Investment- und Pensionsfonds (R. Guttmann)

1) Die Entwicklung und Struktur der Investment- und Pensionsfonds in den USA und ihre Bedeutung für das amerikanische Finanzsystem?

Mutual funds (MFs) and pension funds (PFs), which together with insurance companies are commonly referred to as "institutional investors," have during the last couple of decades become the dominant financial institutions in the United States. MFs have currently $6755 billion in total assets while the total asset position of American PFs now exceeds $7 trillion, compared to $5770 billion for US bank assets. In other words, each of these two institutions now exceeds the banking system in size.

In contrast to banks, both MFs and PFs have a relatively stable and long-term liability structure which facilitates investment of funds in long-term assets such as stocks and bonds. Both institutions have thus emerged as key suppliers of funds to the nation's capital markets. With MFs and PFs gradually replacing banks as the primary channels of household savings, we have also witnessed a transformation of the American credit system from loans to securities as the principal form of credit.

This *securitization* of credit has had many far-reaching consequences. I will mention here only three of these:

• The growing importance of securities as a conduit for credit has also spurred tremendous growth of those financial institutions which specialize in organizing securities markets as brokers, dealers, and underwriters of securities - the so-called investment banks. Commercial banks are therefore threatened not only by MFs and PFs, but also by investment banks. As they try to join the securitization trend in order to forestall their decline, commercial banks are driven to invading the turf of all three

competitors. They offer their own mutual funds, manage pension funds, and buy investment banks. This reorganization of the banking system has made the postwar regime of banking regulations obsolete, forced major changes in regulatory structures (e.g. Second Banking Directive of the European Commission in 1989, America's Financial Services Modernization Act of 1999), and created a propitious environment for the creation of "universal" banks or "financial supermarkets" which constitute a major leap towards greater concentration and centralization of financial capital.

• The securitization of credit has also greatly complicated the conduct of monetary policy. For one, traditional monetary policy tools were all set up to focus on the traditional credit circuit (bank deposits -> bank loans) as engine for money creation. These tools are relatively less effective when much of the liquidity creation in the economy is mediated via non-bank institutions and directed towards the financial markets (rather than injected directly into the economy via banks). For that reason central banks all over the world are increasingly obliged to abandon money-supply targeting and instead focus on interest rates and the yield curve (i.e. the structure between short-term and long-term interest rates) as primary policy objectives. This policy shift may be welcome, since it undermines the dominant orthodoxy of Monetarism. But if the shift in monetary policy fails, central banks will have to consider new alternatives - perhaps even selective credit controls to combat bubble-like liquidity creation in securities markets. In this context it is worth noting that with credit securitization capital gains, rather than interest or dividends, have become the primary form of financial income for lenders. Capital gains are intrinsically more attractive than interest and dividend (apart from their lower taxation in the United States), because they appear much less limited. They are not a deduction from profit as are the other two forms of financial income, but instead the product of collective market anticipations of future income and as such subject to a social-psychological pattern of excessive euphoria and sudden panics. A whole nation can be gripped like fever by the race for capital gains, while the economy becomes subject to the dangers of speculative excess. If large capital gains can be sustained for several years, as happened in the United States during the late 1990s, there is a considerable wealth effect (as people spend their capital gains,

even if those are only on paper, and borrow more against their higher-valued assets). This has been the major concern of the Fed since 1998. Yet the wealth effect works also the other way round, threatening to pull down the economy too much if and when the stock market collapses. This scenario presents the Fed with its third monetary-policy complication in the wake of credit securitization, that of crisis management. A central banks has to be an effective lender of last resort to contain financial instability. But all its lender-of-last-resort mechanisms (e.g. deposit insurance, discount loans, open-market purchases) are geared towards banks. These mechanisms will have to be extended towards non-bank institutions as has already begun to happen in the United States with the Fed offering discount loans to non-bank institutions in trouble and organizing the bailouts of non-banks (e.g. stock-market "specialists" in 1987; the hedge fund Long-Term Capital Management in 1998). The role of the ECB is in this regard entirely untested. Suffice it to say that such extensions of crisis management better work fast when they do become necessary, since financial instability mediated by securities markets is of an entirely different caliber than traditional bank-mediated financial crises. Just look at the difference - in terms of speed, amounts of money involved, and contagion capacity across markets and regions - between the Mexican peso crises of 1982 and 1994/5 or the difference between the global LDC debt crisis 1982-1987 and the global emerging-market crisis of 1997-1999. Securities markets offer lenders an exit option which commercial bankers do not have.

• Companies have found that, compared to bank loans, securities markets (e.g. stocks, bonds) give them easier and faster access to more and cheaper funds. Given that advantage, they have been willing to supply the increased amount of publicly available information which the regulators of the various securities markets (above all the Securities Exchange Commission) impose on those issuing securities. They find the impersonal markets easier to handle than intrusive bank loan officers, a preference which we have seen take root even in countries, such as Japan and Germany, where traditionally close bank-industry ties are now coming unglued. But this is in a way a Faustian deal. Once dependent on fickle securities markets for funding and constantly subject to explicit market evaluation (as reflected in stock prices and bond ratings),

companies are under tremendous pressure to maximize investor income, in particular shareholder value in the form of continuing capital gains quarter after quarter. That priority may run counter to guarding the interests of stakeholders, such as the workforce of a company, its suppliers, local communities within which the company operates, and even its consumers, since all these groups may require expenses which run counter to the continuous maximization of shareholder value. Emphasis on keeping shareholders happy surely shortens the investment and planning horizon of corporate managers, many of whom are themselves paid in stock options which they would like to maximize for capital gains. And that same priority also creates a preference for mergers and acquisitions as a growth strategy in lieu of internal growth through new investments in productive capacity, a preference which cements the importance of securities markets while at the same time restricting long-term growth and job-creation capacities.

The last two arguments in particular, those pertaining to monetary policy and changing corporate preferences, depend to a large degree on the behavior of MFs and PFs as the key players in the securities markets. Are those institutions patient or impatient investors? How do those institutions perform in a crisis? In order to answer these questions (see point 2 below), we need first to take a closer look at the structure of these institutions.

Mutual funds are simply pools of funds to which individual investors contribute in order to enjoy the advantages of professional portfolio management (e.g. market knowledge, risk-management techniques) and diversification. The price paid for these advantages is a small management fee, ranging from 0.5% to 2% of one's fund contributions. What is remarkable in this context is that most mutual funds tend to underperform much of the time, consistently racking up results inferior to the market average as measured by the movement of broad market indices (e.g. Standard & Poor's 500). This pattern is not necessarily due to overspecialization, since the same result can be found in very broadly diversified funds. Nor is it due to overly conservative

investment strategies. On the contrary, because the mutual-fund business is very competitive (with much less customer loyalty than is the case with bank deposits) and pays its employees on the basis of quarterly results, mutual-fund managers are under tremendous pressure to trade a lot in search for better results. It is precisely this "churning" of portfolios, this constant turning over of stocks and bonds, which depresses results. Not only are there considerable transaction costs involved in large-volume, high-turnover trading, but stocks in particular tend to achieve good returns only over the longer term. When treated as short-term instruments, they become considerably more risky due to their innate price volatility. Particularly worrisome (and self-defeating) is in this context the tendency of fund managers to sell stocks when their prices are falling. It would probably be better for them to do exactly the opposite, buy more of the stocks that are becoming cheaper. But in the face of investor withdrawals from their funds and the internal command structure of mutual funds (including payment by result), fund managers are rarely in a position to do so.

Pension funds are a bit better in this regard. After all, these institutions have more stable inflows and more predictable outflows than mutual funds. Every month they get a certain percentage of the company's salary payroll in inflows and they know pretty well in advance what their benefit payments to retirees (i.e. their outflows) will be at any given moment of time. We should also add here that this type of "forced savings" is more attractive than mutual funds with regard to their respective tax treatments. Pension fund payments by companies are tax deductible (thus reducing corporate tax burdens) while outright salary payments are not. And pension fund income is not taxable for workers while it accumulates in the fund, allowing them to compound their earnings much more rapidly until retirement.

Still, the behavior of pension funds depends in the end on the type of fund. There are two types of PFs, socalled "defined benefit" funds and "defined contribution" funds. In a "defined benefit" plan, the company promises the worker a guaranteed return, usually paid out as a fixed monthly annuity following retirement until death. In this case all the

risks are with the managers of the corporation, and they have to scramble all the time to meet the promised benefit targets. Such plans tend therefore to turn over their portfolios more rapidly, to be less stable (not least also because they tend to be raided by managers as a "cash cow" the moment they become overfunded), and to contribute more greatly to market instability. "Defined contribution" plans, on the other hand, promise the worker only a guranteed monthly contribution by the company to his or her fund, but leave ultimate benefit levels open and dependent on fund (plus overall market) performance over a long period of time. Here the risk is transferred from management to workers who do not know what the ultimate benefit level will be upon retirement. These funds have less performance pressure, are therefore more stable, and incur much lower administrative costs or risks of corporate raids than the defined-benefit plans. While American unions do not like the risk transfer involved in defined-contribution plans, they have come to accept that the trend in the United States is definitely in the direction of defined-contribution plans (which are now much more common than defined-benefit plans - a reversal of the situation just ten years ago). Companies are also more willing to allow a union role in managing defined-contribution plans than defined-benefit plans, usually in the form of joint-management arrangement or allowing unions a say in choosing the pension-fund managers (typically a bank or an insurance company).

Because American workers are getting more used to carry the risks when it comes to their pensions, we have seen a revolution in terms of individual retirement accounts as an alternative to collectively managed pension plans. There is now a huge proliferation of different types of individual retirement accounts - IRAs, Roth IRAs, 401(k) accounts, Keogh accounts, et cetera. What unites them all is that these are individual accounts set up specifically for retirement, managed directly by the individual workers who usually invest a certain percentage of their monthly salary in a mutual fund for that purpose. What distinguishes all these retirement-investment vehicles are their different tax advantages granted by the government. For example, in an Individual Retirement Account (IRA) a worker can make a certain annual contribution (up to $4000 for a married couple) which he or she can deduct from his/her income taxes that year while all the income earned and automatically reinvested in the IRA is exempt from taxation

until funds are withdrawn. In a 401(k) account the worker pays in a certain amount each month, matched by his employer, and all the investment income from those contributions is tax exempt. Such an arrangement means in effect that the workers pays $1, his/her boss pays $1, and the government pays between $.39 and $.19 cents in tax breaks. Under this arrangement a worker's $1 contribution is worth $2.39 in benefits - a very attractive proposition!

These individual retirement plans have become very popular with growing numbers of Americans and allowed more and more corporations to offer them as an alternative (rather than a supplement) to corporate pension plans. Their popularity has had the additional feed-back effect of strengthening popular support for Republican proposals to semi-privatize the U.S. government's universal pension fund, Social Security, by transforming a portion of the (joint worker-employer) contributions in payroll taxes from collectively managed investments in safe government bonds (at annual returns of 2-3%) into individually managed investments in the stock market whose average return over last century has been 11% per annum.

2) In welcher Weise und unter welchen Bedingungen kann die exponierte Stellung der Investment- und Pensionsfonds eine Gefahr für die Stabilität und Funktionsfähigkeit des Finanzsystems darstellen?

Under normal circumstances both MFs and PFs contribute a great deal of liquidity to the securities markets and thus help make these markets work better. Since both types of funds engage in large-volume purchases, they make it easier for others to sell securities at acceptable prices. To the extent that both types of funds act as major suppliers of liquidity in securities markets, they in turn strengthen the economy by making more funds available for the modernization, reorganization, and expansion of a country's productive apparatus.

During market downturns both MFs and PFs may be a stabilizing factor if and when they decide to use the opportunity of price discounts to buy more securities. PFs are more likely to adopt that kind of behavior than MFs. They have a fairly stable inflow of funds even when markets perform badly. This stability of cash inflows makes it easier for PFs to adopt a longer-term perspective with regard to stock valuations.

By contrast, MFs may well find themselves under pressure to sell during market downturns. Their fund managers are usually paid based on short-term performance which encourages them to cut their losses fast. Moreover, they often face investors who panic easily and are thus inclined to get out of a declining market rather than wait out the downturn. Since MFs generally do not keep a lot of cash on hand, they are soon forced to generate the cash needed for share redemptions by selling off their assets. To the extent that MFs are net sellers when markets turn down, they exacerbate any market decline.

There are other such procyclical forces exacerbating any stock-market downturn, notably program trading with derivatives (see, for instance, the interaction between stocks and stock-index futures in the crash of '87) and, even more importantly, socalled

margin debt (i.e. loans made by brokers to their clients which are secured by the shares thus purchased on debt). When stock prices decline by 25 percent or more, many of those loans will no longer be fully secured. In this case brokers will issue margin calls asking their borrowing clients for more cash to make up the difference between the (now depressed) value of securities serving as loan collateral and the principal of that loan. If clients are not able to come up with the required cash within the same day, the brokers will sell off the shares right away - a practice which can make stock prices fall much faster. It usually takes a combination of these procyclical forces - sell-offs by mutual funds, margin calls triggering defaults on margin debt, and negative price pressure from derivatives - to turn a market decline into a crash. Even then, not every crash will derail the economy. A crash needs to be deep and sustained to trigger a negative wealth effect as a result of which the combination of sinking consumer confidence and impaired capital positions of corporations pulls the economy into a recession. In addition, stock-market crashes are only likely to paralyze the economy if and when they spill over into the banking system. This, of course, is entirely possible via a) defaulting margin debt making it impossible for brokers to honor their debts to banks, b) losses to banks from their own mutual funds, and c) the devaluation of derivatives to which banks had acted as counterparties.

While PFs are not as potentially destabilizing a force as MFs, they do affect the economy in a major way. Initially PFs tended to be passive investors in those companies whose shares they had bought. But as these institutions got larger and larger, their collective shareholdings became so large (with aggregate stakes ranging between 25 percent and 40 percent in major corporations) that any sell-off would threaten to depress share prices of their positions and thus become a self-defeating proposition. Realizing this, PFs understood that they had to take a longer-term perspective with regard to their shareholdings. That realization has gotten PFs more recently involved in *corporate governance*. Led by America's two largest funds, Calpers (the pension fund of California's public-sector employees) and TIAA-CREF (the pension fund of America's university professors), the PFs have tried to change the way corporations govern

themselves. Particular emphasis has in this regard been put on assuring the independence of directors from management, imposing time limits on long-serving directors, modalities of removing bad managers on the top, limiting excessive management pay, and creating greater transparency in managerial decision-making. The PFs have in the last couple of years tried to create a code of standards for corporate governance which they would like all major corporations to follow. And they have publicized companies, whose corporate governance they have found wanting, in order to put pressure on their managers to improve. All these efforts demonstrate the power of PFs to affect the way corporations are run. Even though much of their corporate-governance efforts aim at maximization of shareholder value, their code of standards marks an improvement over current governance practices of many corporations. If PFs can be turned into institutions prioritizing the interests of workers and other stakeholders, they could use this power and their concern for corporate governance in much more progressive fashion.

3) Wie schätzen Sie die Regulierung der Investment- und Pensionfonds in den USA ein?

Mutual funds are regulated by the Securities and Exchange Commission, one of America's more effective regulatory agencies, under the Securities Act of 1933, the Securities and Exchange Act of 1934, and above all the Investment Company Act of 1940. These laws, in particular the last one of 1940 specifically designed for mutual funds, require MFs to provide customers with full and honest disclosure, avoid corrupt practices such as sales compensation or kickback schemes, avoid conflicts of interest between fund managers and fund shareholders, and diversify their portfolio. Other than those restrictions the mutual funds can basically govern themselves.

The major regulatory framework for corporate pension funds in the United States is the Employee Retirement Income Security Act (ERISA) of 1974 which was passed among growing public outcry over questionable practices and weakening investment portfolios of PFs.

- One of the objectives of ERISA was to strengthen the fiduciary responsibilities of trustees of the fund, usually banks or insurance companies, in order to limit mismanagement of these funds.
- The law also established for that very reason relatively stringent reporting and disclosure requirements on PFs.
- Because so many companies had supplied inadequate amounts in their defined-benefit plans to meet expected benefit payments, ERISA toughened minimum funding standards and made corporations liable for such underfunding up to 30 percent of their net worth. That was one of the major reasons why defined-contribution plans have become so much more important since passage of the 1974 law.
- In order to prevent the previously widespread practice of corporations laying off workers just before retirement to get out of their benefit commitment made to those older employees, ERISA imposed socalled vesting requirements on pension funds. Vesting means giving workers a right to their retirement benefits after a certain period

of employment (ranging from 3 to 15 years), even if they are subsequently fired from the job. •Less satisfying were ERISA's rather scant provisions for portability which would allow a worker changing jobs to transfer pension-fund benefits from the old job left behind to the new job. This situation was corrected under President Clinton's successful push to make pension fund benefits more portable from job to job.

•ERISA's provisions for the investment strategies of PFs were quite vague and general. Those managing pension funds must invest those funds in the interest of the beneficiaries (and not their own), must exercise prudence in such investment, and must diversify their portfolios to reduce risk. Within those constraints pension-fund manages can exercise their own discretion in terms of investment strategy.

•Finally, ERISA contained two additional institutional innovations of great significance. One was the introduction of individually managed retirement funds, notably the tax-exempt Individual Retirement Accounts (IRAs), which ultimately became very popular among millions of Americans. •The other was the creation of the Pension Benefit Guaranty Corporation (PBGC), a government-sponsored plan termination insurance, which would insure pension benefits up to $1000 per month in case a fund defaults.

While corporate pension funds have been popular throughout in postwar America because of their tax advantages to both corporations and workers, their reputation had been tainted by a variety of abusive practices by corporations (e.g. underfunding of defined-benefit plans, firing older workers that were not vested to deprive them of their pension) and frequent conflicts of interest by banks managing the funds for corporations). ERISA has certainly helped curb these abuses and thus restored the reputation of pension funds, allowing them to grow rapidly after 1975. In addition, ERISA has played a major role spurring more defined-contribution plans rather than defined-benefit plans because of the law's heavy penalty for underfunding defined-benefit plans.

ERISA could, however, be strengthened even more. For instance, portability provisions in ERISA have been quite weak. Clinton tried to improve those and had some success in doing so, not least because better portability of pension rights improves the mobility of the American labor force - something the business community approves of. The PBGC has worked quite well, even though it may encourage its own moral hazard. Some corporations, knowing that the government will bail out workers hurt by the failure of their pension plans, may be more inclined in tough collective-bargaining situations to make unreasonable promises to workers about their future pensions. The real test of how well pension funds work amidst current regulations will only come in the next decade, after 2015, when the majority of baby-boomers will retire. Even though this demographic time bomb is bound to put a lot of stress on pension funds because of the unprecedented size of benefit payments in the wake of so many retirements, the United States seems to be in a stronger position than, say, Western Europe. The US generates more jobs (and thus also sources of cash inflows for pension funds) and is rejuvenating its workforce by allowing in more immigrants most of whom are quite young.

The mutual funds are even less regulated than pension funds, a paradox in light of the fact that MFs are far more risky than PFs. The latter enjoy a steady influx of funds while the former may be subject to sudden mass withdrawals of funds by panicky investors. Such a scenario has not materialized yet, except for brief moments of panic such as in 1987, 1994, and 1998. Any investor panic will force MFs to sell their assets into a declining market and so make them perhaps inevitably a major factor in any stock-market crash. They are in that sense the Achilles' Wheel of America's financial system, since they could collectively help precipitate a tremendous crash once the fundamentals of the U.S. economy begin to turn sour. If some of the larger MFs fail in such a scenario, it will have a truly devastating effect on investor confidence. The Fed will therefore have to find ways not to let key MFs fail (e.g. by providing emergency-loan assistance through its discount window or organizing private-sector bail-outs as it did with Long Term Capital Management in September 1998).

One other thing I find curious about MFs is that they have consistently underperformed, with most of them yielding returns on their portfolios that lag behind the market averages used as a benchmark for performance. Despite this poor performance they have grown tremendously over the last two decades. This paradox can be explained by a lack of alternatives. There were simply no better investment vehicles around for the average saver. But this situation is about to change with the rapid expansion of the Internet. This medium encourages individual investors to go it alone, providing them with easy access to information (of the kind previously accessible only to financial specialists) and online trading facilities that are quite cheap. So just as individual retirement accounts have become already a major competitive threat to corporate pension funds, so do we see now online trading become a serious alternative to mutual funds. That new competition will put more pressure on mutual funds to perform better. If they fail to do so, more and more of the 50 million American households owning stock will try to invest on their own in search for higher returns.

4) Welche Empfehlungen würden Sie hinsichtlich einer Verbesserung der Regulierung von Investment- und Pensionsfonds zum Zweck einer höheren Stabilität und besseren Funktionsfähigkeit des amerikanischen und europäischen Finanzsysteme geben?

Since mutual funds are quite vulnerable to mass withdrawals and thus can easily turn into a force driving stock prices down fast, they need to be watched carefully. The Securities Exchange Commission (SEC), America's financial-market watchdog and regulator, does a pretty good job overseeing mutual funds. But the commission has so much else to do that it is a bit stretched in its oversight of the MFs. It may be better to create a separate regulatory agency responsible for the supervision and regulation of those funds. The Fed may also play that role, especially if it is expected to act as lender of last resort in any MF crisis. Whoever regulates the mutual funds, it is important to assure extensive and timely disclosure of information about mutual fund cash flows, asset positions, cash reserves, capital, risk-management strategies, and administrative costs. Such disclosure requirements are not only protection for the consumer against fraud or negligence, but also help government identify weak spots in that sector and prepare for crisis-management eventualities.

If MFs are truly the Achilles' Wheel of the financial system, due to their ability of exacerbating market crashes through panic selling, then they will inevitably become the object of active crisis-management by the government and so deserve to be put under tighter supervision and disclosure rules. For this reason we recommend that mutual funds run by banks should be set up as separate subsidiaries, with their own capital base and their own financial statements. It may also be a useful idea for the government regulator(s) dealing with MFs to enforce a certain risk-return trade-off whereby a riskier asset structure should be compensated for by keeping on hand more cash or boosting the fund's capital base.

One of the more remarkable features of the mutual-fund industry is the success of "socially conscious" funds which invest in environmentally conscious, progressively managed, and/or community-oriented firms on behalf of their (usually left-leaning) customers. Those funds, contrary to initial expectations, have consistently performed better in terms of returns than the MF average. In the US these socially conscious funds exist because of market demand from greying baby-boomers who have now in large numbers become savvy investors while still maintaining a certain political consciousness.

With regard to pension funds, ERISA has done a good job shielding workers from the worst abuses. Any country permitting such corporate pension funds to exist will have to face the fact that such regulations of abusive corporate practices and of conflicts of interest among PF managers are necessary. Since there will be more and more defined-contribution plans where risks about the future are transferred to the workers, it will be crucial to insist in this case as well on a very high standard of information disclosure. One could even conceive of imposing regulations pertaining to the asset mix of PFs. While ERISA does not do that vis-a-vis corporate PFs , it should be noted that pension funds for state employees (e.g. CALPERS as the pension fund of California's public-sector workers) are subject to precisely such portfolio restrictions by their respective state governments without exhibiting worse returns than relatively unregulated corporate pension funds. A useful portfolio restriction would be a regulation asking PF s to set aside a certain percentage of their portfolio, something like 5 or even 10 percent, for socially useful investments (e.g. rebuilding the cities, firms specializing in environmental protection) in the form of revenue-sharing participation shares in projects or firms whose operations promise large positive externalities. Such a set-aside regulation would provide a huge financing boost for an alternative sector in the economy, an area of experimentation towards a more humane type of capitalism.

Regulation of MFs as well as PFs will have to include such seemingly arcane issues as accounting rules which can make a large difference to the strength and risk exposure of

both types of institutions. It is, for instance, a good idea to insist that balance sheets of such funds be based on historic costs (i.e. cost of assets prevailing at the time of their acquisition by fund) rather than current market values. In that case the funds would be in a much better position to survive severe stock-market downturns, since their assets would not have to be marked down to (depressed) market value. If deep enough, such mark-downs could easily threaten the solvency of funds. Another technical issue refers to the management of PFs, usually in the hands of banks or insurance companies. This management role must be kept institutionally separate from the rest of the bank or insurance company to keep conflicts of interest and in-house manipulation in check (Note that in the US pension-fund management by banks is conducted in separate trust departments). The PF must have an active board, preferably combining members of the sponsoring corporation, employee representatives (e.g. union officials, elected workforce delegates), and knowledgeable outsiders, whose job it is not least to communicate PF policy to the fund management and oversee the latter's work.

The final question about regulating pension and mutual funds is a much broader one, that of their power in changing the modus operandi of advanced capitalist economies. To the extent that both types of funds become dominant, they will accelerate the securitization of credit, with all its consequences (see above under question 1). The growth of these funds also means that they gain a great deal of potential influence over corporations as their majority shareholders. In this position power can be used to push for better corporate governance, as the work of CALPERS and TIAA-CREF has shown. But more broadly speaking, the power of mutual funds and corporate funds over corporations tends to express itself as growing emphasis by those firms on maximizing shareholder value. This shift in corporate priorities and culture may have dangerous consequences to the extent that is shortens the investment/planning horizon of corporate managers and forces corporate actions harmful to other groups affected, notably workers, consumers, suppliers, local communities, the environment. This is the great contradiction of early 21st century capitalism, the potential conflict between shareholder interests centering on short-term profit and broader stakeholder interests in

socially responsible contributions by corporations to the general well-being of society. The presence of MFs and PFs heightens this contradictions, just as the growing international diversification of these funds accelerates globalization with all its concomitant volatility and uneven development.

Yet at the same time we cannot escape the conclusion that PFs and MFs are here to stay, are likely to become as dominant eventually in Europe as they are already in the USA. Mutual funds are simply a better savings outlet than traditional bank deposits (in terms of returns, not in terms of risks). And corporate pension plans are inevitable as the necessary complement to the guaranteed government pensions which will come under tremendous stress soon with the retirement of the baby-boomer generation having to be supported by much smaller generations of younger workers. It always amazes to see the debates in the European Union about pension funds so divorced from any discussion of the implications of this demographic timebomb. If we accept the growing importance of both mutual funds and pension funds all over the world, then we have to recognize that, with these funds in our midst, broader reforms will be necessary a) to give other stakeholders enough power as a balance to the dictat of shareholder value maximization and b) to stabilize the vicissitudes of globalization. In other words, we need to embed these institutions properly within a new framework of checks and balances.