A Proposal to Equalize Wealth: Precis, Updates and Extensions

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Redistribution via Tax

- Sir Arthur Lewis in the 1940s proposed an alternative strategy for the Labor Party in Britain.
- Nationalization with compensation, he observed, does not redistribute: it merely converts entrepreneurs to rentiers.
- He proposed that purchase of shares out of a surplus of government revenue could be the basis of a gradual transition to public ownership, without disruption such as could arise from a sudden confiscation.

Update to 2017

- McCain (2017) proposes a redistributive policy with two main parts.
  - The first is a wealth tax on larger portfolios of capital, at a rate above the market rate of return, so that (apart from entrepreneurial breakthroughs) the capitals subject to the tax would dwindle.
  - The second is a Social Endowment Fund, essentially a stock mutual fund owned by the public and administered by a public body insulated from political influence.

Further Updating

- Among the trends in the developed economies in the current century are nominal interest rates on safe public and overnight debt that are very low –
- Close to a zero lower bound.
- Nevertheless, wages continue to stagnate (at least until very recent years) and the distribution of income and wealth continued to shift toward large-scale capital.
- What do these trends mean for the proposal?

A Puzzle

- In any case, these two trends are hard to reconcile in a competitive economy.
- In my 2017 book I made the neoclassical assumption that there is one rate of return on capital, the social marginal product.
- However, Piketty offers a little evidence that there are economies of scale in capital management.
- Here is a sketch of a neoclassical-style model of that:

Spending on Capital Management

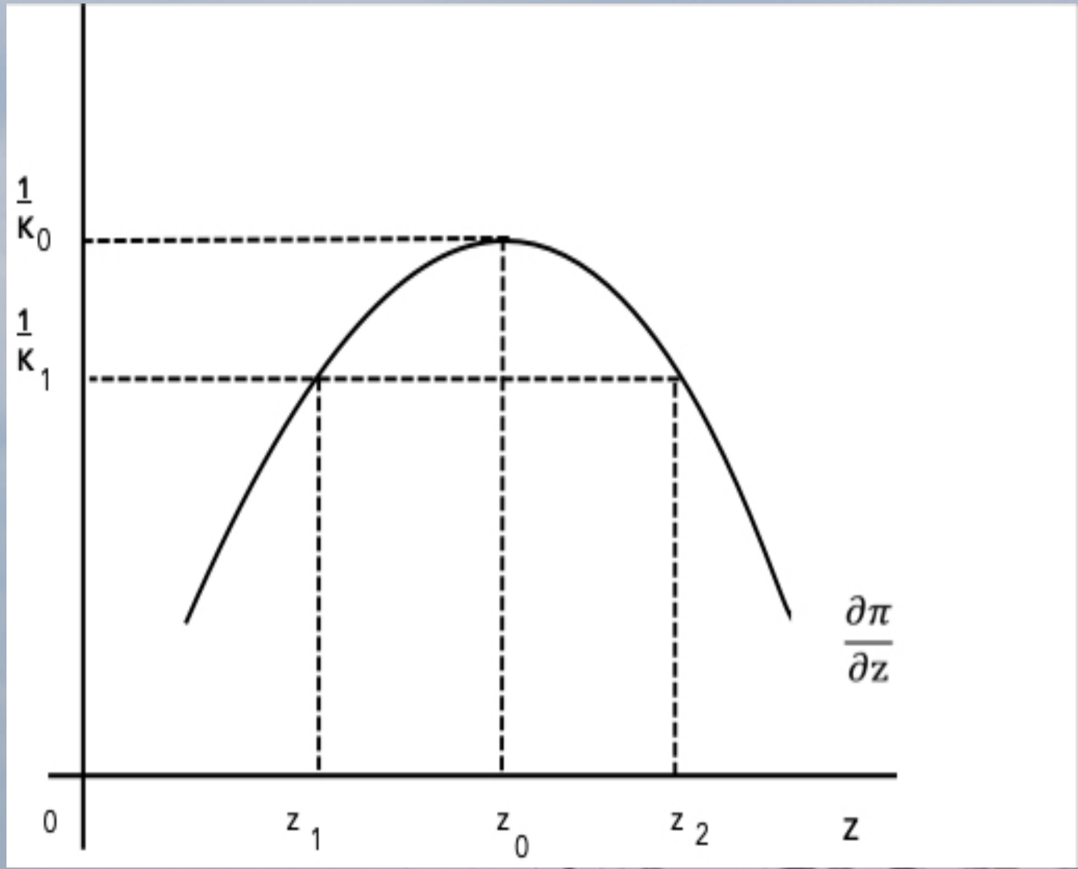
- Suppose that the certainty-equivalent rate of return on a capital of size K is $\pi(K,z)$
- z is expenditure on investment management
- π is a smooth continuous function.

Further, Suppose that

- $\pi(K,0)=r$
- Where where r is the rate of return on riskless capital instruments.
- For some $z_0>0$, for all $z>z_0$ we have diminishing marginal returns.
- Max $\pi K-z$
- The necessary condition is $\frac{\partial \pi}{\partial z} = \frac{1}{K}$

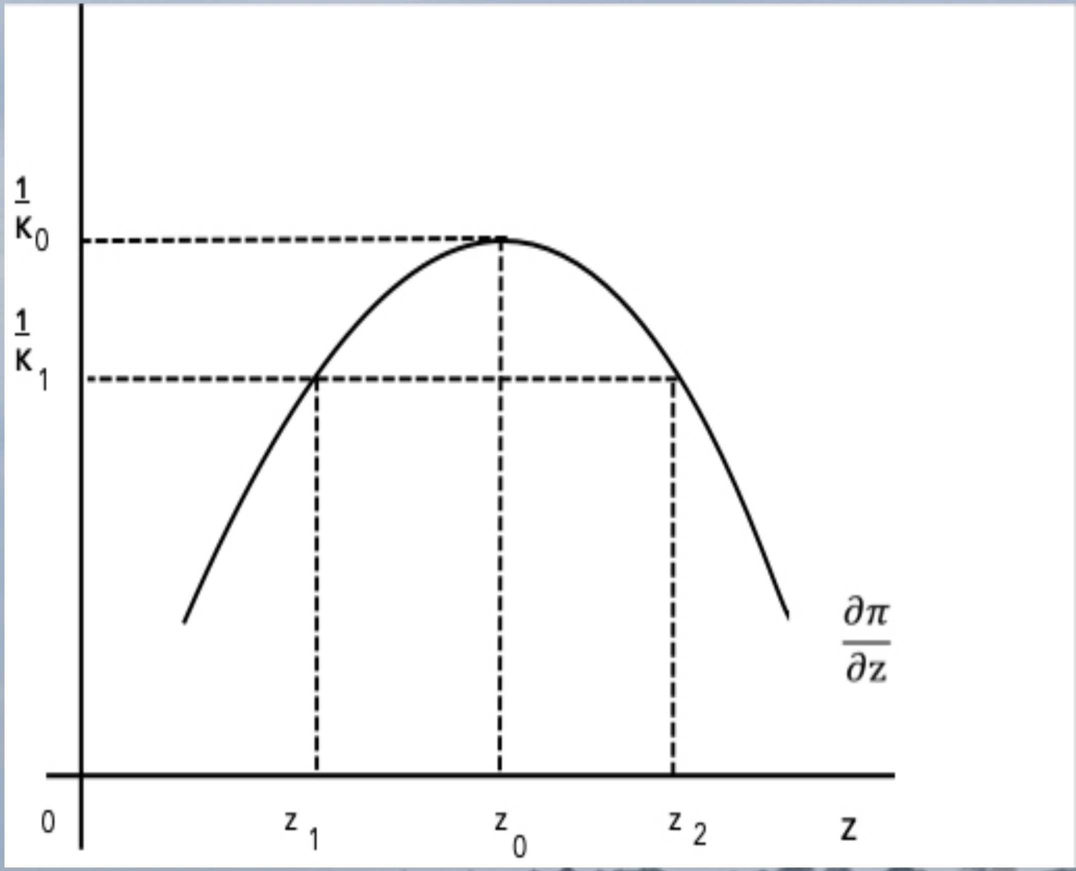
Still Further, Suppose that

- $\pi(.,.)$ is additively separable
- Then we may visualize:
- z is on the horizontal axis
- The inverse of the capital scale is on the vertical.



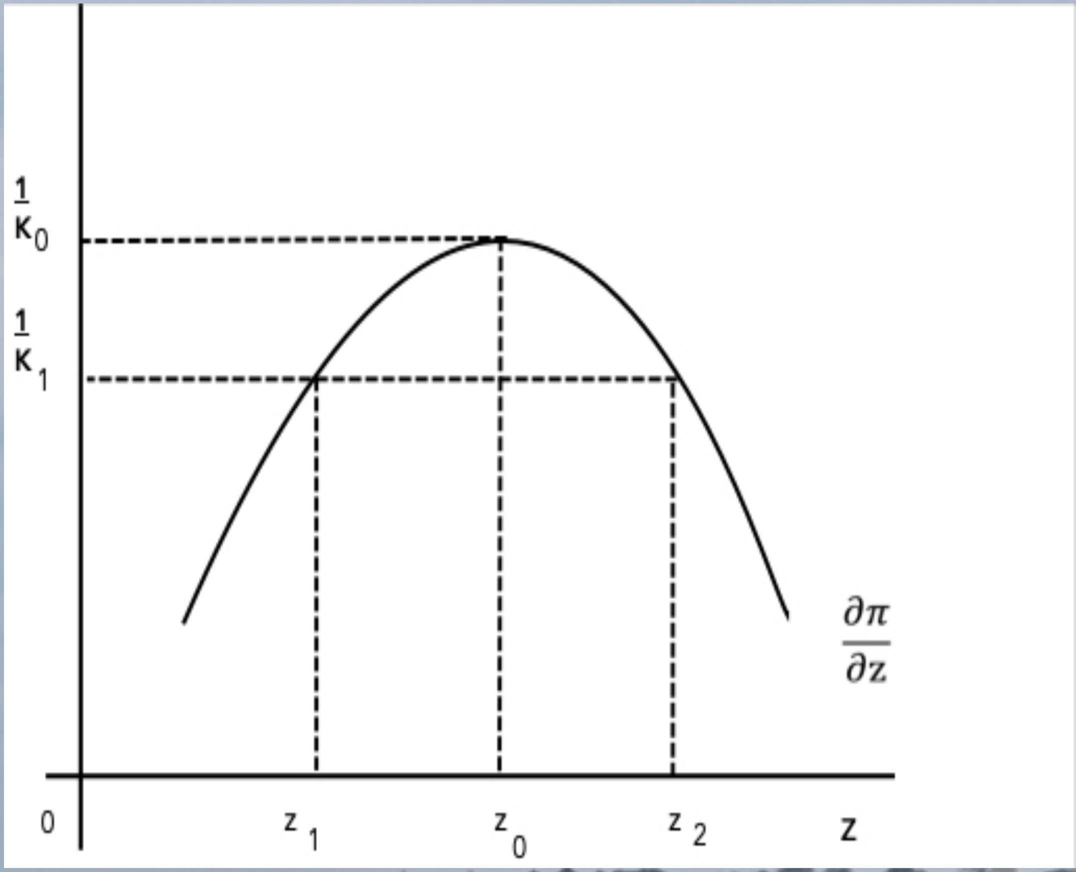
Big Capitals

- For $K_1 > K_0$, there are 3 solutions:
- $z=0$
- $z=z_1$ is a local *minimum*
- $z=z_2$ is the global maximum.



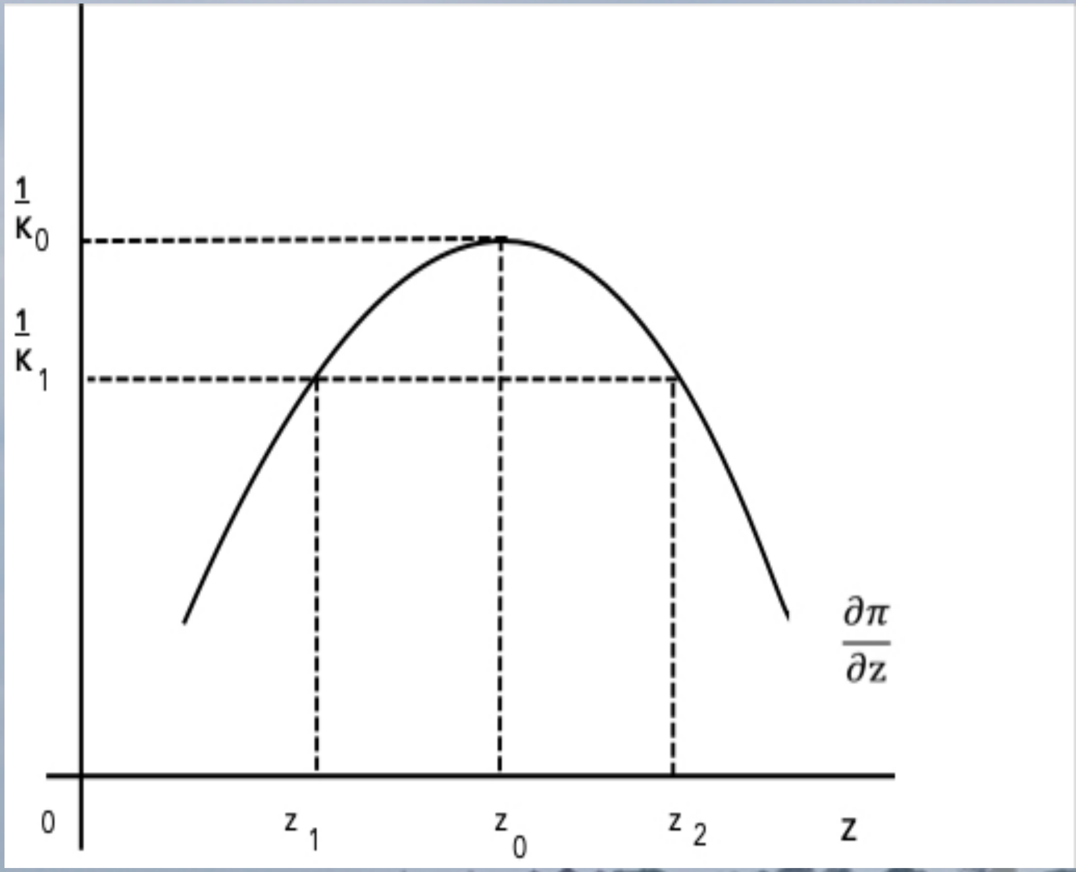
Bigger Capitals

- As $K>K_0$ increases, we move down the curve to larger spending on investment management and thus higher rates of return.



Smaller Capitals

- For K_2 greater than K_0, the only maximization solution is the corner solution at z=0.



Bifurcation

- Thus, the “capital market” is bifurcated, with smaller capital funds invested at a low market rate and larger ones professionally managed and with various rates of return, generally higher rates to larger capitals.

Monopoly

- Another way that the higher rates of return on capital invested in commodity production might be explained is by monopoly power. But –
  - As Schumpeter argues, monopoly profit is transitory in a corporate economy.
  - it is not clear how monopoly power, per se, could explain the bifurcation of capital, as monopoly firms continue to obtain capital at the certainty-equivalent opportunity cost rate.

Capital Glut 1

- An increase in the number of small capitals, with a corresponding increase in the aggregate mass of such capital, could depress the market certainty-equivalent rate of return.
- Thus, we may think of a glut of small-scale, unmanaged or cheaply managed capital coexisting with an expanding share of income and wealth accruing to large-scale capitals.

Capital Glut 2

- Such a glut of small-scale capital would depress the rate of return on safe public debt, presenting to central banks the dilemma that leads to quantitative easing.

In a Bifurcated World, 1

- Suppose, as case 1, that the SEF were invested in safe securities, such as short-term government bonds.
  - This would seem to increase the glut of small-scale capital.

In a Bifurcated World, 2

- Suppose, as case 2, that the Social Endowment Fund were invested as an index fund
  - the rate of return on the SEF, g, would exceed r by the private sector risk premium on corporate shares.

In a Bifurcated World, 3

- Suppose, as case 3, that the Social Endowment Fund were professionally managed.
  - On the one hand this fund is likely to be able rapidly to take advantage of any available economies of scale.
  - However, there is no reason to suppose that the productivity of financial management for a public fund would be the same as that for a fund in the private sector.

SEF Management

- To take the extreme of possible moral hazard, the fund might simply become a slush fund for politicians to reward their friends and supporters.
- There might be pressures for “politically proper” investment.
- it would be appropriate for the SEF to avoid strategies such as monopolization.

Dividend

- In 2017, I proposed that half of the current return on the SEF be distributed as a social dividend, and the rest reinvested.
- This differs from Lewis, who proposed that all be reinvested. But times and conditions have changed.
- If there truly were a capital glut, so that the opportunity cost of invested capital were zero, reinvestment might optimally be even less.

Qualification

- In a world of bifurcated capital markets, however, the growth of the SEF will depend inversely on the proportion of its returns distributed or used to finance consumption, public or private.

Control of Corporations

- As the SEF acquires a significant holding of a particular corporation, it is to be expected that some corresponding proportion of the directors represent the SEF.
- I proposed that these be elected by employees, up to 50%, giving rise to a gradual transition to codetermination.
- This would also work against monopolization through common ownership.

Overall --

- We have examples of sovereign wealth funds that are efficiently managed.
- It seems to be a matter of political will.
- We can expect that such an efficiently managed SEF, funded by a wealth tax, would gradually grow to be the principle proprietor – as Lewis proposed.