

The Religions of Social Responsibility

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Debates on the definition of social responsibility, its tenets and its boundaries, are common. Polyak [2005], for example, notes Paul Hawken, the cofounder of Smith & Hawken, was appalled by Calvert's holdings of Microsoft (criticized for dominating software markets) and by the Sierra Club's holdings of Outback Steakhouse (criticized for cattle production that causes ecological damage). I think we can gain insight into the social responsibility debates if we place them in a framework of the economics of religion.

Investors who follow different tenets of social responsibility and choose different socially responsible mutual funds might be described as members of different religious denominations. Some social responsibility religions have a single tenet, such as protection of the environment, while others combine several tenets, such as avoidance of tobacco, alcohol, and weapons production.

Iannaccone [1998] distinguishes the economics of religion from religious economics. Religious economics includes, for example, analysis of banking systems consistent with the Qur'an and analysis of the medieval Roman Catholic Church's ban on usury. The economics of religion views religious behavior from *an economics perspective*. Economics of religion might analyze markets where religions compete for members, to include the features that attract or deter members, and analysis of differences between denominations of rela-

tively few strongly committed members and those with many weakly committed ones.

A framework of the economics of religion can help us answer questions such as:

- Why do some mutual funds attract many investors, while others attract few?
- What are the differences between strategies that are effective at attracting individual investors to SRI and those effective at attracting institutional investors?
- How do tenets such as opposition to tobacco come to the forefront or recede?
- Are government regulations aimed at fostering SRI likely to accomplish their aim, or more likely to retard SRI? And is the SRI movement likely to grow stronger in the U.S. or in Europe?

TENETS OF SOCIAL RESPONSIBILITY

The origins of socially responsible investing lie in religion. In "1999 Trends Report" of the Social Investment Forum [1999] we read:

In the mid-1700s, the founder of Methodism, John Wesley, emphasized the fact that the use of money was the second most important subject of New Testament teachings. As Quakers settled North America, they refused to invest in weapons and slavery (p. 7).

PREA

Draft

Some of today's mutual funds are premised on religion. For example, the MMA Praxis mutual funds are sponsored by Mennonite Mutual Aid (MMA) which serves as the stewardship agency for the Mennonite Church, the Amana funds follow Islamic principles (including a prohibition on interest (*riba*), so Amana avoids bonds and other interest-bearing securities), and the Ave Maria Catholic Values fund eliminates from its portfolio stocks of companies connected with abortion or pornography, or who offer their employees non-marital partner benefits.

The document adds that while the origins of the social responsibility movement are in religion, much of today's social responsibility movement was born in the 1960s, when struggles for civil rights and women's rights and anti-war and pro-environment policies served to escalate awareness of social responsibility. Opposition to apartheid in South Africa was a rallying cry that brought many into the SRI movement in the late 1970s.

The movement continues to grow today, as emphasis shifts to corporate governance. A 2004 Calvert advertisement says:

Honesty is the best corporate strategy. At Calvert Mutual Funds, we also think it's the best financial strategy After the corporate scandals of the past two years we think you may agree.

In "Introduction to the Economics of Religion," Iannaccone [1998] defines religion as "any shared set of beliefs, activities and institutions premised upon faith in supernatural forces" (p. 1466). In practice, it is often difficult to disentangle beliefs, activities, and institutions that are premised upon faith in supernatural forces from those premised on political ideologies and secular philosophies. For example, opposition to tobacco, alcohol, and weapons is premised on all three. Moreover, some of the debates about the definition, tenets, and boundaries of social responsibility are between those who premise social responsibility upon faith in supernatural forces and those who premise it on beliefs in political ideologies and secular philosophies.

Throughout my discussion, I use the term *religion* in a broad sense to encompass beliefs premised upon political ideologies and secular philosophies rather than supernatural forces.

An MMA survey [2003] of the ethical issues that matter to both religious and non-religious investors shows many similarities between the two groups but also some differences. The top four concerns for both groups are sweatshops, product safety, high executive compensation,

and the environment. Opposition to adult entertainment and abortion products, however, is much stronger among religious investors than among non-religious ones.

There are also differences across denominations. Evangelical Christians are more likely than Catholics or members of mainline Protestant denominations to avoid companies associated with adult entertainment, abortion products, gambling, alcohol production, and equal family benefits to homosexual employees, while Catholics and mainline Protestants are more concerned about companies' environmental records.

Disagreement about the place of religiously conservative and socially progressive characteristics on the list of social responsibility characteristics is on display in an exchange between two posters on the Yahoo SRI message board in 2002. MainiacJoe emphasized religiously conservative characteristics:

The ethical concerns I have are of [a] religiously conservative nature more than a socially progressive nature. As such, in addition to the typical alcohol, gambling and tobacco screens I am more concerned about investing in companies that are involved with abortion and pornography than those associated with nuclear power or military technology. By these guidelines the common social funds such as Domini and Calvert are indistinguishable from a broad index fund.

But marionvb responded with an emphasis on environmental concerns:

I personally am more concerned about not being able to breathe the air than whether or not someone else has an abortion.

Disagreements about the boundaries of SRI go beyond religion. Can companies that outsource jobs be included on a list of socially responsible companies? Phil Thompson does not think so. He wrote to the editor of *Consumer Reports* in 2004:

I was disconcerted that you recommended the Vanguard Calvert Social Index fund. While this fund claims to be socially conscious, the holdings you listed (Microsoft, Pfizer, Intel, and IBM) are involved in the mass exporting/offshoring of U.S. jobs. I'm not sure I see what is socially conscious about putting Americans out of work.

While Thompson wants to exclude from the SRI list companies that export U.S. jobs, Goldstein [2005] wants to include in it companies that provide nuclear power:

For years I have sparred with [one mutual fund] over its policy of not investing in companies involved in the nuclear energy sector. The fund thus shuns a source of electricity that is abundant, domestic, safe, virtually carbon-free and efficient. Yet this fund will invest in companies linked to the production and use of coal. How socially responsible is that?

Organizations that construct SRI indexes agree on some SRI characteristics but disagree on others. I describe them in Statman [2006]. Kinder, Lydenberg, and Domini exclude from the Domini Social Investments 400 index companies that derive any revenues from the manufacture of alcohol or tobacco products, companies that derive any revenues from the provision of gambling products or services, electric utilities with interests in nuclear power plants, and companies that derive 2% or more of sales from military weapon systems. Then KLD evaluate companies in areas such as the environment, diversity, and employee relations. Problems in one area do not necessarily prompt elimination of a company from the DSI 400 index, but companies whose records on balance are negative are excluded.

Calvert, which compiles the Calvert Index, evaluates company performance on the environment, workplace, product safety and impact, international operations and human rights, community relations, and indigenous peoples' rights. Calvert favors Starbucks, for example, because it was the first agricultural commodities company in the U.S. to develop a code of conduct for coffee plantation workers. It excludes companies with interests in gambling, tobacco, and military weapons, but includes companies with interests in alcohol, firearms, and nuclear power unless they are substantial. So, for example, Calvert includes in its index the Darden Corporation, which operates Red Lobster and Olive Garden restaurants because the portion of its revenues attributed to alcohol falls below its 20% cutoff level.

Citizens excludes from its index companies with any interests in tobacco or alcohol, companies that produce power from nuclear power plants, and companies that have material interests in the manufacture of weapons, have gambling as a main line of business, or lack diver-

sity in boards or senior management. Citizens prefers companies with good records on corporate governance, environmental performance, human rights, diversity, employee relations, and no testing on animals unless required by law.

The Dow Jones Sustainability Index (DJSI) is different from the Domini, Calvert, and Citizens indexes because it uses best-in-class selection rules in its construction. The DJSI does not exclude all the companies in the tobacco, gambling, alcohol, and similar industries that are excluded from the other three indexes. Rather, it includes the best companies in each industry.

The Dow Jones Sustainability Indexes comprise the leading companies in each industry selected according to a detailed set of economic, environmental, and social criteria covering both general and industry-specific sustainability trends. The DJSI includes corporate sustainability leaders that:

achieve long-term shareholder value by gearing their strategies and management to harness the market's potential for sustainable products and services while at the same time successfully reducing and avoiding sustainable costs and risks.

Such companies set "the highest standards for corporate governance and stakeholder engagement, including corporate codes of conduct and public reporting," and they manage:

human resources to maintain workforce capabilities and employee satisfaction through best-in-class organizational learning and knowledge management practices and remuneration and benefit programs.

KLD's Socrates database of company social characteristics as of December 31, 2002, included more than 3,000 companies. The overall score of a company is the sum of its scores on the characteristics. For example, the overall score of Lucent Technologies, Inc., was seven: one positive point for community; two negative points for corporate governance; seven positive points and one negative one for diversity; two positive points and one negative one for employee relations; one positive point for environment; and one positive and one negative point for products.

Investors are likely to continue to debate the characteristics that make a company socially responsible, but KLD's scores highlight the observation that companies

are arrayed on a continuum; no company is perfectly socially responsible or irresponsible. Moreover, companies with the same overall score differ in their scores by characteristics. For example, FirstEnergy, a company with a -10 overall score, scored better on corporate governance than Intel or Procter & Gamble, companies with an 8 overall score. Similarly, Intel, with the same overall score as Procter & Gamble, did better than P&G on employee relations, but lagged it on diversity.

STRICT AND LENIENT

Mutual funds, like religions, can be strict or lenient. They can adhere without compromise to a few tenets or compromise among many. Kelley (1986, pp. 79-84) compares the traits of strict religions—absolutism, conformity, and fanaticism—to those of lenient religions—relativism, diversity, and dialogue. Orthodox Jews are strict compared to Conservative and Reform Jews, and Adventists, Mormons, and Jehovah's Witnesses are strict compared to Episcopalians, Unitarians, and Presbyterians. Iannaccone [1998] finds that while strict religions are generally strong, the relationship between strictness and strength is curvilinear. Strict religions are strong because their costs deter those who offer little loyalty. But when the costs of a religion are too high they deter almost everyone and the religion shrivels and dies. Socially responsible mutual funds that are successful in attracting investors hold tenets that appeal to sufficiently large numbers of investors and find the right spot on the scale from strict to lenient.

Socially responsible funds operate in a difficult market where most investors are willing to bear little or no cost for social responsibility. A Yankelovich survey reports that 80% of investors would not consider investing in socially responsible mutual funds unless their returns were at least equal to those of conventional mutual funds (Krumsiek [1997]).

The experience of Timothy shows the consequences of asking investors to bear costs. The Timothy Fund, which takes its name from a letter written by the apostle Paul, was founded by Arthur Ally in 1994 to cater to conservative Christians. Its flagship, the Timothy Plan Small Cap Value, performed near the bottom of its category for several years after 1994. Hakim [2001] wrote:

Many investors stayed with Mr. Ally, but others were not so forgiving. "There were those that thought if they invested in Timothy they'd have top returns, the Lord would bless them," he said.

"When that didn't happen, some of them went to better-performing funds."

The Domini Social Equity Fund is relatively lenient. Many social deficiencies do not automatically lead it to exclude a company from its fund. Polyak [2005] writes that Paul Hawken criticizes the Domini fund for straying away from strict "social purity," by including in its portfolio companies such as McDonald's, but Amy Domini defends her inclusion of McDonald's as a good choice, even if an imperfect one:

I personally may prefer slow food to fast food. I personally prefer the ambiance of organic over nonorganic. But I don't have a mandate from the public to avoid fast food When I look at McDonald's versus the fast-food industry, I see [it] on a path toward human dignity and environmental sustainability. I can live with myself for investing in McDonald's.

Strict funds garner strong loyalty, but the loyalty of a few investors is not enough. Socially responsible funds need a large enough and loyal enough group of investors if they are to survive and thrive. Consider the Meyer Pride Value Fund, founded by Shelley Meyers in 1996. According to its 2001 annual report, Meyers Pride invested in companies "that have openly adopted policies which promote the value, respect, and development of all company employees, including gay and lesbian employees."

Meyers Pride had an extremely loyal investor base, but it was small. By May 21, 2001, the fund's assets amounted to only \$14.4 million. In July 2001, Meyers sold the fund to Citizens, which renamed it Citizen Value Fund. Citizens keeps the fund's commitment to companies that have progressive policies toward gays and lesbians, but it added other criteria such as environmental stewardship so as to broaden the fund's appeal.

Amana's Growth Fund, which follows Islamic principles, survives, unlike Meyers Pride Value Fund, although it fails to thrive. The Amana fund was established in 1994, but its assets at the end of June 2005 amounted to less than \$54 million. The Ave Maria Catholic Values Fund thrives in attracting a much larger and more loyal group of investors. The fund was established only in 2001, but its assets at the end of June 2005 totaled almost \$240 million.

Reform Judaism is lenient while Orthodox Judaism is strict but both do well in the religion marketplace.

The people they attract are different but each is successful at attracting sufficient members and resources to survive and thrive. Similarly, lenient SRI mutual funds, such as the Domini Social Equity Fund, and strict SRI funds, such as the Ave Maria Catholic Values Fund, can survive and thrive if they are well tailored for sufficiently large and loyal groups of investors.

Distinctive Dress and Tracking Errors

The costs of membership in a religion go beyond money to include rituals and distinctive dress that sometime invite ridicule and worse. Singh, a Sikh, wrote about the distinctive dress of his religion: “The Guru wanted to raise a body of men who would not be able to deny their faith when questioned, but whose external appearance would invite persecution and breed the courage to resist it” (Singh [1953], p. 31).

Individual investors who pay for their social responsibility goals with lower returns pay these costs in private. Institutional investors, such as members of boards of pension funds, however, pay in public. Board members who support SRI strategies are like members of a religion who wear distinctive dress; they expose themselves to criticism if not ridicule.

Decisions by boards of institutional investors to adopt SRI strategies, such as the decision of the board of CalPERS to divest tobacco stocks from its portfolio, are decisions that are often opposed by a vocal minority who are eager for an opportunity to say “I told you so” when the returns of SRI strategies lag conventional benchmarks. Board members can reduce the likelihood of ridicule by adopting SRI strategies with low tracking error relative to conventional benchmarks.

Providers of socially responsible investment strategies respond to desires of institutional investors by introducing investment products that offer not only the promise of high returns but also low tracking error. In 2005, for example, Barclays Global Investors teamed with KLD to offer iShares KLD Social Index fund. Companies with higher social and environmental scores are allotted higher weights in the KLD fund than in the Russell 1000 index. But the KLD fund also promises to minimize its tracking error away from the Russell 1000 index.

Changing Tenets

Religions sometimes modify their tenets, as the Mormon Church did in 1978 when it accepted black

men into the all-male lay priesthood, and as the Anglican Church did in 1975 when it began to ordain women. Similarly, tenets of social responsibility change as some issues come to the fore and others recede.

Once, in 1999, gambling was the second-most common screen among socially responsible mutual funds, but by 2003 it had fallen to fifth. Opposition to tobacco was the top tenet in both 1999 and 2003, but its prominence is fairly recent, dating to the second half of the 20th century. Opposition to alcohol was a more prominent tenet in the first half of the 20th century, reflected in enactment of the 18th Amendment to the U.S. Constitution, establishing the prohibition of alcohol that lasted from 1920 until 1933.

Ellickson [2001] writes that the triggering event in the changing of attitudes toward smoking was the accumulation of scientific evidence about the health risk of first-hand and second-hand smoke starting in the 1950s. Medical researchers and public officials, such as Surgeon General C. Everett Koop and David Kessler, Commissioner of the Food and Drug Administration, were leaders in the movement against smoking, joined by non-smokers who suffered from second-hand smoke. In the 1950s, Edward R. Murrow smoked conspicuously on camera, but today’s smokers get dirty looks from passersby as they stand outside office buildings indulging their habit.

The opposition to smoking found its way into investment practice as SRI funds adopted anti-tobacco screens. In 1996, the American Medical Association prodded the mutual fund industry to give up tobacco. Damato [1996] writes that the AMA planned to press fund companies to avoid tobacco company stocks and bonds by publishing an annual list of offending funds while praising funds that signed a no-tobacco pledge.

Iannaccone [1994] illustrates effective and ineffective changes in religious tenets as he compares changes in the Church of Jesus Christ of Latter-Day Saints to those in the Catholic Church. The optimal pace of change in tenets is the pace that minimizes intransigent reaction but also avoids loss of distinctiveness. The optimal pace is set by initial resistance to social change, followed by long-run accommodation. The LDS Church was successful in setting the right pace in its accommodation of the changing roles of women from 1940 through 1987. The Catholic Church was less successful, as it abandoned some cherished features of liturgy, theology, and lifestyle in the Vatican II reforms while refusing calls to soften its hard line on birth control and celibacy of the priesthood.

The Vanguard Group did well as it discarded oppo-

sition of SRI and embraced it. Damato [1996] then counted Vanguard among opponents of SRI, writing:

At Vanguard Group, for instance, company spokesman Brian Mattes says phone representatives are told to deliver a blunt response to investors who raise concerns about tobacco holdings or other potentially objectionable investments: The funds' "sole purpose" is to pursue the maximum return possible within their investment objectives, the script says, so funds "cannot be constrained by any special interest group's definition of acceptable investments."

Then, in 2000, Vanguard embraced SRI as it introduced the Vanguard Calvert Social Index Fund, which had accumulated approximately \$350 million in assets by mid-2005.

No-SRI and Anti-SRI

Some investors do not opt for SRI because they believe they will contribute more to preserving the environment by choosing a Prius over a Hummer instead of by buying stocks of companies friendly to the environment. Other investors eschew SRI because they are unconvinced there are clear lines that distinguish companies that are perfectly pure from those that are not as pure. Wasik [2005] writes:

Since you can't pick a company or fund that's 100 percent environmentally pure—every company consumes energy and wastes resources—why not just construct a diversified portfolio and reduce your investment risk?

Yet other investors believe companies are driven to social responsibility by the pursuit of profits, so there is no purpose in application of SRI criteria in the selection of companies. This belief is long-standing. The *Literary Digest* [1927] quoted J. Edward Baker of the New York bond house of Stone and Webster and Blodget, Inc., as saying: "A good security, judged by the best business tests, will meet the highest requirements of Christian ethics" (p. 34).

But *The Literary Digest* also quoted the critical response of *The Christian Advocate*:

Just when we want [Mr. Baker] to tell us whether it is ethical to hold stock in a company which pays

us 9 per cent and underpays its girls, or in a corporation which cuts melons, and at the same time pares wages to the quick . . . just at these points he becomes vague and unconvincing . . . Absolute security and liberal dividends are enough to establish the investment value of a stock, but the Christian Church feels more and more keenly that it must ask other questions after the investment house has come to the end of its list (p. 34).

Some atheists are content to live in peace with those who believe in God—but others cannot bear not to nettle believers. These atheists resemble Dan Aherns, manager of the Vice Fund, who cannot resist the urge to taunt socially responsible investors. The Vice Fund puts 90% of its assets into groups that SRI won't touch: weapons, liquor, tobacco, and gambling.

Middleton [2005] writes:

Aherns delights in twitting SRI for what he views as gaping holes in its moral armor. "I don't think coffee liqueur is going to be the downfall of society," he jeers.

COMPETITION AND REGULATION

Adam Smith argues that self-interest motivates the clergy just as it motivates secular businesspeople. So while religions that compete in the marketplace exhibit zeal and industry, state-sponsored religions are as complacent as state monopolies. Iannaccone [1998] finds empirical support for Smith's hypothesis in 12 predominantly Protestant countries. Weekly church attendance rates range from 40% of the total population in the U.S., where the Constitution guarantees competition among religions, to less than 10% in Scandinavian countries, where a single, state-run, Lutheran church is dominant.

Some argue that the social responsibility market in Europe should grow faster than the U.S. market, as European governments have established regulations designed to foster socially responsible investing. Yet lessons from the economics of religion suggest that competition in the social responsibility market in the U.S. will continue to be more vigorous than in Europe, and that there should be a more vigorous social responsibility market in European countries that allow competition than in those that regulate it heavily.

For example, the European Social Investment Forum

(Eurosif) noted in 2004 that Germany had introduced regulations with the idea of fostering socially responsible investments. The regulations mandate that pension funds, both public and private, report annually to their members the application of SRI policies. Private pensions are exempt from the reporting requirement if they state in their contractual agreements with their investors that they will not consider social responsibility in the making of investment decision.

The regulations backfired. Many private pensions chose to exempt themselves from social responsibility considerations.

The social responsibility experience in Sweden is better because its regulation of the social responsibility market makes room for competition. Sweden introduced regulations of the Swedish National Pension Funds, stating that these funds “must take ethical and environmental considerations into account without relinquishing the overall goal of a high return on capital” (“Pension Programme” [2004, p. 14]).

The funds were free to choose how to implement that social responsibility mandate, and that freedom fostered competition. For example, one fund tries to engage companies to improve social responsibility and keeps the option of exclusion as a last resort, while another uses a best-in-class approach in the selection of companies.

The Eurosif report says that, apart from the German case, regulations have given SRI a substantial push in Europe, and it looks as if the momentum will continue. But competition might be better at fostering SRI than regulation. For example, the Netherlands does not have specific regulations on SRI, but its pension funds are active on the SRI front.

CONCLUSION

Business executives who compete in a marketplace of fickle customers and fierce competition might envy religions, which would seem immune to the forces of the marketplace. But religious denominations are not immune. They compete for members and resources when members are not always loyal and when competition from other denominations is always present. Religious denominations must be as agile as businesses if they are to survive and thrive. Providers of SRI products and services, such as mutual funds, are like denominations and businesses. They must appeal to large enough and loyal enough groups of customers, and they must always be attuned to competition from other providers who attempt to attract their members.

Studies in the economics of religion shed light on

religious products and services and on competition in the religion marketplace. They can help us understand SRI products and services and the competition in the SRI marketplace. I highlight SRI products and services in terms of differences in tenets of social responsibility among SRI vendors, their need to find the right position between strictness and leniency of tenets, the importance of investment performance and tracking errors, and the likely effects of government regulation.

Executives are often frustrated by calls to keep three bottom lines in the black: make money, protect the environment, and promote social justice. It is hard to do any one of these, and it is even harder to do all three simultaneously. Vendors of SRI products and services, such as mutual funds, are businesses, and their executives suffer the frustrations of all business. They are criticized from both the right and the left, and the loyalty of many of their customers extends no further than the quarterly statement.

Paul Hawken is so vehement in his criticism of the social and environmental criteria of current SRI mutual funds that he is about to form a socially responsible portfolio for high-net worth investors. He told Polyak [2005] that the companies he chooses for the portfolio will be “positive for the planet.” Executives of the SRI funds that Mr. Hawken criticizes must be waiting impatiently to find what these companies are.

ENDNOTE

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