#Buildbackbetter for personal financial wellbeing - insights into policy development priorities for a post Covid-19 environment

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Pandemics and Sovereign Wealth Funds

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It has been argued that throughout history pandemics have been one of the only forces that slow—or even reverse—a steady march towards more inequality. Most notably, decimation of the population by the plague is said to have led to the demise of feudalism in Western Europe. Fewer surviving peasants, it is said, made their bargaining power with elites stronger. Meanwhile, the decimation of elite families led to a disruption in established inheritance dynamics. However, as a recent blogpost by Guido Alfani of Bocconi University, Italy suggests, the Black Death may be the exception rather than the rule. Indeed, waves of cholera hitting Europe in the 19th Century did little to affect Gini coefficients there. Also, during the Twentieth Century, the Spanish Flu failed to put a dent in inequality that kept rising until the stock market crash of 1929.

World War II, by contrast, inaugurated a period that some economists have called the "Great Compression," an epoch of declining inequality in income and wealth that lasted until the late 1960s, when the march toward today's Gilded Age Gini coefficients started. The lesson to draw from these conflicting experiences of major, traumatic world events on inequality is twofold. The first way that a plague, war, or natural disaster can reduce inequality is to decimate such a significant proportion of the population that it shakes up the entire social stratification system. Luckily, so far at least, the COVID-19 pandemic has not racked up mortality rates that would match those of the bubonic plague during the 14th Century. However, absent such major reductions of the population, World War II is instructive

regarding the role of policy as the second important factor in determining the socio-economic consequences of a pandemic. If when faced with a daunting challenge, governments implement policies that are almost confiscatory in their high marginal tax rates, inequality can be tamed. That is, it is not necessarily the pandemic, war, or tsunami per se that dampens inequality directly, rather it is the response to the challenge.

However, responses to the novel coronavirus pandemic so far are unlikely to reduce inequality in any meaningful fashion. It is the case that some governments have provided increased income support, which is, of course, a good thing. However, on the taxation side, we have yet to see any significant changes from the major OECD economies in terms of sharply higher marginal tax rates at the upper end. Indeed, in the U.S., the Trump tax cuts of 2017 are still in full effect, reducing the tax burden on high earners and corporations—so much so that Amazon and other large companies have been reported to have paid zero corporate tax in 2019 despite what appeared to be record profits.

Moreover, there is an increasing disconnect between the state of the economy for the modal citizen and the financial sector. While world stock markets took a short hit due to the pandemic, they quickly rebounded. Wall Street firms like Goldman Sachs, meanwhile, are making record profits even as the unemployment rate remains at Depression Era levels. Meanwhile, tax rates like those that led to the Great Compression do not seem to be in the offing. Thus, what can be done to boost low-wealth families in this time of economic stress and rising inequality?

Of course, augmented *income* support is necessary during a crisis such as that we are currently experiencing. But this crisis also provides a political opportunity to take bolder policy actions—particularly in the asset-policy domain. There are, of course, any number of possible asset-based policy options, ranging from so-called "baby bonds" to the sale of public housing to its residents to reparations to the descendants of slaves in the United States. However, a pandemic that strikes the entire nation is perhaps a particularly opportune time to think about a *collective* asset, namely, a sovereign wealth fund (SWF).

By a sovereign wealth fund, I mean a national mutual fund of stocks, bonds, and real estate holdings, including, but not limited to investments in private firms, established in the hopes of realizing profits as well as public goods that may or may not produce a direct revenue stream but which are important to the long-term productivity of the economy. Several rich nations have SWFs such as the United Arab Emirates, Qatar and Norway. Often these funds are initiated with proceeds from commodities such as oil and gas as in the above cases, or copper in the case of Chile's SWF. However, an increasing number of countries are funding national investment portfolios out of revenue that does not represent windfalls from natural resources. China, for example, has now surpassed the UAE with respect to total assets in its SWF. Likewise, Singapore, Australia and South Korea – to name a few – all have significant sovereign wealth funds seeded from non-commodity sources.

Surprisingly, the only EU country to invest in a SWF is France. Moreover, while Mexico has established one, Canada and the U.S. have not. Rich western countries, in fact, are exceptional as one scrolls down the list of 45 current funds. It is time for that to change.

The benefits to a wealthy nation are manifold. Firstly, the fund would bring in profits for "shareholders"– i.e., American citizens in the U.S. case – but also provide a source of investment funds for business. Not only would it make sense from an accounting perspective to make long-term economic and infrastructure investments through such a fund, but the establishment of such an institution would have other salutary effects on American society, including the reconceptualization of the distinction between public and private capital, the democratization of long-term decision making, the spread of investment knowledge, and the elevation of traditionally low private savings rates. In short, the creation of a sovereign wealth fund is a key step in turning the United States into an "Investor Society."

Let's start with the household savings rate in the U.S. Typically, the U.S. has a savings rate among the lowest of the G-20 countries. As recently as 1984, the rate stood at 10.8% of national income. By 2006 it had slid into the red, at negative 1.0%. It had risen since the Great Recession to 7.2% on the eve of the pandemic. In April 2020, it spiked to a record 33.7%; but this was merely an effect of widespread lockdowns wherein consumer spending was halted by fiat. By August it was down to 14.1% and promises to continue to fall to its average over the last five years of around 7%.

Like our health care system, our savings system is broken to a large extent due to its historic linkage to employers. Today, in an era of flex time and more frequent job change, less than half of workers are covered by an employer retirement plan. And about a quarter of low-income workers (the bottom fifth) have the opportunity to take advantage of such plans. Just as it does not make sense from a competitiveness or efficiency standpoint for the United States to lean on employers to provide health care, the same can be said for savings policy. Individuals should be able to enjoy all the tax and match benefits of savings regardless of employer.

A sovereign wealth fund would have a role to play here. Evidence shows that saving and investing are habit-forming. Once individuals are drawn into the financial system, they are more likely to avail themselves of more sophisticated financial tools. Assets beget saving, which, in turn, begets investment. Financial firms know this, which is why they lure clients into the door with enticing loans, rates of return, and other financial services and then sell them an entire portfolio of services. By this logic, once more Americans have experience with owning an asset, they may be more likely to save and invest privately. That is, we might expect increased investing savvy and financial literacy beyond what is directly produced by the ownership of one share of the fund. Indeed, the rise in private investing over the last three decades has largely been driven by individuals initially brought into the market through their

employer-based 401(k). In this vein, a U.S. SWF may reach the majority of Americans who still do not invest in securities markets and draw them into the "investor class."

Meanwhile, ample research shows that once individuals become owners, they have a different attitude toward the future that, in turn, generates positive externalities in terms of human capital investment, and respect for the rule of law. One study took advantage of a natural experiment in Argentina: By chance, some squatters obtained title to their land, while others arbitrarily did not. Interviews later showed those who owned formal assets had more psychic investment in capitalism and an ideology of individual self-reliance. We know it was not just innate differences in those motivated to obtain assets, since it was random who got formal titles. For their part, commercial banks have known this for years. In urban settings, many banks will not offer home loans to apartment purchasers in buildings where a significant share of the units are not owner-occupied, since owners have a real stake in the upkeep of the community's real estate values in a way that renters do not. While a cooperatively-owned asset is not the same as individual title to land, the same positive effects could be said for our collective future in a universal stakeholder society.

But achieving an investor society will require policymakers to rethink their fundamental economic approach. Until now, politicians have been obsessed with job growth as the only means to foster economic security. But that is fighting against the tides of capital, which inevitably flows to cheaper labour markets. Americans must keep in mind that the growth in jobs is just a means to the desired end of economic security for all Americans. But what if Americans – who prior to the pandemic worked more hours than almost any other world population – needed to work less thanks to great wealth? Not thanks to a universal basic income financed and paid out in the same way welfare, food stamps or even social security is, but rather, due to the returns on a sovereign wealth fund.

Yes, a pandemic may not seem like the ideal time to start saving for the future – but it is precisely when households are feeling the pinch that they understand the notion of saving for a rainy day. In fact, as the data have shown, families are now squirreling away money more than ever. Let us take advantage of the "disruption" to the typical, consumerist approach to household finance that COVID-19 has engendered. It is an apt time to rediscover our Franklin-esque roots of thrift and investment by starting the U.S. SWF.

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