Transforming Economic Power

State and Local Approaches to Corporate Reform

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Demos is a non-partisan and non-profit public policy organization based in New York City. Dedicated to building a fairer America, Demos works to promote a strong democracy, widely shared economic opportunity, and an effective public sector. It combines research and advocacy to achieve these goals.

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About *Business Ethics*

Founded in 1987, *Business Ethics* magazine is the only U.S.-based business magazine focusing on ethics and corporate social responsibility in a media landscape otherwise dominated by traditional business publications. Published four times a year with a total distribution to approximately 10,000 readers, it has a unique position and a unique readership of thought leaders in business, investing, academia, government and civil society organizations interested in corporate social responsibility issues.

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Introduction

Potentially powerful new forces are surging today in the territory of economic reform. At work are relatively little-known yet vigorous new power centers seeking to democratize control over corporations, and hold them more accountable for the social impacts of their behaviors. Among the emerging power centers are state and local pension funds, trustees of labor's capital, state treasurers, and state and local governments. They are advancing promising new movements for a democratically controlled economy, using tools such as living wage laws, corporate subsidy reform, purchasing preference laws, shareholder activism, and corporate charter reform.

Any one of these forces or movements by itself might not be sufficient to permanently change corporate behavior. But in the confluence of many currents—in the coming together of various power centers and movements—a locally rooted force is emerging that might one day serve as a significant economic counterweight to corporate power.

Among the many efforts underway for corporate accountability, this report focuses on a particular set of initiatives. These vital and potentially transformative efforts were chosen because they share three key characteristics:

- First, they represent alternative centers of economic power, with genuine if nascent ability to significantly impact corporate behavior—like the power to pass laws, influence CEO behavior, and allocate investments. The efforts discussed here involve influence that goes beyond protest marches or requests for voluntary corporate initiatives. These forces do not deliver petitions to power. They possess power in themselves.
- Second, these efforts focus reform at fundamental levels. They aim not for minor tinkering but for systemic changes in the way we organize economic activity. In place of the traditional capital-centered, corporate-dominated economy, these initiatives help sketch the outlines of an emerging life-centered, community-controlled economy. This is an economy focused not on maximum gain to capital, but on the economic prosperity of all: a healthy income for every worker, thriving communities, and protection of public goods like clean air and clean water. While we will not step wholly into this new economy overnight, getting there begins with imagining it, articulating its principles, and believing change is possible. The community-based initiatives discussed here help advance this reform agenda.
- Third, what all these efforts have in common is that they originate at the state and local level. At this time corporate power seems out of control and genuine reform is off the agenda in Washington. Yet change is still possible close to home, as states and cities try their hand at exerting effective control over corporations.

New power centers seek to democratize control over corporations and hold them more accountable.

The new power centers discussed here meet all these tests—they represent real power, are focused on fundamental reform, and are based at the local level. In charting these emerging forces, this report aims to map a promising new route to economic reform—a route that runs not through distant, bureaucratic Washington but through our own state capitals and town halls.

NEW POWERS FLEXING THEIR MUSCLE

Consider, for example, the massive potential power of state and local pension funds, which have over $2 trillion in investments—making them among the stock market's largest investors, and thus a potentially significant alternative power center. While these funds have been traditionally conventional in their investing tactics, they are starting to awaken to new ways to use their influence. For example, pension funds led the unprecedented move to withhold votes from Disney CEO Michael Eisner—which forced him out of his role as chairman. As *Investor's Business Daily* put it, "It's hard to overestimate pension funds' strength, especially when they work together."[1]

A new route to economic reform runs not through distant, bureaucratic Washington but through our own state capitals and town halls.

A related facet of pension fund power is the growing movement among labor unions to exercise control over workers' capital. Unions themselves—after decades of attack by corporations—may have been diminished as a transformative force in their traditional role, yet they are finding new opportunities in using labor's capital, pension funds, to advance an agenda of economic democracy. The stewards of labor's capital are recognizing the irony in the fact that investor demands often lead companies to downsize, cut benefits, and send jobs overseas. Yet investors increasingly are employees themselves, since workers' retirement savings are the largest single source of investment capital. Pension funds total $7 trillion, while all stocks trading in public markets total $14 trillion.

To tap the power of pension fund capital, the AFL-CIO runs a Capital Stewardship Program, advocating "active ownership" policies by labor trustees, who hold board seats at both public pension funds and Taft-Hartley funds (which by law are managed jointly by management and labor). The aim is to help union pension trustees manage funds in ways that improve the lives of working families and promote corporate accountability, while achieving sustainable returns. The AFL-CIO Office of Investment, for example, is active in working for shareholder resolutions that urge companies to adopt global standards, rein in excessive CEO pay, or implement human rights policies. It also tracks how money managers vote on such resolutions, publishing the results in an annual "Key Votes Survey," to help trustees evaluate how labor-friendly their money managers are. Recently, a majority of shareholders have approved AFL-CIO Key Votes on golden parachutes at American Electric Power, on stock options expensing at Intel and Raytheon, and on executive pensions at Delta Air Lines. The emerging new message: Labor's capital can be an effective route to promoting corporate accountability.[2]

State treasurers are another emerging source of transformative economic power. Perhaps more than any other economic force, they are in a position to assert another key message of economic democracy: that community capital can be used in service to the community. This is the stance of California State Treasurer Phil Angelides, who since 1999 has followed a policy of "Smart Investments," directing the hundreds of billions in state investments toward vehicles that are both fiscally prudent and socially beneficial. In awarding billions in infrastructure loans, for example, California now gives priority to projects that revitalize struggling communities and support sound environmental practices. Human rights screens have been installed on overseas investments, and a new direct-investment policy supports cutting-edge environmental technology firms. Angelides' voice was among those calling for—and winning—the resignation of New York Stock Exchange Chairman Richard Grasso, after the scandal over his $140 million pay package. And Angelides led a successful Come Home to America Campaign, convincing Stanley Works to abandon its plans to re-incorporate in Bermuda, which it had planned as a way to evade taxes. If we are looking for a new model of the community-oriented capital steward, we can find it in Phil Angelides.[3]

What's particularly impressive about Angelides' approach is that the $300 billion in funds he oversees bring in stellar financial returns while they pursue social goals. With CalPERS—the California Public Employees' Retirement System, the largest public pension fund in the nation—Angelides over the years has pulled the fund out of tobacco stocks, installed human rights screens, and emphasized environmental stewardship. In 2004, according to Wilshire Associates, CalPERS earned a handsome 13.5 percent return, while the average large pension fund earned just 11.6 percent. The way Angeldies uses financial power embodies a central tenet of the emerging democratic economy: that being a good steward of investments goes hand in hand with being a good steward of the community.

State treasurers are an emerging source of transformative economic power.

Angelides is not alone in this stance. Connecticut State Treasurer Denise Nappier, for example, in late 2003 brought together state treasurers and other institutional investors representing over $1 trillion, for a Summit on Climate Risk at the UN. While Washington allows corporations to ignore the dangers of global warming, state treasures are demanding greater corporate disclosures of climate risks—because they see that the disruptions of warming could damage their investments.[4] That's another example of an emerging economic maxim: that public money must not be used to harm the public interest. Institutional investors are in a unique position to assert this truth.

Among other emerging power centers are cities and counties that are beginning to require corporations to pay higher wages—via the burgeoning living wage movement. Since 1994, when Baltimore became the first U.S. city to enact a living wage ordinance, 123 cities and counties have passed such laws. These laws typically require that when companies contract with local government, they must pay wages of $8 to $11 an hour. While living wages laws cover certain categories of workers, an additional four cities (D.C., Santa Fe, San Francisco, and Madison, Wisc.) have passed city-wide minimum wage hikes covering all workers.

Building on this success, grassroots organizations have recently shifted their focus to the state level. Thirty-one states have either set a minimum wage higher than the federal level of $5.15, or had bills introduced in 2005 that would do so. Fourteen of these have already created higher state minimum wages, and most impressively, three of them (Washington, Oregon, and Florida) have added indexing, so new campaigns need not be waged to win future increases.[5]

Do such increases lead to job losses, as critics contend? Research says no. A study of several state minimum wage increases by David Card and Alan Krueger found no measurable negative impact on employment. Similarly, a 1998 Economic Policy Institute study of the 1996-97 federal minimum wage increase found no systematic, significant job loss. Indeed, the low-wage labor market performed better after that increase than it had in decades, enjoying lower unemployment, increased family income, and decreased poverty rates.[6]

The burgeoning living wage movement is based on a simple premise: that working Americans ought to be able to feed their families. A right to a living wage is a fundamental economic right. As more states and cities feel emboldened to assert this premise, it is helping shift the collective definition of economic success. The relevant measurement is not only a rising stock market, but how many working Americans can enjoy a decent life. Economies are not just about gains to capital, but about gains to labor as well.

Democratic, community-controlled economies are also about accountability, which means no more corporate fingers in the public cookie jar, no more blank checks for corporations. That's the message behind the movement for corporate subsidy reform, through which states, counties, and cities are making corporations account for what they promise the community in exchange for subsidies. Subsidies include the low-interest loans, brownfield or other zoning waivers, and tax abatements offered to lure corporations to a region. Subsidy reformers are insisting that meaningful requirements be attached to these—and that if corporations fail to deliver, they must give the money back. Good Jobs First reports that at least 88 localities—including 25 states—have enacted subsidy reforms in the last decade.[7]

As we change the public conception of what economies are about, we are also changing our idea of what corporations are about. Traditional theory says corporations are about maximizing gains to capital and ignoring social costs. This theory is imbedded in traditional state interpretations of directors' duties, which say directors' primary goal is to create maximum profits for shareholders. But since the 1980s, more than three dozen states have enacted stakeholder laws saying directors may consider the interests of other stakeholders—like employees, the community, and the environment—in making decisions on takeovers, mergers, and acquisitions. These laws are not widely known or used, in part because they lack enforcement mechanisms. But they represent legislative intent to move beyond shareholder primacy as the animating spirit of the corporation. In short, they represent a potential Copernican revolution in corporate purpose.

State legislators hold the power to define corporate purpose.

In several states, legislation has been introduced to more fundamentally change directors' duties to explicitly create a corporate social conscience. State legislators like Sen. Richard Alarcon in California and Sen. John Marty in Minnesota are among the leaders of this new approach to corporate chartering. They recognize that because corporations are chartered at the state level—meaning, they come into existence through state law—state legislators hold the power to define corporate purpose. State legislators are beginning to explore changing corporate purpose by redefining directors' duties—asserting a new premise: that corporations may not pursue maximum profit at the expense of employees, the community, and the environment.

Minnesota and Maine legislators are planning to introduce bills that would create a new, voluntary corporate structure—a framework for the responsible corporation—that would be based on an even bolder premise: that responsible corporations have an explicit duty to serve the public interest as part of their core purpose. In the Minnesota approach—being crafted by the grassroots Citizens for Corporate Responsibility—corporations would be granted freedom from hostile takeovers, if they stepped into a voluntary framework for responsible governance (where employees directly elect a few board members, and other seats are reserved for public interest representatives).

Whether a voluntary framework will prove attractive to corporations remains to be seen. With any state-level approaches, the impact will be limited, since corporations are free to re-incorporate in a different state whenever they choose. What corporate chartering legislation does promise, should it pass, is the opportunity for intriguing state-level laboratories on fundamentally new approaches to corporate reform.

REASON FOR HOPE

The message in all the ferment is encouraging: progressive leaders are demonstrating that it is possible to exert community control over corporations in bold, effective, fiscally responsible ways. At the level of states and cities, government leaders and capital stewards have a genuine ability to influence and control corporations. As innovative leaders try their wings, flexing their power, they are showing it is possible to create power bases that rival those of corporations. The state and local levels may once have been the last place anyone thought to look for systemic economic reform, but today they should be the first place.

If necessity forces us to focus our attention at the state or city level, it may be fortuitous necessity. For as Supreme Court Justice Louis Brandeis argued in the early 1930s, "it is one of the happy accidents of the federal system that a single courageous state may, it its citizens choose, serve as a laboratory, and try novel social and economic experiments without risk to the rest of the country." What is true of states is also true of cities: both are places where new approaches can be tried and new power bases built.

As these new power centers test uncharted paths, it is vital they leverage their power in the most focused, potent ways. This report aims to be of assistance. It offers an overview of promising economic reforms underway, and makes suggestions on how these can be most effective. It looks at three primary ways economic power is being reshaped, using state and local actions that are influencing corporate behavior, tapping the power of institutional investments, and changing legal structures that govern corporations.

Influencing Corporate Behavior

RAISING INCOMES WITH LIVING WAGE LAWS

In the traditional economic worldview, the aim of the corporation is to maximize profits for shareholders and to minimize costs. That means minimizing wages, since almost two-thirds of costs are wages and other compensation. Maximum income to capital and minimum income to labor is not acceptable to most Americans—and yet Congress has not raised the minimum wage since 1997. The current federal minimum wage of $5.15 an hour is now 40 percent lower than its historical high in 1968.[8]

A decent income for all is a key goal of a democratic economy. This means paying a living wage, and today the living wage movement is one of the most advanced and widespread movements for economic democracy. By early 2005, 123 cities and counties had enacted these laws.[9]

45 percent of Americans live in a jurisdiction with a minimum wage above the federal standard.

A common approach for living wage laws is to mandate wages of $8 to $11 per hour for government employees and contractors. One example is Louisville, Kentucky's 2003 living wage law, which mandates $9 per hour for full-time metro government employees. A more cutting-edge example of including benefits as part of the standard was enacted in 2000 by the city of Santa Cruz, Calif. Its law requires all full-time city employees—as well as full-timers working on city contracts of $10,000 or more—to be paid $11 per hour with healthcare, or $12 per hour without healthcare. These high standards are today atypical, yet represent a model worth following.

Another approach can be found in Santa Monica, California, which in 2001 passed an ordinance requiring that living wages be paid by all businesses operating locally with over $5 million in annual revenue. The innovation was that the law reached beyond government contractors to all businesses—a move again worth emulating.

A still broader approach is to cover all workers in a state with a higher minimum wage. This approach was taken in 2004 with a Florida ballot initiative to raise the state minimum wage to $6.15, with indexing (meaning the wage rises with inflation). Illinois raised the minimum wage by 35 cents an hour for 2004, and an additional $1 an hour for 2005. Similarly, Vermont increased its minimum to $6.75 in 2004, rising to $7 the following year.[10] By late 2005, 45 percent of Americans lived in a jurisdiction with a minimum wage above the federal standard. While the federal government stood still, the states acted.

Another important approach—discussed below—is to combine the living wage requirement with economic development initiatives, so that when localities attract businesses, the result is good jobs rather than poverty-level jobs.

Opponents of living wage legislation often say that raising wages above market levels causes business to hire fewer workers. But research by the Economic Policy Institute and the Brennan Center for Justice at New York University School of Law suggest that higher wages often serve to increase worker health, training, and productivity, while reducing absenteeism and turnover.[11] Living wage laws work.

CREATING ACCOUNTABILITY WITH CORPORATE SUBSIDY REFORM

A second avenue for impacting corporate behavior is subsidy reform—insisting that when government subsidies are offered to corporations, they must deliver real public benefits and face public accountability. The dollars involved are enormous. In his book *Competing for Capital*, professor Kenneth Thomas estimated that in 1996 states were spending nearly $50 billion on economic development. Wal-Mart alone has received more than $1 billion in subsidies from state and local governments. And the costs per job are often mind-boggling. Many states now have deals on the books that cost more than $100,000 per job. The worst example of ineffective incentives was the $153 million that Alabama gave Daimler-Benz in 1993 for citing a new Mercedes manufacturing plant in Vance. In effect, the state spent between $150,000 to $200,000 per job, to help a European company make luxury vehicles. When the promised economic benefits failed to materialize, the state was so cash-strapped it had to raid education and pension funds simply to keep operating.[12]

When corporations receive government subsidies, they must face public accountability.

The first state to put an end to such abuses was Minnesota, which in 1995 passed its Corporate Welfare Reform Law. As Good Jobs First noted, it "mimicked federal family-welfare reform proposals by requiring, for example, that recipients set goals and meet them in two years or else repay the subsidy." The law requires that granting agencies set wage levels and job-creation goals, and report publicly on progress toward goals. It remains one of the nation's most effective laws. A 2003 report found it resulted in increases in civic engagement, more media coverage of economic development, smaller subsidy requests, and more high-wage deals.[13]

Today, less than a decade after the Minnesota law passed, accountability standards have been adopted by most states. At least 43 states—as well as 41 cities and five countries—have attached wage or healthcare requirements to subsidies. An example is Iowa's New Jobs and Income Program, which requires company coverage of 80 percent of health insurance, plus a median wage for new workers of $11 or 130 percent of the county average (whichever is higher).[14] As Good Jobs First executive director Greg LeRoy puts it, "Denying taxpayer subsidies for poverty wages is truly an idea whose time has come."

The most innovative and effective elements needed in accountability legislation are "clawbacks" and disclosure requirements. These are starting to catch on, and should be adopted more widely. Today, at least 19 states and over 100 cities use clawback clauses, which mandate that if companies fail to deliver on contractual guarantees, they must give the money back. While the traditional economic view might dismiss such requirements as "government intervention," these clauses are smart and simple business. They turn open-ended grants into two-way contracts. Such provisions might have more legitimacy if we renamed them. By calling them "clawbacks," we imply government is in a weak position, trying to "claw" money back. We might more powerfully characterize these as "freeloader penalties," to emphasize the moral responsibility companies shirk in failing to deliver on promises.

Working hand-in-hand with freeloader penalties are public disclosure requirements. At least seven states have provisions for annual reporting. As Good Jobs First notes, "If the state contracted for 100 miles of road surfacing, but the contractor paved only 50 miles, wouldn't you want to be able to find out what happened?"[15]

One approach that doesn't work, unfortunately, is to unilaterally outlaw subsidies. New York and New Jersey, for example have several times made agreements to stop luring companies away from each other, but have always broken the agreements.

Given the pressure on local authorities to compete, some experts say only third-party intervention could stop the race to the bottom. A number of scholars have called for a federal ban on all such subsidies.[16] In the meantime, accountability laws are an important step states and cities can take to make sure the public gets a fair exchange.

A coordinated approach to government purchasing would use the public purse as a lever to support the kind of economy we want.

INFLUENCING CORPORATE BEHAVIOR WITH PURCHASING PREFERENCE LAWS

Refusing to do business with offending corporations is the oldest tradition in America—dating to 1767, when Boston and Massachusetts boycotted British goods. The best example is the Boston Tea Party. Another legendary use of purchasing preference laws were the anti-apartheid laws of the 1980s, when 25 states and 164 local governments forbade buying from or investing in companies doing business in South Africa. Purchasing preference laws represent significant ways to use the public purse to influence corporate behavior. But at present, that power is diffused in small, piecemeal, uncoordinated rules. For example, in 47 states we find preference laws for recycled goods.[17] Additionally, 19 states have soy, alternative fuel, and energy-efficient preferences. Hawaii, Idaho, Illinois, Indiana, Iowa, and Kansas are among states having "buy-local" preferences for in-state companies. Louisiana gives a 10 percent preference to milk produced in-state, while Georgia gives preference to in-state forest products. Others create preferences for small or minority-owned businesses or businesses in enterprise zones. In early 2004, 33 states were trying to pass "Buy American" laws.[18]

While such laws are gestures in the right direction, the real potential is missed. The most effective idea would be a coordinated approach to purchasing that sees the public purse as a lever to support the kind of economy we want. The premise: Public money should be spent with companies that support the public good. This would be a way of taking California Treasurer Phil Angelides' "Smart Investments" policy and spreading it to other government business decisions. Every purchasing and contracting decision ought to be viewed with an eye toward the kind of companies the state is supporting.

One innovative step was contemplated in California in 2003, when senate bill 974 was introduced (but not passed,) proposing a 5 to 10 percent purchasing preference for socially responsible businesses. Rather than rewarding single behaviors, this bill envisioned a preferred class of responsible business. It is in that sense similar to the "R

Corporation" envisioned in draft federal legislation proposed in 1996 by Thomas Daschle (D-SD) and Jeff Bingaman (D-NM), who proposed granting lower tax rates and streamlined regulatory treatment to responsible corporations.[19]

States should not contract with companies that fight unions or that have repeated EPA or OSHA violations.

The California bill, as introduced by State Senator Richard Alarcon, offered a good starting definition: "Socially responsible business' means a business that has shown due respect for, and safeguards, the environment, human rights, public health and safety, the welfare of the community in which the business operates, and the dignity of its employees."[20] The bill defined eligible businesses as those meeting 10 out of 13 criteria, including paying a living wage and providing health insurance, using environmental best practices, having nondiscrimination policies, not violating the law, having a job retention program, creating safe products, contributing to the community, encouraging worker ownership or gain sharing, offering retirement benefits, practicing fair trade, and offering training and apprenticeships. While such an approach is bold, it sets the bar so high that only a few boutique firms will qualify. It asks businesses not to be good but to be near-perfect. What it does right, on the other hand, is offer a good definition of responsible business.

State purchasing ought to encourage all businesses to follow that model of responsibility. Instead of using preferences to do so, purchasing policies should create outright screens. A policy might prohibit purchasing from companies with felony convictions, for example, or companies that incorporate in tax havens. Similarly, states should not contract with companies that fight unions, or that have repeated violations with the Environmental Protection Agency, or the Occupational Safety and Health Administration.

One example of this approach was the federal government's recent decision to temporarily withhold billions in contracts from Boeing, in the wake of ethics violations. While that move was only temporary, it signals the latent potential in withholding government contracts. If governments were to regularly withhold contracts for social and ethical reasons, it would send an unmistakable message—one that companies would be likely to heed.

Tapping the Power of Institutional Investments

STATE TREASURERS LEAD THE WAY

All the money stolen by bank robbers in the U.S. between 1996 and 2000 totaled slightly over $200 million. The amount of money California state pension funds lost on WorldCom alone was more than four times that—$850 million.[21] That intriguing fact was quoted by California State Treasurer Phil Angelides in the report he issued following the Enron scandal, "The Power of the Purse: How Investors Can Restore Integrity to Our Financial Markets." In a speech at the University of California Law School in March 2003, Angelides termed the report a call to action for investors, "urging them to take the lead in ensuring that corporate reform becomes a reality." Angelides' plan—and the way he has put it into action with the $280 billion in assets his office oversees—offers a road map for the ways state and local treasurers can use their unique influence with corporations.

The report called for ethical standards—and Angelides later ruled that in selling $30 billion in bonds each year, California would deal only with ethical investment banks that avoided conflicts of interest.

Angelides called for investors to act like owners, with the right to axe an incompetent board of directors. CalPERS soon after withheld votes from directors at Hewlett-Packard, Coke, Citigroup, and Safeway.

The report called for rewarding value not greed—and Angelides later proposed barring pension investments in companies that reserved stock-based compensation for executives. He encouraged broad-based plans rewarding regular employees.

Angelides said shareholders should send the message that conduct counts—and later sponsored shareholder resolutions at Tyco, Ingersoll Rand, and McDermott asking them to repatriate to the U.S.[22]

Angelides systematically searches for every way he can use his "Smart Investments" policy to make deposits, investments, and loans with an eye to social impact. The Pooled Money Investment Account, for example, has invested more than $1.3 billion in Community Reinvestment Act (CRA) loans for low- and moderate-income Californians.[23] In 2004 California announced a Green Wave environmental investment initiative, calling for investments in new environmental technologies, an environmental audit of real estate holdings, and environmental disclosure by companies. Denise Nappier, treasurer of Connecticut, has similarly begun using her financial clout to advance the public good. One of her preferred tools is the shareholder resolution. After filing resolutions with American Electric Power for three years, she got the company to agree in 2004 to release a report on planning for constraints on CO_2 emissions. A different tool—deposits—are being used by the Illinois treasurer, via a new state policy requiring consideration of banks' CRA rating in placing deposits.[24]

State treasurers show that taking social issues into account is compatible with fiduciary duty.

The actions of treasurers like these demonstrate to other leaders that taking social issues into account is compatible with fiduciary duty. Indeed, Nappier says that since social and environmental issues have a bottom-line impact, looking at those issues is required by fiduciary duty.[25]

If individual actions by treasurers are powerful, collective actions are more so. One excellent recent example was the 2003 petition of the Environmental Fiduciary Project, calling for greater environmental disclosures by companies, signed by seven state treasurers and comptrollers—including those of Oregon, Maine, Connecticut, Vermont, and New Mexico. Other institutional investors—such as churches and foundations—are likewise getting in on the act. The New York-based Interfaith Center on Corporate Responsibility, a coalition of 275 faith-based institutional investors, has been organizing social and environmental shareholder campaigns for over 30 years. Its members control assets of over $100 billion, and in one recent proxy season filed 140 shareholder resolutions.

In the foundation world, trustees at the Nathan Cummings Foundation committed several years ago to voting proxies in ways that support the mission of promoting economic and social justice. Chief Financial and Investment Officer Caroline Williams has also started an ad-hoc group of 20 foundations to discuss proxy voting. She said many trustees are interested because they believe the SEC eventually will require foundations to disclose voting policies and votes.

What we need in the future are more treasurers using their clout, more collective actions by treasurers, and greater involvement by other institutional investors—such as foundations, endowments, religious organizations, and private pension funds. Their potential role in shifting national economic priorities is substantial.

PUBLIC PENSION FUNDS EMBRACE SOCIAL AWARENESS

Pension funds are required by law to work exclusively for the well-being of their plans' beneficiaries. Thus social issues can be considered only when compatible with healthy financial returns. Fortunately, that is the case. Pension fund managers are finding they can diversify, add value, decrease risk, and earn competitive returns while doing social good. They can, in other words, be responsible stewards of both the community and of the community's capital.

Consider, for example, the Contra Costa County Employees' Retirement Association (CCCERA) in California. While most pension funds believe fiduciary duty requires them to be cautious about applying social criteria to investments, CCERA takes the opposite view. It has seen evidence that excellent company environmental performance is a leading indicator of superior management. So it's using environmental criteria to find value other investors might miss. With $2.6 billion dollars in investment assets, CCCERA has worked with Innovest Strategic value Advisors to create a $150 million eco-enhanced S&P 500 index for its portfolio. And this "green index fund" has outperformed its benchmark.[26]

Pension fund managers are finding they can be good stewards of both the community and the community's capital.

Screening is one way to bring social issues into investing decisions. A second way is through community investing: earmarking deposits to be placed with community-oriented banks or community development financial institutions. CalPERS is having excellent returns with this approach. Over ten years, CalPERS' highest returning investment category was its mission-related Single Family Housing Program—which earned more than 20 percent annually. The portfolio also brought great social returns, with the building of 32,000 homes in 200 California communities. As CalPERS Board of Administration President William Crist has explained: "This program has shown us we can diversify and add value to our investment portfolio while supplying housing to California's real estate market and generating jobs and services for state and local economies." That's what a community-oriented economy is about: generating both social and financial returns.

A third responsible investing strategy is shareholder activism: dialoguing with companies, voting proxies, and filing shareholder resolutions to influence corporate management. Here, New York City pension funds have taken the lead. In 2003, NYC resolutions asked Exxon-Mobil to implement human rights standards, urged Federal Express to join the Global Reporting Initiative, and asked Halliburton to review operations in Iraq—among some 30 resolutions the NYC pension funds sponsored.[27]

Pensions funds can also act in concert—as Connecticut pension funds have done by taking part in Campaign ExxonMobil, a broad investor effort urging the company to take a more responsible position on global warming. The group makes a compelling case that by denying the reality of climate change, ExxonMobil is damaging its market value—much as tobacco companies damaged market value by denying the harms of cigarette smoking.

Pension funds wanting to get started in social investing should follow the recommendations offered by a new handbook — *Corporate Governance, Social Responsibility and Obligations of Ownership*. The authors are social investing professionals Joe Keefe and Steve Lydenberg, who suggest pension funds should:

- Develop comprehensive formal voting guidelines for the corporate governance, social, and environmental issues appearing on annual proxy statements. The states of California and Connecticut have pioneered the development of such guidelines.
- Vote proxies in accord with theses guidelines, and publically disclose votes. CalPERS had disclosed its proxy votes starting in 1999, and was the first public pension fund to do so.
- Engage corporate management in direct dialogue on social environmental and corporate governance issues—as is done by Connecticut and California pension funds.

- Offer "social choice" investments to pension plan participants. TIAA-CREF, one of the nation's largest retirement plans, make a "social choice" account available that applies social screens. Other defined contributions accounts can do the same. Among public pension funds already doing so are the cities of New York, Chicago, San Francisco, King County, in Washington, and the states of Alaska, California, Colorado, Illinois, Indiana, Tennessee, Vermont, Wisconsin and Massachusetts.28

Tapping the Power of Labor's Capital

As AFL-CIO Secretary-Treasurer Richard Trumka put it, "There is no more important strategy for the labor movement than harnessing our pension funds...so we can stop our money from cutting our own throats." Labor has begun to tap the power of worker pension funds by using three tactics of "active ownership": 1) directing investments toward worker-friendly funds and companies; 2) filing shareholder resolutions and dialoguing with companies; and 3) working for labor representation on company and pension fund boards.

The Heartland Labor Capital Network is a collective effort to use the capital of labor pension funds to fund worker-friendly companies, by creating funds for "economically targeted investments." An example is the Landmark Growth Capital Fund, which makes direct investments in smaller, worker-friendly companies. Executive Director Tom Crofts says such funds can do well, since employee ownership and worker participation increase productivity.

Pension fund managers are finding they can earn competitive returns while doing social good.

Canada offers a unique, progressive investment model that allows the public to invest directly in labor-friendly funds—and it should be emulated in the U.S. The Canadian Labour Sponsored Investment Funds are venture capital funds that pool individual retirement savings and invest with a focus on worker participation, employee ownership, and concern for stakeholders. The funds sometimes require companies to have employee board seats, or offer economic literacy education for employees.[29] That is a powerful model of how capital influence can be used to directly create economic democracy inside companies.

At the AFL-CIO, the Capital Stewardship Program works to educate pension fund trustees, helping them select and manage labor-friendly fund managers. In 2003 the group sponsored an Ohio meeting on using pension fund power—which is an approach that could be easily replicated. Among the tools used by the program are shareholder resolutions. In the 2002-03 proxy season, the program sponsored 400 resolutions—double the number the year prior. Unfortunately, many labor resolutions focus on conventional issues, like separating president and chairman roles, or expensing stock options, when they could focus on more fundamental changes to the rules of the game. One example of efforts to create a democratic economy was the 2003 resolution by the Service Employees International Union, asking Wal-Mart to tie executive pay to employee health insurance coverage. Also, union pension funds in 2004 asked Intel investors to base stock grants on employee performance—rather than give enormous grants only to executives. Moves like this reshape corporate incentives, in the process spreading prosperity broadly.

Another key tool of a democratic economy is employee voice in pension management. Teresa Ghilarducci, an economist at Notre Dame, argues that if worker trustees had been on the Enron board, they would have been more diligent in protecting employee interests—and might have reduced losses. Some 65 percent of pension assets in the U.S. are already managed with employee representation—most of these in state and local government plans, Ghilarducci says. To spread this further, state and local governments should systematically create worker representation—starting with 401(k) plans. Management should conduct direct worker elections of representatives (unless a collective bargaining agreement offers other mechanisms). Ghilarducci recommends workers be at least one-third of pension board members. And they should come form all worker categories—exempt, non-exempt, and clerical—in proportion to their presence in the workplace.[30]

Yet another progressive move would be to create employee representation on corporate boards, which is a goal of the AFL-CIO. Worker board reps were apart of the Sarbanes-Oxley bill, but were stripped out at the last minute. That's an example of an opportunity lost, since employee representation on boards is far more promising than the mainstream focus on "independent directors." As John Logue of the Ohio Employee Ownership Center has written, outside directors cannot be effective when "by definition they have no personal knowledge of the firm, are nominated by management or its buddies on the board, are ratified in uncontested elections, and fly into town a few times a year for high-level meetings disconnected from the life of the firm." Logue says the U.S. needs what Europe has: "a 'loyal opposition' of non-managerial employee representatives on company boards." [31] Of particular importance, suggests economist Moshe Adler, is employee representation on the audit committee of boards of directors—since they know what's going on inside companies. If employees want to report false accounting, for example, they will find employee directors approachable.[32]

Changing Corporate Structures

DEFINING CORPORATIONS WITH STATE CORPORATE CHARTERING

"R" corporations would embrace a duty to serve the public interest.

Ultimately, economic reform comes around to a key question: What are corporations for? Why does society create them? Does it do so to make investors wealthy, to serve the public good, or both? This is an old conversation in America. At the nation's founding, corporations were chartered only to serve the public good, with a life limited to the length of a socially useful project, like building a turnpike or bridge. In the mid-19th century—in the heyday of the Robber Barons—corporations were reconceived as private entities, with unlimited life and limited liability, with the sole aim of creating wealth for owners.

This 19th century conception of the corporation is still embedded in the state law of director's duties, where corporate purpose finds its legal expression. The law says directors must act in the best interests of the corporation and its shareholders—which is interpreted by courts to mean focusing on maximum profits.

But since the New Deal, the emergence of external regulatory constraints—like wage and hour laws, and clean air and water laws—have sent business the message that maximum profits must not be its only concern. Thus a disconnect now runs through the heart of business law. In internal governance, corporations are told to focus only on profits. But externally, they're told to pay a minimum wage, run a safe workplace, produce safe products, and keep air and water clean. Labor, consumer, and environmental laws have evolved to meet the demands of the 21st century. But directors' duties remain mired in the 19th century.

The profit mandate for directors finds its most insidious expression in courts' insistence that companies be sold to the highest bidder, which means benevolent (or sleepy) management can be forced out, and the most ruthless management can sue its way in. This effectively puts all public corporations on notice: squeeze out every dime of profits—sending jobs overseas, cutting benefits, evading taxes, demanding subsidies—or be taken over by someone who will. In many cases, this has happened. In the 1980s, corporate raiders used this mandate to launch a hostile takeover wave—which led to downsizing, factory closings, and other social mischief. To stop this forced march of social destruction, stakeholder laws were passed by 32 states—including Massachusetts, Minnesota, New Jersey, New York, and Oregon. They laws say directors can consider the interests of other stakeholders—like employees, the community, and the environment—in making takeover or merger decisions.[33]

Such laws have been upheld in several cases—most notably, when Conrail directors in 1997 sold to CSX, rather than accept a significantly higher bid from Norfolk Southern, because the other deal was better for shippers and employees. In his ruling, the judge said that focusing on maximum value for shareholders was "myopic."[34]

Though valid, the laws are little used. Critics warn they represent "a revolutionary break in corporate law." But the revolution has not been seen, because the laws are incomplete. They aim to give directors leeway to serve other stakeholders—yet leave all power in shareholder and CEO hands: Shareholders hypothetically elect the board (in practice the management often hand-picks directors); shareholders retain exclusive right to sue if their gains are not maximized. Thus corporate governance remains overwhelmingly focused on share price gains, and hostile takeovers have become business as usual. It's as though the stakeholder laws had never passed.

Two states—California and Minnesota—haven take up the issue again, introducing bills in 2003 and 2004 that seek to broaden directors' duties. And England has seen similar legislation presented in Parliament known as the Corporate Responsibility Bill. The U.S. bills have generally begun as variations on the Code for Corporate Responsibility, a model bill drafted by attorney Robert Hinkley—who believes directors' duties are the source of virtually all social harms by corporations. His model code says directors may not maximize profits for shareholders at the expense of employees, the community, and the environment. Some versions create standing to sue for parties who demonstrate harm. This penalty provision was stripped out when the bills were introduced in both Minnesota and California, because of concern about too many new lawsuits.

Fundamental economic transformation is brewing.

In Minnesota, more than 16 legislators endorsed the legislation. Most recently, it has been redrafted as a voluntary governing framework, designed to attract responsibility corporations to incorporate in Minnesota—granting them freedom from hostile takeovers and allowing them to identify as "R" (for responsible) corporations. In return, corporations would embrace a duty to serve the public interest, bring employees and public-interest directors onto the board, and educate directors on their broadened duties. Maine is considering a similar approach, featuring a two-thirds direct vote by employees on any sale or merger of the company. Other efforts related to corporate accountability have surfaced in Arizona, New Jersey, Pennsylvania, Massachusetts, and Nebraska. Several have to do with "corporate personhood," seeking to limit the constitutional rights for corporations, while in Nebraska the focus was on an Anti-Corporate Farming Law.

Overall, these corporate governance approaches remain piecemeal and at an early stage. But if the growing grassroots movement around them continues to build, the issues could burst onto the national radar screen and spark a badly needed national conversation about how corporations should be governed.

* * * * *

Demos president Miles Rapoport, a former state legislator and Secretary of State in Connecticut, has observed that there is a need to rethink the fundamental design of the corporation, and we can use state law as a vehicle for doing so. The Tellus Institute in Boston has taken up this work of corporate redesign with its Corporation 2020 project. The project is bringing together diverse stakeholders—from law, business, finance, government, academia, and civil society—to craft a design for the corporation that embraces both financial and social purposes. Ultimately, the project aims to work with other groups to host a constitutional convention for the new corporate form, to draft a new legal design for the corporation. Developing a vision like this could be a key way to reinvigorate the stalled economic agenda of progressive reform.

While such big-picture efforts are still on the drawing board, something significant does indeed seem to be stirring. What is brewing is nothing less than fundamental economic transformation. On many state and local fronts—from state treasurers and pension fund trustees to legislators—powerful forces are beginning to carry forward a host of promising new efforts. If federal power is locked in conservative hands, state and local power is not. There are avenues outside Washington for tapping and creating forms of power that can help control the power of corporations, capital, and CEOs. A good deal of work remains—but much has already begun. In the progressive effort to transform economic power, state and local approaches may well hold the key.

Resources

LIVING WAGE LAWS

- *Living Wage Resource Center* offers an excellent outline of the "Elements of a Living Wage Ordinance," such as health benefits, scope of coverage, covered workers, sanctions, and so forth. www.livingwagecampaign.org/ordinance.php

CORPORATE SUBSIDY ACCOUNTABILITY LAWS

- *Good Jobs First* is the leading nonprofit authority on creating accountability for public subsidies to corporations. Its web site offers model legislation, discusses the various components of legislation, and publishes studies of effectiveness. "The Policy Shift to Good Jobs" offers an overview of legislative trends. See www.goodjobsfirst.org.
- *Business Incentives Reform Clearinghouse* offers information on policy, legislation, case studies, and resources about subsidy reform—including a state-by-state listing of "the most interesting subsidy provisions." See http://www.cfed.org/sustainable_economies/business_incentives/index.html.
- *High Road Service Center* is a clearinghouse and legislative hub on economic development approaches that take the "high road"—meaning they are high-wage, low-waste, worker-friendly, and publicly accountable. www.highroadnow.org

RESOURCES ON THE CODE FOR CORPORATE RESPONSIBILITY

To support the code in your state, join the nascent national network, USA CORE, by e-mailing coalition@c4cr.org.

For further information:

- Text of CA bill: http://info.sen.ca.gov/pub/bill/sen/sb_0901-0950/sb_917_bill_20040113_amended_sen.html.

- On California Code for Corporate Responsibility: http://groups.yahoo.com/group/c4cr_california?
- On activity in Minnesota: http://www.c4cr.org.
- To help start a group in Massachusetts, contact Lois Levin: lois_levin@hms.harvard.edu.
- On the background of the Code for Corporate Responsibility: http://www.citizenworks.org/enron/corp_code.php.

RESOURCES FOR INSTITUTIONAL INVESTORS

- *ishareowner.com*—News and resources on social investing for institutional investors.
- *The Initiative for Fiduciary Responsibility*—Network of institutional investors interested in mission investing. See www.theglobalacademy.org/ifr.asp. Contact Steve Viederman phone 212/639-9497, email stevev@igc.org.
- *The SRI Advantage: Why Socially Responsible Investing Has Outperformed Financially*, by Peter Camejo—Sophisticated analysis for institutional investors seeking to understand social investing. New Society Publishers (www.newsociety.com), cloth, $24.95.
- *The Triple Bottom Line Simulation*—Starting in mid-2001, treasurers in five categories—endowments/foundations, family officers, not-for-profits, religious institutions, and shareholder advocates—each built portfolios simulating the investment of $100 million across all asset classes, using exclusively social investments. In six quarters through September 2002, four out of five had outperformed their benchmarks. Endowments/foundations outperformed by 7.56 percent. Sponsored by Capital Missions of Elkhorn, Wisc. See the portfolios at www.capitalmissions.com.
- *"Corporate Governance, Social Responsibility and Obligations of Ownership"*—This guidebook offers recommendations on steps pension funds can take in bringing social awareness into their investing activities. It is posted on the Social Investment Forum website, www.socialinvest.org.

RESOURCES ON LABOR'S CAPITAL

- *AFL-CIO Center for Working Capital*, Dir. Robert Pleasure, 815 16th St. NW, Washington, DC 20006. Phone 202/974-8020.
- *Heartland Labor Capital Network*, Dir. Tom Croft, c/o Steel Valley Authority, One Library Place, Suite 201, Duquesne, PA 15110. Phone 412/460-0488. Web: www.heartlandnetwork.org
- *Working Capital*: *The Power of Labor's Pensions*, published in 2001 by the Heartland Labor Capital Network, describes a variety of activities by labor pension funds. Edited by Archon Fung, Tessa Hebb, and Joel Rogers, Cornell University Press, Sage House, 512 E. State Street., Ithaca, NY 14850. Phone 800/666-2211(cloth, $35.00). Web: www.cornellpress.cornell.edu.

Notes

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3. See www.treasurer.ca.gov
4. See "Institutional Investor Summit on Climate Risk: Summary Report," at www.CERES.org.
5. David Swanson, "A Livable Minimum Wage," Alternet, Feb. 21, 2005.
6. "Minimum Wages Facts at a Glance," Economic Policy Institute, March 2005.
7. See www.GoodJobsFirst.org.
8. In 1968 the federal minimum wage had a purchasing power of $8.14 as measured in 2001 dollars. The minimum wage was $5.15 in 2001. See: http://www.fiscalpolicy.org/MinimumWageGraphs.pdf.
9. Swanson, "A Livable Minimum Wage."
10. "Progress in the States: A Report on Proactive, Progressive Victories in 2003," Center for Policy Alternatives, 2003.
11. See David Neumark, "How Living Wage Laws Affect Low-Wage Workers and Low-Income Families," Public Policy Institute of California, March 2002. For a response and critique of Neumark, see Mark Brenner, Jeanette Wicks-Lim, and Robert Pollin, "Measuring the Impact of Living Wage Laws: A Critical Appraisal of David Neumark's How Living Wage Laws Affect Low-Wage Workers and Low-Income Families," University of Massachusetts, Political Economy Research Institute, Working Paper No. 43, 2002.
12. The Wal-Mart figure is from Anna Purinton *Policy Shift to Good Jobs* (Washington, D.C.: Good Jobs First, 2003). The $50 billion state spending citation is from Greg LeRoy and Sara Hinkley, *No More Secret Candy Store* (Washington, D.C.: Institute for Taxation and Economic Policy, 2002). The Mercedes deal was mentioned by David Bucholz, "Mercedes-Benz: The Deal of the Century," Business Incentive Reform Clearinghouse, April 4, 2004.
13. "Get Something Back! How Civic Engagement is Raising Economic Development Expectations in Minnesota," Good Jobs First, October 2003.
14. The $11 median wage stipulation requires inflation indexing based on 1993 dollars. See Iowa Legislative Information System: Iowa Code 1999: Section 15.329.
15. "Frequently Asked Questions About Development and Fiscal Accountability," Good Jobs First.
16. Robert Lynch, "Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development," Economic Policy Institute, May 23, 2004.
17. "Summary of State's Purchasing Language for Recycled Content Purchase Preference," Council of Great Lakes Governors, April 5, 2004.
18. See a listing of state preferences laws at www.DOA.State.NC.US/Pandc.rplaw.htm.
19. Draft legislation for a federal R Corporation was floated in 1996 by Thomas Daschle (D-SD) and Jeff Bingaman (D-NM). The R Corporation would have been a new kind of federally chartered corporation, receiving lower taxes and streamlined regulatory treatment. To qualify, companies would have had to meet several tests: contributing 3 percent of payroll to a portable pension plan, devoting 2 percent to employee training paying half the costs of health care, having profit sharing or employee ownership, and holding executive compensation to no more than 50 times the lowest paid employee. Other provisions: an R Corp. must have a layoff agreement, be unionized or have an employee-involvement plan, not use child labor, and do half of its new investment in the U.S. See Robert Kuttner, "Rewarding Corporations That Really Invest in American," *Business Week*, February. 26, 1996, p. 22.
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21. Phil Angelides, "The Power of the Purse: How Investors Can Restore Integrity to our Financial Markets," 2002. See: www.treasurer.ca.gov/publications/PowerofthePurse.pdf
22. Robin Sidel, "Shareholders Say: Not MY Vote!" *Wall Street Journal*, March 31, 2004, p. C1; and "California Treasurer Takes Aim at Executive Pay," Reuters, April 20, 2003.
23. See www.treasurer.ca.gov/publications/doublebottomline/20030320.pdf.
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32. Marjorie Kelly, "Eureka: An Opening for Economic Democracy," *Business Ethics*, Summer 2003, p. 4.
33. For a discussion of stakeholder laws, see Marjorie Kelly, *The Divine Right of Capital*, pp 138-143. The best scholarly, legal overview of the controversy around stakeholder laws can be found in Eric W. Orts, "Beyond Shareholders: Interpreting Corporate Constituency Statues," *The George Washington Law Review*, Vol. 61, No. 1, November 1992, pp. 14-135. The count of stakeholder laws was made by Terry O'Neill, "Employees' Duty of Loyalty and the Corporate Constituency Debate," *Connecticut Law Review*, Spring 1993, p.682.
34. Kelly, *The Divine Right of Capital*, p.139.

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