

Capital-market incidence beyond the named taxpayer

Trace the chapter's proposed repricing mechanisms through pensions, endowments, insurers, and households. Learn to distinguish exposure from demonstrated harm, a current price loss from future returns, and an institution's asset movement from its ability to meet obligations.

2 lessons · approximately 5 hours, plus multi-day practice

How to use this workbook

Read the assigned manuscript first. This workbook contains accompanying teaching and invented cases, not a revision of the source. Attempt exercises before consulting the rubrics and explanations. Written work is self-assessed or discussed with a tutor; no secure examination, academic credit or certificate is implied. Use a clearly labelled fictional case when live practice or personal disclosure would be unsuitable. Links use the course's intended publication address; for offline review, open the supplied source PDF at the full-book page numbers shown.

- Map direct and indirect market exposure.
- Differentiate four repricing mechanisms.
- Distinguish price levels, cash flows, and expected returns.
- Compare pension, endowment, and insurance adjustment rules.
- Evaluate a complete distributional policy ledger.

[Open the module and source reading links](#)

Lesson sequence

1. Shared ownership and the mechanics of repricing
2. Institutions, household effects, and the complete ledger

Shared ownership and the mechanics of repricing

Allow approximately 75 minutes, plus any continuing activity.

Learning objectives

- Map direct and indirect exposure to asset values.
- Distinguish cash-flow, discount-rate, liquidity, and forced-sale channels.
- Explain how defined-contribution and defined-benefit plans distribute risk.

Assigned source readings

Chapter 15: Collateral Damage—Pensions, Endowments, the Middle; I. The first misunderstanding: “the rich hold stocks; ordinary people do not”; II. How equity repricing happens: the four levers policy pulls; A. Lower expected after-tax cash flows; B. Higher required returns (risk premia); C. Reduced liquidity; D. Forced sales and market-impact pressure; III. The pension channel: the quiet taxation of retirement; A. Defined contribution plans: the individual takes the hit; B. Defined benefit plans: the institution takes the hit—then passes it on

Full-book PDF pages 201–204. Section links open the chapter at the relevant page.

Chapter 15 Notes;; The "Hazlitt" Examples (Primary); Part V — The Real Reforms: Ladders, Not Levelling

Full-book PDF pages 207–210. Section links open the chapter at the relevant page.

Develop the argument

Start with exposure, not the identity on the bill

Chapter 15 argues that a tax aimed at wealthy holders can affect others through shared capital markets. The distinction is between legal liability and economic incidence. A pension member might owe no asset tax while owning claims affected by market prices. The source lists pension funds, retirement plans, mutual funds, insurance portfolios, endowments, public funds, and bank balance sheets. Build an exposure map rather than assuming every household holds the same portfolio. Some exposure is indirect, through institutional funding or employment. Exposure alone does not quantify a loss or prove that a particular policy causes one. Identify the instrument, the holder, the relevant price or cash flow, and the path to a household consequence. The book’s “shared plumbing” metaphor is a prompt for that analysis, not a substitute for it.

Separate the four valuation channels

Section II describes four routes to lower equity prices. Lower expected distributable cash flows can reduce value. A higher required return can reduce the present value of unchanged expected cash flows. Reduced liquidity may increase trading costs and the return investors require. Forced sales may create temporary or persistent price pressure when buyers cannot absorb them at prevailing prices. These are conditional mechanisms. A tax on one owner’s wealth is not automatically a tax on the firm’s operating cash flow, and a tax-exempt holder may face different direct treatment from a taxable holder. Market composition, timing, financing choices, and expected future policy all matter. The lesson is to name the exact channel before calculating a price effect. Listing four channels does not justify adding four unmeasured losses or assuming each operates independently.

A lower price and a lower future return are not identical

The chapter sometimes moves between a fall in asset values and a reduction in future returns. Preserve the distinction. If expected cash flows remain unchanged but a higher required return lowers today's price, existing holders experience a valuation loss while a new buyer pays less for the same expected stream. That is not the same as every future buyer earning a lower expected return. In an invented perpetual-flow model, annual cash of 5 with a required return of five percent is worth 100; with a required return of six percent it is worth about 83.33. Alternatively, reducing cash to 4 at five percent gives 80. Both lower prices, but they tell different stories. The source's price-pressure examples motivate investigation; they do not establish that an annual tax necessarily institutionalises a market-wide fire sale.

Pension design determines who adjusts first

In a defined-contribution plan, a member's account reflects contributions and investment outcomes, so a market decline changes the account balance directly. In a defined-benefit arrangement, the promise and the asset pool must be analysed together. A shortfall can lead to contributions, sponsor support, benefit changes where permitted, or a different investment strategy. The chapter highlights workers, employers, and taxpayers as possible bearers. Do not infer a funding gap solely from an asset-price change without inspecting liabilities, discounting, hedging, and the governing rules. Its OECD, Pew, investment-industry, and fire-sale references are attributed support, not independently checked current measurements here. A credible pension analysis states exposure, liabilities, horizon, and adjustment rules before predicting retirement consequences. It also separates a temporary mark-to-market change from a permanent impairment of the plan's capacity to pay.

Two retirement arrangements, one market shock

Invented for this course.

In an invented economy, an equity index falls 10%. Lina's defined-contribution account holds 60% in that index; a municipal defined-benefit plan holds 40% and also has long-term liabilities.

1. With other assets unchanged, calculate Lina's immediate account impact as a 6% decline.
2. Calculate the plan's asset-only impact as a 4% decline, keeping liability changes unresolved.
3. Ask whether the price fall came from lower cash flows, changed required returns, or selling pressure.
4. Identify who would bear any confirmed funding adjustment under the plan's rules.

The same market movement has different institutional consequences. The example does not attribute the shock to a real tax or establish the defined-benefit funding gap.

Practice and evidence

1. Draw the incidence network

Map a proposed tax on concentrated shareholdings to three indirect holders and one non-investor household channel.

Deliverable: A labelled network with four conditional paths and evidence requirements.

1. Identify the legally liable person.
2. Name the mechanism linking that person's response to a market or firm outcome.
3. State what must be true for each household consequence to follow.

Incidence · 2 points

Keeps legal payment separate from price, employment, and institutional effects.

Mechanisms · 2 points

Names a specific channel at every step rather than relying on a shared-market slogan.

Limits · 2 points

Identifies exposure and offsetting effects needed to estimate net consequences.

2. Compare two present-value shocks

Use annual cash flow 5 and required return 5% as the perpetual baseline. Compare cash falling to 4 with the rate unchanged against the rate rising to 6% with cash unchanged.

Deliverable: Three values and a 300-word explanation for existing holders and new buyers.

1. Calculate baseline and both alternatives.
2. Explain the two mechanisms without treating prices and future returns as synonyms.
3. Identify two omitted real-world features.

Arithmetic · 2 points

Reports 100, 80, and approximately 83.33.

Conceptual clarity · 2 points

Separates cash-flow loss, discounting, existing-holder loss, and prospective return.

Model limits · 2 points

States that growth, risk, horizons, and market response are simplified.

Reflection

Which step in an indirect-incidence story is most likely to be asserted without evidence?

Formative self-check

Choose an answer before looking at the answer key. These questions are open practice, not a secure assessment.

1. An untaxed retirement fund owns affected shares. What establishes its indirect burden?

- A. Only the name of the tax.
- B. A demonstrated price or cash-flow effect on its holdings and the relevant time horizon.

- C. The fact that its members are not wealthy.
- D. Any political disagreement about redistribution.

2. Cash flow is unchanged but the required return rises. Which statement is best?

- A. The model's current price falls; this is not identical to lower expected returns for all new buyers.
- B. Both current price and required return must fall.
- C. Every holder must sell immediately.
- D. The tax necessarily bankrupts every pension.

3. A defined-benefit fund's assets decline 4%. What should an analyst inspect next?

- A. Only the number of retirees.
- B. Whether the chapter's political conclusion is popular.
- C. Liabilities, discounting, hedges, funding rules, and adjustment options.
- D. Nothing; the funding gap must rise exactly 4%.

Answer explanations

1. B — A demonstrated price or cash-flow effect on its holdings and the relevant time horizon.

Indirect exposure needs a mechanism and measurement. The legal label neither guarantees immunity nor proves a loss.

2. A — The model's current price falls; this is not identical to lower expected returns for all new buyers.

Higher discounting lowers present value in the specified model. Claims about all future returns, forced sales, or bankruptcy require additional assumptions.

3. C — Liabilities, discounting, hedges, funding rules, and adjustment options.

Funding compares assets with liabilities and institutional obligations. Asset movement alone does not determine the funding-ratio change or who bears it.

Institutions, household effects, and the complete ledger

Allow approximately 75 minutes, plus any continuing activity.

Learning objectives

- Trace possible adjustments through endowments, insurers, and households.
- Evaluate the shared-reservoir analogy and its limits.
- Construct a policy comparison that counts redistribution benefits and indirect costs.

Assigned source readings

IV. The endowment channel: universities, hospitals, charities; V. The insurance channel: annuities, premiums, and solvency; VI. The middle-class balance sheet: when “wealth taxes” leak into home life; VII. “But the rich still have more”: the moral evasion; VIII. A plain household analogy: the shared reservoir; IX. What a responsible policy discussion would require; The Lesson Line; Chapter 15 Notes;; The “Hazlitt” Examples (Primary); Part V — The Real Reforms: Ladders, Not Levelling

Full-book PDF pages 204–210. Section links open the chapter at the relevant page.

Develop the argument

Endowments turn asset pools into services

Section IV describes endowments as financing mechanisms for scholarships, research, health services, and community programmes. A change in asset values can affect spending through the institution’s payout rule, reserves, restrictions, and time horizon. The chapter lists reduced spending, drawing down principal, fundraising, and riskier allocation as possible responses. Model those choices instead of assuming an immediate proportional cut to every scholarship. A spending rule based on several years of values may delay adjustment; restricted gifts may also constrain which activities can change. These are considerations to investigate in a particular institution, not assertions about every endowment. The source’s “mission tax” example makes the beneficiary visible. The analytical task is to show the bridge from a portfolio effect to a service outcome and to avoid attributing an institution’s entire funding problem to one policy.

Insurance is an asset-and-liability problem

Section V extends the argument to insurers’ investment portfolios and promises. The author proposes higher premiums, reduced guarantees, changed coverage, more capital, or risk-taking as responses to weaker returns. Each requires inspection of the products, contracts, asset mix, liabilities, and regulatory treatment. Existing guaranteed payments and prices offered on new contracts are different objects. A market movement may affect assets and obligations in different ways, so a general equity-price fall does not identify a particular premium increase. The book’s concern about chasing returns is an incentive hypothesis: an institution under pressure might increase risk, but risk controls or capital rules could constrain that choice. A useful analysis states who has the option, who bears the downside, and what evidence would establish that the option was exercised.

Households respond through time and expectations

Section VI connects retirement accounts, home equity, small businesses, and institutional services to household planning. The chapter predicts saving more, working longer, relying on public support, and postponing commitments. These are possible responses, not descriptions of how every family must behave. Resources, age, employment, disability, caring responsibilities, and policy benefits affect available choices. Avoid presenting a delayed retirement as an easy remedy for someone unable to work. Sections VII and VIII argue that the wealthy remaining wealthier does not erase collateral harm. That is a valid request to evaluate incidence, while the book's shared-reservoir analogy can overstate uniformity. Investors hold different assets, benefits may reach nonholders, and repricing creates buyers as well as sellers. Keep the analogy's interconnection insight without treating the economy as a single tank in which every person receives the same dose.

Compare the full policy rather than a slogan

Section IX asks for a clear base, valuation analysis, mobility and avoidance assessment, and honest incidence modelling. Translate these into a review that includes intended public services and distributional goals as well as market costs. A burden on a pension holder does not by itself prove the entire policy lowers welfare; a large transfer to intended beneficiaries does not by itself dismiss that burden. The weights assigned to different groups and periods are normative choices that should be explicit. The chapter notes invoke asset-fire-sale research, pension exposure, and funding gaps, but moving from those observations to inevitable wealth-tax damage requires further evidence. The attached Part V heading and Lincoln epigraph transition from critique toward opportunity and open entry. A strong learner carries forward the method: trace mechanisms, compare alternatives, state uncertainty, and distinguish moral priorities from predictions.

A scholarship budget under a payout rule

Invented for this course.

An invented college funds scholarships with 4% of a three-year average endowment value. Values in the first two years are 100 million each; the third year falls to 85 million.

1. Calculate the new three-year average as 95 million and the formula payout as 3.8 million.
2. Compare with the previous 4-million payout rather than assuming scholarships fall 15% immediately.
3. Consider reserves, restrictions, fundraising, and other budget commitments before predicting the scholarship count.
4. Include any benefits the proposed public programme gives the same students in a separate net-incidence assessment.

The rule transmits a market change with smoothing. The cause of the decline and the net effect on students remain separate questions.

Practice and evidence

1. Trace a mission-budget adjustment

Using the fictional scholarship case, compare immediate market-value spending with the three-year-average rule and one reserve option.

Deliverable: A calculation sheet and a 300-word institutional memo.

1. Calculate the formula amounts.
2. Specify which spending decisions remain open.
3. Separate the asset-price mechanism from claims about the policy's cause and student welfare.

Arithmetic · 2 points

Reports 3.4m immediate-value payout and 3.8m smoothed payout.

Institutional detail · 2 points

Explains reserves, restrictions, and timing without assuming automatic cuts.

Incidence · 2 points

Includes who loses services and any relevant offsetting benefits.

2. Build the complete distributional ledger

Review a fictional capital-tax proposal affecting pension funds and financing accessible transport. Include both groups and overlapping membership.

Deliverable: A five-group ledger and a 400-word comparison with an alternative funding instrument.

1. List direct payers, retirement savers, service users, workers, and future taxpayers.
2. Record mechanisms and evidence confidence without inventing quantities.
3. State your welfare weights and explain a recommendation that could be revised.

Completeness · 2 points

Includes intended benefits and indirect costs, including people in multiple groups.

Causal discipline · 2 points

Does not equate exposure with measured harm or count the same loss twice.

Fair judgment · 2 points

Compares feasible alternatives and grades outcomes rather than moral labels.

Reflection

How would you explain an indirect cost without implying that the policy's intended beneficiaries do not matter?

Formative self-check

Choose an answer before looking at the answer key. These questions are open practice, not a secure assessment.

1. An endowment falls 15%, but spending uses a three-year average. What is the strongest conclusion?

- A. All services must immediately fall 15%.
- B. No services can ever change.
- C. The spending rule can delay and smooth the transmission; inspect other budget choices.
- D. The cause must be a wealth tax.

2. Which is the strongest response to “the rich still have more”?

- A. That fact alone does not evaluate collateral costs, programme benefits, or their distribution.
- B. It proves redistribution is always harmful.
- C. It proves pension losses are irrelevant.
- D. It establishes the exact incidence on all households.

3. What is the main limitation of the shared-reservoir analogy?

- A. It denies that institutions own assets.
- B. It proves markets are disconnected.
- C. It means valuation models are unnecessary.
- D. It can hide different exposures, horizons, buyer effects, and benefits received.

Answer explanations

1. C — The spending rule can delay and smooth the transmission; inspect other budget choices.

A payout rule changes the timing and scale of the immediate budget effect. Neither the eventual service outcome nor the cause follows from the asset movement alone.

2. A — That fact alone does not evaluate collateral costs, programme benefits, or their distribution.

Relative wealth is relevant to values but does not replace policy analysis. A complete judgment considers both benefits and burdens.

3. D — It can hide different exposures, horizons, buyer effects, and benefits received.

The analogy usefully shows interconnection but can imply uniform consequences. Analysis must disaggregate those consequences.

Module assessment

Retirement and public-services impact review

A fictional tax package is forecast to reduce an equity index 5% while funding elder transport. A defined-contribution fund holds 50% in that index, a charity holds 30%, and a defined-benefit plan has both assets and liabilities that may reprice. Review the forecast and its consequences without assuming it is correct.

Required evidence

- An exposure calculation for the first two institutions.
- A mechanism and liability-check register.
- A 600-word benefits-and-costs recommendation with an alternative financing comparison.

Assessment criteria

Calculation • 5 points

Finds 2.5% and 1.5% asset-only effects under the stated unchanged-other-assets assumption.

Mechanism • 5 points

Checks why prices change and separates cash flow, required return, liquidity, and selling.

Institutional incidence • 5 points

Examines payout rules and liabilities before predicting benefits, premiums, or funding gaps.

Balanced evaluation • 5 points

Includes transport beneficiaries, overlap, uncertainty, and a feasible alternative.

Model response: consult after your attempt

A strong review treats the 5% forecast as an assumption needing support and calculates only the impacts justified by it. It does not infer a defined-benefit funding gap without liability information or equate all price declines with permanently lower future returns. It traces charity spending through its payout rule, evaluates the transport benefit for overlapping households, and states what evidence would change the preferred funding approach. Agreement with the chapter's policy stance is unnecessary.

Source cautions and interpretation

- Complete source range 01987–02133, including the Part V transition, was read with mapped footnotes 57–59. No figures or tables are present.
- OECD exposure figures, Pew funding-gap claims, the American Investment Council figures, and the interpretation of Coval and Stafford are source assertions not independently verified here. Footnote placement does not always coincide closely with the paragraph claim.

- A fall in asset prices is not synonymous with a fall in prospective expected returns. Funding assessments must examine liabilities as well as assets.
- Observed fire-sale effects do not establish that every wealth tax forces synchronized liquidation or bankrupts pensions. Policy design and market response require separate evidence.
- The course cases are invented, and no portfolio, pension, insurance, or tax advice is provided.
- Exact mapped footnote locations read: 57 at lost-lesson-b02021; 58 at lost-lesson-b02025; 59 at lost-lesson-b02036.

Source coverage

I. The first misunderstanding: “the rich hold stocks; ordinary people do not”

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

Read source section: [full-book PDF page 201](#)

II. How equity repricing happens: the four levers policy pulls

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

Read source section: [full-book PDF page 202](#)

A. Lower expected after-tax cash flows

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

Read source section: [full-book PDF page 202](#)

B. Higher required returns (risk premia)

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

Read source section: [full-book PDF page 202](#)

C. Reduced liquidity

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

Read source section: [full-book PDF page 202](#)

D. Forced sales and market-impact pressure

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

[Read source section: full-book PDF page 202](#)

III. The pension channel: the quiet taxation of retirement

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

[Read source section: full-book PDF page 203](#)

A. Defined contribution plans: the individual takes the hit

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

[Read source section: full-book PDF page 203](#)

B. Defined benefit plans: the institution takes the hit—then passes it on

Lesson 1 maps indirect ownership, develops each of the four repricing channels, and distinguishes defined-contribution from defined-benefit transmission through exposure and present-value exercises.

[Read source section: full-book PDF page 203](#)

IV. The endowment channel: universities, hospitals, charities

Lesson 2 develops endowment, insurance, and household adjustments, evaluates the moral objection and reservoir analogy, and builds the responsible-policy ledger.

[Read source section: full-book PDF page 204](#)

V. The insurance channel: annuities, premiums, and solvency

Lesson 2 develops endowment, insurance, and household adjustments, evaluates the moral objection and reservoir analogy, and builds the responsible-policy ledger.

[Read source section: full-book PDF page 204](#)

VI. The middle-class balance sheet: when “wealth taxes” leak into home life

Lesson 2 develops endowment, insurance, and household adjustments, evaluates the moral objection and reservoir analogy, and builds the responsible-policy ledger.

[Read source section: full-book PDF page 204](#)

VII. “But the rich still have more”: the moral evasion

Lesson 2 develops endowment, insurance, and household adjustments, evaluates the moral objection and reservoir analogy, and builds the responsible-policy ledger.

[Read source section: full-book PDF page 205](#)

VIII. A plain household analogy: the shared reservoir

Lesson 2 develops endowment, insurance, and household adjustments, evaluates the moral objection and reservoir analogy, and builds the responsible-policy ledger.

[Read source section: full-book PDF page 205](#)

IX. What a responsible policy discussion would require

Lesson 2 develops endowment, insurance, and household adjustments, evaluates the moral objection and reservoir analogy, and builds the responsible-policy ledger.

[Read source section: full-book PDF page 206](#)

The Lesson Line

Lesson 2 develops endowment, insurance, and household adjustments, evaluates the moral objection and reservoir analogy, and builds the responsible-policy ledger.

[Read source section: full-book PDF page 206](#)

Chapter 15 Notes:

Both lessons critically read the pension, endowment, and liquidity-cascade notes and primary examples; Lesson 2 tests the gap between cited exposure or fire-sale findings and general policy conclusions.

[Read source section: full-book PDF page 207](#)

The "Hazlitt" Examples (Primary)

Both lessons critically read the pension, endowment, and liquidity-cascade notes and primary examples; Lesson 2 tests the gap between cited exposure or fire-sale findings and general policy conclusions.

[Read source section: full-book PDF page 208](#)

Part V — The Real Reforms: Ladders, Not Levelling

Lesson 2 identifies the Part V heading and Lincoln epigraph as the transition from collateral-cost analysis to institutions and open opportunity.

[Read source section: full-book PDF page 210](#)