

# Piketty & Economic Inequality

Choice, Commerce, and Conflict  
Ryan Doody

## AGORA LECTURE: Jeremy Waldron

Friday, November 12th 6pm Eastern  
Time

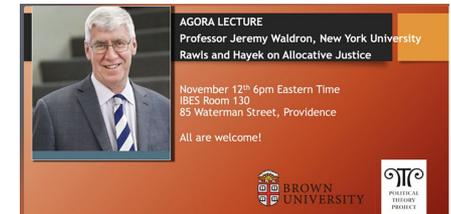
Professor Jeremy Waldron (NYU)

IBES Room 130

85 Waterman Street, Providence

He will discuss "Rawls and Hayek on Allocative Justice"

All are welcome!



AGORA LECTURE  
Professor Jeremy Waldron, New York University  
Rawls and Hayek on Allocative Justice

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85 Waterman Street, Providence

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BROWN UNIVERSITY  
POLITICAL THEORY PROJECT

## Contents:

Review: Market Failures  
Insurance & Obamacare  
Moral Hazard  
Piketty on Inequality

## Market Failure

Causes of Market Failures:

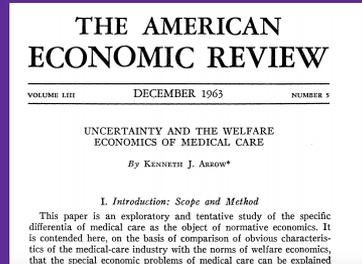
- Externalities
- Non-excludability
- Asymmetric information
- Transaction costs



### ARGUMENT FOR THE EXCHANGE CLAIM

- P1 X would be voluntarily exchanged for Y only if the person who has X (Person A) prefers having Y to having X and the person who has Y (Person B) prefers having X to having Y ( $Y \succ_A X$  and  $X \succ_B Y$ ).
- P2 If  $Y \succ_A X$  and  $X \succ_B Y$  then both A's and B's preferences are better satisfied by engaging in the transaction than by not.
- P3 Satisfying a preference makes one better-off.
- P4 No one else is affected by the exchange.
- 
- C If X is voluntarily exchanged for Y, then the participants of the exchange are made better-off and no one is made worse-off.

# Uncertainty & Medical Care



## Kenneth Arrow

American Economist  
1921-2017



## Uncertainty & Medical Care

Arrow identifies several sources of uncertainty / asymmetric information in the health care sector.

- Patient/Doctor Relationship
- Health Insurance

Arrow, "Uncertainty and the Welfare Economics of Medical Care"

## Patient/Doctor Relationship

## Uncertainty & Medical Care

### Patient/Doctor Relationship

Doctors have better information about health conditions and interventions than patients.

### What Can Be Done?

Quality Assurance with **licensing**

Relationship of **trust** between doctors and patients

# Health Insurance

## Uncertainty & Medical Care

### Health Insurance Market

Consumers have better information about their health than insurers.



## Uncertainty & Medical Care

### Health Insurance Market

Consumers have better information about their health than insurers.

### What Can Be Done?

# Obamacare



## Obamacare



The Affordable Care Act (ACA, or “Obamacare”), 2010:

- Subsidizes the cost of buying insurance
- Disallows insurance companies to discriminate based on pre-existing conditions
- **The Individual Mandate:** everyone must purchase health insurance

## Obamacare



The Affordable

- Subsidizes t
- Disallows in s on  
pre-existing
- The Individu health  
insurance



## Obamacare



The Affordable Care Act (ACA, or “Obamacare”), 2010:

- **The Individual Mandate:** everyone must purchase health insurance

Challenged by the court (2012); upheld as a tax  
Tax was made 0% in 2017.  
New court challenge

## Obamacare



LAW

### Obamacare Wins For The 3rd Time At The Supreme Court

Updated June 17, 2021 - 5:05 PM ET  
Heard on Morning Edition



Challenged by the court (2012); upheld as a tax  
Tax was made 0% in 2017.  
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## Obamacare



LAW

### Obamacare Wins For The 3rd Time At The Supreme Court

Updated June 17, 2021 - 5:05 PM ET  
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We haven't seen an insurance market "death spiral".  
Why not?

## Moral Hazard

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When you have an **incentive** to increase your exposure to risk because you no longer stand to suffer the **full costs** of that risk.



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### Principal-Agent Problem

One person (the “agent”) is able to make decisions on behalf of another (the “principal”). Their interests may diverge.



## Moral Hazard

When you have an **incentive** to increase your exposure to risk because you no longer stand to suffer the **full costs** of that risk.

### Principal-Agent Problem

One person (the “agent”) is able to make decisions on behalf of another (the “principal”). Their interests may diverge.

Insurance can create *moral hazards*.



## Moral Hazard

When you have an **incentive** to increase your exposure to risk

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# TOO BIG TO FAIL

MORAL HAZARD

## What Do You Think?



## The Fundamental Theorems

### The First Fundamental Theorem of Welfare Economics:

The allocation resulting from any **perfectly competitive equilibrium** is Pareto-efficient.

- (1) Full Information
- (2) No Transaction or Enforcement Costs
- (3) No Externalities
- (4) Traders are rational
- (5) Products are undifferentiated

## Greenwald-Stiglitz theorem

### The First Fundamental Theorem of Welfare Economics:

The allocation resulting from any **perfectly competitive equilibrium** is Pareto-efficient.

Greenwald and Stiglitz (1986) showed that the Fundamental Welfare Theorems do not hold if there are **incomplete markets** or **imperfect information**.

## Stiglitz on Inequality



## Stiglitz on Inequality

Stiglitz argues that **inequality** is **self-perpetuating**.

Economic inequality is the product of **rent-seeking**.

It leads to greater market *inefficiencies*.

NEW YORK TIMES BESTSELLER

JOSEPH E. STIGLITZ

WINNER OF THE NOBEL PRIZE IN ECONOMICS

"A searing read." —Nicholas Kristof

THE PRICE OF  
INEQUALITY

HOW TODAY'S DIVIDED SOCIETY  
ENDANGERS OUR FUTURE

WITH A NEW PREFACE

## Stiglitz on Inequality

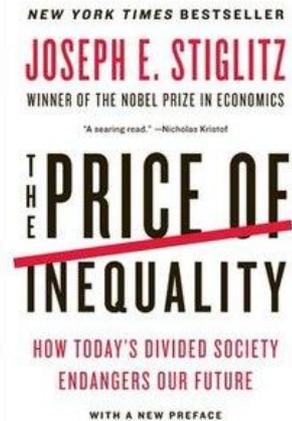
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### **Solution:**

More governmental regulation



## Piketty on Inequality



## Contents:

Activity: Piketty Film

Who Is Piketty?

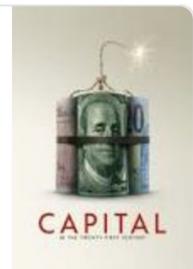
Main Ideas:  $r > g$ ,

Patrimonial Capitalism

## Activity: Piketty Film

### Capital in the Twenty- First Century

2019 · Documentary · 1h 50m



## Activity: Piketty Film



### Group Activity

In your groups, answer the following questions:

1. So far, **technology** has always produced more jobs. Will that always be the case? Why or why not?
2. Piketty worries that the 21st century will resemble the **18th/19th century**. Do you think he's right? Why or why not?
3. What's so bad, if anything, about **wealth inequality**?

## Thomas Piketty

French Economist  
1971 -



- Professor of economics at the Paris School of Economics
- Wrote the book *Capital in the Twenty-First Century* (2013)
- Argues that, under capitalism, inequalities in wealth will continue to grow larger (because  $r > g$ ).

## Piketty on Inequality

What does Piketty do in the book?



## Piketty on Inequality

What does Piketty do in the book?

- $r > g$   
The rate of return on capital is greater than growth
- **Inherited wealth** grows faster than **income**

Result: **Patrimonial Capitalism**



## Piketty on Inequality

### Patrimonial Capitalism:

"Under such conditions, it is almost inevitable that inherited wealth will dominate wealth amassed from a lifetime's labor by a wide margin, and the concentration of capital will attain extremely high levels — *levels potentially incompatible with the meritocratic values and principles of social justice fundamental to modern democratic societies.*" [pg. 26 (emphasis added)]



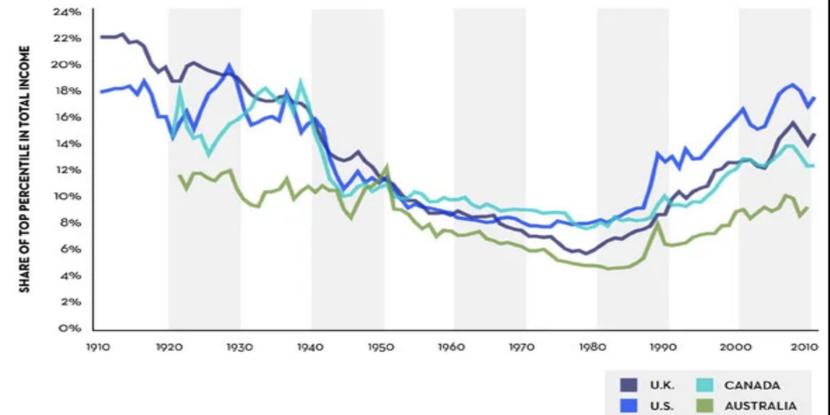
## Piketty on Inequality

Piketty compiles a lot of historical data about **wealth inequality** across the world.

### INCOME INEQUALITY IN THE UNITED STATES, 1910-2010



### INCOME INEQUALITY IN ANGLO-SAXON COUNTRIES, 1910-2010



## Piketty on Inequality

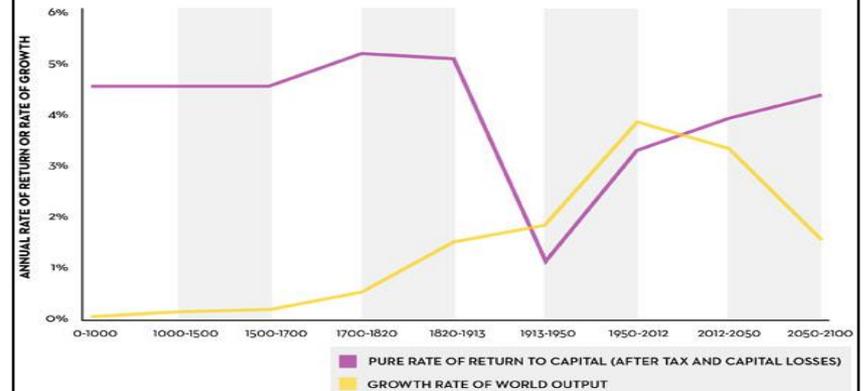
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### The U-shaped Curve

What explains the U-shape?



## AFTER TAX RATE OF RETURN VS. GROWTH RATE AT THE WORLD LEVEL, FROM ANTIQUITY UNTIL 2100



## Piketty on Inequality

### Patrimonial Capitalism:



When the rate of return on capital exceeds the rate of growth of output and income, as it did in the nineteenth century and seems quite likely to do again in the twenty-first, capitalism automatically generates arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based. (Piketty 2014, 1)

**Arbitrary and unsustainable inequalities**

## Piketty on Inequality

Piketty's proposed solution:



### A Global Wealth Tax



**Arbitrary and unsustainable inequalities**

## Review:

# Piketty on Inequality

$$r > g$$

## Patrimonial Capitalism

## Piketty on Inequality

What does Piketty do in the book?

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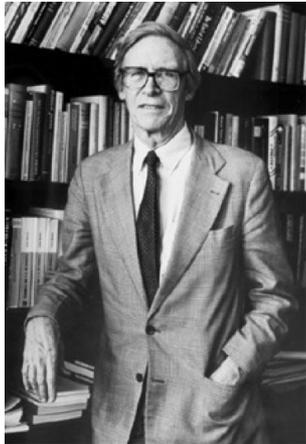
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**Arbitrary and unsustainable inequalities**







**Idea Behind Justice As Fairness:**  
"Once we decide to look for a conception of justice that prevents the use of the *accidents of natural endowment* and the *contingencies of social circumstance* as counters in a quest for political and economic advantage, we are led to [Rawls' Principles of Justice]. They express the result of leaving aside those aspects of the social world that seem *arbitrary from a moral point of view*." [14]

## JUSTICE AS FAIRNESS

1. **Equal Rights:** Each person is to be granted an equal right to the most extensive basic liberty compatible with a similar liberty for everyone else.
2. **Social Inequality:** Social and economic inequalities are to be arranged so that they are . . .
  - (a) . . . attached to positions and offices open to all under conditions of fair equality of opportunity (*Equal Opportunity*);
  - (b) . . . to the greatest expected benefit of the least advantaged (*The Difference Principle*).

## Two Principles of Justice

1. What do these two principles say?
2. Why think that these two principles are the correct principles of justice?
3. What would a society that obeys those two principles look like?

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## Two Principles of Justice

### 1. What do these two principles say?

- (a) Extensive Basic Liberties for everyone.
- (b) Equal Opportunity
- (c) The Difference Principle

**The Second Principle of Justice:** "social and economic inequalities are to be arranged so that they are both [2.(b)] reasonably expected to be to *everyone's advantage*, and [2.(a)] attached to positions and offices *open to all*." [Theory of Justice, 53]

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"Equally Open"	"Everyone's Advantage"	
	Principle of Efficiency	Difference Principle
Careers Open to All Talents	System of Natural Liberty	Natural Aristocracy
Fair Opportunity	Liberal Equality	Democratic Equality

## Two Principles of Justice

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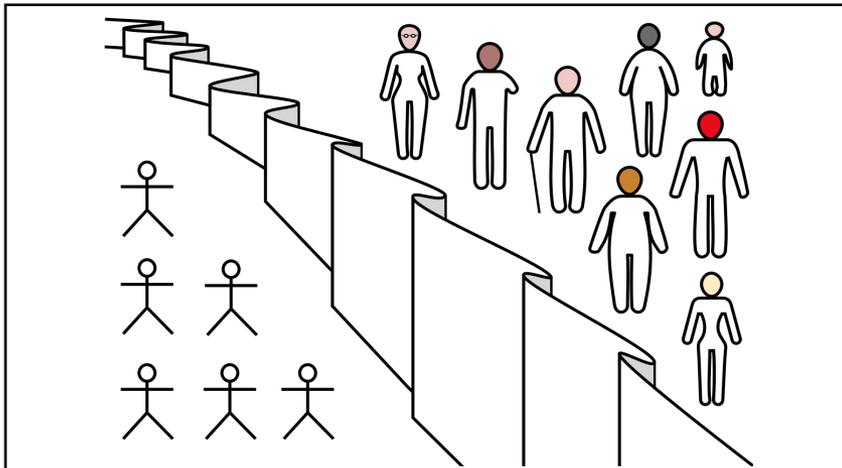
Race, gender, sexual orientation, etc. = morally arbitrary  
 Social class (wealth of your parents) = morally arbitrary  
 Which natural talents you have = morally arbitrary

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## The Original Position



## The Original Position

“By ensuring that no one knows his or her place in society ... the veil of ignorance ensures that no one can advantage, even unwittingly, of a favorable bargaining position” (A Theory of Justice)

- A **fair** and **impartial** point of view from which we deliberate about the principles of justice that should govern a fair society.
- We are to imagine ourselves deliberating **without knowing** anything about our talents, abilities, gender, religious views, sexual orientation etc.
- We do know fundamental facts about science, economics, psychology, and so forth.

# What Principles Would We Choose?

## JUSTICE AS FAIRNESS

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### DECISION IN THE ORIGINAL POSITION

	Person X	Person Y	Person Z
Society A	10	10	10
Society B	12	13	14
Society C	5	10	25
Society D	2	9	100

You don't know who you are (Person X? Person Y? Person Z?)

Which society should you choose to bring about?

**Rawls:** in this decision situation, you should *MaxiMin*.

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Which society should you choose to bring about?

**The society in which the worst off is doing best.**

## Argument for the Difference Principle

The natural talents we are born with are a matter of luck. They are **arbitrary** from the **moral point of view**.

Therefore, those who are talented do not **deserve** more of the 'pie' just because they had good luck.

But, the least-advantaged benefit from encouraging the development and exercise of some of those talents. (e.g. teachers, doctors, etc.)

Therefore, it is in the interests of the least well-off that there be an unequal distribution of resources that rewards and encourages that pool of talent.

## Why the Least-Advantaged?

A society is organized fairly when its principles can be justified **even** to the worst off in society.

From the original position, we are concerned with coming up with a social contract whose justification can be appreciated by everyone in society.

Inequalities that obey *The Difference Principle* can be justified even to the least-advantaged.

## Why the Least-Advantaged?

Inequalities that obey *The Difference Principle* can be justified even to the least-advantaged.

“Without that inequality, you'd be even worse-off!”

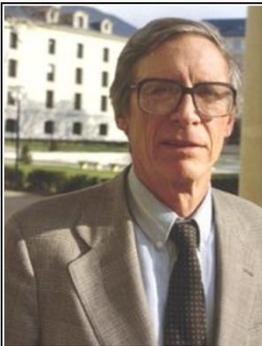
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## The Rawlsian Utopia

- Everyone is guaranteed an **extensive set of basic liberties**.
- **Fair Equality of Opportunity**: people with the same natural talents have comparable life chances.
- What economic inequalities there are obey **The Difference Principle**: they are to the expected benefit of the least advantaged.

## The Rawlsian Utopia



A just society is a society that if you knew everything about it, you'd be willing to enter it in a random place.

— John Rawls —

AZ QUOTES

## The Rawlsian Utopia

A Regulated Market

Redistributive Taxation

Social welfare programs (A wide and secure social safety net)



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— John Rawls —

AZ QUOTES

Questions?