

Risk, inequality and the economics of disaster

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I am struck by the excessive, near Pollyannaish optimism of mainstream economics in its assumptions about human reason and, in an odd way, the peaceable nature of economic order. Our discipline tends to gloss over the central role of power and violence in the creation of wealth, the distribution of opportunity and the fact that suffering and well-being are tightly connected. This paper, reflecting the horror and obscenities of New Orleans' agony, keeps the blood-stained nature of economic life firmly in mind.

Climate Change and the Social Contract

I am sorry to say that I am about to confirm my marginal status in the economics profession by digging into a most unpleasant aspect of the already far too scary matter of climate change. I am going to consider why climate change will inevitably shred the contemporary American social contract – that evolving mix of markets and violence that creates knowledge and wealth, billionaires and prisoners, opportunity and social death in ways that fascinate and horrify the rest of humanity. I want to explain why climate change will force the United States, and every other market society, to abandon the practice of creating disposable classes of persons whose primary function is to serve as blood and bone buffers who absorb the risks of life at the cost of their bodies and souls. I am suggesting that the market fundamentalism of Milton Friedman and Friedrich Hayek, the inspirational twin intellectual dynamos of the profession for the past three decades or more, will soon slip into oblivion because climate change will push all of us to understand that unlimited capitalism is, in the end, inextricably connected to the disposability of human beings.

First, climate change destroys market fundamentalism by showing why market based inequalities necessarily lead to hierarchies of pleasure and suffering where the well-off regularly sacrifice the well-being and lives of the poor and vulnerable. Second, climate change poses such severe collective risks to societies that polities must explicitly choose whether to reorient national and local economic policy in ways that share these risks in an egalitarian manner or to deliberately shift these risks to the bottom of society, even at the cost of escalating the degree low-intensity civil conflict by broadening the American race/poverty/prison complex beyond the hard black/white color boundary.

Consider the by now well known and ominous predictions by the Intergovernmental Panel of Climate Change that changing weather patterns and rising sea levels will destroy the lives and livelihood of millions of poor people in Asia, Africa and Latin America.¹ Many analysts and activists from threatened societies have noted, with great politeness given the dire nature of the forecast, that the rich world of Europe, North America and Northeast Asia, which grew rich by emitting the vast bulk of the greenhouse gases that are raising the Earth's temperature, is now imposing the costs of filthy production methods on the world's weakest people. Citizens of the rich world can hardly deny these facts – try as they might – nor can they justly object to billions of people seeking to become rich themselves by following the

¹ IPCC (2007).

same dirty road to wealth in the absence of an explicit transnational deal about how to share the world's atmosphere in ways that avert, or at least minimize, the climate crisis.

The public in the rich world will soon have to face up to the fact that its wealth has been purchased at a vast human cost as well as choose whether or not to resist changing their methods of production and habits of consumption in the interest of reducing the mortality and morbidity they impose on the rest of the world. In other words, the hierarchy of pleasure and suffering on a global scale is slowly becoming quite plain to citizens in rich societies, just as their willingness to either accept or resist change will soon tell the world whether fighting or negotiation will be the mechanism for allocating the right to use high concentrations of GHG's to drive the growth of national wealth. The danger for market fundamentalism is crystal clear: once citizens of rich societies realize that they have purchased their well-being at the expense of the lives and well-being of others living far away, they may become curious about whether this system of pleasure and suffering exists closer to home. Imagine what would happen to white middle class America's faith in markets if enough of them were to honestly ask if their pleasures required the suffering of others in their country?

Why Philosophy Matters for the Economics of Climate Change

We must dig a bit deeper into the logic of market fundamentalism to expose the radically destructive core of this doctrine that somehow became synonymous with liberty.

The central claim of the Hayekian vision is that a just society is one that treats all of its members equally with regard to the rule of law by specifically disavowing redistributive policies that would transfer resources from the rich to the poor or from the strong to the vulnerable. Justice is concerned with establishing a system of rules that respects each person's freedom – especially how owners choose to make use of their property – without discriminating in favor of any particular person, group, region, race or set of purposes. Therefore, both the free market system, especially the distribution of economic benefits and burdens generated by markets, are just so long as these are the result of the unregulated activity of self-interested parties. Since the results of competition are the unintended outcome of market activity rather than the goal of any particular person or group, the pattern of rewards and suffering, including the allocation of risks, may be unfortunate but *cannot* be unjust. By contrast, public policies that attempt to alter the outcomes of market processes by either redistributing resources or by deliberately altering the balance between the costs and benefits of economic activity so as to encourage some actions while discouraging others are necessarily unjust.²

This elevation of Pareto Optimality from the status of an observation about the nature of tradeoffs in market economies under very restrictive conditions to a quasi-ethical bar to all forms of redistribution has become the de facto standard by which economic policies are judged in my country and around the world over the past thirty years. While almost no government actually follows the Hayekian injunction against public action in economic matters – except to justify regressive policies that injure poor and working people while favoring elites – the market fundamentalist vision has so reshaped policy discourse that there is now a presumption against acting on behalf of poor and vulnerable people unless such actions benefit the non-poor as well. While we can all think of a few public policy moves that can

² Andrews (2005) develops a detailed critique of Hayek's formulation of justice under conditions of liberty as these are developed in Hayek (1976).

improve the well-being of everyone in society, most policies are inherently redistributive to the extent that these impose costs on the better off members of society while delivering benefits to the worse off. Modern public policy discourse has recast the Hayekian bar to redistributive policy as a “universalist” policy standard that seeks to raise the well-being of all persons and groups in society in the interest of avoiding social conflict – this in a market society where (hopefully) nonviolent fighting via prices, quantities and technological change is the source of both wealth and poverty.

Amartya Sen has taught us, with grace, humor and the infinite gentleness of a teacher conveying a most difficult and upsetting lesson, that the fatal flaw in the Hayekian project is its elevation of an exceedingly limited number of formal rights over substantive capabilities to exercise these same rights.³ Sen’s point in the context of climate change takes on an especially lethal character: the market fundamentalist’s concern with property rights insists that society refrain from protecting its weakest members from climate risks because such actions are inherently redistributive and unjust on their face. So when the City of New Orleans warned its citizens that Katrina was coming, and urged everyone to leave, it had more than done its Hayekian duty. Further, the city, state of Louisiana and the Federal government were under no obligation to help the city’s poorest residents to escape because any such action would have required the use of resources gained via an ever so mildly progressive tax system that injured the well-being of high income and wealthy citizens for the benefit of poor people.

By contrast, Sen’s capability approach to justice insists that government must not only respect all persons by promoting equal treatment before the law as well as refraining from favoring one set of private projects over others, but that society is obliged to make sure that its members are capable of exercising rights on a roughly equal basis if rights are to have any substantive meaning. So, any substantive view of freedom-as-capability would insist that governments guarantee that all citizens have an equal chance of escaping disasters, including redistributive actions providing the poor with publicly provided means to leave New Orleans as Katrina bore down on the region.

But Sen’s analysis of freedom-as-capability exposes the brutal heart of the Hayekian vision by showing why the latter is not only indifferent to the capability of citizens to exercise their rights, but indeed requires that a perhaps sizeable portion of the community be barred from becoming capable. Freedom-as-capability is, like Rawls theory of justice, an analysis of the nature and content of justice in a liberal society.⁴ One of the requirements of a really free society is that its members be capable of exercising their freedom by being granted access to crucial developmental resources in childhood – like health care, education, nutrition, personal safety, parental care or at least care by adults in conditions of affection and commitment (if possible) and other essential goods. Societies that regularly and deliberately fail to invest in the human capital of the children of the poor or members of outcast groups are systematically destroying the capability of future adult citizens to exercise their freedoms. Also, societies that regularly and deliberately neglect the development needs of the children of the poor or outcasts are also creating other castes who will themselves be unable to provide for themselves or their children on their own, or to defend themselves and their children from the animus of the larger or richer community.

³ See Sen (1992), pages 31-56, Sen (1995), pages 307-330, Sen (1998), pages for evolving formulations of and support for this crucial point.

⁴ See Rawls (1995).

Philosopher Harry Brighouse reminds us that parents are only the first among many adults who share ethical responsibility for the development of the young since communities are to be judged by how well or how badly they fulfil their stewardship role vis-à-vis children as future free citizens.⁵ Malignant societies that regularly and deliberately cripple the capacity of some of their younger members to grow into self-reliant and economically competent adults – like New Orleans, the state of Louisiana and the Federal government by virtue of each government’s high tolerance for and in many case active participation in the well documented racial discrimination in jobs, education, housing and medical care afflicting black New Orleans – create social classes that are incapable of protecting themselves from even the most obvious harms, to the point where they are too poor to leave a region on the brink of destruction.

The foregoing remarks suggest that a really free society will, at a minimum, do all it can to make sure that its weakest members are capable of exercising their rights, including their right to survive harm by having means of escape. Of course, a decent and free society will do much more than make sure that all of its members are capable enough to escape oncoming disaster. The facts of human development recommend a substantial degree of redistribution in the interest of developing a non-trivial level of economic capability for all citizens, at least enough so that someone can pay for a bus ticket to get themselves and their families out of town when a hurricane is on the way.⁶ Sen’s move beyond procedural to substantive justice extends far beyond the predatory character of the Hayekian project by insisting that *equal value of lives* – as a nexus of embodied rights and capacities contained in human beings – is the object of liberal statecraft, not the equal treatment of persons as abstract bearers of an extremely spare slate of rights whose physical survival is of no importance.

Climate Change and the Common Good

Climate change will, in time, push even the most market obsessed societies to see the ethical and practical sense of Sen’s analysis of freedom, discrediting the Hayekian nightmare as the radical, nearly predatory mantra of a dangerous cult. But will the close of the Hayekian system have any practical impact on public policies for dealing with the costs of climate change – beyond the considerable benefits of so marginalizing market fundamentalism that sensible redistributive policies can be developed and implemented? The

⁵ Brighouse (2000) is a powerful and creative analysis of social justice in the context of education that brushes past the usual constrictions of contemporary debate to open up new areas. For instance, Brighouse makes a convincing *left-liberal* social justice case in favor of Milton Friedman’s proposal for school vouchers, on the condition that all educational systems must enhance individual autonomy and equal educational opportunity. The first two chapters of the book contain a useful synthesis of the implications of liberal political theory for education and the rights of children that most economists – particularly those mesmerized by the Hayek/Friedman project – might want to consider in some detail.

⁶ Margalit (1995) develops a harsh yet compelling theory of the ethics of public policy that is informed by the author’s sense that justice is a utopian and therefore hopeless ambition in the world as we now it. Instead, Margalit suggests that the best we can hope for in society is to craft collective institutions that do not require the humiliation of large numbers of persons or social groups – like the poor or racial outcasts – thereby limiting the extent to which the ordinary routines of economic and social life inflict injury on the weakest members of society. By this definition, there can be little doubt that markets under American economic and racial conditions are deeply humiliating institutions, not least in a situation like that facing thousands of New Orleans’ poorest citizens on August 29, 2005, where thousands of people were too poor to evade an oncoming hurricane.

following remarks consider two areas – insurance in risky regions and how society might price greenhouse gas emissions – where the freedom-as-capability approach to economic policy and climate change can shape practical policies in important ways.

The vexing problem of climate and insurance along the Gulf coast of the US offers a chance to test the practical utility of freedom-as-capability. The best work on climate change suggests that structural change in the climate system will impose severe *common* risks to life, health and property over large populations, such large risks that markets will shy away from providing affordable insurance to middle class populations who could once count on being able to protect themselves. Professor Kunreuther's piece on the opinion page of the *New York Times* this past August put the point quite starkly: private insurers will not be able to provide affordable property and liability insurance for homeowners and businesses. Kunreuther suggested that the federal government make flood insurance mandatory for all property owners – particularly home and apartment owners, as well as all local governments managing public housing units.⁷ Further, the National Flood Insurance Program should set premiums based on actuarially sound calculations of losses, without any regional cross-subsidies. Kunreuther also suggested that the resulting substantial increase in the cost of owning a home be partly offset by a well-designed subsidy program that cushioned the blow for low to moderate income homeowners.

Kunreuther's proposal is an example of how to "get the prices right" in the matter of pricing risk along the Gulf Coast without barring low and middle class home ownership along the Gulf. Yet, this sensible proposal, which is sure to be resisted by realtors, contractors, mortgage brokers and all others in the Gulf region with a keen interest in building and selling homes – but not necessarily in protecting moderate income homeowners – does not take adequate account of the brutal logic of dependence and domination inherent in market inequality. Many thousands, perhaps millions of poor people living in dreadful conditions will still flock to the Gulf region, and any region facing disaster risk, because living under the threat of disaster is still their best alternative. Decent market societies will find a way to prevent local enterprises from exploiting poor populations by exposing them to climate risks from which better off citizens are protected – especially undocumented populations pushed into risk by poverty and their lack of papers.

One viable approach might be to incorporate the vulnerability of poor people into the risk pricing mechanism. Contemporary computational economics and actuarial science are as capable of estimating the risks that climate change poses to the lives and well being of the uninsured as the risks facing the insured – but do not for obvious reasons. The National Flood Insurance Program as well as other agencies in the federal government should first calculate the frequency and severity of property and human losses that extreme weather poses to poor people and then impose an insurance surcharge on both wind and flood premiums that reflects the vulnerability of poor people to weather risks. At a minimum, the proceeds from this "poverty weather risk tax" should accumulate in a special fund, managed by regional consortia monitored by the Federal government, which can be used to finance investments in infrastructure that increase the weather security of the poorest residents in an area.

⁷ Howard Kunreuther's proposal is summarized in a recent *New York Times* opinion piece, "Who will Pay for the Next Hurricane?", August 25, 2007. A detailed analysis of the economics of compulsory natural disaster insurance as part of a comprehensive national natural disaster is developed by Kunreuther in "Has the Time Come for Comprehensive Natural Disaster Insurance?" in Daniels, Kettl and Kunreuther (2006).

This policy would accomplish three goals. First, it would force all property owners to take account of extreme weather risks as they make location and business decisions on the basis of prices that accurately reflect near and longer-term losses. Second, these policies price an important but neglected negative externality – the exposure of vulnerable poor and outcast populations to weather risk – flowing from the self-interested behavior of consumers, producers and governments in societies with high degrees of economic inequality. Third, a sharp and permanent increase in the price of insurance in more risky relative to less risky regions would force local and regional governments to invest in and maintain water and weather infrastructure as a condition of economic survival in a competitive national and global economy.

There is little doubt that local elites and their publics will object to the proposed regulations because this portfolio of policies will so raise the cost of doing business in risky regions that population centers will move to safer ground. Indeed, the policy portfolio offered above is distinctly anti-populist to the extent that beautiful shorelines in risky areas will become so expensive that only the rich can afford to pay to protect themselves from disaster – so long as an anti-tax, anti-government ethos limits public investments in protective capital capable of providing real climate security for large populations of middle income and poor people. Yet, economic reason and the principle of the equal worth of citizens compel the federal government to impose an expensive regime of market-based risk pricing, large-scale infrastructure investment and tough building codes on localities and states all too willing to allow racial animus and economically illiterate forms of greed to result in large concentrations of vulnerable persons and property. Rare though it may be, this is one instance where government policies can promote both equality and efficiency by “getting the prices right” and forcing communities to address the ways that ordinary business activity and racial/class fighting expose the most vulnerable populations to dangerous weather. Above all, the federal government can never again allow nor assist local concentrations of power and hatred bent on using natural disasters as mechanisms for racial “cleansing”.⁸

Solidarity and Carbon

Most economists agree that the best way to reduce greenhouse gas (GHG) emissions is to assign a price to GHGs that reflects the current and future environmental and social costs of this atmospheric filth. At present, the useful debate between those who favor imposing a carbon tax and others favoring a “cap and trade” system is inspiring excellent

⁸ In passing, one can almost hear the protests of the Friedmanians and Hayekians as they cry out against policies that end up costing jobs and depriving the most vulnerable people in society of economic “opportunity”. We are all so used to Chicago-esque pap about how regulations end up hurting the people they are supposed to help, in this case by boosting the cost of producing and living in regions exposed to extreme weather risk, that we fail to see the predation at the heart of this argument. The Chicago mantra against regulation in this instance, and in most instances, is not unlike the kidnapper who claims that the death of hostages is the responsibility of family members who refuse to submit to ransom demands. We would all object (or should object) to the claim that the death of hostages is the fault of those who refuse to pay ransom rather than the kidnapper. Similarly, the Chicago mantra is all too frequently an excuse by the strong to overlook their role in creating the lousy and frequently deadly roster of choices facing weak people. Policies that allow prices to “tell the truth” about climate risk may well reduce employment and growth in risky regions, as well as bar persons of moderate incomes from ocean views and the presumed benefits of the culture of the beach. Of course, another way to improve the well-being of poor people is to reduce their poverty directly – perhaps by forcing dominant castes and classes in society to invest in the capabilities of the weak on the principle that all citizens deserve genuine equal opportunities to achieve a good life. As the saying goes, “freedom isn’t free”.

work on the connection between economic activity, GHGs and the environmental costs thereof. For instance, a recent working paper by Professor James Boyce of the University of Massachusetts estimates both the connection between the distribution of income and the resulting burden that families place on the environment as well as the increase in costs that families across the income spectrum must bear once GHGs are priced.⁹ Boyce's findings include the unsurprising observation that higher income families generate higher levels of carbon and other GHG emissions (though this "demand" for GHGs appears to be slightly income inelastic) as well as the more surprising estimate that the average family will see their costs rise about \$1,500 per year if GHGs prices were set at \$200 per metric ton. Needless to say, this underscores the fact that pricing carbon and other GHGs will surely cut into the living standards of all Americans, and especially families with modest incomes, thereby dampening whatever limited support the public may have for dealing with GHG emissions.

One way of handling with this matter – apart from the ongoing fuss over whether the nation should impose a tax or implement a cap and trade system to price GHGs – is for the receipts of GHG pricing to be recycled to families, either on a per person, per family or progressive basis. Boyce's analysis suggests that such a policy of equal per family payments from GHG pricing will actually boost the real incomes of more than 60% of families, thereby reducing opposition to the policy of pricing GHGs on the grounds that this regressive tax will ultimately cut living standards. Note that distributing the receipts from GHG pricing on a per family or per capita basis takes a bit of the bite out of the usual Hayekian snarl against public policy – all families in exactly the same way, which is *not* the same thing as being treated equally – though a die hard might still complain that any form of GHG taxes is an affront to freedom.

One might think that the proceeds from pricing GHGs might best be applied to financing technological developments and investments in cleaner energy sources, thereby reducing the cost and increasing the pace of innovation as well as the transition to a low GHG economy. While a policy of recycling revenues in the form of subsidies to those enterprises investing in new technologies is better than nothing, it still offends against equality to the extent that it actually blunts the impact of pricing GHGs on polluter profits. Filthy production processes have generated a vast amount of wealth, in turn contributing the obscene rise in economic inequality that warps American life and is the source of so much avoidable suffering. It makes little sense to first impose costs on producers whose choice of technologies is the source of GHG emissions, only to then offer these same polluters a bribe to change their ways – a bribe which will in any case cushion the costs of GHG pricing on the returns to those who own filthy enterprises. The demands of distributive justice suggest that people should not be rewarded for doing what they are obligated to do by ethics and morality – there is no good reason for polluters to be rewarded for refraining from poisoning the planet in ways that threaten the lives and well-being of millions of poor people via climate change. Also, the demands of retributive justice suggest that the owners of filthy enterprises whose actions have contributed the climate crisis should bear the costs of repairing the problem, thereby transforming a substantial portion of their ill-gotten gains into cleaner, safer technologies.

⁹ Boyce (2007).

Restatement of Principles

Safety and equality are tightly connected in liberal democratic societies committed to the principle that all lives are of equal value and are therefore worthy of equal protection against extreme weather risk. The structural inequalities in economic opportunity, political power and social status that are the source of unequal exposure to weather risk must be corrected by forcing stratified societies to both recognize the role of markets, customs and raw political power in creating vulnerable populations, and force dominant social groups in these communities to extend the circle of protection to include *all* of the community's members.

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