On the Ethics of Redistribution

Redistribution policy analyses violate their own behind-the-veil-of-ignorance criterion when they ignore poor country impact

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Executive summary

Analysts of optimal policy often advocate for redistributive policies within developed economies using a *behind-the-veil-of-ignorance* criterion. Such analyses almost invariably ignore the effects of these policies on the well-being of people in poor countries. We argue that this approach is fundamentally misguided because it violates the criterion itself.

Introduction

When evaluating economic inequality, economists frequently employ the ethical principle referred to as *behind-the-veil-of-ignorance.* Originated by Nobel Laureate John Harsanyi and philosopher John Rawls, this criterion imagines the social contract that would be developed by a society of risk-averse people who don't yet know where each of them will end up in that society's distribution of income.[1] So, for example, income transfers from those with high innate skills (and therefore high incomes) to those with low innate skills (and low incomes) are justified as a type of insurance. Such transfers represent the outcome of an insurance contract the mythical behind-the-veil individual would have been eager to sign if only he had been given the chance to do so.

But such insurance schemes also have incentive effects. For instance, policy mechanisms that transfer income from highly skilled people to those with low innate skills frequently require progressive income taxes. Such policies affect incentives regarding the acquisition of skills through effort and education.

If high incomes are highly taxed, high-innate-skills individuals may have less incentive to get, say, a medical degree. Economic arrangements seen as best using the behind-the-veil criterion typically trade off such output losses against the "insurance" or welfare gains associated with transfers.

From behind the veil of ignorance, no individual could know into which country (or economic class) he or she will be born. Behind-the-veil, risk-averse people would therefore want to ensure that people born in rich countries do not adopt policies that hurt people born in poor countries. Nevertheless, analysts almost invariably ignore the effects of domestic tax policy on those in other nations. But consistent use of the behind-the-veil criterion would mean that analysts cannot treat people who live in rich, developed economies differently than they treat people who live in poor, less-developed economies.

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Are policies that purport to help the comparatively well-off (those at, say, the poverty line in developed countries) at the expense of the superlatively well-off (the rich in developed countries) desirable from the behind-the-veil perspective assuming that that perspective is global?

In particular, taking this perspective means analysts should care about *global* versus within-country inequality. It further implies that those considered poor in developed countries are, in absolute terms, quite wealthy compared to the vast majority of the world's population. A typical American in the lowest 5 percent of income (for America) has a higher income than 95 percent of Indians, 80 percent of Chinese and 50 percent of Brazilians.[2] In the United States, 99 percent of households have indoor plumbing (a toilet with a sewer connection).[3] In India, it's 12 percent.[4] For Americans below the poverty line, nearly three-quarters have a car (and 31 percent have two or more)[5] and 97 percent have air conditioning.[6] In India, only 5 percent of all households have cars and 2 percent of all households have air conditioning.[7]

This then begs the following question: Are policies that purport to help the comparatively well-off (those at, say, the poverty line in developed countries) at the expense of the superlatively well-off (the rich in developed countries) desirable from the behind-the-veil perspective assuming that that perspective is global?

Increasing world trade is an example of the tension between policies that help those in developing countries versus those that help those lower in the income distribution in developed countries. According to a World Bank Study, in the three decades between 1981 and 2010, the rate of extreme poverty in the developing world (subsisting on less than $1.25 per day) has gone down from more than one of every two citizens to roughly one of every five, all while the population of the developing world increased by 59 percent.[8] This reduction in extreme poverty represents the single greatest decrease in material human deprivation in history.

But this decrease in extreme poverty in the developing world has coincided with a marked increase in income inequality in the developed world, and the latter has received much more attention, at least from policy analysts in these richer nations.

One possible cause of both trends has been the increase in international trade, which lessens the market value of less-skilled labor in developed countries while increasing its value in developing countries.[9] If one uses a behind-the-veil criterion focused only on developed countries, then the increase in trade has made things worse. If instead one considers the entire world, then the trade increase has made the world phenomenally better.

But trade is not the only way in which policies in developed countries affect those in developing countries. Nobel Laureate Robert Lucas has developed an economic model in which countries "take off" by removing impediments to becoming a growing economy (China's abandonment of central planning, for example) but vary regarding when such impediments are removed.[10] Two key implications of his model, both of which match the data, are that the later historically a country takes off economically, the further its per capita output will be at that point from the rest of the world, and the faster its subsequent growth. (The country will, in a sense, go through a stage of "catch-up growth.") These implications can arise either from economic growth through diffusion of ideas or from diffusion of practical knowledge through education.

Consider the following highly stylized example: In a world with just two countries, one developed and the other poor, output is produced in each by a combination of skilled workers and unskilled workers. When they're young, unskilled workers have the opportunity to become skilled by working with older, skilled workers.

But imagine that young, unskilled workers can work with older, skilled workers from *either* country. In particular, assume that skilled, older workers (such as plant managers) from developed countries can train young, unskilled workers from developing countries. (Alternatively, imagine that young, unskilled workers from developing countries travel to developed countries to become educated and then return home as skilled workers.) When these young workers age, they in turn train future generations of young workers at home.

Suppose further that in each country only some young workers are born with an innate ability to acquire skills, while others are born without that ability. Suppose also that young workers who have this ability must exert effort to acquire skills and therefore must be provided with appropriate incentives to do so.

A rich-country policy to tax high incomes will redistribute income (within that country) from those with high innate abilities (and, by assumption, with the ability to become highly skilled) to those with lower innate abilities. In so doing, that policy will reduce inequality within the rich country, but it will also create disincentives there to becoming highly skilled and thereby reduce the global supply of skilled workers. This reduced supply of skilled workers from the developed country then reduces opportunities for young workers in the poor country to become skilled.

Applying the Harsanyi-Rawls behind-the-veil-of-ignorance criterion but considering *only* people in the developed country would appear to make this a beneficial policy because it helps the poor of that rich country. But, in our example, it hurts the poorest of the poor in the world, those in the developing nation. A *proper* application of the behind-the-veil-of-ignorance criterion—one that takes all people in all countries into consideration—can thus lead to the implication that such a policy is extremely undesirable. At the very least, a proper application of the criterion says that redistribution within rich countries imposes costs on people in other countries which need to be taken into account.

We conclude that using the behind-the-veil-of-ignorance criterion to advocate for redistributive policies within developed countries while ignoring the effect of these policies on people in poor countries violates the criterion itself and is therefore fundamentally misguided.

Many economic analysts use social welfare functions in which, implicitly, only the well-being of domestic residents matters. This type of analysis is acceptable as long as the analyst acknowledges that such a social welfare function is not developed from deeper ethical considerations. A giant literature in public finance justifies such social welfare functions by appealing to the veil of ignorance. Our point simply is that those who use this criterion should weight the welfare of poor people in Chad, the world's poorest nation, very heavily. To our knowledge, very little if any of the relevant research does so. R

Endnotes

[1] In *A Theory of Justice,* Rawls (1999, p.118) writes, "[N]o one knows his place in society, his class position or social status; nor does he know his fortune in the distribution of natural assets and abilities, his intelligence and strength, and the like."

[2] See Milanovic (2011, p. 116).

[3] U.S. Census Bureau, 2009-2013 5-Year American Community Survey.

[4] Population Reference Bureau. prb.org/Publications/Articles/2012/india-2011-census.aspx

[5] *Backgrounder.* heritage.org/Research/Welfare/bg2064.cfm

[6] U.S. Energy Information Administration. eia.gov/consumption/residential/data/2009/#undefined

[7] Population Reference Bureau. prb.org/Publications/Articles/2008/howindianslive.aspx

[8] World Bank. worldbank.org/content/dam/Worldbank/document/State_of_the_poor_paper_April17.pdf

[9] While it is clear that extreme poverty in the developing world has decreased, it is unclear whether *inequality* in the developing world has increased or decreased. See Goldberg and Pavcnik (2007).

[10] See Lucas (2000).

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