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PENSION FUND POLITICS: THE DANGERS OF SOCIALLY RESPONSIBLE INVESTING

Edited by Jon Entine

Public employee retirement funds collectively hold almost $2 trillion in assets. Should pension fund managers have the right to gamble with these retirement dollars by using the money to promote social or political causes? And can pension officials follow socially progressive principles to do good and still make a killing in the stock market?

The answer in both cases is a resounding "no."

In *Pension Fund Politics: The Dangers of Socially Responsible Investing* (AEI Press, September 2005), Jon Entine of Miami University, Ohio; Jarol B. Manheim of George Washington University; Alicia H. Munnell and Annika Sundén of Boston College; and Charles E. Rounds Jr. of Suffolk University Law School examine the controversial use of public pension funds by the social investing movement.

The management of these funds had traditionally been left almost exclusively in the hands of professional managers, with little interference from the local and state officials who technically oversaw these monies. Because public employee funds have an important responsibility to provide secure retirement benefits to their 15 million members, few pension funds incorporated social criteria for fear of violating the most basic standards of fiduciary accountability. In recent years, however, that has changed, and those self-imposed constraints have been abandoned.

The authors note that in the late 1990s, when markets went only up, the seductive possibility of socially responsible investments (that is, the plan to do good and make money too, by buying stock in companies that reflect certain ideals) captured the attention—and hundreds of millions of investment dollars—of some of the top public pension funds in the United States.

This decision, however, proved to be a prescription for financial disaster for many California, New York, and Connecticut teachers, firefighters, and other public employees who lost hard-earned retirement dollars that had been invested by their pension fund managers in socially acceptable corporations (so-called "Green Giants") such as Tyco, Arthur Anderson, Enron, WorldCom, Adelphia, and Tenet Healthcare.

Within a few years, every one of these social investing superstars proved to be disastrous investments. The country's largest public funds, CalPERS and CalSTRS (the California Public Employees' Retirement System and the California State Teachers' Retirement System), for example, lost an estimated $1 billion by following the trendy recommendations of social investors and eschewing the plodding energy, manufacturing, and tobacco stocks that have led the market revival since 9/11. Fund managers who, because of their own political agendas, avoided energy and resource companies saw those discarded stocks soar to all-time highs.

The authors acknowledge that individuals certainly have the right to invest their own savings in companies they admire. But should pension-fund trustees, who have a fiduciary mandate to maximize investment returns for their pension holders, endanger returns by throwing money at pet political projects instead of pressing for changes in corporate behavior that could result in better returns for their pension holders?

In *Pension Fund Politics* an ideologically diverse group of scholars addresses the legal, political, and fiduciary consequences of injecting social and environmental criteria into the management of pension funds. The authors argue that social investing, by both the political Left and Right, frequently ends up hurting the very people—particularly the economically disadvantaged—that it is supposed to help.

Some key points:

- Public pensioners have no say in how their funds are invested, leaving politicians with a free hand to use the money according to their personal political beliefs.
- Using social criteria to guide investment decisions has proved a bad bet in recent years.
- Efforts by politicians overseeing public pension funds to bail out favored local companies or save union jobs has led to hundreds of millions of dollars in losses in Connecticut, Kansas, Alaska, and elsewhere.
- Examples abound:
  - The Texas legislature temporarily banned investments in Disney stock after offended conservatives protested against teen sexuality in programs.
  - California's Public Employees Retirement System (CalPERS) and State Teachers Retirement System (CalSTRS) have been mired in conflict of interest charges, while the California state treasurer Philip Angelides touts his ideologically minded management of both funds to bolster his pursuit of the Democratic nomination for governor.
  - Disinvestments in tobacco stocks has resulted in billions of dollars of public pension fund losses.
  - The latest social investing movement encourages the boycott of companies that produce a genetically modified rice (Golden Rice) even though the world's poor would gain from its vitamins and pesticide-free growth.

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