

Inequality in Market Design

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The work and open directions below focus on how we can harness market design to achieve more equitable outcomes for market participants. Some applications include rent control policies in housing markets, price floors in Iran’s kidney exchange (Dworczak, Kominers and Akbarpour (2020)), and allocation of food to food banks (Prendergast (2017)).

Reading through more of the literature on matching markets, combinatorial assignment, and market design more broadly, I’ve become more interested in the potential to design markets with equity as a primary objective. These works below all link to that goal, despite being applied in very different settings.

1. Redistribution through Markets

Price regulations, such as rent control and minimum wage laws, typically face tradeoffs between reducing inequality and maintaining efficient outcomes. In an age of dramatic inequality (see: anyone, perhaps Piketty most specifically), it is critical to design markets with equity in mind.

Early work exploring this balance includes Weitzman (1977), who asks whether competitive prices or rationing in a one-commodity market is more effective at ensuring agents with the highest need receive the good. Weitzman focuses primarily on goods which are deemed a societal need, potentially including housing, food, or medical care. As in actual marketplaces, agents have both differing incomes and differing needs for the good. Intuitively, if income distribution is relatively egalitarian and agents’ needs vary widely, then competitive prices bet-

ter identifies those agents with greater need. On the other hand, if income inequality is high compared to the dispersion in need for the good, rationing is more effective.

Formally, Weitzman (1977) reach these results by parametrizing agents’ demand functions according to λ and ϵ , where λ represents the agent’s marginal value for money (falls as income rises) and ϵ represents the agent’s need for the good. Critically, these types are unobservable by the market designer, a problem which will arise again in later work as well.

Weitzman now considers two possible rules for allocating a fixed quantity of the good to each agent. Under competitive prices, the market designer sets a price to ensure market clearing. Under pure rationing, the market designer equally divides the good between all agents. Note that Dworczak, Kominers and Akbarpour (2020) build on this model by, among other improvements, considering more nuanced rationing schemes that allocate to a subset of agents or impose multiple price levels. Weitzman then may compute a loss for each method in meeting actual need, and compare the two schemes’ outcomes based on the prior distributions of λ and ϵ in the populace. This formalizes the intuition of when rationing or competitive prices better meet needs in the market.

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Dworczak, Kominers and Akbarpour (2020) characterize the Pareto frontier of this tradeoff by framing price regulation as a market design problem, with buyers and sellers seeking to buy an indivisible good. They frame the Pareto frontier as determining the welfare-maximizing solution when agents have different valuations for money and for the good. (Roughly speaking, the valuation for money falls with an agent's wealth). They find that when there is significant inequality between buyers and sellers, optimal price controls take the form of a "tax" which charges buyers a lower price than that of sellers, then transfers the surplus to the poorer side of the market. When there is significant inequality between agents on one side of the market, price controls take a more complex form but may still be optimal.

The key obstacle which Dworczak, Kominers and Akbarpour (2020) overcomes, as was faced by earlier models such as Weitzman (1977), is that the market designer does not perfectly identify agents' needs, and hence setting a price at which the commodity is rationed helps to identify these needs.

One interesting novelty of the Dworczak, Kominers and Akbarpour (2020) model is their use of agents' differing marginal values for money, instead of the more standard approach of giving agents different Pareto weights to construct the Pareto frontier. The authors show that these two formulations are actually equivalent. Intuitively, an agent having a higher marginal utility for money is akin to a market designer placing greater weight on the money they are given in the final allocation. They show that agents' actions are fully characterized by their rate of substitution between the good and money.

The bulk of the paper describes the optimal mechanisms to address cross-

side inequality (between sellers and buyers) and same-side inequality (between agents on the same side of the market). The paper discusses applications in markets for kidney exchange (rather, the one market which runs in Iran), which is generally an example of same-side inequality among sellers. It also discusses applications in the housing rental market, which is generally an example of cross-side inequality.

The paper raises several interesting extensions. Most immediately, the model only studies an indivisible good without wealth effects. Both of these modeling assumptions could be extended. The model also neglects possible aftermarkets of trade between agents, which could be explicitly modeled. Finally, the rationing mechanism used to address same-side inequality is randomized; work on designing non-random mechanisms could be fruitful. It would also be interesting to find real-world examples where this randomization impacts participant behavior in measurable ways.

2. *Fair Equilibrium in Combinatorial Assignments*

Budish (2011) opened exploration of the combinatorial assignment problem, in which a market designer must allocate indivisible bundles to agents, and in which monetary transfers are prohibited. Critically, the market designer cares about both the efficiency and fairness of the allocation. This problem becomes interesting to study because the only efficient and strategyproof mechanism is a serial dictatorship which is (no surprise) not at all fair. Budish first defines two fairness criteria for the problem, then proposes a mechanism which achieves fairness with relaxations of the efficiency and fairness requirements.

The two fairness conditions, "maximin share guarantee" and "envy bounded

by a single good,” generalize existing fairness notions to the indivisible goods case. The proposed mechanism, the “Approximate Competitive Equilibrium from Equal Incomes” mechanism, guarantees fairness when incomes are arbitrarily close (but not equal), and when the market designer can tolerate an error in the market clearance. Budish then shows that this satisfies a relaxation of the strategyproof condition. Finally, Budish illustrates that the mechanism empirically improves on existing methods to allocate courses to students.

Babaioff, Nisan and Talgam-Cohen (2019) generalize the results of Budish (2011) to agents with budgets that can be far from equal. Here, the intuition is that in some cases, the designer may wish to favor some agents’ preferences over others. For example, in Budish (2011), all students have the same priority to the market designer. In Babaioff, Nisan and Talgam-Cohen (2019), the authors suggest the motivating example of a charity allocating food to food banks of different sizes, which should likely have different budgets.

Prendergast (2017) describes the implementation of a similar combinatorial assignment mechanism for Second Harvest, a charity which distributes food to food banks. The charity faced a combinatorial assignment problem in distributing its goods to affiliated food banks, and implemented a system similar to Budish (2011), by using artificial currency and having food banks bid on items.

3. Miscellaneous

Perhaps the application of market design most directly motivated by alleviating inequality has been school choice. Avery and Pathak (2021) do very interesting work to extend models of school choice, motivated by the idea that

un-tethering schools from their neighborhoods changes neighborhood housing prices. Intuitively, school choice tends to equalize the performance of schools within a city, resulting in a compressed spectrum of housing prices. They then uncover an “ends-against-the-middle” tradeoff, wherein families at the high and low ends of the socioeconomic spectrum have an incentive to leave the town. In particular, even when the lowest-performing schools improve, low-income individuals may not benefit. For an early overview of school choice mechanisms, Pathak (2011) was helpful.

4. Other Papers to Read

- Scheuer, F. (2014): “Entrepreneurial taxation with endogenous entry,” *American Economic Journal: Economic Policy*, 6, 126–63.
- Weitzman, M. L. (1977): “Is the price system or rationing more effective in getting a commodity to those who need it most?” *Bell Journal of Economics*, 8, 517–524.
- Akbarpour, M., P. Dworczak, and S. D. Kominers (2020): “Redistributive Allocation Mechanisms,” Working Paper.
- Maybe: Saez, E., and Stantcheva, S. (2016). Generalized social marginal welfare weights for optimal tax theory. *American Economic Review*, 106(1), 24–45.
- Kominers, S. and Teytelboym, A.: “More Equal by Design: Economic Design Responses to Inequality”. (Forthcoming book).
- <https://news.mit.edu/2021/building-equity-vaccine-distribution-0204>
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- Sönmez on Vaccines

5. Open Questions

I still need to deepen the *specificity* of these questions, I think, and a better sense of how to sharpen good theory questions. I still need to develop a more crisp understanding of how Dworczak, Kominers and Akbarpour (2020) differs from the prior literature on optimal taxation and rationing.

- 1) In cases of significant same-side inequality, the optimal mechanism proposed by Dworczak, Kominers and Akbarpour (2020) is a randomized mechanism, in which some agents can only trade with a given probability. As the authors point out, randomized rationing in practice can be particularly harmful to poorer individuals, who may have less tolerance for uncertainty. There is also a long tradition in computer science of trying to "de-randomize" randomized algorithms. **Can we model the harm to poorer agents in this model that results from randomization? Can we develop a mechanism that "trades off" efficiency for less randomization? How might these answers change if the good is divisible?**
- 2) Budish (2011) addresses the combinatorial assignment problem, in which agents are allocated bundles of indivisible objects, monetary transfers are prohibited, and the market designer cares about efficiency and equity. Budish proposes the Approximate CEEI algorithm to resolve the problem, and empirically tests its results on student course assignments. Yet the only applications of this mechanism, to my knowledge, have been in Budish's course allocation and Prendergast (2017) applying the mechanism

to food distribution for food banks. Budish only alludes to one other applications, that of shift scheduling for workers in a firm. Yet it still feels that there are other killer applications of fairness in combinatorial assignment to be tapped. **What other applications of combinatorial assignment problems might be out there?**

- 3) Avery and Prathak (2020) model a city using school choice assignment of students, and complicate previous models by modeling (a) the effect of school quality on neighborhood housing prices and (b) an outside option where residents can move to a different city with neighborhood-based assignment. They find an "ends-against-the-middle" tradeoff in which both low-income and high-income types leave the city after it adopts school choice. Intuitively, implementing school choice compresses the range of school qualities, thus compressing the range of housing prices as well, and inducing those at the high and low ends of the spectrum to leave. **Do we actually observe high and low income types leaving cities after the adoption of school choice? To what extent?** This is motivated by some studies (one from the NBER labor conference which I need to find), showing that workers don't follow idealized perfect geographic mobility models (e.g. residents in manufacturing towns hit by NAFTA tended to stay there, despite economic pressures). On the other hand, authors like Baum-Snow and Luntz (2010) find many wealthy families leaving Boston in response to desegregation there.

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- Babaioff, Moshe, Noam Nisan, and Inbal Talgam-Cohen.** 2019. "Fair Allocation through Competitive Equilibrium from Generic Incomes." '19: *Conference on Fairness, Accountability, and Transparency*.
- Budish, Eric.** 2011. "The Combinatorial Assignment Problem: Approximate Competitive Equilibrium from Equal Incomes." *Journal of Political Economy*, 119(6).
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