

# **Making Capital Accessible**

## **How to Put Pension Savings in the Service of ‘Financial Pluralism’?**

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### **Abstract**

Since the late 1980s, financial geographers have argued, against the tenets of mainstream neoclassical economics, that most political economies harbor a growing unevenness in the accessibility of capital, which is due to the increasing consolidation within the financial sector. However, financial geographers have been less strong in offering institutional answers to this state of affairs. To address this deficit, I propose a mandatory levy on the surpluses of regular pension funds in order to develop an alternative financial infrastructure that could start to redress the multidimensional unevenness found in many contemporary political economies. The underlying idea is that ‘financial pluralism’ is the key to a more even accessibility of capital. As such, this proposal is primarily aimed at redressing the ‘financial monism’ that is the rule in most political economies.

<b>1. Introduction.....</b>	<b>3</b>
1.1. The nature of the undertaking .....	8
1.2. The scope of the argument.....	8
1.3. Pension crisis?.....	10
<b>2. Why a conditional pension saving levy? .....</b>	<b>10</b>
2.1. Advocacy .....	11
2.2. Screening.....	13
2.3. Targeted investment .....	13
2.4. Supplementary, conditional and incremental.....	14
<b>3. Why target pension savings?.....</b>	<b>16</b>
3.1. The moral nature of pension savings.....	16
3.2. The ‘public’ nature of pension savings .....	17
3.3. The ‘fuzzy’ nature of pension surpluses.....	17
<b>4. How to overcome cost and information problems? .....</b>	<b>18</b>
4.1. Cost problems.....	18
4.2. Information problems.....	19
<b>5. How feasible is it? .....</b>	<b>23</b>
5.1. Corporate sponsors.....	23
5.2. Contributors and beneficiaries .....	24
5.3. Pension funds, banks and insurers .....	26
<b>6. References.....</b>	<b>28</b>

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## **How to Put Pension Savings in the Service of ‘Financial Pluralism’?<sup>1</sup>**

### **1. Introduction**

In a powerful criticism of the efficient market hypotheses, which maintains that prices in ‘free’ capital markets reflect all available information, suggesting that no profitable investment opportunity will remain structurally un(der)funded, financial geographers since the late 1980s have increasingly focused on territorial, functional, ethnic and sexist unevenness to show that even within well-developed political economies there is a marked inequality in access to capital (See Martin 1988; 1992; Martin & Minns 1995; Martin et al. 2002; Mason & Harrison 1999; 2002; 2003; Leyshon & Thrift 1995; 1999). The financial industry is seen to favor some and to disfavor others. The notion of ‘financial exclusion’ that is employed to describe this state of affairs, however, does not only pertain to the lack of access to basic financial services of ethnic minorities, the un(der)employed, women, and other marginalized groups (Leyshon & Thrift 1995; 1999), but encompasses also the phenomenon of lack of investment capital for small-and-medium-sized enterprises (SMEs), greenfield industries and peripheral regions. For instance, Martin for the 1980s (1988; 1992) and Mason & Harrison (1999; 2002) for the 1990s have convincingly demonstrated that the geographical distribution of venture capital in the UK is highly skewed towards the affluent South East. In a more recent study, Martin et al. have found that this unevenness can be observed in France, Sweden and the Netherlands too; venture capitalists as well as their clients tend to cluster around national financial centers, i.e. Paris, Sweden and Amsterdam respectively (Martin et al. 2002). More widespread is the observation that small firms have difficulty financing their expansion because of insufficient ‘retained earnings’ and lack of external capital (see OECD 1996; 1998; Godley & Ross 1996).

In the geographical literature, the extent to which financial unevenness occurs is explained by the structure of the financial sector. Most political economies have historically harbored different regulatory regimes for different segments of the financial sector in order to satisfy the financial needs and requirements of different economic agents. Instruments of ‘financial segmentation’, as it

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is called, are legal walls between investment banking, retail banking, private banking, insurances, pensions, and mortgages. The American Glass-Steagall Act of 1933 which separated deposit banking from investment banking, or the saving account business from securities underwriting, by restricting the income that could be derived from the latter activity to a mere 10 percent in the case of deposit banks, clearly belongs to this type. As does the Bank Holding Company Act of 1956 which prohibits banks from undertaking insurance activities. Functionally equivalent are legal prohibitions on border-crossing, either within states or between states.

Underlying both functional and geographical financial segmentation is the need to ensure more or less equal access to capital for center and periphery and large and small firms that is forced upon states by peripheral interest groups with political clout (Verdier 2002). Since different actors have different financial needs which reap different rates of return, states have usually tried to attract capital providers to less-rewarding capital outlets through taxation measures while simultaneously preventing cross-segmental concentration by construction 'fire walls' between financial services providers. As a result, each of these segments is populated by a distinct set of financial agents, providing a distinct number of financial products that cater to different consumers, requiring distinct mixtures of codified information and interpretative skills, entailing different risk and return profiles, distinct ownership and control structures as well as diverging investment criteria (Deeg 1999; Verdier 2000a; 2000b; 2002).

The same is true for equity markets, indicating that the need for decentralized financial structures cuts across the well-known distinction between bank-based and market-based economies (Gerschenkron 1962; Verdier 2002). Given the need for 'thick', qualitative information to determine the value of small firms there is a strong rationale for proximity. As such, it makes sense to have specialized, regionally based equity markets in order to provide local monies to local firms based on local knowledge of local conditions. Historical studies have indicated that regional stock exchanges used to be important pillars buttressing the 'economy of industrial districts' of 19<sup>th</sup> century England of which Alfred Marshall so famously spoke (Zeitlin 1995; Newton 1996). In Germany, cooperative banks and provincial stock exchanges still fulfill this function (Deeg 1999; Clark & Wojcik 2002; Wojcik 2002). Hence, despite diametrically opposed state traditions — a unitarian and highly centralized state in the case of the UK and a pluralist and decentralized one in the case of Germany — and despite being on opposite ends of the shareholder/stakeholder dichotomy (Albert 1991; Hall & Soskice 2000), both political economies have harbored, at one time or another, a multi-layered financial system, indicating strong political (local constituencies) and economic (information asymmetries) rationales for financial segmentation.

In the following I will refer to — spatially and functionally — segmented and decentralized financial sectors as 'financial pluralism', which I take to be a species of the genus of 'institutional pluralism'. Like the latter, the notion of financial pluralism refers to a diverse financial architecture that is explicitly designed to cater to the financial needs of different groups and uses different mixes

of state regulation, self regulation and market pressures (institutional pluralism) to ensure that. Forms of financial pluralism can be found in many political economies, including Germany, Italy, Japan, the US and Switzerland — all classic federal states —, but also, albeit to a much lower extent, in France, Sweden, Portugal, the Netherlands and the UK. In fact there is no political economy with at least a modicum of financial pluralism. Hence what matters is the extent of segmentation as well as the level of concentration, and these differ widely between political economies. In 1996, for instance, the share of the commercial banking sector of the five largest banks in terms of turnover ranged from 30 percent in the US, 56 in Italy, 62 in Spain, 66 in Germany to 83 in Switzerland. Their share in the overall banking sector though, encompassing both commercial banking and public and not-for-profit banking, was 17 percent in the US, 34 in Italy, 47 in Spain, 21 in Germany and 63 in Switzerland. The comparable figures for typical monist political economies like the Netherlands, France, Sweden and Australia are 76 and 66 respectively for the Netherlands, 60 versus 37 for France, 94 versus 63 for Sweden and 73 versus 62 for Australia (Verdier 2002: 146).

The premise underlying this paper is that pluralist political economies demonstrate a lower level of financial exclusion than monist ones. To my knowledge there have been no studies trying to establish such a claim systematically across states. However, there is some circumstantial evidence to back this claim. Recent figures from the EC, for example, demonstrate that SME's have a harder time to get finance in political economies with more concentrated and desegmented financial systems than in economies with pluralist ones (EC 2003a). Figures from the US corroborate that. Using a sample of 1.6 million loans to US businesses by US banks, Berger et al. (1995) showed that size is crucial. The largest banks tend to lend predominantly to large firms, whereas SME's have to do with more locally oriented capital providers. Moreover, the accessibility of capital is seen to be dependent on the degree of concentration within the financial sector. In the absence of alternative means of financing — state banks or local savings and cooperative banks — increasing concentration leads to a contraction in capital for SME's. Vice versa, a more even economic growth requires a more even distribution of capital and hence a segmented financial structure (Williams & Gardener 2002; MacKay & Molyneux 1996; Dow & Rodriguez-Fuentes 1997). These insights largely explain the growing emphasis by policy makers on the need to bridge financing gaps in peripheral regions, marginal sectors and smaller firm sizes. However, it appears that such attempts are both more urgent and less successful in highly consolidated, desegmented financial systems (Marshall 2004). According to Verdier this is due to the lack of countervailing powers in desegmented political economies, which, in turn, is an effect of the structure of the national polity. Highly centralized polities are both the cause and effect of the long term marginalization of peripheral political elites and hence do not provide these elites with the political resources to counter the centripetal effects of financial consolidation (Verdier 2002). In other words, one could make the argument that pluralist financial systems are superior to monist ones on both prudential and moral criteria. Prudentially, because a more even distribution of economic growth obviates

either expensive dislocations or costly redistributive measures, while morally a more even distribution of capital across regions and industries can be seen as one of the institutional requirements derived from the exhortation to enhance equality of opportunity (Roemer 1998).

Nevertheless, since the 1970s pluralist financial systems have come under increasing pressure. The liberalization and deregulation of capital markets, the introduction of new information and communication technologies (ICT), the reduction of transaction costs, as well as general increases in cross regional and cross national stocks and flows of capital, have resulted in an ongoing process of consolidation and amalgamation within the financial sector. According to a recent study of the Group of Ten (G10) this is a global trend. In almost every member state the number of banks has gradually declined since the 1980s, resulting in a level of concentration that ranges from 26 per cent market share for the largest five commercial banks in the US (up from 14 in 1980) to 82 per cent in the Netherlands (up from 73 in 1990). Even a highly decentralized and segmented banking system as the German has been subject to increasing concentration pressures. During the 1990s the overall number of banks in Germany declined from 4,719 to 3,167, primarily because of mergers among local and regional savings and cooperative banks. Moreover, over the last couple of years there has been a considerable built up of political pressure within the EU and the Bank for International Settlements (BIS) on Germany to abolish state guarantees and to tear down the legal walls between different banking markets (G10 2001). Despite resistance from local, national and even supranational representatives of savings banks and other local and regional financial institutes, especially in Germany, Spain and Italy ([see www.savings-banks.com](http://www.savings-banks.com)), there is an enormous accumulation of pressure at the supranational level by agencies like the EC, the OECD, the BIS and the World Bank on states to deregulate financial markets and integrate national capital markets. Telling are the policy recommendations of the 2003 'Access to Finance'-report of the EC which exhort members to comply with the restrictive state aid rules of the Treaty and refrain from providing 'below market interest rate products', while at the same time noting that most micro-credits are provided by savings and cooperatives banks, which are highly dependent on the very same advantageous fiscal facilities it tries to wipe out (EC 2003b). Many supra-national reports on the issue betray a singular mismatch between analysis and recommendations, raising urgent questions about the ideological nature of the latter.

According to a recent report of the G10, the tendency toward consolidation has taken place against the background of a rapidly growing market for financial services and an increasing economic importance of the financial services as such. During the 1990s, in almost every member state the financial industry has provided more jobs every year, while the value of assets under control have in some cases risen to four times the gross domestic product (GDP), clearly enhancing the political clout of the biggest players within the financial industry. Some have described these developments as 'financialization', referring to a gradual process in which financial values (shareholder value, capital market gains), backed by a professional business press and well organized

interest groups, become leading institutional and organizational design criteria, while the financial sector as a whole, because of sheer scale, starts to dominate cities, regions and even national economies. Not just in terms of employees, firms and share of financial flows, profits and investments, but rather in the sense of installing a 'finance-led accumulation regime', as Robert Boyer has dubbed it (2000: 116), that is characterized by a reversal of the causal link between the real economic sphere and the financial sphere.

Driving this process are the investment needs of the world's largest pension funds as well as other institutional investors (banks, insurers, mutual funds), which during the 1990s have become domineering players on the world's capital markets. Those needs are largely determined by the four objectives that are embedded within the institutional logic of funded pension arrangements: risk and cost minimization, and return and liquidity maximization (Clark 2000). Since pension funds are subject to a process of maturation during which the ratio between contributors and pensioners gradually changes, the exact weighing of the four objectives also changes. To be more precise, during maturation the liquidity requirement becomes the most important objective, resulting in a shift away from committed ownership to increasingly speculative investments in the most liquid markets and the most liquid assets (Engelen 2003).

If one accepts the generalization that market-based political economies have a more centralised and consolidated financial system, which generates higher rates of social, functional and spatial unevenness, while bank-based political economies have a more decentralized and segmented financial system and lower levels of unevenness (see Hall & Soskice 2001), the tendencies just described are reason for concern. Since they are inimical to the moral requirements of equality — equal market access, on the demand side as well as the supply side (Roemer 1998) — but also to the prudential requirements of building and maintaining long-term wealth generating capabilities — internal control, patient capital, loyal workers, and a high degree of organizational integration (Lazonick 2000; O'Sullivan 2000) — there are good moral and prudential reasons to look for instruments that could either shore up still existing pluralist financial systems or develop a diverging financial infrastructure in already largely monist financial systems.

While financial geographers have been good at describing and explaining uneven development and financial exclusion, their policy proposals have not risen above the admonition to widen regional policy 'to incorporate measures which promote the decentralization of financial powers' and 'impose regional reinvestment conditions' (Martin & Minns 1995: 142). The aim of this paper is to make up this deficit, by proposing to impose a conditional levy on the savings surpluses of pension funds whose proceeds are sluiced into a 'Fund for Economic Renewal' (FER) that has three broad objectives: regional and urban (re)development; economic innovation; combatting social exclusion. Whether this levy will actually be imposed, depends on the amounts of capital that pension funds do already invest in these areas voluntarily.

I start with a discussion of the basic design principles of the levy. Next I discuss the choice

of pension savings as a source of funding. In the two subsequent sections, I discuss the main objections that can be leveled against this proposal, namely: that it does not solve the cost and information problems related to alternative investments. I end the paper with some notes on political feasibility. Before embarking, three preliminary remarks are in order.

### 1.1. The nature of the undertaking

Obviously this undertaking is neither descriptive nor explanatory in a traditional sense, even though it uses descriptive and explanatory work done by others. Instead, it is an exercise in institutional imagination, informed by a type of utopianism that uses a mix of moral, prudential and realist design criteria to enlarge the domain of the feasible while keep our moral flights of fancy in realist check. I call this type of utopianism 'concrete utopianism'. It is 'utopian' because it presupposes the possibility of creating a better, more just world, and as such is premised on the recognition of the contingent nature of what is. And it is 'concrete' because the imaginary journey starts with a detailed description of the multiple logics of existing institutions and explicitly tries to accommodate the desiderata of political feasibility (Bader & Engelen 2003; see also Wright 1995; Bourdieu 1988).

### 1.2. The scope of the argument

This paper is written against the background of the highly regulated Dutch society, implying a multi-layered pension system consisting of: (i) a sober, publicly administered pay-as-you-go facility for all Dutch inhabitants; (ii) an encompassing, funded layer for private and public sector employees, jointly managed by unions and employers; and (iii) a small, voluntary layer of defined contribution plans, managed by commercial insurers (Clark & Bennett 2001). Moreover, it explicitly addresses issues of market access in a context of a highly consolidated financial sector in which the traces of functional and territorial segmentation have mostly disappeared.

As such the emphasis is on creating a supplementary financial infrastructure in order to reintroduce financial pluralism rather than on shoring up still existing segmentations. This distinction highlights the institutional similarities between the Netherlands and the UK and its contrast with countries like Spain, Italy and Germany where pay-as-you-go systems predominate and financial consolidation is only beginning (Minns 2001; Verdier 2000a; 2000b; 2002; Deeg 1999). However, the mix of demographic developments and deregulatory pressures bodes ill for the political sustainability of a pluralist financial system on the European continent. In many continental European countries the debate on pension restructuring is not so much about whether existing systems need a strong dose of capitalization but how and when to do so. Elsewhere I have argued that capitalization is closely related to financial consolidation, since funded pension savings imply the availability of a growing stock of capital whose management generates increasing flows of income for financial service providers while their cost structure has strong 'economies of scale'-properties, resulting in a forceful drive for liquidity (Engelen 2003). In these countries, the moral requirement of equal market access could take the form of making the introduction of capitalized

pension arrangements conditional upon the introduction of a similar facility like the levy proposed here, that would obliged providers of capitalized pension schemes to allocate a certain percentage of the savings through the saving and cooperative banking network to SME's, urban and regional renewal projects and marginalized groups. Unions in particular could make their assent to a capitalized pension system dependent on legal obligations of pension funds to channel part of their capital to the cooperative and savings banks sectors. In other words, the lever would be similar to the one described here while the institutional structure on the receiver's end would largely conform to already existing institutes. I have not much to say about the latter in this paper.

The other relevant institutional property of the Netherlands relates to the availability of legal means for institutional (re)design. As is well known from the rich tradition of comparative political economy, states differ substantially with regard to the institutional 'thickness' of their economies (Albert 1991; Whitley 1999; Hall & Soskice 2001). Especially relevant here is the legitimacy of state interventions in the economy: in liberal market economies intervention is much more controversial, while in coordinated market economies it is much more accepted. The growing interest in the regulatory possibilities of pension fund engagement of American scholars, activists and practitioners clearly derives from a diminished access to the legislative process and a diminished faith in the efficacy of a state oriented strategy, and has everything to do with the weakness of labor unions in the US and the absence of a strong socialist movement. Hence, organizing grass roots activism seems to be the only route available. However, as a general assessment of the political chances of progressive ideals in the American legislature this is overly pessimistic. As is well-known from work done in the tradition of critical legal studies, the American legal tradition contains sufficient ideological resources — 'counter principles' in Roberto Unger's terminology — to pursue progressive policy aims. A case in point is the current discussion in the US on the mandate of the Securities and Exchange Commission (SEC) and whether it entails the right of the SEC to enforce social next to financial disclosure requirements (Williams 1999; 2002). In fact, the public alarm over corporate misbehavior and elite fears of a legitimacy crisis of key institutions of American capitalism crises have already resulted in legal attempts to 'remoralize markets' and could be a window of opportunity for further reforms.

Nevertheless, it remains the case that one of the big differences between Europe and the US is that in the latter progressive ideals cannot count on immediate backing by the legislative power and hence have to be pursued much more through civil activism. Even in that case, though, there are lessons to be drawn from the proposals made in this paper. Making them palatable for an American audience would probably mean transforming its mandatory parts into voluntary ones. This suggests, for instance, the construction of an alternative investment facility, mimicking the organizational model of the well-developed American venture capital market, by coordinated action of the Taft-Hartley pension funds, in order to enhance the mass of capital currently available for 'targeted investment' and create the momentum that is needed to topple the hold of conventional

investors on what 'economic rationality' means.

### 1.3. Pension crisis?

The third remark deals with the source of capital that is meant to be channeled into a secondary investment circuit. As will become apparent below, the rationale for using only surpluses for such a goal is strong. Nevertheless, it will strike one as odd to argue for such an instrument in times of 'pension crisis', for this means that actually no money is entering the fund at all. However, there are good reasons to see this not a weakness of my proposal but rather as one of its strengths. For this implies that it will function counter-cyclical rather than pro-cyclical. In times of scarcity no extra-functional requirements have to be met, while under conditions of plenty when pension funds have no problem meeting extra-functional requirements they are in fact obliged to do so.

A second qualification has to do with the fact that stock markets seem to have overcome their hesitancy and have rebounded to their mid-1990s level. Even though most pension funds have not yet reached the level profitability of that period, nor are they in the dire straits they were in in 2000-2002. If the figures presented by Dutch pension funds over 2003 are anything to go by, the worst is definitely over. The crucial 'coverage rate' (i.e. the ratio of assets to liabilities) has increased with 5 percentage points to 111 percent, well above the 105 percent that is required by the Dutch public regulator, the Pension and Insurance Chamber. Partly because of increased contributions and cut backs in benefits, but also because of increased returns on investments. In 2003, total assets of Dutch pension funds rose with € 55 billion to € 485 billion, of which almost half (€ 226 billion euro) was invested in shares. After three years of losses, 2003 brought an overall market gain of almost 10 percent (CBS 2004). According to the Pension and Insurance Chamber, the upsurge in 2003 helped most pension funds to get out of the danger zone. Currently, there are only eight multi-employer funds whose asset position is still worrisome.

A third qualification is that even at the height of the pension crisis some corporate pension funds were still able to transfer surplus returns on investment to their main sponsor, either in the form of one off lump transfers or in the form of contribution holidays. Even in the worst years of the pension crisis — 2000, 2001 and 2002 — Dutch pension funds still transferred amounts of the order of € 412 mln, € 128 mln and € 597 mln to their sponsors. Although much less than the € 3 billion that was transferred in 1998, even in periods of falling share prices and hence of declining investment returns some funds are apparently able to beat the index and will hence provide at least a small trickle of capital.

## **2. Why a conditional pension saving levy?**

The idea that pension savings are 'deferred wages' and should be invested in ways that promote the long term interests of workers, consumers and citizens more generally has a long pedigree within

the socialist movement, ranging from Fritz Naphtali's 'Wirtschaftsdemokratie' (Naphtali 1966) and Gleitze's 'Sozialfund' to the capital gains sharing-plans that were discussed in the Dutch and Danish social-democratic parties in the mid-1970s (Beus & Koelble 1994; Dercksen 1985; De Kam & Vermeend 1979). Recently, after two decades of near silence on this topic, there is growing interest in the possibility of using pension savings to initiate what has been called a 'new politics of ownership' to overcome the excesses of corporate greed and — in reaction to the bursting of the 'equity bubble' since mid-2000 — to find new, more sustainable investment outlets (Blackburn 2002; Clark & Hebb 2004; Dymksi et al. 1993; Fung et al. 2001; Gamble & Kelly 1996; Hirst 1994; Hutton 1995; Pollin 1995; Unger 1998).

Fung et al. in their excellent North-American overview of initiatives in this field have identified three types of engagement which more or less cover the whole field. These are 'advocacy', 'screening' and 'targeted investment' (Fung et al. 2001). Advocacy is based on the direct leverage pension funds can have over corporate strategy by becoming major stockholders and exercising their voice rights. Screening is less direct and involves the use of social, moral and environmental criteria as investment screens filters. Targeted investment, finally, requires a much more active stance of pension funds. For in that case pension funds do not only initiate investment opportunities but commit themselves to become patient investors, more or less along the lines of venture capitalists. Despite the enthusiasm with which these forms of engagement are propagated and discussed, the magnitude of assets thus invested is, for good reasons as I will argue below, still small.

### 2.1. Advocacy

In spite of a growing awareness among pension fund trustees of the consequential nature of their investment decisions, their strategies are still highly conventional and consist predominantly of investments in liquid stocks and bonds. In the US, which saw the birth of this form of pension fund engagement, pension funds have mainly used their voices to address issues of corporate governance, such as CEO compensation, corporate bylaw amendments, and limits on anti-takeover measures (O'Connor 2001). Since the mid 1990s this type of activism has crossed the ocean and has turned large continental pension funds into powerful carriers of the shareholder ideology that is eroding the continental stakeholder regime, which, ironically, is viewed by many American scholars as a paragon of progressivism (Blair 1994; Roe 1995; Blair & Roe 1999; Lazonick & O'Sullivan 2000).

This has everything to do with the structural constraints facing pension fund trustees. The first constraint has to do with the extent of internal democracy. If you want progressive output, you will have to have progressive input. Hence questions arise regarding the organization of collective decision making within the fund. What is the composition of the board? What are its rights and duties? To whom are trustees accountable? Ideally, the composition of the supervisory board is

based on 'parity' and has ultimate determination rights over investment decisions. In the Netherlands that is legally proscribed, both in corporate funds and in multi-employer funds. In the US however, equal representation is allowed for multi-employer funds only. Corporate pension funds are taken to fall under the full 'dominium' of the employer. Hence, the employer has fiduciary duties only and is not obliged to share prerogatives with worker representatives. The implication is that American workers have voice over less than 8 per cent of their 'deferred wages' (Ghilarducci 2001: 165).

Even if internal democracy is formally guaranteed, effective advocacy is not. Whether assets can be transformed in voice depends on the institutions of corporate governance, the ownership structure of the firm in question, as well as the absence or existence of legal investment restrictions. Whether getting access to the General Shareholders' Meeting (GSM) is in fact a first step towards gaining control over the corporation, depends crucially on the rights and responsibilities of the GSM. Since national corporate governance regimes differ hugely with regard to the power of the GSM, it is not surprising that pension fund activists the world over have plead for a more shareholder friendly regime of corporate governance.

Crucial too is the degree of ownership dispersal. If ownership is widely dispersed it is much easier to build up a substantial minority stake than if property titles are closely held. If there is a sufficient spread of titles, as is generally the case in deep and liquid equity markets, a minority stake of 2 to 4 per cent suffices to gain leverage over the shareholders meeting and hence to get preferential treatment over other shareholders in the form of so-called 'investor's meetings' with the board of directors (Scott 1997).

The final constraint has to do with what I have called the 'logic of funding' that is inherent to the institutional make up of pension funds (Engelen 2003). For the board of trustees — however willing they may be to push for engagement — has every reason to follow conventional investment strategies and hand over large chunks of investment decision making to the financial industry. This has to do with the conflicting objectives pension funds face: the minimization of risks, the maximization of returns, the maximization of liquidity, and the minimization of costs. These objectives serve the interest of the contributors and beneficiaries in a stable, secure and high pension. At the same time, they boil down to investment strategies that do not lend themselves easily to pension fund endearment.

This is obvious for the requirement to diversify risks. Since beneficiaries demand a stable and secure pension, fund managers do well to distribute assets over a large number of categories with complementary risk and return profiles, and hence to sacrifice 'social leverage' or 'democratic pressure' for guaranteed returns — with or without legal restrictions. The same holds for the maximization of returns. Since surpluses are translated in lower employer contributions in the case of public and multi-employer pension funds, and in substantial pay-backs and/or lower contributions in the case of corporate ones, principals (the sponsoring corporation(s)) have an

interest in designing an incentive structure that incites agents (trustees) to invest in those assets that are perceived to be most rewarding. Since pension funds are subject to a life cycle during which the ratio of contributors and beneficiaries changes gradually, they face an increasing need to maximize liquidity. This results in a radical transformation of their risk profile and their investment strategies, forcing them to invest in the most liquid markets and within these markets to buy the stocks of those corporations that have the largest daily 'free float' and turning them willy-nilly from committed, long-term owners into speculative investors. Both developments work against the active use of voice rights.

Finally, there are strong economies of scale at stake. Since investment management is extremely costly, there is a strong tendency toward standardization. However, standardization itself is only worthwhile if there is sufficient effective demand. As a result, the cost advantage of conventional investment strategies is such, that most pension funds will decide against non-standard investment and will choose for conventional asset categories, in particular 'blue chip' stocks and 'gilt edged' bonds.

## 2.2. Screening

Screening, having germinated from the counter-culture of the 1960s, gained public notoriety in the 1980s as a result of its role in bringing down the South-African apartheid-regime (Seidman 2003). Currently a little more than \$ 922 billion is part of a socially responsible portfolio, or approximately 5 per cent of all capital under professional management in the US, while the screens themselves have become ever more fine-grained, ranging from tobacco, alcohol ('sin screens'), and weapons, to human rights, sweatshops, the environment as well as specific countries known for human rights abuses like Burma, Nigeria and Turkey (Becker & McVeigh 2001: 46). Although no negative effects on investment returns have been observed (Becker & McVeigh 2001: 52-59; Bauer et al. 2002), neither is there any proof of changing corporate behavior.

As a means of corporate correction screening seems to suffer from similar faults as consumer boycotts. Only in the case of glaring offences of moral norms, catching the eye of public media, will the use of exit rights by investors affect corporate behavior. Minor offences — or hidden offences — will remain unpunished. Moreover, the potential effects on corporate strategy, in the form of self imposed 'corporate citizenship charters', should not be overestimated. Without the 'shadow of hierarchy', social and environmental audits largely remain public relations instruments and will continue to be contingent upon economic performance, the public attention and the visibility of its misbehavior (Seidman 2003: 384).

## 2.3. Targeted investment

Targeted investment refers to investments in non-standardized investment categories, such as community development, public housing, infrastructure and local businesses. What these investments have in common is their non-tradable nature. In other words, there are no well-

developed markets for these investments and hence no easy means of liquidation. As a result, investments tend to be small. And even though many pension funds are increasingly directing capital to intermediate green and ethical funds, partly for fiscal reasons, the amounts tend to be negligible, while the intermediate funds are grappling with a dearth of available investment opportunities, highlighting the difficulties of alternative investment strategies in general and of targeted investment in particular.

There are good cost-related explanations for that. First, the size of unconventional investment objects tends to be small, raising the costs of investment per unit. Secondly, determining the risk and profit-profiles of alternative asset categories requires a kind of knowledge that conventional analysts are unable to provide. Thirdly, alternative investment opportunities do not fall from heaven but have to be discovered and even nurtured, which requires a local scouting and assessment network, personalized and informal contacts, and entrepreneurial skills (Bygrave & Timmons 1992; Mason & Harrison 2002). If such an infrastructure is not available, it has to be set up *de novo*. Once again, a difficult, time-consuming and costly enterprise (Minns 1980: 78-125).

#### 2.4. Supplementary, conditional and incremental

Given these constraints, there is a clear need for an institutional facility that could incrementally provide the capital with which to construct a stable, alternative financial circuit that could (partially) compensate for the uneven outcomes of conventional capital flows, without endangering the saving function of mature pension funds. The aim to plug existing 'capital gaps' while simultaneously respecting the legitimacy of the dependence of pension funds upon the conventional financial industry, lies at the root of the idea of imposing a levy on the surpluses of only those pension funds that do not voluntarily invest in a circumscribed list of targets. As such, this proposal takes the liquidity requirement of pension funds seriously and acknowledges the wisdom of making maximal use of the sophistication of mainstream fund management to ensure high, stable and secure pensions. Hence, the supplementary and incremental nature of the strategy followed here.

The main source of inspiration for the principles of supplementarity and incrementality are Klaus Novy's reconstructions of the 'socialization' debates that took place in the German socialist movement of the 1920s, which are a treasure trove for concrete utopists (Novy 1974). Particularly ingenious are the proposals falling in the rubric of 'partial socialization'-strategies. These strategies are based on the perceived inefficiencies of market allocation and the hope that the introduction of elements of social planning within the productive sphere would render the planned parts of the economy more efficient than the marketized parts and would ultimately outcompete them. The similarities with my proposal lie in the expectation that alternative investment practices will prove to be just as rewarding as conventional investments and will thus increasingly be perceived as a sensible thing to do, both by financial professionals and the public at large. The hope is that the financial mainstream will tether towards 'reconstructed' risk and return criteria as soon as the

number of participants and the amount of capital of the alternative investment circuit reaches a certain threshold. In other words, what both approaches share is the emphasis on 'demonstration effects', as we would call it (Hood 2000).

But there are also crucial differences. These have primarily to do with a much more sophisticated perspective on markets than was available to the Austrian-Marxists and German socialists of the early 1920s. Instead of taking planning per se as a viable alternative to market allocation per se, my proposal is based on the insight that markets are institutions in their own right, which are open to premeditated design and have, pending their layout, different behavioural effects. According to this view it makes sense to argue for more just markets, implying markets which (i) feature a fairly equal distribution of market power, (ii) provide relatively easy entrance and exit, both at the supply and the demand side, and (iii) induce agents to take account of the long term effects of their actions. Many contemporary financial markets do bad on these criteria. By creating a secondary financial circuit that scores better in terms of market power, entry and exit, and the internalisation of long terms effects, the goal of economic justice is served (Roemer 1998). Hence, rather than replacing markets by planning, this proposal aims to fortify the allocation of capital by markets by targeting the cannibalising and self-eroding elements of current market behaviour.

The origin of the idea of a conditional levy is more mundane, and in fact derives from recent policy discussions in the Netherlands concerning the restructuring of the public housing sector. As part of a sector-wide bargain in the mid-1990s, public housing corporations gained regulatory independence in exchange for financial self-sufficiency. However, it quickly became apparent that the emphasis on financial autonomy resulted in conservative investment strategies, which was detrimental to their other, public housing, mission. While many corporations got richer and richer, others, especially those who possessed large housing stocks in the large cities, increasingly lacked the financial resources to make new investments. Since the autonomy of the corporations stood in the way of direct state intervention, one of the ideas that was launched to change this state of affairs was the construction of a private 'Investment Society for Urban Renewal' that would sluice funds from capital-rich corporations to a number of targeted urban renewal projects. Since the primary goal was to get these projects going, rich corporations could either invest in them voluntarily or they could pay a levy to the Investment Society, who in turn would do so for them. Since this was only one of the ideas launched and of these the most obliging one, it should come as no surprise that it has met with fierce criticism from the side of the corporations. However, since the political pressure on the corporations to come up with some kind of redistributive mechanism is rising, it may well be that within time the attractiveness of an imposed redistributive mechanism, above weak forms of self-regulation, along the lines of the Investment Society will grow (Conijn 2003; VROM-raad 2002; 2003). To my knowledge, there has been no suggestion to earmark part of the Dutch pension savings for this goal, although the Dutch pension sector as a whole is heavily implicated in Dutch (and foreign) real estate and is in fact one

of the main capital providers of the Dutch public housing sector in general.

### **3. Why target pension savings?**

As the Dutch example of public housing corporations demonstrates, there is no intrinsic reason to limit the scope of proposals like the one presented here a priori to pension savings. Nevertheless, there are good reasons, besides their size, to start the work of institutional imagination that is the hallmark of concrete or realist utopianism with an attempt to transform the investment strategies of pension funds through institutional means. These have to do with the moral, public and 'fuzzy' nature of pension savings respectively.

#### **3.1. The moral nature of pension savings**

Since pension savings are 'deferred wages'<sup>2</sup> and serve the long-term welfare of contributors, investments should reflect the full panoply of their interests. That means that pensioners should not only be treated as abstract 'rentiers' by their trustees but as 'concrete' consumers, fathers, mothers, grandparents, husbands, wives, citizens, etc. The point is that different roles give rise to different interests, which sometimes go hand in hand but at others collide. It is obvious that equating such a plurality of interests with the one-dimensional interest of the fictional speculator is reductionist to say the least. Doing justice to this full panoply of interests requires the adoption of what demographers have called a 'life course perspective', which emphasizes different needs and interests as individuals pass along different life phases (Elder 1994; Hogan 1981; Mayer & Tuma 1990). To accommodate these needs and interests a radical transformation of the conventional techniques of investment management into more pluralistic ones is required. This in turn demands changes in governmental supervision, professional standards, accountancy rules, statistical techniques, audit formats as well as different systems of data-collecting and processing. It is obvious that the technical and political problems involved are too numerous to be discussed in this paper.<sup>3</sup>

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<sup>2</sup> This is not to deny that some 'pension savings' are more a common-pool resource than an individual wage, the distribution of which is not so much guided by the moral philosophy of desert and contribution as by that of social rights. Although most of the arrangements set up to embody social citizenship are of a pay-as-you-go kind and hence do not embody 'pension savings' in a strict sense, there are some examples of funds that do. However, in this paper I have only those pension arrangements in mind that collect, aggregate and invest income based contributions and provide benefits according to some individualized formula. Hence, also left out of consideration are defined contribution plans such as provided by mutual funds and insurers.

<sup>3</sup> But see Silvers et al. (2001) for an interesting attempt to reconstruct the dominant conception of 'value' from a worker/contributory perspective. See also Blair (1995).

### 3.2. The 'public' nature of pension savings

In most political economies, corporate and industrial pension funds are established as 'trusts'. As such, they have an explicit non-profit orientation and are exempted from profit and capital gains taxes. Moreover, most individual contributions are exempted from income taxes. Only when benefits are disbursed does the recipient have to pay income taxes. However, given the fact that most pensioners will have lower incomes than they enjoyed while working, they will normally fall into lower tax brackets, implying that pensioners in fact receive a substantial state subsidy in the form of missed tax income. Hence, most supplementary pension systems are heavily subsidized by the state. Blackburn estimates the annual amount of taxes foregone in the US at \$ 100 billion and in the UK at £ 100 billion, leading to the conclusion that at least part of their assets are 'public'. As such, the huge fiscal subsidies granted to pension funds provide an excellent legitimation ground for states to toy with their governance structure in order to oblige them to serve public ends.

### 3.3. The 'fuzzy' nature of pension surpluses

Pension surpluses are 'fuzzy' in both a technical and a political respect. In general, surpluses refer to the positive difference between expected incomes from current assets and expected contributions on the one hand and current and future liabilities on the other. As such, the exact determination of surpluses depends upon a number of fairly arbitrary financial, economic and demographic assumptions regarding long term population growth, returns on investments, inflation, economic growth, labor productivity etc., which make some demands upon the interpretative skills of trustees, managers and actuaries. To preclude self-serving manipulation, most national regulatory regimes contain procedural prescriptions regarding actuarial methods and assumptions, resulting in remarkably uncontroversial determinations of deficits and surpluses (Bennett 1994: 11-14).

The second respect in which surpluses are 'fuzzy' is more relevant here and has to do with their ownership status over and above 'public ownership'. Basically, the issue is whether surpluses are owned by the fund itself, by its sponsor, by contributors or by pensioners. In the first scenario, the surplus is viewed as an extra buffer to absorb the uncertainties of the underlying assumptions. In the second scenario, the reasoning is that since sponsors are obliged to cover deficits, they have the obverse right to appropriate surpluses. In the third scenario, it is maintained that pension assets are 'deferred wages' and that contributions should be fixed at a level that is sufficient, no more and no less, to cover future liabilities. Since surpluses indicate that contributions have been too high, it follows that contributors should receive a contribution holiday until the surpluses are gone. In the last scenario too, the surplus is viewed as being owned by 'workers'. However, since most schemes at best provide indexation against inflation and since pensioners can no longer improve their socio-economic position, surpluses should, for fairness sake, be used to improve the quality of the benefits of current pensioners (Bennet 1994:15-33).

In view of the controversies surrounding decisions in favor of any of these latent 'owners',

there is much to be said for a levy that skims off a substantial percentage, say 50 percent, of these surpluses and redirects them towards a financial circuit that truly serves the public interest instead of serving the presumed interests of speculators only.

#### **4. How to overcome cost and information problems?**

##### 4.1. Cost problems

As shown above, the main explanation for the limited amount of pension savings that has gone into targeted investments are its prohibitive costs. However, these arguments are not decisive. Because the FER would have an explicit, that is: institutionalized, non-profit orientation and hence would not have to generate the same level of returns as is demanded of commercial fund managers, higher costs would not endanger its viability to the same extent. Since the assets controlled by the FER are supplementary in a true sense and do not have to contribute to the coverage of current and future pension liabilities, the FER is free, in an economic sense, to wield a reconstructed conception of 'profitability' when assessing potential investments.

Post-war experiences in Western Europe with public investment banks have demonstrated that there is indeed a tension between the goals of plugging capital gaps on the one hand and generating mainstream profits on the other. These banks either supplemented market allocation and hence had to accept lower short term financial returns (Pontarollo 1983), or had to satisfy mainstream financial requirements and hence substituted conventional market allocation (Minns 1980: 78-102; Eliasson & Ysander 1983). However, the fact that there is a tension between financial and social goals does not mean that the choice for the one requires sacrificing the other. For the very same experiences taught that public investment banks without profit requirement either became 'charities' who squandered taxpayers' money or turned into state instruments that were required to 'back losers' rather than 'pick winners' (De Jong & Spierenburg 1983; De Grauwe & Van de Velde 1983). Hence, the profit requirements of the FER will have to be set at such a level that operational costs are covered to ensure state independence, while excluded groups, firms, industries and regions can be provided with access to 'cheap' capital, turning it into a veritable 'revolving fund', that is: a fund whose proceeds are plowed back into the circuit and whose growth is completely determined by the levy.

A second consideration has to do with the observation that regional development, SME-investment, infrastructural investments and urban renewal generate different rates of return, implying that different measures are required to jump start different kinds of projects. In some cases sub-market interest rates are required or lower levels of guarantees, i.e. 'cheap' capital, while in others customization and hands-on support can do the trick. In other words, not all chartered activities are necessarily loss-making activities. The point is that a diversified portfolio, crossing

different asset categories, such as is required here, creates cross-subsidization possibilities that could help to overcome at least some of the cost constraints. In a scheme, as the one envisioned here, the gains from successful initial public offerings (IPOs) are plowed back into the FER to facilitate urban renewal and public housing projects. In the conventional financial industry cross-subsidization is increasingly seen as bad business practice.

#### 4.2. Information problems

Much harder to overcome are information-related objections. Here, two problems in particular stand out. First, the problem of 'investment identification'; how to identify promising investment opportunities. And secondly, the 'assessment problem'; how to assess the economic potential of non-standard investment opportunities and the creditworthiness of non-standard debtors? The problem is that the FER is after profitable investment opportunities that are nevertheless disregarded by the mainstream financial industry, either because their risk and profit profile does not conform to mainstream standards or because they are unable to find their way to a regular financial outlet. The first issue is covered by the reconstructed norm of profitability the FER is able to use (see above), but to be able to address the second one it will have to build an alternative network for the allocation of its capital.

This can be done in four ways. The first one is through close cooperation with existing financial service providers who, for reasons of a diverging ownership structure (savings banks, cooperative banks, state banks) or an explicit ideological orientation, use lower performance thresholds and do have access to local networks. Of course, this presupposes a segmented financial system and hence less need for arrangements like the one envisioned here. However, to the degree in which these segmented systems are threatened by pension driven consolidation tendencies (see above), it does make sense to include a social levy in the charters of the pension funds to be, in order to anticipate the genesis of financial market gaps.

Obviously, in consolidated financial markets where a secondary financial circuit is most needed, this way out is unavailable. Here the required expertise has to be acquired through other means. This can be done in either of three ways. The first is by selecting and hiring professional asset managers on a case-by-case basis, while the second is to simply buy asset managers wholesale. The disadvantage of both routes is that in both cases the type of skills that are acquired are of 'the analytical, financial engineering, deal-making and transaction and closing' kind and not the 'company forming, building and harvesting skills' that are needed to bring small start ups to fruition (Mason & Harrison 2002: 430), let alone the specialized expertise that is needed to assess costs and profits of large scale urban renewal, regional development and infrastructural projects.

This leaves us a third solution that, although hard to build, does shelter the FER from the intellectual and ideological hegemony of the financial industry. The idea is to construct a multi-layered organization, a true 'fund of funds', that divides tasks, rights and responsibilities over a large

number of legally independent but functionally dependent units, following the principles of federalism and subsidiarity: i.e. jurisdictional competencies should not only be devolved to the lowest possible level of aggregation (subsidiarity) but should also be segmented along functional lines (functional federalism). Which agent should be responsible for which kind of decision at which level of aggregation depends both upon expertise and commitment and on functional requirements.

As a rule of thumb, the following design principles could be followed. Parametric decisions, i.e. decisions regarding the allocation of capital over asset categories as well as the performance indicators for each category, should be made by the board of directors of the national FER, which consists of accountable representatives of both capital providers (pension funds) and capital recipients (SME's, local interests). The reason why these types of decisions should be made at a central level has to do with their redistributive nature. In order to enhance the problem solving-capacities of the board of directors the decision making process should be as depoliticized as possible by distancing the decision-making advocates from the interests they are representing (Scharpf 1997: 132). Moreover, the lack of tacit and situated knowledge — one of the main drawbacks of high level decision making (Scott 1998) — does not matter much, since these types of decisions generally entail the balancing general interests, abstract criteria and abstract types of knowledge.

Instead, the more quotidian decisions, i.e. decisions regarding the granting of specific loans to specific clients or of making specific investments in specific objects, do require tacit and situated knowledge while the more concrete nature of these decisions limits the need for depoliticisation strategies. Hence there should be a sizeable autonomy for the directors of the smaller local funds. Since they have to act within the parameters laid down by the central fund and will hence be subjected to a sufficient degree of ex post control to preclude manipulation and favoritism, this autonomy will always be of a circumscribed nature.

Following these precepts, the FER could take the following form. It would consist of a central fund — the 'fund of funds'— where the aggregation of the proceeds from the pension levies, the administration as well as parametric allocation takes place. Day-to-day assessment and management, however, would be done by smaller funds, whose jurisdiction would be either territorial (regional funds) or functional (sectoral funds). In this manner economies of scale — joint administration — can be combined with the advantages of devolution and smallness, i.e. flexibility, diversity and an effective use of local knowledge. To prevent that hierarchical control and coordination would remove these advantages, centralized administration and decentralized handling should be kept legally distinct. Otherwise central decisions will often trump local needs and requirements. On the other hand, to guarantee a 'shadow of hierarchy' and preclude that local funds are hijacked by local interests the relationship with the local fund should be arms length. Contracts should stipulate performance indicators as well as sanctions and rewards. The flow of capital from

central to local fund could take the form of a loan over which local funds have to pay a low interest rate. If the local funds reach their quota they will be rewarded with lower interest rates, if not they will be punished with higher ones. In this way, local funds have an incentive to maximize the amount invested capital in the prioritized categories as well as to so prudently, for returns of investment over an above the central fund rate accrue to the local funds. Finally, to ensure that investment opportunities are in fact identified, nurtured and brought to fruition, the local funds should actively seek out local representatives from industries, governments, universities and labor unions to take a seat on formal advisory boards in order to enlarge and refine the funds' catchment area.

[ Figure 1. about here]

Such a design may look farfetched but is in fact largely modeled after the structure of the venture capital market, as described by Mason & Harrison (2002: 430). For here too the effective use of local knowledge is guaranteed by delegating the responsibilities of day-to-day-management to local venture capital firms who possess the required mix of financial and entrepreneurial skills and are locally well-embedded, while parametric management is undertaken by regional or national venture capital funds, staffed by managers with skills that are much more geared towards financial management (Bygrave & Timmons 1992; Kenney 2000; Mason & Harrison 1999; 2002). The main differences between the venture capital industry and the FER are (i) that the latter operates under a non-profit charter; (ii) that pension fund sponsoring is mandatory rather than voluntary; and (iii) that its charter is politically determined and gives greater weight to social, environmental and geographical aims. Otherwise, their organizational properties are identical.

Given these similarities, the question arises why a duplicate is needed in the first place and why we shouldn't oblige pension funds to direct a portion of their capital to the venture capital industry instead. To answer that question we have to delve deeper in the structure of the venture capital industry. It is customary within the literature to distinguish between two types of venture capitalists, i.e. 'classic' and 'merchant' venture capitalists. 'Merchants' focus primarily on management buy-outs and buy-ins, ownership changes, and corporate restructurings, target larger firms, and possess mostly conventional financial management skills. They are predominantly located in the larger financial centers and have increasingly become intertwined with the mainstream financial industry. Classic venture capitalists, on the other hand, seek to finance entrepreneurial opportunities, which promise substantial growth, but which fall outside the scope of conventional credit provision for reasons of high uncertainty, intangibility of assets and absent secondary asset markets. Hence, this type of activity is long term, committed and entrepreneurial in nature. It requires hands-on advice, constant coaching and grooming, and a willingness and ability to invest social and human capital next to financial capital to turn the venture into a success (Bygrave &

Timmons 1992).

If the situation in the UK is anything to go by, the inroads the conventional financial industry has made within the market for venture capital has radically changed its nature almost everywhere. As Mason & Harrison observe, '[s]ince the late 1980s, the UK venture capital has become progressively more geared to investing in [management-buy-outs] and [management-buy-ins]'. An increase that 'has been at the expense of investments in seed capital, start-up and early stage ventures', or the 'classic' venture function (Mason & Harrison 2002: 435). So, updating on Martins earlier observation that venture activity was highly unevenly distributed in the UK (Martin 1988; 1992), Mason & Harrison conclude that although aggregate figures do indeed show a more even distribution for the 1990s, if these figures are broken down for 'classic' and 'merchant' venture capitalist, the distribution of the former still follows the pattern identified by Martin in the 1980s.

According to Mason & Harrison this has to do with the preference of institutional investors, notably pension funds, for standardised and hence liquid investments. Moreover, 'merchant' activities do not come with the same proximity constraints as 'classic' ones. The latter require co-location of investor annex coach and advisor, and investee. Whereas the financial nature of the relation between investor and investee in the case of 'merchant' venture activities allows the investor to remain at a distance from the object of investment (Mason & Harrison 2002: 435, 443).

Recent attempts by the British government to stimulate institutional investors to redirect capital from merchant to classic venture activities by setting up so-called 'Regional Investment Funds' (RIFs), which match private investments with public money, indicate that addressing these issues will not be easy. According to Mason & Harrison four issues in particular stand out. First, the liquidity preference of large institutional investors. It is unclear whether the matching scheme is sufficient incentive for pension funds to become involved voluntarily, but there are good reasons for scepticism in this regard. Second, the lack of 'classic' venture capital skills, including a supportive infrastructure, to provide a venture capital-friendly environment (Kenney 2000). Third, the long-term financial viability of the RIFs. Since it will be hard to overcome the liquidity preference of large investors, the RIFs are due to remain small, resulting in high costs per unit of investment, making the funds vulnerable on a number of accounts. First, because of a lack of ability to diversify. Second, because of an inability to provide follow-on money, either as a result of a lack of capital or of diversification requirements. Third, because of an inability to 'harvest' and built a 'track record' that might attract institutional investors. And, fourth, because of a lack of viable investment opportunities (Mason & Harrison 2002: 445-446).

Not all of these issues are relevant here, for the mandatory nature of the FER addresses both the first and the third, while its organizational structure explicitly requires that the regional and sectoral funds set up an advisory board consisting of a broad cross section of all the interests involved. The networks of representatives from industries, local governments, universities and labor unions which the advisory boards are meant to bring together are to ensure that local investment

needs are in fact detected and that potential entrepreneurial skills are in fact available, which largely dispels the second and third of Mason & Harrison's fears.

The crucial point is that only in segmented financial systems do we encounter a venture capital industry that is sufficiently dispersed. Germany being the prime example (Martin et al. 2002). In monist environments, on the other hand, the venture capital industry tends to follow the precepts of the dominant financial industry, resulting in a preference for the 'buy outs' and 'buy ins' at the mature end of the entrepreneurial cycle as well as a preference for investment opportunities in the near proximity of the largest financial centers. As such, the venture capital industry replicates rather than supplements the dominant structure of the financial industry, raising doubts about the extent to which venture capital actually can be seen as a tool to bridge existing capital gaps (Martin et al. 2002).

## **5. How feasible is it?**

Since existing institutional arrangements represent temporary compromises between contending interests, each and every proposal for institutional experimentation implies an infringement upon vested interests. In other words, institutional change involves real costs for at least some of the actors involved. Hence, the feasibility of a proposal for institutional experimentation depends upon its ability to identify winners and losers, to calculate the costs involved, and to reimburse losers as much as possible. In this particular case, three types of immediate interests can be identified. These are: (i) the sponsors of pension funds, in particular large corporations; (ii) their contributors and beneficiaries; and (iii) the financial industrial complex, especially large insurers and banks. I discuss each of these in turn.

Once again, I have to stress that the particular choice of relevant interests discussed here reflects the Dutch actor constellation and should not be taken as imperative for other contexts. For example, in the UK and the US insurers are large providers of defined contribution plans, implying that the provision of pension is less the exclusive dominion of pension funds than it is in the Netherlands. However, the point of this exercise is less to give an universally valid account of the actor constellation surrounding pension issues than to indicate how an actor-centered institutionalism (Scharpf 1997) could help to delineate potential fissures among apparent homogenous agents as well as potential coalitions among apparent irreconcilable interests.

### **5.1. Corporate sponsors**

Although there is widespread consensus, at least in the Netherlands, that pension savings are 'deferred wages', corporate sponsors generally do advance strong ownership claims on pension fund surpluses. As such, strong opposition from corporate sponsors to the proposal advanced here can be expected. However, there are at least three arguments against corporate ownership claims.

The first we have already encountered and pertains to the 'public' nature of pension savings and hence of pension fund surpluses, giving the state a legitimate say — which is not the same as a controlling say — over the uses of these surpluses. The second has to do with the unequal treatment of the surpluses of multi-employer pension funds vis-à-vis those of corporate pension funds. In the first case, the link between sponsors and fund is indirect, blocking restitutions (though not contribution holidays), while in the second the link between sponsor and fund is much stronger, allowing for restitutions in good times and obliging sponsors to refund in bad times. Allowing such practices thus implies a preferential treatment of large firms over SMEs. The idea of a levy over surpluses hence reveals a long-standing antagonism within the 'class' of capitalists, opening up the possibility to forge cross-class alliances (between SMEs and labor unions for instance) that enhance the possibility to overcome the resistance of large corporate sponsors.

The final argument builds forth upon the much observed interest large corporations have in a vibrant, innovative environment, based upon the availability of a number of crucial production factors such as loyalty, commitment, trust, high qualifications and competencies, networks of cooperation, etc. (Streeck 1992: 1-40; Thelen 2003). Since these factors have public goods properties, 'pure' market coordination generally results in their undersupply. Hence, 'beneficial constraints' are needed that force rational agents to forsake short-term gains and take the long-term effects of their behavior into account (Streeck 1997). Similar to institutions like legally mandated collective bargaining, minimum wages, co-determination, works councils and vocational training, the proposed levy would dampen the short term liquidity preference of pension funds and would instead force them to take long term social, environmental and geographical considerations into account.

Even though many large firms possess the means to create 'islands of order in an ocean of chaos' (Lipietz 1985), in most cases such a process of internalization is set in motion by a low trust environment, that is: an environment lacking the institutionalized constraints that force agents to produce common pool-resources like trust, loyalty and commitment. However, even large firms are better off with an abundant supply of public goods than without them. Since trust, loyalty and commitment lower transaction costs, large firms can externalize the costs of producing them in house and can hence forgo the costs of building large hierarchies. Hence, investing in the trust-building capacities of a region is in the long-term interest of large firms too. Consequently, they should explicitly be invited to aid the construction of local investment networks to enhance their geographical embeddedness. Moreover, part of the capital of the FER should be made available to large firms, for instance to finance experiments with sustainable products and sustainable production.

## 5.2. Contributors and beneficiaries

The main concern of pension plan participants is a high, stable and secure pension. As such,

redirecting savings away from the conventional investment industry appears to go against the grain of workers' interests. However, these interests too are less homogenous than might seem. For both in cases of underfunding and overfunding, beneficiaries collide directly with contributors. In situations of underfunding, deficits can be remedied either through increasing contributions or through reducing the plan's quality or through a mix of the two. In the first case the burden is shouldered by contributors, in the second by beneficiaries, while in the third both lose. In the case of overfunding, surpluses can be distributed either to beneficiaries in the form of better conditions or to contributors in the form of contribution holidays. Given the fact that every decision, even non-decisions, will affect different parties differentially, trustees face the difficult task to determine who is to shoulder the burden or who is to reap the prize.

The only way out of this predicament is to emphasize that all present and future contributors will eventually turn into beneficiaries. If preference formation can be kept apart from immediate interests and if participants can be encouraged to take a life course perspective, the clash between lower contributions and higher benefits stands a chance of being solved. However, adopting a life course perspective would not only imply the inclusion of both contributors and beneficiaries in the plans strategy formation procedure, but, as I argued above, also that all their relevant interests and preferences should somehow be included in its outcomes.

The first is currently being addressed in the Netherlands by incorporating so-called advisory 'stakeholder councils', consisting of representatives of current pensioners, into the governance structure of pension funds. After a halting start, many pension funds now seem to take these councils much more seriously, partly because of the pension crisis and the political saliency of its redistributive consequences, partly because of a covenant between the employers' federation and labor unions, which aims to strengthen the legal position of stakeholder councils. However, the call for one or more pensioners' representative in the board of trustees still meets fierce resistance from the labor unions, who claim to represent both workers' and pensioners' interests and fear a divide and rule-regime from their counterparts once pensioners' are recognized as a separate interest group.

The second implication of adopting a life course perspective is left unaddressed, however. The pension savings surplus-levy, envisioned here, is explicitly meant to fill this vacuum. By supplementing the conventional financial industry with an alternative financial circuit, it embodies the collective need for equal and sustainable development later while simultaneously recognizing the legitimacy of the need for high, stable and secure pensions now. Moreover, the moral imperative to adopt a life course perspective will only strike agents as convincing if there is already an institutional framework embodying it. It is not only the case that 'ought implies can', but also that the actual availability of morally required action options makes the moral requirement to pursue that course of action so much more binding. Obliging pension funds to reserve half of their surpluses for investment in projects that, according to our current knowledge, serve the long term wealth and

welfare generating capacities of the regional economy, is a step that takes the brute social fact of inter- and intragenerational interdependence and the 'weak' 'moral community' it constitutes seriously.

### 5.3. Pension funds, banks and insurers

Even though desegmentation and consolidation are phenomena that can be observed worldwide, this is not the say that there are no longer any differences between distinct financial institutes that could be manipulated by the legislature. Even monist financial markets still harbor legal remnants from the period of segmentation, resulting in different rights and responsibilities for different financial institutes (Verdier 2002). What is crucial here is the preferential fiscal treatment that pension savings get in many political economies, whether segmented or not. As I noted earlier, these fiscal grants provide an excellent lever for the state or others to claim at least some say over the employment of these savings. More important here, however, is the fact that through these grants the state is actually privileging some financial service providers over others. Especially since Dutch pension funds are increasingly seen to enter markets that used to be the domain of commercial financial service providers, their preferential fiscal treatment has more and more become a cause of complaint, especially for insurers, whose field of operation is increasingly penetrated by huge pension funds while, reciprocally, the market for pension provision remains closed.

Whether the differential treatment of insurers and pension funds can claim continuing legitimacy depends on the willingness and ability of national and international regulators to keep both markets separate. However, upholding walls between financial markets has become increasingly difficult. Not only because of international market pressures, but also because of European Union (EU) policies aimed at the creation of a European financial market (Clark 2003). As such, this constellation provides an excellent opportunity to implicate pension funds in a political bargain. By offering them a legal guarantee to continue their preferential fiscal treatment against the increasing complaints of insurers, and even against European pressures, in exchange for their passive consent to a pension saving surplus-levy, national governments could overcome the organized resistance of the pension fund community.

On the other hand, such a levy, and especially the accompanying FER, poses new threats to banks, for allocating productive capital to firms and aspiring entrepreneurs is a classic bank function. Hence, banks can be expected to be among the most vocal opponents. Although the investment criteria of the FER are meant to service investment opportunities that are currently outside the reach of the financial industry, implying that charges of unfair competition would be misplaced, the many precautionary measures surrounding the establishment of state investment banks in Europe in the 1940s and 1950s — such as charters containing explicit prohibitions to tread on the turf of commercial banks (Hindley 1983) — demonstrate that formal arguments like these

will in all probability be insufficient to deflect the complaints of commercial banks. What did help, though, were equal ownership and control rights for state, banks and institutional investors (De Jong & Spierenburg 1983: 63-64). Since the FER is supposed to break the monopoly of the conventional financial industry over the management of workers' savings, cooptation strategies like these are unavailable.

Hence, at the end of the day we seem to be faced with a standoff between moral and economic requirements. The FER either serves purely moral goals, will not tread on the turf of commercial and will be prudentially unsound, or it follows conventional economic desiderata and will hence crowd out private investment. And, as is well-known, in the face of strong economic motives moral considerations generally lose out, implying that the decision to redirect some capital toward social goals cannot be left to the funds themselves but seems to require some form of state intervention. However, under the hegemony of neoliberalism state intervention tends to take the form of 'market making' instead of 'market correcting' and hence seems to go against the grain of the financial segmentation argued for here.

There are some reasons for optimism, though. First, the growing fears of national and supranational regulators for 'systemic crises' have increased the appreciation for 'fire walls' between different financial segments and can lead to a re-assessment of the advantages and disadvantages of 'financial pluralism'. Secondly, the pension crisis of the early 21<sup>st</sup> century has highlighted the increased vulnerability of Western pension savings because of their increased dependence upon rising share prices for their long term security. The search for alternative, less risky investment opportunities that many pension funds initiated in its wake, might provide a fertile breeding ground for institutional arrangements that sluice some of their capital in 'targeted investments'. Thirdly, one of the most important 'demonstration effects' of the current wave of pension engagement is that the notion of economic and moral objectives are less mutually exclusive than is often presumed. There is ample proof that what is morally desirable can be profitable and vice versa (Bauer et al. 2002; Hebb & MacKenzie 2001; Becker & McVeigh 2001). Partly because there actually is some overlap between the two, as is argued by Streeck and others in their discussion of institutionalized 'beneficial constraints' (Streeck 1997), and partly because in our complex world human cognitive capacities are easily overwhelmed, resulting in search-strategies that aim for satisficing rather than optimizing moral and prudential objectives (Simon 1982). In other words, we do not know a priori what is morally and prudentially required of us.

However, neither these qualifications, nor the use of divide and rule -strategies will ultimately allow us to overcome all objections. At the end of the day someone is going to get hurt, and since that is the case states will always have some role to play in guaranteeing everyone a fair access to capital, the legitimacy of which is based on paternalistic arguments whose moral validation is grounded in a well-reasoned balance between moral, prudential and realist imperatives. That is what 'concrete utopianism' is about.

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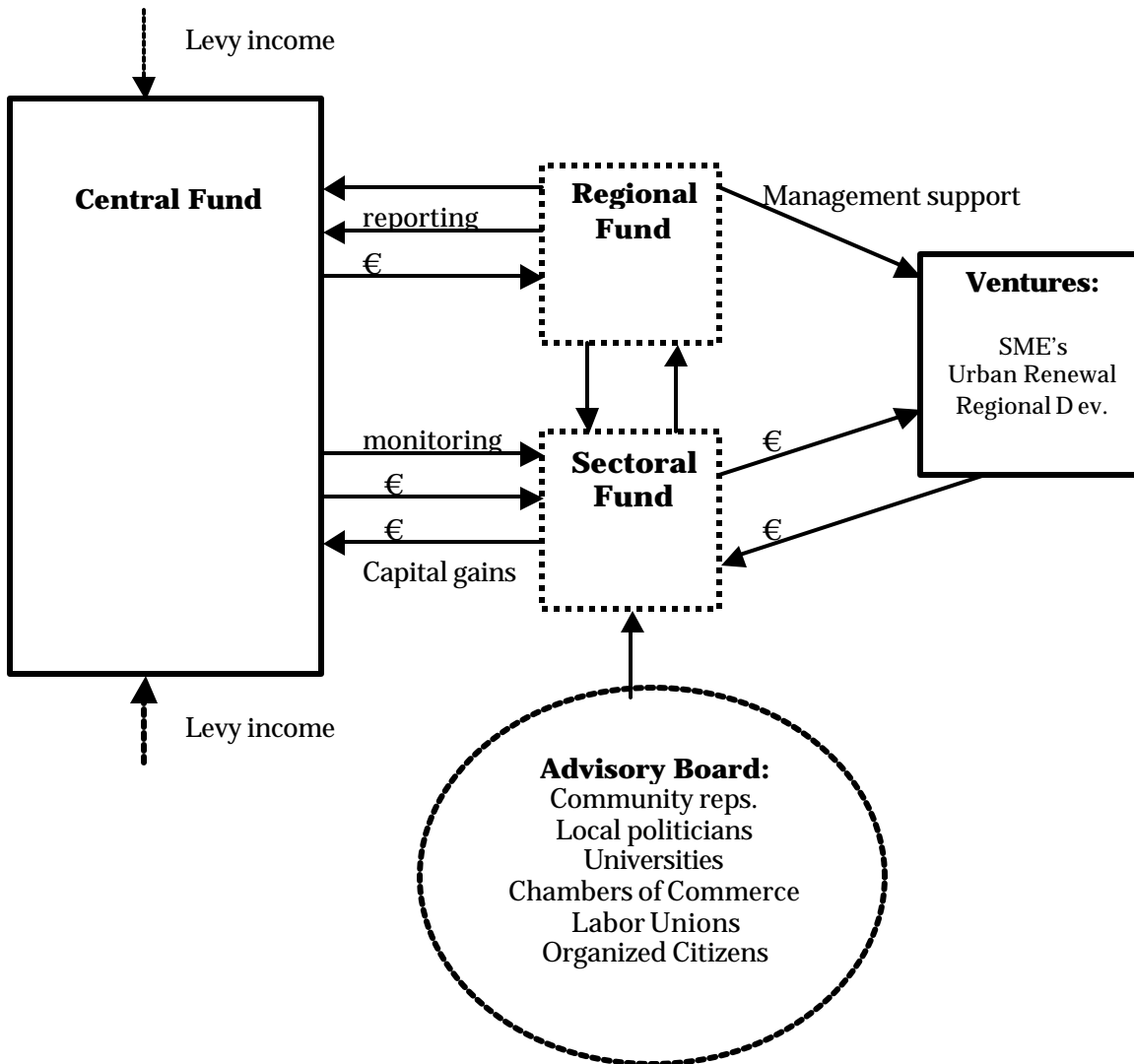


Figure 1. Fund for Economic Renewal