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Whose Conscience Counts? Beneficiary Value Alignment and ESG Public Pension Funds

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Environmental, social, and governance (ESG) investing has reshaped public pension fund management. This paper explores whether ESG investing or proxy voting based on subjective social values violates fiduciary duties when diverging from the diverse beliefs of beneficiaries. As pooled investment vehicles lack inherent values, assigning moral weight to ESG portfolios challenges fiduciary neutrality. Fund managers face an untenable task in representing conflicting views. The article also questions whether ESG undermines fiduciary pluralism within the federal system, as global efforts to standardize ESG metrics may conflict with varied state laws, complicating compliance and eroding local discretion in pension fund governance.

Introduction

Despite a downturn in environmental, social, and governance (ESG) investing (Warner 2024; White and Lee 2024; Johnson 2024), the concept of responsible investing continues to gain traction as lawyers and issuers leverage ESG metrics as primary inputs for their investment decisions. This trend reflects rising support for stakeholder capitalism ("stakeholderism") and optimism about ESG investing, notwithstanding recent ESG net outflows.

Despite this optimism, ESG investing confronts specific moral dilemmas that have not yet been fully grasped or grappled with. This is a vital issue, as even a tiny percentage of a portfolio invested in ESG[1] represents a significant amount of money overall. ESG investing in public pension funds, in particular, has created conflicts between asset managers' fiduciary duty to serve beneficiaries'

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1 According to one study, "Just 8 percent of pensions surveyed said that more than a tenth of their portfolio is invested in ESG private equity" (McElhaney 2023). Moreover, "Only 1 percent of respondents had more than 10 percent invested in ESG private credit, but pensions' investments in the the [sic] asset class remain relatively low" (McElhaney 2023).

diverse interests and the socially motivated goals of ESG strategies (Mahoney and Mahoney 2021, 877). Public pension fiduciaries include asset management firms, public pension fund boards of trustees, and government officials such as state financial officers or comptrollers. Unlike private retail or household investors who choose to invest in ESG funds, these fiduciaries serve diverse beneficiaries with differing interests by controlling public pension money, making it unfeasible to attain unanimous consent for ESG activity due to the beneficiaries' heterogeneous preferences.

Although the Employee Retirement Income Security Act (ERISA) does not regulate these fiduciaries, several states have codified legislation governing their duties to beneficiaries.[2] These disparate rules broadly reflect the heterogeneous values and preferences of the states' constituencies. Accordingly, efforts to standardize global ESG practices and metrics risk undermining these pluralistic approaches to fiduciary obligations and pension fund management across different U.S. states.

This article examines whether ESG investing of public pension funds or proxy voting by fund managers overseeing pension assets based on subjective, nonfinancial factors like social values violates fiduciary obligations when these actions diverge from the diverse interests and beliefs of the underlying beneficiaries. Most funds are merely pooled investment vehicles without inherent values, but ESG-weighted portfolios aim to assign these funds moral significance. Fund managers face an untenable challenge in satisfying their fiduciary duty to represent pension fund beneficiaries' vastly diverse views and conflicting perspectives. Their ethical obligation is nearly impossible to fulfill when pension fund participants hold widely divergent social and political attitudes. From an ethical and normative standpoint, these practices are problematic and inadvisable, even if they do not technically breach *legal* obligations. The core issue lies in using funds to support causes that may conflict with beneficiaries' values, regardless of potential financial gains. This approach overlooks the fact of moral pluralism, undermining the principle of respecting diverse viewpoints among fund beneficiaries and raising questions about the appropriate use of entrusted resources.

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2 To clarify, state law governs these fiduciaries. ERISA governs most private pension plans such as 401(k)s.

Finally, this article explores ethical questions regarding the pluralistic, diverse approaches to fiduciary duties and state pension fund investments within the U.S. federal system and whether ESG risks undermining them. Given the efforts by national governments, international bodies like the United Nations, and non-governmental organizations to standardize ESG metrics and practices globally, compliance with varying state laws in these areas may become unachievable. Moreover, we note that progress toward standardization would entail a decline in total fiduciary representation of the values and preferences of all represented beneficiaries.

This paper primarily adopts a normative approach. Though it engages with theoretical and ethical considerations, it does not present quantitative data, empirical findings, or detailed legal arguments addressing, for instance, the standing challenges plaintiffs face in defined-benefit plan cases instead of defined-contribution plan litigation.[3] The focus here is on the issue's broader philosophical and policy implications.

Fiduciary Obligations and Beneficiary Representation

Asset managers investing pension funds must act as agents representing the interests of their principals: the beneficiaries (i.e., the pension fund participants) (Schanzenbach and Sitkoff 2020, 384; Fisch and Schwartz 2023, 5). This duty has become more complex with the rise of ESG, which raises questions about whether value-based investment and wealth maximization are compatible. According to Fisch and Schwartz (2023, 5), who focus on private rather than public pension funds, "Failure to represent beneficiaries' views not only harms those whose views are ignored but is deeply undemocratic. Issues like addressing climate change are fundamental public policy questions, and fund managers lack the legitimacy to make such choices on their own." The shift from individual to institutional ownership adds complexity to this already complex situation.

3 Public pension beneficiaries generally receive defined benefits determined by a fixed formula, meaning their payouts do not depend on the fund's investment performance. Accordingly, beneficiaries may have little incentive to scrutinize how the funds are invested because their benefits are assured regardless of returns. In Thole v. U.S. Bank, N.A. (2020), the United States Supreme Court held that the plaintiffs, who challenged a defined-benefit pension plan under ERISA on fiduciary duty grounds, lack Article III standing to sue in federal court because the litigation's outcome would not impact the fixed monthly benefits they were already guaranteed. A recent challenge in New York State court, contesting the decision by the trustees of the New York City pension plans to divest from most fossil fuel holdings, was dismissed because the plan participant plaintiffs lacked standing since the plans were defined-benefit pensions (Roy, Lichtenstein, and Skinner 2024).

For most of the twentieth century, corporate ownership was dispersed among numerous individual investors; each shareholder's influence on governance was minimal (Berle and Means 1932, 47; Wells 2015, 1064–1074; Coffee 2001, 33–45). Due to their small ownership stakes, individual shareholders' engagement in governance activities was expensive, so the potential benefits were low. This cost-benefit imbalance generally deterred active participation in board engagement or voting (Berle and Means 1932, 87).

However, the rise of institutional investing changed this dynamic. These institutional investors are mostly asset management firms, such as the Big Three: BlackRock, State Street, and Vanguard (Mendenhall and Sutter 2024, 77–78; Strampelli 2018, 810–811; Fisch and Schwartz 2023, 10–11, 13). Institutional investors mitigate collective action problems with their substantial holdings, allowing them to participate actively in corporate governance, enhancing oversight and influencing corporate policies. However, these benefits come at the expense of representing the full variance of beneficiaries' preferences—they cannot represent myriad principals' investment priorities.

Public Pensions as Fiduciaries

This cost is exacerbated when there is little or no choice in funds, as with public pensions. Public pension systems represent pooled retirement plans that provide state, local, and other government employees with benefits that are purportedly guaranteed for the entirety of the retiree's lifespan. These pension funds aggregate the contributions of numerous public-sector workers, intending to fund the long-term obligations owed to retirees. Public pension investment is invariably mired in politics (Kahan and Rock 2007, 1057–58). The large sums of public pension money enable asset managers to acquire substantial shares in publicly traded companies and, thus, to wield significant voting power as shareholders even though they may have no direct economic stake in the companies whose shares they are voting.

When large asset management firms exercise voting power for millions of beneficiaries, they cannot accurately represent each individual's long-term interests. The diversity of interests and the complexity of determining them create logistical and financial difficulties, potentially leading to a misalignment of incentives. Given the impracticality and cost of tailoring voting strategies to each beneficiary, fund managers must resort to generalized approaches that do not, and cannot, fully align with the specific long-term objectives of individual beneficiaries. This reality raises concerns about the effectiveness of current fund management practices in representing the diverse interests of their beneficiaries, highlighting the need for innovative solutions to align voting strategies with individual preferences.

Quantifying beneficiaries' preferences would be more straightforward if investors focused solely on maximizing financial returns. However, the rise of values-based and responsible investing—or ESG—has introduced substantial complications since some individuals now invest for reasons beyond financial gain. This investment trend inhibits fund managers' ability to align their actions with beneficiaries' diverse and conflicting objectives, which range from maximizing returns to supporting specific social or environmental causes. As a result, it is increasingly difficult, if not impossible, for fund managers to ensure that their incentives align with the varied interests of their beneficiaries—beneficiary pools are invariably constituted by disparate and conflicting investment preferences—underscoring the need for more nuanced strategies in the investment management industry to reflect modern investors' complex preferences accurately.

Modern Solutions to the Representation Problem and their Weaknesses

Technological advancements have opened up new avenues for beneficiaries to participate more actively in corporate governance (Fisch and Schwartz 2023, 6). These innovations give beneficiaries more significant influence over how their shares are voted and how fund managers engage with corporations as shareholders. One such approach is pass-through voting, which mitigates agency problems inherent in intermediary investing by allowing specific clients or beneficiaries to either vote their shares directly or have more input on how the fund manager votes on their behalf (Fisch and Schwartz 2023, 6).

Although this evolution in shareholder engagement could result in a more accurate representation of beneficiaries' interests in corporate governance, aligning investment practices more closely with the preferences of the individuals and institutions whose capital is at stake, pass-through voting is inadequate to resolve the problem of fiduciary obligation for two reasons. The first is low voter turnout (Fisch and Schwartz 2023, 44). "Given the small stake that mutual fund shareholders hold in any given portfolio company and the large number of companies in a mutual fund portfolio, fund shareholders lack the incentive and capacity to exercise pass-through voting rights effectively. As a result, shares are likely to go unvoted or may be voted based on limited analysis" (Fisch and Schwartz 2023, 6–7). The second reason is the "agency costs between fund managers and their beneficiaries," where the "solution is not to return to the previous era of unaccountable corporate executives but to render fund managers accountable to fund beneficiaries" (Fisch and Schwartz 2023, 7).

These problems with pass-through voting are exacerbated in the public pension context because government employees have less opportunity to opt out of the system or to provide input on voting and alternative engagement decisions (Mahoney and Mahoney 2021, 860–865). Moreover, trustees of large public pension plans often make decisions driven more by political considerations than market conditions (Mahoney and Mahoney 2021, 844). Public pension funds wield disproportionate influence over corporate policies, including marketing and advertising, because they are less constrained by market forces, allowing them to exert power beyond what their ownership stake typically suggests (Mahoney and Mahoney 2021, 878). This strength consequently increases the risk that fund managers' actions, whether as shareholders or otherwise, may not align with the actual interests of beneficiaries.

Fisch and Schwartz propose a model to address some of these concerns: "informed intermediation," in which "a fund manager's fiduciary duties require it to make a reasonable effort to identify and evaluate fiduciary preferences in order to ensure that the manager is voting and engaging in the interests of its beneficiaries" (Fisch and Schwartz 2023, 7–8). The informed mediation model involves proactive steps by fund managers to understand beneficiaries' preferences before casting votes or engaging with corporate boards. It could involve several strategies: conducting regular surveys to gauge beneficiaries' views, implementing online platforms to detail their investment priorities, using data analytics to aggregate individual preferences into actionable insights, and developing systems to obtain explicit permissions for specific voting or engagement actions (Fisch and Schwartz 2023, 48). These methods would enable fund managers to make decisions that better reflect the collective will of their beneficiaries. By leveraging technology and data-driven techniques, fund managers could bridge the gap between fiduciary duties and the diverse preferences of their beneficiary base, ultimately enhancing transparency and alignment in investment stewardship practices.

Some asset management firms are already taking steps in this direction. For instance, BlackRock introduced two customized voting options through proxy advisory firms like Glass Lewis, Institutional Shareholder Services (ISS), and Egan-Jones, including a policy that abandons stakeholderism's focus on social responsibility instead of a narrow focus on wealth (BlackRock 2024). One criticism is that, while these customized voting options offer more choice, they still limit the range of possibilities to a narrow set predetermined by the proxy advisory firms (Wall Street Journal Editorial Board 2023). From this perspective, these customized voting options offer only limited agency, creating the illusion of choice while failing to represent the full spectrum of shareholder interests.

State Street recently launched a dual-track stewardship program featuring a standard service and a new "Sustainability Stewardship Service" designed to "support those clients who wish for more active engagement on sustainability topics" (Webb 2024b). Initially, State Street stated its aim to "provid[e] our clients with choices" (Webb 2024b).

However, these options appear to differ only in the extent of their climate-focused engagements—essentially, investor clients of State Street can choose between a sustainability-focused stewardship service and an even more sustainability-focused option. According to *Responsible Investor*, State Street's ESG division clarified that the new voting choice program allows investors to decide how actively the stewardship team engages with corporate entities on climate-related goals (Webb 2024a). Reportedly, the standard engagement team and the new sustainability stewardship team will deliver consistent messages to corporate entities, collaborating in engagement meetings to ensure they "avoid 'mixed messaging' on expectations" (Webb 2024a). Karen Wong, State Street's ESG Head, noted that the firm's approach in its non-sustainability-focused stewardship remains unchanged, addressing concerns that the new offering might reduce its ambitions. The global voting and engagement policy will continue to consider sustainability issues. To underscore State Street's commitment to ESG principles, Wong confirmed that the company has "no plans" to introduce "a service for clients who would like to opt out of any kind of stewardship on sustainability issues" (Webb 2024a).

State Street's new dual-track stewardship program, designed to offer clients more options, raises critical questions about its practical implementation, effectiveness, and ability to resolve the collective action and fiduciary duty problem. The distinction between the program's two services (the standard stewardship service and the "Sustainability Stewardship Service" for clients seeking more active engagement on sustainability issues) may not be as clear-cut as initially suggested. The allegation that the primary difference lies in the intensity of climate-focused engagements rather than in fundamentally different approaches to sustainability or that clients can choose between varying levels of sustainability focus rather than opting out entirely raises practical concerns about whether a single asset management firm can effectively offer multiple stewardship options.

The engagement process could become confusing or counterproductive if the messages between different services diverge. For instance, one team at the firm might advise an energy company to invest in clean-energy technologies while another team advises divestment from those same technologies; one team may advocate increased drilling while another recommends drilling reductions; one team may champion a set of responses to geopolitical conflicts that contradict the suggestions of another team. Such potential inconsistencies highlight the challenges of implementing a dual-track approach within a single organization. Although State Street aims to provide flexibility for its clients, the effectiveness of its strategy depends on clear communication and alignment between the different stewardship teams. Without careful coordination, the initiative could undermine the very goals it seeks to promote, potentially leading to mixed outcomes for both investors and the companies involved.

The lack of uniformity in pension investment-related laws across different states poses additional challenges for a program of this nature. Various states—South Carolina (South Carolina House Bill 3690), Georgia (Georgia House Bill 481), Arkansas (Arkansas House Bill 1253), Florida (Florida House Bill 3), Indiana (Indiana House Bill 1008), Kansas (Kansas House Bill 2100), and Kentucky (Kentucky House Bill 236), for example—have enacted legislation to push back against ESG investments by requiring public fund managers to prioritize pecuniary factors over social or environmental considerations when making investment decisions. This patchwork of state-level prohibitions (i.e., differences in rules from state to state rather than within a state) creates a complex and inconsistent landscape that can undermine the effectiveness and implementation of a comprehensive dual-track stewardship program. The lack of harmonized investment rules and practices across state lines introduces complications and potential legal implications. Fund managers may find themselves torn between adhering to the specific requirements of individual state laws and adhering to the principles and guidelines of the stewardship program. This tension could lead to confusion, inconsistencies, and potentially suboptimal outcomes for pension fund beneficiaries.

Diverting public funds away from specific industries based on subjective ESG criteria risks alienating the beneficiaries whose retirement security these funds are meant to safeguard. Public fund managers risk a beneficiary backlash by pursuing socially motivated investments or engaging with portfolio companies on controversial environmental or political issues, especially since the beneficiaries cannot quickly or easily exit or transfer their retirement savings (Mahoney and Mahoney 2021, 860–865). Moreover, public employees may have personal affinities for or professional affiliations with specific businesses or industries deemed undesirable under an ESG framework. Forcing the exclusion of these businesses or sectors from pension portfolios could breed resentment and undermine the trust essential for the effective functioning of these retirement systems. One could make this argument for *any* company excluded from a fund for any reason, underscoring a broader issue with retirement funds in general. However, as Eric John Finseth notes, “in the case of the typical employee pension fund, the state has not formally created a corporation with shares of stock nominally owned by the employees” (Finseth 2011, 315–16). Another critical difference is the level of choice available to individual retail investors versus government employees contributing to pension funds. Government employees are paid with public funds, and their pension contributions are drawn from those publicly funded paychecks.

ESG investment of public pensions is also hazardous in light of its probable violations of the First Amendment’s free speech protections. In *Janus v. AFSCME* (2018), the U.S. Supreme Court held that state law cannot compel public employees to financially support a union if they opt not to join or disagree with its positions. Kubisch argues that the Court’s compelled speech doctrine, as expressed in *Janus*, likely renders public pension funds and other mandatory investing unconstitutional if they follow ESG principles. Public pension funds may face First Amendment challenges for requiring state and local employees to be members while engaging in ESG investing that manifestly expresses ideological or political views (Kubisch 2023, 83–86). ESG investing is increasingly considered political speech because it promotes controversial policies beyond financial interests (Kubisch 2023, 81–82). The laws in Florida and Texas that ban public pension funds from using ESG criteria or working with companies boycotting fossil fuels, as well as the broader backlash against

ESG, including divestment from asset managers like BlackRock, evidence the politicized nature of ESG investing (Kubisch 2023, 81–82). Kubisch analogizes mandatory pension schemes to compulsory membership dues in state associations and cites appellate cases holding that the latter cannot be used to engage in political or ideological activities unrelated to their core purpose (Kubisch 2023, 85–86). The *Janus* precedent probably at least requires opt-out rights for government employees with public pensions (Webber 2019, 2105).

Fiduciary Requirement Differences for Public and Private Pensions

Earlier, we mentioned that state financial officers, pension fund boards of trustees, and asset managers investing the public pension money are not subject to the constraints and regulations of ERISA because each state codifies its fiduciary rules for these fiduciaries. However, that is not the case with private employers. Pilot Bryan Spence has filed a class-action lawsuit against American Airlines alleging that the company violated its fiduciary duty under ERISA by investing millions of employees' 401(k) money in underperforming ESG investments. His complaint alleges that BlackRock, the asset manager investing those funds, is also a large shareholder of American Airlines, thus creating a conflict of interest.

The disparity in standards between government pension investing and private retirement savings management raises significant normative concerns. This inconsistency creates unequal protection because public sector employees potentially receive less safeguarding for their retirement investments than their private sector counterparts. It allows government officials to make investment decisions prioritizing political or ideological goals over fiduciary responsibility, potentially compromising beneficiaries' financial interests and moral convictions. Looser standards for public pensions may create opportunities for political maneuvering or ideological influence in investment decisions. If we accept that specific standards of fiduciary duty are crucial for protecting retirees' interests, it becomes difficult to justify their inconsistent application across public and private sectors. Over time, this disparity could lead to significant differences in retirement outcomes between public and private sector employees. Moreover, the perception that public pension funds are subject to less stringent oversight could erode public trust in government financial management more broadly. As evidenced by emerging legal challenges, this inconsistency will likely lead to complex legal battles, creating uncertainty in the pension fund landscape.

These concerns collectively highlight the need for a more consistent approach to pension fund investments across public and private sectors, ensuring that all retirees' interests are adequately protected.

In short, asset managers overseeing public pension funds will invariably struggle to balance beneficiaries' diverse interests while upholding their fiduciary duties. The inevitable clash of interests between beneficiaries creates an intractable dilemma for fund managers: prioritizing ESG preferences may compromise overall portfolio performance, whereas focusing solely on returns could alienate those with social, environmental, or political convictions tied to their investments. The complexity is further exacerbated by the inconsistent regulatory landscape across U.S. states that forces fund managers to navigate conflicting legal requirements. Even innovative solutions like "pass-through" voting or customized stewardship programs fail to fully address the collective action problem, as low voter turnout and the difficulty of representing millions of beneficiaries' preferences persist. These structural limitations raise doubts about asset managers' ability to effectively reconcile pension participants' varied trade-offs and priorities while safeguarding their financial futures.

Investment Federalism

To formulate a viable solution to this collective action problem, we need to assess the problems with collective action and those with individuation. While investment standardization is inefficient, as we will elaborate, it is also not the case that all economic agents would do better to take complete control of their investment portfolio.

Of course, the intuitive response is to let the market decide, allowing economic agents to choose how much their investments are self-directed or managed by a financial professional. However, given the current reality of regulatory determinism of financial markets, it is worth theoretically explaining the challenges of such a top-down approach. This theoretical work allows a market-based solution to emerge as the preferred solution.

The Inefficiencies of Individuation

The general case for investment standardization hinges on recognizing inefficiencies in financial investment self-direction. While individualized investing accurately reflects heterogeneous preferences within the market, it fails to create and exploit *specialized* knowledge that would allocate investment monies more effectively.

Specialization in financial investment allows a division of labor in which most economic actors are not required to know or pay close attention to the business fundamentals of organizations. Professional financial investing is a highly knowledge-intensive process (Aggarwal, Kryscynski, and Singh 2015, 2685–2706; Atmaningrum, Kanto, and Kisman 2021, 103; Dimov, Shepherd, and Sutcliffe 2007, 481–502). Nonprofessionals who manage their own portfolios have been found to rely heavily on simple heuristics, including emotions, for their investment choices (Barron, Enis, and Qu 2021, 230; Chen, Harding, and He 2021, 43–63; Jansson et al. 2024, 861–863; Mušura Gabor and Gamulin 2016, 15–25). Generally, nonprofessional investors are better off relying on specialists with greater knowledge who can extensively research businesses' operational health and strategic plans. This division of labor allows knowledge economies to emerge and be efficiently exploited.

These principles also seem to imply an increasing centralization of investment decision-making as the information necessary for such decision-making becomes more accessible with modern technologies. In particular, big data and analytics technologies allow effective investing strategies and techniques to be applied to virtually all market aspects. Progressivity in developing more efficient market predictors, capturing more accurate data, and more advanced analyses suggests that, over time, financial optimization efforts will incrementally manifest as standardization.

The Inefficiencies of Standardization

Valid arguments militate against the standardization of investment protocols, two of which we will highlight here. First, standardization falsely assumes that state constituents have standardized investment preferences and risk profiles. Secondly, such standardization is economically inefficient, resulting in *lower* portfolio performance. Let us elaborate on both of these points.

First, while it is easy to assume that beneficiaries are uniform in their preference for higher returns and social progress, empirical evidence reveals this to be false (Khan 2017; Shou, Olney, and Wang 2022). Although U.S. state populations are, due to modern advancements in communications and mobility technologies, far "thicker," i.e., more culturally proximal to each other, than at any point in history, there remain meaningful subcultural differences across regions and states (Bertsch 2009; Lieske 2010). This implies that a uniform, one-size-fits-all investment strategy would fail to account for the variance between states' risk preferences and investment values.

Second and perhaps more importantly, investment standardization is economically inefficient for two key reasons: (1) It fails to exploit the dispersed knowledge of a populace, and (2) it confronts the severe challenges of centralized decision-making regarding dynamic information processing. F.A. Hayek (1945, 519) famously noted that centralized economic decision-making, such as in the case of standardized investments, is purely a matter of logic "*if* [the decision makers] possess all the relevant information, *if* [they] can start out from a given system of preferences and *if* [they] command complete knowledge of available means." But, he observes, "the knowledge of the circumstances of which [they] must make use never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess." Thus, the so-called "efficient market hypothesis"—where "prices fully reflect all known information and even uninformed investors buying a diversified portfolio at the tableau of prices given by the market will obtain a rate of return as generous as that achieved by the experts" (Malkiel 2003, 59)—requires that economic agents are free to transact according to their own unique "knowledge of the particular circumstances of time and place" (Hayek 1945, 521). When such decisions are centralized, the market loses its efficiency, reflecting only a narrow subset of the total knowledge of a population.

Relatedly, Ludwig von Mises (1951) pointed out that markets are highly dynamic, an evolution of not only individual knowledge but also individual circumstances, ideas, values, and preferences. Thus, for Mises (1951, 139), "the problem of economic calculation is a problem which arises in an economy which is perpetually subject to change, an economy which every day is confronted with new problems which have to be solved." Because of this, economic action generally and "entrepreneurial" investment specifically are bound up in necessary speculation. This speculation is facilitated by market prices, which, by their dynamic nature, reflect the changing preferences, circumstances, and knowledge of all market actors. However, when such speculation is centralized—e.g., through standardized investment protocols—again, the efficiency of markets and the wisdom of crowds (Surowiecki 2005) is lost.

Some (e.g., Camarinha Lopes 2021) have argued that the era of big data and big computing solves the knowledge and calculation problems of central planning, allowing dynamic accounting of market factors to enable centralized economic planning and standardized investment. While we do not intend to drift into an argument about the limits of AI and big data, the socialist calculation problem holds, even for Laplace's demon. This is because what is wanted in the market, what is valuable, is *consumers'* choice (Hutt 1940; Witt 2001) and is not captured well by some utility or social welfare function. In other words, big data and AI cannot tell us what we *will* and *should* want, now or in the future. It cannot fathom what ideas entrepreneurs might generate, shifting the foundations of economic value and production structure in "kaleidic" waves of "creative destruction" (Schumpeter 1942; Shackle 1974). Economic demand is constantly and altogether a *momentary* "snapshot" of affairs reflecting the current aggregate state of all market participants' tenuous and ever-evolving value judgments.

Because of these core problems, standardized investment protocols are generally inefficient, and standardized portfolios will tend to underperform more decentralized market investments, which embody the knowledge and judgments of all market participants rather than a few people's narrow understanding and judgments or, alternatively, a particular identifier derived from historical data that is unlikely to hold in all possible contexts. Market participants would variably account for the value and benefits of social welfare commitments to the extent that they perceive them to be economically valuable. However, the value of such social welfare commitments, particularly to "sovereign" consumers (Hutt 1940; Mises 1998), is not uniform, and so over-privileging such commitments in standardized investment protocols will generally overinvest in such organizations and underinvest in those more committed to other values. Over time, such systemic "malinvestments" would manifest as business cycles, economic "bubbles" of overinvestment that pop and collapse when market demand fails to bear that level of investment.

Toward a Federalized Approach

Unsurprisingly, a market-based solution would resolve both inefficiencies. To the extent that individuals do not have sufficient specialized knowledge to invest their savings effectively, we expect them to hire professionals to manage their accounts. However, we would also expect fund managers to cater to the heterogeneity of beneficiaries' investment preferences. Different funds would integrate different social values as key criteria for inclusion in their portfolio, which would be marketed to investors who prioritize such values. Others would expectedly avoid value investing, focusing on market value and economic efficiency as primary inclusion criteria. Whatever the preference, there would be a fund to cater to it.

However, this preferential market organization is severely diluted in the case of public pensions and other institutional investment funds. Yet modern organizational advancements and technologies render the individual customization of benefits quite possible. Thus, states (and organizations) would do well to allow their employees to choose their preferred financial specialists and retirement funds.

This may take several forms. In the most radical market approach, the organization would pass compensation on to its employees, who can then do with it what they will. In the current institutional context of tax-privileged retirement allocations, the more likely solution is that organizations provide retirement funding that can be invested in any number of vehicles at the stakeholder's discretion. More moderately, introducing multiple portfolio options, managed by various firms with the inclusion criteria transparently published would constitute significant progress. Employees would, thus, enroll electively in funds most representative of their preferences. Portfolio self-management options might also be made available. The terms of enrollment—including personal and employer contributions, vesting period, interfund transferability, and the like—would be determined by the organization, negotiated with fund managers, and made transparent to employees. At a minimum, states (and organizations) should avoid value standardization and instead represent their stakeholders' value preferences with a portfolio that caters to their populace's general culture, values, and preferences. These sort of "federalization" approaches would minimally allow constituents to "vote with their feet," if they so choose, which severely attenuates the challenge of moral pluralism we have described.

Any such change is likely to be opposed, particularly by those fund managers who now enjoy privileged positions as managers of the state's (or organization's) retirement funds. Sweetheart agreements may limit fund options. We encourage anti-corruption institutions to dissuade such limitations.

Conclusion

ESG investing in public pension funds creates conflicts between fiduciary duties and socially motivated goals as fund managers struggle to represent diverse beneficiary interests. The rise of institutional investing has changed corporate governance dynamics, and it is challenging for asset managers to represent millions of beneficiaries' preferences accurately. Some asset management firms are introducing customized voting options and dual-track stewardship programs to address these challenges, but these solutions have limitations. A growing patchwork of state-level legislation pushes back against ESG investments in public funds, creating a complex legal landscape. ESG investment of public pensions may violate First Amendment free-speech protections by compelling public employees to support political or ideological views through retirement savings.

The disparity in standards between public and private sector pension management raises concerns about unequal protection and potential conflicts of interest. Standardization of state investment protocols is problematic because it assumes uniform preferences across diverse state populations, and it is economically inefficient, failing to exploit dispersed knowledge and struggling with dynamic information processing. States should allow employees to choose their preferred retirement funds or, at minimum, develop portfolio options catering to their constituents' values and preferences. Ultimately, the complex interplay of fiduciary duties, diverse beneficiary interests, and evolving ESG considerations necessitates a more nuanced and flexible approach to public pension fund management that respects individual choice and state-level autonomy.

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