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The Excessive Churning and Speculation Act of 1989
by Senator Nancy Landon Kassebaum
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Mr. President, the legislation we have introduced today is designed to encourage pension fund managers to adopt a better long-term investment strategy. This summer the Senate Committee on Banking, Housing, and Urban Affairs conducted a series of hearings regarding our industrial productivity. The witnesses included an impressive array of investment bankers, economist, and corporate leaders. Their assessment of our economy was urgent and unequivocal--we must "lengthen" our institutional investors short-term investment mentality. Absent such a change, we face the stark prospect of losing our status as a major industrial player.

Corporate America is increasingly being acquired by institutional investors having only a transient interest in the companies they own and control. This transient ownership problem is compounded by the short-term mentality of institutional investment managers. A decade ago these managers were criticized for taking a too passive approach toward their investments. Today, however, the pendulum has swung to the opposite extreme. Fund managers are hired and fired on the basis of their quarterly performance. This quarterly treadmill encourages a short-term investment mentality that undercuts long-term industrial productivity.

The Martin Marietta case is classic. A few years ago Martin Marietta announced an increase in research and development. Rather than reacting favorably to this announcement, the company's institutional owners dumped their shares fearing a possible reduction in short-term earnings. The price plummeted six points in a matter of days. Although Martin Marietta proceeded with the research program, its fortitude is painfully unique. Fearing a negative institutional reaction, how many corporate managers simply ignore R&D or applied technology opportunities?

Such behavior encourages corporate managers to concentrate more on the immediate price of their stock than on innovation and productivity. This is the equivalent of trying to run an airline on fares insufficient to cover future maintenance.

In fairness to institutional investors and corporate managers, they are not the only ones afflicted by this short-term mentality. As Richard Darman, the director of the Office of Management and Budget, recently stated in his widely acclaimed "New Balance" speech, this affliction is endemic to our society and pervasive in our public policy.

The pervasiveness of the affliction, however, does not justify excusing and ignoring it. This is particularly true in the limited but critical context of institutional investment. The question is how do we address the problem without causing more harm than good? The challenge is to create a tax structure that encourages long-term institutional investment.

The legislation we have introduced today would place a 10 percent tax on gains from asset that are held less than 30 days and a 5 percent tax on assets that are held for less than 180 days. This rifle-shot approach provides

pension managers a tax incentive structure to hold their assets on a more long-term basis.

It is specifically designed to curtail excessive churning and speculation. It does not seek to raise revenue, and in fact, I would be completely happy if it did not raise a penny. It applies only to short-term assets turnovers and therefore should not affect those plans who invest on a long-term basis. Arguments that such a churning fee would somehow make the market less liquid or distort its efficiency frankly are nonsense.

Encouraging pension fund managers to adopt a long-term investment strategy makes for both common sense and improved performance. In this regard, the Council of Institutional Investors has found that large pension funds with a long-term investment strategy ultimately out-perform similar funds having a short-term focus.

Those who argue that such a proposal would substantially tax the pension benefits of low- and middle-income workers are in error. Most pension beneficiaries--particularly those low- and middle-income workers employed by large corporations are covered by defined benefit plans. Under these plans, which cover approximately 80 percent of all pension beneficiaries, the workers' retirement pay is based on a fixed formula that is not affected by pension fund investments. If the fund profits by investing in takeovers, leveraged buyouts, or by turning over its portfolio on a short-term basis, those earnings only serve to reduce the employers contributions to the fund. In fact, when pension funds have been extremely profitable some corporate employers have actually taken money back from the fund. Since 1980, employers have taken back $18.7 billion from pension fund assets.

In summary, a sliding scale fee or tax on short-term asset turnovers encourages long-term investment and discourages short-term speculation. Such an approach to our institutional investment behavior is going to become increasingly important as we compete in a global market. From a productivity standpoint, it is an approach we cannot afford to ignore.

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