g., Alexander Volokh, Prison Accountability and Performance Measures, 63 EMORY L.J. 339, 347 (2013).
201. See supra Section IV.C.
be limited in their effectiveness, especially if they are not refundable.\textsuperscript{203} In addition to having less flexibility in the degree of redistribution, tax expenditures also have less flexibility in the targets of redistribution. When running everything through the Tax Code, the participant pool is essentially everyone. Even those who do not purchase the good in question may be called upon to subsidize another’s purchase of it. That may be appropriate in many situations, but there may also be good reasons to limit the pool to those who purchase the good. For example, asking the higher-income recipients of higher education to disproportionately support the subsidies to low-income recipients of higher education better reflects the disproportionate benefits they have received.\textsuperscript{204}

The main point, then, is that quasi-public spending is particularly flexible because it is unconstrained by the tax system itself. Policymakers may choose to use aspects of the tax system, such as with the ACA, but may also choose to work largely outside of it, as with income-driven student loan repayment. Indeed, student loans provide a good example of the limitations of the tax system. There are a number of tax expenditures for higher education but, as noted above, they have had limited effectiveness.\textsuperscript{205} Student loans, on the other hand, have done much more to make higher education more widely available. This may in part be because taxes are generally not particularly relevant for students. Embedding the quasi-public spending within the loan system, rather than the tax system, thus ensures more effective delivery of the policy.

VI. Applications

In this Part, I briefly apply the prior Part’s framework to areas that could possibly benefit from a quasi-public intervention: K–12 education, child care and early education, and legal services.

A. PRIMARY AND SECONDARY EDUCATION

Public primary and secondary education—K–12 education—is a major piece of state and local government budgets, and it is expensive. It is labor intensive, with low labor productivity growth, and it is not amenable to technological improvements to boost productivity.\textsuperscript{206} There may be inefficiencies that can be rooted out, but as long as we expect teacher salaries to at least keep pace with average wage growth, we should expect public school budgets to rise faster than the rate of inflation and to consume a growing share of overall spending. In

\textsuperscript{203} If a tax credit is not refundable, then it can only reduce taxes to 0. It thus provides little or no benefit to low-income individuals who pay little or no income tax. A refundable credit, by contrast, can lead to negative tax liability and thus operates essentially as a cash transfer without regard for income tax liability.

\textsuperscript{204} See Brooks, supra note 54, at 279–81.

\textsuperscript{205} See supra note 35.

\textsuperscript{206} I do not know of a serious suggestion that there be online distance learning for kindergarten.
many ways, it is a classic example of Baumol’s cost disease and the problem of low labor productivity growth.\textsuperscript{207}

Thus, we either need to resign ourselves to ever-rising school costs (and therefore local property taxes) or consider another option. But what would a quasi-spending model look like for K–12 education? It would essentially ask families with children to pay schools directly as costs go up rather than put those costs on property owners in general. The payments themselves would be partly a function of income so as to be progressive and ease the burden of higher costs on low-income people especially.

However, such a program would likely fail because the existing institutional structure of K–12 education would not work well with a quasi-public spending overlay. Because K–12 education is financed at the local level through local property taxes, a quasi-public spending program similar to the ACA or income-driven student loan repayment would not be a good fit. First, because many school districts are segregated economically, the pool of potential participants within a district is unlikely to have the income diversity needed to have effective distributional adjustments. The pool of participants would instead have to be drawn at the state or national level. Second, even a national program would rely on an imperfect pool if it included only families with children currently in school because those families are likely to have less disposable income than families with no children or whose children have left the household. Although shifting the burden from all property owners to families with school-aged children might tighten the connection between cost and benefit, it would be a dramatic and likely regressive change.\textsuperscript{208}

To make such a program work, there would have to be revenue raised from relatively high-income people without children in high-income districts to fund subsidies and other distributional adjustments for parents paying fees in low-income districts. But this just highlights that from a fiscal and equity standpoint, the most pressing problem with public schools is the distribution of resources as a result of their current financing structure, not the overall level of resources. The national per-pupil average annual spending is over $12,000,\textsuperscript{209} well above the Organisation of Economic Cooperation and Development (OECD) average,\textsuperscript{210} but with wide variations in spending across school districts. In the near term, finding ways to better distribute that spending across uneven school districts is more important than finding ways to finance an increase in the

\textsuperscript{207. See supra Section II.C.}

\textsuperscript{208. The ratio of public spillovers to private benefit for K–12 education is likely more skewed toward public benefit than the ratio is for higher education. If so, then the public should bear a larger share of the cost of K–12 education than it should for higher education because it also gets a bigger share of the total benefit. Thus, putting more of the burden on current parents is not as justified as putting more of the cost of higher education on the student.}


overall level of spending. Thus, some sort of national-level equalization would be a more natural first step rather than first implementing a quasi-public cost-sharing program.

B. CHILD CARE AND EARLY CHILDHOOD EDUCATION

In some ways, early childhood education is institutionally a closer analogy to higher education than K–12 education. Both have historically had a large role for private payments and a network of private providers (though with an increasingly large government role) and thus are more institutionally amenable to a quasi-public solution. In addition, early childhood education is a growth area and therefore is in need of more funds. In 2013, only about 68% of four-year-olds attended some form of preschool, yet research has now made clear the importance of some sort of education for preschool-aged children. Furthermore, child care is necessary to increase labor force participation, especially among women. But, like K–12 education, it faces the problem of high labor costs and low labor productivity, leading to high and growing overall costs. As with higher education, expanding access to early childhood education and child care is thus a reasonable, perhaps vital, role for government.

Many states and districts already provide public pre-Kindergarten (pre-K). New York, in particular, has recently begun an ambitious, universal pre-K expansion, and other states may follow. An important innovation of some of these programs is using state income tax revenue rather than local property tax revenue to fund the expansion—which partially solves the pooling problem that K–12 education faces. But this nascent public system exists alongside an existing, largely private, system of child care and preschool. That makes the system complicated for purposes of the cross-subsidies in a quasi-public spending program, particularly because high-income people could choose free, public pre-K in New York if they wished, thus potentially cutting off a source of progressive funding.

Universal pre-K could instead take a different approach, one more like the ACA. Families could purchase pre-K and child care in the private market but

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213. See supra Section VI.A.

with income-based subsidies for those with lower incomes. The subsidies could come in the form of a voucher or tax credit, or could even be sent directly to schools, like the method used for health insurance companies under the ACA. That approach would likely have a much lower budget cost than the $1.5 billion over five years that New York is projected to spend on universal pre-K because more families would be paying out-of-pocket.\textsuperscript{215} The necessary revenue might come from an incremental tax on high incomes, in order to have the distributional element of a quasi-public spending program, or from a higher list price for the service, much like for higher education.\textsuperscript{216} Interestingly, New York City Mayor Bill de Blasio originally proposed during his 2013 mayoral campaign to pay for expanded early childhood education with a small tax increase on incomes above $500,000.\textsuperscript{217} But that was assuming full public spending; an incremental tax to fund means-tested subsidies could be much smaller.

An important design question, therefore, would be whether to use a voucher system or other quasi-public spending program to add incremental redistribution to the current system of private expenditures or whether early childhood education should simply be paid for wholesale by the government, funded by general tax revenue. Given cost disease pressures and the inevitable growth of the government sector, there may be good reasons for a gradual approach so as not to crowd out other programs. It may be better, for example, to use the same tax increase suggested by de Blasio to fund a less expensive voucher program, with the balance used to shore up K–12 schools.\textsuperscript{218} Direct payments by parents to providers would make up the difference. The total cost to many people may not be that different than under direct public spending, but the lower nominal taxes would mean less budget pressure.

To be clear, the idea of providing means-tested vouchers for preschool is not particularly novel, and some communities have already implemented it.\textsuperscript{219} Furthermore, this is not intended to be a full examination of the relevant issues. But framing a system of private expenditures, subsidized with means-tested vouchers, as a quasi-public form of collective spending allows a clearer comparison to direct public spending, particularly for the distributional consequences. Indeed, an important difference between the typical voucher proposal and a


\textsuperscript{216} If the latter, then the subsidies would happen partly at the school level through increased financial aid.


\textsuperscript{218} Another issue would be quality and accountability because a voucher program would still rely on private providers. Experience with voucher programs for K–12 education shows that this is a real concern. Thus, there would be a need for regulation and oversight, see supra Section III.A.3, though, of course, this would be true for expanded public early childhood education as well.

\textsuperscript{219} See generally Nat’l Inst. for Early Educ. Research, supra note 212.
quasi-public spending program is that the typical voucher is just a lump-sum substitute for full, direct public spending—providing individuals with a fixed voucher equal to the average per-pupil cost. The purpose of such vouchers is only an attempt to use a market mechanism, rather than a political or agency decision, to allocate the funds. In a quasi-public spending program, however, the voucher would be variable in order to cover only the distributional correction needed to make the purchase reasonably affordable.

C. LEGAL SERVICES

Like education and health care, the legal industry has relatively low productivity growth and thus has costs rising faster than average. Although technology supplies some boost—legal research, for example, takes much less time than it did previously—a given associate can still only read so many contracts or draft so many briefs in a day. And sure enough, hourly fees have risen at roughly a 3.6% annual rate over the last ten years, and clients are increasingly groaning under the weight of their legal expenses.

That alone does not necessarily mean that something must be done. Perhaps lawyers are like household servants, a service that will gradually diminish as the wages demanded by highly educated individuals become more and more unaffordable to clients. But lawyers do, of course, provide something special, namely access to the bodies of law that guide almost every interaction between individuals and business entities in the modern world, not to mention access to our justice system. They are an indispensable part of the modern regulatory state. Although there may be arguments about exactly how many lawyers we need, and whether we now have too many or too few, it is not a service that we can let die off, nor should we let the cost structure lead to distributional differences in access to justice. Legal services are thus arguably the sort of


221. This is similar to the design of the premium assistance tax credit under the ACA, where the credit is the difference between the cost of the “applicable second lowest cost silver plan” and an applicable percentage of the taxpayer’s income. I.R.C. § 36B(b)(2)(B) (2012). In other words, the credit is intended only to bring the out-of-pocket cost down to a particular percentage of income. This is in contrast to, for example, proposals to simply give every citizen a fixed insurance voucher amount. See, e.g., CONG. BUDGET OFFICE, A PREMIUM SUPPORT SYSTEM FOR MEDICARE: ANALYSIS OF ILLUSTRATIVE OPTIONS 1–2 (2013) (analyzing congressional proposals to provide Medicare recipients with a premium support amount that would be equal across most recipients, adjusted only for health and age).


223. Ironically, increasing the use of quasi-public spending may mean an increasing role for lawyers because they could, in effect, be the government’s agents for implementing a particular policy through private actors.

224. It feels incredibly quaint and naïve to write this sentence, given how clearly income and wealth correlate with access to legal services. But that does not mean it is appropriate.
good a society might want to finance collectively, and so we should at least ask the question of whether there is a reasonable collective response. 225

The medical industry once faced a similar problem but solved it (for a while) with health insurance. There have been proposals for legal insurance, 226 but they have never really gone anywhere, largely out of moral hazard concerns—there are fewer barriers against becoming litigious than against becoming unhealthy or injured, for example. 227 Alternatively, there are legal aid services and similar public programs funded from tax revenue and contributions from attorneys, but they are woefully inadequate in meeting the demand. Although we could dramatically increase funding for legal services, that raises the familiar problem of an expanded government sector bumping up against budget constraints or crowding out other government programs.

What might a quasi-public spending program for legal services look like? Two possible options are expanded pro bono requirements 228 and funding of legal services by other lawyers rather than taxpayers and donors. Either of these options would take the form of a transfer from clients who can pay full price to those who cannot, consistent with the distributional adjustments under the ACA or PAYE. If attorneys have a substantial pro bono requirement, for example, they might charge higher hourly fees for their paying clients. Similarly, if state bars required greater payments into a legal services fund, that also likely would be passed on to paying clients.

Again, these proposals are not particularly novel. However, it is perhaps novel to see them not merely as ways to expand access to justice, but as ways to collectively purchase a more socially optimal amount of legal services in the face of rising costs.

CONCLUSION

This Article has introduced the concept of quasi-public spending to describe a new approach to the public financing of goods and services. The Article’s claim is that programs for the collective and progressive provision of certain goods can be (and often already are) accomplished through a synthesis of private spending by individuals and incremental government subsidies and taxes, as opposed to full, tax-funded direct public spending. At a first approximation, this

225. It should be noted, however, that the positive externalities from legal services are perhaps less obvious or salient than for education. Most probably agree that everyone benefits from an educated populace, but it’s not as immediately clear that everyone benefits from, for instance, a lawyer helping with an individual’s divorce. But the externalities are still there—smoothing out disputes, efficiently navigating the court system, managing legal risk before entering into a transaction or relationship, helping to ensure compliance with the public purposes of laws—these are all things that benefit society as well as the clients themselves.


227. See id. at 425–36.

228. For example, New York now requires fifty hours of pro bono work for bar admission. 22 N.Y. Jud. Law § 520.16a (McKinney 2015).
describes both the ACA and income-driven student loan repayment for higher education. Although both these programs are relatively small today, widespread adoption of each would have a similar societal effect as full public funding of each but with much of the spending still nominally private.

This Article further shows that in certain situations, using a quasi-public spending design for a large-scale public spending program may be a reasonable alternative to other structures. This challenges the conventional wisdom that it is best for public programs to be on-budget and funded directly out of tax revenue. The standard argument that citizens ought to know of the existence and cost of public programs is compelling. Yet that benefit has costs: higher taxes, a larger public sector, and perhaps less likelihood of enactment.

In situations where the government may need to become the purchaser of a good in order to counter distributional limitations on individual purchases—such as with pre-ACA health care and pre-PAYE higher education—a quasi-public spending program can provide a way to achieve the government’s allocative and distributional objectives with a smaller public sector, greater reliance on existing markets and institutions, greater policy flexibility, and more diffusion of power. In that situation, the right answer is no longer quite as obvious. Although quasi-public spending is not suited for all government activity, it is nonetheless a tool that policymakers and academics should take seriously.