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3-7-2014

Which Side is Your Pension On?

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[Which Side Is Your Pension On?]

The failure of unions to gain control over their pension funds gives insight into corporate-controlled finance and the obstacles to democratizing it.

By Michael A. McCarthy

3.7.14

In the wake of the financial crisis, pundits left of the center argue for the need to restructure finance. Ideas like a return to Glass-Steagall or a new New Deal have been floated — welcome changes, to be sure. However, these policy proposals leave a deeper question unresolved: how did Wall Street elites end up gaining control of finance in the first place? How did they channel large pools of finance into a narrow range of obscure financial investments without Americans knowing it? How did our financial system become so undemocratic?

The standard narrative points to deregulation under the Clinton Administration in 1999. But at best, this can only be what social scientists like to call a “proximate cause.” There was a time in the postwar period when average Americans made a real effort to control finance through institutions of collective bargaining. The exact way in which they failed reveals a fifty year war in America waged by the elite against financial democracy.

Pension Fund Finance

To offer some insight into the state of finance in America, we need to venture into the arcane world of union pension fund investment. Pension funds are ground zero for financial democracy for three related reasons. First, workers’ retirement funds have accumulated a huge financial fortune since their widespread emergence in the 1950s. They went from small holdings during the war to currently totaling over $10 trillion in assets.

While collectively-bargained union pension funds comprised the large majority of these assets in the few decades following World War II, they are now the minority. Much of current fund assets derive from non-union 401(k)-type retirement plans. However, the union funds aren’t small potatoes. Today they control over $1.7 trillion in assets — about one-tenth of total US GDP.

Next, pension funds have become a critical source of finance capital for American firms. After the war, these funds were initially investing in the less risky corporate and government bond markets. In 1950, almost 30 percent of pension assets were invested in government securities while about 42 percent were invested in corporate bonds. That rapidly changed. Within a few decades, bond market investments were dwarfed, while equity market investments, previously quite marginal, were increasingly favored by fiduciaries. By 1972, nearly 74 percent of all pension fund investments were directed into corporate stocks. The move, which tied retirement income to the market, entailed a real shift toward risk for workers.

As these pension investments into the stock market grew in the two decades after World War II, the funds came to control a greater share on total US corporate equity. By the 1970s, pension funds

controlled almost 25 percent of all US stocks, far more than workers' funds anywhere else in the world in both relative and absolute terms. The scale of these holdings alone has led some to characterize Anglo-capitalism as "pension fund capitalism."

Finally, despite having some property rights over these funds, workers and the unions that represent them have had a difficult time controlling them. Instead, professional fiduciaries, employed by banks, hedge funds, and other financial institutions and under the direction of employer-dominated trustee boards, have followed investment trends in financial markets and chased risk for returns. In fact, union funds themselves were heavily invested in subprime mortgages in the lead up to the financial collapse — just like the corporate pools of finance in hedge funds and banks where workers have no real legal claims.

But unions have not been simply duped by the rhetoric of investment returns and portfolio diversification (modern portfolio theory, as it called). American labor has made real attempts to control pension funds for pro-worker ends — and were beaten back.

The failure of unions to gain control over their pension funds provides some insight into the nature of corporate-controlled finance and the obstacles to democratizing it. The corporate control of finance is not simply due to the weakness of regulations on the system. Instead, active state intervention since World War II has pushed labor's finance into the hands of corporate fiduciaries. For some level of financial democracy to be possible in pension funds — the best place to spark a movement for financial democracy — political barriers need to be removed.

The Corporate Control of Labor's Finance

Labor and capital were at loggerheads over pensions in the few years after World War II. Because of price and wage controls during the war, many firms had given pension benefits to workers as a substitute for wage increases. But the workers that primarily benefitted from the boom for wartime goods were in salaried positions, and tended to be better-paid workers or managers. The average wage worker was still largely excluded from pension benefits by the war's end.

This was turned around in the years following the victory of the Allied Forces. With the assistance of Northern Democrats and the Truman administration, unions were able to win collectively bargained pension plans. First mining, then auto, then steel — like falling dominoes, industries were compelled by political pressure and workers' organizations to adopt pension plans during bargaining negotiations. Pensions then spread to the non-union sectors as well, as firms had to compete for the labor supply.

It started in 1946 when John L. Lewis and the United Mine Workers put capital and the Right into a panic. The mine workers won a pension and welfare fund financed by contributions of the coal industry on a pay-as-you-go basis and financed according to output (10 cents a ton) rather than hours worked, so that it would grow with the mechanization of the industry that was underway. In addition, they won full control over the fund's investment decisions – in essence, turning the fund into a pool of labor controlled finance. The potential for a modicum of workers' control over the financial system was born.

This spurred Southern Democrats and Republicans into political action. In Congressional testimony on the anti-labor Case Bill in the same year, Senator Harry F. Byrd, a Democrat from Virginia, stated, “I am endeavoring to strike against the attempt of representatives of labor to use such payments in establishing funds over which no one but the labor representative would have any control. I assert that if such a condition were allowed to take place, labor unions would become so powerful that no organized government would be able to deal with them.” The idea that workers could collectively control their own pension investments sent shivers down their spines.

Truman successfully vetoed the Case Bill. But the Republicans won both houses of Congress between 1947 and 1949, the first time they had done so since 1931. And the conservative coalition they formed with Southern Democrats provided the Congressional power necessary for a full frontal attack on the gains labor had made since the 1930s. This culminated most spectacularly in the passage of the Taft-Hartley Act in 1947.

Taft-Hartley is the cardinal anti-union bill in America’s twentieth century. It helped create right-to-work states, made secondary boycotts illegal, and was a factor in the McCarthyite red scare by making union leaders sign non-communist affidavits. Less well known, however, is that it was the first step taken by capital and the Right in a war to keep unions from controlling their own pension finance. In particular, the law makes it illegal for unions to control more than 50 percent of the trustee seats on pension boards. Pension boards manage the pension funds. Senator Robert Taft’s (R-Ohio) justification for including the provision in the bill was that “unless we impose some restrictions we shall find that the welfare fund will become merely a war chest for the particular union.”

This led to an almost immediate crackdown on union capacity to control their funds. The Reuther-led auto workers and the Murray-led steel workers were both forced to backtrack on efforts to democratize their pension finance. Not controlling the boards meant not controlling the decisions about where the finance was to be channeled.

Some unions did manage to work around the law. In unions that had multi-employer pension plans, where the union negotiated with several employers rather than one, they had more ability to influence investment decisions. The reason for this is simple enough: On boards with several different employers, with sometime distinct interests, it was easier for the union to influence the outcome of a vote.

In 1961, the US Bureau of Labor Statistics found that multi-employer funds, typically in the construction and building trades, were much more likely to make decisions jointly between union and employer trustees while employers tended to delegate investment decisions to money managers in banks and insurance companies in the single-employer pension plans.

Unsurprisingly, these multi-employer plans, which represented a small minority of plans and plan participants, were more likely to be invested in union projects, worker housing, or investments intended to create new jobs for the community.

But these experiments in people’s finance were further hampered when the Employee Retirement and Income Security Act, or ERISA, was passed in 1974. ERISA is a comprehensive law that

governs almost every aspect of private pensioning. In many respects, the act was quite progressive. It includes several provisions that are intended to make traditional pensions more secure for future retirees. Yet it would be a mistake to characterize ERISA as pro-labor, as it included rules that further advanced the war against financial democracy for businesses and the right.

There is a provision in ERISA known as the "prudent man rule" (now the "prudent person rule"). The rule dates to common law doctrine in the mid-nineteenth century and stipulates that pension investments have to be made for the exclusive benefit of plan beneficiaries. Up until the postwar period, the American state interpreted this to mean investments that were less risky, namely fixed bonds. However, this began to change after 1950. In that year, General Motors executives proposed to direct the investments of their new pension fund into equities rather than bonds and argued that they could overcome risk by diversifying their investments. In doing so, they roughly articulated the basic point of modern portfolio theory about two years before Harry Markowitz penned his Nobel Prize-winning article formalizing it.

By the 1970s, diversification and stock investment were the norm in big banks and mutual funds. Modern portfolio theory had won. ERISA turned this narrow and purely financial notion of prudence into a federal legal standard for investing workers' retirement funds. According to Ian D. Lanoff of the US Department of Labor, the agency responsible for enforcing the law, "what the pension plan fiduciary needs to determine about an investment is not, first, whether it is socially good or bad, but how the proposed investment will serve the plan's participants and beneficiaries." The definition of "serve" is limited to what will benefit the beneficiaries financially. To get big returns on an investment, you need to chase risk. And chase they did.

The law made pension managers mimic financial investment trends in the corporate sector. A 1977 study by the International Foundation of Employee Benefit Plans of more than 1,900 pension fund trustees, administrators, and advisors representing all regions of the country found that a large majority of fiduciaries, 83 percent, said that ERISA has made them less willing to invest in anything but "blue chip" securities. It also reined in the control efforts of unions with multi-employer funds.

The Teamsters provide a good example. In 1955, Jimmy Hoffa helped to build the now-notorious Central States Pension Fund. Hoffa was a brilliant and cunning negotiator, someone to be feared from across a bargaining table. From the outset, he knew from that the main issue was how many trustees were on the board and he knew how to work it in his union's favor. The employer's association, the American Trucking Association, pushed hard in negotiations for a smaller board that excluded employers that weren't affiliated with the association. Hoffa wanted a larger board that included independent employers — some of which he was on friendly terms with. This would make it easier for the union to get what it wanted come time to vote on investment decisions.

A larger and potentially divided employer side of the board could lead to greater union control. The employers refused to budge until Hoffa brazenly promised to take the whole industry out on strike if they didn't give in. Given that the transcript record from the March meeting where Hoffa made the threat was peppered with "God damnits," he was probably yelling it in their faces. That was enough to win the larger board.

This small procedural victory was enough to give the Teamsters substantial autonomy in directing the fund. With control out of the hands of capitalists or institutional investors guided by the principles of modern portfolio theory, union trustees broke from the main practices of corporate finance. Instead of investing the funds into stocks, they increasingly moved their money into trustee-selected mortgages — typically commercial real estate that used union labor for the jobs. The fund was no paradigm of prim and proper social investing, for sure. It had a lot of money sunken into shady casino deals, including the now-defunct Aladdin in Las Vegas. But the money was used for pro-worker ends.

After ERISA was passed, the government found the fund to be in violation of the "prudent man rule." It fired most of the trustees in 1976 and took over the fund a year later. As a result, the government began shifting the investments of the funds, by that point a little over $2 billion in assets, into the equities market.

The takeover sent a clear message to other unions with multi-employer funds that exerted the kind of administrative control that reflected the workers' interests, mostly in the building and construction trades — deviate from financial industry's investment practices and you will be dealt with by the heavy hand of the state.

Markets, Regulations, or Democracy

In *Which Side Are You On?*, reflecting on the corporate control of pension finance, Thomas Geoghegan writes that "[it was] the longest-running mistake in the history of labor, the unwitting, almost Gandhi-like renunciation of power. It was so stupid . . . It took a kind of genius for labor to get to its current state of weakness." In an important call to arms for unions, *The North Will Rise Again*, Jeremy Rifkin and Samuel Barber similarly wrote that, "Unions have relinquished the day-to-day control of their share of the pension fund pool to a handful of banks and insurance companies to use as they see fit, they have had to suffer the consequences of seeing their own moneys used against them by the investment community."

In this case, pointing to the strategic blunders of either unwitting or self-interested labor bureaucrats misses the point. Unions did try to control their pension funds. And not just the strong social democratic ones in the postwar period, like the auto workers. Even relatively conservative unions with craft origins, like those in the building and construction trades, made efforts to democratically direct their own pools of finance.

But labor's struggle for financial democracy was beaten back as quickly as it began. As Byrd's Congressional remarks in 1946 show, the prospect of a level of financial democracy for workers was almost too terrible for business and political elites to comprehend. And so a business-backed political movement, of an increasingly bipartisan character, passed laws that hemmed unions in more and more. This led to increasing control of corporate interests like the sponsoring employers and fiduciaries that managed the funds, such as big banks and institutional investors.

The result was less than stellar from labor's point of view. In 1979, Jacob Sheinkman of the Amalgamated Clothing and Textile Workers Union said,

> The massive sums accumulated in pension fund assets are often used against the direct economic interests of the workers in whose name the funds were created . . . The 'money managers' would say they are seeking a better business climate, but almost invariably the pension fund assets — in effect, billions of dollars of deferred wages of American workers — end up subsidizing a climate hostile to workers.

Loss of democracy meant that labor's finance would be directed into anti-labor firms that operated with poor labor conditions, in effect contributing to a race to the bottom in working standards, and were used in leveraged-buyouts to finance the stripping of firms and firing of workforces. Labor's finance became yet another weapon in capital's arsenal.

This history should cast a different light onto the current debates about finance. Simply put, the core issue isn't the question of freer markets or stiffer state regulations. A return to Glass-Steagall would be welcomed, but doing so alone leaves deeper questions about financial democracy unaddressed. At the heart of the crisis is the fact that financial flows are directed by a small financial elite cloistered in high rise buildings on Wall Street.

This needn't have been. But in the battle over union control of pension funds, business won out, and by the 2008 crash union pension funds mimicked the investment practices of mutual funds and banks, chasing risk for returns rather than using their funds strategically to benefit the working class. With retirement funds accounting for 25 percent of the stock investments in the US, to a large degree labor's capital is Wall Street's. Democratizing it is as urgent today as it was fifty years ago.