EC9AA Term 3: Lectures on Economic Inequality

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

Preparing for the Future

"Meanwhile there will be no harm in making mild preparations for our destiny, in encouraging, and experimenting in, the arts of life as well as the activities of purpose."

John Maynard Keynes, "Economic Possibilities for Our Grandchildren," 1930.

Individual alternatives

Social alternatives

Individual Alternatives

Age-old anxiety: “capital” will inherit the earth.

- But the real worry should be the personal distribution of income.
  - That depends on individual holdings of labor and capital.
- **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.
  - Holding an index fund is at best neutral (on average)
  - At current levels of poverty, a near impossibility in developing countries.
- **More generally**:
  - I’m pessimistic about intelligent, informed equity-holding;
  - But society must learn to **equitably** scale alienable endowments.

Social Alternatives

- **Universal basic income**
  - (India) *Ideas for India* special issue 2016, *Economic Survey* 2017
  - Usual debates: truly universal or targeted, economic incentives, etc.
- Opponents of UBI acknowledge the **simplicity of universality and cash**:
  - But correctly worry about NREGA, health care, nutrition, social insurance
  - Or adequate indexation and protection against inflation.
- **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 ⓡ Ray 2021

Social Alternatives: UBI

How expensive is it?

- India is full of **redistributive schemes and directed subsidies**:
  - food, fertilizer, transportation, electricity, water, “revenues foregone” …
  - Not counting state level subsidies, around 6% of GDP.
- **Monthly poverty line at Rs 972 (rural) and Rs 1407 (urban)**

  Rangarajan Committee (2014)
- 1.4 billon people, 13000 per person = 18.2 lakh crore, or **8% of GDP**.
  - CGI spending is around **12.5% of GDP**, maybe 14% after pandemic.

Social Alternatives: UBI

- **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.

The Universal Basic Share

- Six merits of this proposal:

A. **Neutrality:** Scales with country income, comparable across countries.

B. **Starts small:** Addresses the argument that we "cannot afford it."

C. **Insulation:** against fiscal shocks that are correlated with GDP shocks.

D. **No indexation needed:** UBS moves with nominal GNP.

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.

Sovereign Funds

Sovereign Funds

- **Universal basic share is a dividend payable from national wealth**:
  - from stocks, not flows.
- Alaska Permanent Fund:
  - takes 25% of State income from natural resources, pays citizen dividend.
  - "Alaska's natural resources are owned . . . by the Alaskan people themselves." Jay Hammond, 1994.
- Norway fund:
  - oil-based, around $200,000 per Norwegian citizen.
  - It could pay out, but as of now, it does not.

Sovereign Funds

- **But why shouldn't sovereign funds go beyond natural resources?**
  - Both a philosophical and a pragmatic question.
- **The philosophy** is clear from the first part of my talk:
  - If labor share goes to zero, we all need to hold shares of physical capital.
  - 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 ⓡ Ray 2021

India — and developed countries — should build a sovereign fund.

- 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:

- Issue x% of existing share base new to the government.
- Immediate dilution of shareholder value $\rightarrow$ social ownership.

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;
  - No auditing the portfolios of individuals.
  - *Every* investor automatically pays.

No payment is required in cash.

  - No liquidity problems or complaints about payment.
  - Parikshit: “Elon, just hand over the stock and save the brokerage fee.”
- All in all, this is an extremely effective form of taxation.

Advantages of the Proposal

Separation of ownership and management.

- Distinguishes this plan from classical socialism
  - The State does not organize and manage production.
- Problem: State could get rights over corporate decision-making.
  - Suggestion: only issue “Class B” shares to State: no voting rights.

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.”

Advantages of the Proposal

- **More general functional alignments:**
  - Protectionism and immigration restrictions
  - 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

Limitations and Concerns

Economic Incentives:

- The initial one-time dilution of existing shares has no distortion
  - 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.

Limitations and Concerns

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.

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.

Summary

- **The Fourth Fundamental Law:**
  - The labor share must decline, even as absolute wages rise.
  - We discussed various aspects of this.
- **Main Lesson:**
  - Human endowments need to fundamentally change.
  - Individual and social responses
  - Building a social fund on the basis of **share dilution**.