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Realization of democratic capitalism by Universal Fund

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Abstract

In this paper I propose establishing democratic capitalism by means of a Japanese Universal Fund. The purpose of the Universal Fund is to realize democratic capitalism. The Universal Fund would be a fund available to every citizen. Anyone over 18 could register for the Universal Fund. All persons registered for the Universal Fund could receive dividends and have the right to vote according to the shares of each company's stock held in the Universal Fund. The original idea of a Universal Fund was proposed in Lynn Stout, Sergio Gramitto, and Tamara Belinfanti (2019). My proposal is that the Japanese Universal Fund would receive the shares from ETF (Exchange Traded Funds) held by BOJ and registered members could select the appropriate proxy advisor to vote.

BOJ has bought up major holdings in ETF as a way of monetary easing policy. The share of its holdings is over 80 %. Therefore, the selling of ETF by BOJ would have a huge impact on the stock markets. I recommend that BOJ transfer ETF to the Universal Fund. Registered members could vote according to the shares of companies, but they would need appropriate proxy advisors. Not only asset management companies but also many institutions such as NPOs and labor unions could become proxy advisors. Proxy advisors would express their approval or disapproval of the proposals at the general meetings of shareholders. Registered members could select an appropriate advisor and vote for their equity.

Contents

Introduction

The issue of income disparity has long been pointed out in Japan, the U.S., Europe, and other countries. Since the 1980s, liberal economic policies have taken the lead and deregulation has been promoted. In Japan the ban on temporary staffing to manufacturing industry has lifted in 2004, and later dispatch workers has rapidly increased toward 2008. In addition, the use of outsourced contract labor, such as that seen in the Uber Eats business, has also increased. Through these movements, various types of inequality and poverty has been pointed out. We can see income disparity and wealth gap, shown by rising of Gini coefficient, and most of all disparities has been passed down through generations.

Under the proposal of "new capitalism," the Kishida administration, which took office in 2021, has been implementing various policies aimed at reducing inequality. Under the slogan "Virtuous Circle of Growth and Distribution," the growth strategy includes the promotion of scientific and technological innovation through University Fund and the concept of a digital garden city nation, while the distribution strategy includes wage increases and maintaining the middle class. As one of the plans of maintaining middle class, they planned of ‘Doubling Asset-based Incomes’. In the press of Sep. 2022, ‘permanent NISA investment scheme’ will be a major policy as a ‘Doubling Asset-based Incomes’. The maintenance and revival of the middle class is an important issue not only in Japan but also in Europe and the United States, and I believe that it is a critical issue that affects the very foundation of the economy and society. However, if the specific policy to achieve this goal is the ‘permanent NISA investment scheme,’ then the goal of "maintaining the middle class" will be nothing more than a pie in the sky. As discussed in the main text, “maintaining of middle class” is difficult even a policy of ‘permanent NISA investment scheme’ is implemented, if the structure of present holdings of equities has not changed. In fact, there is even a risk of widening income and asset disparities.

The Universal Fund proposed in this paper seeks to address these problems through the democratization of stock ownership. Capitalism has developed largely through the system of corporations. Corporations have huge capital, talented human resources, and an abundance of technology and knowledge. The democratization of stock ownership through Universal Fund will transform the corporations into an organization that not only reduces inequality but also aims for a long-term sustainable society.

1　What is Universal Fund?

The Universal Fund is an initiative proposed primarily by researchers at Cornell University. I will describe the outline of Universal Fund based on the idea of Lynn Stout, Sergio Gramitto, and Tamara Belinfanti (2019).

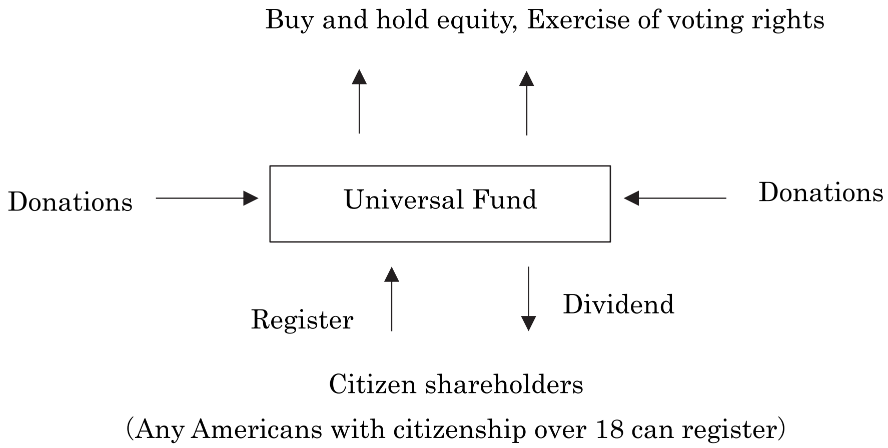
1.1　Outline of Universal Fund

In the U.S., since the 1980s, the idea that ‘maximizing shareholder value’ is the goal of a corporation has grown against the backdrop of increased M&A activity. “Maximizing shareholder value" simply means increasing the share price, i.e., maximizing market capitalization. The goal of "maximizing shareholder value" in corporate management leads to a long-term decline in the labor share and widening income inequality[1], which in turn leads to social divide. In addition, companies become too focused on stock price movements and too concerned with short-term business goals, and lack consideration for maintaining a sustainable society, such as the environment and governance.

Lynn Stout, Sergio Gramitto, and Tamara Belinfanti (2019) have introduced the attempt to find a solution to these current problems in American

1 “Economic report of the president 2022” pp.159-161.

Figure 1　Structure of Universal Fund



society through Universal Fund. Universal Fund seeks to democratize stock ownership through Fund, reduce income inequality, and orient corporations to more strongly reflect a long-term sustainability of society, including the environment and governance, in their management.

I will explain the outline of Fund with Figure 1. The Universal Fund first raises money through donations, which are then used to purchase shares. Then, anyone who is 18 years of age or older and has citizenship in the U.S. can register for the Universal Fund, and everyone is equally eligible to own a unit. Those enrolled in the Universal Fund can receive dividends from the shares held by the Fund. While registrants can receive dividends, they cannot buy or sell shares of the Universal Fund itself. In addition, the stocks purchased by the Universal Fund will be those of the S&P 500 and will be managed as index funds[2]. Therefore, it is said that it enables to lower the management　cost of Fund.

1.2　Purpose of Universal Fund

The Universal Fund has two objectives. One is to reduce income inequality and poverty. The Universal Fund accepts all citizens over the age of 18 as registrants. There are no restrictions on assets or income, and each person, whether poor or wealthy, is allocated one unit. The Universal Fund will distribute to its registrants the remainder of the dividends from their shareholdings, minus the costs of operating the fund. When the average return of Universal Fund is 2.25% with an asset size of 3 trillion dollars, Fund can distribute $300 to every 225 million citizens[3]. Registrants are free to dispose of the dividends they receive, either using them for consumption or transferring them to others. However, it is not allowed to buy and sell ownership of the Fund to others. It is same as that people cannot transfer their political voting rights to others. Therefore, in the event of the death of a registrant, his/her interest in the fund will be returned to the fund. It is also prohibited to borrow money using the fund equity as collateral, or to create derivative financial instruments such as derivatives based on the right to receive dividends from the fund.

If one considers only income redistribution, such as reducing inequality, it is conceivable to set a certain income limit for fund registrants, but as described below, the Universal Fund aims to revitalize civil society and to encourage broader citizen participation in corporate governance. For this

2　The corporations, which Universal Fund holds its equity will be large, listed companies, not small and medium companies.

3　Lynn Stout, Sergio Gramitto, and Tamara Belinfanti (2019) p.53.

reason, it is open to all citizens 18 years of age and older, without limitation based on income or assets.

The second objective of the Universal Fund is to create a mechanism for corporations to become more aware of the long-term sustainable development of society, including the environment, gender, and governance, through the exercise of voting rights. Each registered member of the Fund will be granted one unit of voting rights, which they will be able to exercise. The granting of voting rights to citizens is an important pillar in realizing the objective of the Universal Fund, which is not simply to redistribute income, but to involve citizens in corporate governance, and through this, to make corporations more oriented toward a sustainable society. Citizens are shareholders who indirectly own shares by owning interests in the Universal Fund, but they are also consumers, and many of them are also engaged in productive activities as workers and sole proprietors. When many citizens participate in the exercise of their voting rights, they participate in the management of a corporation not only as shareholders, but also as consumers, producers, and members of society. By reflecting such diverse voices in the management of a corporation, we are trying to create a system that will enable the corporation to exert its power in a direction that will bring about the development of a sustainable society. However, it is very difficult for each citizen to properly judge the voting rights of all the companies in the S&P 500. For this reason, it is stated that an appropriate voting advisor will be needed, which can be used by registrants [4].

Consistent with these objectives, the fund will operate in accordance with the following provisions. The Universal Fund does not buy and sell stocks on a short-term basis, but rather buys stocks based on an index such as the S&P 500 and holds them for the long term. This is not only to keep fund management costs low, but also to realize sustainable development of society through the exercise of voting rights, rather than to profit from short-term stock price appreciation. In addition, the remuneration paid to the fund manager shall be fixed, regardless of the fund's performance. By fixing the remuneration of the fund manager, it will prevent the Fund from pursuing transient short-term profits. The fund manager must be independent and understand the purpose of the Fund. The manager must also ensure transparency of the Fund as much as possible. They are required to disclose not only income and expense reports related to operations, but also their own background, possible conflicts of interest, and decisions regarding the selection of investment and voting advisor.

These are the Universal Fund proposed by Lynn Stout, Sergio Gramitto, and Tamara Belinfanti (2019). The most distinctive feature of Universal Funds is that they seek to realize a sustainable society by reflecting the voices of diverse citizens in the management of large corporations, in addition to redistributing income. Stout et al. emphasize the influence that corporations have on society in terms of technology, knowledge, and production capacity, and how these can be used to create a better society. As a result, the proposal for Universal Fund was born. Although the Universal Fund has not yet been realized, its goal is attractive to many who are concerned about the problems of inequality, poverty, and democratic regression in modern society.

2. ʻNew Capitalismʼ and Japanese Universal Fund

2.1. Characteristics of Japanese Universal Fund

In this paper, I propose a Japanese version of the Universal Fund concept, referring to the U.S. version of the Universal Fund proposed by Stout et al. The Universal Fund discussed in Lynn Stout, Sergio Gramitto, and Tamara Belinfanti (2019) is discussed with the realization of the Fund in the U.S. society in mind, so there are several obstacles to its use in Japan. The biggest point is the method of raising

4 Ibid., p.58-60.

funds. Stout et al. envision donations as the source of funds for Universal Fund. This is rooted in the U.S. culture of giving. Traditionally in the U.S., donations have come from individuals as well as corporations. The Center on Wealth and Philanthropy at Boston College estimates that in U.S. charity will reach $27 trillion by 2061 [5]. This situation differs greatly from that in Japan.

Another issue is the exercise of voting rights by registrants. Stout et al. state that a voting advisor is needed to ensure that citizens who register with the fund can make appropriate voting decisions. They point out that the voting advisor must be a non-profit organization, transparent, free of material conflicts of interest, and funded solely by fees from the Universal Fund [6]. Various conditions are imposed, and it would be difficult to find an organization in Japan that meets all of these requirements.

I propose to deal with these two problems by the following methods. To address the first issue of funding, I would like to propose the transfer of ETFs held by the Bank of Japan (BOJ) to Universal Fund. Although donations would be accepted, as in the U.S. version, the size of the fund would be expected to remain small on its own. Therefore, I think that it would be desirable to transfer the approximately 37 trillion yen (book value) of ETFs currently held by the Bank of Japan to Universal Fund.

BOJ has implemented various policies to deal with deflation since the 2000s[7]. It introduced quantitative and qualitative monetary easing in 2013 and negative interest rate policy in 2016. As part of this series of monetary easing policies, the BOJ has been purchasing assets, including ETFs and REITs. According to Hirayama (2021), as of September 2020, the BOJ held 84.5% of all ETFs in Japan as a result of its asset purchase policy [8]. In other words, the BOJ holds the majority of Japan's ETFs. Therefore, even when considering an exit strategy for the BOJ's monetary easing policy, it is not realistic to sell BOJ ETFs in the secondary market, according to Hirayama (2021). Since the BOJ's ETFs have become much larger than originally envisioned, Hirayama proposes that they not be sold in the secondary market, but held semi-permanently by the BOJ and used as a fund to achieve long-term growth of Japanese economy. Like Hirayama, I believe that BOJ ETFs should be utilized for the future of the Japanese economy, and propose that they must be transferred to Universal Fund as a specific method of utilization.

ETF purchases by the BOJ mean that the BOJ indirectly becomes a shareholder through ETFs, and the amount of ETF purchases is so large that by 2020 its holdings exceeds the GPIF's holdings of Japanese equities, and the BOJ is now the largest holder of Japanese equities[9]. Although ETFs held by the BOJ represent 5% of market capitalization of the Tokyo Stock Exchange book value and 7% of market value[10] at the end of 2020, this issue is more significant when viewed from an individual company basis. The BOJ has become the largest shareholder in some of these companies[11]. Therefore, the BOJ's ETF issue has important implications not only in terms of monetary policy, but also in terms of the governance of corporations, and many commentators have pointed this out[12]. Many of them have pointed out that the BOJ's ETF holdings have weakened corporate governance. Voting rights of stocks included in ETFs are exercised by the trust banks

5 Ibid., p.61.
6 Ibid., p.59.
7 ETFs held by the Bank of Japan in this section are obtained in Kenichi Hirayama (2021).
8 Ibid., pp.20-21.
9 Shingo Ide (2021)
10 Kenichi Hirayama (2021) pp.28-29.
11 Shingo Ide (2021)
12 Kimie Harada（2017）, Kenichi Hirayama（2021）chap.4, Shingo Ide（2021）, Yosuke Torii（2020）.

according to the instructions of asset management company[13]. The asset manager, or ETF management company, effectively exercises the voting rights of the shares included in the BOJ's massive ETF holdings. Many asset managers exercise their voting rights in accordance with the Stewardship Code, and many of them publicly disclose the status of their exercise[14]. Therefore, some argue that there is no problem as long as the asset management company exercises its voting rights appropriately, but I believe as follows.

The activities of large corporations, such as those incorporated in ETFs, have a significant impact on our lives and society in general. Therefore, the exercise of voting rights through Universal Fund may help to orient corporations toward the realization of a more democratic and sustainable society. Next, we will take a closer look at the exercise of voting rights through Universal Fund.

In the U.S. version of the Universal Fund, all fund registrants would have one unit and exercise their voting rights equally. In the proposed system, the Universal Fund would select a voting advisor so that fund registrants can make appropriate decisions regarding the exercise of their voting rights. However, as mentioned above, Stout et al. have imposed various conditions on the advisor to ensure that the Universal Fund would select an appropriate voting advisor. Although there are still firms that provide voting advisory services, such as ISS and Glass Lewis, it is difficult for them to meet all of the conditions for Universal Fund advisor that Stout et al. discuss, namely that they must be non-profit organizations, ensure transparency, and operate solely on fees from the Universal Fund.

Therefore, I propose that instead of imposing such conditions, the Japanese version of Universal Fund introduce the other way as follows. It is a system that allows registered members to select an organization to which they can entrust the exercise of their voting rights from among several voting advisors. Potential advisors include not only asset management companies that set up ETFs, but also institutional investors such as GPIF and life insurance companies, labor union organizations such as RENGO, and NPOs and NGOs that become involved in a variety of initiatives. The hurdles to entry for the asset management companies and institutional investors will be low because they are already engaged in the business of exercising voting rights. In addition to them, I envision that RENGO and other corporate labor unions, as well as NPOs and NGOs, will play the role of voting advisors for the Universal Fund.

Currently, labor unions and its federation RENGO may not be expressing their approval or disapproval of the proposals made at the general shareholders' meeting of the company. However, it is the employees of each company who are the most closely involved in the day-to-day management of the company. I hope that unions composed of people in such positions, and the RENGO that unite them, will act as voting advisors to the Universal Fund.

NPOs and NGOs are also strong candidates for voting advisors. Many NPOs and NGOs are already making various proposals to corporations through shareholder proposals at shareholder meetings. For example, organizations such as Kiko Network, which has made shareholder proposals to Mizuho Financial Group and Mitsubishi UFJ Financial Group, can be assumed[15].

Voting advisors are required to understand the purpose and the meaning of Universal Fund, to announce their approval or disapproval of all proposals at general meetings of shareholders of over

13 Kimie Harada (2017) p.16.

14 Financial Services Agency of Japan, List of institutional investors signing up to “Principles for Responsible Institutional Investors” ≪ Japan’s Stewardship Code ≫ (July 31, 2022).

15 See "[Press Release] Japan’s Largest Bank Targeted by Climate Resolution: Mitsubishi UFJ Financial Group told to align with Paris (March 29, 2021)" on the Kiko Network website.

2,000 companies included in TOPIX, and to disclose potential conflicts of interest against exercising voting rights. Registrants of the Fund decide which of several voting advisors, including labor unions, to entrust the voting rights of one of their units to. The Universal Fund would pay a fee to the advisors, the amount of which would be determined by the number of units for which the advisor has been entrusted with voting rights by the registrant. In other words, the advisor who receives the approval of the larger number of registrants earns the larger fee.

Some may be concerned about the technical feasibility of such individual registrant selection of voting advisors. However, a system similar to this type of system is already being introduced around the world. BlackRock, one of the largest asset management firms in the world, offers institutional investors in its funds the option to exercise voting rights at the shareholders' meetings of the companies in which they invest (BlackRock Voting Choice)[16]. As of March 31, 2022, 47% of the indexed equity funds managed by BlackRock are eligible for this program, and investors themselves participate in voting rights in 25% of these funds.

Institutional investors may choose to exercise their voting rights in one of various ways as follows. The first, they may vote directly. Some large institutional investors, such as pension funds and insurance companies, have staff to scrutinize corporate governance, and such investors will likely exercise their voting rights directly. The second option is for investors to exercise their voting rights only in specific areas, such as governance, energy, or the environment. This applies only to funds operated in separate accounts managed separately for each investor. The third is to choose from among seven existing voting advisors, including Glass Lewis and ISS. And the last is to outsource voting rights to BlackRock.

Currently, this service is available only to institutional investors, but BlackRock has announced that it will expand this service to individual investors on a trial basis in the United Kingdom starting in 2023 [17]. While details are still unclear as to whether or not the method of opening up voting rights to individual investors will be similar to the institutional investor service described above, BlackRock has stated that the introduction of such a system is technically feasible and will lead to a “revolution in shareholder democracy” that will “transform the relationship between asset owners and companies”. Moreover, not only BlackRock, but other firms such as Charles Schwab and Vanguard are considering implementing such a system. This shows that voting rights exercised by registrants through Universal Fund is technically feasible.

What must be taken into consideration, however, is the issue of the rising proportion of abstentions that do not exercise their voting rights. Considering the recent situation in Japan where the voting rate in national elections has remained at around 50%, it is expected that the exercise of voting rights in Universal Fund will be similar or even lower. A discussion is needed on an appropriate mechanism to prevent such a situation, as a higher percentage of abstentions could weaken governance or hinder the operation of the company[18].

The Japanese version of the Universal Fund discussed in this paper assumes basically the same structure as the U.S. version, except for the proposals regarding funding sources and voting advisors as noted above. The specifics are as follows.

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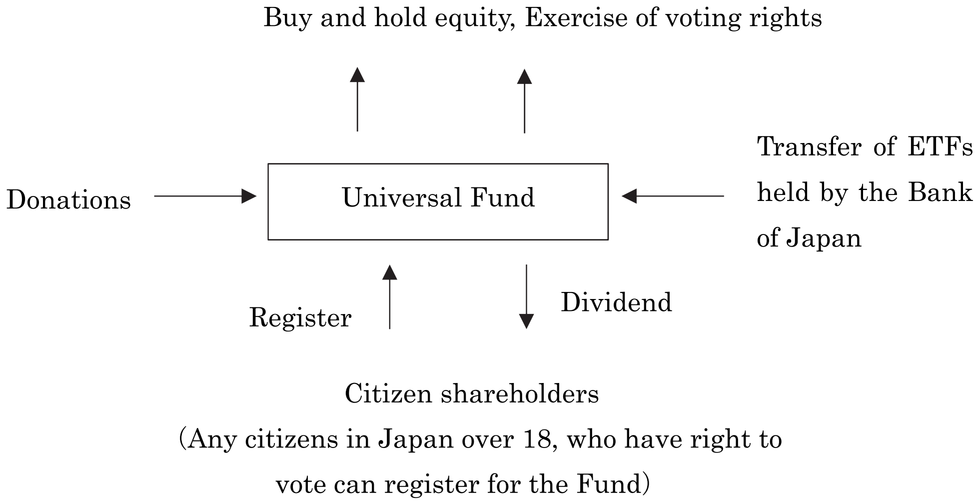
16 BlackRock (2022)

17 Financial Times, “BlackRock opens doors for retail investors to vote in proxy battels”, Nov. 3. 2022.

18 Dividends will be paid only to registrants who have exercised their voting rights, or the voting rights of registrants who have abstained will be considered the same as those of registrants who have exercised their voting rights, and votes for and against votes of registrants who have exercised their voting rights will be divided into respective proportions, and those proportions also apply to those of registrants who abstain.

Figure 2　Structure of Japanese version of Universal Fund



(1) All citizens of Japan who are 18 years of age or older, can register for Universal Fund, and everyone will equally own one unit.

(2) Those who register for the Universal Fund are entitled to receive dividends from the shares held by the fund.

(3) Although registrants can receive dividends, they cannot buy or sell their equity in the Universal Fund itself. Therefore, in the event of the registrant's death, the equity is returned to the Fund.

(4) It is prohibited to borrow funds using the fund equity as collateral, or to create derivative financial instruments such as derivatives based on the right to receive dividends from the Fund.

(5) Stocks purchased by the Universal Fund shall be index fund-type investments, such as TOPIX, and shall not aim to earn capital gains through short-term trading of stocks. Also, Universal Fund cannot operate with leverage.

The assets to be held by the Universal Fund in (5) are assumed to be ETFs held by the Bank of Japan at the start of the program. Currently, ETFs owned by the Bank of Japan are listed and there are other investors other than BOJ, and it is impossible for the BOJ alone to determine the voting rights of ETFs it owns. Therefore, as proposed by Hirayama(2021), the ETF held by BOJ will be brought to the authorized participants and exchanged for individual company's stocks, and then the Universal Fund will exercise voting rights as a money trust (discretionary investment contract). At the same time, since the Universal Fund also accepts donations, the new money added to the Fund through donations will also be used to purchase stocks included in index so that they will be managed in an indexed manner. Figure 2 illustrates this mechanism.

2.2 "New Capitalism" by Japanese Universal Fund

What changes will be brought about by a Japanese Universal Fund? The first is the reduction of income inequality. As of March 2022, the BOJ's ETF holdings totaled approximately 37 trillion yen (book value) [19]. In addition, investment income from ETF holdings in FY2021 was 842.7 billion yen. Dividing this by 105.51 million domestic resident electors yields an annual investment profit of ¥7,987 per person[20].

19 From the Bank of Japan website, "Bank of Japan Accounts for the 137th Fiscal Year, etc."
20 Population is from Ministry of Internal Affairs and Communications HP "Electoral roll".

Although fees paid to voting advisors will be deducted from this amount, citizens aged 18 and over will receive a distribution of just under 8,000 yen each year. Although this amount may seem too small compared to the current income and asset disparities, if donations from those who share the Universal Fund philosophy increase, it will be possible to expand the size of the Fund and increase its distributions.

Another important change is that through the exercise of voting rights by Universal Fund, corporate management can be oriented toward a more democratic and sustainable society. The influence of corporations in today's society is significant. Corporations have large amounts of capital, a large number of skilled workers, technology and knowledge. If these superior resources can be applied to the realization of a sustainable society, i.e., addressing environmental issues, reducing inequality and poverty, they will surely be able to exert great power. This is a point reiterated by Stout et al. [21].

Against the backdrop of the expansion of household stock ownership in the United States from the 1920s through the 1950s, the increase in small stock ownership has been viewed as the realization of an "investor democracy". The idea is that when a large portion of the population owns shares of stock, companies can be run more democratically, and individual economic independence can be preserved. Even today, there are many calls to encourage the public to invest in stocks based on this idea[22]. In reality, however, the disparity in financial assets is even greater than the disparity in income in both Japan and the United States. In Japan, from 2005 to 2019, the amount of financial assets held by the ultra-high-net-worth individuals with net financial assets of 500 million yen or more increased by 2.1 times (from 46 trillion yen increased to 97 trillion yen), and the high-net-worth individuals with net financial assets of 100 million yen or more and less than 500 million yen increased by 1.4 times (from 167 trillion yen to 236 trillion yen), while the mass market with less than 30 million yen remained at 1.2 times (from 512 trillion yen to 656 trillion yen)[23]. While the number of households that are considered wealthy or ultra-wealthy is increasing, the number of households with no financial assets (households with zero financial assets) reached 10% of all households in the 2019 National Survey of Family Income, Consumption and Wealth. When totaling households with less than 1 million yen, the ratio is up to 23%[24]. In the U.S., the ratio of assets held by the top 1% of households to the median assets was 36 times in 1963, but by 2016 it was 107 times[25]. Stocks and mutual funds held by the top 10% of Americans in 2021 hit a record high of $33.15 trillion, accounting for 88.7% of all households financial assets[26]. This reality shows how "investor democracy" is nothing more than an illusion in today's society. A Universal Fund is needed as a framework for the true realization of "investor democracy".

Universal Fund is also desirable for companies whose stocks are owned by the Fund, from a medium and long-term perspective in corporate management. Since the 1990s, as cross-shareholdings have been

21 Lynn Stout, Sergio Gramitto, and Tamara Belinfanti, (2019) pp.15-25.

22 Julia C. Ott, (2011) points out that "investor democracy" in the United States is an illusion, and that financial markets can only perform with regulation and social welfare. The book points out that not only the Reagan administration, but even former Democratic President Barack Obama have recommended investing in stocks in personal pensions like 401Ks. (Julia C. Ott (2011) p.221.) In Japan, also, there is an argument based on "investor democracy" that investing in stocks is like casting a vote for company with money, and that the democratization of finance can be realized. (Ryu Murakami (2000)).

23 Nomura Research Institute (2020) in Japanese, p.2.

24 Daiwa Institute of Research (2021) in Japanese, pp.3-4. Takashi Oshio (2016) also found that the percentage of households with savings balances of less than 1 million yen rose.

25 Akira Ohashi and Satoru Nakamoto (2020) in Japanese, p.5.

26 Kimiya Ito (2021) in Japanese, pp.33-34.

eliminated in Japan, the percentage of shares held by foreigners has increased to over 30%[27]. At the same time, institutional investors have expanded their shareholdings. There is criticism, which these changes in shareholder composition have brought about a shift in corporate management that emphasizes shareholder value, specifically management that emphasizes strengthening short term profit pursuits and shareholder returns such as dividends and share buybacks rather than future investment and R&D[28]. In addition, activist funds, which are actively involved in corporate management, have come to exert a significant influence on corporate management, both domestically and internationally. While there are cases where activist funds cooperate with companies to reduce costs and improve management efficiency, there are also cases where activists' advocacy is biased toward shareholder returns, such as dividends and share buybacks, leading to conflicts with stakeholders and management confusion[29]. This situation is serious problem for corporate managers who seek sustainable development over the long term[30]. Universal Fund would be desirable for companies seeking long-term development, as it would hold shares of the companies in which it invests on a semi-permanent basis.

3 Relationship between Existing Framework and Universal Fund

Currently, there are already initiatives to realize a sustainable society through equity investment and corporate governance by institutional investors, such as ESG investment, sustainable finance, and stewardship codes, which are widely influencing the management of corporations through the financial market. I propose a new system, that is Universal Fund, in addition to such an already functioning framework, then this chapter describes the relationship and differences between existing systems such as ESG investment and Universal Fund.

3.1 ESG Investment and Universal Fund

ESG investment is a type of investment that emphasizes companies that consider the environment, society, and governance in their selection of investment targets. It is part of the United Nation's "Principles for Responsible Investment", and has been attracting attention in Japan as well, with many ESG-themed mutual funds being sold in recent years. The term "sustainable finance" is sometimes used as a broader concept that includes not only ESG investments in stocks and bonds but also loans by financial institutions.

ESG investment emphasizes a company's efforts to address environmental and social issues as a criterion for investment decisions. It can be said that ESG investment and Universal Fund are heading in almost the same direction in terms of investment styles that emphasize the interests of various stakeholders, including shareholders, employees, suppliers, and consumers, rather than the conventional perspective of maximizing shareholder value, and in terms of the goal of realizing a sustainable society.

Although they share the same goal of achieving a sustainable society, there are some differences in the methods used to reach that goal as follows. First, ESG investments cannot eliminate the element of pursuing short-term profits, since it is possible to sell shares of the companies in which one invests. Since corporate environmental and socially conscious actions are not necessarily effective in the short term, investment decisions in sustainable finance,

27 Tokyo Stock Exchange (2022) "2021 Shareownership Survey".
28 Masaru Ushiyama, Shigekatsu Kumagai, and Yasuhiro Kobayashi (2005) in Japanese, Chapter 1 and 9. Jun Shirota, Hiromi Konishi, and Ysutaka Fukami (2021) in Japanese, Chapter 1.
29 Yumiko Miwa (2022)
30 As can be seen in Kansai Economic Federation (2022), corporate managers are also seeking medium and long-term growth, eliminating short-term profit orientation.

including ESG investment, should not be made in the short term, but rather over a multi-year period (2-5 years or longer) [31]. However, the performance of all investments, including ESG investments, is often evaluated on a monthly or quarterly basis, and the personal performance of fund managers who select investment targets is also reviewed on a quarterly basis[32]. Even if the ultimate investors, such as individuals or institutional investors, intend to manage their investments for the long term, it is difficult to eliminate the possibility that the above evaluation system will result in the pursuit of short-term profits. On the other hand, in the case of Universal Fund, the stocks purchased are index fund-type investments such as TOPIX, and the objective is not to earn capital gains through short-term stock purchases and sales. In addition, registered investors in Universal Fund are not allowed to buy and sell fund shares themselves. Therefore, the investment is inevitably a long-term investment. As mentioned above, this is also desirable for the corporations whose shares are held by the Universal Fund.

The second difference is in the exercise of voting rights for shares held. In ESG investment, in the case of mutual funds, the asset management company that organizes them determines voting rights[33]. With the introduction of the Stewardship Code in Japan, the asset management companies and asset owners, such as pension funds, are now required to aim for the sustainable growth of their portfolio companies, including ESG factors, and to increase medium- to long-term investment returns for their clients and beneficiaries[34]. As of September 30, 2022, 322 financial institutions have announced their acceptance of the Japanese version of the Stewardship Code, and the majority of them have publicly announced the results of their exercise of voting rights, including the reasons why they voted the way they did, on their websites[35]. These developments are expected to have the effect of steadily promoting corporate ESG initiatives. Therefore, ESG investment, together with the Universal Fund proposed in this paper, can be said to have a complementary relationship toward attempts to realize a sustainable society.

In ESG investments, the asset management company exercises voting rights in the portfolio company, but in the Universal Fund, each registrant exercises one unit of voting rights. As mentioned above, since it is difficult for registered investors to make all decisions on their own, they select an organization to which they entrust their voting rights from among various voting advisors. For this system to function, it is desirable to have advisors from various backgrounds. In addition to the asset management companies, which have been responsible for the exercise of voting rights up to now, the RENGO (a federation of labor unions), NPOs, NGOs, and other organizations could act as voting advisors, enabling a wider and more diverse range of public opinions to be reflected in corporate management.

In addition, ESG investments and Universal Fund can also be considered complementary from the following perspectives. ESG investments are typically active funds in which asset managers select companies that meet ESG objectives and create portfolios. Because it is an active type, it is possible to make more ESG-friendly investments. On the other

31 Dirk Schoenmaker and Willem Schramade (2019) pp. 190-203.

32 ibid. pp. 90-94.

33 Japan Securities Research Institute (2022) p.112. In some cases, real shareholders (asset owners) who hold assets such as pension funds present "voting guidelines" and the management company makes a decision, but in general, the asset management companies make decisions.（Yosuke Torii (2017) pp.64-66.）

34 The Council of Experts on the Stewardship Code (2020) “Principles for Responsible Institutional Investors ≪ Japan’s Stewardship Code ≫ ”, p.11.

35 For example, Nomura Asset Management “Results of exercising voting rights at general shareholders meetings from April to June 2022”.

hand, while passive funds have maintained a certain scale along with active funds in the current financial market, it is said that it is difficult to effectively implement sustainable finance because passive funds cannot select ESG-conscious companies to invest in because their investment targets are linked to TOPIX and other indexes[36]. Since the Universal Fund will invest in passive management linked to TOPIX, etc., it will be able to reach out to a wider range of companies that ESG investments have not been able to cover in the past. In other words, while ESG investments provide funds for the realization of a sustainable society to specific companies in a more concentrated manner through active fund management, Universal Fund seeks to achieve their objectives through the exercise of voting rights in a wide range of companies listed on the stock market with a larger amount of funds.

3.2 Sovereign Wealth Fund and Universal Fund

Next, sovereign wealth funds (SWFs) will be discussed. SWFs suddenly came into the spotlight during the 2008 global financial crisis when they purchased shares of U.S. and European financial institutions such as Citigroup and Merrill Lynch[37]. It seems that various definitions are given to SWFs in the literature, but they are generally defined as "public investment institutions whose management is controlled by the government and whose investment targets include risky assets such as foreign stocks" [38]. Typical SWFs include those funded by oil revenues, such as the Abu Dhabi Investment Authority and the Kuwait Investment Authority, and those funded by foreign exchange reserves, such as the China Investment Corporation (CIC).

The aim of SWFs is to stabilize public finances and export earnings by using oil revenues and foreign currency reserves as a source of funds while increasing them through various types of investments. The objective is to obtain medium- to long-term earnings for the state or government. For example, the Abu Dhabi Investment Authority seeks to generate income through long-term equity holdings of three to five years, rather than through short-term trading capital gains[39]. SWFs are also generally not leveraged by borrowing, which allows them to invest for the long term[40].

In addition, in recent years, SWFs have also increased their climate change-related investments by taking advantage of long-term investments. The One Planet Sovereign Wealth Funds (One Planet SWFs) were established in 2017 in response to the 2015 Paris Agreement, which was passed as a response to climate change issues[41]. The main objective is to utilize SWF funds to increase investments to meet the goals of the Paris Agreement. The SWF's investment style, which is based on long-term investments, is intended to be used to achieve a sustainable society. The initial founding members started with six funds, including the Abu Dhabi Investment Authority, Kuwait Investment Authority, and Norges Bank Investment Management (NBIM), expanding to 43 members, including 18 SWFs in 2021. SWF investments in climate change-related sectors were only $600 million in 2015 but has quadrupled to $2.3 billion in 2020 [42]. Although still a small proportion of the SWF's overall massive assets, climate change-related investments are on the rise.

Thus, while SWFs, with their long-term investment style, are well suited for investment in the environmental field, including climate change, they differ from the Universal Fund discussed in this

36 Dirk Schoenmaker and Willem Schramade (2019) chapter 7 and 8.
37 Atsuji Ohara (2009) in Japanese, pp.184-186.
38 ibid., p.11.
39 ibid., p. 107.
40 Abdullah Al-Hassan, Michael Papaioannou, Martin Skancke and Cheng Chih Sung (2013) p.7.
41 IFSWF (2021) “In Full Flow: Sovereign wealth funds mainstream climate change”.
42 ibid., p.12.

paper in the following ways: The first is transparency. Universal Fund is required to disclose not only their asset size, portfolio content, and returns to be distributed to registrants, but also voting rights advisors to disclose information such as approval or disapproval of proposals at general meetings of shareholders and possible conflicts of interest. Transparency is highly valued. In contrast, many SWFs, with a few exceptions, do not disclose the details of their assets, raising concerns that they are opaque[43]. In response to such criticisms, the "Santiago Principles" were formulated in 2008 as a set of principles for SWFs to follow. While this has led to a certain level of disclosure, it must be said that the level of disclosure is far from the level envisioned for Universal Fund[44]. Although the SWF aims at stable expansion of national budgets and foreign currency reserves over the medium to long term, its earnings are only returned to the public finances, and with a few exceptions as we will see later, there is almost no direct distribution to individual citizens[45]. As mentioned above, dividends earned by Universal Fund are distributed equally to registrants. While SWFs are similar to Universal Fund in that they seek to realize a sustainable society through medium- to long-term investments, but they differ significantly in terms of transparency and income distribution.

3.3 Alaska Permanent Fund and Universal Fund

In the previous section, I discussed the differences between SWFs and Universal Fund. However, among SWFs, the Alaska Permanent Fund ("APF") is quite similar to Universal Fund in various aspects. In the following, the characteristics of the APF are explained and the feasibility of Universal Fund is discussed.

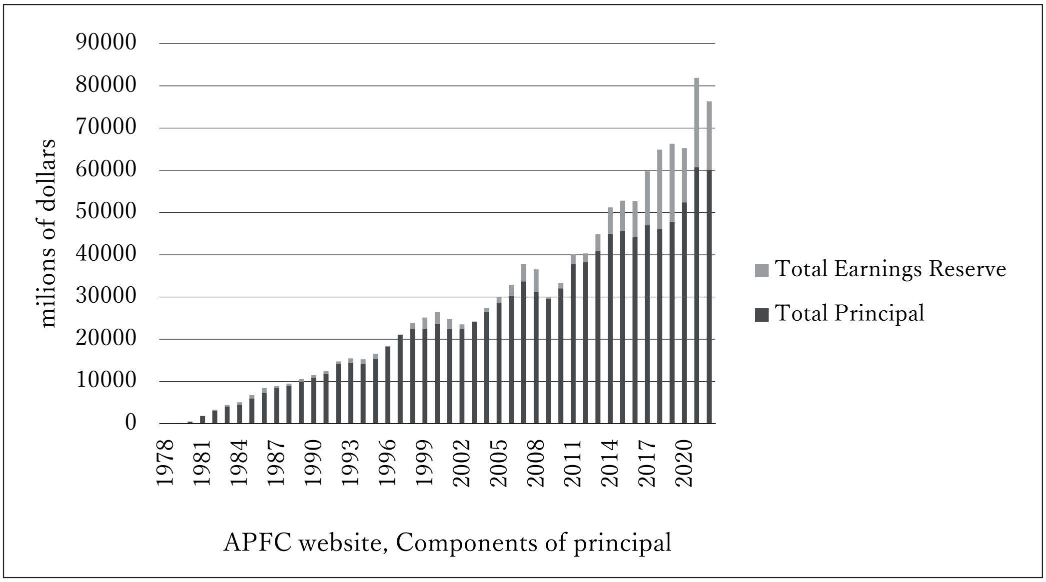
The APF was established in 1976, 10 years after the discovery of oil in Alaska[46]. It was established by the State of Alaska with the funding of $900 million obtained from the sale of oil and natural gas lease as a fund for all citizens of Alaska, including future generations as well as the current generation. In 1980, the APF Corporation (APFC) was established to administer the fund. Since then, the fund has been managed by APFC's Board of Trustees, which consists of six members appointed by the governor. Initially, the fund was invested mainly in bonds, but since the 1980s it has also invested in stocks and real estate.

APF shares many similarities with Universal Fund. The first is its long-term investment style. APF aims to generate an annualized return of the Consumer Price Index plus 5% over a period of more than 10 years[47]. In line with the above objectives of the fund, a risk-return analysis is conducted and the assets are reviewed every five years. Compared to ordinary mutual funds, which are evaluated monthly or quarterly, APF's investment evaluation timeframe is considerably longer. In addition, APF aims for sound portfolio management, and short selling of stocks and bonds is prohibited without the approval of the Chief Investment Officer (CIO) or Chief Risk Officer (CRO). The use of derivatives is also limited for risk hedging and risk control purposes.

The second is APF's high level of information disclosure. APF not only publishes investment performance, investment stocks, and investment costs, but also the minutes and videos of board of trustee meetings are available on the APFC website. Alaska citizens can also attend the board of trustee's meetings. Although it is a SWF, its attitude toward information disclosure differs greatly from that of

43 Kikuko Takeda (2018) in Japanese, p.7.
44 ibid., pp.8-10.
45 At the time of Iraq's invasion of Kuwait, the Kuwait Investment Authority had over $100 billion in assets under management, of which $80 billion was spent on government finance. (Atsuji Ohara (2009) p.153.)
46 In the follow, see APFC (Alaska Permanent Fund Corporation) website about APF.
47 APFC (2022) APFC Investment Policy, Adopted May 21,2020, amended on May 18, 2022, p.3.

Figure 3 APF total fund value



other SWFs.

The third is that the APF distributes dividends directly to citizens. Since 1982, the APF has paid dividends to all Alaskan citizens without income thresholds. The amount of the dividend varies each year depending on fluctuations in oil prices and investment returns, but it is approximately $1,000 per person per year[48]. Forty-six years have passed since its establishment, and the fund has continued to provide dividends to citizens for 40 years, and the size of the fund's assets has been increasing steadily as shown in Figure 3. As seen in Figure 3, the APF is divided into two parts: the Principal and the Earnings Reserve Account[49]. The Earnings Reserve Account consists of income gains such as interest and dividends from investment management and realized capital gains. Dividends distributed to residents are paid only from the Earnings Reserve Account.

The APF pays dividends to residents while at the same time maintaining and growing its principal over the long term, which is accomplished through the following mechanisms. First, to maintain the size of the fund, at least 25% of the revenues generated from petroleum resources are incorporated into the principal of the APF each year. In addition, a certain amount of the income from asset management is added to the principal each year to compensate for the loss of principal due to inflation (inflation proofing). In addition, a certain amount is added to the principal when the fund's earnings grow, which is irregular (special appropriations). Outstanding principal balance at the end of June 2022 was $60.7 billion, of which 36% came from oil revenues, 35% from inflation proofing, and the remaining 29% from special appropriations[50]. APF aims for long-term returns while saving a portion of the oil revenue, therefore the size of the fund is maintained and dividends are paid to residents.

The APF has been analyzed from the aspect of basic income, and the following problems have been pointed out[51]. After the APF began to pay out dividends, the demand for social welfare services

48 Mathew Berman and Random Reamey (2016)
49 The structure of APF is from “Fund structure” of APFC website.
50 APFC website, Fund Structure, Principal.
51 Scott Goldsmith (2010) pp.14-19.

increased dramatically due to the migration of elderly people, especially those over 65 years of age, to Alaska in search of dividends. Some critics have argued that the APF should be used as state funds for infrastructure development or to support indigenous people living in rural areas, instead of being distributed to all Alaskans. In addition, since the APF provides dividends regardless of age, payments to children under the age of 18 can be placed in a trust, but in 1984 survey, about half of the parents decided how to spend the money without consulting their children.

Among these criticisms, the one that could be levied against the Universal Fund as well is the use of the dividends. Especially since studies have shown that most of the dividends paid out by the APF were used for consumer durables such as electronics, while others were used for alcohol, trips to Hawaii, and a surge in advertising by companies that counted on the dividends at the time of payment. Then, the debate arose as to whether it was appropriate to pay dividends to all residents. The same argument could be made for the Universal Fund. However, even if the ETF held by the Bank of Japan is transferred to Universal Fund, the expected distribution would be less than 8,000 yen per capita. It is considerably different from the APF, which provides around $1,000 per capita, so the above issue is not as important as it seems. Rather, the Universal Fund is not focused on the amount of money distributed, but on the democratic management and sustainable development of the corporation through shareholding through the Fund.

Conclusion

This paper discusses the goal of mitigating the growing income disparity in Japan through a new initiative called "Universal Fund" and making corporate management more strongly reflect a viewpoint that aims for a long-term sustainable society. As noted in the main text, the current financial asset disparity in Japan is even greater than the income disparity. Even if the “Doubling Asset-based Incomes Plan” is implemented under these conditions, the middle class will not be restored. Under these circumstances, the Universal Fund aims to realize a more democratic, long-term sustainable society in which the public indirectly participates in the income distribution and management of corporations through the ownership of shares by the Fund.

This paper only provides a broad overview of Universal Fund. There are still issues that need to be resolved. Even if ETFs owned by the Bank of Japan are transferred to the Universal Fund, the expected distribution would be about 8,000 yen per person, which is too small to alleviate the widening gap. In addition, registered voters over the age of 18 will exercise their voting rights through the Fund, but it is inevitable that the percentage of abstentions will be quite high. Considering that the voting rate in national elections is around 50%, it is assumed that the same level of voting rights will be exercised in Universal Fund. An appropriate mechanism to prevent such a situation should also be discussed. This is the issue to be discussed in the future.

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