# Economic implications of passive investing

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## Abstract

Index funds have grown significantly in recent years in most of the developed markets as investors have become less satisfied with the performance of active managers. Further, the flow of funds to passive investing has been supplemented by a high level of quasi-indexing undertaken by numerous active managers fuelled by their perception that they have to strictly control their tracking error relative to their given benchmark. The focus of this paper is on the economic implications of this major swing to passive investing. In particular, the paper highlights that (1) the assumed constraints on the growth in passive investing envisaged by writers such as Lorie and Hamilton (1973) is never likely to come into play; and (2) a high level of passive investing is likely to contribute to excessive and wasteful investment which results in lower economic growth and investor returns. This all suggests that although a heavy reliance on passive investing might appear rational for investors, it may well prove not only to be to their economic detriment but also that of the national economy.

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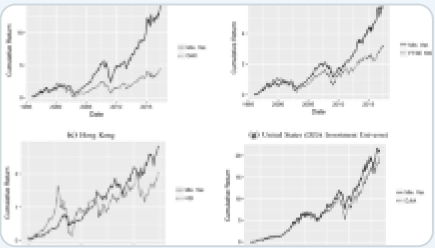

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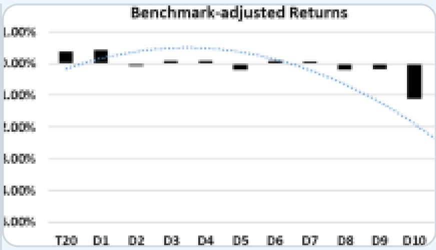


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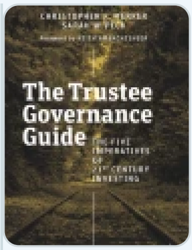


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