October 5, 2020

Jeanne Klinefelter Wilson,
Acting Assistant Secretary
Employee Benefits Security Administration
Office of Regulations and Interpretations
U.S. Department of Labor
Attention: Proxy Voting and Shareholder Rights NPRM
Room N–5655,
200 Constitution Avenue NW
Washington, DC 20210

Re: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights (RIN 1210–AB91)

Via Federal eRulemaking Portal (www.regulations.gov)

Dear Ms. Wilson:

I am pleased to provide these comments on the proposed rule "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights."[1] The Department is to be commended for proposing this rule. The rule will protect investors from those seeking to pursue political or social objectives at the expense of those investing for their retirement.

Fiduciaries are obligated to act in the interest of plan beneficiaries and are not be permitted to take actions that reduce the return to beneficiaries to further a social or political objective of the fiduciary. Specifically, the Employee Retirement Income Security Act of 1974 at 29 U.S. Code § 1104(a) requires that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." The proposed rule furthers that objective by generally requiring, when deciding how and whether to vote proxies, that fiduciaries "act solely in accordance with the economic interest of the plan and its participants and beneficiaries considering only factors that they prudently determine will affect the economic value of the plan's investment."[2]

The proposed rule does a good job of outlining the factors to be considered by fiduciaries when assessing whether and how to vote proxies. It addresses a gap that exists in the otherwise laudatory proposed rule "Financial Factors in Selecting Plan Investments Proposed Regulation."[3]

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[1] "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights," Proposed Rule, *Federal Register*, Vol. 85, No. 173, September 4, 2020, pp. 55219-55243.
[2] Proposed Rule § 2550.404a–1(e)(2)(ii)(A).
[3] "Financial Factors in Selecting Plan Investments Proposed Regulation," Proposed Rule, *Federal Register*, Vol. 85, No. 126, June 30, 2020, pp. 39113-39128. For an explanation, see section entitled "A Proposed Improvement" in Comment Letter of David R. Burton regarding Financial Factors in Selecting Plan Investments, July 30, 2020 https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00595.pdf.

Fiduciaries should be in the business of providing economic value to beneficiaries and plan participants not pursuing political or social objectives at the expense of beneficiaries and plan participants. This proposed rule, in conjunction with proposed rule "Financial Factors in Selecting Plan Investments Proposed Regulation," ensures that fiduciaries will act in beneficiaries' and plan participants' interest.

*Environmental, Social and Corporate Governance (ESG)*

This section provides a very brief critique of environmental, social and corporate governance (ESG) criteria, corporate social responsibility (CSR) requirements, socially responsible investment (SRI) requirements, sustainability requirements, diversity requirements or stakeholder theory. Sometime rhetorical obfuscation notwithstanding, the goal of proponents of ESG, CSR, SRI, sustainability requirements, diversity requirements or stakeholder theory is not to increase corporate profits but to instead alter corporate behavior by legislative, regulatory or other means in furtherance of some (or many) social or political objectives in a way that will reduce shareholder returns. If ESG did not reduce returns, there would generally be no need to require that ESG objectives be pursued. The normal pressures to earn a profit in a market economy would push management to do so.

ESG, CSR and stakeholder theory proponents are trying to alter the very purpose of businesses. Their aim is to pursue a plethora of social objectives rather than earning profits or meeting consumer wants. This would reduce social welfare. It would make American businesses less competitive and cost workers their jobs. It will reduce wages. It would make the American economy less efficient and productive, raising prices to consumers. It would make businesses become poor stewards of scarce resources. It would make management less accountable since the metric of "success" will become extremely amorphous. It would reduce the returns to investors and have an adverse impact on the pension plans and defined contribution retirement accounts of well over a hundred million people. Perhaps most fundamentally for purposes of this comment, it is unlawful under ERISA for fiduciaries to consider ESG objectives rather than simply considering how to maximize the risk-adjusted return to plan beneficiaries.

The purpose of businesses is to deploy investors' capital and employees' labor in the service of consumer needs and wants with the aim of making a profit. Businesses can and do engage in philanthropy, help to improve communities and undertake other social engagement because it promotes their businesses and in management's judgment will increase profits. Shareholder can, but very rarely do,[4] vote to instruct management to pursue various social goals even if it reduces profits.

*Economic Analysis*

The economic analysis of the reduction in administrative costs that the proposed rule would generate is generally sound given the general lack of available data on such matters. The economic analysis, however, does not address the broader social costs associated with ESG requirements. This section provides an analytical framework that the Department may find useful in analyzing the social welfare costs of ESG requirements.

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[4] See, e.g., Proxy Preview, 2020 https://www.proxypreview.org/2020/report-cover.

To the extent ESG objectives are not pursued by businesses for the purpose of making a profit, $R > R_{ESG/CSR}$ where R is the rate of return on investment in the absence of ESG, CSR, sustainability requirements, diversity requirements or stakeholder theory implementation and $R_{ESG/CSR}$ is the rate of return after implementation of those requirements.[5] The difference, $R - R_{ESG/CSR}$ is economically analogous to a tax. It is a reduction in return due to the pursuit of ESG objectives. Thus, $R - R_{ESG/CSR} = Tax_{ESG/CSR}$. This means that various techniques used in public finance to analyze the social welfare impact of taxes may be used to quantitatively analyze the social welfare cost of these provisions (i.e. $Tax_{ESG/CSR}$). A tax has an excess burden or deadweight loss that can be calculated.[6] By introducing a wedge ($Tax_{ESG/CSR}$) between, in this case, the gross return and the net return, ESG/CSR reduces the size the capital market and therefore output and employment. In a well-functioning market, the price of a capital asset should be equal to the present value of the expected future income stream generated by the asset net of taxes and depreciation.[7] Introducing a new tax (in this case $Tax_{ESG/CSR}$) will reduce the expected future income stream and therefore the price of the asset. It will also cause investment to flow out of the affected sector or jurisdiction.

Who bears the actual economic burden of the corporate income tax is an open question.[8] The analysis of who bears the burden of $Tax_{ESG/CSR}$ would be the same. One thing is certain: It cannot be corporations. A corporation is a legal fiction, and legal fictions do not pay taxes—people pay taxes. The corporate tax could be borne by corporate shareholders in the form of lower returns;[9]

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[5] Of course, entrepreneurs are today free to form benefit corporations or benefit limited liability companies that serve a social purpose as well as the purpose of making a profit. But relatively few businesses are so organized and relatively little investor capital flows to benefit corporations or LLCs. Individuals are free to invest in these companies but fiduciaries have no business investing other's money in such enterprises absent an explicit indication that investors agree with the social goals of the enterprise and are willing to accept a lower rate of return.

[6] Arnold C. Harberger, "The Incidence of the Corporation Income Tax," *Journal of Political Economy* (June, 1962), pp. 215-240; Alan J. Auerbach and James R. Hines, "Taxation and Economic Efficiency," Chapter 21 in *Handbook of Public Economics*, Martin Feldstein and A.J. Auerbach (Editors) (North Holland:2002); John Creedy, "The Excess Burden of Taxation and Why it (Approximately) Quadruples When the Tax Rate Doubles," New Zealand Treasury Working Paper No. 03/29, December, 2003 https://treasury.govt.nz/sites/default/files/2007-10/twp03-29.pdf. Also see, for example, N. Gregory Mankiw, *Principles of Economics*, 4th Edition (2006), Chapter 8 (or many other textbooks on price theory, microeconomics, or principles of economics).

[7] See Robert E. Hall and Dale Jorgenson, "Tax Policy and Investment Behavior," *American Economic Review*, Vol. 57, No. 3 (June, 1967), pp. 391-414 for the basic user cost of capital analysis with taxes. See also Dale W. Jorgenson, *Investment: Capital Theory and Investment Behavior* (The MIT Press:1996) and John Creedy and Norman Gemmell, "Taxation and the User Cost of Capital: An Introduction," New Zealand Treasury Working Paper No. 04/2015, March, 2015 https://www.victoria.ac.nz/sacl/centres-and-institutes/cpf/publications/pdfs/2015-pubs/WP04_2015_Taxation-and-User-Cost.pdf.

[8] In the economics literature, this question is usually phrased as "What is the incidence of the corporate income tax?"

[9] Government estimators are among the few who cling to the view that shareholders bear most of the burden. Joint Committee on Taxation, "Modeling the Distribution of Taxes on Business Income," JCX-14-13, October 16, 2013, https://www.jct.gov/publications.html?func=download&id=4528&chk=4528&no_html=1 (25 percent labor); Julie Anne Cronin, Emily Y. Lin, Laura Power, and Michael Cooper, "Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology, "National Tax Journal, March 2013 https://www.ntanet.org/NTJ/66/1/ntj-v66n01p239-62-distributing-corporate-income-tax.pdf (18 percent labor).

owners of all capital (again in the form of lower returns);[10] corporate customers in the form of higher prices;[11] or employees (in the form of lower wages).[12] It is, almost certainly, some combination of these.[13] The economics profession has changed its thinking on this issue several times over the past four decades, but the latest —and highly plausible —consensus is that workers probably bear more than half of the burden of the corporate income tax because capital is highly mobile.[14] Labor's share of the corporate tax burden is potentially as high as three-quarters.[15] Shareholders (investors) probably bear most of the remainder.[16] Initially (i.e. in the short run), the impact on shareholder returns will be greater. Adjustments take time. Thus, to the extent that the rule reduces the ESG tax ($Tax_{ESG/CSR}$) which would have borne disproportionately

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[10] The non-corporate sector can be affected because competition will eventually cause wages, prices, and after-tax returns in the corporate and non-corporate sectors to be the same. For a more detailed explanation, see Arnold C. Harberger, "The Incidence of the Corporation Income Tax," *Journal of Political Economy*, Vol. 70, No. 3 (June 1962), pp. 215–240.

[11] The focus of the economics profession to date has been almost exclusively the impact on capital and labor rather than customers.

[12] Arnold C. Harberger, "The ABCs of Corporation Tax Incidence: Insights into the Open-Economy Case," in *Tax Policy and Economic Growth* (Washington, DC: American Council for Capital Formation, 1995); Arnold C. Harberger, "The Incidence of the Corporation Income Tax Revisited," *National Tax Journal*, Vol. 61, No. 2 (June,2008), pp. 303–312, http://www.ntanet.org/NTJ/61/2/ntj-v61n02p303-12-incidence-corporation-income-tax.pdf; Matthew H. Jensen and Aparna Mathur, "Corporate Tax Burden on Labor: Theory and Empirical Evidence," *Tax Notes*, June 6, 2011, https://www.aei.org/wp-content/uploads/2011/06/Tax-Notes-Mathur-Jensen-June-2011.pdf; Kevin A. Hassett and Aparna Mathur, "A Spatial Model of Corporate Tax Incidence," American Enterprise Institute, December 1, 2010, https://www.aei.org/wp-content/uploads/2011/10/-a-spatial-model-of-corporate-tax-incidence_105326418078.pdf; Robert Carroll, "The Corporate Income Tax and Workers' Wages: New Evidence from the 50 States," Tax Foundation Special Report No. 169, August 3, 2009, https://taxfoundation.org/corporate-income-tax-and-workers-wages-new-evidence-50-states/; Desai Mihir, Fritz Foley, and James Hines, "Labor and Capital Shares of the Corporate Tax Burden: International Evidence," December 2007; and Jason J. Fichtner and Jacob M. Feldman, "Why Do Workers Bear a Significant Share of the Corporate Income Tax?" in The Hidden Cost of Federal Tax Policy, Mercatus Center, 2015, Chapter 4, https://www.mercatus.org/system/files/Fichtner-Hidden-Cost-ch4-web.pdf. For a contrary view, see Kimberly A. Clausing, "In Search of Corporate Tax Incidence," *Tax Law Review*, Vol. 65, No. 3, 2012, pp. 433–472, http://ssrn.com/abstract=1974217.

[13] It requires extreme, implausible assumptions about elasticities of demand for, or supply of, factors for this not to be the case. Alan J. Auerbach, "Who Bears the Corporate Tax? A Review of What We Know," National Bureau of Economic Research Working Paper No. 11686, October,2005, http://www.nber.org/papers/w11686.pdf; William M. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax," Department of the Treasury, Office of Tax Analysis OTA Paper No. 101, December,2007, https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-101.pdf; and Stephen J. Entin, "Tax Incidence, Tax Burden, and Tax Shifting: Who Really Pays The Tax?" Heritage Foundation Center for Data Analysis Report No. 04-12, November 5, 2004, http://s3.amazonaws.com/thf_media/2004/pdf/cda04-12.pdf.

[14] In a competitive market, capital will flow from jurisdictions with a relatively low expected after-tax return to jurisdictions with a relatively high expected after-tax return until the expected after-tax returns are equal. Social and legal barriers reduce labor mobility relative to capital mobility. Gentry, "A Review of the Evidence on the Incidence of the Corporate Income Tax"; William C. Randolph, "International Burdens of the Corporate Income Tax," Congressional Budget Office, August,2006, https://cbo.gov/sites/default/files/cbofiles/ftpdocs/75xx/doc7503/2006-09.pdf; and R. Alison Felix, "Passing the Burden: Corporate Tax Incidence in Open Economies," Federal Reserve Bank of Kansas City, October,2007, https://www.kansascityfed.org/Publicat/RegionalRWP/RRWP07-01.pdf.

[15] Ibid.

[16] As opposed to non-corporate capital and customers.

by labor due to capital factor mobility, the rule can be expected to have a positive impact on workers as well as shareholders.

Sincerely,

David R. Burton
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