Social Investing

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Pension Funds and Social Investments: A Tale of Two Cities

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by Clarence C. Walton*

Individuals held responsible for managing enormous sums of money intended for the good of others—and for policy formulations on complex issues related thereto—are understandably restive when asked to consider the usefulness of an inquiry rooted in a form of moral reasoning. Moral reasoning, unlike financial analysis, draws its substance from philosophy, a discipline recently distinguished more by methodological virtuosity than by substantive solidity. Today's men of affairs would applaud Callicles, the friend of Socrates, when he said that philosophy was a "pretty thing" for youths to study but is the "ruin of man" if continued into adult life: "In a word, they are completely without experience of men's character. And so when they enter upon any activity, public or private, they appear ridiculous, just as public men, I suppose, appear ridiculous when they take part in your discussions and arguments."[1]

Restiveness is likely to be intensified when inspiration for a way to approach dilemmas posed by social investments is found in so improbable and implausible a source as St. Augustine—a man who cared little for the secular dominion. However, by

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[1] Plato, *Gorgias*, in *Great Books of the Western World*, ed. Robert Maynard Hutchins, (Chicago: Encyclopaedia Brittanica, 1952), p. 272.

contrasting the City of God to the City of Man, he showed how tensions build when communities with different value systems intersect. Pension managers must also be concerned with two intersecting cities: one is financial and the other moral. While the contours of each are definable, the moral dimension will receive—in what may appear to be an unnecessary detour—the greater attention because ethical analysis is less familiar to financial experts.

The City of Finance

The financial world is built on fact. In 1977, when three experts discussed critical problems facing investment managers responsible for handling the $650 billion in employee pension funds, their comments ranged over such issues as concentration of investments in stocks listed on the New York Stock Exchange, inattention to venture capital, problems occasioned by dual regulation by the Labor Department and the Internal Revenue Service, amounts held in private and public funds, the step toward institutional ownership of corporations, and the like.[2] If their conversation had stopped at this point—which it did not—the trio could have been seen as heirs to Bounderby and Gradgrind (Charles Dicken's heroes of *Hard Times*), who viewed ethics as "sentimental humbug." For these Dickensian characters, reality existed only when imagination, feeling, and other useless sentimentalities had been stripped away by an ethic of personal gain and by a world of hard fact.

Now, no one is unappreciative of the importance of empirical data or unaware that certain beautiful theories have floundered on a single ugly fact. The fact world, important to pension fund managers, is the bottom line. These are part of reality, and to be able to say "that's a fact" is to foreclose many debates. This reality, however, is not the whole. Joseph Schumpeter, one of the century's great economists (who took great pride in his own fact orientation), put it this way: "The stock exchange is a poor substitute for the Holy Grail"—the Grail symbolizing the good life.[3] At a much earlier time in the Boston environs, another

[2] "Private Pensions and Public Policies: A Symposium with William Greenough, Dan M. McGill and Robert Tilove," *Employee Benefits Journal* (1977), pp. 2–13, 26–27.

[3] Joseph Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper & Row, 1942), p. 137.

hardheaded realist, Oliver Wendell Holmes, told the Massachusetts Medical Society in 1860 that

> in every calling are those who go about the work of the day before them, doing it according to the rules of their craft, and asking no questions of the past or of the future, or of the aim and end to which their special labor is contributing. These often consider and call themselves practical men. They pull the oars of society and have no leisure to watch the currents running this or that way; let theorists and philosophers attend to them. In the meantime, however, these currents are carrying the practical men, too, and all their work may be thrown away and worse than thrown away, if they do not take knowledge of them and get out of the wrong ones and into the right ones as soon as they may.[4]

Even more relevant to our purposes is John Ruskin, who once said that "among the delusions which, at different periods, have possessed themselves of the minds of large masses of the human race, perhaps the most curious—certainly the least creditable—is the modern *soi-disant* science of political economy, based as it is [on the idea] that an advantageous code of social action may be determined irrespectively of the influence of social affections."[5] How pension funds are handled is influenced by the postulates, premises, and methodologies of political economy which is the discipline concerned with power and the polity. The gigantic size of such funds provides ample power for those who control them to influence the community. It is, therefore, worthy of note that Ruskin, along with Carlyle and others who shared his view, are remembered as "romantics" because, among other reasons, they feared that if fact became the only basis for analysis (which it did in value-free social sciences), such a world would be one of delusion.

Today's moralists are often seen as romantics. Like Callicles in Socrates' story, they seem aliens to the real world. When granted passports, they behave like recluses, ignoring the outside domains and speaking their own specialized idiom. Yet there are sufficient numbers of ethicians who insist that their singular interests reflect an authentic, albeit not commonly acknowledged, kind of reality. Robert Nozick, Harvard's distinguished

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[4] Oliver Wendell Holmes, *Collected Legal Papers* (New York: Harcourt Brace Jovanovich, 1920), pp. 380–81.

[5] John Ruskin, *Unto This Last*, vol. 13, (New York: John Wiley & Sons, 1866), p. 25. See also Thomas Carlisle's seminal essay, "Signs of the Times," in *Critical and Miscellaneous Essays* (New York: John Wiley & Sons, 1866). For an excellent analysis of British social thinking of this period, consult Peter Gay, *The Enlightenment: An Interpretation*, vol. II, (New York: Alfred A. Knopf, 1961), especially Chs. 4, 6, and 7.

philosopher, has suggested that the realm of fact can neither be defined nor specified without using certain values, that it is impossible to stand firmly on the fact side of the fact-value distinction while treating the other as vaporous, and finally, that the same processes which carve facts out of undifferentiated unconceptualized stuff also carve out the values.[6] So it is well to look hard at the moral dimensions of decision making in pension fund uses.

The City of Morals

Examples suggest why Nozick is correct. The facts about the 1982 Falkland Islands crisis are clear enough. Yet Argentina risked the consequences of an invasion because they saw the Malvinas not simply as a national inheritance from Spain but as a possession which, in justice, was theirs. On the other side was England. Why would a financially hard-pressed nation make a fantastic investment in sending a gigantic fleet over 7,000 miles? Certainly not because of 1,800 sheep herders. Remotely because of oil. George Will gave a better answer when he wrote, "Every little injury to the forms of international law lowers the tone of life on the planet. It also lowers, perhaps imperceptibly but not innocuously, the threshold at which disputes become violent."[7] Morality is inseparable from politics and from business. The "tone of life" has psychological and ethical connotations.

There is no need, of course, to find examples of the importance of ethics in the experience of others. Americans have been tutored by their history to recognize the existence of the moral world, and slavery has been our sternest taskmaster. While historians debate its economic significance, a persuasive case can be made that slaves were a positive factor in the infant nation's productivity, adding to export markets and thereby increasing prosperity. But who would argue that the economic gains, assuming their reality, justified the moral costs? A second instance occurred in the 19th century when management attitudes toward labor, premised on Ricardian economics and Social Darwinism,

[6] Robert Nozick, *Philosophical Explanations* (Cambridge, Mass.: The Belknap Press, Harvard University Press, 1981), pp. 535–7.

[7] George Will, "Just a Little Crisis, But . . . ," *The Washington Post*, April 8, 1982, p. 27.

led bosses to treat workers as disemboweled agents in the process of production.[8] Bloody and unnerving skirmishes (pitting coal and iron police and Pinkerton bullies against workers) were fought before the Wagner Act assured protection and respect for the worker's fundamental right to organize. An ethical principle ultimately overruled a maxim of economic theory.

But past events are not the only mentors. In our own day, we wrestle with ways to provide more equitable treatment for women in the workplace. Society's double standard in sex and salaries recalls the railroad's double sets of bookkeeping: dishonest, deceitful, and demeaning. There is also awareness that our historically great cities are becoming outposts of decay rather than centers of civilization, that public education is in sad repair, that unemployment impoverishes more than people's pocketbooks, that the aged and the disabled require attention. It simply might be recalled that the three analysts mentioned previously, having canvassed the "facts" of the pension fund world, moved easily and naturally toward a moral level by talking of the appropriateness of encouraging pension money to go into "socially desirable" areas—all of which had ethical overtones.[9] In the foregoing instances, facts took on a larger significance because society had cloaked them with certain values.

Citizens in the city of morality acknowledge the interdependence of material and moral values; they wish only to assure that the relationship is not sundered by obsession with the importance of one over the other. This means, practically, that dividends are to be seen in a dual dimension—economic and ethical. That interest in social dividends is widespread was demonstrated by the famous "Campaign GM." A social-uplift group of young attorneys made two rather modest demands on General Motors: (1) establish a committee on corporate social responsibilities (consisting of corporate, union, and Campaign GM representatives), and (2) increase the number of directors by three with the additions representing the public interest. Alarmed, the corporation distributed a long pamphlet to demonstrate GM's concern with pollution, its commitment to automobile safety, its advances in affirmative action, and the like. Campaign GM was

[8] Richard Hofstadter, *Social Darwinism in American Thought* (Boston: Beacon Press, 1955).

[9] "Private Pensions and Public Policies," pp. 7–8.

roundly defeated in 1970; yet three years later, when the Rockefeller Foundation and the Oppenheimer Investment Fund came out publicly in favor of the two proposals, the corporation capitulated.

Universities have also been the centers of controversy. Princeton trustees were asked to sell their institution's shares in corporations having operations in South Africa, Rhodesia, Angola, and Mozambique because these countries were presumed to be racist and repressive. Yale, Harvard, Chicago, and Columbia had similar experiences. The common academic view was expressed by Yale President Kingman Brewster, who said his institution could not let itself "be mobilized for any cause, no matter how noble, or for the achievement of a social objective extraneous to its purpose, no matter how worthy."[10] The University of Chicago expressed its opposition in even stronger terms.[11]

Worth noting is the fact that university resistance was based less on an economic and more on the moral criterion of freedom where commitment to a particular cause posed an intrinsic threat to academic autonomy. Freedom of professors to hold and teach positions contrary to those formally taken by university trustees was perceived to be in mortal danger—something that had to be resisted if institutional integrity were to be preserved. Nevertheless, Peter Landau concluded this survey of the practices of nearly 100 institutions by saying that social and moral concerns "may sooner or later become inevitable" for those responsible for investment policies.[12] "Later" has become "sooner"!

In sum, the city of morality, as Augustine so forcefully insisted, is as real and as important as the citadel of finance. If, however, investment and moral dividends are intertwined, the first is more easily explained than the second. In this respect, worth recalling are the Princeton economists who, two decades

[10] *Report of the President: 1967–68* (New Haven, Conn.: Yale University Press, 1968), p. 38.

[11] *Report of the Kalven Committee on the University's Role in Political and Social Action* (Chicago: University of Chicago, 1967). See also *The Austin Committee Report* (Cambridge, Mass.: Harvard University, 1971), and the later statement for Harvard President Derek Bok, *Beyond the Ivory Tower: Social Responsibilities of the Modern University* Cambridge, Mass.: Harvard University Press, 1982).

[12] Peter Landau, "Do Institutional Investors Have a Social Responsibility?" *Institutional Investor*, July 1970, p 83.

ago, looked at the issue of social investment and raised three questions:

1. Are there companies whose securities should not be held in the portfolio for social, political, or moral reasons?
2. Should the portfolio manager be guided by such considerations in voting his institution's stock?
3. Should an investing institution employ any of its resources in a positive manner for the sake of social, political, or moral objectives?[13]

Definitions and Purpose

Despite a generally rewarding treatment of the issue, the authors neither outlined the ethical postulates employed to answer their own questions nor provided a map for their moral landscape. This analysis seeks to go a step beyond by providing an ethical framework within which the problem of social investments can be handled. Social investment policy may be manifested in four ways: (*a*) refusal to invest in countries or companies whose practices or products are generally viewed as harmful to the social good, (*b*) withdrawal of investments from such countries or companies, (*c*) investment in socially important projects where the return is equal to or not significantly lower than investments in other projects, and (*d*) investments in socially important projects where the risk is perceptibly higher than risks in other areas.

Three reasons suggest why emphasis on the last definition is the way to proceed. In the first place, of the various interpretations of social investments, the fourth represents the most conscious and affirmative decision to bear some cost involved in meeting a critical social problem. The choice reflects the well-known "Hirschman thesis" that energy and vitality are restored to institutions in only two ways: exit and voice.[14] While refusal

[13] Burton G. Malkiel and Richard E. Quandt, "Moral Issues in Investment Policy," *Harvard Business Review*, 49, (March-April 1971), p. 38.

[14] Albert O. Hirschman, *Exit, Voice, Loyalty: Responses to Decline in Firms, Organizations and States* (Cambridge, Mass.: Harvard University Press, 1970). The subtleties of the economic-political nexus are explored by Hirschman in his book, *Essays in Trespassing: Economics to Politics and Beyond* (New York: Cambridge University Press, 1982).

to invest is not, strictly speaking, an exit decision, it is similar to withdrawal in that it reflects an unwillingness to participate in any venture deemed morally repugnant. Voice is a more dangerous route implying, as it does, a willingness to make a judgment, a determination to confront the problem, and a courage to back both judgment and determination with one's own resources. Voice adherents become, probably unconsciously, protégés of the great (and not widely known) European economist, G. L. S. Shackle, who "wrestled with championship problems and played a game he was never likely to finish."[15] In more modest ways, voicing a judgment in favor of social investments represents involvement in one "championship problem" that is not likely to be finally resolved in any clearly defined manner.

The second reason for choice of this commodious—and least defensible—definition of social investment is that if a case can be made for accepting a burden for something that is not of the donor's making, other forms of social investments are almost automatically legitimized. Finally, there is the fact that the billion dollars in pension funds (which will soon reach a trillion) make trustees and managers of such resources pivots of social and economic power. At this point, two "iron laws" of society become relevant. The first, the "law of power concentration," holds that the public expects responsibility to be proportionate to the powers possessed; the second is the "law of social maturation" which asserts that in advanced industrial, affluent, and democratic societies, people demand that consideration of the common welfare be borne in mind by large private associations—even when the law is silent on such demands. This second proposition works toward mitigating and softening the harsher aspects of competition and self-interest.

Because the preferred definition of social investments carries greater risks—and probably imposes greater costs in the short run—the defense rests on a logic which holds that, under certain conditions, the public constitutes a genuine claimant on the fund's total resources. But against whom are the public's claims pressed when pension funds involve a tripartite contract with employers, workers (unions), and beneficiaries? Who shall determine the validity of the claim? Establish the price to be paid by

[15] Quoted from Mark Perlman's review of G. L. S. Shackle's *Imagination and the Nature of Choice*, *Journal of Economic Literature* 18 (March 1980), p. 116.

the contracting parties? Ethical analyses cannot, therefore, be restricted exclusively to what the common law or ERISA says about responsibilities; so constrained, the answer is clear—act with prudence solely on behalf of the beneficiaries. So there is need to distinguish between moral and fiduciary responsibilities, and this critical difference will be addressed in a subsequent portion of this paper. To further the analysis we shall attempt to

Develop a rough kind of "ethical geometry."
Apply this geometry to the issue of social investments.
Offer tentative criteria for policy making.

Toward an Ethical Geometry

In the philosophical idiom, an axiom is "an indexical term in fundamental moral principles" which, if breached, literally invades the humanness of a person and "thus dehumanizes to one degree or another."[16] Axioms state primary values in general terms; theorems stipulate axioms' derivatives and give them some specificity. To understand how the terms will be used, it is helpful to recall how Euclid, when unveiling his system of mathematics, employed axioms to demonstrate what was self-evident and theorems to explain their derivatives. Jefferson, for example, was translating the Euclidean idiom into a political vocabulary when he wrote of certain self-evident truths in the Declaration of Independence. From these basics were derived other truths which were given specificity in the Constitution.

Twentieth century philosophy has, by and large, rejected such indexical terms. Leading the rejection was Cambridge Professor G. E. Moore who published his magisterial *Principia Ethica* in 1903.[17] Some of Moore's brilliant students described their master's theory in glowing terms. For Maynard Keynes it was the beginning of a renaissance, for Lytton Strachey it shattered all ethical formulations from Aristotle and Christ to Spencer and Bradley, for Virginia Woolf it was the lodestar for lost souls.

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[16] Nozick, *Philosophical Explanations*, p. 548. See also Joel Feinberg, *Rights, Justice, and the Bounds of Liberty* (Princeton, N.J.: Princeton University Press, 1980).

[17] G. E. Moore, *Principia Ethica* (London: Cambridge University Press, 1903). See also *Ethics* (London: Oxford University Press, 1912), especially Chs. 3 and 4.

Moore's basic insight was that values are simply expressions of individual preferences, attitudes, or feelings and, as such, can be neither true nor false. Sometimes called emotivism, Moore's philosophy boiled down to a proposition expressed by one of his outstanding disciples, C. L. Stevenson: " 'This is good' means roughly the same as 'I approve of this; do so as well.' "[18]

While giving greater rein to individual expression, the regnant philosophy has generated substantial uncertainties. A half century ago, the then dean of American journalists, Walter Lippmann, commented that "the wisdom deposited in our moral ideals is heavily obscured at the present time. We continue to use the language of morality . . . but the words are so hackneyed that their meanings are concealed. . . . Morality has become so stereotyped, so thin and verbal, so encrusted with pious fraud, so much monopolized by the tender-minded and the sentimental, and made so odious by the outcries of foolish and sour old women, that our generation has almost forgotten that virtue was not invented in Sunday schools but derived originally from a profound realization of the character of human life."[19] What the journalist said in 1921 was reechoed in 1981 by professional philosopher Alasdair MacIntyre who decried the continued use of common terms in moral discourse and our simulcra of morality when the terms themselves have lost meaning. Moral utterances are simply "fragmented survivals from an older past," and moral reasoning faces insoluble problems unless this fact is clearly understood.[20] In some philosopher's

[18] C. L. Stevenson, *Ethics and Language* (New York: AMS Press, 1975), Chap. 2. Reprint of 1944 ed. See also Roberto M. Unger, *Knowledge and Politics* (New York: Macmillan, 1975). Unger has written that no understanding of the political/market systems can be achieved without comprehension of the "liberal psychology" which legitimizes it: "The morality of desire defines the good as the satisfaction of desire, the reaching of the goals to which our appetites and aversions incline us. Contentment is the imaginary state in which all desire is satisfied. The task of ethics in this view is to teach us how to organize life so that we shall approach contentment. We call this contentment, 'happiness' ", p. 490.

[19] Walter Lippmann, *A Preface to Morals* (New York: Macmillan, 1929), p. 226. If Lippmann bemoaned the confusion, another journalist of our day sought to dispel it. George Will wrote that "politics should be citizens expressing themselves as a people, a community of shared values, rather than as merely a collection of competing private interests inhabiting the same country. Instead, politics has become a facet of the disease for which it would be part of the cure. The disease is an anarchy of self-interestedness, an unwillingness, perhaps by now an inability, to think of the public interest, the common good. This disease of antipublic-spiritedness is not a candidate's disease. It is a social disease." *The Pursuit of Happiness and Other Sobering Thoughts* (New York: Harper & Row, 1978), p. 192.

[20] Alasdair MacIntyre, *After Virtue: A Study in Moral Theory* (South Bend, Ind.: Notre Dame Press, 1981), pp. 104–5.

mathematics two plus two equals five—or three—or does not exist. We may be a people of "homeless minds!"[21]

The foregoing detour was taken with full awareness of its potential for diversion from the main argument. Its necessity, however, should be clear: if some philosophers argue that ethical values are simply expressions of individual preferences, while others argue that they reveal basic needs common to all individuals, a wide chasm exists. While this apparently uncrossable gap may be bridged by epistemologists, it is sufficient to indicate that the approach used in this analysis has been influenced by those who hold certain truths to be self-evident and, that from them, moral theorems can be logically deduced, adjusted to changing circumstances, and made the basis for appropriate legislation. Equality, individualism, fraternity are often employed as indexical terms by some philosophers; economists prefer to speak of "cardinal utilities" to describe what people prefer and not what they should seek—even though Pareto doubted such preferences were measurable. For present purposes, neither the indexical terms nor the cardinal utilities just noted will be used; the choice, rather, is four axioms which seem most relevant to social investments: liberty, justice, duty, and authority (See Chart I).

The ethical geometry is helpful in three ways.

It signals what is omitted from the moral discourse.

It uses history to show when harmonious and distorted relations existed, while establishing the anteriority of axiom to theorem.

It provides opportunities to determine which theorems are most relevant to the issue of social investments and where "conflicts of goods" may occur.

Omissions

Critical omissions in our moral geometry should be noted. Excluded are certain secular values—such as the hallowed business principles of maximizing profits, competition, and legal rules giving stockholders primary claims against a corporation's profits. Religious perspectives giving great weight to charity,

[21] Peter Berger, Brigitte Berger, and Hans Kellner, *The Homeless Mind: Modernization and Consciousness* (New York: Irvington Publications, 1973). See also Orio Giarini, *Dialogue on Wealth and Welfare: An Alternative View Toward Capital Formation* (Oxford: Pergamon Press, 1980), and Richard Rorty, *Philosophy and the Mirror of Nature* (Princeton, N.J.: Princeton University Press, 1980).

Chart I

	Axioms	*Theorems*
I. *Freedom:*	Every person has a right to freedom defined in five distinct ways: *Rational freedom*—the ability to conceive and recognize mental and social rules and the power to obey. *Relational freedom*—the right not to be enslaved or dominated. *Teleological freedom*—the right of an individual to pursue those ends that one wishes to achieve. *Negative freedom*—the freedom from war, from fear, from want, from hunger. Collective *freedom*—the right of people to participate creatively in the making of their own history.	Freedom implies a right: I*a*. To form associations to promote the legitimate needs of the members. I*b*. To private property. I*c*. To contract. I*d*. To participate in decisions affecting their welfare. I*e*. To expression of one's views. I*f*. To assembly. I*g*. To privacy. I*h*. To be excluded from the liability of others holding private property.
II. *Justice:*	*Every person has a claim to justice.*	*Justice implies a right:* II*a*. To receive income proportional to his or her input. II*b*. To meet basic human needs. II*c*. To use one's ability. II*d*. To have equal opportunity to compete without external favortism or discrimination. II*e*. To share equitably in increments to the social wealth.
III. Duty:	Every person has a duty to ensure self-preservation and growth and a responsibility to respect the rights of others—the "other regarding" obligation.	III*a*. Society has obligations to seek to provide work opportunities for willing and able individuals. III*b*. Failure to provide work opportunities brings to society an obligation to help the unemployed and underpaid. III*c*. Able individuals refusing reasonable work forfeit their claims on society. III*d*. Voluntary associations have primary obligation to their members unless other goals have been stipulated.

Chart 1

Axioms	*Theorems*
	IIIe. Voluntary economic associations (corporations and unions) also have responsibilities to promote the common good according to the "principle of subsidiarity"; (See IVe)
IV. *Authority:*	
Since the fundamental law of the mind is to "act intelligently," fulfillment of the law requires social units (states, families, corporation, unions) to provide intelligent direction for human activity which is impossible for isolated individuals to achieve. This is the social unit's moral force—*authority*. Power, unlike authority, is the ability to coerce. It is ethically neutral and summoned when authority fails. Used as a surrogate of authority, power becomes unethical.	IVa. The highest form of authority is the State. IVb. The State alone has a monopoly of power to enforce its authority. IVc. The State expresses its authority through laws which, (when ethically derived, rationally stated, and widely promulgated) bind individual consciences. IVd. Since the State is not the only social unit which individuals need, others may be formed and their authority (and power) are proportionate to their functions. IVe. Because omnipotent States threaten individual freedom and because they cannot meet all legitimate needs of their citizens, private associations serve as buffers between State and citizen and contribute to the general welfare (See IIIe).

self-sacrifice, repentance, hope, and piety are also omitted. The foregoing secular and spiritual values give substance to both social and individual morality, and it is hard to conceive of a free society where market and religious institutions do not exert strong influences on the way people are motivated, the conduct they exhibit in everyday affairs, and the like. These omissions suggest that the strictly ethical approach is a somewhat narrow one.

Axioms and Theorems: Fulfillments and Frustrations

In practice, it is not always easy to draw the correct theorem from self-evident truths, and societies have recorded both successes and failures in the effort. Liberty and justice, universally accepted by Americans, have been interpreted in diverse modes. So far as successes are concerned, possibly the most arresting demonstration of a harmonious working between axiom and theorem is the history of the federal government's dispositon of its land—a story of monumental detail.[22] On the surface, public land policy reveals only those elements traditionally at work in this country—the power of small business, the commitment to free enterprise, the ideology of states' right, and a laissez-faire outlook. Underneath all, however, was a moral principle which, when properly understood, demonstrated clearly that divestment was never the whole policy—nor even the sole reason for public policy. As Professor Friedman observed in introducing his penetrating study on American law, "The professed social goal was not to make government weaker or smaller, but to create a country of free citizens, living independently on their land. Where strict market principles clashed with this goal, they had to yield."[23]

Individual liberty was the axiom governing its related theorem on private property; when Macaulay, in 1832, said that property was the "great institution for the sake of which chiefly all other institutions exist," he implicitly admitted that this institution came along to serve higher values.[24] Land ownership also worked inexorably to draw justice into the economic sphere because it was a means, especially in a farm economy, to meet basic human needs (IIb) and to permit individuals to share equitably in the social wealth (IIe). Property is, therefore, essential to both liberty and justice.

But people see the relevance of theorem to axiom differently, and the liberty/property nexus is a good example. When William Howard Taft was serving as Chief Justice of the Supreme Court, he wrote:

> In the last analysis, personal liberty includes the right of property, as it includes the right of contract and the right of labor. Our primary conception of a free man is one who can enjoy what he earns, who can spend it for his comfort or pleasure if he would. . . . Personal liberty and the right of property are indispensable to any possible useful progress of society.[25]

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[22] Paul W. Gates and Robert W. Swenson, *History of Public Land Law Development* (Washington, D.C.: Zenger Publishing, 1978). Reprint of 1968 ed.

[23] L. A. Friedman, *A History of American Law* (New York: Simon & Schuster, 1973), pp. 2–3.

[24] Lady Trevelyan, ed., *The Works of Lord Macaulay* (New York: George D. Sproul, 1908). "Miscellaneous Works," Part IX, pp. 27–8.

[25] William Howard Taft, *Liberty Under Law: An Interpretation of the Principles of our Constitutional Government* (New Haven, Conn.: Yale University Press, 1922), pp. 25–26.

Yet what Taft hailed as the bulwark of freedom, the influential French journalist Proudhon (1809–1865) condemned as theft because the commons had been raided by robbers who, in the name of liberty, confiscated what belonged to the community; therefore justice, not liberty, was the governing axiom, and its application demanded return of private property to the community. And while Marx was skeptical of Proudhonists and their schemes to dethrone capitalism (referring to the advocates as "those jackasses . . . to whom I shall give a good thrashing"), he nevertheless held somewhat similar views toward private property, especially when used in production.[26]

If the negative views held by Proudhon and Marx toward private property appear wrong, it should be noted that they are not far removed from ancient Jewish practices where flocks and land were often owned by the community as a whole and where, after settlement of the land, property was seen as belonging to an extended family. Dr. Robert Gnuse has argued that under Jewish law the commandment against stealing did not function to protect individual property because "the essentially important property was owned by the entire community or the extended family. . . . There was no notion about the inviolability of property owned by individuals, and such a notion . . . is a Western idea."[27] Indeed, families, tribes, and communities had a right of access to those things upon which their lives depended. Reinforcement for this view is seen in practically all peasant societies where land was not divided into private holdings but held by the entire family through time; land was so revered that it was seldom sold.

Feudal law provided that in certain unforeseen contingencies, the land reverted to the original grantor, or lord of the fee. Called escheats, the reversion of property to someone other than a possible heir was generally accepted. In the United States, the property went to the state if there was no individual competent to inherit. So precedents for public property have had a long history. It was England which, in the 12th century, began first to break this pattern of communal property since geographical mobility was high and children often worked as servants to oth-

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[26] Otto Ruhle, *Karl Marx: His Life's Work* trans. Eden and Cedar Pauls, (New York: New Home Library, 1928), p. 268.

[27] Robert Gnuse, "But Who is the Thief? Reflections on Community and Property," New Orleans: Loyola University Institute of Human Relations, 35 (April 1982), pp. 3, 5.

ers.[28] In sum, property rights have been viewed differently because they have been seen as derivatives from liberty and justice. The choice of the relevant axiom conditioned the reasoning and the conclusion.

Justice also reveals itself in strange guises when translated from principle to practice: under the common law of torts, workers could sue employers for damages caused by fellow employees under the doctrine of *respondent superior*. But the American courts rejected the doctrine to favor the "fellow servant" rule under which an injured employee could only sue the person directly causing the injury. Employers were not liable for damage caused to an employee by a "fellow servant." The major statement of this doctrine was an 1842 case where the Massachusetts Supreme Court, following the reasoning of classic economic theory, held that one "who engages in employment for another for . . . compensation, takes upon [oneself] the natural and ordinary risks and perils incident to the performance of such services, and, in legal presumption, the compensation is adjusted accordingly." While modified during the latter part of the 19th century, it remained so well established that, in 1913, Theodore Roosevelt, in a *Colliers Magazine* article, used the following case to denounce the fellow servant rule:

> A young woman, Sarah Knisley, had her arm torn off by the unprotected gears of a grinding machine on which she was working. The state law provided that the gears should be covered; Miss Knisley had complained to her employer that they were not, and expressed fear about working at the machine in its present condition. But the employer warned her to do her job or quit, and she complied out of need of the job. The court held that in so doing she had assumed the risk of the dangerous condition and could not recover damages. Had she not known or complained of the illegal condition she would have had a cause of action; her knowledge made her liable.[29]

Other examples could be used to illustrate distortion of moral theorems. Theorem I*a* (the right to form associations to promote the legitimate interests of the membership) was flouted when workers were prohibited from forming unions on grounds that labor organizations were threats to the good ordering of society;

[28] Alan MacFarlane, *The Origins of English Individualism: The Family, Property and Social Tradition* (New York: Cambridge University Press, 1978).

[29] Quoted from James Weinstein, "Big Business and the Origins of Workmen's Compensation," *Labor History* 8 (Spring 1967), p. 158.

Theorem Id (the right to participate in decision making on matters vital to the individual's interests) was denied by suffrage restrictions to members of certain religious groups, to Blacks, and to women; Theorems IIc and IId were made inoperative by the Dred Scott decision.

The point at issue is the distance between moral and political geometries that has existed in America. Even the heroic efforts of Jackson to bring greater equality into society were tinged with frustration because, at the end of his presidency, he knew that relatively few people—most of whom had inherited their position—controlled vast amounts of property and that his ideal was not completely achieved. In this century, the New Deal and the Great Society programs also failed to fully meet their lofty goals. It follows, therefore, that the translation of ethical precept to institutional practice is often inadequate and that laws and customs may fail to reflect fully the ethical geometry. It does not follow, however, that ethics is simply and exclusively situationalist, relative, and subjective; without an inner core of constants, societies would be governed by the whim of the powerful—not by rules of law subject to testing against basic values.

Relevant Theorems

To review Chart I is to perceive rather quickly that certain theorems have more direct relevance to the problem of social investments than do others. Among such theorems are these:

Freedom to:

- I*a*. Form associations to promote the legitimate needs of the members.
- I*b*. Private Property.
- I*c*. Contract.

Justice in:

- II*a*. Receiving income proportional to input.
- II*b*. Meeting basic human needs.
- II*e*. Sharing equitably in increments to the social wealth.

Duty implies that:

- III*d*. Voluntary associations have primary obligation to their members in helping them to achieve a good life.
- III*e*. Voluntary economic associations (corporations and

unions) have responsibilities to help others achieve their good according to the "principle of subsidiarity."

Authority means:

IVc. Persuasion through logic and the invocation of force when logic fails to a point where the community life is threatened.

IVd. Possession of authority by voluntary private associations according to their social roles.

IVe. Involvement of private associations in matters of common public interest when state intervention threatens individual liberty or is likely to be ineffective.

Applications of Selected Theorems to Social Investments

What follows is an illustration of how certain ethical precepts can be applied to policies governing social investments. In the analysis, the moral geometry is given priority over what might be called a socioeconomic geometry. As a consequence, little attention will be given to the details of ERISA except where its provisions help clarify a point on one of the applicable theorems; nor will important recent cases *(Donovan v. Grumman)* be analyzed; finally, new and existing studies by states, particularly California and New York, will not be incorporated.[30] Such omissions require an unduly long treatment when this assignment is to demonstrate what happens when economic realities and ethical precepts intersect. Yet even within such self-imposed constraints, interesting applications can be posited.

Theorem Ib: *The right to private property.*

We have already seen how penetrating minds differ over the question whether people have a right to private property in the first place. In most moral formulations, it is seen as a derivative of the right to liberty. Marxists deny the right on theorems derived from their view of justice. Because of such differences, justification of private property requires legitimizing its acquisition in the first place. On this point, philosophers who support private property have split. European thinkers like Immanuel

[30] See the *Final Report of the Governor's Public Investment Task Force*, North Highlands, Cal., October 1981.

Kant (1724–1804) and G. W. F. Hegel (1770–1831) have argued that in the "state of nature" everything was originally the property of no one—it was *res nullius*.[31] Since it was a case of first-come, first-served, the presumption was that property, once gotten, was inviolable. The ethical duty was to use the property wisely and bequeath it to heirs in a condition better than when it was inherited.

Opposed to this "continental" theory of original property acquisition were the leading English philosophers—Locke, Bentham, Mill, and Green. In the British tradition, the premise was that in the state of nature all property was common until it was privatized by people who infused their own labor into the common property: animals killed were the hunter's own and land tilled was the farmer's own. Locke phrased the process of property acquisition in terms that have become famous: "To remove out of the state of nature what nature hath provided and left in it, he hath mixed his labor with it, and joined to it something that is his own, thereby making it his property."[32]

Locke's reasoning influenced England's common law tradition which, in turn, influenced American legislators and jurists. There were, however, important modifications. Since English law emphasized such notions as primogeniture, rules of inheritances, liens, and mortgages, Americans systematically went to work to brush aside such doctrines ill-suited to their new land.[33] What survived—one is tempted to say in the subconscious mind of Americans—was the idea that private property, though extracted from common property, was not to be severed absolutely from its original source. Private property is a distinctive achievement in that it helps to disassociate the political and the economic (Theorem IVe) and provides opportunities for individuals to provide for themselves (Axiom III).

While the courts moved to protect land ownership as a basic right because of its connection to liberty, signs of a modified

[31] Immanuel Kant, *The Metaphysical Element of Justice* trans. John Ladd, (Indianapolis: Bobbs-Merrill, 1965), pp. 51–57, and George Friedrich Hegel, *Philosophy of Right* trans. M. Knox, (Oxford: Oxford University Press, 1952), p. 51. Relevant is C. B. MacPherson's essay, "A Political Theory of Property in Democratic Theory" from *Essays in Retrieval* (Oxford: Oxford University Press, 1975).

[32] John Locke, *Of Civil Government* ed. Ernest Rhys (London: J. M. Dent and Sons, 1943), p. 187.

[33] Chancellor Kent, *Commentaries on American Law*, 2d ed. (New York: Halsted Press, 1832), Vol. 4.

view began to emerge when stock markets began to replace land markets as sources of wealth. In his minority opinion in a 1921 case Justice Holmes warned against the

> dangers of a delusive exactness (which) is a source of the fallacy throughout the law. By calling a business "property" you make it seem like land, and lead up to the conclusion that a statute cannot substantially cut down the advantages of ownership existing before the statute was passed. It (business) is a course of conduct and, like other conduct, is subject to substantial modification according to time and circumstances both in itself and in regard to what shall justify doing it a harm.[34]

Since pension funds are a form of business property, it is well to heed Holmes' caveat against "delusive exactness." In defining it, the warning is especially appropriate when ownership is diffuse. Unions insist that contributions to the fund belong to employees since pensions are deferred incomes; employers say that their contributions give them a voice, and the taxpaying community claims rights in public pensions because taxes are levied only after payouts have been made. Often the easiest route is to assume that workers are the beneficial owners of fund assets, but even here, if they have a prorated fixed claim and share no responsibility for either the profits or losses on the investments, their claims to ownership are diluted. One thing is clear: even when possession seems absolute, the possessor carries certain obligations, and such obligations increase when the property is large and when the nonpropertied are in need. The point is illustrated in corporation law where managers are held responsible for the pudent use of stockholder property and yet may divert resources or profits to the common welfare. Those large problems which remain on properties like technology, knowledge, trade names, and such fugacious materials as oil, coal, and water are serious precisely because the public responsibilities of private property owners have not been settled.

There is a final point: while revulsion against monopoly is grounded on fear of the irresponsible use of power, the aggregating of wealth designed for distribution to millions of people of modest means does not automatically exorcise public fears that the controllers of that wealth may not use it in such narrowly focused ways that the community is harmed. If small property holders have responsibilities toward themselves and to others,

[34] Truax v. Corrigan, Supreme Court, 1921.

huge concentrations of property (even when overseen by trustees) carry proportionately greater responsibilities to participating owners and to the general public.

Theorems I*a* and *c*: *The right to form associations to promote the needs of the members and the right to contract.*

Few philosophers have emphasized, as Hegel has done, how ownership involves an action: "A person puts his will into a thing (and) this is the just concept of property."[35] Every intention to "own" carries with it an intention to do something about the property. The intention is normally revealed through some form of contract the right to which, like private property, is a derivative of liberty. The relevant question at this point is directed to the purpose of those who, in Hegelian terms, "put their will into it" by establishing pension funds. The intent of legislators who accept pension funds as a good is also at issue. The legal answer to questions of intent is clear: to assure employees a package of benefits, including pensions, for which they or their representatives have bargained with employers. The act of bargaining itself fits Holmes' definition of it as "a course of conduct" to further a specific goal, namely, financial security for the beneficiaries through a form of ownership. Following Holmes, the trust is the result of contract by owners and is consequently "subject to substantive modification according to time and circumstances."

In the formative years of the republic, individuals established trusts to avoid passing property to bankrupt or disliked in-laws—this was precisely what Thomas Jefferson did to his daughter's husband, the insolvent Thomas Randolph. There were also "dynastic trusts" whose founders recognized the need for flexible management since they anticipated prospects for frequent change in the portfolios. Bostonians were out front in these endeavors and Massachusetts legislators passed the first statutes adaptable to the new needs; in the famous *Harvard College* v. *Amory* case of 1830, the Massachusetts Supreme Court enunciated a standard of trustee responsibility that has come to be known as the prudent investor rule. Unlike rigid restrictions imposed in other jurisdictions which bound trustees to invest

[35] Hegel, *Philosophy*, p. 119A.

only in government bonds or in first mortgages on land, Massachusetts trustees could behave as any prudent investor would by investing in corporate stocks or bonds. The Harvard College principle became the Magna Carta for the private professional trustee.

In a sense, today's pension funds are forms of dynastic trust with the important exception that the dynasty has been established not to advance the interests of the rich, but the economic security of nonrich employees. How that interest is to be promoted is difficult to determine since pension funds often have multiple founders, but all who participate in establishing the fund are entitled to have a voice in how the property will be handled. Let us suppose, however, that the "contractors" intended the funds to be used for the exclusive good of stipulated beneficiaries who are assured a fixed income, adjusted to inflation. What, if any, ethical obligations fall on such property holders and their representatives? On the basis of ethics, could they be expected to have some responsibilities toward society even as were rich industrialists like the Lowells and Abbots of earlier times? The answer comes through the applications of Theorems IIb, IIa, and IIe.

Theorem IIb: *To receive income sufficient to meet basic human needs.*

Justice, the governing principle for pension fund use, is usually interpreted in the way benefits and contributions are defined. The law is normally the most practical reference point, but it is always possible that the statute itself is ethically deficient.

However, reliance on abstract principles of justice is difficult. Their comp'exity is illustrated by asking a simple question: when are wages just? Are they just when an individual is paid enough to get the job done in a manner desired by the employer? Or paid according to the quality of the performance and the difficulty of the assignment? Or paid enough to permit workers to live decently?[36] If pension funds are judged mainly by the effectiveness with which they help people to live decently, it

[36] Ralph A. Cordero, "Right Pay," in *Human Values and Economic Activity* ed. James B. Wilbur.: *Proceedings at the Twelfth Conference on Value Inquiry* (Geneseo, N.Y.: State University of New York, 1978), pp. 247–65. Helpful, too, are John Rawls' masterly study, *The Theory of Justice* (Cambridge: Harvard University Press, 1971), and James Sterba, "Justice as Desert" in *Social Theory in Practice*, vol. 3 (Spring 1974), pp. 101–116.

follows that no invasion of the funds is justified if beneficiaries themselves are denied opportunities to meet basic needs (Theorem IIb). One must therefore translate justice to mean that funds are first used for the legitimate needs of beneficiaries before questions of social investment can even be raised; only when the funds are of such magnitude that room for trustee discretion exists are other theorems called into play.

Theorem IIa: *To receive income equivalent to input.*

Subtle issues float beneath the surface of justice when it is defined mainly as a quid-pro-quo relationship which says you get what you give. On one hand, a defensible argument can be made that retirees are entitled to everything in the fund since they are the victims of political policies imposed by a strong group on a weaker one in order to foster an efficient economic system or protect one's own group. Realism suggests that ideologies toward the aging are less the product of a social conscience and more the result of efforts to preserve partisan self-interest—a phenomenon particularly evident in such occupations as sales, printing, and education.[37] The logic then produces a conclusion which says that, since the retirees are already "victims" of unjust treatment, they should not be compensated in strict conformity to the contract but should receive increments when the investment performance allows "extras to be distributed.

On the other hand, the way pension funds operate has important effects on the way work is distributed across a lifetime. Old Age and Survivors Insurance (OASI) is the cornerstone of the country's pension system, and arguments have been made that its operation has caused a decrease in work among older men and an increase in work by younger men.[38] Do older workers "victimize" their juniors? In 1947, nearly 50 percent of all men aged 65 or older were in the work force; today that number is 20 percent. While retirements are voluntary, the logic of the system

[37] William Graebner, *A History of Retirement: The Meaning and Function of an American Institution 1885–1978* (New Haven, Conn.: Yale University Press, 1980).

[38] R. V. Burkhauser and J. A. Turner, "The Effects of Pension Policy Across Life: Discussion Paper" (Madison, Wisc.: University of Wisconsin Institute for Research on Poverty, October 1978). This hypothesis has been challenged by Cordelia Reimers in her essay in the collection edited by Robert L. Clark, *Retirement Policies in an Aging Society* (Durham, N.C.: Duke University Press, 1980).

operates to make early retirement sensible. Older workers eligible for a private pension or OASI must weigh the consequences of continuing work and receiving wages against the consequences of accepting retirement benefits. While retirement will lead to benefit payments, OASI benefits are reduced for those who earn wage or salary incomes. Private pensions usually require workers to leave their jobs and, in some cases, restrict earnings from other jobs. The increase in lifetime income has increased the overall consumption of leisure, but the entire increase has been taken in old age.

The adjustments to the antiwork constraint of present pension systems take place not only when workers become eligible for OASI or private pensions but throughout their lifetimes. By decreasing the wage rate for work performed at older ages, the earnings-test provisions in many pension funds induce workers to substitute leisure for work at older ages while encouraging them to substitute more work at younger periods for what they would have performed later. It is this additional adjustment to the earnings test occurring throughout a worker's life which is captured in a life-cycle framework.

What issue of justice is at work in this admittedly complex process? Two contradictory answers can be given. If young persons holding jobs continue to work harder and longer (often with a working spouse) then work opportunities for others are diminished because shorter work weeks are rejected by those who managed to gain admission to the labor force. If pensioners over 65 are encouraged—as they now are not—to stay in the work force, the same result is produced. In either case, the workers and the pensioned have had rewards from a system which helps deny jobs to others. Overhaul of the incentive system may correct the more serious aspects of the problem, but, in the interim, the ill-housed, ill-fed, ill-clothed, and ill-serviced have legitimate claims against those better circumstanced. Social investments, wisely considered and applied, can help mitigate the hardships of those excluded from the job world or restricted to low-level work.

Theorem IIe: *To share equitably in increments to the social wealth.*

The question at this point is whether others, not party to the pension contract, should receive attention from fund directors when the plan's beneficiaries are very well cared for. The issue, therefore, is not retiree survival but their enhanced living standard through better management of the portfolio versus the desires of the needy to share, albeit modestly, in the increasing wealth of the beneficiaries. At this stage, two interpretations of responsibility are open—a "representationalist" ethic and a "trusteeship" ethic (Axiom III). Representationalism has been espoused by both labor and corporate apologists. George Brooks of Cornell defined it for labor 20 years ago when he said that

> it has become respectable in certain quarters to expect union leaders to rise above the interest and judgment of the members, to be looking for the national interest, to be worried about inflation, to be reluctant about pressing management too hard. . . . Wrong! This violates the ethics of representation for a trade union leader deliberately to subordinate the interest of his members to some other interest, no matter how noble the purpose.[39]

It should be noted, however, that Brook's careful insertion of the words "subordinate the interest of his members to some other interest" modifies the basic premise. How the Brook thesis is working today in the pension fund area is demonstrated by the angry union reaction to a 1979 study showing that substantial portions of the $147 billion in fund assets had gone into nonunion companies and a determination to prevent such practices in the future. Shock was reinforced by the discovery that U.S. Steel and Bethlehem Steel retirement funds owned $133 million in 10 banks that made loans to the Japanese steel industry. Since U.S. Steel pension fund assets equal or exceed the total value of the company's common stock, its use to protect labor interests is a blunt power instrument legitimized under the representationalist view. Trucking and construction are other industries where unions have secured a voice on investment policies; for example, California building trades unions share decisions with management and have placed funds into low-interest mortgages to boost construction and union jobs. A little-noticed clause in the United Auto Workers's 1979 agreement with Chrysler gave the UAW a limited advisory role in fund investments. Such actions reveal the representationalist ethic at work.

Exponents of the representationalist ethic for business are also

[39] George Brooks, "Ethical Responsibilities of Labor," *Stanford Business Bulletin* (1963) p. 27.

plentiful. In a view reminiscent of Gradgrind, Theodore Levitt argued that "if something does not make economic sense, sentiment or idealism ought not to let it in the door. Sentiment is a currupting and debilitating influence in business. It fosters leniency, inefficiency, sluggishness, extravagance, and hardens the innovating arteries."[40] The dominant objective for business, in practice as well as in theory, is the long-term maximization of profits. In an echoing voice, Milton Friedman said that "few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."[41] So far as pension funds are concerned, a recent expression of this position was made by the trust division of the American Bankers Association which noted that pension funds were—and should be—used for the sole good of the beneficiaries. The justifying appeal was to the law; the intent was to sail the pension ship for the exclusive pleasure of its passengers.

The representationalist ethic is the one endorsed under the fiduciary rubric of the common law and ERISA. In its broadest terms, a fiduciary relationship arises whenever one person reposes trust and confidence in another with the expectation that the fiduciary will act in good faith to protect the interests of the one reposing the confidence. Reciprocal responsibilities occur between

> two persons in regard to a business, contract, or piece of property, or in regard to the general business or estate of one of them, of such a character that each must repose trust and confidence in the other and must exercise a corresponding degree of fairness and good faith. Out of such a relation, the law raises the rule that neither party may exert influence or pressure upon the other, take selfish advantage of his trust, or deal with the subject matter of the trust in such a way as to benefit himself or prejudice the other except in the exercise of the utmost good faith and with the full knowledge and consent of that other, business shrewdness, hard bargaining, and astuteness to take advantage of the forgetfulness or negligence of

[40] Theodore Levitt, "The Dangers of Social Responsibility" in *Business and Government: The Problem of Power*, ed. Howard D. Marshall (Lexington, Mass.: D. C. Heath, 1971).

[41] Milton Friedman, *Capitalism and Democracy* (Chicago: University of Chicago Press, 1962), p. 133. Friedman extends this rationale to labor leaders by saying that "as business executives must use their resources and engage in activities designed to increase its profits so long as it stays within the rules of the game—similarly, the 'social responsibility' of labor leaders is to serve the interests of the members of their unions." p. 130.

another being totally prohibited as between persons standing in such a relation to each other. Examples of fiduciary relations are those existing between attorney and client, guardian and ward, principal and agent, executor and heir, trustee and cestui que trust, landlord and tenant, etc.[42]

The difference between becoming a fiduciary by a moral standard and becoming a fiduciary by operation of the law is that the former looks outward to accept many claimants while the latter is restricted to the contracting parties. But there is also an important difference between a legal fiduciary and a fiduciary of a plan. The named fiduciary of a plan is a creation of ERISA, and those named in the pension plan instrument possess certain powers not granted to persons who are fiduciaries by operation of law. Fiduciaries are required by ERISA to perform duties for the exclusive purpose of providing benefits to plan participants and their beneficiaries. In so doing, they must (*a*) act with the same prudence that would be exercised by persons familiar with such matters acting in a like capacity, (*b*) diversify the investment of the plan's assets so as to avoid the risk of large losses, and (*c*) see that the plan is administered in accordance with its terms. Fiduciaries failing in any of these responsibilities can be held personally liable for resulting losses and be subject to substantial penalties and excise taxes if they cause or permit the plan to engage in any one of a series of "prohibited transactions."[43] The representationalist ethic is regnant in pension fund operations as it once was for corporate managers. But the "corporate" ethic has undergone substantial modification in the last 20 years, and the same thing could happen for pension funds.

Trusteeship, probably first introduced by E. M. Dodd in a seminal article that defined management's responsibility not only to stockholders but to the public at large, involves both a negative and a positive aspect.[44] Negatively, it asserts that maximizing returns occurs only in generally imperfect markets, and therefore representationalist decisions to maximize stockholder

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[42] *Black's Law Dictionary* 5th ed. (St. Paul, Minn.: West Publishing, 1979), p. 564.

[43] Glenn R. Drury, "The Strategy of Drafting Fiduciary Provisions under ERISA," *Prentice-Hall Pension and Profit Sharing Plans: Forms* (Englewood Cliffs, N.J.: Prentice-Hall, 1981), pp. 25, 467–80. Helpful is the short analysis by Donald E. Bowman, "Fiduciary Responsibilities under ERISA," *Employee Benefits Journal* 2 (Fall 1977), pp. 2–5; 26–7.

[44] E. M. Dodd, "For Whom are Corporate Managers Trustees?" *Harvard Law Review*, vol. 45, (1932) pp. 1145–63. For philosophical perspectives see Toni Vogel Carey, "Institutional Versus Moral Obligations," *Journal of Philosophy* 74, (1977), pp. 577–89.

benefits are often "accomplished at the expense of other interest groups. . . . The stockholder rule encourages the manager to create situations where one party gains at the expense of another."[45] From this perspective, representationalism is an ethic of irresponsibility! The positive side of the trustee ethic was compellingly advanced by John Maurice Clark who spoke of "social housekeeping" to indicate the moral necessity of power groups (big business, big labor, and big government), to temper their powers by wise responsibility to the larger interests of the community.[46] If such power centers "conduct their economic dealings in the spirit of getting as much and giving as little as possible, in that way lies the death of liberty.[47]

In the debate over the representationalist and the trusteeship ethic for corporate managements, facts have outrun theory: business has, by and large, opted for the trusteeship ethic. They see the need to respond to the total community expectations because, as Philip Blumberg has argued, "it is simply a fact of life that in a public-relations oriented society, it is important to keep a good corporate image to assure product acceptability, employee support, and even investor interest. Even though the trusteeship commitments may have no immediate profit potential, they still represent a business-oriented decision to advance the long-term position and interest of the corporation; expenditures are regarded as the politically inevitable cost of doing business."[48] Blumberg's justification is on utilitarian grounds and contrasts with Clark's which is deontologically rooted; the Blumberg position is essentially reactive in that managers are used to respond to issues raised by others. Clark's view, on the other hand, incorporates a proactive element where the moral agent is held responsible for judging the ethical significance of the decision before, not after, the consequences have been ascertained. Of the two positions, Blumberg's may be more practical, but Clark's is more principled.[49]

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[45] J. Scott Armstrong, "Social Irresponsibility in Management," *Journal of Business Research* 5 (September 1977), p. 188.

[46] John Maurice Clark, "The Changing Basis of Business Responsibility," *The Journal of Political Economy* 5 (September 1955), p. 188

[47] John Maurice Clark, *Economic Institutions and Human Welfare* (New York: Alfred A. Knopf, 1957), p. 5.

[48] Philip Blumberg, "Corporate Responsibility and the Social Crisis," *Boston University Law Review* 50 (1970), p. 4.

[49] Clarence C. Walton, "Corporate Social Responsibility: The Debate Revisited," *Journal of Economics and Business* 34 (Spring 1982), pp. 173–87.

The important conclusion flowing from preference for the trusteeship ethic is that ethical responsibilities are seen as being not fully discharged by a fiduciary who obeys the letter of ERISA.[50] Acting solely in the interest of the plan participants and beneficiaries satisfies the law but may not satisfy the ethic. The "exclusive benefit" rule is actually expanded by the requirement to diversify investments and stay strictly within those instruments governing the plan that are consistent with the Act.[51] While the ethical issue could presumptively be answered by reliance on Theorem IV*b* (the state has monopoly power to enforce its decisions and therefore the fiduciary must do exactly what the law requires), the fiduciary concept in law is only a part (albeit a very important part) of larger responsibilities which fall on those managing vast amounts of resources.

Theorems: Conjunctions and Conclusions

Private property is—as has been repeatedly stressed—an important expression of freedom. Yet, irony of ironies, freedom has its own bondage—a bondage created by chains of responsibility to many claimants, including the community at large. So far as property is concerned, ethical freedom means it should be exercised with a kind of prudence that transcends the meaning given to it in the precedent-establishing *Harvard College v. Amory*. This is the time to lift prudence from its stark legal meaning to the high place originally built for it by classical and medieval ethicians, namely, a due regard for one's own *and* others' needs. Prudence becomes conjoined to altruism since the decision maker is concerned not only with present but with long-term needs as well; so understood, it becomes imprudent to do things so self-oriented that they ignore society's basic needs.[52] Ethical criteria for social investments are therefore met when the investments actually work not only to the private but to the public good as well.

This may appear as a "jellyfish" conclusion because it makes

[50] Employee Retirement Income Security Act of 1974.

[51] Section 404 (a) (1) See R. M. Sanchez, D. M. Cain, and James Wood, "The Pension Reform Act of 1974: Fiduciary Responsibilities and Prohibited Actions," *The Tax Adviser* 7 (February-March 1975), pp. 86-98; 148-60.

[52] Thomas Nagel, *The Possibility of Altruism* (New York: Oxford University Press, 1970). See also Gilbert Harman, *The Nature of Morality* (New York: Oxford University Press, 1977), Ch. 5.

the world "a wonderful place when profits and good works are so neatly laced together. Unfortunately, however, good works are more easily related to cost than to profits."[53] While pension fund managers cannot ethically impose costs adversely impacting a rightful return to the beneficiaries, they can and should consider the common good, even when there is no legal compulsion to do so. Social investments flow from voluntary actions taken by pension fund trustees who see in them indirect but real linkages to other needy segments of society. Given the restrictions in ERISA, following the moral high road may be fraught with peril; however, the road does not vanish because legal sands hide it from view. Perhaps the most immediate ethical challenge is to address those structures in the law which deny to managers and beneficiaries alike an opportunity to alleviate some of the social ills affecting the contemporary world. To recall John Maurice Clark's intriguing insights, "social housekeeping" transcends pure market and financial requirements, and the same holds true for social investments.[54] Once the principle has been accepted, possible changes in the law can come optimally by inviting experts to suggest criteria to govern policy formulation and decision making. Various criteria could then be carefully measured and the best elements extracted for application by Congress to statutory reforms. As a first effort in this direction, the following tentative guidelines are outlined.

Possible Criteria for Social Investments

Before discussing criteria that meet the test of both morality and practicality, it is useful to distinguish between two kinds of decision making: *judicial* and *financial*. The former, concerned with past events, seeks answers to questions such as these: What happened? How did it happen? Who caused the happening to occur? Was there culpability (or honor) in the actor's motivation and performance? Financial decision making, on the other hand, is future oriented and the actors often walk across a fog-laden

[53] "What Business Can Do For the Cities," Fortune, January 1968.

[54] Clarence C. Walton, *Corporate Social Responsibilities* (Belmont, Cal.: Wadsworth Publishing, 1967), p. 18. Relevant is John G. Simon, Charles W. Power, and Jon P. Gunneman, *The Ethical Investor* (New Haven, Conn.: Yale University Press, 1972), p. 27; and Charles Powers, *Social Responsibility in Investment* (Nashville: Abingdon Press, 1971).

terrain where obstacles are hidden and the strengths of adversarial forces are unmeasured. Nevertheless, the actors are concerned with using their powers to bring about a desired result. Effective decision making in the second category requires of trustees a capacity to comprehend the situation accurately and to assess its impact on their own enterprise and the public welfare, a delicate sense of timing, and a blend of prudence and courage. Future-oriented decisions are harder to measure by ethical yardsticks, and instinct moves a responsible fiduciary to approach a risk-laden future with caution.

At this point, it is well to dispel a myth which holds that financially oriented decisions are "solid" whereas socially oriented decisions are "soft." In today's climate, wise investment decisions are possibly more difficult than moral decisions; 30 years ago a return on investment of as little as 10 percent enabled a corporation to be classified as a good business, that is, one where an invested dollar in that business could be expected to have a market value of more than 100 cents. During that halycon period, American businesses earned roughly an 11 percent average on equity capital employed, and stocks sold far above the book value—possibly averaging 150 cents on the dollar. In the face of today's inflation and interest rates, companies achieving a 14 percent annual gain in earnings per share (while paying no cash dividends) are an economic failure for their individual shareholders. They produce less aftertax return for individual investors than so-called tax-exempt passive rates of return.

It is incorrect, therefore, to jump automatically to the conclusion that financially oriented decisions are more reliable than socially oriented investment decisions. With refreshing candor Warren Buffett, Chairman of Berkshire Hathaway and one of the shrewdest investors in contemporary America, confessed that, so far as acquisition policies were concerned, "We have made plenty of mistakes—both in the purchase of noncontrolling and controlling interests in business."

> Of course it is necessary to dig deep into our history to find illustrations of such mistakes—sometimes as deep as two or three months back. For example, last year your chairman volunteered his expert opinion on the rosy future of the aluminum business. Several minor adjustments to that opinion—now aggregating approximately 180 degrees—have since been required.[55]

[55] Warren Buffett, Berkshire Hathaway: *Annual Report*, 1982, p. 5.

One inference is clear: the belief that social investment policies are inordinately dangerous because they are too risk laden, hence unjustifiable, is part of a myth that keeps ethics in the shadow lands.

General Criteria

Having established certain points regarding the nature of decison making and the nature of ethical responsibilities, it is now appropriate to suggest criteria for social investment decisions which respond fairly to all the rights and duties of all members explicitly named in the contract (employers, unions, workers, and retirees) and those others who join such contracting parties in the communal arrangement that constitutes the social contract.

Beneficiaries. Disposition of responsibilities toward beneficiaries depends not only on the terms of the initial contract but on how their basic needs (as distinct from expectations) are met. As a generalization, however, it seems safe to consider the beneficiary as one expecting a fixed return. As such, the beneficiary takes no apparent risk if investment yields vary from year to year and this position may be likened to a bond-holder-"a functionless *rentier*."[56] Nevertheless, denial of all responsibility to *rentiers* simply on the basis of their receiving a fixed income leaves some ethical issues unanswered. Do not even *rentiers* have claims and responsibilities? In highly inflationary times, fixed incomes soon dissolve into fixed liabilities; those responsible for supervising the pension funds and those responsible for themselves have obligations under justice to make compensatory adjustments. Pension fund beneficiaries, even if considered as *rentiers*, have a right to expect trustee adherence to justice. Having received the *rentiers*' goods, property, or money for future use, trustees not only have a "clear right but, more to the point, a clear duty to exercise stringent control over the assets for which they must keep care, guard, guide, and, in general, be held seriously responsible." Theirs is an obligation "to make sure that

[56] Edward Mason, *The Corporation in Modern Society* (New York: Atheneum Publishers, 1966), p. 2.

these goods are used justly, morally, and beneficially."[57] To expedite the discharge of such duties, trustees must provide mechanisms for input by beneficiaries (Id).

Other Contracting Parties. Employers who contribute to the funds and, depending on the contract, union representatives who have negotiated on behalf of workers, also have claims and obligations. Assertion of claims comes in various guises. Management may want to use pension funds as part of a defensive strategy to hamper unfriendly takeover bids. Unions may seek to employ them as weapons against nonunionized workers. In each instance, the corporate and union agents find their justification in what has earlier been called a "representationalist ethic": they promote and protect the interests of those to whom they are responsible, namely, stockholders and workers, respectively. In exercising this right, the claims of the beneficiaries obviously cannot be impaired.

The representationalist ethic is, however, essentially self-interest, and the approach we seek to defend is a more commodious interpretation of fiduciary responsibilities called the "trusteeship ethic," namely, a concern for parties not directly involved in the contract. Because this is the sensitive area where costs accrue to the contracting parties, it is the terrain where most scuffling occurs. Who pays the cost? Allocates the cost? Judges the worthiness of the potential beneficiary?

Suppose, for example, that even though the beneficiaries are perfectly content to allow fund managers to direct surplus income toward charitable causes, the principals cannot agree. Management wishes that a grant be given to a hospital located in the city where its major plant is located. The unions want the grant to go toward subsidizing a low-income housing project in the same city. In the event of an unresolved conflict, the prudent course may be to do nothing, split the subsidy, or appeal to the workers and beneficiaries in a referendum. Clearly the ethic of benevolence at work cannot be faulted but the decision-making process might be seriously defective. The point is that good will

[57] David Bayne, "The Basic Rationale of Proper Subject," *University of Detroit Law Review* 34, (1957) p. 579. See also Michael Ross and Don Diteco, "An Attributional Analysis of Moral Judgment," *The Journal of Social Sciences* 31 (Fall 1970), pp. 91–110.

alone does not assure good practices and good results. In the kind of situation noted, the decision ought to tilt toward those things where help brings results, where progress can be monitored, and where escape hatches can be used if things go awry. By way of summary, therefore, it appears reasonable to conclude that the representationalist ethic is defensible only if the fund's beneficiaries are kept "whole." And the trusteeship ethic, though preferred, is acceptable only when judgments are made according to policies and procedures ratified, directly or indirectly, by the beneficiaries.

The Public. It has already been established that societal claims on pension funds are subordinate to rights of the contracting parties. However, since pension funds have been established "to do good," the question is whether or not the "good" has to accrue exclusively to the stated beneficiaries. It has been observed that ERISA is fairly clear on this point, but a reasonable ethical position would go further to invoke Theorem Ia (the right of private associations to participate creatively in shaping the contours of the society), Theorem IIIe (responsibilities to advance social and racial justice), and Theorem IVe (serve the society by providing things which buffer the citizen from state control). Finance craft, like statecraft, is "indirectly but inevitably, soul craft."[58]

The property rights of pension fund beneficiaries do not exculpate them from responsibilities attached to owners of other kinds of private property. Nor do they relieve pension fund trustees from moral obligations to the larger society unless public authorities themselves assume such responsibilities—or impose such punitive sanctions on those who invest socially that the funds themselves are jeopardized. From ethical perspectives, a useful analogy can be made between pension funds and ownership in a corporation. The law insists that ownership rests exclusively with the stockholders, but Donald S. MacNaughton, former chairman of Prudential Insurance Company, challenged the adequacy of the law when he said:

> As institutional buying of equities continues to grow, the schism between equity interest and true ownership widens. The market behavior of a

[58] George Will, *The Pursuit of Happiness and Other Sobering Thoughts* (New York: Harper & Row, 1978), p. 3.

> stock may be a measure of company performance, but it is less and less an indication of ownership. The interest of the enterprise and their managerial responsibilities are much broader, and the citizen tunes out when the corporate manager sounds off on the protection of property rights. . . . Further, I do not think we should distinguish between stock and mutual life insurance companies in this respect. Owners make little difference, be they stockholders or policy holders. What is important is that management has a responsibility to either or both of them. But it also has an equal responsibility to all other elements of society that have an interest in the enterprise.[59]

In a sense, pension funds represent a blend of quasi-private and quasi-common property, and, however defined, their use cannot be exercised in ways inimical or indifferent to the needs of the larger community. What must be shared are those significant things in society which sustain the quality of life for everyone, such as access to productive resources, to food, and to the necessities for healthy physical and emotional growth.

Specific Criteria

Assuming, therefore, that the laws can be modified to permit social investments, it is necessary to suggest guidelines for those making the investment decisions. The criteria must relate to both strategic and tactical goals. The first requires a statement of philosophy by the pension fund managers which, at a minimum, would include: portfolio integrity, problem identification, participation, penetration, efficacy, audits, and escape hatches.

Portfolio integrity is governed by ethics' deontological principle to "do no harm." If social investments threaten substantial harm to those for whom the investments have been established, such actions are ethically impermissible—a restatement of the legal fiduciary principle.[60]

Problem identification requires monitoring the social landscape to determine what festering problems most threaten the common good. Beneficiaries must be told what problems are of primary concern to their fiduciaries—union

[59] Donald S. MacNaughton, "A Responsible Business," Life Insurance Conference on Corporate Social Responsibilities, October 10–11, 1971 (New York: Institute of Life Insurance, 1972), pp. 3–4.

[60] Arnold N. Levin, "The Future of Employee Benefit Trust," *Pension and Welfare News*, part 2 February 1970, p. 57.

survival? Disabled workers? Urban decay? Women workers? Blacks? Small business? Housing?

Participation—Beneficiaries are not silent partners who must acquiesce in trustee decisions, so they should have opportunities to voice their views. In this regard, something can be learned from a major investment house which recently took steps to allow shareholders to designate recipients of the corporation's charitable contributions; of 932,206 eligible for participation, nearly 97 percent responded affirmatively. The "father-knows-best" school of corporate governance is less desirable than some participation by the beneficiaries themselves.[61] It does not follow, however, that referenda are necessary for each decision; it is sufficient only that procedures allow beneficiaries or their selected representatives to review performance and effect change if serious errors are uncovered.

Penetration—While legal obligations require portfolio managers to diversify investments, it is not unethical to direct social investments into a targeted one. As a matter of policy, such an approach makes practical sense. Issues close to the interests of the beneficiaries take precedence over issues of social interest to other groups.

Efficacy is defined as the capacity to achieve results. Relevant is an old principle from the theory of the just war which holds that a nation can go to war morally only when it has reasonable grounds to feel that victory can be achieved or, at a minimum, catastrophe averted. The question of effectiveness is therefore essential. Since there is virtually no major company whose activities do not touch one strand in the social web, the matter of determining what will bring effective results is less than easy.

Audits—Some accounting firms are following Arthur Andersen's example in establishing a board of externs to review annually, among other things, management's responsiveness to social responsibilities. A similar body for pension funds, with a right and duty to publicize the results of its appraisal, might be a useful method to assure trustee accountability to beneficiaries and to the public.

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[61] Buffett, Berkshire Hathaway, p. 12.

Escape Hatches—In the case of high-risk social investments, arrangements should be made for escape hatches through which pension fund managers can, in the face of emergencies, move quickly toward safe land. This is simply the prudent man rule at work—but at work under special conditions.

Conclusion

For those who like precise moral sliderules to guide action, application of ethical principles to the social investment area may prove disappointing. The chief contribution lies precisely in the ethician's insistence that pension fund managers operate in two cities—the city of economic fact and the city of moral values. To act as though each operated with its own rules or, even worse, that each is at war with the other, is to blur reality. Pension fund managers who are expected to have competence in judging what investment areas promise solid financial returns should be equally competent in determining what ethical judgment promises substantial social returns. While the relationship may be marked by tension and uncertainties, the important thing to recognize is that the relationship exists—and that social investments are not necessarily riskier than financial investing.

Since every pension fund represents a portfolio whose total assets are both economic and ethical, investments must be made to seek total returns. Total returns, so defined, involve policy making which blends the moral geometry to a financial geometry. That it is possible to perform ethically while doing well financially is a moral to be drawn from the Dreyfus Third Century Fund, a money market fund that examines a company's regard for consumer protection, its commitment to an affirmative-action philosophy as shown by the hiring record, its concern for the physical environment, and sensitivity to its neighbors needs. The result? By a substantial margin Dreyfus was ahead of the average stock performance in 1980–81.[62] Where we now stand in this blending process between the financial and moral geometries can best be answered by experts themselves: how

[62] A. H. Raskin, "Pension Power", *The Journal of the Institute for Socioeconometric Studies*, Winter 1981–82 (White Plains, N.Y.: The Institute for Socioeconometric Studies, 1982).

many trustees, how many legislators, how many regulators engaged in pension fund operations recognize their roles as moral geometers in America? If the thesis of this paper is correct, the question will become the center of critical debate during this decade—even as corporate social responsibilities and corporate governance were the lively issues of the last two decades.