PENSION FUND INVESTMENTS:
THE ISSUE OF CONTROL

STUDIES IN PENSION FUND INVESTMENTS

CENTER FOR ECONOMIC STUDIES
CONFERENCE ON ALTERNATIVE STATE AND LOCAL POLICIES
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By Marc A. Weiss
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Published in conjunction with the Center for Economic Studies
457 Kingsley Avenue,
Palo Alto, California 94301
The Conference on Alternative State and Local Policies is a national clearinghouse and policy research center for state and local public officials and community leaders. In addition to providing research, analysis and technical assistance, the Conference organizes frequent national and regional conferences and operates a nationally recognized publications program featuring innovative policy studies and legislative proposals.

The research reported herein was performed pursuant to grant 770-0094 from the Ford Foundation. However, the opinions expressed herein do not necessarily reflect the position or policy of the Ford Foundation, and no official endorsement by the Ford Foundation should be inferred.
Foreword

Public and private employee pension fund assets approach a $500 billion pool of capital in the United States, but, until recently, very little thought has been given to their potential impact on the economic and social vitality of American communities.

Marc A. Weiss's paper, Pension Fund Investments: The Issue of Control, was one of the first seminal pieces of work on this issue. Originally published as part of a study undertaken for the Ford Foundation, it persuasively argues the case for greater governmental and community control over both private and public sources of investment capital.

Weiss singles out pension funds as a particularly important source of investment capital that could be redirected to new and more socially responsible uses. He notes that although these funds are capitalized by worker's earnings and considered deferred wages, employees cannot borrow, trade or use this money as collateral. To address these problems, Weiss maintains that innovative uses of these monies must be devised and implemented to meet the economic problems that pension fund participants and beneficiaries face as employees.

Weiss's paper makes a singular contribution to the beginning of such an undertaking, presenting a lucid conceptual overview of the issues involved, and by proposing two new criteria for pension fund investments: employee control and public need.

William Schweke
January, 1981
INTRODUCTION

The creation of capital represents, in a narrow sense, the production of physical assets such as buildings and machinery which are used to fuel the process of economic growth. In a broader sense capital really represents the monetary value of these assets and the claims of ownership and control over them. American society is characterized by extreme concentration of private ownership and control of capital. A study by the Congressional Joint Economic Committee in 1976 found that the richest one percent of the U.S. population had nearly 26 percent of total net worth, owning more than half of all corporate equity and also more than half of all outstanding debt (60 percent of bonds), including corporate and government debt (see Table 1). Half of even this small group, or just over one million people, owned 50 percent of the total value of all outstanding corporate stock in 1972 (JEC, 1976, p. 13).

<table>
<thead>
<tr>
<th>Asset</th>
<th>Value (billions) held by the richest</th>
<th>Share held by the richest</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All persons 1 percent 6 percent</td>
<td>1 percent 6 percent</td>
</tr>
<tr>
<td></td>
<td>(1)          (2)          (3)</td>
<td>(4)          (5)</td>
</tr>
<tr>
<td>Real estate</td>
<td>$1,392.6</td>
<td>$925.0</td>
</tr>
<tr>
<td>Corporate stock</td>
<td>870.9</td>
<td>491.7</td>
</tr>
<tr>
<td>Bonds</td>
<td>155.0</td>
<td>94.4</td>
</tr>
<tr>
<td>Cash</td>
<td>748.8</td>
<td>101.2</td>
</tr>
<tr>
<td>Debt instruments</td>
<td>77.5</td>
<td>40.8</td>
</tr>
<tr>
<td>Life insurance</td>
<td>146.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Trusts</td>
<td>99.4</td>
<td>89.4</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>851.6</td>
<td>83.5</td>
</tr>
<tr>
<td>Total assets</td>
<td>$4,392.4</td>
<td>$1,066.9</td>
</tr>
<tr>
<td>Liabilities</td>
<td>2,089.5</td>
<td>131.0</td>
</tr>
<tr>
<td>Net Worth</td>
<td>3,305.9</td>
<td>915.9</td>
</tr>
<tr>
<td>Number of persons (millions)</td>
<td>209.0</td>
<td>2.1</td>
</tr>
</tbody>
</table>


Redistribution of income, rather than wealth, is already being attempted through the many income support and income transfer programs now in operation. Though such programs are necessary to remove some of the hardship of poverty and to fulfill basic needs, they are still only marginally effective. Despite them, the distribution of income has remained virtually unchanged since World War II: the top quintile of the population holds just over 40 percent of the income and the lowest quintile has 3 percent. Even these figures underestimate how rich the rich really are for the top quintile of families have almost 80 percent of total personal wealth. Clearly income will not become more equally distributed in this country until the base of wealth holdings is broadened.
In recent years, direct purchase and ownership of securities issued through capital markets (and thus representing claims to assets) has increasingly been dominated by financial institutions (see Table 2). Individuals have been more likely to place their savings with a financial intermediary than to invest directly in corporate stocks or bonds. This does not change the picture for the top wealth-holders, however, because if they are not directly purchasing new securities, they still control these new assets through their continuing ownership of the institutional purchasers.

**TABLE 2. Purchases of Primary Security Issues by Individuals and Financial Intermediaries (Representative Years 1960-1973)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total primary securities issued in year</td>
<td>$33.5</td>
<td>$57.2</td>
<td>$95.0</td>
<td>$144.8</td>
<td>$156.2</td>
<td>$152.7</td>
</tr>
<tr>
<td>Purchased by financial institutions</td>
<td>$26.2</td>
<td>$56.4</td>
<td>$87.2</td>
<td>$130.6</td>
<td>$152.6</td>
<td>$185.9</td>
</tr>
<tr>
<td>Net purchase by individuals and others</td>
<td>$ 7.3</td>
<td>$ 0.8</td>
<td>$ 7.8</td>
<td>$ 14.2</td>
<td>$ -2.4</td>
<td>$ -33.2</td>
</tr>
</tbody>
</table>


The tendency toward ownership and control at the top exists both between the financial institutions and between the most powerful of these and the large non-financial corporations through interlocking directorates. As an example of the former, in the life insurance industry, which is the most important source of corporate long-term debt financing and also a major source of mortgage financing, the 11 largest companies held 55 percent of the $220 billion worth of total life insurance assets in 1971. Just two companies—Prudential and Metropolitan Life—held 27 percent (Faux and Lightfoot, p. 130).
TABLE 3. Companies with Recent or Existing Director Interlocks to Citibank, 1973

<table>
<thead>
<tr>
<th>Rank (by sales)</th>
<th>Company</th>
<th>Rank (by sales)</th>
<th>Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>General Motors</td>
<td>99.</td>
<td>Olin</td>
</tr>
<tr>
<td>2.</td>
<td>Standard Oil (N.J.) (EXXON)</td>
<td>103.</td>
<td>Colgate-Palmolive</td>
</tr>
<tr>
<td>4.</td>
<td>General Electric</td>
<td>111.</td>
<td>Kennecott Copper</td>
</tr>
<tr>
<td>5.</td>
<td>IBM</td>
<td>116.</td>
<td>Martin Marietta</td>
</tr>
<tr>
<td>7.</td>
<td>Mobil Oil</td>
<td>132.</td>
<td>Bristol-Meyers</td>
</tr>
<tr>
<td>9.</td>
<td>ITT</td>
<td>133.</td>
<td>St. Regis Paper</td>
</tr>
<tr>
<td>12.</td>
<td>United States Steel</td>
<td>134.</td>
<td>Kimberly Clark</td>
</tr>
<tr>
<td>15.</td>
<td>E. U. DuPont</td>
<td>160.</td>
<td>Ingersoll-Rand</td>
</tr>
<tr>
<td>de Nemours</td>
<td>164.</td>
<td>National Distillers</td>
<td></td>
</tr>
<tr>
<td>16.</td>
<td>Shell Oil</td>
<td>168.</td>
<td>Phelps Dodge</td>
</tr>
<tr>
<td>26.</td>
<td>Boeing</td>
<td>204.</td>
<td>Magnavox</td>
</tr>
<tr>
<td>28.</td>
<td>Proctor &amp; Gamble</td>
<td>209.</td>
<td>Koppers</td>
</tr>
<tr>
<td>36.</td>
<td>United Aircraft</td>
<td>266.</td>
<td>City Investing</td>
</tr>
<tr>
<td>43.</td>
<td>Monsanto</td>
<td>284.</td>
<td>Potlatch Forests</td>
</tr>
<tr>
<td>46.</td>
<td>General Foods</td>
<td>314.</td>
<td>Bell &amp; Howell</td>
</tr>
<tr>
<td>50.</td>
<td>W. R. Grace</td>
<td>343.</td>
<td>ACF Industries</td>
</tr>
<tr>
<td>56.</td>
<td>American Can</td>
<td>475.</td>
<td>F &amp; M Schaefer</td>
</tr>
<tr>
<td>71.</td>
<td>Xerox</td>
<td></td>
<td></td>
</tr>
<tr>
<td>76.</td>
<td>Anaconda</td>
<td></td>
<td></td>
</tr>
<tr>
<td>81.</td>
<td>Allied Chemical</td>
<td></td>
<td></td>
</tr>
<tr>
<td>82.</td>
<td>American Standard</td>
<td></td>
<td></td>
</tr>
<tr>
<td>87.</td>
<td>National Cash Register</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Life Insurance Companies</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Retailing Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Sears, Roebuck</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Transportation Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Southern Pacific</td>
</tr>
<tr>
<td>5. Pan American World Airways</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Utilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. AT&amp;T</td>
</tr>
<tr>
<td>2. Consolidated Edison</td>
</tr>
</tbody>
</table>

Out of more than 14,000 commercial banks in the United States at the end of 1974 with total deposits of $754.7 billion, just 4 banks—Bank of America, First National City Bank, Chase Manhattan, and Manufacturers Hanover Trust—held 20 percent of these deposits. In addition to their own asset holdings, Congressional Hearings conducted in 1968 by Representative Wright Patman demonstrated how a small number of the largest commercial banks controlled huge blocks of corporate stock through their trust departments. Claims to the earnings of the trust funds belong to the beneficiaries (including many billions of dollars worth of pension plans), but power over the investment of the funds belong to the bank trustees.

In 1969 these same four banks plus 28 other giants had a total of 514 interlocking directorates with the 220 largest corporations (Faux and Lightfoot, p. 133). This represents one aspect of a whole complex of inter-relationships whereby the top wealth-holders in the United States maintain their effective control over America's economic life (Domhoff, 1967).

As long as financial control of capital remains so tightly concentrated, competition for funds will be heavily weighted in favor of the needs and priorities of the large corporations. This becomes particularly important in the years ahead, when the availability of new sources of funds for capital investment seems to be lagging far behind the demand, to the point that Treasury Secretaries William Simon and Michael Blumenthal and business leaders such as David Rockefeller and Henry Ford II are openly concerned about a "capital gap." The results of this "gap" are rising interest rates (good for the large lenders) and a steadily increasing proportion of corporate debt. The JEC study noted:
In the first three decades of the 20th century, stocks provided 11 to 19 percent of the funds for U.S. nonfinancial corporations. As Table 2 makes clear, the contribution of stocks as a source of funds dropped dramatically over the next three decades to a range of 4 to 9 percent.

TABLE 2. — Stocks and Bonds as Sources of Funds for U.S. Nonfinancial Corporations

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks</td>
<td>14</td>
<td>11.2</td>
<td>19.4</td>
<td>--------</td>
<td>9.0</td>
<td>4.6</td>
<td>6.6</td>
<td>6.4</td>
<td>4.0</td>
<td>0.9</td>
</tr>
<tr>
<td>Bonds</td>
<td>25</td>
<td>7.2</td>
<td>7.1</td>
<td>--------</td>
<td>11.4</td>
<td>-6.1</td>
<td>11.7</td>
<td>10.6</td>
<td>9.3</td>
<td>9.0</td>
</tr>
</tbody>
</table>


During the last 15 years, their role has been insignificant; during the 1960's new equity issues accounted on the average for only 7 percent of the total financing sources of nonfinancial companies, while the average for the 1970's to date has been 5.9 percent. Last year, new equity offerings for nonfinancial companies totaled only 7.1 billion out of a total level of financing for these companies of $147.3 billion, with just 568 companies using new stock issues to help raise capital. At the same time, the total market value of stocks traded on all registered exchanges in 1975 was $157.3 billion which indicates that less than 5 percent of stock transactions were for directly fostering new capital formation. Clearly the stock market no longer plays a significant role, as it once did, in financing the growth of the economy.

The rapid growth of bond financing has accompanied this decline of stocks as a significant source of funds for corporate expansion through new capital formation. Apart from the first decade of this century, bonds were a minor partner to stocks as a source of external funds until after World War II. Beginning immediately after the war, and continuing for the next two decades, as seen in Table 2, their share was usually approximately double that of stocks.

In recent years, there has been a much more dramatic shift towards debt. In the first half of the 1960's, new equity issues exceeded additions to debt by $10 billion while during the past 10 years, the position has been more than reversed with debt additions exceeding new equity by $190 billion. In the 1964-74 decade, the overall debt-equity ratio for all U.S. manufacturing corporations rose from 25 to 43 percent. This trend has become so pronounced that many argue that business has built far too much debt into its capital structure. The more dire warnings revolve around the theme that unless equity financing increases relative to debt, the rate of economic growth will slow down and possibly halt, or epidemic business failures will occur.
Of course there are and will continue to be losers in the competition for scarce capital. First of all, the bailing-out of individual investors from the stock market and their replacement by large institutional investors has resulted in the development of what most economists and business analysts agree is a "two-tier" market, whereby the insurance companies, pension funds, trust funds, investment companies, and others concentrate their stock-buying on a small number of favorite blue chips, to the virtual exclusion of medium-sized companies also traded on the Exchanges. Smaller companies are completely frozen out. And with the collapse of the new issues market in the last few years, it is virtually impossible for new enterprises to raise capital through public offerings of common stock. They are further hurt by the decline of venture capital investment companies, who have also been adversely affected by the collapse of the new issues market (Katzman and Daniels, pp. 27-31; Dougall and Gaummitz, pp. 181-3).1/

1/ The smaller, higher risk companies provide a good measure of the corporate growth in the country. Yet it is these companies that have the greatest difficulty in raising capital and in their early stage, attracting good management.

The following data on the venture capital industry show how little venture capital is presently being invested.

The National Venture Capital Association, which includes the major venture capital groups in the country, has commissioned a two-year study by Professor A. Ofer, Northwestern University, on the flow of venture capital. The most recent study showed the following for the Venture Capital Industry (143 Venture Capital Firms):

<table>
<thead>
<tr>
<th>[In millions of dollars]</th>
<th>1975</th>
<th>1974</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments in new projects not previously in the portfolio</td>
<td>52.4</td>
<td>80.6</td>
</tr>
<tr>
<td>Investments in companies already in the portfolio</td>
<td>56.9</td>
<td>101.3</td>
</tr>
<tr>
<td>Total</td>
<td>111.5</td>
<td>181.9</td>
</tr>
</tbody>
</table>
Perhaps more importantly, there are a massive number of unmet needs in this country: better and more universal health care, low-income housing and neighborhood revitalization, rebuilding of cities and economic rebirth of rural areas, pollution control, transportation upgrading, environmental enhancement, energy retrofitting, and many other things.

Professor Ofer's studies indicate that the flow of venture capital investment is slowing materially. His data also show how little money is now being directed by the venture industry into start-up or barely emerging companies:

<table>
<thead>
<tr>
<th>In millions of dollars</th>
<th>1975</th>
<th>1974</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount invested in startups</td>
<td>15.6</td>
<td>12.9</td>
</tr>
<tr>
<td>Amount invested in 1st-round financings</td>
<td>8.1</td>
<td>37.5</td>
</tr>
<tr>
<td>Amount invested in somewhat more seasoned 2nd-round financings</td>
<td>17.7</td>
<td>23.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>41.4</strong></td>
<td><strong>74.0</strong></td>
</tr>
</tbody>
</table>

Prior to 1973, the public markets were a significant source of financing for the successful emerging innovative companies. Firm public underwritings for companies with a net worth (prior to the public offering) of less than $5 million reflect the following pattern.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of offerings</th>
<th>Total dollar amount (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>548</td>
<td>$1,457.7</td>
</tr>
<tr>
<td>1970</td>
<td>209</td>
<td>333.7</td>
</tr>
<tr>
<td>1971</td>
<td>224</td>
<td>551.5</td>
</tr>
<tr>
<td>1972</td>
<td>418</td>
<td>918.2</td>
</tr>
<tr>
<td>1973</td>
<td>69</td>
<td>137.5</td>
</tr>
<tr>
<td>1974</td>
<td>8</td>
<td>13.1</td>
</tr>
<tr>
<td>1975</td>
<td>4</td>
<td>16.2</td>
</tr>
</tbody>
</table>


which run into the billions and probably even trillions of dollars (Faux and Lightfoot, pp. 4-9). Given the stacked deck of capital competition, the question is not whether "private enterprise" will do the job but simply whether or not the large financial institutions and corporations are planning to do it. State and local governments do not currently control enough sources of revenue to expand their indebtedness and capital spending much farther. The Federal government, of course, does have relatively unlimited spending powers, but it is constrained by the priorities of the top wealth-holders (in order to avoid an unemployment crisis) and by the need for price stability.

It seems clear that these unmet needs will attain a higher place on the list of capital priorities only when the distribution of wealth itself has changed. This can be done through greater assertion of control over assets and sources of funds that workers collectively and public citizens generally already "own" or hold claims over. The most prominent examples are Federal, state, and local government funds now controlled by private financial institutions, and employee retirement funds now controlled by private financial institutions. If public and private pension funds, Federal trust funds such as unemployment insurance and Social Security, and state and local government bank accounts are put to work on behalf of a different set of priorities than presently, this could result in an effective redistribution of wealth. One of the ironies of the emergence of the large institutional investor is that a considerable portion of the half-trillion dollars in pension funds are now invested in the equity capital of American industry. Assertion of ownership and rights of control by the worker-beneficiaries could turn
capital investment in new policy directions. The consequences of this movement could be the beginnings of a more equitable distribution of income, a genuine full-employment economy, and greater democracy at the workplace and in the community.

The Need for Control

The residents of Youngstown, Ohio, are beginning to understand what lack of control over private capital really means. They have continued to go to work each morning these past few years while Lykes Corporation, a conglomerate that purchased Youngstown Sheet & Tube in 1969, quietly diverted YS&T's capital resources and cash reserves into more profitable investments overseas. With this job completed, Lykes Corp. announced in September of 1977 that it was closing down Youngstown Sheet & Tube. Youngstown residents, feeling powerless, tried to fight back by raising enough capital to purchase the enterprise and keep it open. In spring 1978 they were still trying.

On a statewide basis the Ohio legislature began considering a bill which would require companies shutting down plants and leaving Ohio to give two years notice and pay a severance tax. Whether this bill will pass or not, and what effect it will have remains to be seen. But the whole matter points up the vulnerability of the public to the mobility and power of private capital. States and localities that attempt direct regulation have little leverage with which to apply pressure. Companies can leave, and investors can move their money elsewhere. Even the Federal government, short of imposing severe (and enforceable) restrictions on capital export, can do little under the current power arrangements. At the present time profits earned by American corporations overseas are not even taxed by the IRS so long as they are reinvested abroad.
The problem of the lack of public control is also felt when government uses the "positive" approach of providing monetary incentives to direct capital investment, rather than using the "negative" approach of regulation. In either case the threat of a capital strike always looms in the background, thus limiting the bargaining position of the Federal, state, or local government. For example, many state and local governments use a myriad of incentives such as tax exemptions, rebates, credits, direct loans, loan guarantees, industrial revenue bonds and other devices to encourage corporate relocation to their area, expansion of existing enterprises, hiring of the unemployed, etc. (Eichner, 1970; N.Y. State Dept. of Commerce, 1976; CCED Survey, 1979). The net result of this incentive approach, however, is a self-defeating strategy in which the corporations hold up the states and localities for subsidies that enhance their profits and lower their costs, while doing nothing in return that they would not have done regardless. Some areas may occasionally come out ahead (at the direct expense of others) using this approach, but in general all areas lose out by foregoing badly-needed revenue (Harrison and Kanter, 1976; Chernow, 1978; Katzman, 1976).

Bank of North Dakota

An example of a state that recognized the need for more direct control over capital and did something about it is North Dakota. It created a state-owned bank in 1919 that is still flourishing today.

The Bank of North Dakota was founded after a long and bitter political battle which resulted in the populist Non-Partisan League winning control of the state government in 1918. The creation of a state-owned bank was one of the principal planks in their platform. Farmers at that time were heavily in debt to the Minneapolis banks, who
were charging prohibitively high interest rates (12½%) for short-term loans. By establishing a state-owned bank the Non-Partisan League hoped to keep money within the state and make it more readily available for business expansion.

The bank was initially capitalized by the sale of $2 million in bonds, bonds which were boycotted by bankers and bond traders until the Central Labor Councils of Minneapolis and Chicago broke the blockade. The lower interest rates charged by the bank on mortgages and short-term loans saved many small North Dakota farmers from financial ruin in the 1920s and 30s.

Today the Bank's assets are over $500 million, making it the largest bank both in the state and in the entire western plains area. Total profits for its 58 years of operation are nearly $112 million, and its average annual profit rate compared to total assets is more than three times that of an average commercial bank. Part of the reason for this is that the Bank of North Dakota pays no taxes, but even if it did, its profits would be well above average for a commercial bank (Barron's, 1975). The Bank is managed by a professional manager, but its operations are directed by a three-member Industrial Commission consisting of the Governor, the Attorney General, and the Commissioner of Agriculture.

The state government deposits all of its funds with the Bank, while local political subdivisions have the option of doing so. Together these government deposits account for 90 percent of the Bank's total deposits, with the remainder coming from corporate sources and some 4000 individual checking and savings accounts. The Bank is prohibited from making direct loans except in the following areas: FHA and VA guaranteed
home mortgages, Federally Insured Student Loans, and real estate loans to farmers secured by first lien on the property. The Bank has more than $50 million in loans outstanding in all three of these categories. It also has $3 million in special home mortgage loans to low and moderate income people.

In addition, one of the Bank's principal activities is to act as a main underwriter and marketer for the bonds of the small political subdivision in the state. Many of these entities do not even have a rating, and it would be far more costly and extremely difficult to sell these obligations without the Bank. Over $15 million of these bonds were underwritten and sold in 1977 alone, financing 181 separate political subdivisions. Herb Thorndahl, the Bank's President, noted recently, "Since the Bank pays no income tax, you might ask why do we buy tax-exempt securities? The answer is to provide an efficient and economic service to the instrumentalities of our state" (Cal. Senate Select Committee, 1977, p. 7).

Other services the Bank provides are secondary marketing of Small Business Administration (SBA) and Farmer's Home Administration (FMHA) guaranteed loans within the state ($80 million), underwriting Industrial Revenue Bonds, acting as a clearinghouse for the state's private banks (check-processing), loaning money to the state government and its various agencies, promoting housing construction and solar energy loans, and managing the portfolio of several state trust funds including the state university and the Public Employee's Retirement System. Last year the Bank returned 8 million dollars to the State Treasury out of its net profit of 34.1 percent.
Mr. Thorndahl testified in September 1977 at California state legislative hearings on the creation of a California state-owned bank, and made the following comments:

The Bank pays no taxes. We pay more into the State Treasury, as a percentage of profits, than any bank would pay in combined taxes and dividends. As an example, in 1976 84 percent of our net operating earnings were paid into the State Treasury. The national average for banks is 41 percent for paid-in dividends. We pay more than seven times the amount paid by all banks and savings and loans combined in North Dakota in taxes to the state. In no way could the financial community make this up, if the Bank of North Dakota dispersed its deposits to the other institutions (p. 13)

...recently in North Dakota, we placed $6.5 million of FHA insured mortgages in the State Teachers' Retirement Fund. All of these mortgages were purchased from, and are being serviced by, local banks and savings and loan associations. They are a good investment, yielding as much or more than out-of-state corporate bonds of the same average maturity. This investment helped the housing situation in North Dakota. It is an example of "public money for public good" (Cal. Select Committee, 1977). (p. 11)

Other State Banks

In March of 1975, Stanley Steingut, the Speaker of the New York State Assembly, introduced two bills which would have created a Public Bank for the State of New York. After extensive public hearings throughout the state, the bills passed the Assembly, only to be defeated in the more conservative State Senate under intense pressure from the banking lobby.

The bank would have been capitalized with a $50 million appropriation from the state budget, and its deposits would have consisted of the six billion dollars of state funds currently on deposit with private banks. According to Steingut, this money was then (and presumably still is) "...used to build new factories in Germany, luxury hotels in the Mediterranean and, ironically, is loaned to foreign governments at lower interest rates than the city of New York can negotiate" (Press Release, June 4, 1975).
The public bank would also accept demand and time deposits from private citizens and institutions, and would join the Federal Reserve System, so all accounts would be fully insured. The bank would make commercial loans, finance commercial and residential mortgages, and act as an underwriter and marketer of bonds for the state and its cities and other political subdivisions. Steingut claimed the bank "would provide a yardstick for measuring the performance of private banks, and it would meet the financial needs of the people of this state not now being met by the private sector."

Among these unmet needs were listed the following: 1. "Redlining," or the policy by private banks and thrift institutions of refusing to write any mortgages or home improvement loans in particular areas, thus marking the area for inevitable decay. 2. Along the same lines, a refusal by private banks to make money available for long-term community development in lower-income neighborhoods. 3. The lack of venture capital available for the start-up of new industrial and commercial enterprises.

Another concern was the bleeding dry of rural areas of the state of their financial resources by the big banks (through their ownership of the smaller banks by bank holding companies, and by the correspondent relationship) in a process called "strip mining," as in this quote from the President of an upstate New York bank,

To the international giants like Citibank, Chase Manhattan and others, their upstate banks are like strip mining operations. The raw material, money, is extracted from our local communities to be used anywhere in the world where they can get the best terms regardless of local consequences (Briefing memo, 1975).

Probably the most important area of concern was the difficulty that municipalities were having in borrowing short and long-term money and the extremely high interest rates they were being forced to pay. Steingut declared that a "money squeeze is on the state and its subdivisions"
and that the banks "are making unconscionable profits marketing government obligations." He cited the example of New York City, which at that time was forced to pay almost 9.5 percent interest in order to place its tax-exempt securities with syndicates from Chase Manhattan and Bankers Trust.

Since the New York Public Bank Hearings, bills to create state-owned banks have been introduced in Oregon, Nevada, Massachusetts, Washington, and California, with legislators studying their feasibility in Florida, New Jersey, and Colorado.

A state-owned bank can take the state's funds sitting in checking and savings accounts of private banks and put these funds to work inside the state to achieve economic and social goals. The limits to this approach are that the state's account balances are seasonal and unstable in nature, so the bank's activities are generally confined to provision of short or perhaps medium-term business loans—what is termed "working capital"—and to secondary marketing of Federally-guaranteed loans. This is certainly the case with the Bank of North Dakota, which does not make long-term development loans, nor take any equity positions, while it does commit a high proportion of its assets to holding U.S. Treasury Bills and Federal Agency Securities, to selling Federal Funds, and to other short-term money market instruments which enhance the Bank's liquidity and profits, but don't help solve the credit problems of North Dakotans.

Many people recognize that capital must be available on a steady and long-term basis both in the form of credit and of equity investments in order for public and private development in the areas of the "unmet needs" to occur. In addition to the welter of government activity to
stimulate mortgage credit, many proposals have come forward for development banks to provide capital for existing enterprises to make major long-term expansion plans and allow new enterprises to start-up and ultimately flourish. But the problem becomes one of where the development bank's own capital will come from. Massachusetts' innovative Community Development Finance Corporation, which attacks the structural deficiencies of the "dual labor market" by making equity investments in community-sponsored enterprises located in high unemployment areas, was forced to invest 80 percent of its initial $10 million capital (from the state treasury) in marketable securities to earn enough income to pay operating expenses and cover possible losses from its community investments.

In response to this problem, American people past and present have looked to the Federal Treasury for direct grants, direct loans, subsidies, tax credits, loan guarantees, and even equity investments. The list of activities is already legion: from the old Reconstruction Finance Corporation to the Small Business Administration, Economic Development Administration, Farm Credit System, Federal Home Loan Bank System, Federal Housing Administration, to the newly-proposed National Development Banks of President Carter, Congressman William Moorhead, Congressman Michael Harrington, and the Ralph Nader-inspired National Consumer Cooperative Bank Act, which passed the House in 1977 and is currently before the Senate. With the exception of direct grants, however, many of these programs are either guarantees or leveraging devices which still require the mobilization of private capital resources for success. (A recent Congressional Committee report listed 164 separate Federal loan guarantee programs.)
Where will this private capital come from? Or rather, how can it be redirected from its existing uses? One place to start looking is employee retirement funds, now the second largest financial institution in the United States, with more than $400 billion in assets. These funds are increased by billions each year, and the search for new long-term investments need not always end up in the hands of Wall Street brokerage houses.

Pension History

The earliest pension plans began in the United States after the Civil War. The American Express Company started one in 1875 (Brooks, 1975, p. 8). Most of the early plans were in railroads and related industries, with some of the giant industrial corporations forming plans around the turn of the century. By 1925 approximately 4 million workers were covered by 400 plans. More than 40 percent of these workers were employed by railroad companies, and roughly 1.3 million worked for just 4 corporations: U.S. Steel, American Telephone and Telegraph, Pennsylvania Railroad and New York Central (Harbrecht, 1959, p. 6).

The principal reasons for establishing pension plans were to promote loyalty to the corporation (the worker would be less likely to quit his job if it meant sacrificing his retirement benefits) and to make it easier to squeeze out older workers when they became less productive. The employers did not feel that they "owed" anything to their employees in the way of retirement benefits; rather the pension plans were viewed as a bonus that could be given or taken away at the employer's discretion. Paul Harbrecht describes:
The early attitude of employers toward pension plans was pensions were gifts to their workers in recognition of 'long and faithful service' and that no legal rights were thereby given to employees who became beneficiaries of a plan. Plans at this period were extremely informal, often consisting of mere statements that the employer expected to pay certain benefits to those who fulfilled certain service requirements. In general the employer did not set up a special fund to provide pension benefits and the text of the plan was carefully worded to relieve him of all liability. (Harbrecht, 1959, pp. 5-6).

This legal view was underscored by the U.S. Supreme Court in 1889 when it ruled in Pennie v. Reis that even though two dollars had been taken out of a policeman's pay each month and put in a pension fund, that money did not belong to him and he could not claim it as his property if he did not qualify for pension benefits.

Organized labor maintained a very skeptical attitude toward pension plans in this period. Samuel Gompers of the American Federation of Labor argued that if workers were paid a decent wage they would be able to save for their retirement without being dependent on their employers. This arms-length attitude by labor leaders is one reason why pension plans did not become more widespread (Greenough and King, 1976, p. 28; Harbrecht, 1959, p. 91).

The first real impetus for pension plan growth came from the Federal government. In 1921 Congress exempted the income earned by pension funds from paying income tax, and also exempted employees from paying income taxes on the contributions made to the fund on their behalf. (They must pay income tax when they actually receive the benefits during retirement, but at this time they are generally in a lower bracket.) During the 1930s and 40s the Congress and Internal Revenue Service tightened up the regulations so that employers could not divert the money in the fund for any purpose other than paying out pensions,
but the basic seed for expansion was planted when employers were allowed to deduct their contributions to a pension fund from their gross income.

The second major impetus was the Great Depression of the 1930s. Millions of people lost their savings in the bank failures and stock market crash. Concern for old-age financial security became a principal issue of the New Deal, leading to the Federal takeover of the bankrupt Railroad Retirement funds and the passage of the Social Security Act in 1935.

The establishment of Federal Old Age and Survivors Insurance (Social Security) legitimized the need and desire of American workers to receive an adequate retirement income. Yet the benefits paid by Social Security were far from adequate. As a result, labor leaders, particularly in the newly-emerging CIO (Congress of Industrial Organizations), began pushing for pension benefits from industry to supplement Social Security. This dove-tailed nicely with the situation during World War II, where high corporate income tax rates made the tax-deductible contributions to pension funds suddenly look very attractive to the large corporations. By contributing a portion of their earnings to the retirement funds, corporation taxable income was greatly reduced and these companies were able to save millions of dollars. The fact that the pension contributions could then be reinvested in the company by the fund managers made these plans even more lucrative. In addition, since pension plans were considered a "fringe benefit" not subject to the tight wartime wage freezes, this created an added incentive in the eyes of both the unions and the management.

All that was needed was one final step, which the Supreme Court provided in 1949 when it ruled that Inland Steel was obligated to
bargain with the United Steelworkers Union over a pension plan because pensions were part of the structure of wages as defined by the Taft-Hartley Act. As unions pressed their demands and corporations became convinced of the tax and other advantages, pension plans grew at a fantastic pace in the 1950s.

**Legislative Reform**

As the pension plans proliferated in the 1950s and 60s, so too did the books and articles describing the many "horror stories" where workers, either individually or collectively, did not receive the retirement benefits they had been promised after many long years of employment (see Nader and Blackwell, 1973; Bernstein, 1964). For example, while it is true that a pension fund can receive tax advantages only if the funds are used for the sole benefit of the eligible recipients, the fund can always be terminated and no further benefits paid. This is exactly what happened in South Bend, Indiana, in 1964, when the Studebaker Corporation closed its doors and left thousands of workers and retirees with virtually nothing in pension benefits. Other widely-publicized abuses include the large Teamsters Union pension funds being used to finance Las Vegas gambling casinos and other pet projects of organized crime.

In 1958 Congress passed the Welfare and Pension Plans Disclosure Act which required all pension plan administrators to file financial reports with the Department of Labor, so that abuses of funds could be monitored. While this law helped curb some of the more flagrant abuses, the fact that so many workers in covered plans were reaching retirement age without ever receiving their promised pension led to a long
legislative battle in Congress which finally culminated in the passage of the Employee Retirement Income Security Act (ERISA) of 1974. Peter Henle and Raymond Schmitt, two Congressional researchers who worked on ERISA, give some background:

... the origins of the legislation can be found in a continuing flow of complaints from participants regarding specific private pension plans—severe age and service requirements before eligibility for a pension, inadequate funding by employers, termination of plans without funds to assure pensions to qualified employees, and the diversion of pension funds for private purposes by the employer or union involved (Henle and Schmitt, MLR 1974, p. 3).

ERISA deals with several of these problems (for private pension plans only) by requiring minimum standards for plan eligibility and vesting of benefits (the non-forfeitable right to receive a pension once certain age and service requirements have been satisfied, even if the worker is no longer with the company at the time of retirement); by requiring employers to insure themselves with a Federal Pension Benefit Guaranty Corporation, so that benefits will be paid in the event of a plan termination; by establishing standards for reporting and disclosure, fiduciary responsibility of fund trustees and portfolio managers, requirements for fully-funding plans, and other such provisions. No employer is required to have a pension plan, and in fact, many smaller employers have since terminated their plans in the face of the higher costs and more stringent requirements of ERISA (Schmitt, 1977). But any private plan that does exist must conform to these standards.

TYPES OF PLANS

In the early days of pensions, most plans were financed on a "pay-as-you-go" basis, with the employer simply paying the contributions out of his current operating budget. Some small, informal private
plans still use this method today, as do some state and local governments. It has become common practice, however, for most plans to have an actuarially-calculated, separate and permanent fund into which contributions are made and from which pension benefits are paid.

This fund is held in a kind of trust on behalf of the plan participants. Managers of the fund invest the money in government or corporate securities or some other type of debt or equity instrument that will either pay interest or appreciate in cash value. As of the end of 1976, the total book value of all assets held by pension funds was 443.4 billion dollars. Of these, Federal pension funds were 87.7 billion. These funds are invested exclusively in U.S. Government or Agency securities. State and local government accounted for 117.2 billion. At one time these were invested primarily in U.S. Government securities or state and local government bonds, but an increasing proportion of these funds are investing in corporate stocks and bonds.

Private pension funds had total book value assets of 240.5 billion dollars. 80.1 billion of this was in insured funds, meaning that the employer pays the contributions to an insurance company which is contracted to pay the pension benefits according to eligibility requirements and the benefit schedule. The insurance companies generally place the funds together with the rest of their investment portfolio, though in some cases they do maintain separate accounts. A goodly portion of the insurance portfolio is invested in corporate bonds and stocks, with various types of mortgages also taking a large chunk.

The other 160.4 billion is in private non-insured pension funds. Single employer plans are generally administered exclusively by the employer, through appointed trustees. The funds can either be managed
in-house, or what is more common, turned over to bank trust departments or independent asset managers. Bank trust departments manage the bulk of these funds.

There are also a number of funds which are not solely corporate-administered, but are jointly-administered by employers and union representatives under Section 302 of the Taft-Hartley Act. These funds are primarily in industries where there are many employers but one large union, such as the Teamsters, Maritime Union, Ladies Garment Workers Union, or the various Building Trades. Together these funds represent about 35 billion dollars out of the total 160.4 billion for all private non-insured funds (Blodgett, 1977, p. 10). Some of these "union" funds were originally established through the members' own contributions and were later converted to employer contribution pension funds. The overwhelming majority of all private pension plans are financed exclusively by employer contributions which are deductible from the employer's taxable income.

While almost all Federal and most state and local government employees are covered by pension plans, only around 48 percent of all full-time employees in the private sector are covered. Labor union collective bargaining is one of the most important reasons for private sector pension plans. The areas with the least coverage tend to be non-unionized, low-paying, marginal-type occupations and industries (Kolodubretz, 1972, p. 20).

Of the roughly 500,000 private pension plans covering 38 million active and retired workers more than two-thirds cover 10 or fewer employees. At the other end of the scale, the 17 largest plans cover more than 20 percent of all private sector workers, and the 25 largest
plans, each with assets of more than one billion dollars, total to nearly one-fourth of the amount for all private non-insured funds (Davis and Strasser, 1970, p. 4; Greenough and King, 1976, p. 109).

The total amount of assets in pension funds is a huge figure, and by all projections it is going to continue growing at a very rapid pace. The question that is becoming more and more important in light of this massive growth is: who owns the pension funds, and who should control them?

OWNERHIP AND CONTROL

At the turn of the century, pensions were viewed largely as a gratuity or "gift" by the employer. This idea, like so many others, began to change radically during the 1930s as more and more people claimed retirement security as a "right." Still, it was primarily seen as something for the government to provide, and it was only in the Post-War period that the push came on private employers. Even then, CIO unions, particularly the UAW, adopted a position that pensions were a form of "human depreciation" that a corporation was bound to pay for retiring worn-out workers, just as it sets aside depreciation funds for eventual replacing of worn-out equipment. The UAW argued that the level of benefits should be based on the worker's needs rather than his wages, and that all workers should be included equally. This argument for management's responsibility is still essentially a moral argument, and it has gradually been replaced over the last 30 years by the position that pension benefits are really a form of deferred wages, as in this excerpt from a labor pamphlet:
A pension plan is not... a conditional or discretionary gift by the employer, but a deferred wage earned by current labor services, and required by the terms of the contract... the worker's interest in the pension fund is not established solely by reason of advanced age and 'long and faithful' service with an employer. That interest is established by reason of the work performed by all the members during the term of the contract (Harbrecht, 1959, pp. 95-6).

This viewpoint probably got its biggest boost in the Inland Steel case of 1949, where the Supreme Court upheld and quoted with approval the National Labor Relations Board contention that...

... realistically viewed, this type of wage enhancement or increase, no less than any other, becomes an integral part of the entire wage structure, and the character of the employee representative's interest in it, and the terms of its grant, is no different than any other case where a change in the wage structure is effected.

Subsequent Supreme Court decisions, while not directly addressing the question of "ownership" of the funds, have also taken the position that pension contributions by employers must be viewed as part of the employee wages (Harbrecht, 1959, p. 269).

The tax laws have also contributed to this argument by making the condition for tax-exempt status of a pension fund that it must be for the sole benefit of the employees. Once a contribution has been made to the fund, that money no longer belongs to the employer. And while no taxes are paid at the time the contribution is made, the retired employees do pay income tax when they receive their pension benefits, which again reinforces the deferred wages principle.

This idea, in fact, has become so respectable of late that even conservative social commentator and business consultant, Peter Drucker, enthusiastically endorses it. In his new book, The Unseen Revolution: How Pension Fund Socialism Came to America, he states:
If 'socialism is defined as 'ownership of the means of production by the workers'--and this is both the orthodox and the only rigorous definition--then the United States is the first truly 'Socialist' country. Through their pension funds, employees of American business today own at least 25 percent of its equity capital, which is more than enough for control....Indeed, aside from farming, a larger sector of the American economy is owned today by the American worker through his investment agent, the pension fund, than Allende in Chile had brought under government ownership to make Chile a 'Socialist country,' than Castro's Cuba has actually nationalized, or than had had nationalized in Hungary or Poland at the height of Stalinism. (Drucker, 1976, pp. 1-2).

If the money contributed to the fund belongs to the workers, then the workers own the fund's assets, which among other things is a huge bloc of stock in America's largest corporations. But in a case such as this, "ownership" means very little. The worker cannot borrow the money, trade it, use it as collateral, or any of the other things ownership normally implies. And what is more, with few exceptions he or she has absolutely no control over how the funds are utilized. These decisions are being made on his and her behalf by the trust departments of America's giant banks. Paul Harbrecht describes:

In the end, the anatomy of control of the pension trusts may be described quite simply. In general, financial control has been delegated by the employers to the banker-trustees, which exercise considerable power in the capital markets as a result. The employer controls the day-to-day operation of the plan itself, in many cases in accordance with a basic agreement arrived at with a union. It is the employer who, either unilaterally or in conjunction with a union, fixes the amount of pensions and usually alone determines how a plan is to be financed. The employee himself, without his union, has little or nothing to say about the pension plan which, ultimately, is financed out of his earnings (Harbrecht, 1959, p. 236).

Not only do a large number of corporations turn over management of their pension fund portfolios to asset managers or bank trust departments, but many Taft-Hartley joint union-management funds also follow this same practice. As a result, at year-end 1975 the 100 largest banks controlled over $145.6 billion in pension funds, and the top ten banks
controlled $80 billion. Banker's Trust and Morgan Guaranty Trust each control nearly $15 billion in pension funds (Pensions & Investments, May 9, 1977, p. 3).

And where do the trustees place most of this money? A 1976 study by the Congressional Joint Economic Committee revealed that at a time when individual investors have been bailing out of the stock market to the tune of $5 billion a year, pension fund trustees have been pumping into the New York and American Exchanges a major portion of their $12-20 billion annual increase in investable funds. "In fact, for the last decade, only the retained earnings of industry have been a larger source of funds for capital formation." (p. 15) Individual investors' share of equity ownership has declined from 91.5 percent in 1945 to 64.7 percent in 1975, with institutional investors making up the difference: 11 percent for private non-insured pension funds, 3.2 percent for state and local government trust funds, 3.5 percent for insurance companies (which hold $80 billion in pension funds), and the rest distributed among other institutional investors which also includes some pension money. The JEC estimated that pension funds hold approximately 20 percent of the market value of all outstanding stock, and predicted that this figure would increase to 50 percent ownership by 1985. The authors of the report were not entirely happy with this development, because of the enormous transfer of power to the hands of fund managers:

Some are concerned that with this trend, capital market decisions are effectively being transferred to asset managers from 'entrepreneurs.' Theoretically, since asset managers must follow the 'prudent man' rule, they will not be as able to take risks in investing for the future and thus may diminish the amount of capital for change and growth, particularly for the new small and growing business.

This follows from the fact that institutions tend to buy and sell large blocks of stock, concentrating their activity on a relatively small number of large issues (JEC, 1976, p. 15).
A more extensive investigation into these problems was held in the spring of 1977 by the U.S. Senate Subcommittee on Private Pension Plans and Employee Fringe Benefits and the Select Committee on Small Business. These Hearings, entitled "Pension Simplification and Investment Rules," probed a situation in which "a mere two dozen private financial managers have responsibility for managing over $130 billion in pension assets." The Washington Post described the scene:

More than one-third of all the shares of Kaiser Aluminum & Chemical purchased in 1975 were bought by the trust department of one bank, Morgan Guaranty Trust Co. of New York. In that same year, none of 100 pension funds that previously had invested in fledgling businesses did so.

This is an extreme example of concentration of plan assets in blue-chip stocks on the one hand and the drying up of this source of venture capital for the Xeroxes of tomorrow on the other. Both are unintended results of the Pension Reform Act of 1974.

Last week, a Senate Finance Subcommittee held hearings on a bill to remedy this situation by preventing a pension manager from buying more than 5 percent of any company's outstanding stock (there are no limits now) and, by permitting him to invest up to 2 percent of a fund's assets in small new companies, something improbable under current regulations.

While the bill was greeted enthusiastically by venture capitalists, Treasury and Labor Department officials expressed fear such leeway for fund managers could endanger workers' benefits.

The concentration occurred as a direct consequence of the Employee Retirement Income Security Act's "prudent man" rule, which increased the liability for fund managers making bad investment decisions. When the International Foundation of Employee Benefit Plans surveyed pension trustees last year, 64 percent of them stated they were unwilling to invest in anything but blue-chip securities.

As the bill's author, Sen. Lloyd Bentsen (D.-Tex.), put it, "No one is going to bring a suit against a manager because the stock of General Motors or IBM went down the tube, but they might if he had invested in Widget Corp."

Public and private pension funds are big business today. With assets in excess of $445 billion, they are second only to commercial banks. But the funds are managed by a very small number of institutions.

Some 15 bank trust departments, 12 insurance companies and about 24 private financial managers control more than 90 percent of the pension assets in this country. And they tend to invest in perhaps the same 200 or 300 securities, according to Bentsen.
For instance, Georgetown University Law School, which did a study last year, stated that in the same year Morgan Guaranty's trust department bought 38.5 per cent of the Kaiser stock, it also bought between 25 and 30 per cent of the shares traded of Potlatch, International Nickel, Crown Zellerbach and Manufacturer's Hanover. And it sold one out of every eight shares of Philip Morris and Schlumberger's traded in 1975.

Between 1973 and 1975, there were 128 occasions when Morgan, the largest bank trust department, accounted for more than 5 per cent of the total sales and purchases of Big Board issues. On 16 occasions, Morgan accounted for more than 20 per cent according to the Georgetown study.

In introducing the Pension Investment Act of 1977, Bentsen warned that the potential for manipulation of the market by large institutions could result in "a very substantial reduction of stock prices . . . to the detriment of countless American workers and retirees."

He said, "If one of this very small group of pension managers decides to sell a major investment on a bit of news, and other managers attempt to follow, they may find that the 'gate' suddenly gets very narrow."

He has proposed tax penalties to limit investment by a pension fund with more than $1 billion in assets to 5 per cent of a company's outstanding stock. Those with more than 5 per cent already would not be affected. At the same time, pension managers would have the option of investing up to 2 per cent of a plan's assets in new companies with less than $25 million in capitalization without being subject to the prudent man rule. Insurance companies and mutual funds currently are subject to similar regulation.

Besides protecting the safety of pension assets and preventing excess economic concentration, the Pension Investment Act aims to promote greater liquidity in the stock markets and to encourage investment in small, growing companies.

A panel of representatives of venture capital organizations testified that, prior to ERISA's passage, approximately 100 pension funds put up money regularly for fledgling businesses. According to Stewart Greenfield of Charter Oak Enterprises in Darien, Conn., zero pension dollars were received by the 70-odd venture capital firms in the country in 1974 and 1975. In 1976, approximately four funds put up $5 to $6 million (Washington Post, 5/15/77).

The concentration of such a large amount of financial power in relatively few hands leads to all sorts of problems and abuses. Many of these have been documented by the House Banking and Currency Committee in their 1968 report on "Commercial Banks and Their Trust Activities," and also in a 1975 study by Professor Edward S. Herman for the Twentieth Century Fund. The abuses go both ways: banks exerting pressure on the big corporations through their ability to buy and sell large blocks of
stock, various conflicts of interest such as bank pension fund managers investing in the stock of the bank's best loan customers, holding onto stock in declining companies where the bank fears suffering large loan losses, corporations giving their pension funds over to trust departments of banks from which they hope to obtain favorable loan terms, and a whole host of other examples where the earnings of the pension fund are sacrificed to other priorities.

Of course the problem is not only with bank trust departments. The Twentieth Century Fund also has conducted studies of abuses and conflicts of interest of pension fund management where it is done in-house by corporate directors (Brooks, 1975), by large labor union trustees (Blodgett, 1977), or by state and local government investment boards (Kohlmeier, 1976). The point is that where the workers have no say in how the funds are invested, not only may the financial integrity of the fund be sacrificed but more importantly, other key economic and social priorities will be ignored or may even be directly in conflict with the workers' own goals. Thus we can have a situation where in a region of declining industrial employment, the workers' pension fund managers are investing in corporations which are closing plants in that region and moving overseas. Or a situation where a union is fighting to organize a non-union employer and the union's pension fund managers are buying stock and loaning money to that employer. Or a situation in which public employees are passing resolutions opposing the Vietnam War, while their pension fund managers are purchasing government securities to help pay for that war. The list is endless. The problem: control over the funds is in the wrong hands.
TABLE 5. Connections between Citibank and Selected U.S. Corporations, 1968

| Company                             | Employee Benefit Funds Managed by Citibank | Director Interlocks | Percentage of Outstanding Stock Held by Bank (when in excess of 5%) *
|-------------------------------------|-------------------------------------------|--------------------|----------------------------------------------------------
| Blue Diamond                        | 1                                         | --                 | 15.0-C                                                  |
| Panoil Company                      | 1                                         | --                 | 5.2-C                                                   |
| General Foods Corporation           | 2                                         | 2                  | --                                                       |
| National Distillers and Chemical Corporation | 2                                         | 1                  | 12.4-P                                                  |
| Wyomissing Corporation              | 2                                         | 1                  | --                                                       |
| St. Regis Paper Company             | 1                                         | 2                  | --                                                       |
| Monsanto Company                    | 2                                         | 2                  | --                                                       |
| Allied Chemical Corporation         | 1                                         | 1                  | --                                                       |
| Colgate-Palmolive Company           | 2                                         | 1                  | --                                                       |
| Exxon                               | 1                                         | 1                  | --                                                       |
| Phillips Petroleum Company          | 6                                         | 1                  | 6.6-C                                                   |
| Sinclair Oil Corporation            | 1                                         | 2                  | --                                                       |
| Corning Glass Works                 | 4                                         | 2                  | 8.5-C                                                   |
| Anaconda Company                    | 2                                         | 2                  | --                                                       |
| Phelps Dodge Corporation            | 1                                         | 1                  | --                                                       |
| Scovill Manufacturing Co.           | 1                                         | --                | 15.8-P                                                  |
| American Can Company                | 1                                         | 2                  | --                                                       |
| National Cash Register Co.          | 1                                         | 2                  | --                                                       |
| Westinghouse Electric Corp.         | 2                                         | 1                  | 6.6-P                                                   |
| International Telephone & Telegraph | 4                                         | 1                  | --                                                       |
| Borg-Warner Corporation             | 1                                         | 1                  | --                                                       |
| ACF Industries                      | 1                                         | 1                  | --                                                       |
| Oneida, Ltd.                        | 1                                         | --                | 5.5-C                                                   |
| Merchants Refrigeration Co.         | 3                                         | --                | 10.2-C                                                  |
| Pan American World Airways          | 2                                         | 1                  | --                                                       |
| Consolidated Edison Co. of New York | 1                                         | 2                  | 6.1-P                                                   |
| Panhandle Eastern Pipe Line Company | 4                                         | --                | 9.5-P                                                   |
| International Gas Co.               | 1                                         | 1                  | --                                                       |
| Consumers Power Co.                 | 4                                         | 1                  | --                                                       |
| Mercantile Stores Company, Inc.     | 1                                         | 2                  | --                                                       |
| Jewel Companies, Inc.               | 2                                         | --                | 6.0-C                                                   |
| City Investing Company              | 1                                         | 1                  | --                                                       |
| Foote, Cone & Belding, Inc.         | 1                                         | --                | 6.6-C                                                   |

*C=Common Stock    P=Preferred Stock

For the workers to take control of their pension funds and assert a different set of priorities than the corporate interests that now predominate, it will first be necessary to insure that the retirement plans are fully-funded. This, of course, is not a problem for defined-contribution plans, but the majority of plans are defined-benefit whereby the worker is owed a pension but the amount of money in the existing fund may not be enough to cover all existing liabilities. The situation today is such that while all current retirement benefits are being paid, the vast majority of funds are in arrears in putting aside money for future benefits owed. The catch-all term for this is unfunded liabilities. Conservative estimates of the unfunded liabilities at the end of 1976 for 1500 large U.S. corporations came to more than $48 billion (Business Week, July 18, 1977, p. 87). The unfunded liabilities of Federal, state, and local government retirement plans were even larger (Fortune, Nov., 1977, p. 114).

Recent studies of the actuarial assumptions behind pension contributions indicate that the reported figures in unfunded liabilities may be significantly understated due to overestimating the rate of return on investments of the fund (an increase of one percentage point can cut the cost of contributions by as much as 25 percent), and underestimating the amount of future wage increases on which retirement benefits are based. Some corporate investors are now concerned about the trend toward unfunded liabilities because ERISA prescribes that if a company's pension fund is unable to pay benefits, up to 30 percent of the net worth of the company can be claimed by the government for the pension beneficiaries.
This claim has the status of a tax lien, meaning that it is senior to the claims of other creditors, stockholders included. If the corporation's pension obligations exceed 30 percent of net worth, then the rest of the money comes out of the insurance fund of the Federal Pension Benefit Guaranty Corporation (PBGC), which charges premiums on all corporate defined-contribution plans. In other words, other corporations must pay. A recent study by Investors Management Sciences, a subsidiary of Standard & Poors, revealed that a large number of corporations have unfunded benefits which exceeded 30 percent of corporate net worth, including such giants as Westinghouse, Lockheed, Uniroyal, Chrysler, and Bethlehem Steel. Fortune magazine wondered recently what would happen if the stock market took a general nosedive, since pension funds are so heavily invested in common stocks. They argue that in such an extreme situation no corporation would have enough assets to meet the obligations of the others, and the whole system would collapse into the hands of the Federal government. They noted that even Lloyd's of London refused to underwrite the PBGC insurance plan for unfunded pension liabilities on the grounds that it amounts to "insuring the profitability of the American economy." Fortune suggests that each company should be liable only for their own pension obligations, and that this will induce more management "responsibility" in trying to hold down wages and retirement benefit increases.

Professor Mordecai Kurz of Stanford University argues in an unpublished paper, "Economic Power and the Functional Distribution of Income," that the major U.S. multinational corporations are deliberately underfunding pension funds as a bargaining chip to force their workers to accept lower wage increases in order to make sure that they will
receive their pensions. This strategy seems particularly aimed at dividing the older workers from the younger ones in terms of wage demands.

... as of 1976 General Motors' corporate pension plan had unfunded vested benefits amounting to 3 billion dollars which represents 21% of GM's net worth. If we take into account all unfunded prior and/or past service costs then the amount rises to 7.3 billion dollars which is 51.1% of GM's net worth. Now, although it appears that GM's workers have a good pension plan the natural question which arises is why has GM not funded its plan in spite of the very significant tax advantages which the company may gain if it decides to fund. Depending on the method of finance, GM can save some 150-300 million dollars annually by funding (Kurz, 1978, p. 24).

Kurz points out that in 1977 the airline pilots of Pan American Airways, who had the largest pension plan, "led the move to cut wages in an effort to ensure that the company would not go under." At the end of 1976 Pan Am had $209.5 million unfunded vested benefits representing 59 percent of net worth (Kurz, 1978, p. 24).

Another management study indicates that the problem of unfunded liabilities has been rapidly accelerating since the passage of ERISA, which lends some credence to Kurz's feeling that this may be a deliberate corporate strategy.

A recent study of 40 large industrial corporations by BEA Associates, a New York-based investment counseling firm, found that even though the aggregate pension assets of the sample rose by 27 percent in 1976, to $39.3 billion, the total unfunded vested benefits rose by 8 percent, to $12.3 billion. Furthermore, unfunded vested benefits as a percentage of the average company's net worth increased from zero in 1973 (which meant the average company was fully covered) to 7.5 percent of net worth in 1976.

"These numbers are incredible," said Mr. Regan, the co-author of the book on pensions and a vice president of BEA. "Even though pension assets were growing, the plans wound up worse funded than they had been. What would have happened if the economy and the stock market collapsed?" (New York Times, January 1, 1978, p. 64.)
Asserting Control

Once employees insure that all retirement benefit plans are fully funded, then the next step is to assert greater authority and control over the use of the funds. Union funds and Taft-Hartley labor-management funds are already within the power of union leadership, as are most teachers and some other state and local government employee funds. This is not the case with defined-benefit pension funds that are controlled either directly by corporations or farmed out by them to insurance companies, money managers, and bank trust departments. Here the workers will have to use the argument about "deferred wages" and the other positions advanced earlier to make a case for direct ownership rights over the fund itself. This will probably be a long and protracted battle in the Federal courts and in Congress.

One consequence of asserting control would be for plan beneficiaries to take an active role in trying to influence the policies of the corporations in which they hold stock. The current pattern is for fund managers to passively support management in matters of internal corporate policy, but this is beginning to change. Recently some union, non-profit organization, and other employee retirement funds have voted
on behalf of stockholder resolutions condemning corporate investment in South Africa, for example.

An area where unions have occasionally asserted their pension power is in union recognition drives. Teamster pension funds purchased $1 million in Montgomery Ward stock during a crucial proxy fight in the 1950s and wound up with a long sought-after recognition contract from a previously die-hard union foe, Ward's President Sewell Avery. More recently, the United Mineworkers Union forced Duke Power Company to settle a labor dispute after 50 other unions pledged to not invest any pension money in Duke securities until it recognized the UMW.

The success of this tactic led to another type of threatened boycott: unions withdrawing their pension funds and other accounts from large banks who support recalcitrant corporate foes. The Amalgamated Clothing and Textile Worker's Union, stymied in their unionization drive by J.P. Stevens' numerous unfair labor practices (well-documented by the NLRB), has launched a campaign to pressure Stevens' management by forcing Stevens directors off the boards of other large corporations. The ACTWU zeroed in on Manufacturer's Hanover Trust (fourth largest commercial bank in America), on whose board of directors sits Stevens' Chairman, James Finley. After an affiliate of the ILGWU withdrew a $6.4 million health and welfare fund account managed by Manufacturer's Hanover, the International Association of Machinists threatened withdrawal of a $160 million retirement fund and then other unions threatened withdrawal of a total of $1 billion in union deposits and pension funds. The net result: Finley announced he would no longer be a Manufacturer's Hanover director, saying he had decided "not to go where you're not wanted." (Business Week, March 20, 1978, p. 147; Forbes, March 20, 1978, p. 37.)
Aside from the union organizing focus, employee-controlled retirement funds have taken no more interest in the management policies of companies whose stock they own than have bank trustees. One notable and important exception to this is the Employees' Retirement System of the State of Hawaii. When the trustees discovered that the System owned 16 percent of the stock of Hawaiian Independent Refinery, Inc., they successfully elected their own candidate to the Board of Directors of the company, who represents the interests of the pension fund and its beneficiaries on matters of company policy (Tilove, 1975, pp. 219-20).

Direct representation on company boards could become even more significant in cases where pension funds hold stock in their own company. ERISA now limits the amount of corporate stock a pension fund can hold in its own company to 10 percent of the outstanding shares and 5 percent of the total pension portfolio, but this is still a sizable amount (and there is still no limit on profit-sharing plans). If, as Drucker suggests, the workers really do own a substantial piece of their own company, they could exert considerable influence over the management of the enterprise, including such policy areas as the organization of work and employee relations within the plant.

A second alternative proposal is for the pension funds to be directed by the workers into investing in equities and securities which finance projects and endeavors of economic and social value to the plan participants and the wider community.

Housing

Walter Reuther, former head of the United Auto Worker's Union, first raised the housing issue in 1958 negotiations with the Ford Motor Company. The fund trustees had been investing in construction of
high-rise luxury apartments in Houston, and Reuther argued that it would be far more beneficial if the workers' pension funds were invested in moderately-priced housing and other community facilities in the areas where Ford workers actually live. The company rejected this claim on the grounds that the only thing the fund owed the workers was their retirement benefits.

Using pension funds for low-cost housing for workers is common practice in West Germany, France, Sweden, and other European countries, and some Taft-Hartley pension plans in the United States, such as the International Ladies Garment Workers Union, have also invested in housing. Former Congressman Wright Patman, as Chairman of the House Banking and Currency Committee, introduced a bill in 1970 that would have required pension funds which receive Federal tax exemptions to invest up to 2.5 percent of their total assets in a Federally-funded bank which would provide home mortgages for low and moderate-income families.

Many of the AFL-CIO Building and Construction Trades Unions have a long history of using their pension funds to promote jobs for union members in residential and commercial construction. For example, the million-member International Brotherhood of Electrical Workers (IBEW) puts 40 to 50 percent of its $900 million pension fund into FHA-insured and VA-guaranteed home mortgages. Testifying before Congress in 1970, IBEW International Secretary Joseph Keenan stated,

The international officers also believe, as a matter of principle, that it is not always a requirement that the highest possible rate of return be realized. Given the choice between an investment in an AT&T bond paying 9 percent, and in an 81/2 percent investment in an FHA or VA home loan for a young couple starting out in life, the IBEW will select the home loan" (JEC Hearings, 1970, p. 216).
To qualify for IBEW financing, homes must be built completely with union labor. This is also true for direct construction loans, which the IBEW makes along with other Building Trades unions. Some of the direct construction loan activity has been curtailed since ERISA, because the prohibited transactions provision prevents union funds from being loaned to employers who contribute to the fund. Many of these unions are also involved in direct real estate investment, such as "purchase-leaseback" arrangements, mostly on commercial property whose development with union labor also promotes members' employment as well as income for the pension fund.

For those unions whose Taft-Hartley or union pension funds are not large enough to handle the administrative costs of directly servicing home loans, the AFL-CIO maintains a $100 million Mortgage Investment Trust, which is a pooled trust for investment in Federally-insured or guaranteed construction loans and mortgages. Recent yields on investments have averaged between 8 and 8.3 percent. Again, all of the Trusts' investments are in projects built by union labor. The AFL-CIO Convention in December, 1977, adopted a resolution urging all unions to put at least 10 percent of their pension portfolios into guaranteed mortgages or into the Mortgage Investment Trust.

While union-controlled pension plans and some non-profit organizations and public employee plans invest substantial amounts in housing construction, the bulk of the massive corporate-controlled private non-insured pension funds have shunned such investments. Of the 160.4 billion dollars in book-value assets at the end of 1976, less than 1.5 percent were in mortgages, and most of these were in large commercial properties or multi-family developments rather than single-family homes.
Kenneth Rosen, who authored "The Role of Pension Funds in Housing Finance" for the Harvard-MIT Joint Center for Urban Studies in 1975, argues that the reason large corporate-controlled plans shy away from real estate and housing is not because of risk or relative yields, but simply because of the preference of the bank trust departments and money managers for corporate stocks and bonds. He points out that even life insurance companies, with similar financial requirements to pension funds plus more than 80 billion dollars in pension reserves, play a much larger role in housing finance than the non-insured corporate funds. Rosen's study and a similar one conducted for the California Employment Development Department in 1975 conclude that yields on Federally-insured FHA mortgages compare favorably with AAA-rated corporate bonds, and at lower risk.

For pension fund managers who are concerned about the administrative problems of acquiring mortgages, there are now a number of mortgage-backed securities which are no more difficult to handle than any Federal agency security or corporate bond. The most prominent is the GNMA "pass-through." The Government National Mortgage Association, which is part of HUD, began selling these in 1970, primarily as a way of attracting large institutional investors and pension funds into the market for FHA-VA single-family home mortgages. Back in 1957 the National Housing Conference recommended

> Exploration of a broadened financial base for housing through investing a portion of Social Security reserves in a Federally-guaranteed bond-type security which would be attractive to pension funds and to the general bond market (Keith, 1973, p. 130).

As yet no Social Security Reserves or other Federal Trust Funds have gotten into GNMA's, but the private market now holds nearly
$50 billion of these securities. GNMAAs, sold in various denominations, are backed by large pools of FHA-VA mortgages. The principal and interest are "passed-through" to the security holder, and monthly payments are guaranteed by the Federal government, regardless of whether or not they are collected. Current yields on GNMAAs are between 8.3 and 8.4 percent. Another similar security, issued by the Federal Home Loan Mortgage Corporation ("Freddie Mac"), pools conventional non-guaranteed mortgages and guarantees monthly interest payments to the security-holder, but pays principal only as collected. Because of the greater risk, yields are somewhat higher (Connolly, 1977). In addition to either of the above, a pension fund could also purchase the bonds of various state housing finance agencies.

Two problems with the indirect investment approach is that the purchaser has no control over which mortgages are backing the security. This becomes an issue if a fund wants to target their mortgage investment to a particular geographic area. Since the amount of pension fund money available for this purpose is potentially large, some experts feel that they can insist on GNMA or FHLMC putting together targeted pools. The State of Washington Retirement System recently got GNMA to put together a package of $50 million in FHA-VA mortgages entirely from Washington state (Webb, 1977). Others could presumably do the same.

Another problem is that pension funds may be putting money into housing, but not necessarily housing that benefits low and moderate income people. Pressure would have to be applied to GNMA and FHLMC to make sure that a certain proportion of mortgages were of this type.

At the present time it is estimated that pension and retirement funds hold about 10 percent of GNMAAs, which, given the total size of their portfolios, is still not a very large percentage.
Other Investments

In addition to putting money into housing, pension funds can also provide capital for job-creation and economic development in targeted areas such as high-unemployment urban and rural communities. The pension funds' financial requirements are for stable and long-term growth, with very little concern for liquidity. This, as was argued earlier, puts them in an ideal situation to make the long-term loans and equity investments with which new enterprises, community development corporations, and neighborhood revitalization programs can grow and plan for the future. Many of these investments, while ignored by bank trust departments and asset managers, can have quite competitive yields for a given level of risk.

In particular, there are a whole host of loan programs for which there is practically no risk because they are guaranteed by the Federal government. A recent Congressional publication listed 164 Federal loan guarantees including HUD, EDA, and SBA programs that relate to minority communities. A pension fund could either make direct loans using the guarantee programs, or purchase the guaranteed portion of an already-made loan from the lender, thus freeing funds for further use. State loan guarantee programs could be utilized in the same two ways.

A good example of the latter approach, purchasing the guaranteed portions from another lender, is the involvement of the Kansas Public Employees Retirement Fund in the secondary marketing of the guaranteed portion of SBA loans by the Kansas Development Credit Corporation. A campaign by KDCC called "Kansas Funds Promote Kansas Jobs" convinced the pension fund in 1971 to commit 5 million annually of its $270 million assets to the program. Previous to this time, all of the pension fund's
investments were located out of the state. The KDCC program has made millions of dollars in additional money available for medium-term expansion financing of small business in Kansas. Katzman and Daniels describe:

The participating banks and the KDCC each receive 1/2 point for servicing the loan while SBA receives a 1/4 point fee. Hence, the incentive needed by KDCC to engage in secondary marketing operations is a one and one-fourth point spread between the interest rate on the SBA loan and the interest rate acceptable to a KDCC buyer. At the end of 1975, KDCC was purchasing 10 1/2 percent SBA loans and selling them in $250,000 packages at a yield of 9 percent.

Sixteen other states have followed or are planning to follow Kansas DCC's pioneering efforts in the secondary marketing of the guaranteed portion of SBA loans. This technique has become so widely diffused that banks have begun to develop direct links to state pension funds, by-passing the DCC's. (Katzman and Daniels, 1976, p. 50.) (emphasis added)

Another example of taking an economic development approach to the pension portfolio is the $6 million loan (at 8.5 percent for 15 years) made by the Pennsylvania state employees' and teachers' pension funds to Volkswagen as part of the package by which Governor Shapp convinced VW to locate in the Keystone State. In this case the fund managers took into account not only yield but the over-all climate of economic growth in the state and fiscal health of the state government, which of course is of direct concern to the union membership (Chernow, 1978).

Katzman and Daniels also point out that the Ohio State Teachers' Retirement Fund invests $13 million of its $3 billion assets (.4 percent) in seven venture capital firms. While only a small percentage of the fund's total assets, this is still a large amount of money for venture capital markets, which are currently starved for money to promote new business development, as testimony at 1977 Senate Hearings indicated. While the Ohio Teachers' investments are based on yield and
are located throughout the nation, such investments can be targeted geographically with the added goal of promoting state or local economic development.

One possible approach to economic development on a state level is to combine state-owned banks with public employee pension funds. Based on the "deferred wages" argument, and particularly because public employee retirement plans generally involve substantial employee contributions, it would not be politically acceptable for the state to mandate particular pension investments. However, it is possible for the state bank to act as fiduciary and manage the pension portfolio. This is done in North Dakota, where the Bank of North Dakota manages state employee retirement funds, and tries to maximize yield while still paying attention to state economic development goals. Bank President, Herb Thorndahl, was quoted earlier discussing how pension funds are invested in FHA single-family mortgages in North Dakota as an example of "public money for public good." The proposed legislation to create a state-owned bank in California contains a provision that would allow the bank to manage the portfolio of state and local government employee retirement funds.

Another area in which pension funds can play a major role is in state and local government finance. At one time a large percentage of the portfolios of state and local government retirement systems were in municipal bonds, but there has been a trend away from this in the last ten years because tax-exempt pension funds derive no income advantage from holding tax-exempt municipal bonds, which generally pay several percentage points less interest than comparable taxable corporate securities. Today more than 80 percent of all public pension fund assets
are in corporate stocks and bonds. Some retirement systems still hold municipal bonds, either because they do not want to sell them and are merely waiting for maturity, or to bail out the local government from bankruptcy and save their own jobs, as in the case of the New York City public employee unions which bought $3.1 billion worth of City bonds in 1975 to rescue the city from default.

Senator William Proxmire introduced a bill in 1972 to allow states and municipalities to issue taxable securities at competitive interest rates to corporate bonds, with the Federal government subsidizing one-third of the interest costs. He argued that since tax exemption already involves a substantial Federal subsidy, the alternative of a direct subsidy of interest payments would cost the Treasury no more, and it would be much more effective for local governments because it would enable public and private pension funds to purchase the bonds. Adding this massive pool of capital to the municipal bond market would greatly expand demand and therefore probably lower overall interest costs. Proxmire's bill was defeated, but many experts in development finance continue to advocate such a measure.

"Prudent Man"

ERISA raises a potential problem in the area of "socially-oriented" investments by placing all fund trustees and asset managers under fiduciary responsibility subject to civil suit by the U.S. Department of Labor (in addition to private lawsuits by plan beneficiaries). The basis for this fiduciary responsibility is the famous "prudent-man rule," first expressed by Justice Samuel Putnam in 1830, that a trustee "is to observe how men of prudence, discretion, and intelligence manage their own affairs" and to do likewise in the management of the trust (Kampner, 1976).
Unfortunately, in most cases it is considered "prudent" merely to do what everyone else does, such as invest heavily in blue-chip corporate stocks. During the 1950s and early 60s stocks were appreciating in value at a fast pace and this was a good area for pension investments. So much so, in fact, that many states and local government retirement systems that were legally prohibited from purchasing equities lobbied successfully to lift this ban and have been investing heavily in the stock market ever since. The only problem is that the average rate of return on stocks since the late 60s, including capital gains (or losses) and reinvestment of dividends, has been abysmally low compared to other types of investments. *Fortune* describes:

During the five years ending in 1975, the total return (i.e., including dividends, which are assumed to be reinvested) on the Standard & Poor's 500 ... was at a 3.2 percent annual rate. The figure for ten years ending in 1975 was 3.3 percent. The median rate of return for managed pension-fund stock portfolios over those ten years was only 1.6 percent (Ehrbar, 1976, p. 146).

An example of one pension fund that got caught up in this process is the Los Angeles City Employees' Retirement System (CERS), which won a referendum in 1967 allowing trustees to invest in common stock (the portfolio before then consisted of corporate bonds and government securities). At the close of fiscal 1967, CERS held $1.2 million in common stock. Ten years later, CERS held $112.8 million, or 21.5 percent of its total portfolio. The stocks consisted entirely of blue-chip, high-priced equities such as Eastman Kodak and Atlantic Richfield. The average rate of return on the stocks over the last ten years was a mere 3.9 percent. The *Los Angeles Times* comments:

That means that for all its advisory fees, staff salaries and other expenses involved in buying and selling stocks, the city would have been better off with its money in a bank drawing ordinary 4% or 5% passbook account interest (*Los Angeles Times*, December 15, 1977)
During this same period FHA and VA Federally-guaranteed home mortgages were paying 8 and 9 percent. This is to point out that while fiduciary responsibility and "prudence" are real concerns, sometimes "social" investments can have as good or even better yield than the "blue-chip" variety, and not necessarily at greater risk. Thus the bank trust departments' and institutional money managers' policy of concentrating on only a handful of America's largest corporations may not be the only "prudent" one. Indeed, a recent Fortune article labeled newly-appointed Federal Reserve Board Chairman, G. William Miller, a "whiz" at running Textron's pension funds because he was smart enough to take the funds out of the hands of the big bank trust departments in 1974, manage them himself, sell nearly all the stock holdings and replace them with fixed-income securities. Between 1974 and 1977 Textron's pension funds earned an annual return of 9.4 percent with the average for 3500 pension funds tracked by Becker Securities only 3.2 percent. So much for the wisdom of institutional investors favoring a small group of stocks! (Loomis, 1978)

The 1977 Senate Hearings on "Pension Simplification and Investment Rules" dramatized the way in which the "prudent man rule" has been used as a justification for portfolio managers to turn their backs on investments in all new enterprises and indeed in any firm with annual sales of less than $100 million. Senator Lloyd Bentsen's response to this problem is a proposal to suspend the fiduciary responsibility clause for investments of up to two percent of a pension fund's assets. Others argue that this is not necessary; what is needed is simply for employee-beneficiaries to insist that their funds be more diversified. This, of course, is one element.
Problems

Perhaps the most significant problem in adopting any "alternative" investment policy is that it introduces another set of assumptions into investment decision-making besides consideration of rate-of-return within a given risk class. The question of the use to which the money is put becomes critical. Evaluating investments on the basis of social benefits generated may prove extremely difficult, complicated, and conflict-ridden. Where beneficiaries of a plan can adopt a policy that is democratically-conceived as being of direct benefit to the membership, such as building trades unions creating construction jobs for themselves, then there may not be any problem at all, so long as yield is sufficient to insure adequate retirement benefits. But institutions such as public banks or development banks will have a tough time creating standards of measurement and priorities for decision-making to achieve the multitude of goals in the "unmet needs" category. Geographical disparities of economic growth, jobs vs. environment, public vs. private or mixed enterprise, distributional effects, hiring and labor policies, will be joined by a host of other issues which can cloud up any large-scale efforts to redirect investment patterns.

Related to this is the question of scale. Many successful alternative economic institutions in the United States to date, such as Community Development Corporations, producer and consumer cooperatives, worker-owned and self-managed enterprises, have tended to be rather small in size. What would be the administrative cost and political and economic impact of trying to invest half a trillion dollars in these types of concerns? The opportunities don't even exist for such large-scale capital shifts at the present time. They would have to be
created from scratch. Could this be done without running into the same problems of giant bureaucratic institutions and concentration of capital all over again? And what political changes would be needed in order to ensure equitable distributions of both wealth and decision-making power? The continuation of small-scale experiments, unfortunately, will not help provide the answers to these questions.

The other side of the coin, of course, is what effect such a large change would have on existing capital markets. Many current financial institutions would either die or have to be significantly reconstituted. Presumably new institutions will grow to fulfill some of these same functions. What difference will this make, or will it even make any difference? A massive sector-by-sector analysis is called for.

Given the current concentration of capital and of political and economic power noted at the beginning and throughout this paper, it should be obvious that those on top will not give up their place without a fight. The possible effect of severe economic disruption on the lives of large segments of the population acts as a strong conservatizing force. Whether this force can be overcome and workers can gain more confidence in the ability of themselves and/or representatives chosen by them to manage huge portfolios and large-scale enterprise is a significant psychological and political problem.

Enterprise management becomes an important point because were pension investments to withdraw from corporate debt and equity markets these businesses would face such a severe capital crisis that the workers may be forced to reinvest in the company and assume major management responsibilities in order to save their own jobs. Should this
situation arise, problems of intersectoral and regional wage differentials, productivity and international competition, saving jobs and traditional prerogatives vs. introduction of new technology, and democratic workplace decision-making will have to be faced by the unions in a new and different context. For the individual worker, the problem of control over excessive concentration of power in the union hierarchy will have to be confronted. After all, some unions already do control their pension portfolios, and not necessarily to the benefit of their membership, as the Teamsters have repeatedly demonstrated.

A different issue pertains to the quality of administration and leadership of the individual people who would staff the alternative investment institutions. Two separate questions arise: competency, and integrity. Corporate critics like to cast doubt on the ability of public agencies or unions to intelligently handle the decision-making associated with large-scale financial investment and management. The easy answer is to point out that big bankers certainly have no monopoly on wisdom, as the disastrous performance of bank-held REITs (Real Estate Investment Trusts) and pension asset management by trust departments has recently shown. Similarly, Federal loan guarantees, bailouts, and subsidization of corporate cost overruns don't speak well for any particular innate powers of wizardry endowed by businessmen as a class. However, the problem of competency is still a serious one, which argues powerfully for incremental stages of experimentation to enable a new class of managers, "public and worker entrepreneurs," to develop their skills and test their mettle before large-scale responsibilities are placed in their hands (or confidence in their efforts).
With the issue of integrity, certainly Bert Lance dispelled that myth, to the everlasting dismay of the American Banker's Association. The Patman Hearings and the Twentieth Century Fund's "Conflicts of Interest" series marshal a wealth of impressive evidence that the present concentration of financial control does not lend itself to clean and pure transactions at all levels. The solution is strict accountability, and this can be built into the institutional framework and applied as vigorously to "public and worker entrepreneurs" as it should be to their corporate counterparts. The Bank of North Dakota has maintained a record of integrity through its 58 years. Eliminating corruption always depends on the people involved, of course, but still more importantly on the framework for accountability and control.

One final issue deals with the question of whether changes in capital flows are to come about on a voluntary or mandatory basis. Arguing that people who already hold claims to capital should exercise greater control is different from proposing that the state should exercise greater control over private claims. Concern over the latter point, sometimes called "credit allocation," has long been debated in this country. (See for example 1975 Hearings on an Act to Lower Interest Rates and Allocate Credit, House Banking Committee; Thurow, 1972; Yeager, 1977). Given that a great deal of credit is already "allocated" by a small number of large private institutions, would government be worse? Or perhaps the issue is not public vs. private, but centralization vs. decentralization. Certainly one priority that continues to occupy a high position among the unmet needs is how to maximize freedom and opportunity. Even for those who argue that "countervailing powers" or "checks and balances" are what most need to be preserved, it would
seem that control over wealth is currently so highly concentrated that many actions need to be taken before a better balance can be found. This includes pension and trust fund beneficiaries' assertion of claims over capital resources, social experimentation with alternative economic institutions, and greater assertion of public direction and control over capital by government institutions. Or, as Bank of North Dakota President, H.L. Thorndahl, called it: "public money for public good."
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