Sovereign Equity as a Solution to Sustainability of Market-led Economy

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ABSTRACT

With the market-led 'laissez faire' model, the economies of the West prospered and reached their pinnacle during the end of the last century. But the advent of the new century is met with several obstacles. The economies in the West continue to stagnate today and are no longer able to generate sustainable level of tax revenue. A third of the wage-earners is suffering from income deficiency. The ballooning national debt and widening fiscal deficit are affecting the quality of public services, including the adequacy of welfare provisions. This brief paper examines the situation and propose a policy initiative to privatise the sovereign economy itself by commoditising the national economic potential as a market based solution. With this innovative but unorthodox solution of sovereign equity creation, the state can generate additional revenue without resorting to excessive taxation or borrowing. This should also enable the state to relieve excessive tax burden on the working families as well as boost their income.

Keywords: laissez faire, stagnation, fiscal deficit, sovereign economy, equity

INTRODUCTION

The effectiveness of the market economy in the West is in question today. Economies based on Anglo-American model prospered for centuries under the concept of market-led 'laissez faire', thanks to Adam Smith. Although it withstood several economic challenges in the past, the recent financial crisis and the prolonged stagnation in the West remain the biggest threat that the market economy ever had to face. The pioneers of the market-led capitalism are losing the battle to retain the status quo and their hegemonic state is being challenged.

In the 1980s and 1990s, however, the West managed to export the concept to the rest of the world. The developing countries were embracing it wholeheartedly and the barriers to free trade seemed easing. Even the privatisation of public enterprises spread worldwide like wildfire. It essentially meant to be the cause for lesser state involvement and lesser tax burden on individuals' income. It also meant lesser debt burden on the state. For the developing countries, it offered opportunities for employment and income growth. The pioneers, however, had to endure the cost of mounting sovereign debt and the adverse impact of globalisation.

The capitalist bankers who fueled the economic growth and the producer-sector firms that exploited the market model were rather greedy. Nearly a third of the society in the UK is in the threshold of poverty and failed to fully enjoy the benefit of the market economy. According the Institute for Fiscal Studies (BBC News, 20/05/2015), individual income growth stood at all times low. Moreover, its personal finance reporter Kevin Peachey says that workers' pay growth prospects seem dreadful (BBC News, 24/11/2016). Even the welfare system that was meant to provide a safety-net to the disadvantaged working class did not prove to be effective.

The Western economies were no longer able to generate adequate tax revenue as in the old days. While more than a third is suffering from income deficiency, widening fiscal deficit is also affecting the adequacy of welfare provisions. This brief paper attempts to analyse the current situation and the causes to propose a viable single policy initiative as a market based solution to the problem. The proposal is to privatise the sovereign economy itself by commoditising the national economic potential to generate Sovereign Equity.

BACKGROUND AND LITERAURE REVIEW

Market Economy and its Lifecycle

The market economy cannot sustain by itself without continued consumer spending, and often, in excessive levels. With generous lending and other credit facilities, the market-led economy could support excessive consumption. Today, however, it has reached its saturation point which can no longer sustain and we are witnessing the gradual decline of Western economic dominance. It is also a sign of obsolescence. In general, there is a dearth of innovation in political, social and economic thinking and it affects even our institutions of government which are essentially obsolete.

With the post-war economic growth in the US, its regeneration initiatives in the war-torn countries of Europe and Japan proved to be effective. Also, the growth in trade between the USA and its allies offered economic stability. The fifties and sixties were the golden era and seemed the most stable period economically. Although, there were ups and downs in the seventies and eighties due to the prolonged Vietnam War and the oil crisis, the US and its allies could sustain their dominance. With the Bretten Woods institutions preaching the open market model, eighties and nineties saw enormous growth and prosperity but at the mercy of growing sovereign debt and corporate expansionism leading to the birth of globalisation.

The market-led capitalism was to reach its maturity stage by mid-nineties and the regional wars during this period provided further incentives for the dominance hungry Western economies. The expansion of the military machine remained a huge opportunity for the West to further sustain economic growth. Moreover, growth in home ownership also assured the continuity of market-led capitalism. Thanks to Margaret Thatcher, with financial de-regulation and easy mortgage loans, most of us in the UK could aspire to own a home since the mid-eighties. Growth in construction of housing and home ownership triggered several secondary and tertiary sectors to boom with multiplier effects on income and employment. However, by 2005s, the market economy has reached the end of its maturity stage. Debt-financed discretionary income of individuals was already causing consumption fatigue. Cheap products from surrogate economies have begun to flood the market. The market-led economy is crippling the housing affordability with skyrocketing prices. Ordinary wage-earners couldn't afford to rent either. With the financial and banking crisis of 2008, government moved to rescue the economy with further borrowing which was adding to the already growing sovereign debt.

The phenomenal growth and economic influence of the West that emerged with globalisation is also said to slide gradually along with the current economic malaise. The global financial crisis and the current prolonged stagnation supports the author's view that the economic hegemony of the West is coming to an end. Unfortunately, the negative consequences of the debt-financed economic prosperity and market-led globalisation already have begun to hurt the status quo.

Impacts of Globalisation

There is no doubt that the market-led capitalism remained a catalyst for the rapid spread of globalisation since late eighties. The consequences of globalisation are however both beneficial and adverse. The emerging economies of the developing world, obviously, have benefited enormously but the developed economies of the West have taken the brunt. It is claimed to have brought about misery to some by taking away the traditional manufacturing jobs. In other words, with cheap labour, the surrogate economies of the emerging markets did engage in the production for the developed economies.

As the time passed on, the economic decline continued and the talk of retraining the unemployed workforce to feed the new economy remained just a rhetoric. Moreover, most service sector jobs failed to provide adequate level of income for the workers. In the meantime, poverty among the working class continues. Several working families are being evicted from their rental homes as they could not afford to pay the rents (The Telegraph, 07/12/2016). With skyrocketing rents and tax burden along with a broken welfare system, the disenfranchised working class continues to struggle. But globalisation marches on and it will continue to haunt the politicians in the West.

Sovereign Debt Trap

The growth of the market economy worldwide from the 1960s further provided the sovereign nations the convenience of borrowing from the market and to engage in economic development. Nevertheless, in the eighties and nineties, most market-led economies piled up their sovereign debts. The US become the highly indebted nation on the earth with over $10 trillion in 2008 (treasurydirect.gov, acc. 13/10/2017). Debts of some economies in Europe and Japan even exceeded 200% of the GDP. In the early 2016, the US debt stood at $19.948 trillion (treasurydirect.gov, acc. 13/10/2017) while the UK debt was £1.64 trillion in the same period and £1.83 trillion in March 2018 (ukpublicspending.co.uk, acc. 04/01/2018). The US national debt had hit $20.24 trillion U.S. mark in September 2017 (statista.com, acc. 04/01/2018).

As the economies stagnate, the countries in the West are forced to borrow more. Some have even resorted to printing money under the banner of quantitative easing which means buying back their debt and writing it off. The diminishing tax revenue, therefore, remains a serious problem in the West. Today, we rarely find a developed economy with a surplus current budget and most have exceeded the threshold level. In 2012-2013, the UK fiscal deficit was nearly10% of the GDP which was the same as the economically crippled Greece during the same period (ukpublicspending.co.uk, acc. 10/11/2017). Fiscal deficit can widen for various reasons. As the market economy matures, pension and other welfare spending could grow. During stagnations, not only tax revenue could decline but welfare handout would also increase. Long life expectancy among the retirees is also a burden on the public purse. Moreover, growth in military and war related expenditure would further boost the deficit. Lastly, the interest payment on the ballooning national debt would swallow up a chunk. Obviously, fiscal deficiency affects welfare and essential services provisions.

In Britain, public housing and welfare spending is the hardest hit. When the economy is in doldrums, the quality of public services is said to suffer and the austerity measures would hurt the provision. The irony is that we are in a debt trap. The economy cannot grow without borrowing but the national debt burden is already high. The fiscal deficit in Britain in 2016 was expected to exceed be £67 billion (ukpublicspending.co.uk, acc. 10/11/2017) and the site of a balanced budget seems several years away.

The Proposed Policy Initiative

From the foregoing analysis, it becomes clear that the market-led system has its deficiencies. However, the basic principles of the market-led economy are not to be discarded. The market-led system still seems to hold huge potentials if effective measures are taken to mitigate its negative consequences such as the falling national revenue and income deficiency among the middle class and working families. It means adopting some form of quasi regulated system, particularly in the areas of financial market.

Addressing the problem of income deficiency among the working families and individuals requires innovative solutions since it is driven by the failure of the market-led economy itself. With the prolonged economic stagnation and diminishing tax revenue, the welfare provision in the UK is at its bottom. The wage-earners also are suffering from continuously falling income while the cost of housing is leaping over the roof. Tax burden on the middle-class in a market-led system is also cause of income deficiency. With a mounting sovereign debt problem, the state seems powerless to do anything as the status quo continues.

The Universal Basic Income (UBI) that some have suggested and tried out elsewhere would not make an incentive for the wage-earners, nor the state can afford to incur such an expense when the economy is already highly indebted. The Tories have recently rejected the UBI as unworkable and expensive (Stone, Independent 14/09/2016).

With the proposed innovative but unorthodox solution of sovereign equity creation, the state can generate additional revenue without resorting to excessive taxation or borrowing. Funds generated from sovereign equity sale can also be used to swap for the existing sovereign debt to reduce the burden gradually. Moreover, the model would enable the state to raise the threshold level of the taxable individual income to £30,000 or £40,000 which can boost the discretionary income of the low-wage earners. Low-income families can also be given a tax rebate for a portion of their rent payment.

Sovereign Equity: Privatisation of the Sovereign Economic Potential

A nation-state economy is not an entity by itself but it is a system of production and consumption. It creates goods and services in the form of finished products or resources for further production which is an integral part of the system.

Economic potential of the system and its intrinsic ability to produce and consume goods and services is said to have a value that we can assign. The author proposes to privatise the sovereign economy itself by commoditising this economic potential to create and assign a value as an equity which can be exchanged in the national stock exchange thereby generating funds for the nation-state plc. This is what is meant by Sovereign Equity (SE).

We tend to assign values to individuals based on their earning potentials and capabilities. We also assign values to productive assets as well as the goods and services in the market. Even the entities without any tangible assets such as the Formula 1 racing team or Chelsea football club are also traded in the share market based on their ability to win. All these values are based on the perceived benefit that we expect to gain. Therefore, it also makes sense to commoditise and assign a value to the economic potential of an entity that can produce and consume. Sovereign notes such as Treasury Bills and Gilts are, in fact, IOU (I owe You) papers which the governments exchange to borrow money from the market. Their market price are based on the perceived values of the country’s economic potential. However, when the economy fails to generate adequate tax income, state would resort to borrowing which can lead to creating a debt pile called the Sovereign Debt.

Debt-financing is in stark contrast to the equity-led revenue generation where the investor takes risk with equity capital and expects to make a dividend with no guarantee. Here, we create and sell share stocks to generate equity capital. The proposed sovereign equity is an intangible commodity which can be monetised and exchanged to raise funds or capital. Equity thus created can also be used for swapping debt.

Commoditisation of an entity engaged in the production of goods and services does not require much explanation. Such entities known as companies tend to sell ownership stakes as equity shares in the share market with a market assigned value.If we compare a sovereign state with a company, its mission may not necessarily be seen as engaging itself in the production of goods and services. Nevertheless, the sovereign state technically is said to outsource this function to the businesses and other entities (both private and public) which are engaged in the actual production of goods and services. Here, the state directly and indirectly dictates and regulates the system with economic policies and tools.

CONCLUSION

The sovereign equity which is derived from commoditising and monetising the economic potential of a sovereign state should help generate revenue by offering stakes in the share market. The mature market-led economies of the West need to use fiscal policy tools innovatively which would relieve the middle-class tax payers from unnecessary tax burden. The traditional belief that tax levies are the only source of national revenue in an economy require critical evaluation. The complexity and the ineffectiveness of corporation tax and the tax burden on the hardworking middle class cannot be ignored. A levy on individual income is a controversial issue and remains a subject for debate. The wealthy may try to avoid and evade paying tax and the poor may be exempt from paying income tax, but the middle-class is increasingly being squeezed leading to creating income deficiency in the lower end of the stratum.

The proposed model would require us to restructure the existing macroeconomic model and trigger changes in the application of fiscal and monetary policy tools. In this brief paper, it is difficult to explain in detail how the proposed model should be implemented. The proposed policy initiative is therefore innovative and unorthodox and its implementation requires strong political will and leadership. The author even proposes to abolish the personal income tax altogether and introduce a Wealth Equalisation Tax (WET) to be levied on a personal income of over £50,000 a year. This can help converting the taxpayers into investor-shareholders while also addressing the looming problem of the state pension scheme.

While the state can set a minimum individual contribution level for every month to purchase the sovereign equity shares, contributors should be allowed to purchase them in multiples depending on their affordability. The Treasury through an independent body will issue a specific number of Sovereign Equity (SE) shares (through right issue) every month against the National Insurance contributions as well as by issuing shares in the share market for the outside investors at market value. As the shareholding and share price increase, the market capitalisation of the sovereign economy will also increase.

However, the suggested income tax threshold level (tax-free allowance) and tax rebates on rent payment for the working families will remain essential. Moreover, the monetised sovereign equity needs to be sold to the taxpayers against their National Insurance (NI) contributions as well as in the share market to other investors at market value. The parliament will need to mandate the Treasury to use the NI contributions to purchase the SE shares every month for a nominal price on behalf of the eligible citizens whose shares are not traded in the share market and cannot be sold until the holder reaches the retirement age.

The SE holders will be entitled for a dividend based on the average GDP growth rate. This requires the Treasury to manage the SE funds through an independent body, investing a chunk of the proceeds in the privatised essential services companies. Outside investors can also purchase UK Plc shares instead of the Gilts or Treasury bonds. It is expected that the Treasury could use at least one-third of the proceeds to balance the fiscal deficits if deemed necessary. With the SE model, sovereign entities can manage their economies effectively without resorting to excessive borrowing while lessening the tax burden on the hardworking middleclass. It also provides a way forward to creating a framework for a sustainable pension scheme for all citizens.

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