

EC9AA Term 3: Lectures on Economic Inequality

Debraj Ray, University of Warwick, Summer 2024

- **Supplement to Slides 3: Sovereign Funds**

Preparing for the Future

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Individual alternatives

Social alternatives

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- **Dramatic changes in access to equity.**
 - Fee-free brokerage accounts common in the United States.
 - Even in developing countries, you can trade at smaller commissions.
 - Trading in fractional shares.
- **Financial education** is fundamentally important.
 - Yes, a distant dream for many, but the processes here are also distant.

Individual Alternatives

■ Limitations to Individual Investments

- Not for **improving** wealth inequality, but **preventing** further decay.
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■ More generally:

- I'm pessimistic about intelligent, informed equity-holding;
- But society must learn to **equitably** scale alienable endowments.

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■ We agree:

“universal basic income is a genuine, structural, distributive transfer. Its proper consideration must appear on top of social insurance programs, not as a substitute ... whatever social insurance we do have, such as NREGA, should not be cannibalized for the purpose of making structural transfers such as a universal basic income.” Ghosh (r) Ray 2021

Social Alternatives: UBI

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- 1.4 billion people, 13000 per person = 18.2 lakh crore, or **8% of GDP**.
- CGI spending is around **12.5% of GDP**, maybe 14% after pandemic.

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■ Inflation and indexation

- Both pernicious problems
- The **universal basic share** (UBS) Ray (2016) and Moene and Ray (2016)
- Commit fixed **fraction** of GDP to the provision of UBI.

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 - E. **Political alignment:** E.g., in treatment of K and L , tax collections, etc.
 - F. **Sharing:** Allows everyone to share in the prosperity of a country.

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- **Norway fund:**
 - oil-based, around \$200,000 per Norwegian citizen.
 - It could pay out, but as of now, it does not.

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 - Natural resources form *only* a variable part of that base.
- **The pragmatics** come from the logistics of fund building:
 - **Several proposals** in the United States: charity (Stout and Gramico Ricci 2017), financial transactions tax (Baker 2017), higher taxes on capital incomes (Barnes 2014), transfer of existing government assets, e.g., spectrum auction proceeds and various levies on companies (Bruenig 2018).

A Proposal

Based on Ghosh (r) Ray 2021

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- Portfolio of equity, bonds and other financial assets
- Managed professionally as any fund would be managed
(subject to certain constraints)
- A fraction of the return can be paid out as a citizen's dividend.
- But the payout will be slow. Patience is of the essence.

A Proposal

- **Proposal has two parts:**
 - I. One-time directive on existing publicly traded companies:
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- II. **Ongoing directive to transfer $x\%$ of every new share issue**

- Whether it is an IPO or expansion of existing share base.

Advantages of the Proposal

Payment via dilution.

- Conceivably the most compelling point in favor of the plan:
 - Stock issues by listed firms easy to track;
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- Parikshit: “Elon, just hand over the stock and save the brokerage fee.”
- All in all, this is an extremely effective form of taxation.

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- Suggestion: only issue “Class B” shares to State: no voting rights.

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Political Incentives

- Citizens come into closer political alignment (Moene and Ray 2016)
- Of course, redistribution motive is still present
- But smaller conflict on **functional** terms: e.g., “capital vs labor.”

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 - Sector-specific taxation, subsidies, directed credit
 - These achieve distributive ends at the cost of reducing the size of the pie.
- **The reason behind these conflicts** isn't personal inequality but ...
 - Discrepancies in relative capital-labor ownership
 - These project on to battles about functional restrictions

Advantages of the Proposal

- Allows for interesting variants:
 - **A flow tax on wealth:**
 - Will require ongoing dilution every year.
 - **A flow tax on unrealized capital gains:**
 - Require fresh dilution in proportion to the **gain** in stock prices every year

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 - Could change if one-time pledge is regarded as non-credible
 - Credibility achievable by device such as a Constitutional Amendment.
- **But additional distortions could arise**
 - Happens with all (non-lump-sum) taxes btw.
 - If only publicly traded shares are diluted, might change capital structure, e.g., swapping equity for debt or converting publicly traded companies into proprietorships.

Portfolio Management:

- **Autonomous management** a necessity
- Co-optation by business interests (e.g., transacting certain shares)
- Experiences of Norway, China, Saudi Arabia may be instructive.

Limitations and Concerns

Constraints on Transactions

- **Sovereign funds often hold a diversified global stock portfolio**
- Unclear whether this can happen immediately for the India Fund.
- Entire fund is based on stock contributions.
- An immediate sale could have large effects on the stock market.

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Logical limit:

- Must the India Fund rise and fall on the national fortunes of India?
- Then one might even mandate that the Fund hold — to the extent possible — the current composition of Indian corporate wealth.
- Worth investigation.

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■ **Main Lesson:**

- Human endowments need to fundamentally change.
- Individual and social responses
- Building a social fund on the basis of **share dilution**.