

Random Notes for *Real Utopias Conference*: Let a Thousand Constructs Bloom

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Although many of us have for years been exploring ways to promote more effective social and democratic control over capital, it is still far too early to rule out almost any approach. If our practical experiences over the past three decades or so can be characterized as fledgling and uneven, the theoretical and quantitative underpinnings of an integral alternative vision for “social capitalism” are little more advanced. Frankly, whether we are advancing a paradigm shift or much more incremental changes in the social accountability of capital and corporations, we have a long way to go before we can afford to advance either/or propositions. While increasingly wide-spread, this entire movement is still in its early stages, with a set of experiences that are too limited to support one approach to the exclusion of others.

It strikes me that a fundamental transformation of expectations and perceptions about how capital and corporations should behave is a prerequisite to broad political and popular acceptance of a movement towards greater social control over capital. A basic – and daunting – challenge for capital activists is the cogent articulation of how such a profound change in the principles that animate economic activity would actually work. The goal, of course, is to promote a popular embrace of the necessity and practicality of applying socially-derived criteria to the investment and corporate decision-making processes.

This must go beyond a critique of the short- and long-term ill effects of the operations of the global financial and corporate markets – however important that continues to be. What is needed are concrete alternative constructs that illuminate ways in which the economic dilemmas posed by globalization can be ameliorated or surmounted. Ideally, these constructs would be both prescriptive (best practices, adaptations of existing financial and corporate mechanisms for new purposes) and proscriptive (thou shall not, an “unrelated business income” tax to penalize short-term investment behavior, more integral understandings of fiduciary duties).

Absent a transformation in the “received wisdom” regarding the dynamics underlying economic life, and a broad popular embrace of social capitalism, support for even modest reforms will be thin indeed. And they will be hugely vulnerable to the inevitable attacks from the neoliberal/neo-classical orthodoxy. In short, we need to promote a paradigm shift in the socio-political engagement with the economy.

Some of these changed understandings of necessity must be broad and conceptual (the social cost of rapid capital mobility, the destructive impact of financial market

expectations and demands, a model for the “ideal” pension investor given its very different nature, a “whole portfolio” theory for responsive investors) while others should be more quantitative and specific (the mismatch between pension funds’ asset and liability profiles, the real cost of actively chasing short-term gains, re-engineering existing financial mechanisms for new purposes).

While I found the papers produced for the *Real Utopias Conference* to be imaginative and thought-provoking, I would like to suggest a number of empirical and conceptual tasks that I believe are critical to building a more solid foundation for our advocacy. In no particular order, these include:¹

- What is the real cost of capital to a pension fund? Unlike other financial institutions, pension funds do not have to pay for their capital up front, but rather over a very long period in the future. Perhaps it is best conceived as a fund’s actuarial interest assumption. This is important, I would argue, because the cost of capital, liquidity requirements and investor/lender expectations clearly influence the ways financial institutions behave. Since pension funds have such a different profile, it seems reasonable that such funds should have distinguishable investment behaviors as well. However, it is difficult to identify how pension funds, with their fairly steady inflows (with no effective up-front costs) and predictable long-term liabilities, behave all that differently from other large institutional investors. Thus, an important research task would be to delineate exactly how pension funds differ from other financial institutions, and document how the service provider market has, in the main, failed to develop techniques and services that reflect these differences.
- As a general matter, after decrying investors’ ceaseless pursuit of short-term maximum returns, we need to address the question of what is a reasonable and achievable long-term investment return? How much is too much – and ultimately unsustainable -- and how little is too little and fundamentally unreasonable? In other words, what should be the “wages” of capital (after all, “capital” is perfectly comfortable opining on what the wages of labor should be)?
- We need to develop a philosophy – or at least an operating construct -- of the *market* as an agent for more democratic control of society’s capital resources. Obviously, this should be linked to notions of the social purpose of the corporation. Together, these concepts could form the basis for a capital/social contract.
- Since, to an important degree, a key impediment to much positive social and economic change is “us” (through the collective power and actions of pension funds), we need to address the responsibilities as well as the rights of shareholders. This is a particularly urgent task given the fact that some pension fund activism strongly reinforces the concept of shareholder primacy. For example, virtually all of the rhetoric surrounding activist shareholder resolutions and “socially responsible” investing employs some variation of the rubric of investor rights and shareholder value. Put another way, the overwhelming

¹ Many of the points made here were presented informally during the Harvard Trade Union Program’s 2003 and 2004 pension conferences.

- emphasis is on investors as *takers*. At this point, we've pretty well refined the arguments for shareholder rights in the face of unresponsive or incompetent management; but what about shareholder *responsibilities*? For example,
- We need to start defining in what ways – and to what degree – are investors culpable for such things as outsourcing, corporate short-termism, job loss, and even corporate scandals? How do investor expectations (and their behavior in the face of underperformance relative to those expectations) drive corporate behavior? What practical remedies would we advocate? This is the flip-side of the long-running “stakeholder” argument, but may provide a more solid basis from which to define the rightful interests of those effected by the behavior of financial and corporate actors.
 - We should be much more clear about the fact that a significant portion of pension assets are socially-provided, through the tax-deductibility of contributions and the exclusion of pension investment income from current taxation. While Blackburn cites a figure of \$100 billion annually. But the total tax expenditure represented as a proportion of existing pension assets is probably between the average corporate and individual tax rates over the past decades. With roughly \$9 to \$10 trillion in assets, a safe estimate of the “social” portion of pension assets would seem to be in the \$2 to \$3 trillion range (this guesstimate clearly needs to be refined significantly). Given the social origin of such a material portion of pension assets, the notion of these investors having a responsibility back to society – to other stakeholders in the economy – has real power. The question we should pursue, then, is what should those responsibilities be, concretely? This approach also provides the basis from which we can begin to sketch out practical solutions to the widely accepted quandary of profit maximization versus social responsibility.
- How can the growing literature on “intangibles” be harnessed to buttress the case for alternative approaches to investments, particularly with respect to the “premature destruction” of human capital and artificially agreed-upon values?
 - For the lawyers, how has ERISA’s introduction of the prudent *expert* (replacing the 150-year old rule of the prudent *man*) impacted investment behavior? What new barriers – and opportunities – has this rule introduced? When taken in combination with the law’s emphasis on *procedure* over *performance*, has the alternative investment movement now effectively created a peer group of “worker-friendly” or “socially-responsible” financial actors that *de jure* actually define a new standard for prudent fiduciaries? Wouldn’t it be interesting for the attorneys among us to help develop our own version of a Chicago School style legal-economic analysis?
 - For the financial technicians, how can we articulate a “whole portfolio” theory of investments that accounts for not only beta, maturity and expected returns, but also incorporates the impact of various investment practices on participants and beneficiaries, as well as on the society at large? Part of such a theory, it seems to me, would include a “social life cycle” analysis that takes into account a range of factors that are traditionally considered to be exogenous.

- One of the most important arguments deployed against greater worker control of pension funds has been the assertion that – in the case of Defined Benefit plans – since the employer bears the risk of performance it should be able to control the investment of pension assets. Setting aside for the moment the clear fallacies in this line of argument (for example, over time, benefits are more-or-less perfectly substitutable with wages), the dramatic shift to Defined Contribution and Individual Account plans renders this employer position moot. Unfortunately, the punch line (employers should have the right to control the pension fund investment process) continues to hold sway. It is far past time for the alternative case to be made, using the very arguments employers used to defend their control of DB plans: since workers bear the entire risk of performance in DC plans, they and not their employers should control such funds.
- Another important, if seemingly prosaic, task would be the systematic translation of social criteria into orthodox financial language. This is a key challenge for those who are actually interacting with investment managers, trustees, lawyers and other fiduciaries on a regular basis, attempting to introduce new concepts and procedures.

A Couple of Comments Reacting to Specific Points in the Papers

Eric Olin Wright is quite correct in pointing to Exit or Voice as the “two broad ways that pension funds might impose constraints on investments.” However, these approaches (screens and disinvestment for the former, leverage-through-ownership for the latter) share a critical conceptual limitation: both presume an adversarial relationship with an entity controlled by others. They are different paths to exerting pressures on a company where there is some form of conflict. For me, the most important step that we should be promoting in the movement towards “social capitalism” could be characterized as developing a strategy for taking the Initiative in investments. Rather than using varying degrees of influence to alter the behavior of existing entities, socially responsive investors such as pension funds should be setting about the task of creating their own investment vehicles and new corporate entities, using socially-informed criteria, standards and procedures. This could include everything from traditional, but re-engineered financial institutions to highly innovative adaptations of the micro-lending phenomenon, secondary market makers for community development funds, or context-appropriate emulations of Mondragon’s Caja Laboral. Although I would welcome some other term, it seems to me that the concept of *Initiative*, as a complement and counterpoint to *Exit* and *Voice*, significantly expands the vision, in Wright’s words, of using “pensions as a device for increasing the capacity of civil society to control capital . . .”

Robin Blackburn makes a fairly compelling *political* argument against any increased reliance on pay-as-you-go retirement income schemes to meet the challenges that will be posed by the looming demographic bubble, which he uses to launch into his advocacy for the creation of an entirely new form of funded national pension system. However, I do not believe that he makes the *economic* case for the superiority of pre-funded retirement

systems over those that rely on taxes or other transfer mechanisms. With either type of retirement regime, the basic issue remains the anticipated growth in the portion of GDP that will be needed to provide some modicum of retirement income security and health care for an aging population. The source of the funds required to meet these needs seems to me far less important than the ability of the economy (or the willingness of the active workforce) to produce the goods and services that such funds are intended to secure. After all, the strain that will be posed by the growing cohort of retirees will be almost entirely about current consumption at the time the pension check is issued or eligibility for publicly-supported health care is certified. And the economy's ability to meet that demand has little to do with whether the funds used to pay for it comes from a transfer tax or the sale of a stock or bond. It seems quite obvious that monies emanating from pre-funded plans will have no more – or less – purchasing power than those coming from the public purse. In either case, that will depend on the ability of the economy to meet demand. Likewise, too many dollars chasing too few available goods and services will result in a sort of rationing via inflation. So it seems to me that, from an *economic* perspective, the argument turns on whether one system or another actually results in greater productive capacity over the long term. And if there turns out to be little or no real difference in that regard, the argument then must address which approach is more socially efficacious. Following on Larry Beeferman's point about the obvious costs – and attendant financial drain – attendant with building a massive new pre-funded national retirement system, I would suggest that the economic case for pre-funding has not been made. As the recent debate in France over important, if relatively modest, changes to that country's mainly pay-as-you-go system of public and private pensions, the concept of intergenerational solidarity (*repartition*) continues to have strong support, even in the face of a sophisticated effort by the global financial industry to advocate a move towards a pre-funded system (*capitalization*). There are social efficacy arguments that would tend to support the creation of new pre-funded systems, but they do not, in my opinion, add up to a compelling case.

I take very seriously Jim Stanford's "sober second thoughts" on the utility and advisability of pension fund activism. And while I believe that he seriously overstates a number of critical issues in his stark recitation of potential pitfalls, he poses some excellent questions that we all must grapple with. Stanford argues that pension fund activism holds little real-world promise for actually being effective and that it is fraught with risks to participants, unions, and the viability of group-based pensions themselves. Assuming, for the sake of argument, that Stanford is broadly correct, I'd like to pose a couple of questions to him: Should pension fund activists simply abandon the field and cede unchallenged control of workers' pension funds to employers and the global financial industry? Is there no useful way that the rules and behavior of institutional investors can be confronted, altered, and even perhaps transformed? Ignoring, for the moment, the "utopian" aspects of pension fund activism, what about attempts to limit various types of socially and economically destructive behaviors that pension and other institutional investors regularly engage in (or are attributable to their portfolio companies)? Finally, are attempts to introduce social constraints and considerations into the process of capital allocation are simply futile and not worth the effort?