

The *Ambachtsheer* Letter

Research and Commentary on Pension Governance, Finance and Investments

Letter #172

April 2000

PUBLIC PENSION FUND POWER: FOR GOOD....OR FOR EVIL?

“....I do not believe it is politically feasible to protect huge public sector pension funds from governmental direction.....The result will be lower capital efficiency, productivity growth, and standards of living.....”

The “Good or Evil?” Question Revisited

The quote above comes from Mr. Greenspan’s testimony to Congress last year on the Administration’s proposal to invest a component of the Social Security Trust Fund in equities. As a response to that testimony, we were asked by a number of U.S. public sector pension funds to conduct a study into Mr. Greenspan’s assertion. That study (“Do Public Pension Funds Underperform Corporate Pension Funds?” with Halim and Scheibelhut, February 1999, see www.kpa-advisory.com) concluded that a sample of 34 U.S. public sector funds marginally outperformed a sample of 51 U.S. corporate funds on a cost- and risk-adjusted basis over the 1994-1997 four year period.

Last year’s rebuttal of Mr. Greenspan’s assertions concerning public sector pension funds focused on measuring actual performance. This *Letter* addresses the “good or evil?” question from a more philosophical perspective. We also generalize it as a global, rather than a USA-only issue. In countries like Canada and the Netherlands, local public sector pension funds could today already buy effective control of their entire domestic corporate sectors, if they were so inclined. Not sur-

prisingly, these countries too have their “public funds are evil” Cassandras. As long as the increased funding of social security and public sector pension liabilities continues to be on national agendas, the issue will continue to be debated in all the developed economies.

This *Letter* concludes that the quantitative findings reported in the U.S. funds study last year should not be surprising. Powerful public sector pension funds can be important sources of societal ‘good’ rather than evil. Here, we set out the necessary conditions to achieve this outcome, and what must be done to put those necessary conditions in place. We start with some basic economic principles and see where they take us.