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When Cultures Collide: Social Security and the Market

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In his 1999 State of the Union address, President Clinton raised the possibility of investing social security funds in the equities market. In this article, two anthropologists who have studied the culture of the financial world assess the President's proposal. The analysis focuses on the vast cultural gap between the private-sector participants in the equities market and the federal bureaucrats who would inevitably manage social security investments. The authors examine similar arrangements at the state level, the cultural differences among the entities involved, and how those differences interfere with fiduciary decision-making. They conclude that the gap is simply too wide for the proposal to be workable, and as a result, the adverse consequences likely outweigh the potential benefits. Although some consequences are foreseeable, more threatening consequences can be envisioned only in the most general terms.

In his January 19, 1999, State of the Union address, President Clinton dropped a mini-bombshell. At first glance, it looked like another step on his path to Republican economic orthodoxy.[1] Predicting that Social Security would be in the red by 2013, and the trust fund exhausted by 2032, he proposed "that we commit 60% of the budget surplus for the next fifteen years to Social Security."[2] Then came the shocker: a single cryptic clause, in which he advocated "investing a small portion in the private sector just as any private or state government pension would do." Slipping back into the predictive mode, and prompting a closer examination of his words, the President assured the country that the higher returns would "keep Social Security sound for fifty-five years."

Treating Social Security like a real pension fund through privatization has been a conservative economic goal for years, enthusiasm for which has been whipped up by the apparent success of the Chilean experiment.[3,4] In private meetings with key members of Congress just before the State of the Union, Clinton hinted that he might be undergoing a conversion to the privatization approach. According to press reports at the time, he offered support for the general principle of investing limited amounts of Social Security funds in the market, under tight but unspecified controls.[5]

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To orthodox conservatives, privatization implies investor autonomy and responsibility. Individual citizens could choose investment approaches, at least at a general strategic level, but would be stuck with the outcome. The President's State of the Union address did contain a proposal that evoked these themes: using 11% of the surplus to fund universal savings accounts, or USAs. In order to promote investment by the least affluent, the federal government would match a portion of citizen savings in USAs. Individual Americans could, in the President's words, "invest as they chose" and thereby "share in our nation's wealth and … enjoy a more secure retirement."

Despite the reference to retirement, however, the President described the USA accounts as being "in addition to" Social Security. While USAs would involve investor autonomy, he seemed to have a very different plan for the budget surplus money that would be invested to shore up Social Security. As fleshed out by White House sources and commentators with administration ties, the President's proposal apparently envisions a federal authority acting as the world's largest mutual fund, orchestrating the investment of more than $700 billion in the securities markets.[6]

Reaction from Republican, business, and free-market circles was swift and almost uniformly negative. Much of the reaction was visceral, rejecting outright the idea of the federal government dabbling in the securities markets. "No, no, a thousand times, no," said Bill Archer, House Ways and Means Chairman.[7] Other critics, including Federal Reserve Chairman Alan Greenspan, began to focus on such specific concerns as market skewing and the improbability of keeping federal investment decisions free of political taint.[8]

We reacted, too, but not on the basis of political predisposition or economic orientation. Our reaction was grounded in anthropology's bread-and-butter concept, *culture,* which is defined as the set of shared beliefs and practices that define a society's way of life. Culture provides the mental map guiding individual members of the society through their daily lives. In the past, anthropologists have focused their study of culture on such small-scale, traditional societies as South Seas islands or villages in the Amazon basin.[9] More recently, however, anthropologists have found that the concept of culture is as relevant to contemporary institutions and organizations as it is to traditional societies.

For example, anthropologists have successfully investigated the American legal system from a cultural perspective.[10] By studying how the law really works on a day-to-day basis, they have learned a great deal about the goals and motives of people going to court, laypeople's conceptions of the law, and the discrepancies between what the law claims to deliver and what it actually delivers. Most important, because of their novel perspective, anthropologists have discovered things that legal professionals are unable to see.

Earlier in this decade, we turned the cultural lens on the world of finance in an anthropological study of pension fund investing. In our 1992 book *Fortune and Folly: The Wealth and Power of Institutional Investing* and several subsequent articles,[11] we reported on the cultures of nine major pension investment organizations and analyzed how their corporate cultures influenced investment behavior. Included in our sample were three of the largest state pension funds in the country, and one of the major issues that emerged from the study was the profound cultural difference between private and public investment organizations.

This earlier research prompted us to ask several questions about the President's proposal: Given what we know about the cultures of state investment organizations, what would a trillion-dollar *federal* organization be like? What kind of people would work there, and how would they behave? How would they respond to the challenges that face pension investment managers in such areas as asset allocation and investment strategies, corporate governance, and fiduciary responsibility? And finally, how would these people interact with their various constituencies, including the public, the government, and the companies whose securities they own?

These questions are the subject of this article. Because our approach is anthropological rather than economic, we focused on culture rather than finance and on behaviors rather than theories. Drawing on our experience with a range of pension funds, we consider how a hypothetical federal pension investment organization might deal with the everyday problems of investing huge sums of other people's money, and how its behavior might influence the rest of the financial world. Our conclusion is not an optimistic one: The issues that challenge large state funds are likely to overwhelm a mammoth federal counterpart. At a minimum, unintended and perhaps unforeseeable consequences may outpace any potential benefits.

We turn now to an analysis of some of the specific issues that are likely to prove most vexing: the allocation of assets, investment strategy, corporate governance, social investing, fiduciary duty, investment time horizons, and the relationship of a fund to its beneficiaries.

Allocation: The Decision That Drives All Others

In the real pension fund world, asset allocation is the primary force behind every decision. In our earlier project, the chief executive of a large public pension fund explained it this way:

> The most critical thing of all is the asset mix decision. All other decisions are likely to be overwhelmed by the basic decision of whether you're in or out of the stock market, or the balance that you've got between bonds, real estate, international, domestic and so on, at any given point in time.[12]

Executives for large funds, particularly those in the public sector, believe almost unanimously that the allocation decision all but determines how well a fund's portfolio will do. With a huge amount of public money to manage, it is both difficult and risky to engage in clever stock picking; large public funds are therefore moving en masse toward indexing. Consequently, the key to performance is not how well you do within a particular sector (equities, bonds, real estate, etc.), but whether your allocation decisions put you in the right sectors at the right time.

Given this reality, the boards of large pension funds study and approve overall allocation guidelines at least yearly, and fund management suggests reconsideration whenever market conditions warrant. Management also carries out a process called portfolio rebalancing throughout the year in order to stay within the board's guidelines. Suppose the board has decided on a 50% equity allocation. After six months of a rising stock market, the fund might find that equities now held 65% of the value of the portfolio, making it necessary to either sell off equities or revise the guidelines.

In the vast and diverse universe of pension fund investing, asset allocation is one of the few strategic areas in which there is near uniformity of behavior. In our earlier work, we found that managers for large funds typically allocate 45% to 55% of assets to domestic equities, 35% to 45% to fixed-income securities (usually government securities and high-quality corporate bonds), and 5% to 15% to international securities. In addition, more and more fund managers are investing as much as 10% of assets in such labor-intensive, non-traditional areas as real estate or mergers and acquisitions.

One way to look at the President's proposal is that he wants to allow the Social Security trust fund managers to make a market allocation decision. The entire fund is currently invested in Treasury securities; Clinton proposes "investing a small portion in the private sector just as any private or state government pension would do." In the State of the Union address, he did not specify what he meant by *private sector*. If it is to be defined the way managers of other pension funds define it, he would mean the entirety of the private sector, including equities, corporate bonds, real estate, and mergers and acquisitions. But, then, how would an asset allocation decision be made?

Ordinary pension fund officers and directors, especially those in public funds, are subjected to external pressures on almost every decision they make: Hire someone's friend as an external money manager, don't invest in companies that aren't environmentally sound, stay out of tobacco stocks, invest in "socially responsible" companies, and so on. Remarkably, the consensus on asset allocation suggests that such pressures are minimal on this most critical of decisions. When deciding what sectors in which to invest, fund managers seem to be left to their own devices, and whether through rational parallelism or herd behavior, they come out at more or less the same place.

Would the President's proposal afford the Social Security fund the same luxury? Perhaps asset allocation is too dry to generate much interest among the major sources of external pressure: the press, politicians, and the public. There would, however, be a fundamental difference between the Social Security fund and even the largest of the existing funds (TIAA-CREF, a private fund for teachers and college professors, and the California and New York state employees' funds). Some of the latter are so large that they have to worry about skewing the market when they buy or sell a position in a particular investment. Offering a huge block of equity in XYZ Corp. for sale, for example, could drive the price down. None of the funds, however, exerts significant influence just by being *present* in the stock market or any other investment sector.

The federal government would create this sort of effect if it were to announce its intention to invest hundreds of billions of dollars in equities over the next several years.[13] The market would presumably rise, if not soar, in response to this massive influx of demand. The stock market has a relationship of both cause and effect with the economy at large. As a reflection of prosperity and investor confidence, a rising market is an effect. But a buoyant market is also a cause in the sense that it stimulates confidence and the risk-taking that promotes prosperity. We might therefore conclude that the government's entry into the market would be an unmitigated good thing. Yet we should also worry about the bubble effect, the kind of runaway overvaluation that sabotaged the Japanese economy and about which Greenspan regularly lectures American investors. Moreover, because the U.S. government has never attempted anything like this before, we must also be wary of unintended consequences.

All of this means that a federal allocation board would face a daunting task. It would not be able just to ask, as ordinary pension managers do, what allocation is likely to produce the best returns for our beneficiaries? It would undoubtedly face the same kinds of petty and idiosyncratic pressures that plague ordinary funds, multiplied manyfold. However—uniquely—it would also have to agonize over the immeasurable probabilities of causing the ultimate ripple effect.

Note also that a Social Security fund might have certain private sectors closed off to it, for practical reasons. For example, as noted earlier, many private pension funds, and even a few public funds, make targeted investments in real estate. This strikes us as a poor idea, given that the evaluation and oversight of such investments are very labor-intensive, even when the details are delegated to outside managers. Not even the largest funds we studied had a realistic level of in-house expertise.

The idea of a federal fund investing in real estate is frankly absurd. Its management might overcome the expertise problem, given the vast resources likely to be available. But the possibility also exists that it will find itself at bizarre cross-purposes with other major federal efforts. To take one instance, the effect of urban gentrification on the stock of decent, low-cost urban housing has been for years one of the most difficult issues facing federal housing policymakers. Yet that same gentrification process creates lucrative opportunities for real estate investors. Should one branch of the federal government be helping to create the very problem that another is trying to solve? Even if the Social Security fund wanted to wall itself off from such issues, would it be politically possible to do so?

To use another example, would a Social Security fund be able to participate in another burgeoning trend, international diversification? Would it be desirable for the fund to insulate itself from foreign policy concerns, and if so, could it be done? We examine some specific international issues later.

All of these allocation concerns may be moot, however. Before his resignation, Treasury Secretary Rubin went beyond the President's general reference to "the private sector" and spoke of investing "15% of the entire Social Security trust fund *in equities*."[14] Does this mean that the President's team has already made the all-important asset allocation decision? There is no evidence in the discussion thus far that anyone has thought about it at all. On the contrary, "private sector" seems to have been equated with "equity market" almost by default. However difficult it may be for the federal government to set asset allocation guidelines, the idea of letting this most critical of investment decisions go by default is far more disturbing. The prevailing insouciance about the asset allocation issue is the first of many indications that the President's plan is full of perils, some obvious and some, like this one, latent.

The Social Security Fund in the Equity Market: Investment Strategies

Like any other investor, a Social Security fund manager entering the equity market would face a series of strategic choices. The first and most significant is whether to adopt an *active* or a *passive* strategy. Active strategies are characterized by the exercise of judgment in an effort to outperform the market. At one extreme, judgment can be exercised on a minute-by-minute basis, as the fund trades constantly in an effort to anticipate minor market fluctuations. At the other extreme, active decision-making can lead to an inactive trading posture if the fund decides to make long-term investments in fundamentally sound companies. There are, of course, a range of intermediate possibilities, including short-term stock picking, sector picking (e.g., small-capitalization growth stocks), contrarianism (buy when the market is down, sell when it is high), and attempting to predict the news and its impact on particular industries. (It has been reported that Governor George W. Bush was remarkably clairvoyant in anticipating Iraq's invasion of Kuwait and its impact on his oil industry investments.[15])

By contrast, the passive investor renounces judgment and becomes a passenger who rides the market. This usually means indexing: buying and sticking with a portfolio of stocks that represents the market as a whole or some specific market component. Among the best-known U.S. indexes are the Standard & Poor's 500, which is dominated by large companies, and the various Wilshire indexes, which tend to be broader-based. Investors can find a prepackaged index purporting to represent almost any segment of the market or can create a customized version. When the market (or relevant segment) rises or falls, so does the index.

In our research, the principal dividing line between private and public pension funds was the active/passive distinction. Any decision to manage actively starts with the belief in one's ability to beat the market. This can-do belief in the possibility of winning the financial game is *the* core value in American corporate culture. Corporate pension fund executives, although theoretically walled off from corporate influence, usually come from within the company sponsoring the fund, and are therefore corporate people. They are not the sort of people to abjure the possibility of winning or to admit that they fear the possibility of losing. Consequently, every private fund we studied engaged in the active management of the bulk of its equity portfolio, whether in-house or by delegation to outside money managers. Tellingly, every activist private fund manager we interviewed admitted to a lack of economic evidence that activism would beat passivity. This was the best possible evidence that cultural factors were the primary determinant of the choice.

The public funds, on the other hand, are primarily and increasingly dedicated to indexing, for which the rational economic argument is the efficient market hypothesis. This hypothesis is based on the tremendous availability of information and holds that the stock market is now such an efficient pricing mechanism that there are no bargains: You really do get what you pay for. You cannot beat the market, so why not just sample it, go along for the ride, and in the process save the enormous transaction costs of active investing? There is also a good empirical case to be made that indexes have outperformed just about every active strategy over the last couple of decades. Finally, the largest funds might find it difficult to trade without exercising immediate influence on the market trends they are trying to capture.[16]

The public fund managers we studied, while occasionally referring to this economic case, put primary emphasis on the cultural reasons for their choices. The culture of civil service permeates every public fund we studied. They are thinly staffed, and the salaries are low by investment standards. And they are, in most cases, *salaries*, rather than performance-based compensation packages. The core values of this culture are security, patience, and the management of responsibility. Risk-taking, competition, and frantic activity in general are seen as deviant.

As we were told over and over again, indexing is a perfect cultural fit. You do as well as the economy itself and you get the same result as the "average" investor, so it is as risk-free as equity investing can be as well as utterly non-competitive. You must, by definition, be patient. Perhaps most importantly, indexing is an ideal tool for displacing responsibility, since results depend entirely on larger market forces. When things go badly, as they did during the October 1987 crash and the October 1989 mini-crash, public fund executives are comfortable going before the press, their boards, and their constituents to shrug and blame the market.

A vignette from an earlier project captures the cultural distinction vividly. The 1989 mini-crash occurred over a Friday-to-Monday period. On Friday, we were to visit a private fund. They told us not to come because everyone was too busy attending meetings, following the market, and executing doomsday strategies. We were scheduled to visit a public fund on Monday. Chastened by Friday's experience, we called ahead to see if we should still come. The answer: "Sure—why not?" We spent the day in unhurried discussion, our interlocutors glancing occasionally at their computer screens, more in curiosity than panic.

For economic, political, and cultural reasons, the Social Security fund would almost certainly choose a passive strategy. Economic commentators on the President's proposal assume that indexing will be the choice because stock- or even sector-picking on such an enormous scale would present insurmountable market distortion problems. Endorsing certain companies or sectors with federal investment stigmatizing those not so fortunate would amount to a stealth national industrial policy. Politically, indexing is probably the only realistic way to avoid the huge lobbying effort that would surround every federal investment choice.

Indexing would also prove a good cultural fit for a federal investment office. The same kinds of people who staff the large state pension funds would probably populate such an operation. These are definitely civil service people. Even near the top, we found individuals who value security, stability, and a relatively humane pace to their lives and who were often refugees from the more private markets. Public employment suits their personalities: While there is no opportunity for "the big score," it is virtually impossible to get fired for anything short of dishonesty. And their bosses, the state comptrollers and fund CEOs who must answer to politicians, unions, the press, and the public, find their personalities and styles attractive. While these executives are perfectly comfortable blaming the poor performance of a passive portfolio on the market, they would never want to have to defend the failure of an aggressive, risk-taking money manager.

If the largest state funds are unwilling or unable to attract assertive Wall Street types, there is no reason that a federal fund would be any different. Would the publicly accountable head of a federal fund be any more comfortable than his state counterparts defending the inevitable ups and downs of active money managers? Moreover, why would such people want to come aboard? Notwithstanding the promises of an independent, thoroughly insulated, market-oriented federal investment operation, it is inconceivable that the federal government would set up a free-market compensation scheme or allow managers the freedom to succeed or fail on a large scale. In our previous work, we often remarked that state pension fund offices had the cultural ambience of a rural post office. We suspect that a Social Security fund would be simply the world's richest post office.

Some Further Thoughts on a Federal Investment Leviathan

Although indexing would be an obvious strategy, the behavior of a hypothetical federal investment vehicle merits closer examination. To start, the mechanics of equity trading are almost beyond comprehension. As we noted earlier, the discovery that the federal government had picked a particular stock would be an endorsement on a scale that the markets have never seen. Divestment would be an equally powerful condemnation.

It is also difficult to imagine how political pressures, both real and perceived, would be managed. Even if the investment agency were surrounded by a theoretically impervious firewall, would the public believe it was working? Assume a Gore administration, with the new president still displaying his longtime solicitude for Silicon Valley and environmentally friendly companies. Would the Social Security fund be able to resist the temptation, however unconscious, to put its money where the boss' heart was? Suppose the fund made an entirely independent decision to invest in companies whose business practices were congenial to President Gore's agenda. Would political opponents and press skeptics continue to believe in its independence?

These kinds of subtle influences are a widely recognized problem in the pension fund world today. A number of private fund managers told us that, although they never received explicit directions or requests from corporate executives, they were aware of their preferences and tried not to run afoul of them when investing. These preferences can take many forms. In one company where an executive's wife had died of cancer, the pension fund stayed away from tobacco stocks. In another, a fund manager reported learning through the grapevine that an outside money manager seeking business was a friend of the corporate CEO. There is every reason to believe that the managers of a Social Security fund would feel these same pressures, but multiplied exponentially.

Avoiding both the reality and appearance of insider trading would present another set of interesting challenges. Every day, various branches of the federal government make routine decisions that can have huge effects on the stock values of particular companies. These decisions include FDA approval of a new drug; the Patent and Trademark Office dropping its opposition to a biotechnology patent; the Pentagon awarding a contract to a supplier; and so on. Then there are the big decisions, like making or rejecting a deal to let China join the World Trade Organization. Can any structural firewall be completely effective in shielding fund managers from rumors of imminent government decisions? Even if it is, will anyone believe in the coincidence of the federal fund investing in a drug company one week before approval of its controversial and long-delayed new drug application?

A final point is that indexing will not solve all these problems. Even the world's largest indexed fund cannot own everything. While indexing does away with the need to pick individual stocks, choices must still be made. Will the Social Security index tilt toward large-cap or small-cap companies? High-tech or traditional? Start-ups or the usual Dow Jones suspects? Not even an index can be wholly neutral, so the required decisions will still send powerful signals and be subject to or at least suspected of every sort of contamination.

Corporate Governance

For the private and public funds we studied previously, one of the most sensitive issues was whether and how to participate in the governance of the corporations whose stock they owned. The dilemma presents itself most starkly when a portfolio company is doing badly because of mismanagement. A pension fund with a large position in the company has two basic alternatives: Sell the stock, or attempt to influence the company to fake a new direction. Here, as elsewhere, we found a fundamental division of opinion between private and public funds.

Private fund participation in corporate governance was reluctant and minimalist. Private fund managers could readily envision what it would be like for their corporate sponsor if other companies tried to meddle in its management. An unwritten Golden Rule dictated standard operating procedure: *Do unto other corporations as you would have their pension funds do unto your sponsor*.

Most of the private fund executives we studied felt they had a fiduciary duty to vote the proxies of their portfolio companies.[17] This was a perfunctory exercise for the most part, however. The voting was usually delegated to outside managers or fund functionaries, and management positions were routinely endorsed. We did not encounter a single instance of a private pension fund trying to influence the management of a portfolio company. When private funds did not like they way a company was managed, they sold its stock.

The public funds behaved very differently. Because the three funds we studied were so large, their executives believed that they could not bail out of a significant investment without depressing the price of the stock they were trying to sell. Many also expressed the view that their status as public fiduciaries required a higher level of scrutiny of the management of companies they owned. This was a ramification of a phenomenon we labeled fiduciary energy. All the fund managers we studied believed they had to do something to discharge their fiduciary responsibility; those who indexed and thus could not buy and sell expended the requisite energy in the corporate governance area. And, of course, the corporate Golden Rule was inoperative in the public sector. Consequently, all three public funds were much more actively involved in corporate governance than their private counterparts.

For starters, the voting of proxies was taken far more seriously. Voting policy was set at the highest level of the fund, and fund managers commonly took antimanagement positions on such things as board elections, structural reforms, and strategic decisions. Under some circumstances, public funds might even sponsor shareholder resolutions. Fund executives sometimes wrote, called, or met with corporate management to express dissatisfaction and ask for changes in direction.[18] Some fund executives were not averse to having these contacts reported in the financial press, to the consternation of the corporations they were trying to influence.

The public funds we studied clearly understood their potential power. Managers of companies in the portfolio took the threat of a huge and public sell-off very seriously; when the fund executives wrote, called, or visited, management paid attention. These were not gadfly shareholders who might attend the annual meeting to put forward idiosyncratic resolutions, but rather powerful institutions whose opinions necessarily carried weight. Public fund executives sometimes called on other funds to join them in demanding corporate reform, which had a multiplier effect on the influence exerted.[19] In their discussions with us, public fund officials debated the propriety of representatives of their funds actually serving on corporate boards.

Against the background of this state fund experience, what might we expect from a Social Security fund in the area of corporate governance? How would it perceive and exercise its duty to vote proxies? Absent some special legislation, its executives, like those of the large state funds, would presumably decide that they were obligated to take proxies seriously. But could they do so free from political influence? Imagine a scenario where IBM had just laid off thousands of workers. Could Congress resist the temptation to pass a resolution encouraging the federal fund to vote against the management slate? The problem of consequences is equally daunting: If the federal fund did decide to vote against the management of IBM or any other company, what signal would that send to the market? What kinds of things would potential target companies do to avoid the stigma of the federal fund's disapproval?

The issues would be even more complex if the officials of the federal fund decided to follow the lead of some of their state counterparts and conduct an active, often public dialogue with the management of portfolio companies. There would be an immediate conservative hue and cry about the federal government meddling in the conduct of private enterprise. Others, farther to the left, would be less concerned about the fact of the meddling than the form the meddling should take. At the very least, it would be wonderfully ironic if the fundamentally conservative idea of pension privatization were to promote the Marxist ideal of government control over instruments of production.

Short of legislation taking the Social Security fund totally out of the business of corporate governance, a solution to these problems is difficult to envision. Every position the fund took would be criticized by some significant constituency as politically motivated. Any fund official who took a public position on any governance issue, however principled, would be castigated by those in the private sector for grandstanding. This has already been the fate of the most visible of the state pension fund managers.[20] The merits of the individual positions would be lost in the controversy over the propriety of taking them.

The Law of Fiduciary Duty and the Politics of Social Investing

One of the more interesting and surprising findings of the earlier study concerned the role of legal standards in investment decision-making. The manager of a pension fund, whether public or private, is a trustee legally obligated to make investment decisions in the best interests of those who will receive the pensions, the beneficiaries. The law further requires the trustee to invest as a reasonably prudent person would under comparable circumstances.[21]

These legal standards are phrased in general terms, however, and leave open the most significant issue of all: how to define the "best interests" of the beneficiaries. The traditional interpretation is that the "best interests" rule forbids consideration of anything beyond the narrow scope of pure economics. In this view, the trustee's sole duty is to maximize the fund's assets by balancing rate of return and safety, ignoring all other considerations. A competing view, often called "social investing," treats the beneficiaries' best interests in a more holistic way. This interpretation permits or even requires the trustee to take into account the quality of the world in which the beneficiaries will live. Social investors, for example, would believe it appropriate to seek out investments in "family-friendly" companies, while traditionalists would flatly regard such a consideration as illegal. The most highly publicized of these disputes concerned investing in companies that did business in pre-Mandela South Africa.

The law says very little about what constitutes the best interests of the beneficiaries. Plausible arguments can be made on both sides, and we found both traditionalists and holists among the executives of the large funds we studied. What was remarkable was the way both sides used the law to justify and explain their respective strategies. For those on either side, the technically correct legal answer would have been, "The law is indeterminate on the question, and I have therefore made what I thought was the most reasonable judgment under the circumstances." But no one gave this answer. Instead, the fund executives, all of whom had access to highly paid legal talent, invariably claimed that the law *compelled* their particular point of view. Traditionalists stated unequivocally that the law forbade taking account of social issues, while holists claimed the law required it.

What would fiduciary duty mean to a federal pension fund? The enabling legislation might simplify the problem by defining the beneficiaries' best interests in narrow financial terms. A better bet is that it would follow the ERISA model and leave the question open. The political pressures to adopt one view of the law or the other would then be overwhelming. One can imagine absolute and unqualified legal opinions flip-flopping from administration to administration. In a Gore administration, the best interests of the beneficiaries might be construed to include affirmative investment action for "green" companies. In a Buchanan administration, the best interests of the beneficiaries might dictate favoring companies that used all domestic content in their products, or that employed only U.S. citizens.

This is a problem that plagues today's public pension fund world, despite safeguards intended to insulate decision-makers from politics. It is hard to imagine that similar insulating efforts would be any more effective on the federal level. On the contrary, as noted earlier, the federal fund would face political pressures on an unprecedented and truly epic scale. One need only contemplate the range of interest groups on whom the various 2000 presidential candidates are dependent: labor unions, trade and industry associations of every sort, the education lobby, gay rights groups, antigay rights groups, ethnic advocacy groups, and so on. Determining the best interests of Social Security beneficiaries could become the hottest political war in town, and the rational interpretation of the law of fiduciary duty would be the principal casualty.

The Relationship of the Fund to the Beneficiaries

A corollary of the fiduciary duty issue is the more practical question of the interaction between a fund and its beneficiaries. Both the private and public funds we studied had episodic but interesting direct contacts with their beneficiaries. There were, of course, the expected customer service transactions involving missing checks or changed addresses. But, occasionally, the interactions were more substantive. On the private side, labor unions sometimes lobbied for investment in infrastructure or housing in the communities where their members lived. On the public side, beneficiaries advocated (publicly or privately, individually or in concert) all kinds of social investing agendas. Some even came forward to offer investment advice. The prevailing view among both private and public fund executives was that such advice should be received politely and then ignored. While it was the beneficiaries' money being invested, the best interest of the beneficiaries was not seen as having any correlation with what the beneficiaries thought was in their best interest.

How would a Social Security fund with 100 million beneficiaries deal with this issue? Would a polite brush-off be politically feasible? Would it be possible to devote significant resources to listening to the constituents without paying any attention to what they were saying? Investment decisions probably should not be made by plebiscite. But given the power of the Social Security beneficiary lobby, how could such an outcome be avoided, and what would the results look like?

Time Horizons

Before picking an investment strategy, a good money manager will ask, "When will you need the money?" A state pension fund manager once explained to us that his fund's time horizon was "just short of the hereafter." By that, he meant that he could not foresee the state government going out of business; there would always be new workers coming in to contribute and old workers retiring to demand benefits. Day-to-day, month-to-month, even year-to-year market fluctuations were not of significant concern. Private fund managers, though they plan for the relatively long term, do not have the luxury of this assumption. Even blue-chip companies vanish (ask Pan American Airlines), leaving the pension fund to meet its liabilities with no additional asset source.

A federal fund would truly be in the "hereafter" mode. Every member of Congress would probably agree that the closest thing to a political certainty in this country is that Social Security will never be abolished. Consequently, the appropriate time horizon for the fund's investment strategy would be the longest possible term. But would its managers be allowed to ignore the inevitable political pressures to react to current events? Comparable pressures are felt on a smaller scale in the large state funds, and they cannot always be resisted. Would Congress, for example, try to enlist the Social Security fund's capital as part of a Keynesian response to a severe recession, or to preserve a threatened domestic industry? We fear that even the strongest guarantees of independence would be no match for the exigencies of politics.

Conclusion

As we write, President Clinton's proposal to invest Social Security funds in the market is a legislative casualty, at least for this Congress. Its death has little to do with its own merit, however. With a pivotal election looming, neither party seems willing to go forward with Social Security reform. It is an issue that cannot be ignored indefinitely, though, and it will be back, probably sooner rather than later. Consequently, it is important that the debate stimulated by the State of the Union address continue.

We join those who are skeptical about the value of this approach to solving the Social Security funding problem. While it is true that those of us whose pension funds have been invested in the market have done extremely well in recent years, we cannot conceive of a workable parallel strategy for an entity with the size, visibility, and political sensitivity of the proposed Social Security fund. The experiences of the large state funds we have studied do not bode well for such a fund, regardless of what specific form it might take. The idea is attractive in the abstract: Enlisting the efficiencies of the private sector as a painless solution to a public problem sounds comforting. But when reduced to practice, political, social, and cultural reality is likely to overwhelm the theoretical benefits. The collision of cultures, we fear, would prove fatal.

Notes

1. President Clinton has gotten remarkable political mileage out of co-opting Republican economic policies, softening their free-market edges to attract just enough Democratic votes for passage, and then claiming credit. His appointment of Wall Street insider Robert Rubin as Treasury Secretary and his reappointment of Federal Reserve Chairman Alan Greenspan were early indications that his economic heart might fall to the right of where his core constituencies had hoped. The juxtaposition during his first term of the passage of NAFTA, which he pushed vigorously, and the ignominious failure of his healthcare plan seemed to commit him irrevocably to the strategy of co-optation. Such political successes as welfare reform, the balanced budget, and the current crusade to "save the surplus" for Social Security soon followed.
2. The full text of the address is available at numerous web sites, including *The Washington Post*'s, www.washingtonpost.com/wp_sYtics/special/states/docs/sou99.htm.
3. See, for example, the analysis by *National Review* editor Ramesh Ponnuru, "In Praise of USA Accounts," *Washington Times*, Feb. 16, 1999, p. A17.
4. See Michael Alan Paskin, "Privatization of Old-Age Pensions in Latin America: Lessons for Social Security Reform in the United States," *Fordham Law Review*, Vol. 62 (1994), p. 2199. Liberals offer their own cautionary tales as counter-examples, including the poor performance of a program for Native Americans called Individual Indian Money Accounts. Mark Trahant, "Government's Dismal Money-Managing Record," *Seattle Times*, Feb. 28, 1999, p. A16.
5. Alice Ann Love (Associated Press), "Clinton Backs Social Security Stock Investing," Dec. 10, 1998, www.bergen.com/morenews/soc 10199812103.htm.
6. See Bob Davis, Gregg Hitt, and Greg Ip, "Sharing the Wealth: More Security or Less?" *Wall Street Journal*, Jan. 20, 1999, p. 1.
7. *Ibid.*
8. *Ibid.*
9. One of the first such studies was Bronislaw Malinowski's report on the cultural life of the Trobriand Islanders, who live off

the coast of what is now Papua New Guinea (*Crime and Custom in Savage Society*, Totawa, NJ: Helix Books, 1985, orig. 1926). A recent example of the genre that is widely read in college anthropology courses is Dennis Werner's *Amazon Journey* (Englewood Cliffs, NJ: Prentice-Hall, 1990), an account of his stay among the Mekranoti Indians of Brazil.

10. John M. Conley and William M. O'Barr, *Just Words: Law, Language, and Power*, (Chicago: University of Chicago Press, 1998).
11. William M. O'Barr and John M. Conley, *Fortune & Folly: The Wealth and Power of Institutional Investing* (Homewood, IL: Business One Irwin, 1992): John M. Conley and William M. O'Barr, "The Culture of Capital," *Harvard Business Review*, Vol. 6 (1991), p. 110; William M. O'Barr and John M. Conley, "Managing Relationships: The Culture of Institutional Investing," *Financial Analysts Journal*, 48 (1992), p. 21.
12. O'Barr and Conley, *Fortune and Folly*, pp. 43–44.
13. White House officials project that a Social Security fund would own over 4% of the U.S. equity market within fifteen years. In addition to being far larger than any other single investor, the federal fund's influence on the market would be qualitatively different if it made a long-term commitment not to bail out of a falling market. Some analysts believe that the mere mention of the President's plan contributed significantly to market euphoria during the first half of 1999. Davis *et al., op. cit.*
14. *Ibid*. (emphasis added). Relatedly, in an op ed piece in the March 31, 1999 *New York Times* entitled "Clinton's Complex Plan Adds Up," Princeton economist and former Clinton adviser Alan S. Blinder described a specific plan to invest $580 billion in equities.
15. Louis Dubose, "Running on Empty: The Truth about George W. Bush's Compassionate Conservatism," *The Nation*, April 26, 1999, p. 11.
16. See *Fortune & Folly*, pp. 49–53, 145–146.
17. *Ibid.*, pp. 181–185.
18. In a widely reported 1990 instance, the head of CALPERS, the California state employees' fund, wrote to the General Motors CEO advising him of CALPERS' intent to file a resolution to amend GM's bylaws to require a majority of independent directors, and to defend independence with unprecedented rigor. After some negotiation, the parties came to an agreement, GM management endorsed the proposal, it passed, and the two sides exchanged mutually congratulatory public letters. *Ibid.*, pp. 186–187.
19. In another 1990 case, the heads of the California and New York state funds both wrote to the GM board, attempting to influence the CEO succession process. The New York letter was leaked to the press, and a public controversy erupted. *Ibid.*.
20. *Ibid.*, pp. 185–189.
21. Private pension funds are governed by the Employee Retirement Income Security Act of 1974 (ERISA), public funds by the common law of trusts. The operative standards are substantially the same, however.