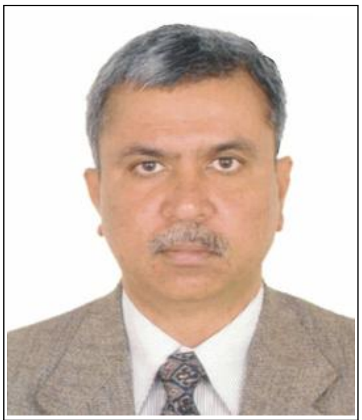
Capital Markets and Poverty Alleviation



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Can we bring two widely different worlds together? The world of capital markets or business in general and the world of economic development, inclusive growth, and removal or alleviation of poverty. Surprisingly, several eminent international economists have been writing about possible solutions. They say that the residents of a country should have the right to some share of the economy's profits. This includes Professors from Harvard, Cornell and other Universities. [1] Their purpose is not poverty removal, but to address the rising inequality around the world.

They also argue that shareholding should be much more widely dispersed. This is not about doles, subsidies, food stamps or direct cash transfers. It is not about income transfers but about asset transfers. For instance, Apple is around $2 trillion in market capitalization. It is difficult to know how many shareholders it has, as most of it is Institutional investors who in turn use funds from the public. However the US GDP is about $23 trillion. Though GDP and market value are different measures, one company is almost 10% of it. The total US share market value as of May 2021 was about $95 trillion. With a population of about 330 million, this comes to about $287,000 per head. About 60% of US citizens have shareholdings, but among those below the median income the shareholding is close to zero. A quick back of the envelope calculation shows that for the 40% who do not have any participation in financial assets [2], dispersing only 25% of market cap to them would give about $180,000 per head. This is a substantial figure. The question remains whether this is fair, and what its value would be to those who get it free or at a low price. We discuss this a little later.

Coming to India, we have struggled with the question not only of income inequality but poverty alleviation as well. From messy land reforms, to subsidies on food, electricity, employment through NREGA, subsidized agricultural interest, loan waivers, direct cash transfers etc. have been tried. The outcomes in some cases may be good, and in other cases are controversial. Use of these schemes to get votes has also become rampant. Other than land which directly transferred assets in some pockets of India, the rest are income transfers.

There are a few principal assets that the Government has. This includes natural resources like natural gas, petroleum, and minerals, which one study estimates is Rs.40 lakhs per capita. [3]. The study also says that several resources could not be included in this estimate due to lack of data. The Government also owns a huge amount of land but it is almost impossible to get a market value for this. Then there are the Public Sector Units. The Navaratnas are not only profitable but have a lot of assets including land. Then there are resources like the spectrum which is auctioned to large telecom companies. Many other natural resources including forests and local mining are difficult to put a value on and no data are available.

At a philosophical level, the question is: who really owns the natural resources and Government land? Legally, the Government owns it but on behalf of the people. This is supposed to be used for overall economic development, keeping some environmental and other concerns in mind. Since the Government is not always efficient, a lot of this is being privatized. When politics enters into the equation, allegations of crony capitalism are made. But do the people get the full benefit of this development, whether run by the Government or by the private sector? This is an age old ideological question and we do not plan to discuss this here. However, can the people of India, including those who are below the poverty line have some small share in the ownership of these assets?

Then, like the US, we too have a share market. There are a few things that are starkly different in India. The percent of people in India who own shares is very small. Available data shows that the number is rising fast but is less than 4% of the population compared to about 60% in the US and over 12% in China. The market capitalization is low compared to the US and China. In India it is about $2.93 trillion, China over $12 trillion and the US $95 trillion. India's population below the poverty line is only a little less than the entire population of the US. So there is not that much available for creating assets for the population at large. But if we target only the 10 crore families below the poverty line, and start with 5% of market cap for distribution, it comes to a little over Rs.1 lakh.

A specific case study may throw some light. KIA Motors invested $2 billion or about Rs.15,000 crores in Anantapur District of AP about 120 km from the Bangalore International Airport. Land was acquired from farmers at Rs.10 lakhs an acre when the then market price was about half at Rs.5 lakhs. Today the price is over Rs. 2 crores an acre – a jump of 50 times in less than 3 years. What if the farmers who sold the land got a small part of the KIA shares? They then become partners and much of the local resentment is handled. This idea needs to be explored for mining, minerals and hydrocarbons as well.

Historical background

Up until modern times, land was a major source of wealth. Given this background, several countries implemented land reforms including India, Korea, Pakistan, Sri Lanka, Philippines, Taiwan and Japan. Even the United States implemented land redistribution after the Civil War. In Canada, the Government purchased land from large landowners and gave it to its citizens. There were usually severe restrictions on these distributed lands being sold. Banking and Finance closely linked to trading was also a source of wealth since historical times, but it was not possible to distribute money. Perhaps it was not desirable as well.

When industrialization took place, the source of wealth shifted to business. It shifted from exploitation of natural resources like petroleum and metals to manufacturing. Today we are in the knowledge economy and the source of wealth is moving towards businesses that have some technology or knowhow that gives them a competitive advantage. Meanwhile, share markets around the world have grown, and the total market cap of a nation is often more than its GDP. What all this shows is that the traditional way of redistributing assets through land is not sufficient or even desirable. Agriculture is not remunerative any longer. In many instances, Governments are acquiring land from the citizens for large industrial projects.

Other than land redistribution, the major direct impact on poverty or inequality was through various forms of income transfers (not asset transfers) as mentioned earlier.

Today's context

Once we recognize that the source of wealth has shifted to business and finance, the type of asset redistribution would also need to change. Economists are now proposing redistribution of the wealth or assets of a nation to its citizens. This could be controversial, and one key question is how can this be done? Of what use will it be? How will it be financed?

In the case of land reforms, the Government had huge tracts of land in the 19th and 20th century and was able to acquire some of it by direct purchase as well. It was relatively easy to implement though it was not merely a Government scheme, it was political as well. But in today's context, other than natural resources and land, the redistributed assets do not belong to the Government. How can the Government finance all this even if it is desirable?

Implementation Challenges

For natural resources, no finance is required. It may be better not to directly transfer ownership of specific assets. Instead, much like shares, a certificate can be given to citizens. This does not preclude the Government from acquiring land and re-selling it to private corporations for setting up new business units. But the holder of the certificate would be a part owner of the assets. This includes land used for constructing factories and as well as areas with natural resources like hydrocarbons and minerals.

The Economists suggestion to redistribute shares traded in the market is more complicated. Perhaps in the US, the Government has the resources to finance it. In India, even if we consider buying 5% of all listed shared for redistribution, it will come to over Rs.10 lakh crores at 2021 prices, which is about 50% of the Central Budget. This is clearly not possible. It at best would need to be spread out over a decade or more. But tax incentives can be given to companies that do this voluntarily, i.e., hand over shares to an Institution set up by the Government which will issue them to the target population. A 5% reduction in corporate taxes as an incentive would lead to a loss of Rs.23,000 crores in 2021. This is a much more manageable cost for the Government. If it leads to reduction in outright and needless subsidies and doles, the actual cost would be far less and may even become a net surplus for the Government. However, some subsidies would remain in some form or the other. For such companies, the 2% CSR burden can then be waived off.

Several details would of course need to be worked out, from the actual numbers to the way of doing this and the new Institutions if any that may need to be set up. Should there be restrictions or some time limit before which such transferred assets are sold? Land reforms did have such restrictions in all countries including the US and Canada.

With the debates on privatization, transfer of a small share of corporate assets to citizens would not affect the deal in any way. Those with such share certificates would continue to be 'owners' of the company, whether Government owned or private.

Impact

Why should we consider doing this at all? The economists referred to earlier wanted to address the issue of rising inequality in the US and the developed world. It also leads to alienation of a large number of citizens who do not benefit much from the present economic model, and this in turn leads to extremist politics. Even the developed countries including the US face this problem.

India can pre-empt such a situation. But can it help to alleviate poverty? After all for the poor, assets that do not yield income may seem useless. Share certificates would entitle them to dividend income, which in turn would reduce the subsidy burden on the Government. Again details need to be worked out, but in 2021, 5% of dividends would mean Rs.600 per family per year for the 10 crore families who are below the poverty line. This is not substantial and perhaps some way of increasing this for the target segment could be considered.

But the big number is the Rs.40 lakhs of natural resource per person in India referred to earlier. This is a very conservative estimate and the actual number is higher. If we target 25% of the population and give them certificates for say 25% of this, the monetary value thus distributed would be 6.25%. Again, no cash would be distributed only certificates. Against this, people can avail low interest loans from formal institutions for education of children and for emergencies. Today such loans are in excess of 22% from the formal sector, while money lenders charge more.

It would also be interesting to see the psychological impact of asset transfers. Several economists like De Sotto have argued in favour of private property. This makes people work harder, invest and earn more. Here we are talking of private property of a different kind. Will it motivate people to work harder and earn more? Will it give them a sense of ownership of the country, which in turn leads to a more stable society and economy?

Conclusions

This is not presented as a panacea for all problems of development. Clearly many details need to be worked out before any decision can be taken about its feasibility and utility. While we continue to work towards inclusive growth, we need to think whether the economic models we use are a legacy of the past, and whether we are missing some opportunities in the 21st century economy. India has been the country of reconciling opposites and creating harmony. Will we be able to take capitalism and socialism and reconcile them? Will ownership of the nation create better citizens and a better society? Will it also help to remove poverty and extreme inequality? As they say, there is only one way to find out.

References

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