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ETI, Phone the Department of Labor: Economically Targeted Investments, IB 94-1 and the Reincarnation of Industrial Policy

Edward A. Zelinsky†

In Interpretive Bulletin 94-1 (IB 94-1), the Department of Labor defines economically targeted investments (ETIs) as investments which bear risk-adjusted, market rates of return and which also generate collateral economic benefits. IB 94-1 declares ETIs, so defined, to be consistent with the fiduciary provisions of the Employee Retirement Income Security Act of 1974 (ERISA). In his critique of IB 94-1, Professor Edward Zelinsky finds the ETI concept unsound as a matter of policy and logic and incompatible with ERISA's statutory standards governing pension trustees' investment decisions. Professor Zelinsky views IB 94-1 as resurrecting the discredited notion of industrial policy. He concludes that the DOL should withdraw IB 94-1 or that Congress should repeal it.

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I INTRODUCTION

On June 22, 1994, the Department of Labor (DOL) issued Interpretive Bulletin 94-1 (IB 94-1), the Department's much anticipated statement on the propriety of pension plans undertaking "economically targeted investments" (ETIs). Approximately two weeks earlier, the DOL had formally requested proposals for "a clearinghouse to collect and distribute information on" ETIs. The DOL portrays IB 94-1 as simply a routine declaration of existing law and the ETI clearinghouse as merely a device to facilitate communications in the pension industry.

A review of IB 94-1 and of the proposal for an ETI clearinghouse leads me to quite different conclusions. The ETI concept, as expounded by the DOL, is unsound as a matter of logic and policy and is incompatible with the statutory standards governing the investment decisions of pension fiduciaries. Moreover, the ETI concept, advertised by the DOL as a routine confirmation of existing law, reflects a more fundamental and unwise agenda: IB 94-1 and the ETI clearinghouse represent troubling steps in the reincarnation of the discredited theory of industrial policy.

The first section of this article discusses the DOL's definition of an ETI. The next section indicates how IB 94-1 makes the law of pension investments less coherent, less logical and less consonant with the relevant

1. 59 Fed. Reg. 32,606 (1994) (to be codified at 29 C.F.R. § 2509.94-1). The DOL unveiled IB 94-1 at a hearing before the Joint Economic Committee on the day before the formal issuance of IB 94-1. See John Godfrey, Prudent Pension Trustees May Use Social Goals To Pick Investments, Reich Says, 63 TAX NOTES 1745 (June 27, 1994); Patricia A. Limbacher, Funds Get ETI Go-ahead, 22 PENSIONS & INVESTMENTS No. 13, 2 (June 27, 1994). It is paradoxical that the DOL characterizes IB 94-1 as a routine declaration of existing law but elected to showcase IB 94-1 before a special congressional hearing. Not surprisingly, the testimony presented at this hearing was heavily weighted in support of IB 94-1. For the statement of an ETI opponent at this hearing, see testimony of William A. Niskanen, Lexis/fedtax/TNT/94 tnt 121-34.
2. The DOL pronouncement on ETIs applies, not merely to pension plans, but to all ERISA-regulated plans, including profit sharing, welfare and 401(k) arrangements. For ease of exposition, I use the term "pension plans" to encompass all of these arrangements.
3. Lexis/fedtax/TNT/94 tnt 115-37. In the fall of 1994, the DOL awarded the contract to implement the ETI clearinghouse. See Meegan M. Reilly, Approved Bill Permits Ex-Participants to Sue Former Fiduciaries Regarding Purchase of Annuities, 65 TAX NOTES 347, 348 (October 17, 1994). In December, 1994, the DOL submitted a public information collection request to the Office of Management and Budget (OMB), seeking permission to gather information for the clearinghouse about plans' ETIs. See U.S. Department of Labor, Pension and Welfare Benefits Administration, Request for OMB Review and Supporting Statement (December, 1994). See also Patricia B. Limbacher, ETI Information Key to Success of Project, PENSIONS & INVESTMENTS, April 17, 1995, at 25 (discussing the DOL's efforts to gather information on investment history from pension funds as the basis for the clearinghouse's database).
statutory standards. The third section of this article explores the current and potential harms stemming from IB 94-1, including its resurrection of the industrial policy program. I close by concluding that the DOL should withdraw IB 94-1 or that Congress should repeal it.\textsuperscript{4}

\section*{II}

**ETIs Defined**

IB 94-1\textsuperscript{5} defines ETIs as “investments selected for the economic benefits they create apart from their investment return to the employee benefit plan.” In its proposal for an ETI clearinghouse, the DOL lists as typical ETI collateral benefits “new jobs, affordable housing (and) infrastructure projects.” In the preamble to IB 94-1, the DOL identifies “real estate, venture capital and small business investments” as exemplars of potential ETIs.

An ETI, the DOL indicates, must generate a competitive return considering the investment’s degree of risk. If an investment yields a market rate of return, controlling for risk, pension fiduciaries may then consider the investment’s collateral economic benefits in deciding whether to make the investment. This conclusion, the DOL states, merely declares existing law under the Employee Retirement Income Security Act of 1974 (ERISA).\textsuperscript{6} Indeed, the DOL has made IB 94-1 retroactive to January 1, 1975, ERISA’s original effective date. Nothing noteworthy is occurring in IB 94-1, the DOL thus suggests; IB 94-1 simply pronounces current law \textit{ab initio}.

To buttress its contention that IB 94-1 merely codifies existing fiduciary standards for pension investments, the DOL cites a number of administrative rulings and prohibited transactions exemptions it has previously issued under ERISA.\textsuperscript{7}

While the current leadership of the DOL characterizes ETIs as optional for pension trustees,\textsuperscript{8} that leadership has signalled its strong support for

\textsuperscript{4} See Employee Benefit Plan Security and Protection Act of 1994 (introduced by Congressman James Saxton, H.R. 5135, 103rd Cong., 2nd Sess.). This legislation would have prevented pension trustees from considering collateral benefits in making their investment decisions and thus would have effectively repealed IB 94-1. See also The Pension Protection Act of 1995, H.R. 1594, which would nullify IB 94-1 and proscribe the DOL from promoting ETIs.

\textsuperscript{5} The Secretary of Labor is authorized to promulgate regulations “necessary or appropriate” to “carry out” ERISA’s fiduciary provisions. See ERISA § 3(13) (defining the “Secretary” as the Secretary of Labor); § 505 (authorizing the Secretary to promulgate regulations for Title I of ERISA which title includes ERISA’s fiduciary provisions), 29 U.S.C.A. § 1001 (West 1985).

\textsuperscript{6} Pub. L. No. 93-406, Title I, § 2, 88 Stat. 832 (codified at 29 U.S.C.A. § 1001 (West 1985)).

\textsuperscript{7} See footnotes 2 through 7, inclusive, of the preamble to IB 94-1. I discuss these administrative rulings and prohibited transactions exemptions below. See \textit{infra} notes 33 through 45 and accompanying text.

\textsuperscript{8} Godfrey, \textit{supra} note 1 (noting DOL Secretary Reich’s characterization of ETIs as optional for pension trustees).
such investments: IB 94-1 and the proposed clearinghouse constitute a forceful official imprimatur for ETIs.9

III

THE UNSOUNDNESS OF THE ETI CONCEPT

A. ETIs and Competitive Returns: An Inherent Paradox

The ETI concept is unsound as a matter of policy and logic and is incompatible with ERISA's statutory standards governing pension trustees' investment decisions.

Consider initially the DOL's definition of an ETI: an investment which carries a market rate of return, considering the associated risk, and which produces collateral economic benefits. Since ETIs yield competitive returns, adjusting for risk, the pension fiduciary may, according to the DOL, consider ETIs' supplementary advantages when making his investment choices without thereby violating ERISA's fiduciary standards.

The DOL's definition of an ETI is designed to avoid the pitfalls of earlier, cruder approaches to social investing by pension plans. Some of the initial advocates of social investing considered the attainment of market returns unimportant given the momentous causes for which they sought to use pension assets.10 In IB 94-1, the DOL disassociates itself from this more extreme approach.11

However, in doing so, the DOL creates a paradox for itself: by definition, an investment yielding a market rate of return is an investment which the market will clear without special consideration of the investment's ancillary benefits. One need not believe that markets operate perfectly, instantaneously or without cost to believe that reasonably competitive markets, over reasonable periods of time, will allocate capital to those ventures which can plausibly be expected to yield prevailing rates of return. If, as IB 94-1 indicates, ETIs generate competitive rates of return, there is no need for pension trustees or the DOL to extend particular solicitude toward those investments; they will be undertaken by someone because of normal market forces.

9. See also statement by Labor Secretary Robert B. Reich on Economically Targeted Investments by Six Pension Funds Working with the U.S. Department of Housing and Urban Development, USDL 94-381 (August 2, 1994) ("This Administration wants to encourage fund managers to consider investments such as these that help their beneficiaries and help the economy overall.") (on file with author).

10. See Targeted Pension Fund Investment: Hearing Before the Joint Economic Comm., 103d Cong., 2d Sess. (1994) (hereinafter Hearings) (testimony of Robert B. Reich, Secretary of Labor, DOL) (defining social investing as "subordinating financial return to some other social objective.").

11. Id. ("ETIs are frequently confused with what is known as 'social investing.' In current parlance, this term usually refers to investment practices that subordinate financial return to some other social objective. The Department of Labor does not condone the use of pension funds in this manner. We prohibit it. ETIs are NOT social investing.") (capitalization in the original).
Instructive in this regard is the pro-ETI testimony of Dr. William Dale Crist, president of the Board of Administration of the California Public Employees’ Retirement System (CalPERS). Since CalPERS formally embraced an ETI policy in April of 1993, the fund has, pursuant to that policy, invested substantially in excess of a billion dollars of state pension monies in California real estate (“single family housing construction, affordable housing mortgages, residential acquisition and development financing and commercial mortgages”). In addition, CalPERS has, under the aegis of its ETI policy, invested $200 million of a planned $500 million in “investment opportunities that are intended to stimulate the California economy.”

CalPERS also intends to invest resources in “private equity placements [that] offer the best long-term opportunity to deploy capital for job-creating projects on a large scale” and in funds and businesses owned “by minorities, women [and] California disabled veterans.” All of these deployments of state pension monies, Dr. Crist insists, generate competitive, risk-adjusted rates of return.

If that is so, CalPERS has accomplished nothing by its ETI program: if these investments carry market rates of return, the regular operation of the market would have resulted in these investments being made. On the other hand, if the market was shunning these investments, that suggests that CalPERS is in reality embracing noncompetitive investments under the aegis of its ETI program.

Dr. Crist’s optimistic analysis contrasts with Alicia H. Munnell’s authoritative study of state pension plans’ efforts to encourage homeownership through their investment portfolios. Much of these efforts consisted of plan purchases of mortgage-backed securities of the Government National Mortgage Association (GNMA). Such purchases were justified as increasing local supplies of mortgage capital. After careful study, Dr. Munnell concluded otherwise:

The roughly $14 billion of GNMAs purchased by state-administered pension plans has provided the pension funds with market returns. However, the ‘Catch-22’ phenomenon generally ascribed to social investing by its opponents seems applicable to this approach to supporting homeownership. Any housing investment that offers a competitive return at an appropriate level of risk, such as a GNMA, does not need special consideration from public pension plans nor will such consideration have any effect on the long-run supply of mortgage loans. On the other hand, investments by pen-

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12. Hearing, supra note 10 (testimony of Dr. William Crist, president of the Board of Administration, CalPERS) (presented at the hearing at which the DOL unveiled IB 94-1). See also Godfrey, supra note 1, at 1475.
13. Id.
14. Id.
15. Id.
sion funds that will increase the supply of housing funds must by definition either produce lower returns or involve greater risk. 17

Perhaps in anticipation of criticism along these lines, the DOL indicates that markets for ETIs are less active and less functional than the markets for other investments available to pension trustees. In particular, ETIs "may be less liquid and may not have as much readily available information on their risks and returns" 18 as other financial opportunities; ETIs may require greater than normal sophistication on the investor's part. 19 Hence, ETIs need particular solicitude.

However, the association of ETIs with inefficient markets compounds the paradox for ETI advocates. Efficient markets are necessary to ensure that returns are, as claimed, competitive. When a pension trustee invests in a poorly-functioning market, there is limited discipline and, consequently, a distinct possibility that returns are in fact below prevailing levels. If the markets in which ETIs are found are terribly flawed, pension trustees cannot be confident that such investments generate market rates of return.

There is, moreover, no reason to associate supplemental advantages with imperfect markets. No doubt, some investment markets are not as active and efficient as others; certain investments require more investor knowledge than others. But there is no reason to equate these problems with the DOL's notion of collateral economic benefits. Indeed, if there is a correlation between collateral benefits and market imperfection, that correlation is likely to be negative. ETIs, as defined by the DOL, typically have important constituencies to merchandise them—i.e. the persons expecting to receive the investments' ancillary benefits. These constituencies have strong incentives to disseminate information about the investments from which they will profit. It is more likely that an ETI will be brought to pension trustees' attention with supporting information than will an otherwise equivalent investment which lacks advocacy from a collateral benefit constituency.

17. Id. at 36.
18. See preamble to IB 94-1.
19. See also Crist, supra note 12 (If not for CalPERS, ETIs "would have gone undiscovered in this very inefficient market").

In a similar vein, Professor Hylton argues that markets are often inefficient and, when they are, "socially responsible" investing criteria may help the investors using them beat the market. For example, a corporation's good environmental record, she suggests, may be a proxy for sound (but presumably underappreciated) management. Maria O'Brien Hylton, 'Socially Responsible' Investing: Doing Good Versus Doing Well in an Inefficient Market, 42 AM. U. L. REV. 1, 36 (1992).

This is not persuasive. Assuming that markets are pervasively inefficient, there is no reason to believe that social investing standards are good surrogates for economic criteria. The most appropriate way to look for superior management is to look for it directly; managers may use exceptional environmental performance to hide their weaknesses in other areas.

See, e.g., Roberto Romano, Public Pension Fund Activism in Corporate Governance Reconsidered, 93 COLUM. L. REV. 795, 829 (1993) (suggesting that South Africa-free investing was in practice investing in small capitalization stocks at times when such stocks underperformed).
Finally, if important instances of market failure exist, the more compelling public policy is to correct that failure structurally rather than to inspire pension trustees to invest in flawed markets. Once market failure is remedied, the entire universe of investors is attracted to the market, not just pension trustees.

In light of these considerations, the ETI clearinghouse is not merely an ambiguous notion but an incoherent one. If the clearinghouse is to be a marketplace for projects not now serviced by active markets, there is no reason to limit clearinghouse participation to pension plans: all investors with capital should be invited to partake of the new markets being established. If, on the other hand, the ETI clearinghouse is envisioned as something other than a marketplace, it is less desirable than creating such a marketplace.

To summarize: when markets are functioning properly, ETIs do not need special investors interested in their collateral benefits because, as defined by the DOL, ETIs carry rates of return adequate to attract capital under normal market criteria. Absent the discipline of reasonably efficient markets, pension trustees cannot be confident that proposed ETIs carry competitive rates of return. When markets are not functioning properly, investors will not overlook systematically investments which yield ancillary benefits; those financial opportunities generating supplemental advantages are more, not less, likely to garner investment due to identification and promotion by the groups anticipating those advantages. Finally, the appropriate remedy for market failure is to correct the market.

In a curious way the earlier doctrine of social investing was more coherent than the precept of economically targeted investing. Social investing largely eschewed concern for competitive returns on pension investments. While economically targeted investing purports to accept the importance of market-rate profits, it ignores the corollaries of such profits: that market forces will generally undertake investments generating competitive returns, and that, in the absence of properly-functioning markets, pension trustees cannot know with confidence that any particular investment does in fact generate market-rate earnings.

B. Identifying Externalities

The foregoing analysis, like IB 94-1, assumes that collateral economic benefits can readily and objectively be identified, an assumption which, in many contexts, is highly questionable. The administrative letters and prohibited transactions exemptions cited by the DOL as examples of ETIs predominantly involve the building trades and yield, as auxiliary benefits, employment for construction workers. When, however, we venture beyond these simple cases, the identification of collateral benefits becomes more subjective and problematic. Indeed, beyond these easy cases, the supple-
mental advantages perceived in ETIs can just as plausibly be found in more conventional investments and many proposals advanced by ETI proponents can reasonably be characterized as generating negative externalities.

Take, for example, venture capital projects, cited by the DOL in its proposal for the ETI clearinghouse as a category of investments potentially yielding auxiliary economic benefits. There is much romance in this notion but no hard reason to conclude that new, start-up enterprises generate more positive externalities than less glamorous, more traditional deployments of pension capital. When a pension plan purchases the existing stock of an established publicly-held corporation, the seller of that stock relocates his capital somewhere else, possibly to the venture capital opportunity which was the pension plan's alternative investment choice. A strengthened price for its existing equity encourages the corporation to issue new stock for expansion with the attendant economic benefits of such expansion. A strengthened price for existing stock also increases the net worth of other holders of that stock which, in turn, encourages their consumption and investment.

Consider another case the DOL cites as an ETI exemplar: affordable housing. Assuming we can agree what affordable housing is, it is difficult to specify collateral benefits generated by such housing which cannot also be found in other, more conventional investments. Affordable housing projects can generate construction jobs, but a pension plan also creates construction jobs when it makes a conventional deposit in a savings bank which the bank then uses to make mortgages. Affordable housing developments help the persons who live in them; however, those persons also benefit when a discount retailer offers consumer goods at lower prices or when the auto industry produces better and less expensive cars.

Again, the CalPERS experience is instructive. CalPERS defines its ETIs geographically, i.e., investments within the boundaries of California. At first blush, this seems reasonable as geography is a credible basis for determining the existence of collateral benefits: externalities are plausibly found when activities are located in proximity to one another.

There are, however, negative effects to consider also: if other state pension plans emulate CalPERS and its geographic ETI policy, those states will similarly withdraw capital from other jurisdictions to invest at home;

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20. For example, Connecticut law defines affordable housing based on the income levels of the families living in the particular locality in which the housing is located, not on metropolitan-wide income levels. Thus, a project in an affluent Connecticut suburb is deemed "affordable" notwithstanding rents beyond the reach of most families in the metropolitan area as long as the project is relatively inexpensive by the standards of the prosperous suburb in which the project is located. See CONN. GEN. STAT. ANN. § 8-39a (1958). It would be particularly ironic if the DOL's encouragement of ETIs and affordable housing channels pension funds into the construction of housing too expensive for most Americans.

21. See Hearing, supra note 10 (testimony of Dr. William Crist, president of the Board of Administration, CalPERS).
some of this capital will be removed from California. The resulting balkanization of the capital markets may on balance benefit California; however, California will just as likely lose capital in such an environment. At a minimum, it is distinctly possible that California's geographical ETI policy, by encouraging other states to repatriate their pension investments too, will yield negative externalities for California, i.e., less net capital for California investments as the California economy loses pension monies from other states' plans.

Moreover, such an ETI policy threatens unjustified underdiversification for California pension plans as those plans withdraw their out-of-state capital and concentrate it locally. ETI advocates seem quite prone to perceiving positive externalities in their proposals while overlooking such proposals' negative spillovers.

In sum, if the concept of collateral benefit is broad enough to encompass all the externalities conceivably generated by traditional investments, then the ETI category loses meaning because it includes the entire universe of traditional investments. If, however, the concept of collateral benefit is to be more carefully demarcated, ETI advocates must distinguish between the benefits which ETIs yield and the benefits just as plausibly found in conventional investments. ETI advocates must also confront the negative effects of their policies. IB 94-1 does not attempt these burdens.

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22. There are cases where a prudent fiduciary might reasonably sacrifice some diversification to further other legitimate objectives of his trust. For example, in recent years, trustees of many universities and colleges located in urban centers have quite sensibly invested portions of their endowments in the neighborhoods bordering their campuses. While such investments tend to concentrate schools' portfolios in communities in which the schools already have significant assets, i.e., the campuses themselves, such investments can stabilize the adjacent neighborhoods and thus make the campuses safer and more attractive places in which to learn, teach and research. In such instances, less geographical diversification is a price plausibly paid to further the college or university's educational mission. On the growing tendency of colleges and universities in urban areas to invest in adjacent neighborhoods, see Joseph N. Boyce, Campus Movement, WALL ST. J., February 1, 1994, at A1.

Similarly, a pension trustee owning real estate might reasonably conclude that externalities justify the acquisition of an adjoining parcel to maximize the value of the pension's portfolio. This would advance the pension’s mission of providing retirement benefits even though acquiring the parcel makes the pension’s portfolio less diversified spatially.

In contrast, the geographic concentration caused by the CalPERS ETI program does not further the pension plan's basic duty, i.e., the provision of retirement benefits, but instead implements the pursuit of collateral economic benefits. In such a context, the decision to eschew diversification is much more troubling because that decision increases risk with no compensating advantage for the beneficiaries of the plan.


24. Consider, for example, the willingness of Connecticut treasurer Francisco L. Borges to overlook the nature of the product manufactured by Colt's Manufacturing Company: guns. See infra note 64, and accompanying text.
C. ETIs and ERISA

Another burden IB 94-1 avoids is the relevant statutory language. ERISA section 404(a)(1)(A)(i) requires pension fiduciaries to act "solely in the interest of the (plan’s) participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries . . . ." This provision replicates the historic "exclusive benefit" rule upon which the Internal Revenue Code ("the Code") conditions pensions' tax-qualified status; this ERISA provision also codifies the traditional requirement that fiduciaries act with undiminished loyalty towards their beneficiaries.

In several administrative rulings cited by the DOL on behalf of IB 94-1, the investments in question are construction projects and the collateral benefits at issue are jobs for plan participants. At first blush, it is a plausible interpretation of section 404(a)(1)(A)(i) that the "benefits" fiduciaries must provide include not only plan distributions but current economic benefits as well, i.e., jobs. On a second look, however, James D. Hutchinson and Charles G. Cole persuasively argue that the "benefits" to which section 404(a)(1)(A)(i) refers are retirement, disability and death payments and not pre-retirement economic advantages like employment.

However, IB 94-1 defines ETIs even more broadly than this, as encompassing supplemental economic bounties for non-employee constituencies, indeed for the economy as a whole. There is no warrant for this approach in the statute, which commands pension trustees to act solely and exclusively on behalf of participants and their beneficiaries.

There is case law under the Code version of the exclusive benefit rule which permits pension assets in practice to yield "incidental" advantages to persons other than employees and their beneficiaries. If the exclusive


26. Conventionally, the tax law's treatment of qualified plans is viewed as a tax expenditure. I disagree with this characterization, concluding that the Code's current approach to pension plans is consistent with normative tax principles. See Edward A. Zelinsky, Tax Policy v. Revenue Policy: Qualified Plans, Tax Expenditures, and the Flat, Plan Level Tax, 13 VA. TAX REV. 591 (1994). For purposes of the present discussion, it is not necessary to resolve this issue but merely to observe that the Code establishes an exclusive benefit rule for qualified plans.

27. See generally John H. Langbein and Bruce A. Wolk, Pension and Employee Benefit Law 610 (2nd ed. 1995).

28. James D. Hutchinson & Charles G. Cole, Legal Standards Governing Investment of Pension Assets for Social and Political Goals, 128 U. PENN. L. REV. 1340, 1370 (1980) ("Although the term 'benefits' is arguably broad enough to encompass all of the rewards—moral and financial, direct and indirect—that a participant might reap from an investment program, the term is used more narrowly throughout the Act to refer to those cash benefits that a participant or his family would receive in accordance with the specifications of the plan.").

29. See, e.g., Shelby U.S. Distributors, Inc. v. Commissioner, 71 T.C. 874, 885 (1979) ("the investments of a trust may result in some benefit to another person without the trust losing its exemption" under the Code's exclusive benefit rule) (emphasis added). Note that the Tax Court said that the third-
benefit rule is to be applied by focusing upon the economic impact of pension investments (rather than upon the criteria utilized by pension trustees in their decisionmaking), such an approach is a practical necessity: when a pension trustee sells or buys an asset, the other party to the exchange profits or he would not be transacting with the trustee. Unless such inevitable third party benefit is overlooked, the exclusive benefit rule would preclude pension trustees from undertaking any investments at all. Moreover, as Professors Langbein and Fischel point out in the context of defined benefit plans and the exclusive benefit rule, employers gain from their pensions’ superior investment performance since such performance reduces the employers’ funding obligations to their plans.30

It is, however, troubling to leap from the recognition that in practice pension investments unavoidably entail such incidental benefits to a wholehearted embrace of incidental economic benefits as legitimate criteria upon which pension trustees can base their investment choices. As a normative statement of the considerations pension trustees ought to contemplate in making their investment decisions, a single-minded concern for the welfare of participants and beneficiaries is both a compelling standard as a matter of policy and the standard embodied in the statute.

Historically, the great challenge of fiduciary law has been to permit beneficiaries to profit from the skill, efficiencies and expertise of fiduciaries without permitting fiduciaries to abuse their positions of trust. The agency problems31 inherent in fiduciary relationships are exacerbated in the pension context both by beneficiaries’ inability to act collectively32 and by the evidentiary difficulties of sorting out *ex post* the frequently complex financial transactions of large institutions. It was logical and appropriate for the drafters of ERISA to address these problems, *inter alia*, through fiduciary law’s traditional duty of loyalty; the mandate that fiduciaries serve exclusively the interests of their principals and not pursue (or even contemplate) extraneous objectives. This very high standard of behavior is designed to deter pension trustees from even thinking about considerations other than participants’ welfare; it also facilitates review of fiduciary decisionmaking: even minimal evidence that something other than participant welfare has

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32. This inability stems from the costs and complications of beneficiaries banding together to protect their interests. When employees are unionized, the union’s existence will sometimes solve their collective action problems for them. When, however, the union and its personnel are the difficulty rather than the solution, employees in their capacities as pension participants will often find it difficult and costly to organize themselves to protect their pension interests.
motivated trustee behavior triggers the standard's protections. The exacting
demands of the duty of loyalty thus insulate the fiduciary decisionmaking
process from forces and factors with the potential of diverting that process
from the welfare of the fiduciary's beneficiaries.

Consider in this context the comments of Olena Berg, assistant secre­
tary for the DOL's Pension and Welfare Benefits Administration and the
administrator who actually promulgated IB 94-1:

Nothing in ERISA prevents the making of [ETI] investments, provided
that they meet the law's fiduciary requirements. Existing Department of
Labor policies on economically targeted investments allow collateral ben­
etfits to be considered in making investment decisions where such invest­
ments are prudent and provide a competitive risk-adjusted return. I want to
reaffirm that it is appropriate for plan fiduciaries to make economically
targeted investments consistent with ERISA's prudence and exclusive bene­
fit rules.33

Both logically and as a statutory matter, this statement is a muddle: In
making their investment decisions, pension trustees can consider supple­
mental benefits to non-employee constituencies as long as the trustees com­
ply with the exclusive benefit rule. But, statutorily and logically, the
exclusive benefit rule is just that, a rule which proscribes trustees from con­sidering any factors other than the interests of plan participants and their
beneficiaries so as to insulate the trustees from extraneous pressures and
temptations. Rather than confronting the inconvenient language of the stat­
ute and the essential incoherence of her position, Secretary Berg contends
that she is merely reaffirming the DOL's existing construction of the
statute.

However, a review of the administrative pronouncements invoked by
the DOL on behalf of IB 94-1 belies any contention that IB 94-1 is the
codification of well-established or convincing administrative precedent.

In support of IB 94-1, the DOL summons seven exemptions34 it has
issued under the prohibited transactions provisions of the Code and ER­
ISA.35 However, citing these prohibited transactions exemptions ("PTEs")

WORLD No. 11, November, 1993, at 16.
34. See the preamble to IB 94-1, n.3. In its public information collection request to OMB, the
DOL again invoked its prohibited transactions exemptions as administrative precedent for the approval
of ETIs. See U.S. Department of Labor, supra note 3, at 1 of the supporting statement ("[T]he Depart­
ment has also granted a variety of prohibited transactions exemptions . . . involving investments which
produce collateral benefits.").
35. These statutory provisions proscribe particular types of transactions (e.g., sales and exchanges)
between plans and insiders positioned to abuse the assets of such plans (e.g., plan trustees, employers,
family members of trustees and employers). Like much of the statutory framework governing employee
plans, there are parallel versions of the prohibited transactions rules in the Code and in the labor provi­sions of ERISA. Administrative exemptions may be granted for specific transactions which would
otherwise be precluded by statute. In 1978, President Carter delegated to the DOL authority to issue
such administrative exemptions on behalf of the IRS.
on behalf of IB 94-1 is, at best, unpersuasive and, at worst, disingenuous. The DOL issued each of the seven PTEs with the explicit caveat that the Department was not approving the exempted transaction under ERISA’s fiduciary standards or under the Code’s exclusive benefit rule but was only suspending the more limited operation of the prohibited transactions provisions. For example, PTE 76-1,36 invoked by the DOL in support of IB 94-1, states that its exemption does not extend to the exclusive benefit rule of ERISA section 404 or of Code section 401(a). Each of the other PTEs cited by the DOL in the preamble to IB 94-1 contains the same or a similar qualification, indicating that the exemption pertains only to the prohibited transactions provisions and not to the other fiduciary standards governing pension trusts.37 Hence, the seven PTEs do not support the proposition that ERISA section 404 permits pension trustees to consider collateral benefits.

In support of its claim of prior administrative interpretation, the DOL also cites three official advisory opinions it has issued pursuant to ERISA Procedure 76-1,39 the Department’s formal process for declaring its views on ERISA issues. Two of these three advisory opinions, 88-16A40 and 80-33A41, pertain to the same practice, an agreement under which Chrysler and the UAW recommend to the institutional fiduciary of the Chrysler pension plans what are now being labelled ETIs. However, for two reasons, 88-16A and 80-33A provide, at most, limited support for IB 94-1 and its construction of ERISA section 404 as permitting pension trustees to consider collateral economic benefits. First, the DOL carefully noted in its analysis of the Chrysler-UAW arrangement that the DOL condoned only the process of recommending ETIs to the institutional fiduciary and that the DOL was not “expressing an opinion concerning whether specific transactions undertaken in accordance with the”42 Chrysler-UAW recommendations satisfy ERISA’s fiduciary standards. Second, in declaring that pension trustees must “ordinarily” concern themselves with the retirement income interests of par-
Participants and beneficiaries, advisory opinion 88-16A provides no reasoning or authority for thus diluting the statutory mandate that trustees consider such interests "solely" and "exclusively."

Similarly, DOL advisory opinion 85-36A, cited in support of IB 94-1, concludes, without any authority or reasoning, that participant welfare should "ordinarily" guide fiduciary investment decisionmaking, and conspicuously disregards the statutory requirement that such welfare be the sole and exclusive concern in such decisionmaking.

Finally, to support its claim that IB 94-1 reflects prior administrative interpretation of ERISA section 404, the DOL invokes a number of private letters which it has issued. However, none of these was promulgated through the DOL's formal process for interpreting ERISA, ERISA procedure 76-1.

Interestingly, the DOL ignores one relevant, albeit informal, declaration of past policy, Ian D. Lanoff's statement on social investing made when he was administrator of the DOL's Office of Pension and Welfare Benefit Programs. That statement supports the contention that the DOL has in the past permitted pension fiduciaries to consider the incidental economic benefits of proposed investments if such investments otherwise pass muster. On the other hand, a retrospective review of that statement and the context in which it was made point to a more complex conclusion, i.e., that, with the social investing movement gathering momentum, permitting pension trustees to consider otherwise acceptable investments' collateral benefits was a short-term stopgap adopted to protect for the long-run ERISA's fiduciary duties.

When Mr. Lanoff served as the DOL's chief pension administrator, it was decidedly possible that ERISA's fiduciary provisions would die stillborn, overwhelmed by the growing social investing movement: at that time, many social investing advocates were calling for the deployment of pension funds to advance various political, social and economic causes without regard for ERISA and its exclusive benefit rule; many of these causes were politically popular and morally compelling; ERISA itself was in its infancy and not widely understood; the courts had not yet created the body of case law which today reinforces ERISA's requirements of prudence.
and loyalty; an ERISA bar, conversant with those requirements and possessing an economic interest in enforcing them, had not yet developed. In this context, Mr. Lanoff quite accurately understood that the social investing movement threatened to "dilute the primary objective" of section 404 before section 404 could be institutionalized.49

Hence, the position crafted by Mr. Lanoff—incidental benefits may be considered if investments are otherwise satisfactory—while not totally congruent with ERISA’s exclusive benefit rule, was tactically astute in 1980 as an attempt to divert some of the pressure for social investing while preserving intact the core of ERISA’s fiduciary duties.

Today, however, is not then. Many of the original advocates of social investing have over the years reexamined their posture.50 ERISA’s fiduciary norms have been strongly reinforced by the courts and by the DOL’s enforcement efforts. In academic debate, the center of gravity has shifted from discussion of social investing to the fiduciary protection of pension funds.51

With the benefit of hindsight, the Lanoff position was a successful effort to buy time for the institutionalization of ERISA, an effort for which Mr. Lanoff deserves important credit. However, in 1995, we can see that that position, despite its valuable service in another time and another context, is not true to the terminology of the pension statute or its underlying logic.

In sum, the administrative precedent cited by the DOL for IB 94-1 is slender. To the extent those pronouncements do support IB 94-1, they cannot be reconciled with the language of ERISA section 404 and they contain no authority or reasoning for disregarding the statute’s requirement that participant and beneficiary interests be the sole, exclusive criteria for fiduciary decisionmaking.

D. Defending IB 94-1

Consider two final defenses of IB 94-1: first, that IB 94-1 does not primarily encourage ETIs, but principally reaffirms the duties of prudence and loyalty;52 second, that pension trustees, confronted with otherwise

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49. Lanoff, supra note 46, at 389.
50. Compare Reich, supra note 48, with Reich, supra note 11. As I emphasize below, infra note 72, I am not criticizing Secretary Reich for altering his opinions. My thinking on these issues has evolved and it is appropriate that his has also. On the other hand, the change in Secretary Reich’s views underscores the difference between the environment in which Mr. Lanoff promulgated his stance on social investing and the environment in which DOL issued IB 94-1 fourteen years later. Undoubtedly, the position adopted by Mr. Lanoff helped significantly in getting us where we are today. That position, however, has now served its purpose.
52. See, e.g., Leon E. Irish, Misunderstanding Social Investing, 64 TAX NOTES 966 (August 15, 1994).
equivalent investment choices, ought be permitted to weigh collateral eco-
nomic benefits to break the tie. Pension trustees either must use some crite-
rion to select from among commensurate alternatives or must select from
among such alternatives randomly; ETI-type benefits are as good as any
other possible tie-breaking criterion and are more seemly than random
selection.53

Neither exoneration of IB 94-1 is ultimately unconvincing. Pension
trustees' obligations of prudence and loyalty do not need administrative
confirmation; they are the core of ERISA's statutory scheme. Had IB 94-1
merely reiterated the exclusive benefit rule, it would have been a nonevent,
a redundant restatement of the statute. The DOL's subsequent advocacy of
ETIs leaves no doubt that IB 94-1 and the ETI clearinghouse are intended
to promote such investments.54

For three reasons, it is equally unpersuasive to defend IB 94-1 as a tie-
breaking device. First, using collateral benefits to select from among
equivalent investments perpetuates the illusion that ETI polices accomplish
something. If investments genuinely yield competitive, risk-adjusted re-
turns—the sine qua non of being ETIs—market forces will clear such in-
vestments without consideration of their collateral benefits. Using ETI
considerations to break ties suggests otherwise and thus misleads plan par-

Second, determining the presence of collateral benefits can be costly
for a pension plan. At a minimum, prudent plan trustees must spend their
own time to divine and quantify the externalities allegedly flowing from
particular investments. More typically, making such determinations re-
quires trustees to hire experts—economists, consultants, accountants, actu-
aries, investment bankers. There are, in contrast, no transactions costs to
flipping a coin.

Third, using ETI criteria to select from among equivalent investments
introduces into pension trustees' decisionmaking inappropriate pressures to
make such investments. If pension trustees use collateral benefits as a tie-
breaker, groups expecting to benefit from ETIs have strong incentives to
compel such trustees to declare ties. These are precisely the kinds of pres-
sures from which the exclusive benefit rule is intended to insulate pension
fiduciaries.

53. This line of thought was suggested to me by the comments of Alvin D. Lurie, Esq., who
reviewed an earlier draft of this article. See also Alvin D. Lurie, ETIs: To the Rescue or To Wreck You?,
67 TAX NOTES 132 (April 3, 1995).

54. See Reich, supra note 9. See also DOL Comments on Interpretive Bulletin Addressing ETIs,
Pension Plan Guide No. 1025 (CCH) 8 (1994) (paraphrasing Morton Klevan, DOL's Senior Director of
Policy and Legislative Analysis: "the DOL encourages ETIs as a tool for economic revitalization").
Given the essential unsoundness of the ETI concept, it is tempting to dismiss that concept as destined for irrelevance. However, for three reasons, the potential impact of IB 94-1 should not be underestimated.

First, in specific cases, IB 94-1 and its approval of ETIs will in practice alter the dynamics of fiduciary decisionmaking, inducing the deployment of pension assets away from conventional investments and toward ETIs. Constituencies expecting to gain from particular ETIs’ collateral benefits will be emboldened by the DOL’s formal support for their interests while trustees who previously resisted such investments find their positions correspondingly weakened. Thus, in particular cases, IB 94-1 will accomplish its intended mission, i.e., to shift patterns of fiduciary investment towards ETIs.

Most susceptible to pressure from ETI advocates are public and multi-employer plans. Government pension plans are ultimately directed, in whole or in part, by elected officials who select the trustees for such plans or who serve as such trustees themselves. It requires little imagination to postulate situations in which elected officials will deploy public pension funds to satisfy ETI constituencies or will encourage their appointees to use pension resources to accommodate such constituencies. Officials inclined to resist the pressures of ETI proponents now find their opposition undercut by IB 94-1 and the DOL’s approval of such investments.

The dynamics of multi-employer plans are similar. Union trustees face potential ETI demands from their members and from colleagues in the labor movement. IB 94-1 has removed the trump card of those multi-employer trustees tending to oppose such demands, i.e., the argument that ERISA’s

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55. Technically, government plans are not subject to ERISA’s fiduciary provisions and thus are not governed by IB 94-1. See ERISA § 4(b)(1). In practice, however, IB 94-1 will have significant influence on government pension plans. Most public plans are subject, by statute or case law, to local versions of the duty of loyalty; given the common origins and purposes of ERISA’s exclusive benefit rule and the local law duty of loyalty, as well as the DOL’s role as the nation’s prime administrative interpreter of pension fiduciary law, IB 94-1 will influence the state law understanding of the duty of loyalty.

More generally, IB 94-1 creates an atmosphere in which the nation’s leading guardian of retirement funds approves pension plans’ pursuit of collateral benefits. Such an atmosphere will embolden the constituencies seeking such benefits and demoralize those resisting ETIs.

See Debate Over Social Investment Policy Continues During Foundation Conference, 12 PEN. & BEN. RPRTR. (BNA) 1453 (Oct. 21, 1985) (citing remarks of Attorney Robert Klausner on the influence of federal pension law on states).

56. For background on multi-employer plans, see LANGBEIN AND WOLK, supra note 27, at 57-61.

57. For a comprehensive discussion of the pressures on public pension plans and their trustees, see Roberta Romano, supra note 19, at 795.
exclusive benefit rule and the DOL forbid consideration of collateral benefits.\textsuperscript{58}

In the past, public and multi-employer plans have, as this analysis suggests, demonstrated the most pronounced proclivities toward ETIs because of their greater vulnerability to ETI constituencies;\textsuperscript{59} IB 94-1 is likely to strengthen those proclivities in the future.

In contrast, private, single employer pension plans have, until now, shown little interest in ETIs. IB 94-1, however, will increase the ETI pressures on such plans. Consider, for example, a corporation seeking government approval or assistance (e.g., a zoning exemption, tax-exempt financing). IB 94-1 emboldens public officials to condition their consent upon the corporation's pension plan undertaking an ETI (e.g., an in-state investment sought by elected officials). In a similar fashion, IB 94-1 encourages corporations with serious public relations problems (e.g., tobacco companies) to deploy pension assets so as to portray themselves as responsible corporate citizens.\textsuperscript{60} If, in practice, ETIs carry competitive rates of return, the likely increase in ETI activity will be a charade which suggests to plan participants, shareholders, voters—indeed, virtually everyone with an interest in pension plans—that something is being accomplished when, in reality, market forces would have caused these investments to be made anyway.

However, it is likely that many, if not most, investments labelled as ETIs will in fact generate below-market returns. The proponents of IB 94-1 have already told us that ETIs are often found in poorly functioning markets; this strongly suggests that proposed ETIs will be declared economically competitive when there is no functioning market to test that declaration. Historical experience with ETIs further counsels that, once the door is opened to consideration of collateral benefits, such concerns crowd out basic financial criteria.

Consider, for example, the investment of the Connecticut state pension fund in Colt's Manufacturing Company, a large gun manufacturer and a major employer in the Hartford area.\textsuperscript{61} When in 1990 Colt's fell on hard

\textsuperscript{58} The management trustees of multi-employer plans might be expected to oppose ETIs since investment losses can impact on employers. However, these trustees frequently face collective action problems hampering their effectiveness. The typical multi-employer plan involves many small businesses; a management trustee often limits his time and energy on the plan's affairs since only a small portion of his effort redounds to the advantage of his particular firm. Now that the DOL has placed its imprimatur on ETIs, even less attention to and resistance against such investments can be expected from these employer trustees.

\textsuperscript{59} See generally Romano, supra note 19.

\textsuperscript{60} If the DOL challenges these sorts of investments under the prohibited transactions rules as, e.g., "transfer(s) . . . for the benefit of" employers, the employers have a compelling retort: that their plans are deploying pension capital in the pursuit of collateral benefits per IB 94-1. For background on the prohibited transactions rules, see supra note 35.

\textsuperscript{61} For background on the Colt's saga, see Kirk Johnson, Crying Betrayal in Hartford, Colt Faces Uncertain Future, N.Y. TIMES, June 12, 1993, at A1; John T. McQuiston, Colt Unit Sold, Connecticut
times, Connecticut treasurer Francisco L. Borges spearheaded a twenty-five million dollar investment by the state pension fund in Colt’s. Four years later, Colt’s was again in bankruptcy with most of the fund’s money lost.

Connecticut’s experience demonstrates shows in a nutshell the dangers of economically targeted investing. While Borges claimed that the Colt’s venture was financially sound and that job preservation was a secondary concern, it is hard to take that argument seriously. The more compelling characterization is that Connecticut state pension monies were used for an election year bail out of a failing firm and that basic economic criteria were discounted, if not ignored. Connecticut’s ETI experience is by no means atypical.

Of course, investments selected without regard to collateral benefits can also go bad. Indeed, when pension plans maintain well-diversified portfolios, very lucrative investments are typically offset by losing ones. However, ETI policies compound pensions’ risk of loss by subjecting trustees to pressures to subordinate financial concerns for the pursuit of collateral benefits which, in a case like Colt’s, cease to be collateral but in reality become the raison d’etre of the investment.

The losses engendered by disregard of the exclusive benefit rule impact most directly on participants in defined contribution plans. Poor investment results diminish participants’ accounts in such plans in comparison with the size such accounts would have achieved with better financial performance; losses actually reduce participants’ defined contribu-


62. Connecticut elects its state treasurer; Mr. Borges successfully ran for re-election in 1990.

63. The Connecticut pension fund invested $25 million in Colt’s in 1990; in 1994, the fund recovered $4.3 million in bankruptcy.

While these numbers are dismal, they actually understate the loss sustained by Connecticut: the Connecticut Development Authority contributed $10 million to Colt’s 1994 reorganization. Thus, in an important sense, the $4.3 million recovered by the pension fund merely came from Connecticut’s taxpayers through another state agency. See Colt’s has reason to celebrate, NEW HAVEN REGISTER, October 4, 1994, at D2.

64. Moreover, Borges and the other advocates of the Colt’s investment never satisfactorily confronted the negative externality of that investment: Colt’s makes and sells guns, a commodity of which many Connecticut cities already have a surplus.

There is evidence that Borges, the chief advocate of Connecticut’s ETI in Colt’s, did more than overlook the nature of the products produced by Colt’s. See Johnson, supra note 61 (“Having invested $25 million in Colt’s on a pledge by the former State Treasurer, Francisco L. Borges, that Colt’s did not make assault weapons, the legislature has now concluded that that is exactly what the company does.”).

Indeed, it appears that the Colt’s investment is not the only unsuccessful ETI stemming from Mr. Borges’ stewardship of the Connecticut state pension funds. See Larry Williams, Building Value Declines; Goodwin Square Has Appraisal, HARTFORD COURANT, April 6, 1995, at A3.

tion accounts and thus their retirement benefits. Hence, in this context, the incidence of below-market ETIs falls straightforwardly upon participants and beneficiaries who receive smaller plan distributions than they otherwise would have.

The repercussions of ETI policies are more complex—but equally unfavorable—in the defined benefit setting. Since employers sponsoring defined benefit arrangements commit to specified benefits, poor investment performance initially impacts on such employers, obligated in the face of such performance to contribute extra amounts to pay for the benefits the employers have promised.

Nevertheless, in the defined benefit environment, participants do not necessarily escape the effects of inferior investments: employers sponsoring poorly-funded defined benefit plans are less likely and less able to agree to benefit increases than are employers whose plans are well-funded. When employers with fiscally sound plans augment benefits, individuals whose employers maintain inadequately financed plans either must migrate to other employers with fiscally secure plans or must accept less deferred compensation than their counterparts working in these other firms. This choice will be particularly costly for individuals with firm-specific skills and entitlements, forced to abandon these skills and entitlements to obtain prevailing levels of deferred compensation.\(^{66}\)

In particularly dire cases, financially weak employers sponsoring underfunded defined benefit plans default on the benefits they have promised. In some such cases, employees receive redress from the employer’s assets in bankruptcy or from the Pension Benefit Guaranty Corporation (PBGC), the government-sponsored insurance program for basic pension benefits. However, if the employer is not subject to PBGC coverage or if an employee’s accrued benefits exceed the minimum level guaranteed by the PBGC, underfunding combined with employer default results in the employee losing some or all of the pension benefit he had earned.

Even if employers fully absorb the impact of below-market ETI investments, the implications of such investments are troubling. In the case of publicly-sponsored plans, poor investment performance is a form of hidden taxation: Connecticut’s taxpayers must replenish the state’s pension fund for the cost of the Colt’s fiasco. In the case of private plans, noncompetitive ETI projects diminish shareholder welfare when such projects compel the employer to compensate the defined benefit plan for its poor financial performance.

A second reason for taking IB 94-1 seriously is that, in the long run, we can anticipate ETI proponents to press for mandatory ETI requirements.

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To date, the current leadership of the DOL has characterized ETIs as optional for pension trustees. However, the underlying logic of IB 94-1 points in a different direction: if ETIs produce significant collateral benefits while traditional investments do not, it is socially inefficient for pensions to make traditional investments when ETIs earn the same risk-adjusted rate of return while also generating positive externalities. Thus, IB 94-1 is probably not the final position of ETI advocates but rather an initial foothold on the path to mandatory ETIs.

Finally, perhaps the most significant aspect of IB 94-1 is that it reincarnates the doctrine of industrial policy and thus reflects the appeal of that discredited doctrine to those interested in off-budget activism. During the early 1980s, several influential commentators advanced the notion of industrial policy as an antidote to the economic strategies of the Reagan administration. Chief among the advocates of industrial policy was the current Secretary of Labor and ETI proponent, Robert Reich.

The most distinctive premise of the industrial policy program was that government should "guide and accelerate market forces." Thus, Secretary Reich stated, "the government's role in industry" should be "more open, more explicit, and more strategic." In practical terms, this vision was to be implemented through such devices as government banks, "provid[ing] low-interest long-term loans to industries that agree to restructure themselves to become more competitive." In this vision, capital is to be allocated not merely in response to market signals; rather, government is to oversee the operations of industry and the deployment of capital.

Most proponents of industrial policy, including Secretary Reich, now claim that their thinking has progressed beyond the industrial policy pro-

67. See generally supra note 8.
68. See Reich, supra note 48, at 278. See also Charles Wolf, Jr., The New Mercantilism, THE PUBLIC INTEREST No. 116, Summer, 1994 at 96, 97-98 (“fundamental premise” of industrial policy is that “government should select certain industries, technologies, and firms whose advancement is of ‘critical’ importance for the economy as a whole, and accord the selected ones some form of preferential treatment—whether through subsidies, tax advantages, import restrictions, special efforts to promote exports, or direct government financing for ‘precommercial development’ of putatively critical technologies.”). In this vision, government should encourage those industries generating “spillover benefits [‘externalities’] that are presumed to accrue to other industries or to the economy as a whole.”).
69. Id. at 14.
70. Id. at 243.
71. This, Secretary Reich assured us, did not imply “national planning, in which bureaucrats—ignorant of or indifferent to market forces—shift capital from industry to industry to nurture their favorite ‘winners.’” Instead, the call was for “well-designed adjustment policies—through which government seeks to promote market forces rather than to supplement them . . . .” Id. at 234 (emphasis in original).
72. In making these observations, I do not intend to criticize Secretary Reich for altering his views over time. My own thoughts in this area have changed over the years, and I hope this is viewed as manifesting further reflection and experience.

On the other hand, the continuities between IB 94-1 and Secretary Reich’s earlier views on industrial policy are striking.
gram. However, the similarities between that program and IB 94-1 are too great to be accidental. IB 94-1 represents the second life of industrial policy, conceived this time as a privatized enterprise: pension trustees are to fill the role previously assigned to government, guiding the society’s allocation of capital with an acumen surpassing the wisdom of the market.

Industrial policy conducted by pension fiduciaries will suffer from many of the same deficiencies as industrial policy implemented directly by the government: There is no reason to believe pension trustees searching for collateral benefits can allocate capital more wisely, efficiently or farsightedly than can markets and traditional market criteria. Mixing the already complex mission of the pension system—providing retirement benefits to employees—with the task of overseeing the market’s allocation of capital will lead to a confusion of roles and, consequently, poor performance of both assignments. The constituencies most likely to promote ETIs are those groups losing in the competition of the market; ETIs will thus be used to bail out failing industries and to satisfy constituencies promoting below-market investments.

Particularly troubling are the possibilities of a mandatory ETI regime. It is only a short step from the federal government requiring that plans make ETIs to the federal government specifying which ETIs plans must make. Thus, the privatized version of industrial policy embodied in IB 94-1 could prove an initial step towards a more robust rendition in which the federal government, via control of the portfolios of pension plans, dominates the allocation of society’s capital.

Ultimately, IB 94-1, and its resurrection of industrial policy, is a manifestation of off-budget activism in an era when many policy makers perceive political and economic constraints as precluding more direct and open forms of governmental activity. IB 94-1 is thus part of a more general proclivity to eschew explicit taxation and expenditures in favor of implicit forms of taxation and spending. Hence, IB 94-1 is, in the last analysis, not simply a problem of the pension community, but of all concerned that public policy be implemented with maximum directness and accountability.

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73. If the ETI concept as articulated in IB 94-1 were fundamentally sound, it might be worthwhile to incur the risk that this scenario will come to pass. However, given the incoherence of IB 94-1, there is no reason to hazard this possibility.

V
CONCLUSION

While the DOL portrays IB 94-1 and its codification of the ETI concept as a routine confirmation of existing law, IB 94-1 is in fact an important and unfortunate development. IB 94-1 is illogical, unsound and inconsistent with the provisions of ERISA governing pension trustees' investment decisions. In its first incarnation, industrial policy came to be repudiated by even its originators; industrial policy does not deserve a second life in the form of the ETI. The DOL should withdraw IB 94-1 or Congress should repeal it.