QUASI-PUBLIC SPENDING

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I. Introduction

In November 2014, video surfaced of one of the architects of the Affordable Care Act, economist Jonathan Gruber, saying that the Act “was written in a tortured way to make sure the [Congressional Budget Office] 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 NFIB v. Sebelius,2 some commentators quickly took this be a confession that the bill drafters had deliberately obfuscated in calling the penalty for failure to buy health insurance a penalty rather than a tax.3 The basis of the NFIB decision, after all, was that the penalty was actually a tax, and therefore fell within Congress’s taxing power.

The commentators were shocked—shocked—that the drafters had mislead 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

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the same video.) The claim was presumably that the American voters would not have accepted the ACA if they knew the penalty was actually a tax.

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 ACA, and in any event were always scored by CBO as government revenue—not a lot of political risk there. In contrast, the mandated premium payments through the exchanges are currently running around $51 billion per year—if that were 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, since that is precisely what CBO did in scoring the similar 1993 Clinton health reform bill. 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—i.e., calling a payment a “price” rather than a “tax”—doesn’t make it any less public spending, if the payment is mandated and especially if the payment is income-based in the same way our income taxes are. Indeed, this Article claims that this structure—mandated or strongly encouraged payments directly from individuals to good providers, rather to the government—may actually be the future of American public spending.

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6 Author’s estimate 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 37 states using the healthcare.gov platform. See Dep’t of Health and Human Svcs., *Health Insurance Marketplaces 2015 Open Enrollment Period: March Enrollment Report*, ASPE Issue Brief, at 5 (enrollment) & 51 (average premiums) (March 10, 2015). I use the pre-tax premium amount since 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.

This Article introduces the concept of “quasi-public spending” to describe this type of policy, whereby public spending on goods and services is effected not through European-style universal government programs funded with tax revenue, 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 directly, but with government subsidies (raised from more limited 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 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.\(^8\)

Though the legal literature sometimes imagines a sharp line between the private and the public,\(^9\) there is in reality a continuum between private and public spending, with varying degrees of government money and involvement. For example, there is obviously 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 under-explored and under-theorized in the literature, namely where private spending on goods for individual consumption takes on such an overlay of regulation and cross-subsidization 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-Affordable Care Act health insurance and federal loan-financed higher education. As this Article will describe, both of these programs

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8 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 take-over of all higher education, however, would be a very different policy (though still financially comparable).

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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. As a result, this Article argues that we should think of these programs as financially comparable to direct public spending, and analyze them accordingly.

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 first to the government, 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 since, as this paper will discuss, government budgets may have a political ceiling that would otherwise limit the ability for 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 Stanley Surrey we have criticisms of 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 divided welfare state,” “the Rube-Goldberg 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

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10 See infra Part II.
17 Steven M. Teles, Kludgeocracy in America, NAT’L AFFAIRS (Fall 2013), at 97.
complexity in general is inefficient and can hide rent-seeking and other anti-public 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. And 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 with 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. Social Security, for example, has achieved an impressive level of political strength in part through a similar structure. Furthermore, while 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 diffuse 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 goal of the reforms—even though 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 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
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some existing scholarship, 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. Policymakers must therefore step carefully, particularly since, as noted above, quasi-public spending may arise as the byproduct of other iterative reforms, rather than as a deliberate goal.

In describing programs such as post-Affordable Care Act health insurance and income-driven student loan repayment as “quasi-public spending,” this Article aims in part 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.\(^\text{18}\) 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.\(^\text{19}\) 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 $150 billion per year toward health care.\(^\text{20}\) But that money appears as lower taxes, rather than higher spending, and furthermore does not go through the typical budget appropriations process.\(^\text{21}\)

What this Article reveals, however, 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.\(^\text{22}\) Income-driven student loan repayment, for example, operates as a quasi-public spending

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\(^{19}\) See Staff of the Joint Committee on Tax’n, Estimates of Federal Tax Expenditures for Fiscal Years 2014-2018 (JCX-97-14), Aug. 5, 2015, 2-8 (discussing the tax expenditure concept and the normal baseline).

\(^{20}\) Id. at 31.


\(^{22}\) There are also a number of tax expenditures that would not qualify as quasi-public spending in my view, since 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.
program in my view, and involves very few tax law provisions.23 But the spending is nonetheless disguised because of how budget rules treat federal loans.24 Thus, an important contribution of this Article is to expand the tools of tax expenditure analysis to other non-tax situations.

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 a sketch of this, consider that the U.S. public sector today is about 37% of GDP, compared to 50% or higher for much of Western Europe.25 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.26 While 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.27 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-

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23 While 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 II.B. Furthermore, they may not even be that effective. See, e.g., George B. Bulman & Caroline Hoxby, The Returns to the Federal Tax Credits for Higher Education, NBER Working Paper No. 20833 (finding that the tax credits have “negligible causal effects” on attendance), available at http://www.nber.org/papers/w20833.


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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 a substitute for public housing or rent subsidies. There is a large economics literature analyzing these issues, some of which this Article will discuss. 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 good, with distributional adjustments playing a secondary role. Although this may not substantially change all of 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 don’t intend with this Article 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

28 In other words, this is an exercise in non-ideal theory; that is, this is a theory for a way to improve the normative results of public finance policymaking 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 vs. 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—that 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
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 that affect individuals’ abilities to purchase optimal amounts of goods are better dealt with 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 saying 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 won’t.

This Article proceeds as follows. In Part II, I review the Affordable Care Act and income-driven student loan repayment, describing how each program operates as a substitute for direct public spending. In Part III, I briefly sketch out some of the reasons for high and growing government budgets, since the political ceiling on the size of government is a key motivator for policymakers to take advantage of quasi-public spending. Part IV discusses the structure of quasi-public spending in more detail and contrasts it with some similar forms of government intervention. Part V examines in detail the unique features of quasi-public spending as compared to direct public spending. Here I focus in particular on the fact that much of the spending is off-budget, and also on the fact that a quasi-public spending program is likely to be complex. While both of these features have given some commentators pause, I provide a qualified defense of each. In Part VI, I use the analysis in the earlier Parts 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 VII applies that framework preliminarily to several other policy areas. Part VIII concludes.

II. Health Insurance 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 Affordable Care Act for health insurance and Income-Based 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 much 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 motivate 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 Affordable Care Act. But from a public finance perspective, some broad observations are instructive.

Looking first at just the Affordable Care Act, 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, 29 the tax on net investment income, 30 a higher floor on deductible medical expenses, 31 and the excise tax on “Cadillac” health plans. 32 These distributional adjustments cause the net payments (or transfers) for health insurance to be broadly 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, while the revenue comes from just these more limited taxes. Contrast this with, e.g., the health care system in the UK or Canada, where the budget costs would include the full cost of health care, and the revenue would be the much higher 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 US would instead be a tax payment in the UK or Canada. But if the premium payment is mandated by the government, is it so different from a tax? Either

29 I.R.C. § 1401(b)(2) (additional Medicare tax of 0.9% on self-employment income); 3101(b)(2) (additional Medicare tax of 0.9% on wages).
30 I.R.C. § 1411 (3.8% tax on income from interest, dividends, annuities, royalties, rents, and capital gains to the extent it exceeds a threshold amount).
31 I.R.C. § 213(a) (deduction for medical expenses that exceed 10% of AGI, as opposed to early floor of 7.5% of AGI prior to 2012).
32 I.R.C. § 4980I.
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 UK and Canada, to a first approximation.

The health care system in the United States is not limited to the Affordable Care Act, however. Most health insurance in the United States continues to be provided through the pre-Affordable Care Act 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 purposes,33 and also by a mandate on some employers. The subsidies are regressive in effect, however, since they are a function of marginal tax rates—Surrey’s classic “upside-down” subsidy. Thus, with respect to the employer portion, at least, the system lacks some of the distributional effects that a direct public spending program would have.

The Affordable Care Act financing structure is undoubtedly complex, and its interaction with the old employer-provided system compounds the complexity. How the two systems will relate 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.34 Furthermore, because the premium assistance tax credits are likely to grow faster than incomes,35 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,36 but it may be relatively easy for employers to avoid this mandate.37 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 gradually converge toward simply individual subsidized purchases on the insurance exchanges.

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33 See I.R.C. §§ 105, 106.
34 See David Gamage, Perverse Incentives 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, e.g., a family of four with income up to 400% of the federal poverty line).
35 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). I.R.C. § 36B(b)(3)(A)(ii).
36 I.R.C. § 36B(c)(2) (denying eligibility for a given month if the applicable taxpayer has minimum essential coverage under, inter alia, an employer-sponsored plan).
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, and the ACA was intended to work alongside the existing system. Contrast that with, e.g., 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.

B. Higher Education

As I’ve 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 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 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 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 20 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, paid for with 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

39 34 C.F.R. § 685.209(a).
40 Discretionary income is adjusted gross income less 150% of the relevant poverty line. 34 C.F.R. § 685.209(a)(1)(v); see Brooks, supra note 38, at TK
41 34 C.F.R. § 685.209(a)(6); see Brooks, supra note 38, at TK.
42 Federal Credit Reform Act § 502(5)(B), 2 U.S.C. § 661a(5)(B); see Brooks, supra note 38, at TK.
nominal amount of money actually loaned to pay tuitions. This makes the budgetary cost at most a few billion dollars a year, rather than $100 billion.\textsuperscript{43}

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 in a sense, society does, by using higher education degrees as a form of gate-keeping for many jobs. For certain swaths of the economy, higher education is essentially mandated. This is contrast to health care, where the lack of insurance is not a barrier to many forms of health care.\textsuperscript{44} Furthermore, loans are increasingly necessary to pay high tuition costs, and the federal government now issues 90\% of all student loans.\textsuperscript{45} So, while not mandated, federal loan-financed higher education is the norm. With that background, public policy could be more focused on the financial aspects of higher education reform.

The complex structure of Pay As You Earn 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 put on high-income students (via higher loan payments) or on taxpayers generally. I explore these at length in the other paper.\textsuperscript{46} But they suggest a need for government regulation, which is already beginning to appear.\textsuperscript{47}

Adoption of Pay As You Earn 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 (or REPAYE) program.\textsuperscript{48} 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.

\textsuperscript{43} See id. at TK.
\textsuperscript{44} For example, emergency room services must be provided regardless of whether a person is insured. CITE.
\textsuperscript{46} Id. at TK.
\textsuperscript{47} For example, the Obama administration recently issued the Gainful Employment regulations, addressing issues of for-profit schools with high student debt and low post-graduation employment. See Program Integrity, 79 Fed. Reg. 64889 (July 1, 2014); Brooks, supra note 38, at TK. The administration has also started publishing information addressing cost and employment for non-profit schools, CITE, and has expressed interest in more regulation and oversight, CITE.
While I have argued that this is a huge change in the way we publicly finance higher education, the structure of the change itself was rather 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 continues to work largely within the existing institutions landscape. Contrast this with, e.g., nationalizing higher education institutions or making the government the direct payer of tuition.

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The Affordable Care Act and Pay As You Earn 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 Affordable Care Act 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 Pay As You Earn in particular, provide for nominal payment of tuition by individuals to schools, but with the cash to finance it coming the government in the form of a loan. Because the student only has 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 portions of our economy, addressing central parts of our lives and our individual and collective well-being. Understanding them fully helps not only 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 era of growing government spending and tight government budget constraints. These two programs, therefore, point toward a model of “quasi-public spending,” which Parts IV and V discuss in detail.

49 Brooks, supra note 38, at TK.
III. Budget Constraints and the Growing Public Sector

Before turning to a fuller analysis of quasi-public spending, it is worth understanding more the motivations of policymakers, at least in the area of health care and higher education, to use the policy tool of quasi-public spending. I discuss some of the key differences between quasi-public spending and direct public spending Part V, and likely all of these factors play a role. But because the primary feature of quasi-public spending is off-budget spending, the effect of large and growing government budgets, and the political ceiling that this imposes of spending, is likely to be a central motivator. Therefore, this Part briefly sketches out some of the reasons for why government budgets have become large and growing, and the political effect this has.

As evidenced by the Affordable Care Act anecdote that began this Article, there are real political constraints on public spending. As we have seen over the last few decades, the nominal amounts of taxes and 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.50 Some in Congress have also tried, either in legislation or in budget negotiations, to lock in public spending as a fixed percentage of GDP.51 Thus, it seems plausible that voters may tolerate only so-large of a nominal public sector.52 And this is not unreasonable. Involving the public sector brings up issues of public choice, liberty, subsidiarity, administrative efficiency, and all the other issues that arise in considering public


52 See, e.g., KENWORTHY, supra note 25, at 150-52 (summarizing surveys).
vs. private action.\footnote{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).} 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.\footnote{See infra note 74 and accompanying text.}

The problem with this is that we can clearly observe that the public sector in modern, developed welfare states is quite large, and growing. And although there are certainly places for cost-cutting and reform, there are also very good reasons why the public sector is and will remain big—namely, that it disproportionately 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 expensive, and I review them here. The purpose of this is not to provide a definitive answer for why, e.g., health care is expensive, however. The purpose is rather 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. Scarcity

The simplest reason for high prices is simply 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, since 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, in the case of housing, 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. Aging

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, etc. Because of improvements in health care, delayed child birth, 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 are likely to rise relative to other parts of the economy. Furthermore, many elderly are outside of the labor force, meaning that they are not producing income that could correspondingly raise GDP—their consumption of goods and services comes disproportionately from transfers, rather than earned income.

Although there may be some policy responses to this, such as increased immigration, pro-natalist policies (or ice floes), 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.55

C. Low Labor Productivity

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 wage growth.56 So while 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).


56 See ROBERT B. ARCHIBALD & DAVID H. FELDMAN, WHY DOES COLLEGE COST SO MUCH? 36-37 (2011); WILLIAM J. BAUMOL, THE COST DISEASE 21 (2012) (“In the long run, wages for all workers throughout a country’s economy tend to go up and down together.”).
The classic example from William Baumol and William Bowman 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 I.” But because real wages for actors have clearly risen since the 16th century, so has the cost of seeing a Shakespeare play, which puts strain on performing arts companies.

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.) As such, government is likely to be particularly burdened by the cost disease and thus see prices go up faster than average.

Importantly, the cost disease is not necessarily an economic problem, since 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 the cost disease. In that case, public spending will naturally grow as a share of GDP, even if the overall basket of goods doesn’t 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.

D. Health Care

The single biggest driver of recent and projected growth in government spending is health care, and so it deserves special mention. 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 productivity of health care providers, the growth of the elderly population, the increase in the number of people with health insurance, and the increase in the cost of medical technology. Many of these factors are difficult to control, and it is likely that health care costs will continue to rise in the future. However, there are also some things that can be done to control costs, such as improving the efficiency of health care delivery and reducing waste.


58 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).

59 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.

60 William J. Baumol, Health Care, Education and the Cost Disease: A Looming Crisis for Public Choice, 77 PUB. CHOICE 17, 17 (1993).
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 a problem. Similarly, high costs due to labor intensity is not a problem to the extent that it is 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 simply to say that governments spend a lot on health care, and they are projected to spend even more in the future.\(^{61}\)

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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 around 37% by 2007.\(^{62}\) 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.\(^{63}\) If society wants wide provision of a cheap good, it may not need

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\(^{61}\) CBO on budget outlook.

\(^{62}\) See Kenworthy, supra note 25, at 10, 82. This figure includes federal, state, and local government.

\(^{63}\) The question 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 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 just to those with high spillovers. These are the goods that standard public finance imagines that governments will provide, see, e.g.,
to do much more than provide a private market. But if the social good is expensive, low-income individuals may not be able to afford the good, and even middle-income individuals may react adversely to the good becoming a larger share of their budgets. 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 or simply stop providing them altogether. 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.

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, non-excludable, non-rivalrous public goods is rather small. Second, the existence of spillovers does not help, since nearly all goods have some spillovers. See Peter O. Steiner, Public Expenditure Budgeting, in The Economics of Public Finance 247 (Alan S. Blinder & Robert M. Solow, eds., 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 reflect broad normative conclusions. See, e.g., Richard A. Musgrave & Peggy B. Musgrave, Public Finance in Theory and Practice 78 (4th ed. 1984) (discusses “merit goods,” which are simply those “which society (as distinct from the preferences of the individual consumer) wishes to encourage,” and thus subsidize, even though the goods maybe rival or excludable, and thus technically “private”); Steiner, supra (“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.”).

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.

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. While 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 60, 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.
IV. 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 Affordable Care Act 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 in order 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 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.

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.66

Mandates raise important liberty concerns, however, and have proven to be politically and legally difficult (though not impossible) to implement. The set of goods that could politically tolerate a mandate may be relatively small.67 But one could take a carrot, rather than stick, approach, through the use of subsidies and other forms of encouragement. Economically, subsidies and mandates may not be that different,68 but using subsidies to drive uptake complicates their role in a quasi-public spending program, and also the relationship between the quasi-public program and the central public finance system.

First, as noted below, subsidies are more directly used for altering the distributional effects of the spending. 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 everyone, not merely those who cannot afford to pay a market price, then the quasi-public 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,69 so it’s not surprising that general taxes would need


67 Though some mandates may be “social,” in the sense that society mandates the purchase of the good, even if government does not. This is somewhat the case for, e.g., higher education, which acts a gateway to particular jobs and professions. See supra Section II.B.

68 As frequently noted during debates around the Affordable Care Act, 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 purchased health insurance. The credit would appear as a subsidy, but the end result would be the same—those who did not purchase health insurance would pay an additional net amount to the government. Prior to National Federation of Independent Business v. Sebelius, 567 U.S. ___ (2012), there was some doubt about whether the ACA individual mandate was constitutional. See, e.g., Randy E. Barnett, Commandeering the People: Why the Individual Health Insurance Mandate is Unconstitutional, 5 N.Y.U. J. L. & LIBERTY 581 (2011). But there was never any doubt that an economically equivalent system of simply raising everyone’s taxes, and then providing a credit for those who purchased insurance, would have been constitutional. See, e.g., NFIB, 567 U.S. at ___ (Scalia, Kennedy, Thomas, and Alito, JJ., dissenting) (slip op. at 10).

Subsidies and mandates can, however, differ in terms of their abilities to achieve optimal social outcomes in the regulatory context, but the literature on Pigouvian price instruments vs. quantity regulation is beyond the scope of this paper. See, e.g., Brian Galle, Tax, Command … or Nudge? Evaluating the New Regulation, 92 TEX. L. REV. 837, 843-47 (2014); Louis Kaplow & Steven Shavell, On the Superiority of Corrective Taxes to Quantity Regulation, 4 AM. L. & ECON. REV. 1, 4 (2002).

69 Id.
to go up in this case—but that would mute somewhat the effect of keeping the program off-budget.

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. It would allow the relative burdens of paying for the good to be distributed in a progressive way, as if the good were paid for out of general revenue. This is particularly important for services that suffer from high costs, since the problem is precisely that many people cannot afford to pay the true cost of the service, even if the average person could.

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 also to 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 one state has been permitted to use Medicaid subsidies under the ACA to pay for private health insurance plans.

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70 MUSGRAVE, supra note 66, at 17. The split is not quite this simple, however. The Allocation Branch may still use progressive financing if, e.g., the benefits of the good rise with income. Id. at TK. To the degree that the distributional adjustments in quasi-public spending are actually an attempt to measure benefit, then the adjustments would still be a part of Musgrave’s Allocation Branch. See Brooks, supra note 38, at TK (analyzing the benefits that flow from income-driven repayment).

71 See infra Section II.A.

72 Brooks, supra note 38, at TK.

73 See Lewis Krauskopf, U.S. Clears Arkansas Medicaid Expansion Proposal, REUTERS (Sept. 27, 2013), available at http://www.reuters.com/article/2013/09/27/us-usa-medicaid-arkansas-idUSBRE98Q0WM20130927. A similar plan in Iowa was approved by the federal government late last year. See Greg Sargent, Another Potential Boost for Obamacare, WASH. POST (Dec. 10, 2013), available at http://wapo.st/1d6XwVj (Iowa’s Medicaid expansion plan “would use federal money to expand coverage to poor Iowans by financing their premiums through the private market.”). New Hampshire and Pennsylvania are contemplating similar plans. See Jess Bidgood,
QUASI-PUBLIC SPENDING

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.

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 essentially privatization with a heavy dose of rent-seeking.

B. Distinguishing Quasi-Public Spending From Similar Programs

As noted earlier, 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 between what is and is not a quasi-public spending program. Furthermore, even programs very 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 other similar forms of government action.

Quasi-public spending 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

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New Hampshire: Deal Reached on Medicaid Expansion, N.Y. TIMES, Feb. 7, 2014, at A15, available at http://nyti.ms/1g1g3oX (New Hampshire “State senators said Thursday that they had reached a bipartisan deal on a framework to expand Medicaid to about 50,000 low-income adults. Under the agreement, the state will use federal money to buy private insurance, similar to a method adopted last year in Iowa and Arkansas.”); Amy Worden & Don Sapatkin, Tom Corbett’s Final Medicaid Expansion Plan: Gentler, But Still an Outlier, MEDCITY NEWS (Feb. 20, 2014, 9:18 AM), http://medcitynews.com/2014/02/tom-corbetts-final-medicaid-expansion-plan-gentler-still-outlier/ (Pennsylvania “seeks to use federal Medicaid dollars to subsidize commercial insurance for hundreds of thousands of uninsured Pennsylvanians.”).

The idea of using Medicaid funding to purchase private insurance is not new. See Sara Rosenbaum & Benjamin D. Sommers, Using Medicaid to Buy Private Health Insurance—The Great New Experiment?, 369 NEW ENGL. J. MED. 7, 8 (2013), available at http://www.nejm.org/doi/full/10.1056/NEJMp1304170 (“Since 1965, Medicaid has authorized the secretary of health and human services to use federal funds to pay insurance premiums in states that elect such an approach.”).
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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 is ultimately about financing of a good, not necessarily who provides it.

Quasi-public spending also does not encompass all government subsidization of private spending. The government of course subsidizes many things for public policy reasons, including food, housing, charitable spending, transportation, finance, and so on. The simplest explanation (other than rent-seeking) is simply that these are (roughly) Pigouvian subsidies to account for positive externalities. Thus the government is simply altering the private market price in order 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. Thus, although, e.g., housing and agricultural subsidies are important government programs, they do not dominate their spaces in the same way that government-subsidized health insurance and federal student loans dominate their respective spaces. That said, as noted 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.

V. Comparing Quasi-Public Spending and Direct Public Spending

The examination of health insurance and higher education financing in Part II, plus the analysis in the prior Part on the component pieces of quasi-public spending lead to several broad conclusions 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.

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 despite the fact that the direct payments from individuals to providers may be mandated in the same way as tax payments, and also that 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, discussed below.
1. Exceeding Budget Constraints

As discussed in Part III, 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. The fact that our two most recent large public spending programs—the Affordable Care Act 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 much 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 to pay for them. Thus, the big-government objection may be more about fears of a too-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 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 between those who believe that, if the choice is between a tax expenditure and no expenditure at all, the tax expenditure wins. The difference with quasi-public spending is that we have a tax expenditure budget, but we do not 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 from lack of budgetary oversight. This is especially important because, as Subsection V.D

74 See KENWORTHY, supra note 25, at TK; MICHELMORE, supra note 125, at 2 (citing survey data).
75 Compare, e.g., Burman & Phaup, supra note 21, with John L. Buckley, Tax Expenditure Reform: Some Common Misconceptions, 132 TAX NOTES 255 (July 18, 2011).
discusses below, the fact that payments are not nominally taxes does not immunize them from having the distortionary effect 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. As noted above, 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 our 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. The fact, for example, that 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, tells us little about whether government is crowding out individuals’ economic activity or liberty.

How these two effects 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 while 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 continue to treat the nominal size

76 See supra Part III.
77
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 Pay As You Earn 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 generally.

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 outside of the 10-year budget window. Keeping the direct government outlays related to the program smaller can therefore make reconciliation—and thus passage—more likely, aside from any of the political optics.

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 Obamacare, 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 themselves directly collected the premium payments and then distributed them to providers. Because of that more direct role for the alliances, the Congressional Budget Office ruled that the alliances were not private entities, but rather agents of the government, and therefore that payments to the alliances would be considered federal receipts (even 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

78 Warren, Dynarski, etc.
80 See Congressional Budget Office, An Analysis of the Administration’s Health Proposal (Feb. 1994), at 20. Large employers could have set up their own corporate alliances, but most spending would have run through an alliance of one sort or another.
81 Id. at 44-49.
82 Id. at 50.
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political obstacle. Moreover, the proposal then became subject to the more specialized, and difficult, procedural rules under the 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 Affordable Care Act 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’s 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 of new institutions to carry out the activity, CBO concludes that the boundaries of regulation have been crossed.

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

the 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.

The reason the CBO’s test gave the ACA bill drafters a way out is that 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 on this Article. One could imagine a program that involved exactly 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


86 CBO, supra note 81, at 46.

87 CBO, supra note 86, at 4.
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 the CBO would have scored those taxes as “taxes” and the spending on vouchers as “spending.” Thus, it seems that the degree of control and choice, although very 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 the 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 in order to achieve a similar result as simple tax-and-spend. 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.

The fact that government programs have increasingly taken on this sort of “hidden” structure has not gone unnoticed. 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 disconnection between the role of the programs and the role of government in general.89 (We might call this the “Keep government’s 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 the fact the certain privatization programs essentially redistribute tax money from the beneficiaries of the program to the shareholders of the government contractor providing the program.90

On the right, scholars are also concerned about the inefficiencies that go along with complexity and collective provision, but more because keeping such bloat off-budget makes the government looks leaner than it really is and allows for a silently expanding state. They also worry about behavioral distortions, but by the beneficiaries of the subsidies and other programs in addition to the providers.91

89 See, e.g., HACKER supra note 14; METTLER, supra note 12; MORGAN & CAMPBELL, supra note 13.
90 See METTLER, supra note 12, at 18.
91 See, e.g., Teles, supra note 17.
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These are all serious and important concerns that policymakers should take into account. However, I also think that the issue is itself more complex than prior commentary paints it. For the reasons that follow, I believe that the complexity of a quasi-public spending should not necessarily rule it out 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, it 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. 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.

Similarly, there is no guarantee that direct public programs be simple. The Tax Code alone is a good place to start to see the complexity that can be associated with direct government activity. Or consider the complexities of administrative procedure and rule-making, 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 backstopping, 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 this same legislation actually made the student loan program more of quasi-public spending program in my view, by expanding income-driven repayment. Thus, it is not the quasi-public structure itself that forms the basis of the objection, but rather the hidden rent-seeking.

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92 A straightforward program still may require some serious legal and technical expertise to operate effectively, even if the effects of the program are clear.
93 See KENWORTHY, supra note 25, at 109.
94 NETTLER, supra note 12, at 86.
95 The Income-Based Repayment program was greatly expanded by the same bill, but Mettler does not mention IBR in her discussion of the bill and its effects.
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That said, one way to make any social program simpler is to make the benefits more universal and less dependent on income.\textsuperscript{96} 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,\textsuperscript{97} or the high rate of EITC audits.\textsuperscript{98} If instead the benefits were universal, regardless of income, much of this work would be unnecessary. Social Security is a prime example, with its universal benefit and its low administrative costs.\textsuperscript{99} While the Social Security benefit formula is progressive,\textsuperscript{100} 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{101} though others say the benefits from a more paternalistic approach are often worth the costs.\textsuperscript{102}

A fuller discussion of the relative benefits of universal vs. means-tested programs is beyond the scope of this paper.\textsuperscript{103} However, it is worth noting that universal does not mean regressive—a system can still be progressive even while providing the same size benefit to everyone. This is because, first, the benefit will still decrease as a share of income as income rises,\textsuperscript{104} and, second, revenue for the program can still be disproportionately raised from those with higher income.\textsuperscript{105} That said, to add more progressivity beyond that would require limiting benefits to high-income individuals.\textsuperscript{106}

\textsuperscript{96} See, e.g., MICHAEL J. GRAETZ & JERRY L. MASHAW, TRUE SECURITY 38-41 (1999) (discussing universalism in social insurance).
\textsuperscript{98} The IRS estimates that the improper payments rate as a percentage of total payments is between 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., INTERNAL REVENUE SERVICE DATA BOOK 2012, at 22 (2013).
\textsuperscript{99} 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 1989-2012. See Social Security Administrative Expenses, SOC. SECURITY ADMIN., http://www.ssa.gov/OACT/STATS/admin.html (last visited Mar. 30, 2014).
\textsuperscript{100} See 42 U.S.C. § 415(a)(1)(A) (calculating primary insurance amount as a decreasing percentage of average indexed monthly earnings).
\textsuperscript{101} See, e.g., ARCHIBALD & FELDMAN, supra note 56, at 214.
\textsuperscript{102} See, e.g., KENWORTHY, supra note 25, at 145-46.
\textsuperscript{103} For a fuller discussion, see, e.g., GRAETZ & MASHAW, supra note 96.
\textsuperscript{104} A flat-amount benefit becomes a smaller fraction of income as income rises.
\textsuperscript{105} See KENWORTHY, supra note 25, at 80.
\textsuperscript{106} See, e.g., Richard A. Musgrave, Fiscal Tasks, in BUCHANAN & MUSGRAVE, supra note 53, at 72, 79.
2. **Opacity and Clarity**

There is, however, another dimension to complexity, which we might call second-order complexity or opacity. That is, 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, that in some circumstances having a more direct connection between the good and the payment could actually increase awareness, understanding, and civic engagement. 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 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. This was, for example, the explicit purpose of keeping Social Security separate from general revenues, funded with a dedicated tax. By clearly tying the retirement benefit to the taxation structure, Social Security has achieved an impressive level of political strength (even while almost no one actually understands the complex benefit formula).

On the other hand, highlighting the redistributive, 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. Thus paying back a student loan—even a public, subsidized one—may appear to be a mere contractual payment from one party to another. But introducing a progressive income-driven element, as the Pay As You Earn program has, makes it appear more tax-like. And paying a tax is more clearly a collective enterprise—“buying civilization,” as it were.

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107 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’m grateful to Larry Solum for this suggestion.

108 Michelmore.

109 See, e.g., MICHELMORE, supra note 125, at 5-6.

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, while too much redistribution decouples the connection between the payment and the benefit. A person calling to keep government’s 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. This will also be a challenge to policymakers making use of quasi-public spending.

3. Choice, Liberty, and Subsidiarity

For those on the right especially who fear a silently expanding state without pushback from voters, the complexity of 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 funneled through an agency’s budget. Thus, for example, we have many private health insurance companies competing on exchanges rather than a single government health service, and a robust market of both public and private institutions of higher education rather than a centralized education agency.

Some have argued that the mandates involved in the Affordable Care Act are an intrusion on liberty, 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.

Above, I criticized the CBO’s methodology in scored the Affordable Care Act for focusing on issues of government control and consumer choice, rather than financing. But, as I stated there, power and choice are still extremely important in policy design generally, and in some cases quasi-public spending may allow for somewhat less centralized government power and somewhat

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111 This ties in with the discussion on the distortionary effects of taxation, infra Section V.D.
112 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.”).
113 See, e.g., Barnett, supra note 68, at 605 (arguing that the government forcing individuals to spend money with a private company is more constitutionally suspect than simply taxing them).
115 See supra Subsection V.A.3
more consumer choice—particularly if policymakers are following CBO’s methodology to avoid a budget score.

Thus, while a strictly mandated program involving purchase of highly-regulated goods from entities with heavy government oversight may be indistinguishable from direct public spending, the more likely scenario is like the U.S. 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). Thus quasi-public spending has the potential to preserve a degree of individual choice, localism, and subsidiarity, at least as compared to direct public spending.\textsuperscript{116}

That said, a different landscape of providers could lead to a different conclusion. Arguably concentration of wealth and power in large corporate form is more damaging to democracy than a similar concentration of wealth and power in government.\textsuperscript{117} 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 little 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. An Historical Trend

Complex and opaque policies may not be ideal, but they may also be simply how the United States does policy. There is a large literature explaining how the United States has throughout its history often take a hidden or disguised approach to government spending, and government power generally, particularly at the federal level, often by delegating that power to other actors.\textsuperscript{118} 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

\textsuperscript{116} 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).


\textsuperscript{118} See, e.g., BALOGH, supra note 27; Clemons, supra note 15.
otherwise out of sight\textsuperscript{119} (and, furthermore, many states heavily regulated for the general welfare\textsuperscript{120}).

Scholars such as Brian Balogh have argued that the \textit{laissez-faire} and “economic freedom” ideas embodied in, e.g., the \textit{Lochner} decision,\textsuperscript{121} did not derive from a historical understanding of America’s legal origins. Rather, \textit{laissez-faire} only became dominant in the relatively short period between the end of Reconstruction in 1877 and the Panic of 1893.\textsuperscript{122} The more explicitly active federal government that thereafter emerged in the Progressive Era and, especially, the New Deal may have have appeared to be something new, but was actually consistent with earlier government intervention and regulation—it was just the \textit{manner} of intervention that was different. The difference was just that the federal government began doing more of what the states and localities had once done,\textsuperscript{123} and it did it more directly, rather than indirectly.\textsuperscript{124}

But the American approach to more out-of-sight regulation, particularly on distributional issues, continued. Much of the New Deal itself was explicitly designed to mask the degree of redistribution in programs such as Social Security.\textsuperscript{125} 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{126} And even early Progressive Era reformers emphasized a

\textsuperscript{119} The government action also focused on issues like internal improvement; regulation of borders and territories; financial, economic, and market regulation; and morality. Thus while the state was always active, it was fiscally light, since it focused more on regulation of private behavior than on direct provision of goods. \textit{See, e.g.,} BALOGH, supra note 27, at 151 \textit{et seq.} (discussing borders and territories); LARSON, supra note 27, 3-7 \& \textit{passim} (2001); NOVAK, supra note 27, at 83 \textit{et seq.} (1996) (discussing market regulation) \& 149 \textit{et seq.} (discussing morality regulation).

\textsuperscript{120} \textit{See, e.g.,} NOVAK, supra note 27 (showing that the “well-regulated society” was a central concern of colonial and early state governments).

\textsuperscript{121} \textit{Lochner v. N.Y.}, 198 U.S. 45 (1905).

\textsuperscript{122} \textit{See BALOGH, supra note 27, at 14-17, 309-15; NOVAK, supra note 27, at 239-41.}

\textsuperscript{123} \textit{See, e.g.,} NOVAK, supra note 27, at 42-50 (discussing the state common-law roots of the “well-regulated society”).

\textsuperscript{124} \textit{See, e.g.,} BALOGH, supra note 27, 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 “strong and more competent governments in early American history” because slaveholders often saw government power and competence as a threat to their interests and acted to prevent it. ROBIN L. EINHORN, AMERICAN TAXATION, AMERICAN SLAVERY 7 \& \textit{passim} (2006). That said, the state-sanctioned power to own another human being is, in a sense, an extreme form of economic regulatory power.


\textsuperscript{126} \textit{See, e.g.,} Michelmore, supra note 125, at 152-160. Surrey.
cooperative approach, involving state and local governments as well as private organizations, rather than simply top-down federal regulation.\footnote{See Balogh, \emph{supra} note 27, at 353, 384; Howard, \emph{supra} note 16, at 11-12 (noting that the size and scope of tax expenditures derive in part from underlying changes in tax rates and other policies); Michelmore, \emph{supra} note 125, at 37-39; Surrey.}

Quasi-public spending could be viewed as the latest iteration of this American approach to hidden government regulation. It differs from some earlier versions of hidden government action in that quasi-public spending, as I describe it, is particularly focused on provision of goods, and not about broader economic regulation or redistribution. The earlier forms of out-of-sight regulation that historians and scholars of government have focused on thus far relate more to market regulation, state power, and risk-sharing and -shifting, for example,\footnote{Moss.} rather than 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 necessarily 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 concentrative on the ends—redistributive, just, representative—rather than bogging down in battles over the means—“statist,” conspicuous, and centralizing.\footnote{Balogh, \emph{supra} note 27, at 397.}
\end{quote}

\section*{C. Existing Markets and Institutions}

Both the Affordable Care Act and income-driven student loans are iterative changes to an existing set of health care and higher education institutions, respectively. These 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 is also in contrast to direct public spending. Even if the providers remained the same, the market would be drastically different if the government become the direct purchaser of the good.\footnote{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. If a voucher program were implemented that had the same effect as}
Although certainly we would not describe these markets—either before these policies or after—as purely competitive, they still have many of the benefits of competitive markets. For example, 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 that government agencies have with the information demanded to price or otherwise configure regulatory instruments. A government agency tasked with, e.g., 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.131

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 provide a way to 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 institutional structure may not be well suited for quasi-public spending. For example, it may be that quasi-public spending works best as an overlay on large private markets and institutions,132 but may not work as well as an adjustment to some largely public structures.133 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 nature and reliance on local property taxes for funding.134

D. Flexible Structure

A direct public spending program generally raises money through the tax system, and then spends the money on the provision of a good or service. That the Affordable Car Act, it likely would also take advantage of the existing market in the same way the ACA does.

132 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, AND LONG-TERM CARE IN AMERICA (Victor R. Fuchs, ed., 1996) 277, 291 (stating that “[m]andates require a well-functioning private market for the mandated good or service if they are to succeed”).
133 Acknowledging, again, that institutions exist on a private-public continuum. See supra note 9 and accompanying text.
134 See infra Section VII A.
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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.\(^{135}\) Quasi-public spending, by contrast, requires the use of several different instruments to get the same effect. While this leads to some of the complexity discussed in Section V.B above, it 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, 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. 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.\(^{136}\) The combination of the tax and the good would leave them no worse off, and perhaps better off.\(^{137}\) 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.\(^{138}\) 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, then we would “obtain the standard distortionary result” as from typical taxation.\(^{139}\) 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

\(^{135}\) More complex structures are possible, of course, particularly if the direct public spending program uses a dedicated tax and/or it has a complicated means-tested benefit formula.


\(^{137}\) If the good was already in their consumption bundle before being publicly provided, then their consumption bundle and budget constraint would be basically unchanged—the money that went to the good now goes to taxes, but the rest of their consumption bundle is the same. If the good is a new one, then at worst they receive no utility from it, but the tax is essentially a lump-sum tax, and therefore has no substitution effect—it doesn’t affect their 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 132, 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 their prior consumption toward the taxes for the good.

\(^{138}\) Summers, supra note 137, 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.”).

\(^{139}\) Kaplow, supra note 136, at 516.
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 retaining existing markets and institutions, and also out of a desire to hide somewhat 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 low end, 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 graduate tax—indeed, the only core difference is that a graduate tax would be mandated, while loans are opt-in. But Pay As You Earn asks borrowers to pay using essentially just two payment brackets—0% for income less that 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, as opposed to many means-tested transfer programs. There is thus far less net redistribution under Pay As You Earn 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 just 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 for 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 just 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 group. To be clear, however, this does not mean that there would not still be potential distortions from the degree of redistribution

140 See Summers, supra note 137, at 181 (“Without close links between taxes and benefits, that tend to be lacking in public programs, large distortions can result.”).
141 I.R.C. § 1.
142 See Poterba, supra note 132, at 291 (“[O]pen-ended mandates avoid distorting the behavior of higher consumption households.”); Summers, supra note 140, at 180-81.
143 See Poterba, supra note 132, 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.”).
Countering this is the general conclusion of the economics literature in optimal taxation that commodities should be taxed uniformly when an income tax is available to handle distributional adjustments. 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. 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.

An additional feature that could affect the degree of economic distortion in a quasi-public spending program is salience. If the distributional adjustments embedded in a quasi-public spending program are less salient than an equivalent tax would be, then there may be less effect on behavior for the same degree of redistribution. 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. If those higher interest rates are less salient than taxes, than income-driven repayment could fund higher education subsidies with less distortion than tax-funded grants.

VI. 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 theory and framework for when policymakers should consider employing a quasi-public spending model. This is, of course, merely a first step, and I hope that 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 that: first, the good or service and its value can be clearly identified, and thus that there is at least an approximate market price for the good or service; second, the identified private benefit is large relative to the diffuse public benefits; third, the pool of potential consumers is large and diverse, especially

145 Rosen & Gayer, Kaplow, Boadway, etc.
147 See, e.g., KAPLOW at 135 (qualifications to A-S), 175-77 (discussing reasons why in-kind transfers may be preferable, including myopia on the part of beneficiary groups, externalities surrounding particular goods, correcting of suboptimal parenting choices, and encouraging goods complementary to labor to offset work disincentives from taxation generally).
148 See generally Deborah H. Schenk, Exploiting the Salience Bias in Designing Taxes, 28 YALE J. ON REG. 253 (2011); Gamage. Add more about elasticity affecting DWL formula.
149 Brooks, supra note 38, at TK.
across income groups; and, fourth, there is an existing set of institutions, public or private, already providing the good.

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 adjustment 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, since 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 able to capture and describe as single goods with prices—they aren’t 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 share 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 paper 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. And 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 separability and pricing of the good is the idea that the goods should have relatively large private benefits relative to public benefits. First, this is part of the reason for 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. That is an alternative—and non-contradictory—form of public intervention, but it serves a different purpose then 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 very good investment, for example.\textsuperscript{150} 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.\textsuperscript{151} 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.\textsuperscript{152} Quasi-public spending would reflect a decision that a distributional adjustment is justified in order to enable such people to be able to purchase the good, but it would not be questioning the underlying pricing and value.

Second, a large private benefit allows separating the provision of the good from the central public finance system. Where an individual’s benefits are just 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 simply a purchasing agent for a discrete good, the total social benefit of which is largely just the sum of individual’s direct private benefits, there is no need to agglomerate the good together with other government-purchased goods. This is not to say, however, that it’s superior to create a separate financing mechanism, however—only that it’s 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 poor—or else why bother?—and rich—or else where will the money come from? Many types of social programs would fail this test, of course. Consider traditional welfare payments,

\textsuperscript{150} See Brooks, supra note 38, at TK.
\textsuperscript{151} See supra note 140 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, while still having some insurance element, see John R. Brooks, \textit{Fiscal Federalism as Risk-Sharing: The Insurance Role of Redistributive Taxation}, 68 TAX L. REV. 89, 94-101, are also in large part an ex ante transfer, since 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.
\textsuperscript{152} On the relevance of myopia to the decision of whether to provide goods in kind, see, e.g., Kaplow, supra note TK, at 175-76; Summers, supra note 137, at 179 (noting the similarities between paternalism and Musgrave’s notion of “merit goods”).
for example. Even if it were possible to determine a market price for the services, asking the participants themselves to fund the program would obviously defeat the purpose. Which is why purely redistributive transfers belong within the central public finance system. While 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, income risk 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, for a large enough group to shrink the overall variance, and, second, for the risks of low (and high) income to be largely uncorrelated across individuals. If the pool has these features, then collective, progressive provision of the good or service can be effective. Health care, since it covers literally every person, satisfies this condition easily. And while the group of higher education recipients is smaller than the group of health care recipients, it also skews toward higher income, which means lower risk and sufficient resources to spread what risk there is at a reasonable cost.

D. Diverse Network of Providers

Finally, in addition to there being a market price for the good, there ought to be an existing diverse network of providers of the good, public and private. First, this is a corollary to the first point, that there ought to be an identifiable good with a (more or less) market price. That implies a somewhat competitive market, rather than 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 network of providers and institutional structure. 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, and related, creating or encouraging new entities to provide the good risks triggering the problems CBO identified in 1994—if the providers owe their existence entirely

153 On the connection between taxation and social insurance, see Brooks, supra note 151, 94-102.
to government, they may be better thought of as government agents, and therefore perhaps less likely to compete on price and quality.\textsuperscript{154}

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

VII. 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 not very amenable to technological improvements to boost productivity.\textsuperscript{155} 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 take up a larger and larger share of overall spending. In many ways it is a classic example of Baumol’s cost disease and the problem of low labor productivity growth.\textsuperscript{156}

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 mean asking families with children to pay schools directly as costs go up, rather than put those costs on property owners in general. And the payments themselves would be partly a function of income, so as to be progressive and ease the burden 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

\textsuperscript{154} Other examples: private prisons, UK trains.
\textsuperscript{155} I do not know of a serious suggestion that there be online distance learning for Kindergarten.
\textsuperscript{156} See supra Section III.C
property taxes, a quasi-public spending program similar to the Affordable Care Act 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 likely not to have the income diversity needed to have effective distributional adjustments. The pool of participants would instead have to be at the state or national level. But, second, even a national program would rely on an imperfect pool if it included only families with children currently in school, since these 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 just to families with school-age children might tighten the connection between cost and benefit, it would be a dramatic, and likely regressive, change.

To make such a program work, therefore, there would have to be revenue raised from relatively high-income people without children outside of low-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 its current financing structure, not the overall level of resources. The national per-pupil average annual spending is over $12,000, well above the OECD average, 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 thus more important than finding ways to finance an increase in the 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 is. 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 thus in need of more funds. In 2013, only 68% of 4-year-olds attended some form of preschool, yet research has now made very clear the


159 Nat’l Ctr. for Educ. Stat., Digest of Education Statistics, Table 202.10: Enrollment of 3-, 4-, and 5-year-old children in preprimary programs, by age of child, level of program, control
importance of some sort of education for preschool-aged children. And child care generally is also 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-K. New York State, in particular, has recently begun an ambitious universal pre-K expansion, and other states may follow. And an important innovation of some of these programs is using state income tax revenue, rather than local property tax revenue, to fund the expansion—that 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 since high-income people could choose free public pre-K in New York if they wished.

Universal pre-K could instead take a different approach, more like the Affordable Care Act. Families could purchase pre-K and child care in the private market, but with income-based subsidies for those with lower income. The subsidies could come in the form of a voucher, tax credit, or could even be sent directly to schools, much like the ACA does for health insurance companies. That approach would likely have a much lower budget cost than the $1.5 billion over five years that New York State is projected to spend on universal pre-K. The necessary revenue might come from just an incremental tax on high incomes, in order to have the distributional element of a quasi-public spending program, or the revenue could come from a higher list price for the service.

161 See Section VII.A.
much like for higher education.164 Interestingly, New York City Mayor Bill de Blasio originally proposed during his campaign to pay for expanded early-childhood education with a small tax increase on incomes above $500,000.165 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 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 very 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.166 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.167 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 the distributional consequences. Indeed, an important difference between the typical voucher proposal and a quasi-public spending program is that the typical voucher is just a lump-sum substitute for full, direct public spending—providing individuals with a voucher equal to the average per-pupil cost. The purpose of such vouchers is only an attempt to use a market mechanism, rather that political or agency decision, to allocate the funds.168 In a quasi-public spending program, however, the voucher would instead cover only the distributional correction needed to make the purchase reasonably affordable.169

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164 If the latter, than the subsidies would happen partly at the school level, through increased financial aid.
166 Another issue would be quality and accountability, since a voucher program would still rely on private providers. Experience with voucher programs for K-12 education shows that this is a very real concern. Thus there would be a need for regulation and oversight, noted in Section IV.A, though, of course, so would expanding public early childhood education.
167 See generally, State Preschool Yearbook, supra note 160.
168 Another purpose may be to use public funds to pay for religious education. CITE.
169 This is similar to the design of the premium assistance tax credit under the Affordable Care Act, where the credit is the difference between the cost of the “applicable second lowest
C. Legal Services

I would be remiss in discussing the risks of high costs in a legal publication without mentioning the effect on legal services. Like education and health care, the legal industry has relatively low productivity growth, and thus has costs rising faster than average. While technology supplies some boost—legal research, for example, takes much less time—a given associate can still only read so many contracts or draft so many briefs in a day (despite what law partners might think). 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 doesn’t 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 just about every interaction between individuals and business entities in the modern world, not to mention access to our system of justice. They are an indispensable part of the modern regulatory state. While 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 is thus arguably the sort of 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.

cost silver plan” and an applicable percentage of the taxpayer’s income. I.R.C. § 36B(b)(2)(B). 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, e.g., proposals to simply give every citizen a fixed insurance voucher amount. See, e.g., Congressional Budget Office, A Premium Support System for Medicare: Analysis of Illustrative Options, at 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).

171 Indeed, ironically, increasing the use of quasi-public spending may mean an increasing role for lawyers, since they could in effect be the government’s agents for implementing a particular policy through private actors.
172 It feels incredibly quaint and naïve to write this sentence, given how clearly income and wealth do correlate with access to legal services. But that doesn’t mean it’s appropriate.
173 It should be noted however, that the positive externalities from legal services are perhaps less obvious or salient than for education. Probably almost everyone agrees that everyone benefits from an educated populace, but it’s not as immediately clear that everyone benefits from someone having a lawyer help 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
QUASI-PUBLIC SPENDING

The medical industry once faced a similar problem, but solved it (for a while) with health insurance. There have been proposals for legal insurance, but they’ve never really gone anywhere, largely out of moral hazard concerns. 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. While we could of course 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 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 Affordable Care Act or Pay As You Earn. If attorneys have a substantial pro bono requirement for example, that might result in 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, neither of these proposals is particular novel. But it is perhaps novel to see them not merely as ways to expand access to justice, but as a way to collectively purchase a more socially optimal amount of legal services in the face of high costs.

VIII. Conclusion

This Article has introduced the concept of quasi-public spending to describe a new approach in 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 is descriptive of both the Affordable Care Act and income-driven student loan repayment for higher education. While 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.

purposes of laws—these are all things that society benefits from, as well as the clients themselves.


175 See id. at 425-36.

176 For example, New York State now requires 50 hours of pro bono work to qualify for the bar exam. 22 N.Y.C.R.R. § 520.16.
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 clearly on-budget and funded directly out of tax revenue. The standard argument that citizens ought to clearly 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. While quasi-public spending is not suited for all government activity, it nonetheless is a tool that policymakers, and academics, should take seriously.