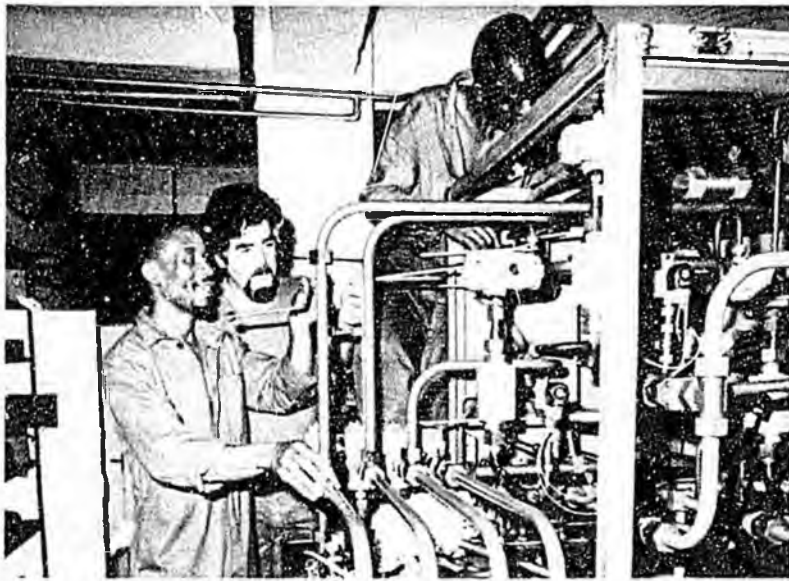


ALASKA LEGISLATURE COMMITTEE FILES 1985-1986 86/2

3735 HSTA HCR 17 (FILE 3) 61



Two black employees getting instructions from the Workshop Foreman in the assembly of a hydraulic unit.

Blacks as % of Total in Supervisory and Management Categories, Sullivan Reporting Signatories

16.7	1979
21.8	1980
25.2	1981
21.6*	1982
21.2*	1983

*Decrease in '82 and '83 is likely a result of the recession.

Increasing the Number of Blacks, Coloreds, and Asians in Management and Supervisory Positions

PRINCIPLE FIVE



Jacob George, left, and his wife attend Goodyear's annual banquet honoring supervisors, artisans, and trainees. Mr. George supervises the 32 employees in the conveyor-beltting department. At right are Mr. & Mrs. Cummage Gaiwe. He is a shift foreman at Goodyear Tire & Rubber Co. (South Africa).

Management meeting
at Coca-Cola



All South Africans work
together in desegre-
gated facilities at
CIBank

**Number of Blacks in Education
and Training Programs Supported by Sullivan Reporting Signatories**

Scholarship and Tuition Refund Programs

	1979	1980	1981	1982	1983
Non-Employees	—	21,147	65,363	21,841	22,154
Employees	5,077	4,919	2,545	4,295	13,369
Sub Total	5,077	26,066	67,908	26,136	35,523

Job Advancement Training (Employees)

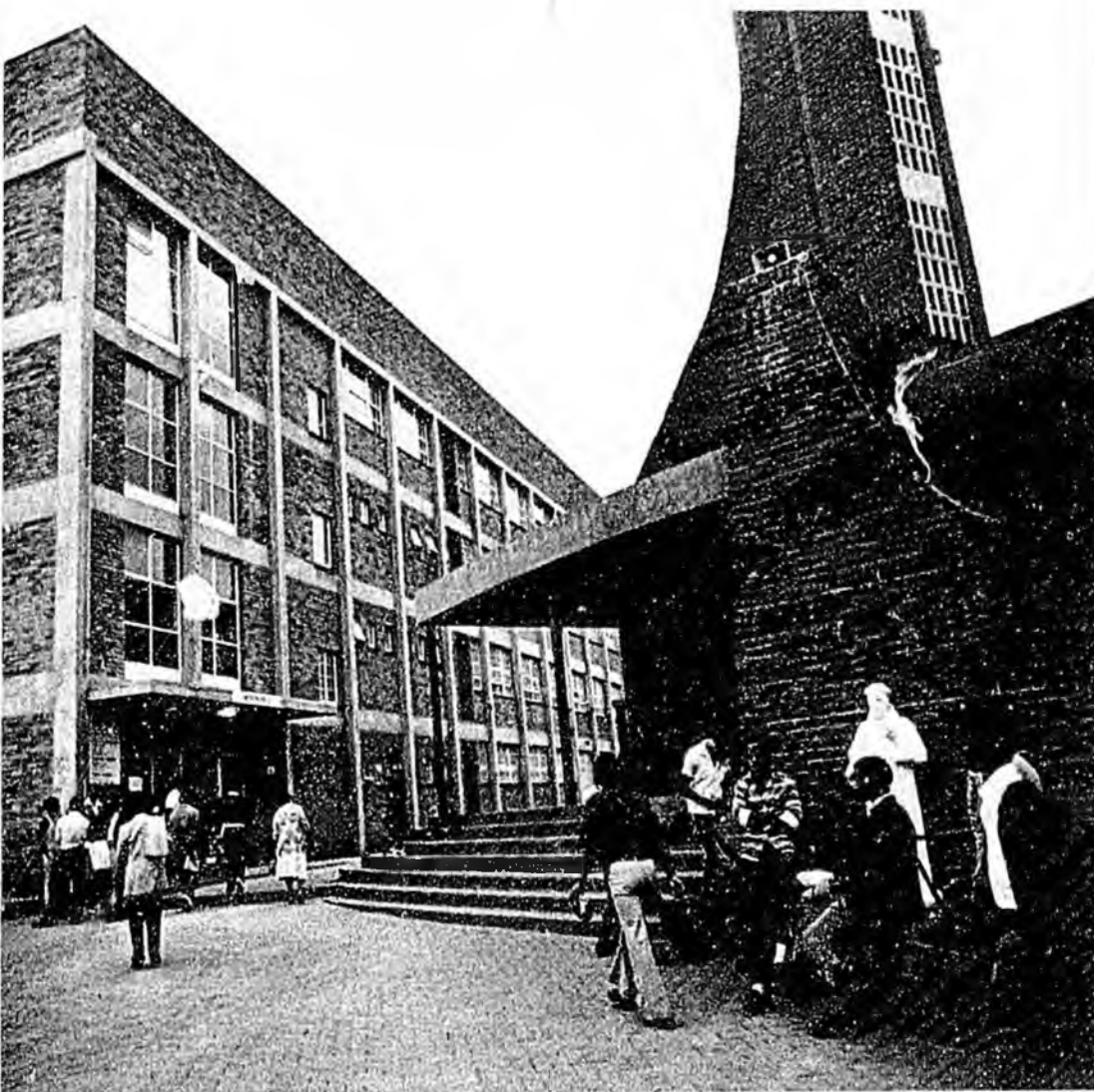
In-House	4,221	11,506	15,275	13,232	11,820
Outside	—	1,659	1,317	1,427	2,765
Sub Total	4,221	13,165	16,592	14,659	14,585
TOTAL	9,298	39,231	84,500	40,795	50,108

They're called industry training centers. Sometimes they're called technical training centers; sometimes they have other titles. By whatever name, they're the places where thousands of black South Africans are acquiring the educational basics and job skills to enable them to move into responsible jobs in industry and commerce.

One of these is St. Anthony's School at

Boksburg in the Transvaal. Here some 5,000 blacks get technical training at day or evening courses. The multi-racial center is supported in both a financial and a management sense by South African, American and European multi-national companies.

In schools of this kind, black progress is made visible. Hopes are kindled. Futures are decided.



How U.S. Companies Help Blacks Train for Jobs: The Story of St. Anthony's School

Exterior
St. Anthony's

*Students at
St. Anthony's training
center supported by
Sullivan Signatories*



*Students attending
class at a technical
center supported by
subsidiaries of U.S.
corporations.*

IBM Video Education Project



ADDENDUM

MEETING THE MANDATE FOR CHANGE

Revised January, 1985

The material in this booklet remains essentially unchanged from the time it was written except for the numerical data.

We offer herewith 1984 data for the charts included.

In each case, refer to the page indicated and to the name of the particular chart on that page, and you will be able to derive updated information on the effort of the Signatory Companies to fulfill their mandate—to bring about change in South Africa.

Page 6

Chart: **Sullivan Participation by U.S. Signatories**

1984	# Sullivan Signatories	128
	# Employees	64,724
	# Reporting Signatories	98
	% Reporting Signatories	76.6

Page 7

Chart: **Desegregation of Equal Pay, Sullivan Reporting Signatories**

1984	% Desegregated	100%
	% Equal Pay/Equal Work	100%
	% White Pay Increase	14%
	% Black Pay Increase	16%
	Inflation Rate	

Page 7 cont.

Chart: Wage of Lowest Paid Employee Related to Minimum

1984:	# Locations	% Locations
Less than 0	2	1
0	0	0
1 - 29*	2	1
30 - 50	83	48
51 - 75	50	29
75 - 100	22	13
More than 100	14	8
No answer	0	0
TOTAL	173	100

* Does not include rural locations which have satisfied non-urban minimum wage requirements

Page 8

Chart: Education and Training Programs for Black Employees*

1984:	# of People Participating	Dollar Contributions
* Basic Training	27,091	408,048
* Industry Train. Cent.	N/A	349,520
Scholarships	849	333,585
Total	27,940	1,091,153*

* Because of differing interpretations of "direct expenditures" in reporting Rand spent on training programs, a large sum of money was not recorded quantitatively by A. D. Little. Therefore, the total for Education and Training programs for black employees does not accurately reflect the effort of the Signatories.

Page 19

Chart: Sullivan Signatory Contributions Outside the Business to Improve Health Care and Living Conditions (in 000's Dollars)

1984:	Housing	\$2,332.4
	Health, Welfare, Civic	2,441.9
	Recreation	1,474.8
	Other	1,623.5
	Total	7,872.6
	Total to Date	\$32,285.0

Page 20

Chart: Sullivan Signatory Contribution Summary

1984:	Average \$'s Per Employee	
	Education and Training	\$176*
	Health and Welfare	122
	Black Entrepreneurship	53
	Total	351
1984:	Average \$'s Per Reporting Signatory	
	Education and Training	\$116,266*
	Health and Welfare	80,333
	Black Entrepreneurship	35,034
	Total	231,633*
1984:	Total \$'s (000's)	
	Education and Training	11,394*
	Health and Welfare	7,873
	Black Entrepreneurship	3,433
	Total	22,700*
	TOTAL \$'s to DATE (000's)	
	Education and Training	55,825
	Health and Welfare	32,394
	Black Entrepreneurship	13,021

* Because of differing interpretations of "direct expenditures" in reporting Rand spent on training programs, a large sum of money was not recorded quantitatively by A. D. Little. Therefore, the total for Education and Training programs for black employees does not accurately reflect the effort of the Signatories.

Page 16

Chart: **Education and Training Programs for Black Non-Employees by Sullivan Signatories**

1984:	# of People Participating	Dollar Contributions
Basic Training	*	*
Scholarships	9,397	1,916,482
Other Programs	—	1,352,858
Total	9,397	3,269,340

* Not Recorded

Page 17

Chart: **Adopt-A-School Programs, Sullivan Signatories**

1984:	# of Schools	250
	Dollar Contribution	\$1,243,965
	Total Dollar Contribution to Date	\$4,807,321

Page 18

Chart: **Summary of Financial Contributions to Educational and Training Programs For Blacks by Sullivan Signatories (in 000's Dollars)**

1984:	Non-Employees	\$3,269.3
	Employees	1,091.2*
	Adopt-A-School	1,244.0
	General Support	5,789.6
	Annual Total (1984)	\$11,394.1*

Chart: **Employees Days Contributed in Education, Training, Advising and Assisting Blacks, Sullivan Signatories – Number of Employee Days Contributed**

1984:	Industry Training Centers	N/A
	Adopt-A-School	4,948
	General Support to Ed. Inst.	8,552
	Small Business Develop. Corp.	234
	Advising and Assisting	97,704
	Total	111,438

* (See next page)

Page 8 cont.

Chart: **Racial Composition of Training Programs, Sullivan Signatories**

1984:	% of Blacks Participating	# of Blacks Participating
Skilled	48	3,090
Sales	45	1,282
Clerical	45	806
Supervisory	43	1,490
Managerial	13	259
Total		6,927

Page 9

Chart: **Black as % of Total in Supervisory and Management Categories, Sullivan Reporting Companies**

1984: 23.2%

Page 10

Chart: **Number of Blacks in Education and Training Programs Supported by Sullivan Reporting Signatories**

Scholarship and Tuition Refund Program

1984:	Non-employees	10,330
	Employees	27,940
	Sub Total	38,270

Job Advancement Training (Employees)

1984:	In-House	7,620
	Outside	2,135
	Sub Total	9,755
	Total	48,025

Page 21

Chart: **Sullivan Signatory Contributions Outside the Business in Support of Black Entrepreneurship (in 000's Dollars)**

1984:	Support of Small Business Develop. Corp.	\$ 513.6
	Consultancy and Assistance	2,919.7
	Total	3,433.3

For Additional Copies:

E. N. Brandt
Chairman, Communications Task Group
% THE DOW CHEMICAL COMPANY
2030 Dow Center
Midland, Michigan 48640

The PACE Commercial College enrolled its first students in July 1981. PACE, a privately funded school in the black township of Soweto, offers a five-year program. American companies, under the auspices of the American Chamber of Commerce in South Africa, provided the initial funding and leadership necessary to design, organize and ultimately build and furnish this unique school.

According to the 1983 enrollment brochure, the aims and objectives of PACE are:

"To give an education of the highest quality leading to a commercial matriculation in order to prepare pupils for university courses, professional diplomas, or business careers.

"To provide an enriching and comprehensive extra-mural programme for fostering qualities of leadership and encouraging a sense of responsibility and service towards the community at large.

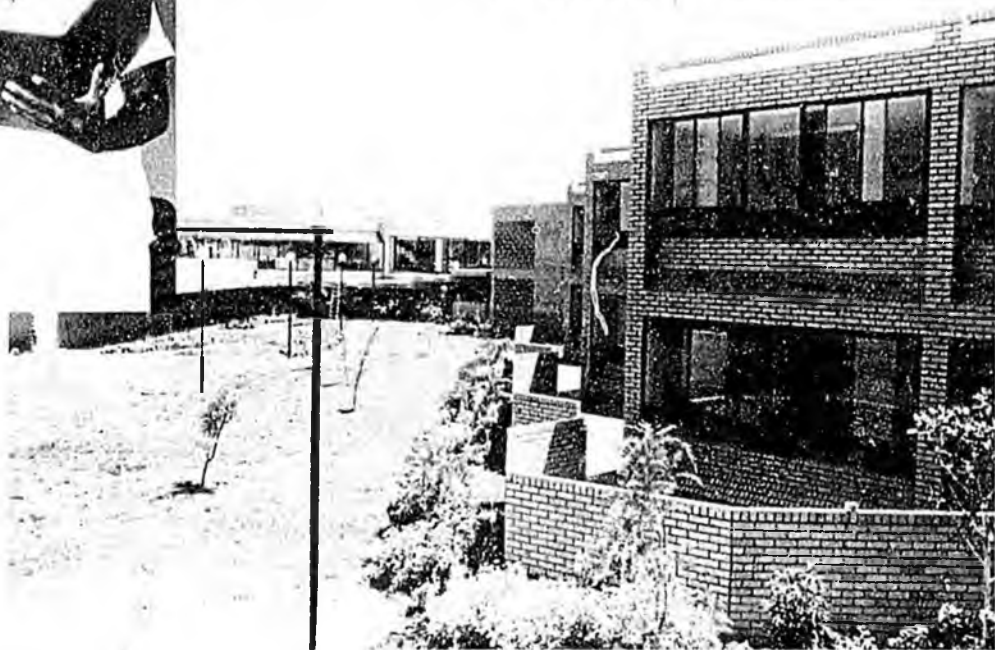
"To instill a confidence in each pupil of his or her individual worth in order that a sense might be gained of being educated for life rather than merely being trained for a living."

Acceptance into the school is based on age and merit. Parents must pay a set portion of the fees. In cases of real need or merit, the parents' portion may be waived. Merit is the essential criterion. The balance of fees is met by scholarships from the private sector.

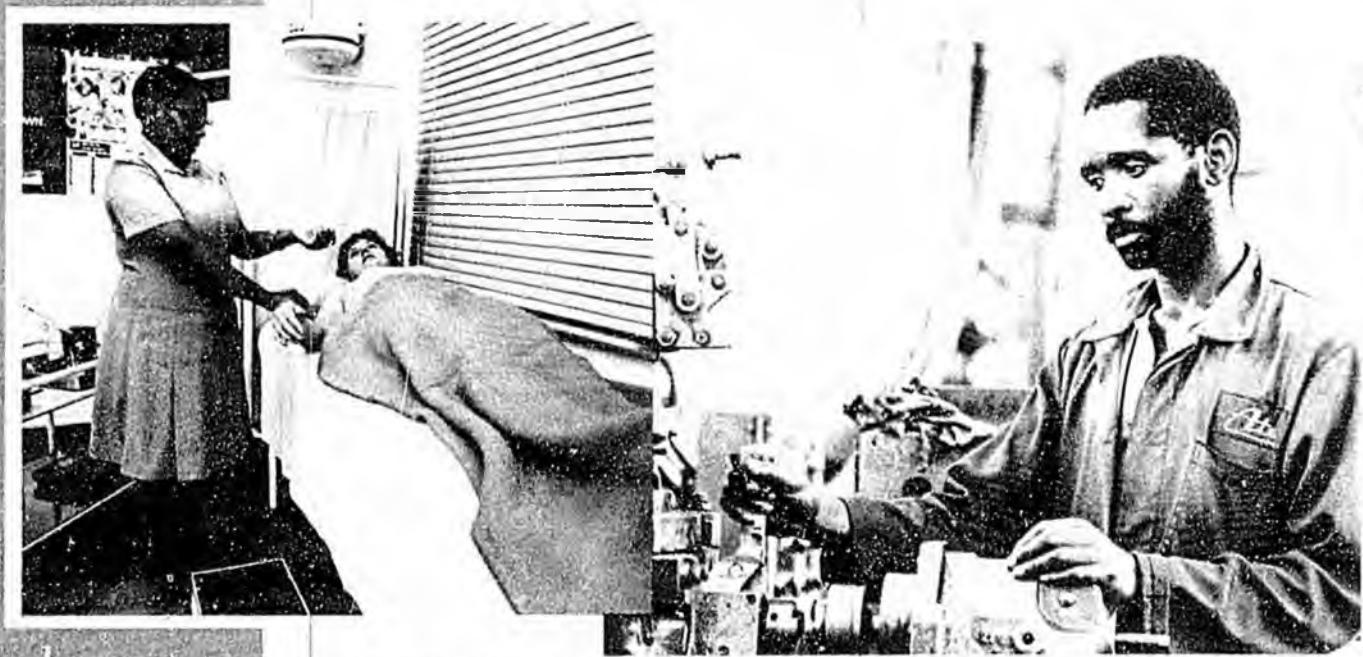


PACE College
Rex Pennington –
Headmaster
Oswald Mtshali –
Deputy Headmaster

PACE College
View of School



PACE
Commercial
College,
the first
of its
kind in
South Africa.



Black Employees of U.S. Companies speak for themselves

1. SR. KATE MALIMELA – NURSING SISTER:

"I am a qualified staff nurse. I began my employment in August 1978. We have four active non-white first aiders, who were trained at St. John's Ambulance for which the company paid. They take over during my absence from work. A qualified doctor comes twice weekly.

"All employees are Chest X-Rayed yearly at our premises for which the company pays. Only eight out of about 300 workers have been found to have TB. Those with TB are getting daily treatment from me, in cooperation with the Public Health Department. If a worker is admitted to the hospital, the company provides him with food and I pay them regular visits. Their jobs are kept for them. We have a personnel officer who assists us with all our problems. I could write a book on what this company does for non-Whites."

2. WASHINGTON MGCOTYELWA – SETTER IN MACHINE SHOP:

"I have grown up with this company, starting on the 8th of December, 1971. My first job was housekeeping. In 1972, the company bought a 4 Station No. 5 machine and taught me how to operate it.

2.

"In September of 1979, I was taught how to operate the grinding and setting of the machines, and in 1980, I started as a learner setter. And now I am happy and enjoying my job. Alfred Teves Engineering gives our country a lot of improvements. May God help me to spend the rest of my life with this company. I have now served 9 years and two months with the company."

3. DAPHNE LUTHULI – BEECHNUT COLOR AND FLAVOR DISPENSER:

"I am a African female working for Beechnut Life Savers for eleven years. I started as a labourer and I was promoted to Quality Control Department where I worked as checker. I worked there for four years. Now I'm a colour and flavour dispenser. I really enjoy this job. The salary isn't bad.

"This factory has been so much improved e.g. our cloakrooms, washing places and our lovely Canteen will be soon in operation. We are all pleased about the School grant we are given to educate our children. We are also very much impressed by the group of trainee supervisors."

PRINCIPLE SIX

Improving the Quality of Employees' Lives Outside the Work Environment in Such Areas As Housing, Transportation, Schooling, Recreation, and Health Facilities.

U.S. companies are spending millions of dollars annually in support of education and training of blacks in the general population as well as among their own employees. In 1983 the annual ex-

Education and Training Programs for Black Non-Employees by Sullivan Signatories

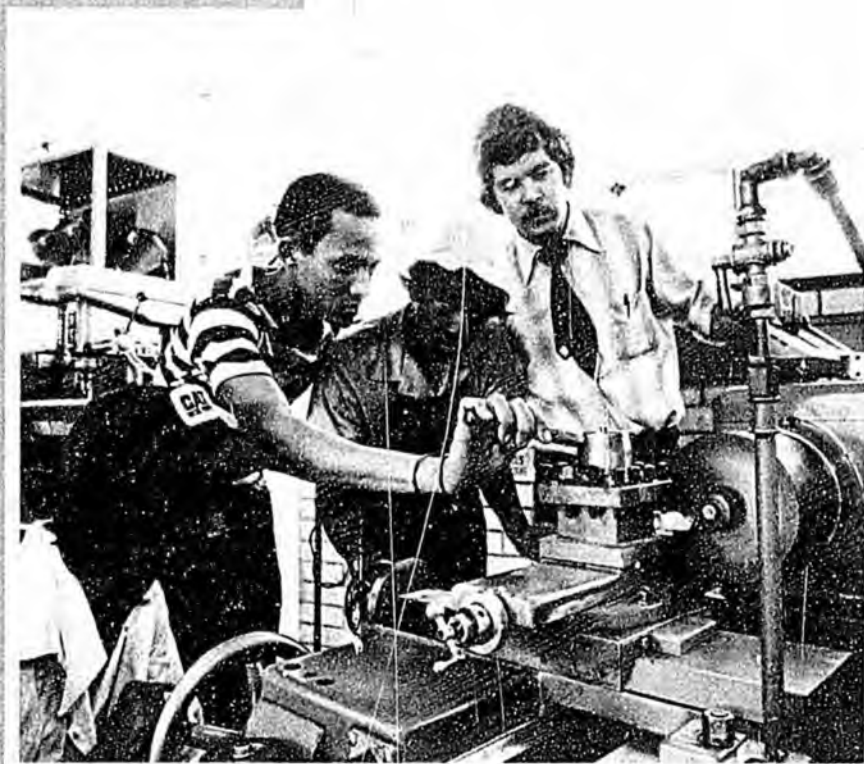
	1982		1983	
	# of People Participating	Dollar Contribution	# of People Participating	Dollar Contribution
Basic Training	14,136	\$ 180,281	12,629	\$ 303,990
Scholarships	7,705	1,262,215	9,525	1,237,748
Other Programs	—	751,650	—	1,263,730
TOTAL.	21,841	\$2,194,146	22,154	\$2,805,468

penditures for this purpose by Sullivan Principle companies amounted to nearly \$3 million.

U.S. companies, cognizant of the fundamental need to improve the quality of black education, are now investing in programs designed to raise academic standards and improve the teaching skills of black educators. Concurrently, remedial programs continue for today's black pupils to compensate for the existing inadequacies.

In terms of the time employees devoted to helping in various programs to improve the education and living conditions of the blacks in various ways, the 120 U.S. companies who are signatories of the Sullivan Principles provided each year for the past four years, on average, the equivalent of 229 full-time persons — an average of 57,072 employe days annually.

In 1983, 200 black schools in South Africa received aid from U.S. companies, and the average aid amount per school exceeded \$4,000.





The Adopt-A-School program originated in Durban three years before the Sullivan Principles were established, and the Sullivan Signatory companies set a goal of adopting 100 schools among their member companies by the end of 1980. By late 1983 the number of "adopted" schools reached 200, and a campaign had been launched by a Johannesburg newspaper, supported by other South African groups, to have 1,000 black schools "adopted" by extending the program to other companies and institutions.

Adopt-a-School Programs Sullivan Signatories

# of Schools	Dollar Contribution	
96	\$1,177,814	1980
142	949,953	1981
150	630,800	1982
200	804,789	1983
	\$3,563,356	TOTAL

**Summary of Financial Contributions to Educational and Training Programs
for Blacks by Sullivan Signatories (In 000's Dollars)**

	Non Employees	Employees	Adopt-A School	General Support	Annual Total
1978*	\$ 1,200.8	NA	NA	NA	\$ 1,200.8
1979*	1,539.7	NA	NA	NA	1,539.7
1980	4,254.5**	\$ 3,743.1**	\$ 1,177.8	NA	9,175.4
1981	2,054.1	3,118.5	950.0	\$ 3,703.7	9,826.3
1982	2,194.1	3,603.9	630.8	2,981.8	9,410.6
1983	2,805.4	6,012.4	804.8	3,655.5	13,278.1
TOTAL	\$14,048.6	\$16,477.9	\$3,563.4	\$10,341.0	\$44,430.9

Since 1978, financial contributions by Sullivan signatory companies to programs covering education and training have increased by a factor of 11 to a 1983 level of \$13,278,100.

* Figures for 1978 and 1979 cover 6 months' activity
 ** Figures may include some assistance of whites
 NA Not Available

**Employee Days Contributed in
Education, Training, Advising and
Assisting Blacks,
Sullivan Reporting Signatories**

**Number of Employee Days
Contributed**

	1980	1981	1982	1983
Industry Training Centers	6,649	2,555*	5,953	NA
Adopt-A-School	1,967	2,418	2,884	4,038
General Support to Educational Institutions	NA	5,105	5,683	7,114
Small Business Development Corporation	NA	NA	209	135
Advising and Assisting	NA	NA	88,839	94,740
TOTALS	8,616*	10,078**	103,568	106,027

*Complete data not requested in these years.
 **Incomplete Count



The Adopt-A-School program originated in Durban three years before the Sullivan Principles were established, and the Sullivan Signatory companies set a goal of adopting 100 schools among their member companies by the end of 1980. By late 1983 the number of "adopted" schools reached 200, and a campaign had been launched by a Johannesburg newspaper, supported by other South African groups, to have 1,000 black schools "adopted" by extending the program to other companies and institutions.

Adopt-a-School Programs Sullivan Signatories

#of Schools	Dollar Contribution	
96	\$1,177,814	1980
142	949,953	1981
150	630,800	1982
200	804,789	1983
	\$3,563,356	TOTAL

Sullivan Signatory Contributions Outside the Business to Improve Health Care and Living Conditions* (In 000's of Dollars)

Housing	Health, Welfare, Civic	Recreation	Other	Total	
\$ 23.2	\$ 1,246.7	\$ 49.2	\$1,112.0	\$ 2,431.1	1978**
478.2	342.4	195.5	651.4	1,667.5	1979**
1,671.1	508.0	639.4	680.9	3,499.4	1980
1,952.9	1,600.0	1,522.9	1,437.0	6,512.8	1981
1,612.6	1,393.11	1,102.7	1,272.9	5,381.3	1982
1,645.9	1,300.7	870.5	1,103.2	4,920.3	1983
\$7,383.9	\$6,390.9	\$4,380.2	\$6,257.4	\$24,412.4	TOTAL

* In some cases whites also benefit from these programs, but never to the exclusion of blacks.

** 6 months only.



Viv Anderson, international soccer star, conducted numerous clinics for local youngsters. His trip to South Africa was organized and financed by a Sullivan signatory company.

Sullivan Signatory Contribution Summary

	Average \$'s Per Employee				Average \$'s Per Reporting Signatory			
	Education and Training	Health and Welfare	Black Entrepreneurship	Total	Education and Training	Health and Welfare	Black Entrepreneurship	Total
1978*	\$ 23	47	NA	\$ 70	\$ 14,827	30,012	NA	\$ 44,839
1979*	28	30	NA	58	15,876	17,196	NA	33,072
1980	117	46	NA	163	91,759	36,080	NA	127,839
1981	118	78	NA	196	97,287	64,485	NA	161,772
1982	136	78	78	292	101,194	57,860	57,720	216,774
1983	201	74	64	339	134,121	49,697	42,626	226,444

* Figures for 1978 and 1979 cover 6 months' activity

Total \$'s (000's)

	Education and Training	Health and Welfare	Black Entrepreneurship	Total
1978	\$ 1,201	2,431	NA	\$ 3,632
1979	1,540	1,668	NA	3,208
1980	9,175	3,608	NA	12,783
1981	9,826	6,513	NA	16,339
1982	9,411	5,381	5,368	20,160
1983	13,278	4,920	4,220	22,418
	44,431	24,521	9,588	78,540

One of the major new programs added by the Sullivan signatory companies in the early '80's has been a campaign to help black businesses get started in South Africa – and to support them with business once they do get started.

Help to aspiring black businessmen by U.S. companies is mainly taking the form of finance capital and expertise, the two main deficiencies in most new black businesses.

U.S. businesses are also helping combat bureaucratic red tape – the impenetrable thicket of permits required – another major deterrent to the launching of black businesses, by working with such organizations as the National African Federated Chamber of Commerce, the Management and Manpower Foundation, and the Career Development Program.

The aid provided by U.S. businesses ranges from consulting help and the installation of sophisticated accounting systems, to the subsidization of property rentals and the provision of scholarships and other assistance for young black students in economics, commerce, and science.



Richard Maponya, Soweto auto dealer, and Lou Wilking, managing director of General Motors South Africa, break ground for a GM showroom in Soweto. Looking on are Paul Morgensen, manager, dealer organization; Jim Fry, director, vehicle sales & service; and Mrs. Marilna Maponya, recently named Black Business-Woman of the Year.

Building Black Businesses in South Africa

Sullivan Signatory Contributions Outside the Business in Support of Black Entrepreneurship (In 000's of Dollars)

	1982	1983
Support of Small Business Development Corporation	\$ 455.4	\$ 386.2
Consultancy and Assistance	\$4,912.6	\$3,834.2
TOTAL	\$5,368.0	\$4,220.4

The interior of one of the new Kewtown houses at Athlone, on the Cape Flats. The houses, 37 duplex and 13 single-story dwellings, were developed and financed by Mobil Oil Southern Africa in collaboration with the self-help organization, Build a Better Society. The houses have a living room, kitchen, bathroom and three bedrooms.



Housing Assistance to Ford Employees.

Looking Ahead

The Signatories believe that their continued presence in South Africa can do more to improve the status of blacks than withdrawal. Contributing to the process of peaceful change, is the overriding goal of the principles.

Many top Signatory executives serve on executive committees of influential South African commerce and industry organizations. Three such organizations – the Associated South African Chamber of Commerce, the Federated Chamber of Industries and The American Chamber of Commerce – have issued public statements in opposition to such proposed legislation as the Orderly Movement and Settlement of Black Persons Bill, intended to further

limit the right of blacks to choose their place of residence. As a result of strong and unified opposition from these organizations, as well as from some political parties, this bill was withdrawn.

In reviewing the progress made from conception of the principles in 1977 – when blacks were not even legally considered "employees" – to today, seven years later, Dr. Sullivan summarizes the significant changes:

- In South Africa, as a whole, plants and offices are being desegregated.
- Blacks are being upgraded, to administrative and supervisory jobs.
- Blacks are supervising whites, for the first time.

- Black unions are now being recognized.
- Technical schools for training blacks have been built.
- Black businesses, in increasing numbers, are being started.
- Equal pay for equal work has been instituted.
- Companies have improved the quality of life for blacks outside the workplace: in housing, health care

and education.

South Africa is a country whose internal fabric is under extraordinary pressure. While the basic injustice of apartheid is widely recognized, no single force in the society will produce pervasive reform. Only a broad coalition of South African constituencies can do that. However, United States firms following the Sullivan Principles have had a significant impact. Their efforts serve as an impetus toward meaningful change.

Listing of the Signatory Companies of the Sullivan Principles (as of January 3, 1984)

AFIA Worldwide Insurance	Cooper Industries, Inc.	The Gillette Company	Merck & Co., Inc.	Sentry Insurance
Abbott Laboratories	Cummins Engine Company, Inc.	Goodyear Tire & Rubber Co.	Mine Safety Appliances Co.	A Mutual Company
American Cyanamid Company		W.R. Grace & Co.	Minnesota Mining & Manufacturing Company	SmithKline Beckman Corporation
American Express Company	D'Arcy MacManus & Worldwide, Inc.		Mobil Oil Corporation	Sperry Corporation
American Home Products Corporation	Dart & Kraft, Inc.	Walter E. Heller International Corporation	Monsanto Co.	Squibb Corporation
American Hospital Supply Corporation	Deere & Company	Heublein, Inc.	Motorola, Inc.	[Standard Oil Company of California]
American International Group, Inc.	Del Monte Corporation	Hewlett-Packard Co.		See Caltex Petroleum Corporation
Amoco Inc.	Deloitte Haskins & Sells	Honeywell Inc.	NCNB Corporation	The Standard Oil Co. (Ohio)
Ashland Oil, Inc.	Donaldson Company, Inc.	Hoover Co.	Nabisco Brands Inc.	The Stanley Works
	The Dow Chemical Company	Hyster Co.	Nalco Chemical Company	Sterling Drug Inc.
Borden, Inc.	E.I. DuPont de Nemours & Company		Norton Company	
Borg-Warner Corp.		International Business Machines Corporation	Norton Simon, Inc. (Avis, Inc.)	Tampax Incorporated [Tenneco, Inc.]
Bristol-Myers Company	The East Asiatic Co. (S.A.) (Pty) Ltd.	International Harvester Company		See J.I. Case Corporation
Burroughs Corporation	Eastman Kodak Co.	International Minerals & Chemicals Corporation	Olin Corporation	[Texaco Incorporated]
Butterick Company, Inc.	Eaton Corporation*	International Telephone & Telegraph Corporation	Oshkosh Truck Corporation*	See Caltex Petroleum Corporation
	Engelhard Corporation	The Interpublic Group of Companies, Inc.	Otis Elevator Co.	J. Walter Thompson Co.
CBS Inc.	Exxon Corporation			Time Incorporated
CIGNA Corporation		Johnson Controls, Inc.	The Parker Pen Co.	The Trane Company
CPC International, Inc.	FMC Corporation	Johnson & Johnson	Pfizer, Inc.	
Caltex Petroleum Corporation	Federal-Mogul Corporation	Joy Manufacturing Company	Phelps Dodge Corp.	Union Carbide Corporation
Camatlon Company	Ferro Corporation		Philbro-Salomon, Inc.*	United Technologies Corporation
Carrier Corp.	The Firestone Tire & Rubber Company	Kellogg Company	Phillips Petroleum Company	See Carrier Corp.
J.I. Case Corporation	John Fluke Manufacturing Company, Inc.			See Otis Elevator Co.
Caterpillar Tractor Co.	Fluor Corporation	Ell Lilly and Company	The Reader's Digest Association, Inc.	The Upjohn Company
Celanese Corporation	Ford Motor Company		Rexnord Inc.	
The Chase Manhattan Corporation	Franklin Electric Co., Inc.	Marriott Corp.	[R.J. Reynolds Industries, Inc.]	Warner Communications, Inc.
Chicago Bridge & Iron Company		Marsh & McLennan Companies	See Del Monte Corporation	Warner-Lambert Company
Citlcorp	General Electric Company	Masonite Corporation	See Heublein, Inc.	Westinghouse Electric Corporation
The Coca-Cola Company	General Motors Corporation	McGraw-Hill, Inc.	Richardson-Vicks Inc.	Wilbur-Ellis Company
Colgate Palmolive Company		Measurex Corporation	Rohm and Haas Corporation	
Control Data Corporation			Schering-Plough Corp.	Xerox Corporation

*New Signatory Company

"After much contemplation, I conclude that the Award which I receive... is a profound recognition that non-violence is the answer to the crucial political and racial questions of our time — the need for man to overcome oppression without resorting to violence."

"The Principles are not an academic response designed to advance the views of those who are proponents of either investment or divestment. To the contrary, the Principles are a pragmatic policy, based upon the most judicious engagement of available resources, and are intended to improve the quality of life... and to help build a peaceful, free South Africa for everyone."

Dr. Martin Luther King
(on receiving the Nobel Peace Prize,
Stockholm, 1964)

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Rev. Leon H. Sullivan
Report from — Law and Policy
in International Business

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 ANTI-APARTHEID ACT OF 1985
 SPONSOR..... GRAY (PA)
 DATE INTRODUCED... MARCH 7, 1985
 HOUSE COMMITTEE... BANKING, FINANCE AND URBAN AFFAIRS
 FOREIGN AFFAIRS
 RULES
 OFFICIAL TITLE.... A BILL TO EXPRESS THE OPPOSITION OF THE UNITED STATES TO THE SYSTEM OF APARTHEID IN SOUTH AFRICA; AND FOR OTHER PURPOSES.
 CO-SPONSORS..... 156 CURRENT COSPONSORS -- 1 DELETED
 MAR 7, 85 REFERRED TO HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS.
 MAR 15, 85 REFERRED TO SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT INSTITUTIONS AND FINANCE.
 APR 1, 85 SUBCOMMITTEE ON INTERNATIONAL DEVELOPMENT INSTITUTIONS AND FINANCE DISCHARGED.
 APR 1, 85 REFERRED TO SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE.
 MAR 7, 85 REFERRED TO HOUSE COMMITTEE ON FOREIGN AFFAIRS.
 PRESS RETURN TO CONTINUE OR ENTER A REQUEST.
 MAR 15, 85 REFERRED TO SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE.
 APR 17, 85 SUBCOMMITTEE HEARINGS HELD.
 APR 18, 85 SUBCOMMITTEE HEARINGS HELD.
 APR 30, 85 SUBCOMMITTEE CONSIDERATION AND MARK-UP SESSION HELD.
 APR 30, 85 FORWARDED BY SUBCOMMITTEE TO FULL COMMITTEE (AMENDED).
 MAR 15, 85 REFERRED TO SUBCOMMITTEE ON HUMAN RIGHTS AND INTERNATIONAL ORGANIZATIONS.
 MAY 2, 85 SUBCOMMITTEE ON HUMAN RIGHTS AND INTERNATIONAL ORGANIZATIONS DISCHARGED.
 MAR 15, 85 REFERRED TO SUBCOMMITTEE ON AFRICA.
 APR 17, 85 SUBCOMMITTEE HEARINGS HELD.
 APR 18, 85 SUBCOMMITTEE HEARINGS HELD.
 APR 30, 85 SUBCOMMITTEE CONSIDERATION AND MARK-UP SESSION HELD.
 APR 30, 85 FORWARDED BY SUBCOMMITTEE TO FULL COMMITTEE (AMENDED).
 MAY 2, 85 COMMITTEE CONSIDERATION AND MARK-UP SESSION HELD.
 MAY 2, 85 ORDERED TO BE REPORTED (AMENDED).
 MAY 9, 85 REPORTED TO HOUSE (AMENDED) BY HOUSE COMMITTEE ON FOREIGN AFFAIRS. REPORT NO: 99-76 (PART I).
 MAR 7, 85 REFERRED TO HOUSE COMMITTEE ON RULES.
 MAY 16, 85 REPORTED TO HOUSE BY HOUSE COMMITTEE ON RULES. REPORT NO: 99-76 (PART II).
 MAY 16, 85 COMMITTEE ON RULES GRANTED AN OPEN RULE PROVIDING TWO HOURS OF GENERAL DEBATE; PROVIDING FOR CONSIDERATION OF THE FOREIGN AFFAIRS COMMITTEE AMENDMENT IN THE NATURE OF A SUBSTITUTE NOW PRINTED IN THE BILL; WAIVING CERTAIN POINTS OF ORDER.
 MAY 16, 85 RULES COMMITTEE RESOLUTION H.RES.174 REPORTED TO HOUSE.
 MAY 21, 85 RULE PASSED HOUSE.
 MAY 21, 85 CALLED UP BY HOUSE BY RULE.
 MAY 21, 85 COMMITTEE AMENDMENT IN THE NATURE OF A SUBSTITUTE CONSIDERED AS AN ORIGINAL BILL FOR THE PURPOSE OF AMENDMENT.
 MAY 21, 85 CONSIDERED BY HOUSE UNFINISHED BUSINESS.
 JUN 4, 85 CONSIDERED BY HOUSE UNFINISHED BUSINESS.
 JUN 5, 85 COMMITTEE AMENDMENT IN THE NATURE OF A SUESTITUTE CONSIDERED AS AN ORIGINAL BILL FOR THE PURPOSE OF AMENDMENT.
 JUN 5, 85 HOUSE AGREED TO AMENDMENTS ADOPTED BY THE COMMITTEE OF THE WHOLE.
 PRESS RETURN TO CONTINUE OR ENTER A REQUEST.

JUN 5, 85 PASSED HOUSE (AMENDED) BY YEA-NAY VOTE: 295 - 127
 (RECORD VOTE NO: 141).
 JUN 10, 85 RECEIVED IN THE SENATE; READ THE FIRST TIME.
 JUN 10, 85 PLACED ON SENATE LEGISLATIVE CALENDAR UNDER READ THE
 FIRST TIME.
 JUN 26, 85 READ THE SECOND TIME AND PLACED ON THE CALENDAR GENERAL
 ORDERS. CALENDAR NO. 206.
 JUL 11, 85 PASSED SENATE IN LIEU OF S. 995 WITH AN AMENDMENT BY
 YEA-NAY VOTE. 80-12. RECORD VOTE NO: 149.
 JUL 11, 85 SENATE STRUCK ALL AFTER THE ENACTING CLAUSE AND
 SUBSTITUTED THE LANGUAGE OF S. 995 AMENDED.
 JUL 17, 85 HOUSE DISAGREED TO SENATE AMENDMENTS BY UNANIMOUS
 CONSENT.
 JUL 17, 85 HOUSE REQUESTED A CONFERENCE AND SPEAKER APPOINTED
 CONFEREES: FASCELL; SOLARZ; BONKER; WOLPE; CROCKETT;
 DYMALLY; BERMAN; WEISS; GARCIA; BROOMFIELD; SILJANDER;
 DORNAN (CA); DEWINE; BURTON (IN); ST GERMAIN; GONZALEZ;
 ANNUNZIO; MITCHELL; NEAL; BARNARD; MORRISON (CT);
 WYLIE; MCKINNEY; LEACH; HILER.
 JUL 25, 85 SENATE INSISTS ON ITS AMENDMENTS BY VOICE VOTE.
 JUL 25, 85 SENATE AGREED TO REQUEST FOR CONFERENCE AND APPOINTED
 CONFEREES: LUGAR; HELMS; MATHIAS; KASSEBAUM; GARN;
 PRESS RETURN TO CONTINUE OR ENTER A REQUEST.

HEINZ; PELL; SARBANES; CRANSTON; PROXMIRE; KENNEDY.

JUL 31, 85 CONFEREES AGREED TO FILE CONFERENCE REPORT.
 AUG 1, 85 CONFERENCE REPORT 99-242 FILED IN HOUSE.
 AUG 1, 85 RULES COMMITTEE RESOLUTION H.RES.251 REPORTED TO HOUSE.
 AUG 1, 85 CONSIDERED BY HOUSE PURSUANT TO H.RES.251.
 AUG 1, 85 HOUSE AGREED TO CONFERENCE REPORT BY YEA-NAY VOTE: 380
 - 48 (RECORD VOTE NO: 288).
 AUG 1, 85 CONFERENCE REPORT CONSIDERED IN SENATE.
 AUG 1, 85 CLOTURE MOTION ON THE CONFERENCE REPORT PRESENTED IN
 SENATE.

CO-SPONSORS..... 156 CURRENT COSPONSORS -- 1 DELETED

AS INTRODUCED... BERMAN; BLILEY; DELLUMS; FAUNTROY; FISH; GRADISON;
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 KASTENMEIER; KENNELLY; KILDEE; KOLTER; KOSTMAYER;
 LANTOS; LEHMAN (FL); LELAND; LEVIN (MI);
 PRESS RETURN TO CONTINUE OR ENTER A REQUEST.

LEVINE (CA); LOWRY (WA); LUKE; LUNDINE; MARKEY;
 MARTINEZ; MATSUI; MCHUGH; MILLER (CA); MINETA;
 MITCHELL; MOKLEY; MORRISON (CT); MRAZEK;
 OBERSTAR; OLIN; OWENS; PURSELL; RANGEL; RODINO;
 ROYBAL; SABO; ST GERMAIN; SAVAGE; SCHROEDER;
 SKELTON; SNOWE; STOKES; SWIFT; TORRICELLI; TOWNE;
 TRAXLER; UDALL; VENTO; WHEAT; WIRTH; YATES; BOGGS;
 CLAY; GRAY (IL); HOYER; JONES (NC); LEHMAN (CA);
 LIVINGSTON (DELETED APR 4, 85); MOLINARI; PENNY;
 PEPPER; WAXMAN; BIAGGI.
 APR 2, 85 ATKINS; BONKER; BOXER; BROWN (CA); CARPER; CARR;
 COELHO; COLLINS; DONNELLY; EDWARDS (CA); ENGLISH;
 FASCELL; FAZIO; FEIGHAN; GONZALEZ; HEFNER; KAPTUR;
 MOODY; OKAR; PANETTA; PERSE; RAHALL; SCHNEIDER;
 SCHUMER; SEIBERLING; SIKORSKI; STUDDS; TALLON;
 TORRES; WALGREN; WEAVER; WEISS; YATRON; STARK;
 BOUCHER.

MAY 14, 85 AUCCOIN; BEDELL; BRYANT; DWYER (NJ); EARLY; FUDUA;
 GEJDOENSON; GLICKMAN; HOWARD; JACOBS; LLOYD;
 MAZZOLI; MOLLOHAN; NEAL; RAY; ROE; SCHEUER.

D BILL DIGEST (REV) JUN 5, 85. (MEASURE PASSED HOUSE; AMENDED; ROLL
 CALL =141 (295-127))
 PRESS RETURN TO CONTINUE OR ENTER A REQUEST.

ANTI-APARTHEID ACT OF 1985 - PROHIBITS ANY U.S. PERSON FROM MAKING ANY LOAN TO SOUTH AFRICA OR TO ANY ORGANIZATION OWNED OR CONTROLLED BY SOUTH AFRICA. EXCLUDES FROM SUCH PROHIBITION A LOAN FOR ANY EDUCATIONAL, HOUSING, OR HEALTH FACILITY WHICH: (1) IS AVAILABLE TO EVERYONE ON A NONDISCRIMINATORY BASIS; AND (2) IS LOCATED IN AN AREA ACCESSIBLE TO ALL POPULATION GROUPS. DECLARES THAT SUCH PROHIBITION SHALL NOT APPLY TO LOANS FOR WHICH AN AGREEMENT IS ENTERED INTO BEFORE ENACTMENT OF THIS ACT.

DIRECTS THE PRESIDENT TO ISSUE REGULATIONS PROHIBITING U.S. PERSONS FROM MAKING ANY INVESTMENT (INCLUDING BANK LOANS) IN SOUTH AFRICA. EXCLUDES FROM SUCH PROHIBITION: (1) LOANS WHICH ARE PERMITTED UNDER THIS ACT; (2) AN INVESTMENT WHICH CONSISTS OF EARNINGS DERIVED FROM A BUSINESS ENTERPRISE IN SOUTH AFRICA ESTABLISHED BEFORE ENACTMENT OF THIS ACT AND WHICH IS MADE IN THAT BUSINESS ENTERPRISE; OR (3) THE PURCHASE OF CERTAIN SECURITIES IN SUCH BUSINESS ENTERPRISES.

PROHIBITS ANY PERSON, INCLUDING BANKS, FROM IMPORTING INTO THE UNITED STATES ANY GOLD COIN MINTED IN OR OFFERED FOR SALE BY SOUTH AFRICA.

AUTHORIZES THE PRESIDENT TO WAIVE THE PROHIBITIONS AGAINST INVESTMENTS IN SOUTH AFRICAN BUSINESSES AND AGAINST IMPORTING SOUTH AFRICAN GOLD COINS IF: (1) THE GOVERNMENT OF SOUTH AFRICA MEETS AT PRESS RETURN TO CONTINUE OR ENTER A REQUEST.

LEAST ONE OF EIGHT CONDITIONS; (2) THE PRESIDENT SUBMITS TO THE CONGRESS A DETERMINATION THAT SUCH CONDITIONS ARE MET; AND (3) A JOINT RESOLUTION IS ENACTED APPROVING SUCH DETERMINATION.

AUTHORIZES THE PRESIDENT TO EXTEND THE WAIVERS. PROVIDES FOR EXPEDITED CONSIDERATION OF SUCH JOINT RESOLUTION.

AMENDS THE EXPORT ADMINISTRATION ACT OF 1979 TO PROHIBIT EXPORTING COMPUTERS, COMPUTER SOFTWARE, OR GOODS OR TECHNOLOGY INTENDED TO SERVICE COMPUTERS TO OR FOR USE BY SOUTH AFRICA OR ANY ORGANIZATION OWNED OR CONTROLLED BY SOUTH AFRICA. EXCLUDES FROM SUCH PROHIBITION DONATIONS OF COMPUTERS TO PRIMARY AND SECONDARY SCHOOLS. REQUIRES SUCH PROHIBITION TO APPLY TO ANY CONTRACT OR AGREEMENT ENTERED INTO BEFORE ENACTMENT OF THIS ACT AND TO ANY LICENSE OR OTHER AUTHORIZATION IN EFFECT WHICH IS ISSUED UNDER THE EXPORT ADMINISTRATION ACT OF 1979 BEFORE ENACTMENT OF THIS ACT.

DECLARES THAT CERTAIN TERMINATION PROVISIONS OF THE EXPORT ADMINISTRATION ACT OF 1979 SHALL NOT APPLY TO SUCH PROHIBITION.

PROHIBITS ANY COOPERATION WITH SOUTH AFRICA UNDER THE ATOMIC ENERGY ACT OF 1954. PROHIBITS THE NUCLEAR REGULATORY COMMISSION FROM ISSUING ANY LICENSE OR OTHER AUTHORIZATION UNDER SUCH ACT FOR THE EXPORT TO SOUTH AFRICA OF CERTAIN NUCLEAR MATERIALS OR TECHNOLOGY. PROHIBITS USING THE AUTHORITY OF THE ATOMIC ENERGY ACT OF 1954 TO DISTRIBUTE ANY SPECIAL NUCLEAR MATERIAL, SOURCE PRESS RETURN TO CONTINUE OR ENTER A REQUEST.

MATERIAL, OR BYPRODUCT MATERIAL TO SOUTH AFRICA. PROHIBITS ANY FEDERAL AGENCY FROM ENTERING INTO A SUBSEQUENT ARRANGEMENT UNDER SUCH ACT WHICH WOULD PERMIT THE TRANSFER OR USE BY SOUTH AFRICA OF NUCLEAR MATERIALS AND EQUIPMENT OR NUCLEAR TECHNOLOGY. PROHIBITS THE SECRETARY OF ENERGY FROM PROVIDING ANY AUTHORIZATION FOR ENGAGING IN SOUTH AFRICA IN ACTIVITIES WHICH REQUIRE A SPECIFIED AUTHORIZATION UNDER THE ATOMIC ENERGY ACT OF 1954. PROHIBITS THE SECRETARY OF COMMERCE FROM ISSUING ANY LICENSE FOR THE EXPORT TO SOUTH AFRICA OF ANY GOODS OR TECHNOLOGY: (1) WHICH ARE INTENDED FOR A NUCLEAR RELATED END USE OR END USER; (2) WHICH HAVE BEEN IDENTIFIED AS ITEMS WHICH COULD BE OF SIGNIFICANCE FOR NUCLEAR EXPLOSIVE PURPOSES; OR (3) WHICH ARE OTHERWISE SUBJECT TO SPECIFIED PROCEDURES UNDER THE NUCLEAR NON PROLIFERATION ACT OF 1978.

DIRECTS THE NUCLEAR REGULATORY COMMISSION, THE SECRETARY OF COMMERCE, THE SECRETARY OF ENERGY, AND THE SECRETARY OF STATE EACH TO PREPARE A LIST OF GOODS OR TECHNOLOGY WHOSE TRANSFER TO SOUTH AFRICA IS NOT OTHERWISE PROHIBITED AND WHICH, IF MADE AVAILABLE TO SOUTH AFRICA, COULD INCREASE SOUTH AFRICA'S CAPABILITIES WITH RESPECT TO NUCLEAR MATERIALS, FACILITIES, OR EXPLOSIVE DEVICES. DIRECTS THE SECRETARY OF COMMERCE TO PROHIBIT THE EXPORT TO SOUTH AFRICA OF THE GOODS OR TECHNOLOGY ON SUCH PRESS RETURN TO CONTINUE OR ENTER A REQUEST.

CERTAIN INFORMATION RELATING TO NUCLEAR MATERIALS FACILITIES;
OR EXPLOSIVE DEVICES AVAILABLE TO SOUTH AFRICA. TERMINATED ANY
LICENSE OR AUTHORIZATION DESCRIBED IN THIS ACT WHICH WAS ISSUED
BEFORE ENACTMENT OF THIS ACT.

PROVIDES FOR THE ENFORCEMENT OF THIS ACT. SETS FORTH PENALTIES
FOR VIOLATIONS OF THIS ACT.

DIRECTS THE PRESIDENT TO ATTEMPT TO PERSUADE OTHER COUNTRIES
THROUGH NEGOTIATIONS TO ADOPT RESTRICTIONS ON NEW INVESTMENT IN
SOUTH AFRICA; ON BANK LOANS AND COMPUTER SALES TO SOUTH AFRICA; ON
THE IMPORTATION OF KRUGERRANDS; AND OTHER RESTRICTIONS IN EFFECT
UNDER U.S. LAW WITH RESPECT TO SOUTH AFRICA. DIRECTS THE PRESIDENT
TO SUBMIT ANNUAL REPORTS TO THE CONGRESS ON THE STATUS OF
NEGOTIATIONS.

URGES THE PRESIDENT TO CONSULT WITH OTHER COUNTRIES ON THE
FUTURE IMPLEMENTATION OF ANY ANTI-APARTHEID MEASURES BEING
CONSIDERED BY THE UNITED STATES OR ANY SUCH COUNTRY.

DIRECTS THE PRESIDENT TO MONITOR AND REPORT ANNUALLY TO THE
CONGRESS ON THE PROGRESS OR LACK OF PROGRESS OF SOUTH AFRICA IN
ELIMINATING APARTHEID AND PROMOTING HUMAN RIGHTS IN THAT COUNTRY.

EXPRESSES THE SENSE OF THE CONGRESS THAT THE UNITED STATES SHOULD
TAKE MEASURES IN ADDITION TO THE SANCTIONS IMPOSED BY THIS ACT

UNLESS SOUTH AFRICA MAKES SUBSTANTIAL PROGRESS TOWARD ELIMINATING
APARTHEID AND PROMOTING HUMAN RIGHTS.

APARTHEID AND PROMOTING HUMAN RIGHTS.

RELATED BILLS -- LIBRARY DESIGNATION
S. 635 (SIMILAR).

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National
Legal Center
for the Public Interest

DISINVESTMENT

Is it Legal?
Is it Moral?
Is it Productive?

AN ANALYSIS OF POLITICIZING INVESTMENT DECISIONS

by
JOHN H. LANGRISH, PH.D. LL.B.
ROYA SHERLAND, LL.B.
and
ALBERT S. BLAISDELL, J.D.

Special Commentaries
by
WILLIAM C. MILLER, JR.
Former Governor of Michigan
and
DORIS G. HOFF
President of Women of America

Introduction
by
THEODORE S. OLSON
Former Assistant U.S. Attorney General

PREFACE

ERNEST B. HUETER
PRESIDENT

This study, another in the Judicial Series of monographs published by the National Legal Center for the Public Interest, brings focus upon the many ramifications of a serious national and international issue: the politicizing of investment policy. Currently much attention is centered by the media and special interest groups upon South Africa and the social issue of apartheid. However, the issue of disinvestment of American corporate securities as a means of forcing social or political change is a concept that extends far beyond a single country or a single political objective.

It is well that our policy-makers and their constituents—the American citizenry—be keenly aware of the many considerations raised by legislation requiring trustees of public pension and endowment funds to divest securities of corporations doing business in a particular geographical area or in a prescribed field.

In keeping with its mission, the National Legal Center concentrates its interests on the legal and Constitutional considerations of issues of national importance. The scholarly evaluations of law professors Langbein, Schotland, and Blaustein address disinvestment from those aspects. This study is further enhanced by contributions from former Governor William G. Milliken of Michigan, President Derek Bok of Harvard, and former Assistant U.S. Attorney General, Theodore B. Olson; each addressing disinvestment from a different perspective.

This publication is provided by the National Legal Center as a public service. It is not intended to advance or inhibit the passage of any legislation before any governmental entity.



National
Legal Center
for the Public Interest

HOOVER STATE AFFAIRS

REP. HURLEY

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RETURN.

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ABOUT THE AUTHORS



THEODORE B. OLSON, currently a partner in the Washington office of the Los Angeles law firm of Gibson, Dunn & Crutcher, is a former Assistant U.S. Attorney General. He was appointed head of the Department of Justice's Office of Legal Counsel on April 6, 1981, a post he held until re-entering private practice late last year. Olson is a *cum laude* graduate of the University of the Pacific, Stockton, California where he majored in speech and history, was editor of the student newspaper and was a member of the Phi Kappa Tau fraternity. He attended the University of California (Berkeley) School of Law (Boalt Hall), receiving his LL.B. Degree in 1965. He was named to the Order of the Coif at law school and was a member of the California Law Review. Upon graduation from law school, he became an associate in Gibson, Dunn & Crutcher, joining the firm as partner in 1972. He is a member of numerous bar associations and is admitted to practice before many state and federal courts.



JOHN H. LANGBEIN is the Max Pam Professor of American and Foreign Law at the University of Chicago Law School where he has taught since 1971. He is a 1968 *magna cum laude* graduate of the Harvard Law School where he served as articles editor of the Law Review. Langbein received a Ph.D. from Cambridge University, England, in 1971. He is a member of the Bar in the District of Columbia and Florida and he is a barrister of Inner Temple in London. He is the author of three books, one on the subject of his doctoral thesis, criminal process in the Renaissance, and numerous law review articles. Professor Langbein's principal areas of legal scholarship are pension law, modern German law, legal history and the law of trusts, investment and probate. On the last subject he is the author, along with Richard Posner, of a definitive article on "Social Investing and the Law of Trusts" published in Volume 79 of the Michigan Law Review (1980).



ROY A. SCHOTLAND has been a Professor of Law at Georgetown University Law School since 1972. Educated at Columbia College and Wadham College, Oxford, England, he is a graduate of Harvard Law School where he received his LL.B. in 1960 and was a member of the board of editors of the Law Review. Upon graduation from Harvard, Schotland served as a research assistant to the law school's Professor Paul Freund (1960-61) and as a Law Clerk to Justice William Brennan, Jr. of the U.S. Supreme Court (1961-62). Associated in a teaching capacity with law schools for twenty

years, Professor Schotland has conducted classes at the University of Virginia and Pennsylvania Law Schools as well as at Georgetown University. One of his areas of scholarship and expertise is the management of pension funds. He has written extensively and has given numerous talks on the subject and currently conducts a seminar at Georgetown University on pension regulation.



ALBERT P. BLAUSTEIN is a Constitutional authority of truly world-wide renown. A professor of law at Rutgers University, he has worked as a consultant in the preparation of the constitutions of several foreign nations including Liberia, Zimbabwe, Peru and Bangladesh. He has been designated as Constitutional Advisor to the Assembly of First Nations in preparing autonomy constitutions for Canada's Indian Nations. A graduate of Michigan and Columbia Universities, Blaustein began teaching at Rutgers in 1955. He is the President and Chairman of Human Rights Advocates International, Inc., and the Editor-in-Chief of "The Influence of the U.S. Constitution Abroad." He is the author of numerous articles, contributions and reviews and has written several books on Constitutional and human rights including: *Civil Rights and the Black American* (1970) and the multi-volume text, *Constitutions of the Countries of the World* (1971); 19 volumes, continuously updated.



WILLIAM G. MILLIKEN retired in 1983 as Michigan's longest serving Governor. First elected Governor in 1970, Milliken, a Republican, was moved up to that office in 1969 after serving as Lieutenant Governor. He is a graduate of Yale University and is a recipient of numerous honorary degrees including honorary Doctor of Laws degrees from the University of Michigan and Yale. Governor Milliken's experience in politics is not limited to holding his state's highest office. He was elected to the State Senate in 1960 and 1962 and was Senate Majority Floor Leader in 1963. Presently he serves as a member of the Board of Directors of Chrysler Corporation, Burroughs Corporation, Ford Foundation in New York and is Chairman of The Center for the Great Lakes in Chicago. Prior to his political career, he was president of J.W. Milliken & Co., a chain of Michigan department stores.



DEREK C. BOK has been the President of Harvard University since 1971. Previously he was Dean of Harvard Law School, a post he assumed in 1968. He has also been a Professor of Law at Harvard since 1961. Bok received his undergraduate degree from Stanford University in 1951 and his J.D. from Harvard Law School three years later. He was a Fulbright Scholar at the University of Paris' Institute of Political Science from 1954 to 1955.

President Bok has had numerous professional affiliations including membership on the Federal Advisory Committee on Affirmative Action at Institutions of Higher Education and the Board of Advisors of the National Endowment for the Humanities. He is the author of a book, *Beyond the Ivory Tower: Social Responsibilities of the Modern University*, published by Harvard University Press in 1982.



ROBERT J. D'AGOSTINO, NLCPI's Legal Advisor, is a business law practitioner who, in 1981-82, served in the U.S. Department of Justice as Deputy Assistant Attorney General for Civil Rights. He had policy authority over the entire division and frequently spoke for the Department of Justice on civil rights issues. Prior to his government service, and immediately thereafter, D'Agostino was a Professor of Law at Delaware Law School where he was

the founding faculty advisor to the "Delaware Journal of Corporate Law" and taught courses in commercial transactions, bankruptcy, and contemporary business law problems. From 1973 to 1975, D'Agostino was a managing editor for Matthew Bender and Co. and was the first head of the publishing company's in-house bankruptcy division. D'Agostino is the author of several articles and books dealing with bankruptcy and civil rights. He is a contributing author to the leading bankruptcy treatise, *Collier on Bankruptcy*.

INTRODUCTION

by

THEODORE B. OLSON*

Former Assistant U.S. Attorney General
Office of Legal Counsel
Department of Justice

The past decade has seen the rise of a political phenomenon that raises questions lying squarely at the crossroads of private and public, domestic and international law. Numerous state and local governments have chosen to express their political disapproval of the domestic policies of foreign governments by divesting their holdings in American companies that do business with those governments or operate branches or subsidiaries in their territories. In the main, these state and local decisions have targeted the government of South Africa with its system of *apartheid*. As of this writing, five states, Connecticut, Maryland, Massachusetts, Michigan, and Nebraska, have passed laws regarding divestment of South African holdings; about fifteen municipalities, including Boston, New York, Philadelphia, and Washington, D.C., have enacted similar divestment ordinances or adopted disinvestment policies, with officials in Chicago, Detroit, Los Angeles, and Seattle apparently contemplating comparable moves.¹

Such local government decisions provoke fascinating legal questions that arise in ordinarily unrelated fields of private and public law. When trustees of state or local government funds divest holdings for avowedly political, rather than economic, reasons, do they act consistently with the standards of care imposed upon fiduciaries by the law of private and charitable trusts, corporate law, and local government law? If state and municipalities divest or disinvest in order to send foreign governments a political message, do their decisions constitute "speech" protected by the First Amendment of the United States Constitution?² If so, what of the First Amendment rights of the individual taxpayers who disagree with their government's "message," but must nevertheless help to pay for it?³

¹See Campbell, *More Municipalities Joining Drive to Cut South Africa Links*, N.Y. Times, Sept. 25, 1984, at A1, Col. 6 and A25, Col. 1.

²Cf. M. Yudof, *When Government Speaks: Politics, Law and Government Expression in America* (1983); Shiffrin, *Government Speech*, 27 U.C.L.A. L. Rev. 565 (1980); Note, *The Constitutionality of Municipal Advocacy in Statewide Referendum Campaigns*, 93 Harv. L. Rev. 535 (1980).

³See Shiffrin, *supra* note 2, at 588-95; Note, *supra* note 2, at 549-53.

*Mr. Olson, a member of the California and District of Columbia Bars, is an attorney in private practice in Washington, D.C. From 1981 to 1984, he served as the Assistant Attorney General, Office of Legal Counsel, Department of Justice. The views expressed here are his own.

9-28 Short
article

Even more tantalizing questions arise when one considers the federalism issues raised by such local government decisions. On the one hand, it could be argued that such state and local regulations, on their face or as applied, impermissibly burden foreign commerce⁴ or violate the Supremacy Clause of the Constitution.⁵ On the other hand, it could be asserted that recent Supreme Court precedent suggest that states and localities who choose to invest in businesses operating in particular foreign countries do not offend the Commerce Clause because in doing so, they act as "market participants," not as "market regulators."⁶ Alternatively, it could be argued that the federal government may not interfere in the manner in which a state or local government chooses to invest its own funds, since such choices constitute "essential decisions regarding the conduct of integral government functions" which the Tenth Amendment to the Constitution insulates from federal regulation.⁷

Yet another level of legal complexity is introduced when one recognizes that customary international law, as reflected in international conventions and treaties, advisory opinions of the International Court of Justice, and writings of international publicists, has come to view systematic racial discrimination as a crime of universal concern against all humanity.⁸ Leaving aside the unanswered question whether congressional legislation that purported "extraterritorially" to punish such conduct would be consistent with principles of international law,⁹ it could be argued that state or local legislation that seeks to achieve the same goal would be preempted by

⁴The Commerce Clause grants Congress, not state or municipal legislatures, the exclusive power "[t]o regulate Commerce with foreign Nations." U.S. Const. art. I, § 8, cl. 3.

⁵See U.S. Const. art. VI, cl. 2. See also Chettle, *The Law and Policy of Divestment of South African Stock*, 15 L. & Pol'y in Int'l Bus. 445, 515-26 (1983) (making this argument).

⁶See, e.g., *White v. Mass. Council of Constr. Employers*, 103 S.Ct. 1042, 1074 (1983); *Reeves v. Stake, Inc.* 447 U.S. 429, 436-37 (1980); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 (1976).

⁷*National League of Cities v. Usery*, 426 U.S. 833, 855 (1976). But see *Garcia v. San Antonio Metro. Transit Auth.*, 104 S.Ct. 3582 (1984) (setting case for reargument and directing parties to address the question whether the Tenth Amendment principles set forth in *National League of Cities* should be reconsidered).

⁸See, e.g., International Convention on the Suppression and Punishment of Crime of Apartheid, adopted November 30, 1973, entered into force, July 18, 1976, Annex to G.A. Res. 3068 (XXVIII), 28 U.N. GAOR, Supp. (No. 30), 166 U.N. Doc. A/90/0 (1974); International Convention on the Elimination of All Forms of Racial Discrimination, adopted Dec. 21, 1965, entered into force, Jan. 4, 1969, 660 U.N.T.S. 195; *Case Concerning Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) notwithstanding Opinion*; *Restatement (Revised), Foreign Relations Law of the United States*, Tent. Draft No. 2, § 404, Reporters' Note 1 at 117 (1982); *id.* Tent. Draft No. 3, § 702(f) (1982) ["Revised Restatement"].

⁹Two unsuccessful bills introduced in the 98th Congress sought to exercise Congress' legislative powers extraterritorially to require United States persons conducting business or controlling enterprises in South Africa and Northern Ireland to comply with certain fair employment standards, as well as to prohibit new loans by United States financial institutions to the South African government and its owned or controlled corporations. See H.R. 1693, 98th Cong., 1st Sess. (1983) (the "Solarz-Gray Amendments" to the Export Administration Act); H.R. 3465, 98th Cong., 1st Sess. (1983) (Northern Ireland).

Article I, S 8, cl. 10 of the Constitution, which empowers Congress to enact legislation to "define and punish Offences against the law of Nations."¹⁰ Or, one could argue that, regardless whether such state and local legislation would interfere with any legislative power specifically enumerated in Article I of the Constitution, such laws inevitably would interfere with either the President's foreign affairs power or Congress' unenumerated foreign relations authority, or both, thereby creating an unconstitutional "intrusion by the State into the field of foreign affairs which the Constitution entrusts to the President and the Congress."¹¹

The complexity and rich diversity of the potential legal and political issues expands geometrically when extended to other nations and other controversial social relationships. For example, what of state and local efforts to reach religious discrimination in Northern Ireland, the Middle East, India or the Soviet Union? How far may state and local government go in refusing to do business with citizens who wish to travel to Cuba, Libya, Afganistan or Nicaragua? May a state withhold contracts from persons who invest in or send funds to Poland or Iran? The potential list is endless. An exhaustive analysis of all of these legal questions could easily fill an entire law review symposium. The articles contained in this provocative monograph begin the task by coming to grips with some of the most difficult of these legal questions. Professor John Langbein of the University of Chicago Law School addresses what he calls the "Unprincipled, Futile, and Illegal," aspects considering whether a state or local government's forced disinvestment for political reasons—a phenomenon he dubs "social investing"—is contrary to established principles of private trust law or its statutory counterparts. Professor Roy Schotland of Georgetown Law School attacks the problem from a different perspective, reviewing the legal issues that arise when states and localities engage in what he calls "divergent investing". He includes a discussion of the "Sullivan Principles."¹²

Professor Albert Blaustein emphasizes the Constitutional implications of a private and state government divestment strategy. President Derek Bok of Harvard and former Governor William Milliken of Michigan address trou-

¹⁰See Revised Restatement, *supra* note 8, Tent. Draft No. 2, S 404, Reporters' Note I at 1 (noting that the question has never been adjudicated, but suggesting that the states of the United States are probably preempted from enacting legislation to punish offences against the law of nations).

¹¹*Zschernig v. Miller*, 389 U.S. 429, 432 (1968). See also *United States v. Curtiss-Wright Export Co.*, 299 U.S. 304, 320 (1936) (describing President's power "in the field of international relations" as "plenary and exclusive"); *Perez v. Brownell*, 356 U.S. 44, 57-60 (1958) (recognizing that Congress also has implicit constitutional authority to regular matters affecting the foreign relations of the United States).

¹²About one-third of the American companies doing business in South Africa have adhered to the "Sullivan Principles," a statement of six principles of corporate conduct formulated in the mid-1970s by human rights activist Reverend Leon Sullivan in order to guide the employee-relations practices of multinational enterprises operating in South Africa. See generally Sullivan, *Agents for Change: The Mobilization of Multinational Companies in South Africa*, 15 *L. & Pol'y in Int'l Business* 427 (1983).

bling issues they themselves have had to face and deal with some of the consequences of a pressure group mandated divestment policy.

Together, these articles provide a useful overview of a social phenomenon that has many legal facets. I commend the National Legal Center for the Public Interest for focusing attention and fostering dialogue on the legal and constitutional, as opposed to purely political, aspects of this perplexing and fascinating social phenomenon.

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SOCIAL INVESTING OF PENSION FUNDS AND UNIVERSITY ENDOWMENTS: UNPRINCIPLED, FUTILE, AND ILLEGAL*

by

JOHN H. LANGBEIN**

Interest groups of various sorts have been campaigning in recent years to politicize the criteria that govern the investment of pension funds and university endowments. These funds should not, say the various campaigners, be invested in companies that do business in South Africa, or that have resisted labor union demands, or that manufacture munitions, or that pollute. Another strand of the ~~social investing movement~~ is localism; particularly as regards the pension funds of state and local government employees, there is ~~pressure to invest for the purpose of stimulating the local economies.~~

~~This article is concerned to explain why the traditions of trust law, pension law, and the law of charity rightly forbid social investing. I shall direct primary attention to pension funds, whose enormous size and importance has made them the main target of the various social-investing pressure groups. In the final section of this paper (Part VII), however, I point to legal factors that make social investing objectionable for university and other charitable endowments.~~

I. UNDERSTANDING THE RISE OF PRIVATE PENSION FUNDS

At year-end 1983 the one thousand largest nonfederal pension plans in the United States had assets of \$806 billion.¹ Total pension-fund assets exceed a trillion dollars.² These staggering sums reveal that a very large fraction of personal savings and of aggregate capital formation in the United States occurs through the medium of pension plans.

¹Pensions & Investments Age, Jan. 23, 1984, at 3.

²*Id.*, Apr. 18, 1983, at 10.

*Portions of this article, especially Parts VI and VII, are based upon material previously published in John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 *Michigan Law Review* 72 (1980). Posner subsequently became a federal appellate judge and has taken no part in the preparation of the present essay.

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Huge demographic shifts underlie this phenomenon. People are living longer, thanks to many factors, of which the twentieth-century revolution in health care (above all, the discovery and refinement of antibiotics) is the most important. In consequence, the gap between the time we cease to work and the time we die is widening. For that interval in our lives, we need a source of income other than current employment—we need what has come to be called “retirement income.” In former times the retirement income gap tended for most people to be small or nonexistent, and transfers within the family tended to cover the gap. The elderly lived with their children and they did not live long. To the extent that private savings were insufficient, children were expected to help. But family structure has changed under the impact of urbanization, population mobility, and longevity. People have fewer children. Children leave their parents when they marry, and the elderly often find themselves living at great remove from their children. Furthermore, with increased longevity comes the problem of decrepitude in advanced old age. The increasing need for care of the elderly tends ever more to be met by specialized providers, both because of their expertise, and because the children of the elderly, especially when living in modern dual-wage-earner families, are ever less able to render such care at home.

As late as the early decades of the twentieth century neither government nor private industry seemed much concerned with the retirement income problem. Individuals were left to their own devices—private savings and intrafamilial arrangements. A few employers began to sponsor pension plans as early as the last quarter of the nineteenth century,³ but the great movement to organize saving for retirement through employer-sponsored plans did not get underway until World War II and thereafter.⁴

The Great Depression struck at a time when many of the demographic changes that caused the retirement income problem were as yet recent. Many elderly people had not fully appreciated the implications of these changes; they had not (and perhaps could not have) made adequate provision through savings. The Social Security program was devised in the 1930s both to provide immediate relief to the destitute elderly of the day, and to guarantee retirement income to future retirees.

The defects of Social Security were long concealed, although they are now widely understood. Social Security is a transfer program rather than a savings plan. Present workers are taxed to pay retirement benefits to present retirees. Today's present workers pay taxes in the expectation that future workers will be taxed to pay benefits when the present workers retire. But because of changes in birth rates and longevity, the workforce is declining in proportion to the number of retirees. Accordingly, the burden of financing the transfers has grown enormously. The prospect looms that tomor-

³See, e.g., William C. Greenough & Francis P. King, *Pension Plans and Public Policy* (New York, 1976) 27ff; William Graebner, *A History of Retirement: The Meaning and Function of an American Institution* (New Haven, 1980).

⁴Alicia H. Munnell, *The Economics of Private Pensions* (Washington, D.C. 1982) 10ff.

row's smaller cohort of workers cannot be taxed enough to pay comparable retirement benefits to today's workers. The sense that Social Security cannot play as large a part in the retirement income of future retirees as it does for those today is one of the most important factors in the explosive growth of the private pension system.

The experience with Social Security has also left us an important lesson about the dangers of exposing the retirement income system to the winds of electoral politics. Successive Congresses sweetened current benefits and eligibility requirements with scant regard to the implications for future retirees. Only the most recent financial crises within the Social Security system have slowed that process. Further, Social Security has had devastating effects upon the economy. There is strong evidence for the view that, by promising substantial future income flows without requiring either individuals or the state to save enough to fund those obligations, Social Security has played the key role in the worrisome decline in American savings rates and capital formation.⁵

Only against this background can we fully appreciate the importance of the private pension system. The retirement income problem will become ever more acute: there are more retirees and they are living longer. Ever larger income flows must be generated to support them. Meanwhile, the financial contradictions of Social Security have put it under a cloud from which it will never fully emerge. The long process of lowering popular expectations about Social Security is well underway. The future of the retirement income system lies, therefore, in the private sector.⁶

II. HOW PENSION FUNDS WORK⁷

The variety of pension plan types and features is large and complex. The details can baffle almost anyone, sometimes even the professionals (accountants, actuaries, lawyers, plan administrators) who specialize in the field. Fortunately, in order to understand the main issues in the social investing debate, it will suffice to describe only some basic distinctions and characteristics.

Funding. The great difference between a modern private pension plan and a transfer system such as Social Security is that private plans are funded. Savings are set aside regularly during the employee's working career. This money is invested, and the investment yield (often called the "build-up") accumulates along with the savings. When the employee re-

⁵See, e.g., Martin S. Feldstein, *Social Security, Induced Retirement and Aggregate Capital Formation*, 82 *Journal of Political Economy* 902 (1974).

⁶But see Dennis E. Logue, *How Social Security May Undermine the Private Industrial Pension System*, in *Financing Social Security* (Colin D. Campbell, ed.) (Washington, D.C. 1979) 265.

⁷See generally, Dan M. McGill, *Fundamentals of Private Pensions*, 5th ed., (Homewood, Ill., 1984).

tires, the fund is used to support him (and, under most plans, to support his spouse as well) until death.

Taxation. Federal tax policy has encouraged the private pension movement, especially since the 1940's. The employer is allowed to deduct his contributions to a qualified pension plan immediately, even though the employee does not actually receive the money until he retires.⁸ Further, the build-up is exempt from taxation during the period of accumulation;⁹ only when the employee begins to receive retirement income from the plan is he taxed on what he receives. Taxation is thereby postponed. Since most people find themselves in lower tax brackets when they retire (retirement income usually being somewhat less than employment income), postponement has the further effect of reducing the amount of taxes for most people.

The Protective Policy. These tax concessions reflect a consensus that has been endorsed repeatedly in tax and other federal pension legislation. The policy is protective. Private pension plans are encouraged for fear that people would not, acting individually, save enough to meet their retirement income needs. The tax concessions are meant to induce employers and employees to allocate a larger share of compensation away from current wages and into retirement savings.

The protective policy is manifested elsewhere in pension law, apart from the tax code. Federal law imposes a "spendthrift" provision on most pension funds, preventing an employee or his creditors from alienating (and thereby consuming) pension savings before he retires.¹⁰ Likewise, federal law forbids the employee from waiving his right to have his pension fund invested prudently.¹¹ The protective policy has been, although not the only policy, surely the centerpiece of pension taxation and pension regulation. It will be seen that the protective policy bears importantly on the question of whether an employee has the power to endorse social-investing proposals that may impair his retirement income security.

The Trust Form. Pension funds typically take the form of a trust. The trust relationship is one of the most highly developed categories of the Anglo-American legal tradition. Thus, although the private pension fund is a relatively young phenomenon, it rests upon a familiar juridical basis.

Trust-investment law, now enforced by special pension legislation, supplies the rules that regulate the investment of pension assets; we shall see that this body of law takes the harshest view of investment activities that are not undertaken for the exclusive purpose of maximizing the economic well-being of trust beneficiaries.

Contributory or Not. Many plans are funded entirely from employer contributions. Because there is no deduction from the employee's pay-

⁸Internal Revenue Code [hereafter cited as I.R.C.] sec. 404.

⁹I.R.C. sec. 402.

¹⁰I.R.C. sec. 401 (a)(13).

¹¹Employee Retirement Income Security Act [hereafter cited as ERISA] secs. 404 (a)(1)(D), 409, 29 U.S.C. secs. 1104(a)(1)(D), 1109.

check, such plans are called "noncontributory"—the employee does not contribute. By contrast, "contributory" plans are those that require the employee to devote some fraction of gross pay—say, five percent—to the plan. Typically, the employer matches the employee's contribution according to some formula, for example, one-to-one or two-to-one.

This distinction between plans to which the employee contributes and those to which he does not would seem to be important, but in economic terms it is not. Because even the employer-paid component of a pension plan is a cost of employment, it is best understood as a part of the wage packet, hence a form of involuntary savings whose true cost is borne by the employee. Both the employer-paid and the employee-paid contributions derive from what is—in economic terms—the employee's wages. Translating this point into traditional trust-law terms, we may say that the employee is in an important sense the "settlor" of his own pension trust.

Defined Contribution and Defined Benefit. Broadly speaking, there are two basic types of pension plans, defined contribution and defined benefit plans. A defined contribution plan is best analogized to a savings account. The plan calls for the establishment of a separate account for each employee. Contributions are credited to the account at a rate specified in the plan, and the account participates proportionately in the investment gains of the plan. When the employee retires, the size of his pension will depend entirely upon the size of his account. Ordinarily, the plan calls for the account to be annuitized and distributed over the remainder of his life (or, in the event of a joint annuity with his spouse, over the remainder of their two lives). The college and university teachers' plan, TIAA-CREF, is the best-known defined contribution plan. IRA and Keogh accounts work on the same principle.

A defined benefit plan, by contrast, is one in which the employer (or other plan sponsor) promises to pay a retirement benefit according to a plan formula—for example, sixty percent of average salary over the last five years of the employee's service. The employer makes regular contributions to the plan, in accord with actuarial projections of the sums needed to fund the promised pension levels.

Defined contribution and defined benefit plans allocate investment risk oppositely. Under a defined contribution plan, it is the individual employee who bears the burden of disappointing investment results or who enjoys the gains from exceptionally good results. Under a defined benefit plan, the employer bears the investment risk; since the employer has promised to provide benefits of a certain level, the employer remains liable to pay the benefits even if the fund turns up short.

Multiemployer Plans. Most pension plans are so-called "single-employer" plans—General Motors has a plan for its employees, IBM for its. In some industries, however, where employment patterns are episodic (the construction trades, entertainment, trucking, the needle trades, and a variety of others) individual companies do not sponsor pension plans. Rather,

groups of employers sponsor a common plan, mostly in response to collective bargaining with a labor union. Although the Taft-Hartley Act requires equal numbers of management and union trustees on the board of such a plan,¹² in practice union interests tend to prevail, and these plans are often spoken of as union plans.

ERISA. Like most substantial fields of finance, pension plans have attracted government regulation. The federal tax concessions have been conditioned on various regulatory requirements since the 1940's. In 1974 Congress greatly extended the scope of federal regulation when it passed the Employee Retirement Income Security Act (ERISA). ERISA limits forfeiture of benefits under pension plans (through the so-called "vesting" rules); it imposes minimum eligibility and funding standards; it narrows the range of plan discretion in the design of benefit-accrual schemes; and it imposes fiduciary rules for the investment of plan assets.¹³ Title IV of ERISA introduced a federal insurance scheme, ostensibly patterned on FDIC insurance for bank deposits, that guarantees most benefits under defined benefit plans against shortfall or default.¹⁴ By making the federal government the pension paymaster of last resort, Title IV creates a further public interest in the financial soundness of the investment practices of private pension plans.

Compulsory Trusteeship. ERISA requires that pension plan assets be placed in trust,¹⁵ and ERISA refines and codifies traditional trust-investment law for the pension field.¹⁶ These provisions further the protective policy of pension law. Pension trustees are financial intermediaries who specialize in investing pension funds. Trusteeship removes investment decisions into the hands of professionals and prevents plan participants (most of whom are inexperienced in matters of high finance) from doing their own investing. Thus, while I am free to be foolish in investing my personal savings, my pension savings will necessarily be invested according to the professional standards of the investment industry.

Preemption. From the standpoint of the social-investing movement, one of ERISA's most important provisions is what lawyers call a preemption clause: ERISA expressly supersedes state law for most pension plans.¹⁷ By federalizing pension law—including pension-investment law—in this way, ERISA has greatly narrowed the scope for social-investing initiatives beneath the level of federal law. If, for example, the Missouri legislature were to enact a social-investing measure requiring the pension plans of Missouri firms to invest their funds in Missouri mortgages, the courts would quickly invalidate the statute for violation of ERISA's preemption rule.

¹²Labor Management Relations Act sec. 302(c)(5), 29 U.S.C. sec. 186 (c)(5).

¹³ERISA secs. 201 et seq., 301 et seq., 401 et seq., 29 U.S.C. secs. 1051 et seq., 1081 et seq., 1101 et seq.

¹⁴ERISA secs. 4001 et seq., 29 U.S.C. secs. 1301 et seq.

¹⁵ERISA sec. 403, 29 U.S.C. 1103

¹⁶ERISA secs. 404 et seq., 29 U.S.C. secs. 1104 et seq.

¹⁷ERISA sec. 514(a), 29 U.S.C. sec. 1144(a).

State and Local Plans. States, municipalities, school districts, and various other public bodies operate pension plans for their employees. These governmental plans are exempt from the requirements of ERISA,¹⁸ which is a main reason why social-investing proposals have so often been directed at them. State and local plans differ from private plans and among themselves in matters of structure and governance. Often a state board, sometimes attached to the state treasurer, is responsible for those investment and administrative functions that would be performed by trustees for most private plans.¹⁹

Like Social Security, most state and local plans are run by bodies that possess taxing powers. As with Social Security, the temptation has been felt to leave future taxpayers to pay the retirement benefits for today's public workers, even though the entitlement to those benefits accrues presently and should be regarded as a cost of current employment. Thus, whereas Social Security is virtually entirely unfunded and is almost a pure transfer scheme, the state and local plans tend to be partially funded. There is some current saving and investment, but not enough to meet future obligations.

III. THE HIDDEN DYNAMIC IN SOCIAL INVESTING

The elderly are, as a group, neither affluent nor politically adventurous. Why, then, is the social investing movement aimed so resolutely at the pension funds that exist to support the elderly? Why do the proponents of social investing treat pension funds as being especially appropriate to bear the costs of an investment strategy that sacrifices financial for political interests?

Social investing could in principle be attempted by any investor, not just pension trustees. There are three small mutual funds which proclaim adherence to various social principles in selecting their investments.²⁰ If an individual decides to invest in such a fund, presumably he has balanced the possible financial costs of such a policy against the personal satisfaction that he derives from supporting the social aims implied by the fund's investment policy. Few individuals have found these funds attractive. Another indication that most investors disagree with most social investing campaigns is that shareholder initiatives in support of the main social investing causes are invariably defeated by margins of 95 percent or worse. Furthermore, there has been little pressure on trustees of individual trusts to adopt social

¹⁸ERISA sec. 4(b)(1), 29 U.S.C. sec. 1003 (b)(1).

¹⁹See Marcia G. Murphy, *Regulating Public Employee Retirement Systems for Portfolio Efficiency*, 67 *Minnesota Law Review* 211 (1982).

²⁰These are Foursquare, Dreyfus Third Century, and Pax World. Foursquare avoids liquor, tobacco, and drug company stocks. According to its prospectus, Third Century limits itself to companies "contributing to the enhancement of the quality of life," whatever that means. Pax World excludes any company more than five percent of whose sales are to the Defense Department. See Pacey, *Investment Do-Gooders: A Look at a Dogged Trio of Socially Conscious Mutual Funds*, *Barron's*, Jul. 21, 1980, at 9.

investing. The main purpose of the typical individual trust is to generate income for the immediate support of the current beneficiary, who would be strongly inclined to protest if the trustee adopted an inconsistent goal. Many trust instruments authorize the beneficiary or the settlor to change trustees, and such a provision tends to concentrate a trustee's mind wonderfully on profit maximization.

Social investing proposals are directed at pension funds not in order to further the interest of the pensioners, but in disregard of their interests. It is the separation of ownership and control characteristic of pension-fund structure that social-investing proponents find so enticing. Vast sums of money are invested for—but not by—the concerned individuals. That separation, we have seen, exists in large measure to protect present and future retirees against the tendency that some might have to undersave for retirement, or to invest unwisely. But by concentrating the pension savings of tens of millions of people in the hands of a few thousand pension trustees, our private pension system has created a pressure point that would not otherwise have existed. Ironically, therefore, the separation of ownership and control that was meant to protect pension plan beneficiaries has also exposed them to a new danger—that pressure groups may politicize the process of investing their pension savings.

The hidden dynamic in the social investing movement is this effort to take advantage of the separation between ownership and control of pension savings. The pension trustees who control pension investment work under the constraints of trust-investment law. The proponents of social investing understand that by reinterpreting trust-investment law to permit politicized investment they could capture pension savings for their causes.

But why should the proponents employ such a surreptitious strategy, pressuring pension trustees, when a more forthright path lies open? Why not pursue political causes in the political arena? It is vital to understand that, almost by definition, the causes that are grouped under the social-investing banner are *those that have failed to win assent in the political and legislative process*. Congress has the power to mandate all the well-known social-investing causes: forbid American firms to do business with South Africa; require American firms to cease making munitions, or to have unionized work forces; require pension assets to be invested locally; and so forth. Federal legislation could accomplish any of these goals. For example, present federal law applies to Cuba exactly the sort of prohibitions on commerce and lending that opponents of the South African regime have sought without success in recent years from both Democratic and Republican administrations. The reason, therefore, that the proponents of social investing are bullying pension trustees is that they have been unable to get their political programs accepted in the political process.

IV. PRINCIPLES OR POLITICS?

Are there principles of social investing that a trustee can follow with ease? If not, then social investing is standardless, a mere label used to clothe pressure-group demands. If social investing is intrinsically standardless, adherence to it will expose pension trustees to a perpetual wave of political demands.

Consider, therefore, the question of investing in firms that do business in or with South Africa. It is important to understand that there is no controversy about the racial policies of South Africa. People on all sides of the matter have equal disdain for apartheid. But there is broad disdain in the United States for many other regimes. The hard question that proponents have not answered is this: Why is the campaign for divestiture directed almost entirely at South Africa, and not at such monstrously objectionable regimes as Libya or Soviet Russia? South Africa is a place in which 80 percent of the inhabitants are denied political and civil rights that Americans regard as basic. But there are many regimes in which 99 percent of the inhabitants are in this position.

In 1978 Yale University's Committee on South Africa Investments tried to duck this question in a report that said: "We acknowledge the possibility that the policies of other governments throughout the world are equally antagonistic to the basic principles of American society and this University; if so, then our recommendations concerning South African investments should be applied to them."²¹ It is not a possibility that there are other such societies; it is a certainty. (At the time that the Ad Hoc Committee wrote its report, the Amin regime was still in power in Uganda and the Pol Pot regime in Cambodia.) What the Committee seems to be saying, if one reads between the lines, is that it will not consider further applications of the social-investing concept until some group raises as great a stink as the opponents of the South African regime have raised. This approach makes social investing a branch of interest-group politics.

In truth, there can be no consensus about which social principles to pursue and about which investments are consistent or inconsistent with those principles. At a time when most of the social activism in investing was liberal or radical rather than conservative, there was some agreement among the activists as to the types of companies that should be avoided and the types that should be embraced. The ranks of the disapproved included companies doing business with South Africa, big defense contractors, non-union companies, and companies that polluted the environment. With the

²¹Yale University, Ad Hoc Committee on South Africa Investments, Report to the Corporation 4 (Apr. 14, 1978).

rapid rise of social activism on the political right, we can expect social-investing advocates to appear who will urge investment managers not to invest in corporations that manufacture contraceptive devices, or publish textbooks that teach the theory of evolution, or do business with Russia.²²

There is also increasing awareness that the criteria used to identify socially irresponsible companies are dubious even if the ultimate objective—say, pressuring South Africa—is accepted. An American corporation that has a plant in South Africa where it creates jobs, provides training, and engages in collective bargaining with a black union is not obviously contributing more to the perpetuation of apartheid than an American corporation that, without having an office in South Africa, manufactures goods that find their way to South Africa. As the *New York Times* reported in September of 1984, “[a] survey among black South African factory workers” established their “overwhelming resistance to disinvestment by American firms.”²³

The Massachusetts legislature has lately supplied us with a splendid illustration of the truth that social investing is nothing more than pressure politics. In a recent statute the legislature singled out, in addition to South Africa, one other country for the disapprobation of the state pension fund: Great Britain. Not Libya or Russia; not Iran, Cambodia or Syria, whose regimes have recently massacred tens of thousands of their dissident citizens; but Britain, mother of parliaments and closest great-power ally of the United States. Why? Oh, nothing serious, just a little gratuitous intermeddling in the difficult Northern Irish situation, for the entertainment of the Boston Irish. (The Massachusetts statute is reproduced below in footnote.)²⁴

If we move beyond foreign affairs and examine other social-investing causes, we find a similar lack of principle. In labor union circles it has become fashionable to decry pension-fund investment in companies whose work forces have rejected labor unions, but that complaint overlooks important distinctions. For example, which unions? Some American labor unions are clean and are devoted to their members, but others are dominated by organized crime. Is it really “anti-social” to resist a latter-day Jimmy Hoffa? And what of the right *not* to join a labor union? The elaborate election and certification procedures for union representation under federal law presuppose that Congress meant to protect both the right to join and the right to

²²See John M. Leger, *Business Links with Soviets under Attack*, *Wall Street Journal*, Mar. 26, 1981, at 23, col. 3.

²³Alan Cowell, *Blacks in a Poll Dispute Apartheid Foes' Tactic*, *N.Y. Times*, Sept. 23, 1984, at 10, Col. 5.

²⁴Annotated Laws of Massachusetts, Cumulative Supplement, Ch. 32, sec. 23 (1)(d)(iii):
[N]o public pension funds under this subsection shall remain invested in any bank or financial institution which directly or through any subsidiary has outstanding loans to any individual or corporation engaged in the manufacture, distribution or sale of firearms, munitions, including rubber or plastic bullets, tear gas, armored vehicles or military air craft for use or development in any activity in Northern Ireland, and no assets shall remain invested in the stocks, securities or other obligations of any such company so engaged.

abstain from union membership. Equating unionization with social rectitude thus flies in the face of federal law. Nor would compulsory unionization satisfy all proponents of this branch of social investing, since some have demanded disinvestment in firms, however fully unionized, that invest abroad ("export jobs").²⁵

Every social-investing cause can be subjected to a similar analysis. How much pollution is too much? Every time somebody goes to the toilet there is increased pollution. The question is not whether there shall be pollution, but how much, of what forms, in what places, subject to what controls, and so forth. The world is not divided into evil polluters and saintly nonpolluters. A vast body of regulatory law and private law exists to draw these difficult lines, and the blunt instrument of social investing has nothing to contribute to it.

Another form of social investing closely associated with labor union pressure is the effort to use pension funds to create jobs—for example, making mortgage loans from the carpenters' pension fund in order to stimulate employment in the construction trades. If the loans were to be made at market rates of interest, there would be no increase in aggregate mortgage lending or in employment, on account of routine substitution effects (described in Part V below, treating the economic flaws of social investing). Thus, the major effort has been to get the pension fund to lend at below-market rates. This would indeed increase construction and thus stimulate some employment in the industry.

The objection to bargain-rate lending is that it is unprincipled in the sense that it violates the primary policies of pension law. By reducing the financial return to the pension fund, bargain-rate lending necessarily sacrifices future retirement income. For present workers it involves just that trade-off of retirement-for-preretirement income that pension plans were created to guard against. But the objection runs deeper: the benefits and the costs affect different people and in different proportions. In particular, pensioners who are already retired and who depend upon the pension fund for current retirement income would derive no benefit from subsidizing employment for current workers. We shall see in Part VI that trust-investment law (and now ERISA) make it flatly illegal to sacrifice the interests of plan beneficiaries in this way.

The root fallacy behind these proposals, which is repeated incessantly in their rhetoric,²⁶ is that unions have the right to use *their* pension plans to promote *their* interests. But, of course, the plans are not theirs. The plans exist for the exclusive purpose of providing retirement income for the elderly. For the same reason that pension funds cannot be used to defray union organizing expenses or union officers' salaries, they cannot be used to

²⁵This last suggestion appears in Rutenberg, Friedman, Kilgallon, Gutchess & Associates, Inc., AFL-CIO Pension Fund Investment Study (Wash., D.C., Aug. 20, 1980) 57.

²⁶E.g., Jeremy Rifkin & Randy Barber, *The North Will Rise Again: Pensions, Politics and Power in the 1980s* (Boston, 1978).

subsidize employment for union workers at the expense of retirement income for present and future retirees.

The most persistent of the social investing causes is also the most transparently ignoble—the protectionist crusade for in-state investing of state and local pension funds (“Michigan pension money should not be exported to Indiana”). But that phenomenon is better examined from another standpoint, in Part V, treating the economic futility of social investing.

To summarize: There is not and can never be a consensus about what causes are socially worthy. Consequently, a pension trustee who sought to adhere to the criteria of social investing would have no means of identifying the causes to which he had committed the fund. Since there are no principles, every cause entangles the fund in a political struggle. Social investing would impose upon the fund the turmoil and administrative costs of perpetual politicization of the investment function. But a pension trustee has no business making political choices for his beneficiaries; his job is to further the retirement-income security of his beneficiaries, and to leave them to participate in the political process on their own.

V. THE ECONOMICS OF SOCIAL INVESTING

From the standpoint of economic analysis, two fundamental flaws impair virtually all social investing proposals. First, most are futile. Powerful and well-understood economic forces would counteract most social investing strategies, rendering them hollow gestures. Second, social investing has costs—economic disadvantages that harm the interest of pension-plan beneficiaries. We shall see (below in Part VI) that these economic flaws bear vitally upon the legal standards that govern pension-fund investment.

Substitution. Capital markets (the markets where companies and countries seek to obtain a share of the available savings) are intensely competitive. Capital flows to users who offer the highest returns, adjusted for risk. The capital markets are also increasingly international, as recent experience with Middle Eastern petrodollars, Continental eurodollars, and Latin American debtors has underlined.

The competitive nature of the capital markets complicates many social investing strategies to the point of impossibility. That point has long been made regarding the campaign for divestiture of the shares of companies doing business with South Africa. The object of the campaign is to starve the South African economy of capital. Although it is unlikely that economic stagnation would really help rather than hurt the oppressed peoples of South Africa, it is even less likely that social investing would have any material effect upon the South African economy. Pension money is by no means the only source of investment capital; nor are American firms and lenders the only actors. To the extent that social-investing pressures succeed in limiting capital flows to South Africa from some American firms, that simply creates opportunities for other American firms and for foreign firms. In

global financial terms, the South African economy is miniscule and its external capital requirements correspondingly small. International enterprises and lenders abound who are free from the pressures of the American lobby that concerns itself with this cause. Thus, the campaign to affect the South African economy has had and will have no demonstrable effect.

An incidental indication that the campaign against South Africa is ineffectual is that nobody has bothered to invoke the doctrine of constitutional preemption, in order to have the federal courts declare unconstitutional the various state statutes and city ordinances that direct the respective state and local pension funds to divest South Africa-tinged holdings. These enactments impinge upon the federal monopoly over foreign relations, reaffirmed by the Supreme Court in 1968 in *Zschernig v. Miller*. In that case the court forbade "an intrusion by [a] state into the field of foreign affairs which the Constitution entrusts to the President and the Congress."²⁷

In a study published recently in the *New England Economic Review*, the distinguished pension economist Alicia Munnell (of the Federal Reserve Bank of Boston) has pointed to the substitution effects that make economic nonsense of the campaign for in-state mortgage lending. Some state pension plans have been purporting to promote in-state construction activity by buying packages of federally insured GNMA mortgages that originate entirely within the state (as opposed to conventional packages that contain mortgages originating in all parts of the country). Since the federal insurance eliminates the risk of default, the regional underdiversification of these packages is unimportant. Munnell concludes that the increasing purchase of these instruments by state and local pension plans has "not increased the supply of mortgage funds . . ."²⁸ Rather, a pair of utterly predictable substitution effects are occurring. First, as pension funds increase their buying of these mortgage-backed securities, they simply displace other institutional purchasers such as insurance companies, who shift their investing toward the government and corporate bonds that the pension funds were previously buying.²⁹ Second, the attempt to stimulate in-state construction by purchasing in-state packages (so-called "targeting") appears to be equally futile, and for the same reason.

Whereas in the absence of the recent targeting rage, a state such as Massachusetts would buy GNMA's backed by mortgages from a number of states, such as Alabama, California, Pennsylvania, etc., now Massachusetts insists on GNMA's backed by Massachusetts mortgages, Alabama on Alabama mortgages, California on California mortgages, Pennsylvania on Pennsylvania mortgages, etc. As long as the state's demand for mortgages is roughly proportional to the size of its pension fund, the developing trend of targeting

²⁷389 U.S. 429, 432 (1968).

²⁸Alicia H. Munnell, *The Pitfalls of Social Investing: The Case of Public Pensions and Housing*, *New England Economic Review* (Sept./Oct. 1983) 20, 22.

²⁹*Id.* at 27-28.

GNMAs should have no impact on the supply of mortgage credit among states.

In summary, while social investing through the purchase of targeted GNMAs produces market returns and thereby has no adverse impact on public pensions, this approach is also unlikely to increase either the aggregate supply of mortgage funds or the supply of mortgage credit within a particular state. This assessment has been generally recognized by financial experts. In fact, those who are less than enthusiastic about social investing often push the purchase of targeted GNMAs as a means of satisfying the pressure on fund managers to pursue socially oriented objectives.³⁰

The largest claim for this form of social investing is, therefore, that it may deceive people into thinking that it alters investments outcomes, whereas in fact it results in no net increase in construction or in employment. We must emphasize that the reason these "targeted" portfolios of in-state GNMA mortgages are harmless to the pension funds that buy them is that they contain market-rate rather than below-market loans; and that the government guarantee against default eliminates what would otherwise be a menacing degree of underdiversification. Munnell has pointed out that other vehicles used by state pension plans to invest in in-state mortgages have lacked the federal guarantee and in some cases have entailed below-market lending. Under a Connecticut scheme, for example, she found that "the rates at which the mortgages have been offered has varied substantially to slightly below market. As a result, the yield to the pension fund has been well below the GNMA yield that prevailed at the time the funds were committed."³¹ In Part VI below I explain that both under the common law rules of trust-investment law and under ERISA, it would be flatly illegal for a pension trustee to sacrifice the financial well-being of plan beneficiaries in this way. (ERISA does not apply to state and local plans.)

Diversification. Over the last quarter-century a great revolution has occurred in scientific understanding of the behavior of capital markets. This revolution in the theory of finance usually goes under the label of modern portfolio theory (MPT) or the theory of efficient markets.³²

Crudely summarized, MPT has established two central propositions. First, a massive body of empirical investigation has shown that it is extremely difficult (some say impossible) even for investment-industry professionals to achieve long-term results better than the broad market averages, such as (for equities) the Standard & Poor's 500. It seems that capital markets discount new information so rapidly and well that there are few opportunities to outsmart other investors by identifying undervalued securities to buy or overvalued ones to sell.

³⁰Id. at 28.

³¹Id. at 34.

³²See generally R. Brealey, *An Introduction to Risk and Return from Common Stocks*, 2d ed. (1983); John H. Langbein & Richard A. Posner, *Market Funds and Trust-Investment Law*, 1976 *American Bar Foundation Research Journal* 1.

Second, the capital-market investigators have shown that there are substantial gains to be had from diversifying investments quite extensively. The common law of trusts has long enforced a duty to diversify trust investments, and ERISA codifies that rule.³³ MPT research has given new meaning to the concept of diversification, by showing that in order to eliminate the uncompensated risk of underdiversification, a portfolio must be much larger than previously thought. Optimal diversification requires equity portfolios with hundreds of stocks. Furthermore, these portfolios must be weighted for capitalization, so that large companies such as the oil, auto, computer, chemical, and telecommunications giants are difficult to eliminate from optimally diversified portfolios. The question arises whether social investing, if rigorously pursued, would impair diversification. As more and more social causes are added to the list, the number of companies that are ranked as offenders will become large enough that an optimally diversified portfolio cannot be constructed from the remainder. Social investing would then require the pension plan to bear the costs of the uncompensated risk of inadequate diversification.³⁴

The campaign for in-state or localized investing raises especially serious risks of underdiversification. The last thing that workers in declining areas need is to have their retirement savings jeopardized for the supposed benefit of the regional economy. Or suppose that a school board in the vicinity of Mount St. Helens had insisted on investing locally.

The Social-Bargain Fallacy. The claim is sometimes made that social investing is really economically advantageous to pension-plan beneficiaries. For example, companies that do business in South Africa could suffer damage or expropriation from civil war or revolution; companies that resist unionization may incur strikes and boycotts; polluters will get entangled in environmental liabilities; and so forth. Avoiding investment in these firms is, therefore, really a strategy for enhancing the financial well-being of plan beneficiaries by avoiding companies headed for trouble.

This argument is simply another theory of how to beat the market, and like all such theories, it runs afoul of the empirical studies underlying MPT, which strongly imply that consistent market-beating strategies are not to be found. The notion must be that the risks associated with the disfavored companies have not been fully discounted by the securities markets, even though those risks are widely known. But securities markets exist precisely in order to discount such information—that is, to take account of the information in securities prices. Accordingly, all that we know about the behavior of the securities markets suggests that political risk, like any other information that affects future profitability, is fully reflected in current

³³Restatement of Trusts (Second) [hereafter cited as Restatement] sec. 228 (1957); ERISA sec. 404(a)(1)(C), U.S.C. sec. 1104 (a)(1)(C).

³⁴This point is developed in John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 *Michigan Law Review* 72, 88ff (1980).

prices. The indifferent performance of the three small mutual funds that have been following social-investing strategies underscores this point.³⁵

To conclude: From the standpoint of economic analysis, there are two types of social-investing outcomes—the futile and the wealth-impairing. The futile are those, such as the in-state GNMA packages, that make no real contribution to the ostensible social goal. The wealth-impairing outcomes lower the return on the fund's savings, or expose it to increased administrative costs, or impose upon it the uncompensated risk of inadequate diversification. We shall now examine the reasons why wealth-impairing social-investing schemes are illegal.

VI. WHY SOCIAL INVESTING IS ILLEGAL

A trustee who sacrifices the beneficiary's financial well-being for any social cause violates both his duty of loyalty to the beneficiary and his duty of prudence in investment.

The Duty of Loyalty. The essence of the trustee's fiduciary relationship is his responsibility to deal with the trust property "for the benefit of"³⁶ the trust beneficiary. The authoritative *Restatement (Second) of Trusts* says: "The trustee is under a duty to the beneficiary to administer the trust *solely* in the interest of the beneficiary."³⁷ Although most of the case law applying this duty of loyalty to the beneficiary's interest has arisen in situations of self-dealing or other conflicts of interest in which the courts have acted to prevent the trustee from enriching himself at the expense of the trust beneficiary,³⁸ the same result has been reached with regard to fiduciary investments for the benefit of a third party (that is, a party other than the trust beneficiary or the trustee). The *Restatement* says, in its Official Comment treating the duty of loyalty: "The trustee is under a duty to the beneficiary in administering the trust not to be guided by the interest of *any* third person."³⁹ Because the entire object is to protect the trust beneficiary, nothing of principle turns on the identity of the party who profits at the beneficiary's expense.

In the leading case of *Blankenship v. Boyle*,⁴⁰ decided in 1971, the duty

³⁵Supra note 20.

³⁶Restatement, supra note 33, at sec. 2.

³⁷Id. at sec. 170(1)(emphasis added).

³⁸See generally 2 Austin W. Scott, *The Law of Trusts* secs. 170-170.25 (3d ed. 1967 & Supp. 1980).

³⁹Restatement, supra note 33, at sec. 170, Comment q (emphasis added). See id. at sec. 187, Comment g (emphasis added):

The court will control the trustee in the exercise of the power where the acts form an improper even though not a dishonest motive. That is, where he acts from a motive *other than to further the purposes of the trust*. Thus, if the trustee in exercising or failing to exercise a power does so because of spite or prejudice or to further some interest of his own *or of a person other than the beneficiary*, the court will interpose.

For decisional authority see, e.g., *Conway v. Emery*, 139 Conn. 612, 96 A.2d 221 (1953).

⁴⁰329 F. Supp. 1089 (D.D.C. 1971).

of loyalty was applied to social investing of pension funds. A multi-employer fund for coal miners that was dominated by the United Mineworkers Union bought large blocks of shares in certain electric utilities in order to induce their managements to buy union-mined coal. On the complaint of some of the pension-fund beneficiaries, the court enjoined "the trustees from operating the Fund in a manner designed in whole or in part to afford collateral advantages to the Union or the [employers]."⁴¹

ERISA codified the duty of loyalty for pension trusts in its "sole interest" and "exclusive purpose" rules.⁴² Section 404(a)(1) provides that the "fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries"⁴³ In an essay published in 1980, a pair of Washington lawyers, Ronald Ravikoff and Myron Curzan, attempt to escape this provision of ERISA.⁴⁴ I shall devote some space in this article to refuting their essay, both because the essay is misleading, and because it typifies the flimsiness of the legal arguments that are advanced in social-investing circles.

Ravikoff and Curzan correctly observe that ERISA restates the common law duty of loyalty.⁴⁵ Accordingly, they reason, since "[t]he purpose of the duty of loyalty is to require a fiduciary to avoid" self-dealing, social investing is unobjectionable "[a]s long as the fiduciary avoids self-interested transactions."⁴⁶ But the view that the trustee's duty of loyalty governs only in situations of self-dealing is simply incorrect. To be sure, most people who steal do it for their own gain; that is why most of the case law concerns self-dealing. But the trustee's duty of loyalty exists solely for the protection of the trust beneficiary, and the duty is equally violated whether the trustee breaches for the trustee's enrichment or that of a stranger.⁴⁷

Regarding ERISA's requirement that the fiduciary invest "for the exclusive purpose of . . . providing benefits to participants and their beneficiaries,"⁴⁸ Ravikoff and Curzan assert that "[t]he concept of 'benefits' . . . need not be limited to payments that a participant or beneficiary would receive upon retirement, i.e., economic return to an investment. It is arguably broad enough to include numerous types of positive returns, e.g., job security and improved working conditions."⁴⁹ This interpretation of the term "benefits" was rejected by the former administrator of the Labor Department's ERISA office, James D. Hutchinson, and a co-author, Charles

⁴¹329 F. Supp. at 1113.

⁴²See H.R. Rep. No. 533, 93d Cong., 1st Sess. 13, 21, reprinted in [1974] U.S. Code Congressional & Administrative News 4639, 4651, 4659.

⁴³ERISA sec. 404(a)(1), 29 U.S.C. sec. 1104 (a)(1).

⁴⁴Ronald B. Ravikoff & Myron P. Curzan, *Social Responsibility in Investment and the Prudent Man Rule*, 58 California Law Review 518 (1980).

⁴⁵*Id.* at 531.

⁴⁶*Id.*

⁴⁷See text at note 39 and note 39.

⁴⁸ERISA sec. 404(a)(1)(A), 29 U.S.C. sec. 1104(a)(1)(A).

⁴⁹Ravikoff & Curzan, *supra* note 44, at 532.

C. Cole, in an article cited by Ravikoff and Curzan but ignored on the precise question.⁵⁰ Hutchinson and Cole point out that ERISA uses the term "benefits" throughout the statute in the more narrow and natural sense "to refer to those cash benefits that a participant or his family would receive in accordance with the specifications of the [retirement] plan."⁵¹ Hutchinson and Cole conclude "that ERISA trusts are to be established and maintained for the limited purpose of providing retirement benefits and not for other, socially desirable purposes which provide collateral or speculative 'benefits' to plan participants or appeal to the philosophical leanings of the plan sponsor or other parties associated with the plan."⁵²

The New York Teachers' Case. The *Blankenship* case insists uncompromisingly that pension trustees must invest for the purpose of maximizing the financial well-being of the pension beneficiaries. Proponents of social investing seeking to escape the force of that precedent have been tempted to juxtapose a misreading of the 1978 case, *Withers v. Teachers' Retirement System*.⁵³ In the *Withers* case, retirees who were beneficiaries of the New York City schoolteachers' pension fund, Teachers' Retirement System (TRS), challenged the decision of the TRS trustees to purchase \$860 million of New York City bonds as part of the plan that prevented the city from going bankrupt in late 1975. Like most public employee pension funds, TRS had not been fully funded. The main asset of TRS was the city's contractual liability to pay benefits out of future tax revenues calculated on past service. City payments to TRS in the 1974 fiscal year constituted sixty-two percent of TRS's total income (as opposed to nine percent derived from employee contributions and twenty-nine percent from investment income). The TRS trustees testified that although the legal situation was far from certain, their best guess was that in the event of city bankruptcy essential city services and past city bond debt would have priority over payments to

⁵⁰James D. Hutchinson & Charles G. Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 128 *University of Pennsylvania Law Review* 1340 (1980). Ravikoff and Curzan cite the Hutchinson and Cole article as it appeared in *Employee Benefit Research Institute, Should Pension Assets Be Managed for Social/Political Purposes?* (D. Salisbury, ed.) (Washington, D.C., 1980). See Ravikoff & Curzan, *supra* note 44, at 531 n. 49. I cite the revised version of the Hutchinson and Cole article that appeared subsequently in the *University of Pennsylvania Law Review*, *supra*.

⁵¹Hutchinson & Cole, *supra* note 50, at 1370 & 1371 n. 151. The only reason that ERISA is less than explicit in defining "benefits" as a strictly economic term is that no other usage even occurred to the draftsmen. In the Congressional findings that constitute the preamble to the statute the term "benefits" is repeatedly used in the conventional and strictly economic sense. "Congress finds . . . that despite the enormous growth in [pension and other] plans many employees with long years of employment are losing anticipated *retirement benefits* owing to the lack of vesting provisions in such plans; that owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate *funds to pay promised benefits* may be endangered; that owing to the termination of plans before requisite *funds* have been accumulated, employees and the beneficiaries have been deprived of anticipated *benefits*

"ERISA sec. 2(a), 29 U.S.C. sec. 1001 (a)(emphasis added).

⁵²Hutchinson & Cole, *supra* note 50, at 1371.

⁵³Restatement, *supra* note 33, at sec. 164(a).

TRS and hence that payments to TRS would cease. In making the loan to the city, the TRS trustees acted in concert with four other municipal-employee pension funds, which agreed to purchase \$2.5 billion in city obligations over a two-and-one half-year period.

The court upheld the trustees' action, even though the bonds bore such a high risk of default that they would not have satisfied the normal standards of prudent investing (the purchase was also excessive in amount and would have been in breach of the duty to diversify). Ravikoff and Curzan interpret the court's rationale as follows:

Withers may represent an interpretation of the prudent man rule that is quite different from that set forth in *Blankenship*. *Blankenship* espouses the traditional conception of the rule: a trustee may not select an investment that fosters nontraditional objectives at the expense of adequate rate of return and corpus safety. In contrast, *Withers* appears to permit a fiduciary to compromise these traditional objectives in favor of the other goals—at least to some extent. The court upheld the trustees' investment only because the investment gave much-needed aid to the fund's principal contributor and helped to preserve the jobs of funds participants. That is, the investment was prudent in this case because it provided "other benefits."⁵⁴

In truth, what the *Withers* court did was to point to the host of special factors that made the TRS purchase justifiable under the traditional wealth-maximizing standards of trust-investment law. The court found that the trustee's "major concern" was "protecting what was, according to the information available to them, the major and indispensable source of TRS's funding—the City of New York," and that the trustees "went to great lengths to satisfy themselves of the absence of any reasonable possibility that the City would be able to obtain the needed money from other sources."⁵⁵ The trustees used the bond purchase to precipitate federal government financing for New York City, thereby creating for TRS's beneficiaries the prospect of reaching the federal treasury to satisfy the City's liability to TRS. They "obtained a provision conditioning the pension fund's investment in the City bonds on the enactment of federal legislation" providing for interim financing for the City.⁵⁶ Indeed, since the trustees' \$860 million investment was about what the City would have had to pay TRS over the two-and-a-half year period in question, TRS "could be no worse off under the plan than it would be in bankruptcy without City funds."⁵⁷ The court in *Withers* endorsed the *Blankenship* case, and declared that "*neither the protection of the jobs of the City's teachers nor the general public welfare were factors which motivated the trustees in their investment decision*. The extension of aid to the City was simply a means—the only means, in their assessment—to the legitimate end of preventing the exhaus-

⁵⁴Ravikoff & Curzan, *supra* note 44, at 523.

⁵⁵*Withers v. Teachers' Retirement System*, 447 F. Supp. 1248, 1252 (S.D.N.Y. 1978), *aff'd*, mem. 595 F. 2d 1210 (2d Cir. 1979).

⁵⁶447 F. Supp. at 1253.

⁵⁷447 F. Supp. at 1253.

tion of the assets of the TRS in the interest of all the beneficiaries."⁵⁸ The trustees found favor with the court for their effort to protect their greatest asset, which was the liability of the City to pay off its obligations to TRS over future decades.

The Duty of Prudent Investing. Another obligation that trust law imposes on fiduciaries is the duty of care known as the prudent-man or prudent-investor rule. The case law is now effectively codified for pension law in ERISA.⁵⁹ The *Restatement of Trusts* words the rule thusly: "In making investments of trust funds the trustee is under a duty to the beneficiary . . . to make such investments and only such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived . . ."⁶⁰

For historical reasons that are widely understood, trust law has placed greater emphasis on risk-avoidance than the modern theory of finance does,⁶¹ but risk and return, however, weighted, are factors exclusively related to the investor's financial well-being. The highly risk-averse investor of traditional trust law accepts a lower return for a lower risk. He does not accept a lower return for some other, nonfinancial purpose. The duty of prudent investing therefore reinforces the duty of loyalty in forbidding the trustee to invest for any object other than the highest return consistent with the preferred level of portfolio risk.⁶²

In 1980, the then chief ERISA administrator, Ian D. Lanoff of the Department of Labor, rejected the suggestion that social investing was not subject to ERISA's rules of prudence and loyalty. He said that ERISA requires that the fiduciary's "overall investment strategy . . . be designed to protect the retirement income of the plan's participants," and that both the duty of loyalty and the prudent investor rule would be violated if a fiduciary were to make an "investment decision based on other objectives, such as to promote the job security of a class of current or future participants."⁶³ Social factors may be brought in only if it is costless to do so. Similarly, the Labor Department approved a 1979 Chrysler/UAW agreement endorsing some social investing of pension-fund assets on the understanding that the investments in question would be "economically competitive with other investment opportunities which may not contain similar socially beneficial features."⁶⁴ (As previously explained, the field for costless substitutions is largely limited to the economically futile forms of social investing.)

⁵⁸447 F. Supp. at 1256 (emphasis added).

⁵⁹ERISA sec. 404(a)(1)(B), 29 U.S.C. sec. 1104(a)(1)(B).

⁶⁰Restatement, supra note 33, at sec. 227.

⁶¹See Langbein & Posner, supra note 32, at 3-6.

⁶²A similar rationale underlies the trustee's familiar duty to invest promptly, in order to make trust funds productive. See Restatement, supra note 33, at sec. 181, Comment c.

⁶³Ian Lanoff, *The Social Investment of Private Pension Plan Assets: May it Be Done Lawfully Under ERISA?*, 31 Labor Law Journal 387, 389 (1980).

⁶⁴Id. at 392.

The attorney general of Oregon issued a formal opinion in 1978 applying the state's statutory prudent-investor rule to the question whether investment managers for the state university endowment funds could "take political and moral considerations into account in making investment decisions." He ruled that "[i]t is inappropriate and irrelevant for the investment managers to consider any factors other than the probable safety of, and the probable income from, the investments required by the statute."⁶⁵

The proponents of social investing have never reconciled the sacrifice of beneficiaries' financial advantage with the prudent-investor rule. Ravikoff and Curzan try to avoid the common-law rule by rewording it to suit their purpose. After quoting the *Restatement* version,⁶⁵ they purport to summarize it in a form which changes it radically, and which they thereafter treat as a statement of the law. The objects of the prudent-investor rule, they say, are "preservation of the trust corpus and attainment of an adequate return."⁶⁷ The term "adequate" is their own invention, and in thus implying a standard less than "optimal" or "maximum" it is wholly without authority. The authors later endorse a movement from "adequate" to "moderate or even no return,"⁶⁸ still in the name of prudence. It is a revealing commentary on the weakness of the legal case for social investing that its proponents are driven to such transparent manipulation of the legal rules that oppose them.

ERISA's No-Waiver Rule Applied to Social Investing. A general rule of trust-investment law, known as the authorization doctrine, permits the settlor to impose on the trust whatever investment policy he sees fit.⁶⁹ The settlor can waive otherwise applicable rules and authorize the trustee to engage in acts of self-dealing or imprudent investment. One of ERISA's innovations was the prohibition against "any provision . . . which purports to relieve a fiduciary from responsibility or liability."⁷⁰ Therefore, as Hutchinson and Cole observe, "the [pension] plan documents cannot authorize a policy of social investment that would otherwise be impermissible under the fiduciary standards of the Act."⁷¹ This rule against exculpation clauses eliminated the authorization doctrine from pension trusts.

Consequently, a pension trust cannot be drafted to permit a social invest-

⁶⁵38 Op. Or. Atty. Gen. No. 7616, at 2 (May 2, 1978), litigated in *Associated Students of the University of Oregon v. Hunt*, No. 78-7503 (Lane County Cir. Ct., filed Nov. 22, 1978).

⁶⁶Restatement, supra note 33, at sec. 227, quoted in Ravikoff & Curzan, supra note 44, at 520.

⁶⁷Ravikoff & Curzan, supra note 44, at 520.

⁶⁸Id. at 528.

⁶⁹Restatement, supra note 33, at sec. 164(a).

⁷⁰ERISA sec. 410(a), 29 U.S.C. sec. 1110(a). See also ERISA sec. 404(a)(1)(D), 29 U.S.C. sec. 1104(a)(1)(D).

⁷¹Hutchinson & Cole, supra note 50, at 1372, 1373-75.

ing strategy that would violate the duties of loyalty or prudent investment. This result is quite consistent with the economic analysis of pension savings (discussed in Part II, *supra*, under the subheading "Contributory or Not"). Because both employer-paid and employee-paid contributions are best understood as deferred wages, they derive from the employee's compensation packet. Since the employee is in this important sense the "settlor" of his own pension-trust account, there is good reason to prevent plan sponsors (whether union or employer) from using the authorization doctrine to impose social investing upon him.

Since, however, the employee rather than the plan sponsor is the settlor-equivalent person, the opposite question arises: Might a pension plan be lawful if it contained a social-investing option that the individual participant could elect or decline? For example, the plan might offer two funds, one that ignored social-investing causes and another that adhered to some political strategy such as excluding the securities of nonunion firms. The employee could elect between the two funds.

It might be possible to bring a social-investing option of this sort within the so-called ratification doctrine of the common law of trusts. Unless a beneficiary is deceived or acts under an incapacity, trust law allows him to ratify investment practices that would otherwise be in breach of the trust instrument or of the common law.⁷² The idea is that if the beneficiary is entitled to receive and waste the trust fund, he is equally entitled to allow the fund to be wasted while still in the hands of the trustee. But it is just there that pension trusts part company from ordinary trusts, on account of the protective policy of pension law. The pension beneficiary is not allowed to reach pension assets on whatever terms please him. For example, we have seen that ERISA's mandatory spendthrift rule prevents the pension beneficiary from consuming his pension account before retirement.⁷³ Further, the Internal Revenue Code now conditions the pension tax concessions on the requirement that retirement benefits be made available in the form of an annuity,⁷⁴ in order to protect the retiree from improvident consumption that could exhaust his pension benefits during his lifetime.

Accordingly, it seems unlikely that a genuinely costly social investing scheme could pass muster even as a beneficiary-elected option. For the same reason we do not allow a current worker to spend his pension account on a sports car, we should not allow him to spend it on contributions to political or social campaigns (which is what he is doing when he accepts a below-market return in his pension savings). On the other hand, this ration-

⁷²Restatement, *supra* note 33, at sec. 216(1).

⁷³*Supra* text at note 10 and note 10.

⁷⁴I.R.C. sec. 401(a)(11) (as amended by the Retirement Equity Act of 1984).

ale seems not to extend to social investing schemes of the merely futile sort, such as in-state GNMA's. Even for these investments, however, the plan sponsor should be obliged to disclose to plan participants that the price of costlessness is futility; and the sponsor should be obliged to arrange for confidentiality respecting the portfolio election of each participant, in order to protect participants from union or other pressures.

This discussion of a social investing option presupposes a defined contribution plan, with individual accounts whose investment risk is borne by each plan participant. In a pure defined benefit plan, where investment risk is shifted to the employer as plan sponsor, there is less reason in law to prevent the employer from assuming the increased costs of a social-investing strategy that entails below-market yields. The employer, however, has good reason to resist such efforts to induce him to increase his pension costs and liabilities. For just that reason, most of the social-investing pressures have not been directed at single-employer defined benefit plans, but rather at union-dominated multi-employer plans, state-and-local plans, and multi-employer defined contribution plans such as the college teachers' TIAA-CREF.

Even within the realm of the defined benefit plan, the plan sponsor does not bear the whole of the investment risk. Under the federal insurance scheme enacted as Title IV of ERISA, a federal agency called the Pension Benefit Guaranty Corporation (PBGC) bears the ultimate responsibility for paying most of the pension benefits promised under a defined benefit plan, in the event that the plan should default.⁷⁵ PBGC thus has an interest in preventing plan sponsors from engaging in improvident investment practices that might require PBGC to have to honor the sponsor's defaulted promises. Furthermore, PBGC insurance does not protect plan participants wholly, because there are statutory ceilings on the amount of the benefits covered.⁷⁶ Since, therefore, the plan participant would remain at risk for the portion of a defaulted plan not insured by PBGC, the protective policies that indicate that the participant should not have the power to acquiesce in a social-investing option under a defined contribution plan pertain as well in an attenuated fashion to a defined benefit plan.

Corporate Social Responsibility. Proponents of social investing sometimes think they can find solace in the authorities that allow a corporation to engage in charitable giving or other "socially responsible" endeavors at the expense of its shareholders. Indeed, this analogy misled the distinguished

⁷⁵ERISA secs. 4001 et. seq., 29 U.S.C. sec. 1301 et. seq.

⁷⁶ERISA sec. 4022(b)(3)(B), 29 U.S.C. sec. 1322(b)(3)(B).

trust writer, Austin Scott, who, shortly before his death endorsed social investing of trust funds.⁷⁷

The legal analysis that has been applied in the corporation cases, is, in fact, directly contrary to that which would be needed to sustain social investing of trust funds. The rationale that has protected corporate directors from liability when shareholders have brought suit complaining of seeming corporate altruism is that the directors were in fact pursuing the longer-range self-interest of the firm and hence that their conduct has been wealth-maximizing.⁷⁸

Constitutional Objections. There are serious doubts about the constitutionality of the two types of social-investing measures that crop up in state legislation directed at state and local pension funds. As regards the legislation directed against South Africa (or any other foreign power), I have previously mentioned the doctrine of constitutional preemption,⁷⁹ designed to preserve the federal monopoly of authority in foreign relations, which was expansively reaffirmed by the Supreme Court in the 1968 case of *Zschernig v. Miller*.⁸⁰

There is also a long constitutional tradition inimical to protectionist state legislation. A main purpose of the commerce clause of the federal constitution was to create national markets. For example, the Supreme Court held in a famous case that New York could not by statute prevent price competition in New York from cheaper Vermont milk.⁸¹ State legislation attempting to create preferences for in-state securities should be no more justifiable under

⁷⁷Scott writes:

Trustees in deciding whether to invest in, or to retain, the securities of a corporation may properly consider the social performance of the corporation. They may decline to invest in, or to retain, the securities of corporation whose activities or some of them are contrary to fundamental and generally accepted ethical principles. They may consider such matters as pollution, race discrimination, fair employment and consumer responsibility Of course they may well believe that a corporation which has a proper sense of social obligation is more likely to be successful in the long run than those which are bent on obtaining the maximum amount of profits. [Scott is here reciting the social-bargain fallacy, refuted above in Part V of the present essay.] But even if this were not so, the investor, though a trustee of funds for others, is entitled to consider the welfare of the community, and refrain from allowing the use of the funds in a manner detrimental to society.

3 A. Scott, *supra* note 38, at sec. 227.17 (Supp. 1980). Scott makes no effort to reconcile his support for social investing with the trustee's duties of loyalty and prudence that he canvassed so extensively in the body of the treatise. 2 *id.* at sec. 170-170.25 (loyalty); 3 *id.* secs. 227-227.16 (prudent investing). He ignores the ERISA rules, discussed above, that contradict his position. Scott cites some of the literature on corporate social responsibility but does not disclose that the legal analysis that has been applied in the corporation cases is the opposite of the rule he is supporting for the law of trusts.

⁷⁸See, e.g., *Shlensky v. Wrigley*, 95 Ill. App. 2d 173, 180-81, 237 N.E.2d 776, 780 (1968).

⁷⁹*Supra* text at note 27.

⁸⁰389 U.S. 429 (1968).

⁸¹*Baldwin v. G.A.F. Seelig*, 294 U.S. 511 (1935).

the commerce clause than legislation preferring in-state enterprises. The privileges-and-immunities clause of the constitution has also been interpreted to forbid protectionist legislation aimed at out-of-staters.⁸²

VII. UNIVERSITY ENDOWMENTS

I have thus far considered the social-investing question only in context of the pension fund. The analysis changes when we move from pension trusts to charitable trusts (or to charitable corporations, which for present purposes are indistinguishable from charitable trusts).⁸³ This is an area of considerable consequence for university trustees; they are currently being pressured to apply social criteria to the investment of their endowment funds, and some boards of trustees have succumbed.

The distinguishing juridical feature of the charitable trust is the absence of conventional beneficiaries. A private trust (including the pension trust) must identify by name or by class the persons who are to receive the trust property, but a charitable trust is void if it is found to serve individual rather than community benefit.⁸⁴ The charitable trust occupies a legally privileged position: it is not subject to the rule against perpetuities; the attorney general or other public officer may enforce it; the *cy pres* doctrine protects it against ordinary rules of defeasance; and it enjoys a variety of tax and procedural advantages pursuant to statutes that follow the common law criteria for defining charitable trusts.⁸⁵ The law conditions the grant of these privileges on the requirement of indefiniteness of beneficiaries. A charitable trust will fail if "the persons who are to benefit are not of a sufficiently large or indefinite class so that the community is interested in the enforcement of the trust."⁸⁶

In place of the definite beneficiaries of private trust law, the law of charitable trusts substitutes the standard of community benefit defined by a circumscribed set of charitable purposes: the relief of poverty; the advancement of religion; the advancement of education and of health (including research); and the promotion of governmental, municipal, and other purposes beneficial to the community.⁸⁷ At the border of each of these catego-

⁸²See, e.g., *Hicklin v. Orbeck*, 437 U.S. 518 (1978).

⁸³See generally 4 A. Scott, *supra* note 38, at sec. 348.1.

⁸⁴A recent Pennsylvania decision dealing with the claim of the Fraternal Order of Police to be a charitable organization concluded that the group "is essentially a labor organization existing solely for the benefit of its own membership," and those that "its benefits are not applied for the advantage of an indefinite number of persons as would be the case if the public were to benefit." *Commonwealth v. Frantz Advertising, Inc.*, 23 Pa. Commw. Ct. 526, 533-34, 353 A.2d. 492, 496-97 (1976). For a good general background on such cases, see 4. A. Scott, *supra* note 38, at sec. 375.2.

⁸⁵See Restatement, *supra* note 33, at secs. 365 (unlimited duration), 391 (public enforcement), 395 (*cy pres*).

⁸⁶*Id.* at sec. 375.

⁸⁷*Id.* at sec. 368.

ries there can be serious questions about whether particular schemes qualify, but the typical university charter declares purposes that fall unambiguously within the category of education and research (and often within that of health as well).

In analyzing social investing by private and pension trusts, we saw that the trustee's obligation to invest for the maximum financial well-being of the trust beneficiaries derives from the trustee's duties of loyalty and prudent investing; but since, by definition, the charitable trustee does not owe such duties to particular private beneficiaries, the question arises whether there are any legal impediments to social investing of university endowment funds. There are several:

Charter. University charters are often granted by special legislative act, both for state schools and private universities. A university may also be chartered under the general nonprofit corporation statute of the jurisdiction. In principle, an authorizing instrument under the common law of trusts would also suffice. Regardless of the form, a university's charter is usually restrictive; it dedicates the institution to educational and related purposes.

A variety of the causes espoused in the name of social investing are not within the purposes of such charters—for example, expressing disapproval of selected foreign governments, or supporting certain labor union organizing campaigns. For university trustees to spend university funds on such causes directly would be *ultra vires* and put the trustees in breach of their fiduciary duty to the institution.⁸⁸ Were the trustees to pursue the same end by engaging in social investing of the university's endowment funds, they would simply be attempting to do indirectly what they may not do directly.

Under conventional charitable trust law, the state attorney general has standing to sue to prevent such misuses of university endowment funds. Because he is a political officer, and there will often be more votes to gain from supporting than from opposing the groups that advocate social investing, his intervention might not always be a serious prospect. But the attorney general probably does not have a monopoly of standing in such cases; other persons who have a significant economic interest in the fate of the endowment—for example, professors and students—probably may sue.⁸⁹

Noncharitable Purposes. If a particular charter is too restrictive to permit a particular scheme of social investing, the proponents of the scheme may reply that the institution ought to get its charter amended. When the charter originates in special state legislation, the legislature can authorize virtually any use of institutional funds (at least as regards the state law of charitable purposes, although not the federal tax consequences). When the charter is

⁸⁸See *id.* at sec. 379.

⁸⁹In *Coffee v. William Marsh Rice Univ.*, 403 S.W. 2d 340 (Tex. 1966), two opposing groups of alumni were held to have standing to intervene in a lawsuit in which the trustees of Rice University were seeking the application of the *cy pres* doctrine in order to eliminate racially restrictive provisions from the trust instrument that had created the school.

nonstatutory and subject to the common law of charitable trusts, valid charter amendments will be impossible for many social investing schemes. The law of charitable trusts denies private autonomy over the definition of what purposes qualify as charitable. The standard of community benefit does not vary with the tastes of universities or their founders, trustees, and donors.

Some of the schemes favored by proponents of social investing are incompatible with these legal standards. In England, a trust for the purpose of changing existing law is not charitable.⁹⁰ Although this rule generally has not been followed in American law, our law does attempt to distinguish between "social" purposes, which are permissible, and "political" purposes, which are not.⁹¹ Trusts to promote socialist political and educational activity have been held not charitable;⁹² a similar fate befell a bequest to create an educational and information center for the Republican women of Pennsylvania.⁹³ A Scottish case held that a trust to support resistance to strikebreaking and lockouts was political and hence void,⁹⁴ and a New Zealand case ruled similarly against a trust for the League of Nations.⁹⁵ University trustees faced with pressures to adapt their portfolios to the requirements of union organizing campaigns, or some group's foreign-policy views, must beware the force of such precedents. The price of yielding to social-investing demands may be litigation costs and potential liability for breach of fiduciary duty.

Costs. From a practical standpoint, university trustees are obliged to give full weight to the savings in administrative costs that result when the institution is spared the needless portfolio reviews and difficult investment decisions that are involved in social investing, especially in view of the absence of a reement on the social principles to be pursued.

Donors. Past donors—more likely their heirs or successors—may claim that since social investing constitutes a diversion from the educational purposes for which the funds were given, it breaches an implied or express condition and ought to trigger defeasance of the funds in favor of the donor. In Illinois, legislation in force since 1874 denies to universities the "power to divert any gift . . . from the specific purpose designed by the donor."⁹⁶ Donors would have a strong argument against applying the *cy pres* doctrine in order to prevent defeasance, since *cy pres* applies only when it "becomes impossible or impracticable or illegal to carry out the original charitable

⁹⁰National Anti-Vivisection Soc'y. v. Inland Revenue Commrs., [1948] A.C. 31.

⁹¹4 A. Scott, *supra* note 38, at sec. 374.6.

⁹²See *id.*

⁹³Deichelmann Estate, 21 Pa. D. & C.2d 65 (1959).

⁹⁴Trustees for the Roll of Voluntary Workers v. Commrs. of Inland Revenue, [1942] Sess. Cas. 47.

⁹⁵In re Wilkinson, [1941] N.Z.L.R. 1065.

⁹⁶Ill. Rev. Stat. 1971, ch. 144, sec. 1.

purpose."⁹⁷ Thus, trustees who yield to pressures to divert endowment funds from education to other causes are exposing their endowments to the restitutionary claims of donors and heirs.

VIII. CONCLUSION

In emphasizing the legal risks that pension trustees and university and other charitable trustees incur in pursuing social investing, I do not suggest that the law requires social grievances to go without remedy. The law of trusts has been constructed on the quite intelligent premise that the grand social issues of the day should be resolved in those institutions whose procedures and powers are appropriate to them. The political and legislative process of the modern democratic state is well adapted to dealing with pressures for social change. Pension trusts have been designed to provide retirement security, and charitable trusts have been designed to serve specialized purposes—in education, healing, the arts, research, and so forth. ~~A board of trustees is not well suited to be a forum for the resolution of complex social issues largely unrelated to its work. There is every reason to think that trustees will best serve the cause of social change by remitting the advocates of social causes to the political arena, where their proposals can be fairly tested and defined, and if found meritorious, effectively implemented.~~

⁹⁷Restatement, *supra* note 33, at sec. 399.

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DIVERGENT INVESTING OF PENSION FUNDS AND UNIVERSITY ENDOWMENTS: KEY POINTS ABOUT THE PRAGMATICS, AND TWO CURRENT CASE STUDIES

by

ROY A. SCHOTLAND

Gary Trudeau made it clear. That cartoonist and *ex officio* philosopher wrote about a football team's pension fund diverted to meet the needs of Lava-Lava Lenny, the "Polynesian Panzer" who was the whole right side of the team's line. Lenny had an insatiable need for pineapples, so the pension fund was used to buy pineapples. Trudeau asks "But how could you use the pension fund for that?" and his answer captures perfectly the approach of advocates of the countless forms of "social investing": "But the fund was just sitting there." As of course it must sit and grow if it will serve its own major social goal, protecting retirement security.

I agree with John Langbein's elegantly reasoned approach, although my view of Social Security is far more positive than his and my concern about the private pension system's limitations is greater than his. Still, one must concur with his point that the economic soundness of private pension plans is becoming ever more important. Four major points warrant focus. I concentrate at the outset on pension funds, involving \$1.277 trillion in assets,¹ and later deal with other institutional investors like endowments, which involve under \$30 billion, and foundations involving about \$47 billion.²

I. CONTEXT

First, let's not use a label that loads the dice: analysis suffers from the outset if the label "social" or "socially responsible" investing is accepted, since few minds will be open to any plea for the anti-social or irresponsible, and hardly any more will think "let the market decide" a sufficient answer. But further, the "social" label is over-broad. Everyone agrees that investing

¹As of September 30, 1984, private pension assets totalled \$934.6 billion, and state and local pension assets were \$341.6 billion. Federal Reserve Board, Flow of Funds, Quarterly Levels (November 1984).

²The endowment figure is based on Nat'l. Ass'n. College and Univ. Business Officers, 1983 Comparative Performance Study (1984), p. 1; the foundation figure is based on Foundation Center, Nat'l. Data Book, p. xi (1984). Those two categories *together* are only just over 5% of pension assets, for all the public awareness of, say, the Ford Foundation or the Harvard and Texas endowments.

for retirement security is itself a socially responsible goal. More accurate labels would be "alternative" or "divergent" investing, since the proposal is to tap pension assets for goals other than retirement security.

Whatever the label, surely it sounds attractive to invest both to protect retirement security and also to promote such other goals as equal employment opportunity or environmental quality, or local jobs or housing—or to avoid investments in firms engaged in social evils.³ If "Investment XX" has as high a return and low a risk as other clearly appropriate investments, but XX also promotes common concerns of the pension fund's beneficiaries, then the only investment manager who wouldn't buy XX for that fund would be a misanthrope, hating both his clients and his own firm's future. Obviously, XX has more bang for the buck.

But we cannot stop with how these proposals sound, and we know how artificial is "all other things being equal." The considerable controversy over "social" or divergent investing is more than a fuss over labels or ideology.

Second, the reality behind the rhetoric: The only real issue in divergent investing is whether non-financial considerations should be taken so far as to justify lower investment returns or uncompensated higher risk or lower liquidity. A proposed divergence from the pension funds' traditional exclusive goal to protect retirement security may involve a financial sacrifice, a hidden subsidy to pursue nonretirement goals. Or, the proposal may be merely that financial considerations need not be the only ones, that others may be taken into account so long as prudent financial criteria are not compromised. That crucial distinction means that a proposal—whether to favor one category of investments or to avoid another—must be evaluated on the facts, the specific terms of what impact it will have on the fund's investment earnings. The critical first step in dealing with any proposed divergent investment is Sergeant Friday's: get the facts. The facts may not end the matter, but neither rhetoric nor even reasoning are meaningful unless first the facts are out in the open. Which facts, is made clear in the two examples treated fully below.

Third, why is it so important to protect the funds' investment earnings? For any institution, this question boils down to "why is it important to carry out the purpose of the institution?" For pension funds, assuring retirement security means being able to honor the pension promise. Gary Trudeau understands that the fund is not "just sitting there." In all the advocacy of divergent investing, nothing is so loud and clear as the emphasis on how huge are the pension assets—indeed, that fact is almost always the very

³Much current attention, and this paper, focuses on divestment of holdings in firms involved in South Africa. But some institutional investors have long avoided such "social evil" industries as alcohol and tobacco. The Commissioners of the Church of England, for example, avoid stocks of breweries, newspapers and similar social evils.

opening point.⁴ But somehow the advocates are Cyclopean, they use one eye and see only the assets, utterly ignoring the liabilities those assets and their earnings must meet. In fact, the assets are small compared to the legal liabilities. State and local funds, with assets now over \$340 billion, have projected unfunded liabilities of about 135% of assets, according to the most reliable and latest study available.⁵ (An unfunded liability is by no means bad in itself, any more than it is bad for a homeowner to owe on a mortgage. Just as with a mortgage, the question is whether the amount owed is appropriate relative to the ability to pay that debt as it gradually comes due. To evaluate whether an unfunded pension liability is at an appropriate level or is instead a "ticking time bomb," one examines (putting it simply but sufficiently) the level and trend of the annual pension expense as a percent of payroll, and the level and trend of the ratio of assets to liabilities.) Private funds, with assets over \$930 billion, have recently been *thought* to have assets greater than their liabilities; but that is only because of a new, misleading accounting treatment forced on the profession and the industry.⁶ For example, General Electric—commendably disclosing more data than

⁴"A great body of money surrounded by people who know exactly what they want." Dwight MacDonald's description in the *New Yorker* of the Ford Foundation, a microscopic fund compared to the ones described here; see n. 2 *supra*.

⁵Arnold, *The Financial Status of State and Local Public Employee Pension Funds: Theory and Evidence* (unpublished Harvard Ph.D. dissertation, 1982, using 1978 data); for its findings, see Kotlikoff and Smith, *Pensions in the American Economy* (N.B.E.R. 1983), Sections 7.7-7.10.

In the past few years, state and local retirement systems overall have probably strengthened their funding thanks to a combination of increased official awareness of the necessity of doing so, and relatively strong securities markets. On the other hand, in the 1981-2 recession several major States cut back on their funding, and many States' local systems are an increasingly acute problem, as highlighted by recent official studies in Missouri and Pennsylvania.

The 135% figure is for state-administered funds, the great bulk of all state and local assets; coincidentally, their unfunded liabilities are also about 135% of all outstanding long-term state debt. The 20 cities with the largest pension fund of their own had unfunded projected liabilities of 106 percent of their fund assets, or just half again of their own long-term debt; and a large sample of other localities with at least one plan of 500 or more participants, showed their unfunded projected liability to be 145 percent of their pension assets or almost two-thirds again of their own long-term debt. *Ibid*.

⁶"Misleading" is strong language in this context, but is the word used by AT&T in its annual report; (see 1982 Report at p.38). The word fits. The Financial Accounting Standards Board, over strenuous opposition of seven of the "Big Eight" accounting firms as well as the actuarial profession and the corporations themselves, has worsened the disclosure of pension data and has pending proposals that will do further harm. There is no question that eventually reality will break through, but meanwhile all that we have readily available is materially erroneous information—wrong by mandated commission as well as improperly allowed omissions. In addition to the ways such data make it harder to implement actuarially sound funding policy, they also confuse or mislead both securities analysis and the formation of public policy. They do so generally by conveying a misleadingly sanguine sense of funds' strength to meet liabilities. They also do so specifically with respect to "social investing" in two ways: 1) Reducing the apparent degree of need to meet liabilities only promotes the illusion that at least some of the pension assets are indeed "just sitting there." 2) Moving the pension assets to the balance sheet only strengthens the argument that these are not sums dedicated to a special purpose but are part of the corporate (or local government) assets and so available to serve general purposes.

required by the unsound current standards—reports that its pension liabilities for 1983 are \$2.575 billion larger than appears from the mandated disclosure.⁷ As GE reveals, the figures it actually uses in operation reveal an unfunded liability of \$899,000,000, in contrast to the artificial figure GE is required to concoct and disclose—a supposed surplus of \$2.233 billion of assets over liabilities.⁸

Many people understandably suffer glazed vision and blurred hearing if an aspect of “accounting” comes up, but this one is simple: pension fund assets are not just sitting there. They and the income they earn are essential to pay promised retirement benefits. If earnings are insufficient, more money must be put into the fund or else the promise is dishonored. Even if the promise is honored, in inflationary times this promise is diluted, perhaps severely, if the promised nominal benefits are not improved during retirement. In fact, most employers (at least large ones) have made such improvements, which obviously depend (at least in part) on the success of the fund’s investment earnings. Among public funds, post-retirement increases are explicitly tied to investment results by 5% of funds.⁹

How much do the investment earnings matter? As Ohio State Teachers Retirement System points out, 1% more investment return—say, 9% instead of 8%—means 10-15% more benefits, or a related improvement in a pension fund’s actuarial soundness or decrease in taxpayer burden or, of course, some of each.

For the Washington D.C. Retirement Fund’s \$438,000,000 at end-1983, the difference between a 7% and an 8% return over the next 20 years comes out to \$433,000,000; the difference between a 10% and an 11% return is \$747,000,000.

Five years ago, investment income was 34% of total receipts for state and local funds; by 1981-2 it had risen to 39% and in 1983-4, it went over 45%. In many systems it is over 50%. This is good news: more investment income equals less battle of the budget—both pension participants and taxpayers gain. But it is important news: how well the assets are managed matters more than ever, not only in absolute dollars—\$23 billion in 1983-4 invest-

⁷The mandatorily disclosed liability of \$8.496 billion is only 76% of the voluntarily disclosed liability, \$11.071 billion. GE Annual Report for 1983, p. 40.

⁸Even sophisticated treatments unaccountably accept the misleading figures as if they reflect reality. Contrast Business Week’s Pension Scoreboard: A Controversial Glow of Health, Sept. 17, 1984, 153-160 with Pension Scoreboard: Improvement is Illusory, Sept. 14, 1981, 114-118. See also Oppenheimer & Co., The S&P 400—Pension Assets and Liabilities II, June 29, 1984 (“many companies have . . . overfunded pension funds”).

⁹Bankers Trust Co., Study of Public Employee Retirement Systems (1984), p. 44.

ment income compared to \$9 billion five years earlier.¹⁰ It matters more also as a proportion of the total income needed each year to keep the funds sound and so protect retirement security.

Fourth, remember Mencken's maxim: The idea that pension investments can be "redirected" and so help solve social problems other than retirement security, is a classic example of H. L. Mencken's rule that "For every human problem, there's an answer that's clear, simple, and wrong."

It is challenge enough to manage pension assets to maximize investment returns (at prudent levels of risk) so as to promote retirement security. But contrast that challenge with managing those assets to promote other goals.¹¹ Consider the difficulties of implementing the impulse toward divergent goals.

II. THE DIFFICULTIES OF DIVERGENT INVESTING

Hurdle 1: What goals? Everyone involved with a pension fund agrees on at least one goal: protect retirement security. But if other goals are added, which? Consider goals actually proposed, mainly for state and local funds:

I. In-state investing—

- a) generally; or
- b) mortgages (or other investment in housing)—
 - 1) generally, and/or
 - 2) for public employees, and/or
 - 3) for senior citizens, and/or
 - 4) for low- and/or medium-income people, and/or
 - 5) rental housing, and/or
 - 6) cooperative housing, and/or
 - vii) rural housing, and/or
 - viii) neighborhood redevelopment;

¹⁰The Washington, D.C. projections are from the testimony of David Eager, director of Meideinger Asset Planning Services, consultant to the D.C. Retirement Board, before House Committee on D.C., Hearings on South African Investment, 98th Cong. 2d Sess. (Jan. 31, 1984), at 130, 141-2.

The data on total receipts and investment income for state and local funds are derived from U.S. Dept. of Commerce, Bureau of Census, *Finances of Employee-Retirement Systems of State and Local Governments*, and *id.*, *Finances of Selected Public Employee Retirement Systems* (various issues).

¹¹"It seems to me that no one really knows *how* to make money, but we all know how to lose it. Common sense and hard knocks teach all of us eventually that one cannot in expectation of satisfactory results or in good conscience serve two masters. It's hard enough to achieve satisfactory results when focusing all of one's energies on making money; it's almost impossible when at the same time one focuses on other objectives—no matter how laudable they may be."

From talk by ERISA Administrator Robert Monks, Dec. 7, 1984, Miami, Florida, on "Social Investing and Social Investing [sic]."

- c) small business; and/or
- d) venture capital; and/or
- e) industry in rural areas.
- II. Energy conservation—
 - a) generally, and/or
 - b) solar.
- III. Environmental protection.
- IV. Equal opportunity employment.
- V. Unionization.
- VI. Avoidance of alcohol, tobacco and defense industries (goals proposed less often for pension funds than for foundations and endowments.)
- VII. Avoidance of firms involved with—
 - a) South Africa or Southern Africa;
 - b) military activity in Northern Ireland;
 - c) Iran;
 - d) Libya;
 - e) Muslim countries generally (because of their treatment of women's rights);
 - f) Communist countries.

Hurdle 2: Which priorities? The above goals are so many and so varied that they bring to mind the child's problem in the candy store: "Which do I really want?" It may come as a surprise that 12 of those goals were proposed by a single group, Governor Jerry Brown's Public Investment Task Force in 1981. (It's hard to believe that the Task Force deliberately omitted Goals III-VII; maybe avoiding investments in defense contractors and alcohol is not an ethical imperative for California public funds, given that State's defense industry and vineyards—swords *and* plows.) A pending bill in New Jersey with important support in the legislature has a similar shopping list.

In fact, the child's quandary in the candy shop is easy compared to this selection or ranking problem, for what is to be done when the goals conflict? For example, Morgan Guaranty Bank is involved in South Africa but also is the first bank to support black business schools, is a leading lender to minority firms and a leading funder for redevelopment in New York ghettos. Avoid or favor buying their stock? Or: Grumman, the largest manufacturer of solar collectors and heaters, was involved in foreign payoff scandals and is a major defense contractor. Or: Atlantic Richfield, fined by the EPA for using leaded gasoline in company cars designed for unleaded only, has been singled out by the Council on Economic Priorities as the leading oil company in pollution control. Buy? Avoid? Punt?

Hurdle 3: Who decides? Fiduciaries have control of other people's money for one reason: they are believed to be capable and trustworthy to further the purpose of the fund in question, be that purpose retirement security or educational or charitable activity. They may or may not have any expertise on divergent goals, their views about such goals may or may not be shared

by many or all or even any of the beneficiaries of the trust, and certainly they were not made trustees to further their own social or political views. This is a crucial distinction between such trustees, and legislators or other elected public officials. (Many state or local teachers', police and firefighters' funds have some elective trustees, but obviously such persons are selected with a single goal in mind.)

It is blatant abuse of trust for trustees selected to further a specified, shared goal, to use their power for personal goals. And if personal goals are pursued to the financial detriment of the trust fund, then the line fades between this conduct and plain embezzlement.

Hurdle 4: How decide? This dichotomy between shared goals and personal goals is not meant to suggest that the only proper goal is the fund's financial gain. Most obviously, compliance with law is required and expected: if a corporation is in sustained, flagrant violation of law, avoiding its stock seems unobjectionable and, I believe, desirable.¹² But slippery slopes are avoided by setting up specific signposts. For example, J.P. Stevens a few years ago was found guilty not merely of repeated, on-going unfair labor practices but even repeated contempts of court, and until its commendable change of course, was the leading labor relations outlaw in the nation. For a collectively bargained pension fund, it would be hard to take seriously any objection to avoiding that stock. But for any trust, such a stock could be avoided for several reasons. First, in the J.P. Stevens instance there was no lack of clarity, or difficulty in determining the degree and uniqueness of the corporate illegality, so there were no information costs or burdens of arguing about the specific situation. Second, there was no lost opportunity or other investment cost, since that particular investment could easily be replaced; the case would be very different were the corporate culprit IBM or GE, but those firms' being guilty of such sustained illegality seems so unlikely that we can leave such a question until, if ever, it arises.

How different the proposition that, for example, a fund should invest only in unionized companies: such a sweeping limit would keep a fund from holding almost any high technology stock, likely inflicting serious loss of investment earnings. But it would be wrong to rush to a sweeping proposition against sweeping propositions. To bar all alcohol and tobacco stocks, for example, has little or no investment implications (because of the modest capitalization involved unlike, say, oil stocks); however, such a ban might reflect shared views in some beneficiary groups, such as a church endowment, but not in others, such as a pension fund with diverse participants. Or, even if there is clear consensus on a divergent goal—say, a state pension fund's favoring investment in firms with in-state employees—one must always determine the investment implications. For New York's funds such a preference would probably make no discernible difference in which secu-

¹²The New Jersey Investment Council has adopted a new standard for its \$13-billion-asset holdings: "good corporate citizenship." Annual Report 1984, p. 11.

rities are held, but for North Dakota, a preference for in-state investing would shrivel fund earnings and drive up pension costs, driving up taxes and injuring economic development instead of aiding it. I remember one small State's pension investment officer's saying that the only thing worse than not investing in-state, is investing in-state and losing.

In short, the specific facts of different proposed divergent investments make some of them desirable, some acceptable, and some injurious or unfair abuse of trust. If there is doubt about whether an investment is prudent, it is unquestionably wrong to go forward, since so many clearly prudent alternatives are available. Similarly, if there is doubt whether a divergent goal (even one which is not injurious financially) commands the necessary overwhelming concurrence of the beneficiaries, then it is improper to pursue such a goal.

What of polling the beneficiaries about whether they want to pursue X divergent goal? Polling has legal limits, certainly has some costs and possibly large ones, and usually is unfeasible. It would be legal to follow poll results if all beneficiaries agree, but it would be illegal to delegate to a mere majority the trustees' responsibility to pursue the shared interest of all beneficiaries. Polling would be costly if the beneficiaries are numerous. And often polling would be unfeasible because the issue is so complex or requires just such investment understanding as to exemplify why we have trustees in the first place. Further, even if one assumed a clear issue and an adequately comprehending group of beneficiaries, the likelihood is that polling secures only such low participation as to preclude any confidence about the degree of agreement. For example, when South Africa divestment (even if that were clear and understood) for the University of Oregon's endowment was put to student vote there in 1977, almost 95% of the voters supported divestment. But the total number of voters was under 10% of the university's 16,000 students, not even counting the future students for whose benefit such funds exist and who would be affected far more by any new investment policy than the voting students who would be gone before the policy took hold.

Perhaps the clearest indication of the difficulty and divisiveness surrounding this question of *how* to choose any divergent goal, is the fact that Gov. Brown's Task Force divided 23-7 on whether to have California public funds take even so modest a step as submitting proxy proposals upon request of only 10,000 participants (or 10%).¹³

Hurdle 5: The lack of information—corporate responsibility and irresponsible responses by institutional investors: Investment decisions are made on the basis of an enormous flow of audited, comparable, continuing data on corporate performance. An entire profession of financial analysts brings trained, experienced expertise to bear on such information. A few

¹³Final Report (Oct. 1981) at 54, 62-3.

nonfinancial goals present no information difficulty, for example, avoiding alcohol or tobacco stocks (although even that is not so easy since the development of corporate conglomeration). But if a portfolio manager must decide whether a corporation has at least 1,000 employees in the state; or worse, whether it is engaged in "doing business in or with South Africa" (the restriction in Massachusetts and several others places); or still worse, whether it does more than SX of such business (the threshold in the Oregon Board of Higher Education resolution is \$500,000) . . . in all such instances, the difficulties are huge. The fact that "there is no systematic method for obtaining and evaluating information about the activities and practices of companies in which the funds invest" is deemed one of the prime reasons "the current decision-making framework [for divergent investing] appears inadequate," according to one of the best studies advocating divergent investing.¹⁴ A similar study, done by an able organization for a California state agency, also emphasized "the incomplete and preliminary nature of much of the data available"—"a prerequisite for development of a coherent ethical investment policy for just these two issues [EEO and involvement with South Africa] requires the gathering of sufficient data upon which informed judgment can be based."¹⁵

The data gap does not mean pension fund managers cannot find out about General Electric's relations with EEOC, or General Motors' relations with OSHA. But how decide whether GE or GM is notably good, or notably bad, without employing some standard of comparison? Without comparable data, investment decisions on non-financial grounds risk being inaccurate (and therefore unfair) as well as ineffective; Company A might look good or bad on, say, equal employment, only as long as one doesn't know how others in its industry or its geographic area are performing. Producing responsible analyses in this area is a considerable task involving substantial costs.¹⁶

The problem of timely data is pointed up by the fact that months before release of that able group's report for California, listing Coca-Cola as a "bad" investment because of its activity in South Africa without agreeing to

¹⁴Coltman & Metzenbaum, *Investing in Ourselves* (Mass. Social & Economic Opportunity Council Task Force, June 1979), at 29.

¹⁵Council on Economic Priorities, *A Study of Investment Practices and Opportunities* (1980), at 68, 144, 159-60.

¹⁶The Council on Economic Priorities' study of political influence and lobbying by military contractors cost \$75,000; its study of nuclear power's impact on job creation (in one locale!) cost \$292,000; its much-praised study of paper companies' pollution practices cost \$50,000 (and that was back in 1969-1970).

Although responsible "social performance" data are costly, they can be developed and certainly I join in believing they should be. But this will occur only if groups, instead of seeking publicity about being "socially responsible," try to implement that goal by joining with major companies and major institutional investors, to bring us social performance data that could be used to supplement financial analysis. We need the economies of scale if such data are to be sound and routinely available, the *only* way such data can be used properly and maybe matter.

the Sullivan Principles, Coca-Cola had switched its position—in response to a shareholder proposal—and signed the Principles. Worse, as late as 18 months after that switch, the group was still handing out a summary with Coca-Cola at the top of the list of sinners, without even oral correction in at least one large meeting, presumably in many.

In short, the goals can be pursued only at information costs which themselves injure net investment results; or cannot be pursued; or can be pursued only incompletely and episodically, producing efforts to reward corporate responsibility or punish corporate irresponsibility on bases that are closer to random than to prudence.

Hurdle 6: Inviting conflicts of interest: To the extent that the divergent investments are aimed to benefit—or bring pressure on—firms or ventures situated in the same locality or industry as the pension fund, consider what kinds of investments are likely to occur: those with political appeal, and often those that raise acute conflicts of interest. If a construction union invests in mortgages to finance a construction project on which its members will have jobs, can we be confident that the projects will be selected by neutral criteria? If state and local pension funds are to invest in local projects, then (once we abandon the discipline of seeking market returns) won't there be enormous maneuvering for the pension fund dollars, with politics replacing market return as the determinant? Fiduciaries who are faithless or unclear about their duty can always find ways to use trust assets to their own benefit.

Politics are the right measure of who gets into office and how public policy issues are resolved. Contrast the safeguards surrounding political decisions (pork-barrel or not) as against what will happen when the bees gather around the pension fund honey pot. Not even the strongest and most representative pension board will have as much independence, as much political balance of countervailing forces, as a legislature. And rarely if ever would a pension fund investment decision have as much public visibility and relative comprehensibility as decisions being forged in the legislature.

Hurdle 7: How hold the fiduciaries accountable? When the only goal is maximizing investment returns at a prudent level of risk, evaluating how well the trustees have done (in setting investment policy and selecting and overseeing the money managers) is easy. Not as easy as measuring the size of a room, but we have recognized methods and expert, independent firms to evaluate investment performance. How do we evaluate the portfolio managers' performance, if we diverge from traditional prudent investing with its sole focus on investment return? How evaluate success or failure in furthering the divergent goals? In short, the pension fund engaging in divergent investing is likely to become captive to whatever interests have muscle—whatever form their strength may take—to shape the choice of divergent goals and the selection of specific investments. As everyone who has ever dealt with money managers knows well, however strong or weak

their investment performance, they are always deft at salesmanship. When performance is not strong, they will unfailingly explain that it was not their own limitations but the result of . . . whatever scapegoats are available.

If trustees cannot evaluate their money managers and the beneficiaries cannot evaluate their trustees, there is no accountability. Accountability is the only effective safeguard against self-serving, negligent or incompetent fiduciaries.

Hurdle 8: For all those difficulties and costs and risks, in anything gained? Possibly. But usually not, even when prudent financial standards are put aside in favor of hidden subsidies for the divergent goal, as exemplified by numerous union and public funds' special mortgage investing during recent periods of scarce mortgage financing (see below, section III.B). And where prudent financial standards are maintained and investments are made on market terms, many observers believe that our capital markets operate so efficiently that the favored divergent goal ends up with no more support than it would have gotten anyway.¹⁷ Since I believe our markets are essentially efficient but less than wholly so, I am confident that there may be gains even if, for example, a state fund makes in-state mortgage investments on market terms, especially if it does so in periods when very little mortgage money is available.

If greater emphasis is to be placed on local investing or other new criteria, two simple steps will assure both protection of retirement security and effective pursuit of the collateral goals. First, the public fund should never buy privately placed securities (or other investments) in which its stake is larger than 50% at maximum, with the balance being purchased on the same terms by other tax-exempt institutions. That assures against investments resulting from improper influence, and also against inadequate analysis. Second, public funds themselves lack adequate staff or expertise to go beyond recognized investment criteria. New York's Comptroller Edward

¹⁷See Langbein, § 5, above. See also Litvak, *Pension Funds and Economic Renewal*, at 13 ("Development Investing in Name Only") (Council of State Planning Agencies, 1981); and see my *Should Pension Funds be Used to Achieve "Social" Goals*, 119 *Trusts & Estates* 26, at 26-27 (Nov. 1980; last of three parts, Sept.-Nov. 1980). The foolishness of trying to use pension investments as a tool for economic development is pointed up by the catchily-entitled 1978 book "The North Will Rise Again," aimed at reviving New England and the upper midwest by local investing of local funds. The book was a good read as fiction; its unreality is analyzed at 119 *Trusts & Estates* 22, n. 8 (Sept. 1980). New England has risen again remarkably, but the "driving force has been education. We have 260 colleges in New England, 65 in the Boston area alone. It's been the wellspring of our entrepreneurship." Bank of Boston's chief economist James Howell explaining New England's gain of 222,000 jobs between 1975-80, *Wall St. Journal*, *New England's Big Recovery: The 'Most Spectacular' Event [in the history of Western capitalism]?*, Dec. 18, 1984, p. 37.

Localizing pension investing also runs the risk of retaliation by local funds elsewhere. San Antonio's well known Mayor Henry Cisneros warned New York City businessmen of this, assuring them he did not feel vengeful but that a popular bumper sticker in his region was "Forget the 55-mile-per-hour speed limit—drive 60 and freeze a Yankee." *New York Times*, *Sun Belt 'Revenge.'* January 27, 1982.

V. Regan has proposed that more local investing can be done and done well if state agencies expert at, e.g., development, will assemble packages of appropriate investments and bring them to groups of private and public institutional investors.

Last, the sheer indirectness of many of the efforts to invest to pursue divergent goals, must be faced. For example, there are a few small mutual funds (long in business but never significant in asset size) aimed at "socially responsible" investing. Pax World Fund, sponsored by officials of the United Methodist Church, is always mentioned and is obviously aimed at a goal we all share. But how much peace is promoted by a fund averaging \$3 million (never over \$13 million in its 13 years)? It has produced results for the firm operating it, an annual expense ratio of about 1.6%, unequaled by few if any other mutual funds. It has produced poor investment returns, an annual average of 11.9% for five years, compared to 13.2% for the average similar fund (Lipper, balanced funds). Wouldn't everyone involved (except the firm managing the fund) be better off with direct contributions to charities working for peace or, say, feeding and educating children the world over?

III. TWO CASE STUDIES

A. *State and local pension funds and recent pressures for in-state mortgage investing*

Between 1980 and 1983, when interest rates were alpine and mortgage money was abyssmal, there were acute pressures nation-wide to draw retirement assets into mortgages. In 31 states, these pressures were represented as "in-state targeting," allegedly to aid local homeowners and the construction industry. In only a handful of such States did homeowners get better-than-market rates; in only a few States was new construction aided. But in most of these States, instead of continuing or expanding holdings of in-state-targeted GNMA's or similar established mortgage investments, new kinds of packages were assembled. As a full analysis by the South Dakota Investment Council¹⁸ found, the new packages were higher risk than alternatives like GNMA's; were also less liquid or completely illiquid; and yet yielded *less* than did the established alternatives. Consider one example of these special in-state packages.

North Carolina's pension fund in 1981 bought a \$53 million package of mortgage-backed bonds issued by a new corporation that was capitalized for \$1,000 and that sold no other securities to anyone. The corporation was owned 50% by the savings and loan associations, 50% by the mortgage bankers of the State. The yield was 34 basis points (i.e., 0.34%) below

¹⁸Analysis of 23 "In-State" Mortgage Packages Privately Placed with State and Local Retirement Funds, Oct. 1980-March 1982 (May 1982), reprinted in Joint Hearing on Public Employee Pension Benefit Plans, House Committees on Ways and Means and Education and Labor, 98th Cong. 1st Sess., at 321 (Serial 98-56; Nov. 15, 1983).

yields available at the same time on GNMA's, which are insured by the Federal Government and readily salable in a highly liquid secondary market.

Why should the "NICMICs" have yielded *less* than GNMA's? The lower yield translates to about \$2 million less return on that size package over its expected life; the difference between insurance by the Federal Government and the NICMICs' insurance by a subsidiary of Merrill Lynch, has been estimated to come to roughly another \$2 million; if, as appears to have been the case, the state fund was obligated to buy under a forward commitment but the sellers were not obligated to sell (they would not if interest rates had shifted in their favor) then that was worth roughly another \$0.5 million; and since the NICMICs could not be sold easily, being an utterly unique security, their lack of liquidity came to roughly another \$2 million. All that comes to a give-up of about \$6.5 million on that package of \$53 million. Why would a state pension fund so subsidize an investment?

Certainly there is agreed-upon social value in promoting home ownership, especially for low or middle-income housing. But, the facts. First, home buyers got market rates, not lower ones. Still, there might be aid enough in getting any mortgage money when it is all but unavailable, especially for lower-income families. But, the flaw in that justification is that only 5% of the funds went to people with under \$12,000 annual income. Well, one may respond, the mortgages must be secure. That is unarguable, but: over 30% of the funds went to people with annual incomes over \$36,000 and the ceiling on how much a borrower could get—not the home price, but the mortgage, for 1981 in North Carolina—was \$150,000. (In another State's similar mortgage package the ceiling was \$200,000.) How does one justify taxpayers' having to subsidize (by contributing more to the pension fund to make up for these poor investment returns) getting mortgage money to *upper*-income people? Well, some defenders of these packages would say, all this occurred when the housing industry was inert, and the State gains importantly from supporting construction jobs. But: half of the mortgages were not for new housing, nor even for new purchases of existing homes—half were for mortgages "off the shelf," that is, ones issued up to five years earlier. Well, one might respond, selling those older mortgages makes new funds available to the savings and loans and mortgage bankers, and those new funds can go to new mortgages. But: while I have been unable to pin down whether the NICMICs involved any commitment as to the use of those new funds, a number of state funds and small multiemployer funds in the construction industry did fail to secure any commitments and soon discovered that the thrifts (and/or mortgage bankers) used the new funds to buy Treasury securities.

North Carolina's was not an unusual deal. The South Dakota pension fund was under pressure from local firms to buy a similar package, insured by the leading private mortgage insurer, MGIC. South Dakota's Investment Council agreed that market terms were essential, so analysis was done on

the 23 in-state mortgage packages privately placed to state and local pension funds between October 1980 and March 1982 (when the data were gathered). All were MGIC-insured, some rated single A, most AA, some unrated. Most had little or no liquidity. How did they compare with the completely liquid, Government-guaranteed GNMA's, which could also be packaged with mortgages from one state or large locale? The average MGIC-insured package was 149 basis points different from contemporaneous GNMA yields, or around 10% of the interest rates then paid.

Of course financial experts would differ on just what is the appropriate margin for the MGIC packages' lower quality, lack of liquidity, etc. But dispute can be avoided because the average MGIC in-state package was yielding not 10% more than GNMA's, but 10% less. Compared to FHLMC "Freddie Macs," the average inferiority of the special in-state packages was 177 basis points. And even those average margins of inferiority would have been worse but for the fact that four of the special packages were of *second* mortgages; not even MGIC could sell those, not even to state funds, at yields lower than GNMA's.

By no means did all state funds crumble before these pressures. Texas State Teachers participated but at strong yields. South Dakota, New Jersey, New Hampshire and others completely stood off the pressures. But an update of South Dakota's study found that as of June 1983, 31 States' funds had participated in \$500,000,000 of special in-state packages insured by MGIC, receiving investment returns at least \$10,000,000 *per year* poorer than were readily available in GNMA's and similar securities.¹⁹ Nor did homeowners benefit: only in Massachusetts, Michigan and Oklahoma were preferential rates given. In addition, Connecticut's fund bought \$473 million of local mortgages (MGIC was not involved, as it was not in North Carolina), at rates badly below GNMA's but also on below-market terms for

¹⁹Munnell, *The Pitfalls of Social Investing: The Case of Public Pensions and Housing*, *New England Econ. Rev.* (Sept/Oct. 1983).

While Munnell and the treatment here deal with only state and local funds, that is partly because the information about their investments is available, thanks to South Dakota's Investment Council. There may be similar problems in some multi-employer pension funds. According to Randall Smith, the leading reporter on pensions, in February 1982 the Labor Department's Los Angeles office recommended that the Department sue the trustees of several construction-union pension funds in Southern California for breaking Federal pension law by investing \$268 million in local union-only projects, much of it at below-market rates. Secretary Donovan received a unanimous staff recommendation to sue, around April 1983. As of Smith's report and as of January 1985, no further decision or action has occurred. *Wall Street Journal*, *Constructive Plan? Use of Pension Funds to Create Union Jobs Raises Issue of Legality*, Jan., 17, 1984, p. 1.

How well any such investing does boost jobs (or tax revenues in the case of public funds) is another matter on which claims outrun facts. For example, Gov. Brown's 1981 Task Force claimed that new housing investment would produce almost twice as many jobs as even the local construction industry claimed. Contrast Final Report n. 13 *supra* at 22-3 with Construction Industry Research Board, *Summary of Economic Impacts: Investment In New Housing Mortgages*. (Sept., 1981), table 2.

the homeowner. The flaw there was that the mortgages were allocated by chance: whoever happened to be buying a house when the money was offered, and got into line early enough the night before (literally) enjoyed a subsidized mortgage. That contrasts sadly with the long-established and regularized program for public employees in Hawaii, or a careful new one for active and retired public employees in New Hampshire.

This 1980-83 experience shows that under such guises as promoting jobs or local home ownership, the taxpayers and pension participants are victimized by closed-door concurrence in complex deals usually bringing benefits neither in jobs nor for home owners. But always benefitted are the politically muscular groups that seek aid they cannot secure in the more open and representative legislative. There is enough legitimate controversy over how, how much and which housing should enjoy public subsidy decided upon in proper legislative process. Hidden subsidies squeezed out of pension funds are a case study in how not to proceed.

B. *South Africa-Involved Investments*

1. Factual context

We may take it as a fact that Americans abhor apartheid. I personally am certain as a matter of morality, politics and history, that American companies cannot "do business as usual" involving South Africa, and that American investors cannot do investing as usual in South Africa-involved firms.

The question is not whether any steps shall be taken, but only what steps may help move the situation away from the abhorrent.

Institutional investors have been involved in more controversy over this issue than any other non-financial one. Some spontaneous efforts and some nationally organized ones have arisen in periodic waves since 1961 on many college campuses and, since about 1980, in several state legislatures and city councils. Many foundations, churches and charitable organizations have also grappled with this issue. Much more than on the other issues noted in this paper, there is here overwhelming rhetoric and unusual impatience to consider facts. And no other issue generates such emotion—and, on unfortunate occasions, such racial divisions—as this one.

Since 1961, when student drives for divestment began, U.S. firms' fixed investment in South Africa has risen about 50 times. Even adjusted for inflation, so great a rise indicates to some people that the divestment drive is farcically futile, to others that it is needed more than ever. As of 1982, U.S. firms' fixed investment there was \$2.3 billion, just-at-cost values;²⁰ that is about 17% of all foreign fixed investment, about 3% of all investment

²⁰This was down from \$2.6 billion two years earlier, according to the U.S. Commerce Dept. Some may attribute the drop to divestment pressures, others may attribute it to the depressed state of the economy in 1981-2 in both countries, and to straight-forwardly commercial decisions to withdraw, like Chrysler's.

there.²¹ In addition, our financial institutions had loaned over \$3.6 billion to South African borrowers, and U.S. investors were estimated to hold about \$8 billion of shares in South African firms, bringing the total U.S. financial stake there to over \$1.4 billion, second to Great Britain's. In contrast, total South African assets in the U.S. were estimated to be only \$200 million as of 1978. Our exports to South Africa totaled \$1.4 billion in 1979, \$2.45 billion in 1980, \$2.9 billion in 1981, \$2.36 billion in 1982 and \$2.11 billion in 1983. That means about 60,000 jobs in the U.S.; each \$1 billion of U.S. exports supports about 28,000 jobs here.²² We have unilaterally embargoed arms sales to South Africa since 1962, and have sold nothing there for nuclear power operation. Our imports from South Africa include 82% of our platinum, 87% of our vanadium, 48% of our chrome, 45% of our manganese, 13% of our gold and 67% of our industrial diamonds. We are South Africa's third largest trading partner, after Japan and Great Britain.

As for how many U.S. companies do business in South Africa, not only is there constant flux but different sources report substantially different figures, wildly different in one major instance.

- One authoritative source, Arthur D. Little, Inc. in October 1984 named 281 companies, including at least 31 with 10 or fewer employees; but the report noted also that as many as 40 more were believed to belong in the list, bringing the total to about 320.²³

- The most thorough study of the investment ramifications of divestment, published in December 1984 by a major investment firm managing a "South Africa-free" portfolio for the District of Columbia Retirement System, listed 229 companies.²⁴

- But a month later, the authoritative Investor Responsibility Research Center published a list with over 287 companies.²⁵

- Another investment study (February 1983) by a major investment firm managing such a portfolio for Michigan State University, listed about 270 companies.²⁶

²¹Unless otherwise indicated, the US-SA data are from Davis, Cason and Hovey, *Economic Disengagement and South Africa: The Effectiveness and Feasibility of Implementing Sanctions and Divestment*, 15 *Law & Pol. Int'l. Bus.* 529 (1983) (advocating divestment) and Chettle, *The Law and Policy of Divestment of South African Stock*, *id.* at 445 (*contra*).

²²Export data from U.S. Dept. Commerce. Job figure from U.S. Dept. Commerce, *Int'l. Trade Admin.*, Export Factsheet (Dec. 20, 1982).

²³Eighth Report on the Signatory Companies to the Sullivan Principles, pp. 2, 12 and 42-4 (1984).

²⁴Wagner, Emkin and Dixon (of Wilshire Associates), *South African Divestiture: The Investment Issues*, *Financial Analysts Journal* 14 (Nov.- Dec. 1984).

²⁵IRRC Directory of U.S. Companies with Operations in South Africa (1985).

²⁶Trinity Investment Management Corp., *Structuring Portfolios from a South Africa Free Universe* (Feb. 1983).

• But one month later, the District of Columbia's study by a major pension consulting firm listed 201 companies.²⁷

• And that same year, three advocates of divestment said "approximately 6,000 U.S. companies do business in South Africa," relying on the most prestigious study, "Report of the [Rockefeller Foundation] Study Commission on U.S. Policy Toward Southern Africa: Time Running Out."²⁸

Two points emerge. First, while a core of companies maintain a presence in South Africa, many others come and go, acquiring subsidiaries and selling them, so that even a fund determined to avoid South Africa-involved companies must either compromise significantly in light of information difficulties, or risk highly imprudent portfolio turnover and costs—or both.

Second, does it make sense to treat a company maintaining a presence in South Africa, regardless of size or amount of business, as more supportive of apartheid than a company with no office or employees there but making major imports or exports? For example, Boeing has fewer than 10 employees in South Africa; considering its products, does its presence matter less than, say, Coca-Cola? If Boeing had no office in South Africa but still sold planes there, wouldn't it still matter a great deal? GM and Ford have plants in South Africa, but the leading sellers of cars there are the Japanese. Does it make any sense to divest GM and Ford stock, but allow unrestrained investing in South Africa's leading trading partners, Japan and Great Britain? What of the New York Times, Washington Post and American Broadcasting company, with offices there but not even Sullivan Signatories? (They may be distinguishable, though *Time* and I doubt it.) How can the advocates of blunderbuss divestment attack companies that are in South Africa, almost none of them doing even 1% of their business there, but at the same time allow investing in American companies importing from South Africa or "using—and so keeping up the price—of South Africa's platinum, vanadium, manganese, chrome, and gold? And, after all, how allow investing in the securities of the most important American institution involved with South Africa, the U.S. Government?

Clearly, the determined South Africa-free investor ends up either keeping

²⁷Meidinger Asset Planning Services, D.C. Special Investment Study: South Africa Proposal (March 31, 1983).

While there were earlier efforts to analyze divestment's investment implications, they (except for Trinity's, *supra* n. 26, and perhaps unpublished ones) either utterly ignored relative riskiness, liquidity, manageability, etc.; or treated such crucial aspects only with a verbal acknowledgment, or only in part; or were simply superficial. For example, one published in 1979 was "heavily qualified" by its author in testimony later that same year because "important procedural, legal and economic implications have not been examined." BNA Pension Reporter, Dec. 17, 1979, p. A-19, reporting on Andrew Rudd's testimony about his Divestment of South African Equities: How Risky?, J. Portf. Mgt. (Spring 1979), p. 5.

²⁸The Commission was chaired by Ford Foundation President Franklin A. Thomas; it was published in 1981 by Univ. Calif. Press. The 1983 article using the 6,000 figure is Davis, Cason and Hovey, *supra*, n. 21.

money in the mattress or making major compromises, questionable not merely in policy and logic but also in fairness. Dubious compromises become indefensible if more sensible alternatives to absolutism are available and being used.

2. The seven lines of action about South Africa-involved investments:

There are fundamental differences between the divestment statutes passed in Massachusetts, Connecticut, Nebraska, Maryland and Michigan, wholly apart from the fact that the first three deal with their state pension funds, Michigan's with its university endowment, and Maryland's only with bank deposits. New York City's pension funds and Harvard have taken still other courses. Unless we focus on these differences, debate may be unnecessarily polarized and unwise action promoted unwittingly.

(a) *Massachusetts* has adopted blunderbuss divestment: its pension fund can hold no companies doing business in or with South Africa,²⁹ which is taken to mean the 250-or so firms usually listed as having a presence in South Africa. Similar blunderbuss restrictions have been imposed on the retirement funds of the District of Columbia, Boston (which adds Namibia), Hartford and Philadelphia. It is important to add that Massachusetts adopted similarly sweeping divestment of firms involved in military action in Northern Ireland—a newer statute signed into law on March 17, 1983.³⁰

(b) *Connecticut* originally passed a similar statute, but after the Governor vetoed it as not having been adequately considered, substantial study was done and a very different approach adopted: divestment is not applied to firms which have secured the top two ratings of compliance with the Sullivan Principles (see section C and Appendix) unless the company supplies strategic products or services to the Government of South Africa.³¹ The State Treasurer has begun reporting on the pension fund's South Africa efforts—what has been sold or put on their "avoid" list, what dialogs are occurring with specified companies, and, happily, which companies have signed the Sullivan Principles since the State's effort began.³² *The difference between the Connecticut and Massachusetts statutes matters enormously in investment implications, treated fully below, and in the morality of the distinctions that Connecticut recognizes and Massachusetts ignores.* The National Association of State Treasurers has formally endorsed the Connecticut approach.

(c) *Nebraska* limits permissible holdings for its pension fund to firms

²⁹Title 32, § 23(1)(d)(vi); Stat. 1982, c. 669.

³⁰*Id.*, § 23(1)(d)(ix); Stat. 1983, c. 661.

³¹Public Act 82-324, Conn. Gen. Stats. § 3-13f. Connecticut has also since 1980 a statute provoked by the Iran hostage crisis, barring investments in firms dealing with Iran "contrary to the foreign policy or national interests of the United States." Public Act 80-431; § 3-13g. That 1980 statute has never been implemented.

³²Henry E. Parker to Members of Investment Advisory Council, March 14, 1984 (first semi-annual report on their two largest pension funds).

in the top rating of Sullivan Principles compliance, a difference with significant investment implications.³³

(d) *New York City's* Retirement System trustees in 1984 adopted a five-phase approach to divesting:

After 15 months: companies doing business with the South African military and police, providing financial services to the Government or refusing to sign the Sullivan Principles.

After two years: companies that have signed the principles but do not allow monitoring of compliance.

After three years: companies that do not achieve the highest rating in complying with the Sullivan Principles.

After five years: all companies except those whose activities are deemed by the trustees to be of substantial assistance to efforts to eliminate apartheid.

Their City Council is now considering barring investments in companies that discriminate against Catholics in Northern Ireland.

(e) *Michigan's* statute requires divestiture by its state university endowment; it is now in litigation, the Board of Regents claiming infringement of their authority under the state Constitution. On the one hand the statute is absolute as in Massachusetts, but its moral absolutism is called into question by the provision that the proceeds of divestiture sales should be invested in Michigan firms. And while the Regents have denied that they are required to comply with the statute, they have chosen to sell some holdings but to keep particular holdings in firms that are substantial Michigan employers and actual or potential donors to the endowment. (Involvement in South Africa is immoral unless we get direct benefit from the immoral firm?)

Similar to Michigan is New Jersey, with two pending bills being supported as a package: one is absolute divestment, the other requires a preference for investing in New Jersey and replaces the prudence standard with an "acceptable" standard. As of June 1984, New Jersey's Investment Council found that of the 103 South Africa-involved firms having the investment characteristics allowing that \$10.2-billion pension fund to invest in them, all but five were Jersey employers.³⁴ Of those 98 Jersey employers, 31 had more than 1,000 employees in the State and another seven had headquarters in the State. Moreover, a far larger proportion of the South Africa-involved firms' market value was also Jersey-linked, since the firms with headquarters or over 1,000 employees in-state included IBM, Exxon, GM, GE, Ford, Mobil, Texaco, Dow, DuPont, Johnson & Johnson, Merck, MMM, Raytheon, Revlon, Schering-Plough, Squibb, Union Carbide, United Technologies, Warner-Lambert, Westinghouse and Xerox. Such blue-chip *in-state* investments would virtually certainly not be divested, so the

³³Legis. Bill 553, signed Apr. 10, 1984.

³⁴All of the 69 current holdings are Jersey employers.

mended by the Rockefeller Commission Report, "Time Running Out."³⁹ That report flatly opposed divestment, advising institutions instead to act as active shareholders pressing corporations to (1) make no new investment in South Africa; (2) contribute to social development there at twice the rate of total charitable giving by the parent company in the U.S.; and (3) sign the Sullivan Principles and advance the Sullivan Principle's content and (at least as of the date of that Report, 1981) their monitoring.

In 1984, New York's State Comptroller Edward V. Regan, as sole trustee of the \$23 billion Common Retirement Fund, began an approach like Harvard's, carefully distinguishing among different companies on the basis of their different Sullivan Principle ratings—or non-rating—and communicating directly with the companies to encourage responsible conduct and further progress.

3. *What will divestment accomplish?* A moment's analysis reveals why blunderbuss divestment will not further antiapartheid goals in South Africa, but will at best (a) leave the problem in *status quo*, (b) probably make it worse, and (c) certainly hurt jobs here at home.

Consider what happens if, say, the D.C. pension fund stops buying stock or bonds of, say, Ford Motor or IBM or Johnson & Johnson. The securities of such big companies are instantly absorbed by other investors which, by definition, care less about the company's activity in South Africa. The stock price is unaffected. The company is not wholly unaffected—no company likes negative publicity. But even as symbol, divestment produces only a one-shot announcement of the sale or the blacklisting of that stock, and no more. In contrast, if the socially concerned institutional investor were to press proxy proposals about the firm's role in South Africa, there is a continuing stream of communication and pressure.

A particularly telling example: United Technologies is Connecticut's largest employer, certainly concerned about its relations at home. Within a month after Connecticut passed a statute putting prudent limits (see above) on its South Africa-related investing, United did not hesitate to acquire a substantial new subsidiary in South Africa.

But even if any significant U.S. company did respond to divestment of its securities by withdrawing from South Africa, what impact would that produce in South Africa?

First, even complete economic sanctions, far more severe than U.S. investors' selling their shares of U.S. firms, have a poor record of effectiveness. Second, the (British) Economist Intelligence Unit concluded in 1982 that South Africa's black-neighbor nations were likely to be hurt more by any sanctions against South Africa than would the target itself.⁴⁰ Third, to come back to the mere withdrawal by U.S. firms, both experience and the current scene indicate ineffectiveness.

³⁹See above, n. 28.

⁴⁰Freer & Samson, *South Africa: Business Prospects Re-assessed*, 93.

11
A particularly telling example: In ~~1977, Polaroid did withdraw~~, not because of divestment but because of sustained, forceful pressure by shareholders who kept their shares to press for change. Polaroid was deemed especially important to South Africa, because its then-unique cameras and film were used for apartheid's key operating tool, the passes. Impact of Polaroid's withdrawal? None. Polaroid supplies went in through Europe, with Polaroid unable to do anything about it.

Should Polaroid have stopped all sales abroad, to stop the flow to South Africa? (*Could* they if they tried?) In answering that, please consider not only South Africa or Polaroid stockholders—how about their U.S. employees?

As for U.S. companies with competitive products, that is, almost all firms: if they withdraw from South Africa, can one believe South Africa will be without the goods or services? Can one doubt that the major foreign presence in South Africa, the British, or else the Japanese, Germans, French, etc., will at once fill the gap, even if local firms could not?⁴¹

For example, U.S. firms' largest share of the South African market is in computers, where we account for 70% of all sales. Can one doubt that the firms doing the other 30%—let alone new entrants—would speed into any gap? And since our firms would withdraw only because of concern about apartheid, the remaining firms are by definition less socially sensitive, so apartheid would be stronger or, at best, unchanged. Leaving, at best, no impact on South Africa, but fewer jobs *back in America* for the withdrawn U.S. firms. Does anyone doubt, if U.S. firms reduce employment because of reduced exports or reduced profits brought home, whose jobs will go first?

Divestment might work if, as Congressman Solarz has been trying to accomplish, the major industrial nations work together on this. Until we get that—and major trade unions could help enormously—divestment's *only* impact will be some Americans feeling morally superior, and other Americans losing jobs.

But ineffective as divestment will be, it is bound to be costly.

⁴¹A provocative prediction of what would happen if the South African economy actually were changed by multinationals' withdrawal, was given recently by Rowley Arenstein, the person imprisoned or "banned" by the South African Government longer than anyone else.

"There is a big movement in the U.S. to break the economy of South Africa. I think that is stupid. Without investments, Africans will be pushed back into the countryside and the trade union movement would collapse. Even if you did get liberation, what kind of liberation would that be? You would starve like the people in Ethiopia or Mozambique."

(Wall St. Journal, A 'Banned' South African Speaks Out, and Faults Some Anti-Pretoria Tactics, Dec. 11, 1984, p. 33.)

Another long-time critic of the Government, opposition member of Parliament Helen Suzman, says the determining factor inside South Africa has been

"the steady upward movement into skilled occupations by blacks eventually giving blacks the muscle with which to make demands for shifts in power and privilege, backed up by the force of black urbanization."

(Washington Post, In South Africa, Washington Can Only Play a Bit Part, Dec. 9, 1984, at C1, C2.)

IV. THE INVESTMENT IMPLICATIONS OF DIVESTMENT.

A. Key distinctions between small funds and large, and between operating funds and investment funds:

This is simple. The number of potential securities investments is vast, and even if your or my own personal investments were barred from 2/3 of those securities, we could still find a dizzying range of appropriate investments. But if we are trying to invest the California state pension funds with about \$30 billion, or even a fund under \$100 million, it is impossible to avoid investing mostly in large companies, whose securities are highly liquid, that is, readily bought and sold in large blocks; and even more important, companies large enough to withstand adverse events. Moreover, many people want massive public pension funds to invest some in small companies, and that is happening. But that "some" must remain a small proportion of those assets of \$340 billion, or government funds would quickly own and control most firms. Therefore almost all institutional funds, public and private, limit themselves to a maximum of 5% of any firm's outstanding stock. Since 5% of a small firm is microscopic for a large fund, research and other transaction costs also limit investing directly in small firms. In short, big funds must have a broad spectrum of securities, which must include the issues of most big firms.

Unquestionably, for small funds even absolute divestment is easier than for large funds. However, it is equally unquestionable that for any institutional-size fund, such divestment means inescapably much higher transaction costs, major opportunity losses (e.g. IBM), increased risk because of the larger number of holdings in smaller stocks and also because of far less diversification. Therefore, such divestment means inescapably either imprudent overall risk or, to balance that, types of investments not usually used or not used so much because they produce lower overall returns. All of this being so, even for smaller funds total divestment is plainly imprudent.⁴²

⁴²For several years, I focussed only on large funds because of my dealing with the divestment issue in the context of state pension funds. See, e.g., my testimony in January 1984, U.S. House Committee on the District of Columbia, Hearings on South Africa Divestment, 98th Cong. 2d Sess., 115, 121, 126. In addition, I have been in contact directly with a number of state pension fund trustees and investment officers, and in July 1984 testified in New Jersey's first round of legislative hearings on this. Therefore I had in mind only the overwhelming evidence that for such large funds, absolute divestment was close to impossible or enormously risky and/or enormously costly, and I failed to focus on what problem there is for smaller funds.

In November 1984, I testified as an expert witness for the Oregon State Investment Council in *Associated Students of the Univ. of Oregon v. Oregon Investment Council*, the suit to compel divestiture for the endowment's approximately \$20 million. Testifying similarly was Wilshire Associate's Wayne Wagner, now managing \$25 million in a South Africa-free index fund for the D.C. Retirement Fund. He, like me, had written focussing on large funds only. See Wagner, *supra* n. 24, at p. 15.

The Oregon trial court ruled on Dec. 5, 1984, that the Investment Council was acting lawfully in refusing to invest despite the resolution by the Board of Higher Education, since the relevant statute required prudent investing and absolute divestment, the court held, is not prudent. The case will be appealed.

One other distinction: for operating funds, e.g. a city's or a state's cash accounts, divestment is not the problem that it is for investment funds, for two reasons. First, operating funds are kept in such cash-equivalents as U.S. Government securities, bank certificates of deposit and perhaps commercial paper, for which any adjustment is much less.⁴³ There are more than enough banks, including large ones, not involved in South Africa.

B. What are the costs and risks for an institution adopting absolute divestment? The picture is clearest if we start with blunderbuss divestment, which imposes seven costs and/or risks on a fund.

Cost 1: Divestment shrinks the spectrum of possible investments to a remarkable extent: Of the Standard & Poor's 500 (the largest firms, constituting the vast bulk of the investments all institutional investors tend to use and which large institutions must use), the South Africa-free fund is barred from holding at least 47% of the market capitalization. Even that rests on limiting the blacklist to 229 companies, which now is unrealistically low.⁴⁴ One cannot respond "Well, that leaves 53% available," because the barred companies are far from fungible with the ones still available. The leading example is IBM, which has a market value of just under \$70 billion: the next largest computer stock is Digital Equipment, with about \$5 billion in market value. (When Wilshire constructed for the D.C. Retirement Fund a South Africa-free index, they replaced IBM with the next largest computer firm not already in the S&P: Commodore.) In one day, albeit a record day, IBM's price rise of \$5.38 per share added \$3.28 billion market value (June 20, 1984). Even within the 500 largest companies of which IBM is the largest, the smallest, Eagle-Picher, has a market value of about \$220 million, 1/320th of IBM.

The barred stocks tend to be so large—IBM, Exxon, GM, GE, Citicorp, etc.—that of all 5,000 stocks in the broadest index (Wilshire's), even the limited blacklist of 229 firms accounts for 35% of total market value. If one tried to build a South Africa-free index of 500 stocks, replacing each barred stock in the S&P 500 with the next largest similar stock not already in the S&P 500, then at least 152 stocks with an aggregate market value of \$554 billion (end-1983), would be replaced by 152 stocks aggregating \$107 billion. The average market value of the barred stocks is \$3.64 billion—for the alternates, \$0.70 billion. The two largest restricted stocks, IBM and Exxon, are worth as much as all 844 issues on the American Stock Exchange. The 12 largest restricted stocks are worth as much as all 3,812 NASDAQ over-the-counter issues.

The best way to grasp how much investment power is lost by absolute

⁴³But see Wagner, n. 36 *supra*.

⁴⁴See discussion at III B. 1. above. The 47% figure is Wilshire Associates' based on values at end-November, 1984. The data in this Section B are from Wagner, *supra* n. 24 and from Trinity Investment Management, *supra* n. 26 and *infra* n. 45.

divestment is to use an analogy suggested by Trinity Investment Management,⁴⁵ the firm managing just under \$10 million of Michigan State U.'s \$45-million South Africa-free endowment. Think of the universe of available stocks like a deck of cards. Rank all stocks into 13 categories of market value, like the 13 different cards. Every institutional investor gets 52 cards, except the South Africa-free funds which give up at least a third of the market value. Such a fund must play with only 30-35 cards against the other funds holding 52 cards. Worse yet, the SA-free fund has given up a disproportionate number of the big stocks or powerful cards: the SA-free deck of 30-35 cards lacks at least two aces, two kings, two queens, and two jacks. Willing to play that way?

Consider concretely what opportunity costs can mean:

If we limit our review to the 27 largest stocks barred—all Aces or Kings in our poker analogy—we see these opportunity costs:

<i>Calendar 1979</i>		<i>Calendar 1980</i>	
Standard Oil	+ 111.2%	Rockwell	+ 96.7%
Mobil Corp.	+ 70.4	Texaco	+ 74.5
Phillips Pet.	+ 58.6	Standard Oil	+ 71.2
Rockwell	+ 43.4	Exxon	+ 58.2
Dow Chemical	+ 37.4	Eastman	+ 52.9
S&P 500	+ 18.5%	S&P 500	+ 32.4%
<i>Calendar 1981</i>		<i>Calendar 1982</i>	
American Home	+ 40.8	Ford Motor	+ 132.1
J&Johnson	+ 14.1	Hewlett Packard	+ 85.2
American Express	+ 13.6	IBM	+ 77.9
Bristol Myers	+ 12.6	General Elec.	+ 73.3
Coca Cola	+ 12.5	General Motors	+ 72.1
S&P 500	- 5.0%	S&P 500	+ 21.4%
<i>Calendar 1983</i>		<i>1984, through 7/31</i>	
Ford Motor	+ 65.4	Coca Cola	+ 41.1
Rockwell	+ 60.0	Bristol Myers	+ 10.2
Du Pont	+ 52.8	Boeing	+ 9.0
Exxon	+ 37.3	Exxon	+ 7.0
Dow Chemical	+ 36.3	American Home	+ 3.3
S&P 500	+ 22.5%	S&P 500	- 6.0%

⁴⁵Investment Implications of South Africa Divestiture (Oct. 1984), "The Poker Analogy," at 5-8.

"Clearly, these are important winners—not only because they outperformed the S&P 500 so much in each of these six time periods, but also because they are all in the top 50 stocks in terms of market capitalization and/or average daily trading.

"To argue that the loss of the opportunity to buy and sell such big stocks—Aces and Kings in our poker analogy—will *not* inhibit performance simply doesn't make sense."⁴⁶

Cost 2: Less information is available on the remaining stocks. Having lost so many of the biggest stocks, the portfolio is inescapably fuller of smaller stocks, which simply are not researched by as many analysts. The 152 barred S&P stocks were the subjects of an average 19.9 earnings estimates by broker-dealers; the 152 replacements were covered, on average, by 10.9 estimates. Having fewer estimates means greater difficulty in relying on research from the brokers normally selected for their good executions, since special efforts will have to be made to use firms providing the scarcer research. It also means the research is probably less reliable. These factors raise only transaction costs, but those too are real. One authority estimates that these research costs might triple normal costs.⁴⁷

Cost 3: The portfolio is riskier because it is more dependent on smaller stocks. Generally, the larger the company the lower the risk, in two senses: First, a greater proportion of small companies go bankrupt. Second, smaller stocks tend to be far more volatile, which means the holder is at risk of the price being quite depressed before he can carry out a decision to sell, or quite inflated before he can buy enough. Of course there are stable smaller stocks and risky larger ones, but the generalization holds. Again, the two firms that are running SA-free funds and, being professionals rather than advocates, have measured the difference in risk levels, show significantly higher risk for the SA-free portfolio compared to the S&P 500. Michigan State U.'s South Africa-free investment manager found 16% greater risk in that firm's "SAF Universe" compared to the S&P (as of February 1983, looking back over the years 1975-82). But that "SAF Universe" earned only a thin margin more than the S&P, 15.4% versus 14.9% (average annual).⁴⁸ The District of Columbia's South Africa-free index manager found 8% more risk as of June 1984, plus 3% more diversification risk plus unquantifiable further strategic risk (see below, Cost 4).

True, a diverse portfolio of higher risk stocks should produce higher returns, a "risk premium." Otherwise, no one would ever venture beyond the blue chips. But will the premium compensate for the risk assumed? And is the higher risk level prudent? The D.C. Retirement Fund has been

⁴⁶*Id.* at 14.

⁴⁷Trinity, *supra* n. 45, at 12.

⁴⁸Trinity, *supra* n. 26, at 8, 9.

advised, its index manager testified, that its risk level in SA-free securities is such that it may need to consider changing other investments, i.e., to lower the total portfolio's risk level by holding more utility stocks or bonds or short-term Treasury securities. Such lower-return holdings wipe out the risk premium from the small stocks and, considering the experienced superiority of stocks over fixed-income investments and similar superiority of growth stocks over utilities, the portfolio will almost surely suffer weaker overall returns than without absolute divestment.

Remember, 1% more returns means 10-15% more pension benefits or a related drop in costs, etc.

Cost 4: The portfolio is riskier also because it is much less diverse. If you have a crystal ball, you don't want to bother with diversification—as Will Rogers would say, just buy the stocks that are going up. But if you lack a crystal ball, the prudent way to cope with the uncertain future is to diversify. Consider the major market sectors, and how many of them and how much of each the SA-free fund cannot buy (using market value of the S&P 500 stocks in each group as of June 1984):

Industrial equipment	: 99%	Conglomerates	: 85%
Banks	: 97%	Office equipment	: 84%
Photography	: 93%	Autos	: 85%
Chemicals	: 87%	Int'l oils	: 76%
Drugs	: 87%		

Again risk rises, sharply. Wilshire Associates found that in addition to the 8% rise in market risk because of the dependency on smaller stocks, there was 3% more diversification risk, plus—

strategic risks that are more difficult to quantify. For example, during late 1983 and early 1984, the only sector to show positive price appreciation was Energy. Energy stocks, however, are heavily affected by divestiture restrictions. Divestiture thus leads to an incomplete exposure to opportunities. The result is a diversification loss beyond the manager's control and a risk that must be borne by the fund.

As a matter of law, recently a British judge held it imprudent for the National Coal Mineworkers' Pension Fund to avoid, as the union trustees insisted, further investing in oil or overseas:⁴⁹

[T]he broad economic arguments of the [union trustees] provide no justification for the restrictions that they wish to impose. Any possible benefits from imposing the restrictions that would accrue to the beneficiaries under the scheme (as distinct from the general public) are far too speculative and remote. Large though the fund is, I cannot

⁴⁹*Cowan v. Scargill*, Weekly Law Reports (Aug. 10, 1984, at 501, 521-2) (Chancery Div., Sir Robt. Megarry, V.-C.).

see how the adoption of the restrictions can make any material impact on the national economy, or bring any appreciable benefit to the beneficiaries under the scheme. . . . In any case, the question is one of excluding a very large sector of the market, and preventing diversification into investments in other countries which may do well at a time when the British market is depressed; and I can see no possible benefit in such an exclusion, especially in the case of a very large fund with highly skilled investment expertise.

Cost 5: Smaller stocks have less liquidity. This is a negative double-whammy. Because smaller stocks are more volatile, investors want to be able to move quickly, certainly if events call for selling but also when trying to accumulate a position. However, precisely because these stocks are smaller and draw much less institutional interest, their normal trading volume is even smaller compared to the big stocks than their relative market capitalization. Recall, for example, that IBM is worth about 320 times as much as the 500th largest company, Eagle-Picher. But IBM's average daily trading volume is \$155,000,000 and Eagle-Picher's is \$100,000; IBM trades over 1,550 times as much. Even if one structured a South Africa-free portfolio with as big stocks as possible, as was done hypothetically for New Jersey's pension fund, the median number of days needed to sell out a holding rose from 17 for the current portfolio to 51 or 31, depending on the hypothetical chosen. Comparing the most illiquid holding that fund has to what it hypothetically would have, the maximum days needed to buy a position rose from 172 to 3,160.⁵⁰

The rise in trading costs—not merely the minor matter of commissions, but the major matter of market impacts—according to an analysis of actual trades by a Wells Fargo officer,⁵¹ would rise by one-quarter for a small fund (\$3.8 million—from 0.8% of price, to 1.0%), by one-half for a middle-size fund (\$38 million—from 1.0% of price to 1.5%), and over three-fifths for a large fund (\$380 million: from 2.3% of price, to 3.7%). Those trading cost rises are believed to be understated for an active manager operating a SA-free fund, since the thin markets in those stocks are likely to react especially sharply to orders from a firm with a good performance record and with a reputation accordingly.

Cost 6: Managing the portfolio will cost more. The portfolio will have to be managed separately. This may mean merely an extra management fee (because of the information costs and unique attention required), but it may mean finding a new manager. For example, when the University of Wisconsin endowment adopted total divestment, the major firm managing that fund refused to continue. Even if a fund doesn't have to go through the delay and cost of finding a willing manager (and though a survey for the D.C. Retire-

⁵⁰Trinity, *supra* n. 45, at 20.

⁵¹Loeb, Trading Costs: The Critical Link Between Investment Information and Results, *Fin'l. Anal. J.* (May-June 1983); relied upon, adjusted to the figures in text above for buys or sells instead of "round-trips," by Wagner, *supra* n. 24, at 17-18.

ment Board found half of the managers surveyed saying they would not accept such an assignment, of course many willing managers are bound to emerge), a great many managers use investment approaches that could not be employed for a portfolio barring so many major investment opportunities. Inability to use a significant proportion of good management firms and standard investment styles—Wilshire estimates 31% of management styles or managers—may itself prove costly in lost opportunity, even if this is not readily quantified.⁵²

Last, Cost 7: How hold the fiduciaries accountable? All the above costs and risks and uncertainties, are certain. If after divestment the fund does poorly or, to use the more pertinent measure, does less well than funds of similar size and nature, how would one decide whether that is the fault of the divestment or poor management? Given the high trading costs, it is artificial to measure an actively managed South Africa-free portfolio against a South Africa-free index. Then use only passively managed, i.e., indexed investing? In some markets, active management will be vastly superior, in some not. Over the long run, we have no data on how a divested index would do. Isn't that in itself a preclusive degree of uncertainty for any prudent fiduciary?

Given such evidence, blunderbuss divesting seems good only for masochists and soap-box simplifiers. What of divesting only non-signatories of the Sullivan Principles, or signatories with lower-tier compliance ratings? If, like Connecticut, the barred companies are those below the top two compliance ratings, then only 15% of the S&P 500 is lost, compared to the 47% that absolute divestment bars.⁵³ However, Nebraska's barring all but top-compliance firms makes a striking difference. Nebraska loses almost all drug firms as well as, this year, Ford and GE *et al.*⁵⁴ In short, Nebraska's

⁵²Wagner, *supra* n. 24, at 19.

Emergence of willing managers is in process. Pensions & Investment Age, Social restrictions make new markets for advisers, Dec. 10, 1984, p. 24.

Note that the investment implications analyzed here focus almost exclusively on equities. Impact on cash equivalents was noted, Wagner, *supra* n. 36; and the severe impact on bonds is also treated in Wagner, *supra* n. 24, at 19. The New Jersey Investment Council has calculated that because so much of the corporate bond market would be barred, U.S. Government securities would have to be used much more, leading to a loss of about \$2.5 million annually for each \$1 billion in a bond portfolio.

⁵³Valuation by Wilshire Associates using data as of end-November, 1984.

⁵⁴As stressed by Arthur D. Little Inc., compliance monitor for the Sullivan Principles, it is wrong and possibly unfair to judge a company on a single year's rating as distinct from its pattern over several years. Economic circumstances external to a firm may cause changes relative to other firms in other industries. For example, both Ford and GM were top-category compliers before the October 1984 Report. The top two categories are both "passing." For fairness and also in light of concern for a fund's manageability and investment implications, not only is Nebraska's narrowness imprudent, but any fund that makes determinative distinctions between the different categories of compliance should be less rigidly mechanical than Nebraska and Connecticut, and should allow some evaluation case by case.

line is more prudent than total divestment, but Nebraska public employees and taxpayers will bear a substantial burden for going as far as their statute does, and given the ineffectiveness of their step, here again is plain imprudence.

The prudent fiduciary will adopt an approach like Harvard's or perhaps Connecticut's.

C. The Sullivan Principles

Four times since their beginning in 1977, the Principles have been amplified from six brief statements to 36 more specific goals concretizing the Principles, and two additional commitments. The Principles are:

Principle 1—Nonsegregation of the Races in All Eating, Comfort, Locker Rooms, and Work Facilities;

Principle 2—Equal and Fair Employment Practices for All Employees;

Principle 3—Equal Pay for All Employees Doing Equal or Comparable Work for the Same Period of Time;

Principle 4—Initiation and Development of Training Programs that Will Prepare Blacks, Coloureds, and Asians in Substantial Numbers for Supervisory, Administrative, Clerical, and Technical Jobs;

Principle 5—Increasing the Number of Blacks, Coloureds, and Asians in Management and Supervisory Positions;

Principle 6—Improving the Quality of Employees' Lives Outside the Work Environment in Such Areas as Housing, Transportation, Schooling, Recreation, and Health Facilities.

(The full current Principles, working objectives and additional commitments appear in an Appendix to this paper.)

U.S. corporate signatories total 128 as of October 1984, down from 148 two years earlier because 29 were dropped in 1983, but the total number of companies reporting has not dropped. Six of the 29 dropped have been reinstated and a few new ones added.

The program began with 12 major firms including Control Data, Ford, GM, IBM and Union Carbide. Reverend Leon Sullivan, pastor of Philadelphia's Zion Baptist Church since 1950 and a leader in the civil rights movement, in 1971 became the first black on GM's Board. There, from the outset he argued that GM should withdraw from South Africa. But in 1975 in South Africa, he was urged—particularly by black union leaders—to advocate not withdrawal but rather marshalling the resources of U.S. and other multinationals "into true forces for change. . . .

It had been talked about, but never genuinely tried. After deep reflection and much prayer, I decided to make such an effort, despite the overwhelming odds against its

success. . . . Persuading leaders of U.S. companies to accept the approach was far from easy. I embarked on a lobbying crusade which required two years of extensive travel and numerous meetings. On March 1, 1977, despite the refusal of many companies to become involved, the initial Statement of Principles, signed by 12 major U.S. companies, was announced.⁵⁵

Today, the signatories employ 65,000, about 74% of the workforce of U.S. companies in South Africa. In addition, the consortium of 10 South African-owned firms working toward the same goals since 1979, employ far greater numbers such as Barlow Rand's over 750,000. There are also European and Canadian codes but the European firms, mostly British, lag behind the Sullivan signatories and their "progress is miserably slow. Japanese companies are doing even less than the Europeans."⁵⁶

What the Sullivan signatories have accomplished, and how much they have stepped up their efforts, is detailed in the next section. Reverend Sullivan is neither patient nor willing to settle for yesterday's goals. In the beginning in 1977, there were merely the six Principles and an effort to expand the number of signatories—no reporting, no compliance rating. Annual reporting was begun despite the failure of Sullivan's effort to secure aid from foundations: the signatories were assessed (\$1,000 to \$7,000 a year, depending on amount of worldwide sales). Since 1978, Arthur D. Little, Inc. annually evaluates the signatories' progress, based on questionnaires which since 1982 are verified in designated parts by each firm's certified outside accountants. The latest questionnaire was 55 pages; many signatories must submit separate questionnaires for separate subsidiaries. The original lack of compliance ratings was replaced first by three categories, then more; now there are 10. The annual evaluations involve both quantitative and qualitative points; the maximum possible is 60—1984's top complier received 52.

Each year, new requirements have been added. In 1983, for the first time a number of signatories—29 of the then-total 148—were dropped, partly for failure to report (nine never had), partly for failure to pay the assessments,

⁵⁵Sullivan, *Agents for Change: The Mobilization of Multinational Companies in South Africa*, 15 *Law. & Pol. Int'l. Bus.* 427, 428-9 (1983). This section rests on that source; on Communications Task Group of the Sullivan Signatory Companies, *Meeting the Mandate for Change* (1984); on Eighth Report, *supra* n. 23; and on the testimony of Sullivan Principles Administrator Daniel Purnell in *Associated Students of the Univ. of Oregon v. Oregon Investment Council*, Lane County Circuit Court, Nov. 30, 1984.

⁵⁶Sullivan, *id.* at 435.

In January 1985, six South African employer groups issued a statement challenging the Government's racial segregation policies. The groups said that the private sector is committed to pushing for six major political and economic changes, including "meaningful political participation for Blacks." These employers, representing about 80% of the country's workers, include the Afrikaanse Handelsinstituut made up of Afrikaner business executives and relied on heavily by the governing National Party. *Wall Street Journal*, *Employers Assail Racial Separation in South Africa*, Jan. 9, 1985, p. 31.

partly for unsatisfactory progress. None of the 29 had been in the top two categories in the preceding two years.

In 1984, for the first time the signatories are called upon to deal more directly with laws and customs impeding social and political justice:

Increased Dimensions of Activities Outside the Workplace

- Use influence and support the unrestricted rights of Black businesses to locate in the urban areas of the nation.
- Influence other companies in South Africa to follow the standards of equal rights principles.
- Support the freedom of mobility of Black workers to seek employment opportunities wherever they exist, and make possible provisions for adequate housing for families of employees within the proximity of workers' employment.
- Support the ending of all apartheid laws.

In 1985, the Ninth Report on compliance will decrease attention on goals that have been accomplished in order to focus on new objectives, concentrating especially on areas of greatest need, "particularly those on which the companies can have a considerable impact in the stimulation of social change."⁵⁷

Sullivan writes:⁵⁸

Critics admonish that the Principles are not the solution to the South African controversy, and I wholeheartedly agree. Many thrusts are needed if a solution is ever to come. [The Principles are only one . . . I plead for a halt to bank loans and new corporate investment, until political equality for blacks is realized! It must nevertheless be argued that the Principles have had some influence favoring political change, and that they will continue to do so. Help a person gain economic rights and you will foster gains in his political rights. Equality at the workplace and massive education programs for black and non-white workers ultimately will affect every aspect of their lives, public and private. . . . Simply put, the evidence reveals that the Principles are a conduit from the workplace through which the workers learn to address broader societal issues, including political rights. . . .

The Principles are not an academic response designed to advance the views of those who are proponents of either investment or divestment. To the contrary, the Principles are a pragmatic policy, based upon the most judicious engagement of available resources, and are intended to improve the quality of life, to help bring justice to unliberated people, and to help build a peaceful, free South Africa for everyone. The ultimate purpose of the Principles is to contribute toward the elimination of apartheid. The enormous resources and influence of U.S. companies present a critical mass which can have a profound catalytic effect favoring fundamental change in South Africa. With the help of Almighty God, I still believe attainment of these goals is possible.

D. The morality of divestment

Even if the costs and risks are high, and even if there is also almost no likelihood of blunderbuss divestment's accomplishing anything, still it is

⁵⁷Eighth Report, *supra* n. 23, at 4.

⁵⁸*Supra* n. 55, at 440-443.

defended on the ground that it is the only moral position. It is neither the only moral one nor even moral.

First, there is the deepest difficulty in predicting which route is more likely to bring the changes we all seek—either responsible presence in South Africa, specifically including educating, training and promoting blacks, or the other route, simple withdrawal. Very few of us have the competence to judge that, and even persons with great knowledge of South Africa and of history can only speculate more knowledgeably. Remember that when Hitler took power in 1933, the German Communists rejoiced because soon the situation would come apart and they would take power. Soon they were dead.

Given the difficulty of predicting which route is more likely to produce constructive change, certainly it is high error and high arrogance to label "immoral" *responsible* involvement with South Africa. In such uncertainty, neither route toward change can be called immoral.

Second, there is no evidence that divestment has had any impact at all. Consider in contrast what the Sullivan signatories have already accomplished:⁵⁹

1. End of all discrimination in all factories and on all company property, by all signatories.
2. Equal pay for equal work, by all signatories.
3. Minimum wages "well above the appropriate local minimum economic living level" paid by all but three signatories.
4. Instead of only hourly wages for blacks, all signatories have common medical, pension and insurance plans.
5. Substantially higher pay increases for black employees than for white, every year from 1979 to 1983.
6. Blacks in signatories' supervisory and management categories: 21.2% in 1983, up from 16.7% in 1979 although down from pre-recession 1981's figure of 25.2%.
7. In 1983, 6,942 blacks in signatories' training programs, up from 1982's 5,544. Another 14,585 in their job advancement training, up from 1979's 4,221. Another 35,523 in scholarship and tuition refund programs, up from 1979's 5,077. And spent on education and training for black *non*-employees in 1983, \$2,805,468 for 22,154 people, up from 1982's \$2,194,146 for 21,841 people.
8. Total contributions by signatories to educational and training programs for blacks, \$13,278,000 in 1983, up from 1978-9's \$2,740,000.
9. Total contributions outside the business to improve health care and living conditions, \$4,098,600.
10. Total contributions—education/training, health/welfare, and black entrepreneurship, \$22,418,000 in 1983, up from \$3,632,000 in 1978.
11. "Adoption" by signatories of 200 schools, up from 96 in 1980 although down in dollars.
12. Similar European and Canadian codes adopted and three South African company codes. In 1979, 10 South African companies, led by Barlow

⁵⁹Sullivan signatories' results are drawn from sources in n. 55, *supra*.

Rand (over 750,000 employees) and including another major conglomerate, formed a consortium for similar action. A number of their member companies, all South African-owned, are recognizing "unregistered" labor unions as well as registered ones, an unprecedented step among such companies.

13. Efforts in Western Europe and South Africa to enlist more companies in the codes.

Given such results, it is even more certainly wrong to call responsible involvement immoral, and even more probable that this route is the more moral because more effective and demonstrably life-enhancing.

Third, since it is wrong to discriminate on bases that ignore merit, absolute divestment is immoral. Kellogg was the first foreign—not just U.S.—company to recognize and bargain with a black union.⁶⁰ Ford was the first foreign company to promote blacks to be shop stewards. Control Data is a way-out-front leader in education, including the most modern skills.⁶¹ Another U.S. firm was the first to bring about desegregated housing. Sullivan signatories have ended discrimination on company property and some have gotten desegregated housing into use. (Sometimes imaginative management is amazing. One factory supervisor, ordered to end segregated dining rooms, tore down the wall between them but immediately replaced it with a complete trellis and planted thick ivy covering the trellis. Soon he thinned the ivy, soon after let it wither, and soon after that he removed the trellis.)

Are such companies the same as Boeing, which will not sign the Sullivan Principles, or Baker International, which was dropped as a signatory and is on record that its only obligations are to its stockholders and customers? Is it moral to ignore the difference between those who care and try, and those who do not? New Jersey's Assembly Speaker Alan Karcher dismisses the

⁶⁰Lane Kirkland declared "aiding South African unions the most effective means of promoting equality." And the head of South Africa's largest black labor federation, Phirosaw Camay, said the most effective way to pressure South Africa to end apartheid is a campaign of "selective divestment." He "noted that unions within his country are divided on strategy, with some advocating total disinvestment, some opposing it, and others saying it should be aimed only at firms abusing workers." Both speakers addressed a strategy conference on labor in South Africa sponsored by AFL-CIO African-American Labor Center and the A. Philip Randolph Educational Fund. *Washington Post, Labor Urged to Pressure South Africa*, Jan. 11, 1985, p. A15.

⁶¹Control Data's Chairman William C. Norris sent most state pension investment officers in December 1983 his paper on "South Africa: A Case for Selective Investment," detailing Control Data's efforts. They also ran full-page ads in South Africa, e.g.:

"Elias Mudau should have been an engineer. He had talent. . . . At the age of 10, Elias designed a bicycle. Now he rides one.

"Elias represents a tragedy—not just for himself, but for South Africa. . . .

"Control Data is meeting the need for training and education with PLATO. This is a computer-based training system, developed by an international team of educationalists, and used in more than 20 countries around the world. . . .

"Call Ron Mukdga . . . or write to Control Data HQ . . . Sandton . . ."

difference, saying the Sullivan Principles remind him of the sign over the entry to Nazi concentration camps: "Work Will Set You Free." Would such a viewer also see no difference between Eichman and Ike, since both presided over killing?

Fourth, is it immoral or only hypocritical to divest but, as a Michigan university did, then assure a divested company (Dow Chemical, a Michigan firm which raised the question after being divested) that its annual contributions were still entirely welcome?

Is it moral to treat South Africa as the only serious problem? Anyone who has discussed divestment knows the ritual arguments about Libya, USSR, Amin's Uganda, Ethiopia, etc. But, it is said, South Africa is unique because it enshrines racism in law. Regrettably, many countries do. Liberia, for example, a country with special ties to the U.S., allows only blacks to be citizens, only citizens to own land, etc.

Last, absolute divestment is immoral because it certainly risks, and almost certainly inflicts, injury on people who may depend on a pension fund's doing well, or who are students relying significantly on an endowment—people whose interest is enshrined in trust obligation. Advocating the diversion of funds in trust for the advancement of education or retirement security is wrong. Inflicting financial loss on the people for whose benefit the funds were established in reliance on fiduciary faithfulness is abuse of trust.

What is right? The most careful exploration we have, by the Rockefeller Commission, made three recommendations: First, no new investment. Second, major giving for social development by companies involved in South Africa. Third, the Sullivan Principles. That is, we must "keep saying to the companies, we must do more, more, more . . . we must move faster, faster, faster . . ." ⁶² If ultimately dialog fails because of corporate disregard for this terrible problem, then divest. We should join efforts like the one (led by President Bok) that now has 300 nonwhite South Africans in U.S. universities. We should join efforts to make sure our own Government is not passive.

All that is harder work than blunderbuss divestment. The moral prudent person will meet the challenge.

E. A postscript on the constitutionality of absolute divestment: Are state and local funds adopting it violating the Commerce Clause and exclusively Federal responsibility for foreign affairs?

A Congressional Research Service analysis in January 1984⁶³ presents the constitutional questions raised by absolute divestment. I am confident

⁶²Rev. Sullivan to the signatories, Nov. 9, 1983.

⁶³Eig. Analysis of Whether the D.C. South Africa Investment Act Violates the Commerce Clause and the Exclusive Federal Power to Conduct Foreign Relations (Am. Law Div., Jan. 31, 1984).

that a statute like Massachusetts' would be held invalid if subjected to a properly framed lawsuit.

States can regulate interstate commerce to promote such local interests as health and safety, and sometimes even local economic interests, so long as no federal interest stands in the way. The question is whether the state statute, on balance, promotes legitimate local concerns without interfering (or interfering unduly) with national concerns. Absolute divestment does not promote local economic concerns, since it does not reflect concern for the stability of the investments: it singles out one nation's possible instability, ignores all other potentially unstable nations and all other types of investment risk, and ignores the extent to which a company would be affected even if its South African investment were lost. Absolute divestment statutes or practices are not as defensible as nondiscriminatory laws barring state agencies and funds from supporting racial discrimination, because it applies to corporate involvement in a specified nation regardless of discrimination elsewhere and regardless of the corporation's actual conduct.

When it is foreign commerce that a state's action affects, there is a greater burden on the state in the balancing between local and national interests.

Absolute divestment statutes or practices are vulnerable first because their purpose involves the affairs of another nation and our foreign relations with that nation and with other interested nations. Purpose is a recognized factor given weight in the balancing.⁶⁴ Second, if many or even several jurisdictions passed such statutes, there would be a significant impact on interstate commerce at least because of securities transactions; and if the divestment had its intended effect even on one corporation, clearly there would be an impact on foreign commerce. Third, the diversity of approaches to divestment (see section III. B. 2. above) is inconsistent with the national interest in uniform regulation of commerce. Fourth, the proliferation of targets of divestment—South Africa of course, but also Namibia (Boston and the Oregon endowment), Zimbabwe (the Oregon endowment), Iran (Connecticut) and Northern Ireland (Massachusetts on military involvement there and New York City's pending ban against firms discriminating against Catholics there)—is both inconsistent with national uniformity, and highlights the extent to which these efforts reflect not local concerns but varying views of what our foreign policy should be. Fifth and last, various Federal statutes—the 1976 Act curbing arms sales; action that has been taken under the 1979 Export Administration Act; and special treatment of Export-Import Bank aid for some South Africa-involved trade and investment—indicate Federal regulation of the subject probably preempting the field even if no other factors were present.

The exclusive Federal power to conduct foreign relations has been held to

⁶⁴See e.g., *Zschernig v. Miller*, 389 U.S. 429, 437-8, 442 (1968).

bar even state statutes reflecting greater local interests and less impact on foreign nations (or on our relations with them) than absolute divestment. The leading case, *Zschernig v. Miller* of 1968,⁶⁵ struck down an Oregon statute requiring its probate courts, before allowing inheritance by someone abroad—essentially, in Russia and its satellites—to find that U.S. citizens would be able to inherit from an estate in that legatee's country, and that that country would not confiscate the inheritance going to the legatee there. While the Court's tests raise the usual questions of just where lies the line, absolute divestment falls on the wrong side. The state interest in probate is traditionally recognized, but the state interest in changing a foreign nation's practices is nil. The impact on a foreign nation if an occasional individual there may be denied a legacy,⁶⁶ is tiny or less. The impact on a foreign nation from an effort to sever American economic involvement with it is potentially massive. And the impact on the Federal Government's ability to conduct foreign relations if state governments are also trying to affect them is clear. Further, the interest in not allowing a state to provoke retaliation from abroad—e.g., cutting off our platinum, chrome, etc.—is obviously a national interest that must be controlled at the federal level.

Note that absolute divestment focuses on South Africa itself, while Connecticut's more prudent course focuses on the conduct of the particular corporations. Here, then, in the constitutional vulnerability of absolute divestment, is yet another indication of its inferiority to steps like Connecticut's.

V. A WORD ON FOUNDATIONS, CHURCHES AND CHARITIES, AND ENDOWMENTS

In the context of divergent investing, few words need be added about these funds.

Foundations, whose total assets are about \$47 billion, are hard to generalize about. Many have purposes sufficiently defined that the label "divergent" remains applicable. Some repose a broader authority in their trustees so that it is wrong to say that the pursuit of any new goals via investing would be "divergence." To the extent that a foundation has a defined goal or range of goals, e.g., promotion of education or the environment, then the considerations pertinent to divergent investments by pension funds are essentially applicable. To the extent that a foundation's goals are more loose-knit, the only caution concerns the efficiency and effectiveness of pursuing non-financial goals by choice of investments. Pax World's mutual

⁶⁵*Ibid.*

⁶⁶The Court in *Zschernig* expressly noted how minor and incidental was the impact on foreign nations, but still held the statute invalid. And this was in the face of an amicus brief from the Department of Justice defending the state statute.

fund (above, section II) is an example of well-intentioned investing that advances one advisory firm more than anything else—if anything else. More significantly, the Ford Foundation built up substantial experience showing that the most effective route is investing to maximize the funds available to pursue desired goals, and then pursuing those goals by direct support. Need more be said?

Churches and other charitable organizations are, for these purposes, substantially similar to foundations, with one important difference. Foundations' board membership tends to be more stable than those other organizations' boards. The more new trustees, the more need to re-educate about investing, prudent or otherwise—and the more likelihood of year-in, year-out discussions of which non-financial goals to pursue and how to pursue them. That in itself seems an argument for investing for strictly financial goals and pursuing non-financial goals with the enhanced means made available by prudent investing (subject of course to the non-injurious overlay of considerations like no alcohol-tobacco or no blatant law-breakers).

University endowments, with about \$30 billion, are unique. No one has treated this matter as fully as Harvard's President Bok.⁶⁷ An informal and incomplete statement of his position is that "A university should in a way compatible with its mission try to make a constructive effort to solve the problems of the world" instead of relying on "negative ineffective ways like fiddling around in stock."⁶⁸ Under a program Bok began and now chairs, 160 non-white South Africans were in American universities in 1983-84, up from six in the year the program began, 1979-80 (a similar number is here in a companion program). Those 160 are here for four-year undergraduate degrees, some for master's degrees. They are selected by a bi-racial committee in South Africa, headed by Bishop Tutu.

A fuller statement of Bok's view that universities are different in crucial ways is to be found in his article reprinted in this monograph; see especially pages 100-102.

VI. CONCLUSION

Institutional investors' assets are huge, with pension funds making the others seem tiny. But these assets are not, as Gary Trudeau put it, "just sitting there." Pension liabilities dwarf the assets, and the protection of retirement security—or the endowments' goal of advancing education and the foundations' varied goals—are all not only socially responsible but truly

⁶⁷*Supra*, n. 37.

⁶⁸Harvard Crimson, *The Bok Alternative*, p. F-5, Commencement Issue 1983.

noble endeavors. How well those objectives are met depends in large measure on the investment performance of their funds.⁶⁹

The varied efforts to divert these funds from their crucially important goals, whether to promote local investing or avoid investing abroad, or to promote a special clearly desirable social goal like environmental improvement or small business or low-income housing, or to discourage clearly undesirable conduct like sustained and substantial violation of law or uncaring and irresponsible involvement in South Africa, come from a variety of motivations. Some advocates of divergent investing are as well-intentioned as people can be, although almost none of those advocates even think about the goals they may be interfering with, and even fewer have the patience to consider the investment implications of their effort. Other advocates may or may not be so well-intentioned, but knowingly put their own goals ahead of the social and legal trust obligation to use other people's money only for the noble purposes for which the fund was created. Such struggle among competing noble goals is natural in a pluralist society. But there are also some advocates who (sad to say) are usually the most powerful of the divergent pressures on these funds—particularly on public pension funds—who use the facade of helping housing or state development to enrich their own firms or their power in politics or in a union, and perhaps their campaign coffers as well.

Confusion, let alone deception, about precisely what is really being advocated usually can be averted only by following Sergeant Friday's practice of getting the facts. If a particular divergent investment or policy will not injure the fund and does not reflect merely the personal view of the trustees, then objection to going forward is either foolishly narrow-minded (as if decisions must be exclusively financial) or else plain foolish. But that "if" is a crucial one. Too often the only investment aspect considered is the likely returns, sometimes measuring them relative to inappropriate comparisons, more often ignoring the other essential aspects of returns: relative risk, relative liquidity, and implementation costs.

Without the persistence to bring out the facts and the patience for full analysis, the legal and moral obligation to abide by the trust power over other people's money and interests will not be honored. Honoring that

⁶⁹To improve the investment performance of such funds, which do not all do as well as they should and are not as accountable as they should be, involves several problems that still need work. See, e.g., my efforts (as task force chairman, editor and part author) in *Twentieth Century Fund, Abuse on Wall Street: Conflicts of Interest in the Securities Markets* (1980); and my *Should Pension Funds be Used to Achieve "Social" Goals*, 119 *Trusts & Estates* 10 (Sept.), 27 (Oct.) and 26 (Nov.) (1980); *Why Mutual Funds are Top Performers (Client as Culprit)*, *Pensions & Investment Age*, July 20, 1981, at 13 and editorial at 10; *Why Have Pension Funds Performed So Poorly?* (unpublished talk, May 1982); *Picking Investment Managers*, *Pensions & Investments*, Apr. 24, 1978, at 61 and editorials at 8; *Government Finance Officers Ass'n, Resources in Review: New Directions in Investment and Control of Pension Funds*, July 1984, p. 20 and *id.*, *New Data on Pension Funds*, Sept. 1984, p. 22 (book reviews).

obligation takes some knowledge and some work. When the challenge is increased by having to fend off soap-box simplifiers, well-intentioned or not, it also takes savvy, durability and even courage. Generations of experience of countless faithful and prudent fiduciaries doing their best to meet their obligations make clear that the challenge will be met.

APPENDIX

The Sullivan Principles

Statement of Principles
of U.S. Firms with Affiliates
In the
Republic of South Africa

PRINCIPLE I: *Non-Segregation of the races in all eating, comfort and work facilities*

Each signator of the Statement of Principles will proceed immediately to:

- Eliminate all vestiges of racial discrimination.
- Remove all race designation signs.
- Desegregate all eating, comfort and work facilities.

PRINCIPLE II: *Equal and fair employment practices for all employees*

Each signator of the Statement of Principles will proceed immediately to:

- Implement equal and fair terms and conditions of employment.
- Provide non-discriminatory eligibility for benefit plans.
- Establish an appropriate and comprehensive procedure for handling and resolving individual employee complaints.
- Support the elimination of all industrial racial discriminatory laws which impede the implementation of equal and fair terms and conditions of employment, such as abolition of job reservations, job fragmentation, and apprenticeship restrictions for Blacks and other non-whites.
- Support the elimination of discrimination against the rights of Blacks to form or belong to government registered and unregistered unions and acknowledge generally the rights of Blacks to form their own unions or be represented by trade unions which already exist.
- Secure rights of Black workers to the freedom of association and assure protection against victimization while pursuing and after attaining these rights.
- Involve Black workers or their representatives in the development of programs that address their educational and other needs and those of their independents and the local community.

PRINCIPLE III: *Equal pay for all employees doing equal or comparable work for the same period of time*

Each signator of the Statement of Principles will proceed immediately to:

- Design and implement a wage and salary administration plan which is applied equally to all employees, regardless of race, who are performing equal or comparable work.

- Ensure an equitable system of job classifications, including a review of the distinction between hourly and salaried classifications.
- Determine the extent upgrading of personnel and/or jobs in the upper echelons is needed, and accordingly implement programs to accomplish this objective in representative numbers, insuring the employment of Blacks and other non-whites at all levels of company operations.
- Assign equitable wage and salary ranges, the minimum of these to be well above the appropriate local minimum economic living level.

PRINCIPLE IV: Initiation of and development of training programs that will prepare, in substantial numbers, Blacks and other non-whites for supervisory, administrative clerical and technical jobs.

Each signator of the Statement of Principles will proceed immediately to:

- Determine employee training needs and capabilities, and identify employees with potential for further advancement.
- Take advantage of existing outside training resources and activities, such as exchange programs, technical colleges, and similar institutions or programs.
- Support the development of outside training facilities, individually or collectively—including technical centers, professional training exposure, correspondence and extension courses, as appropriate, for extensive training outreach.
- Initiate and expand inside training programs and facilities.

PRINCIPLE V: Increasing the number of Blacks and other non-whites in management and supervisory positions.

Each signator of the Statement of Principles will proceed immediately to:

- Identify, actively recruit, train and develop a sufficient and significant number of Blacks and other non-whites to assure that as quickly as possible there will be appropriate representation of Blacks and other non-whites in the management group of each company at all levels of operations.
- Establish management development programs for Blacks and other non-whites, as needed, and improve existing programs and facilities for developing management skills of Blacks and other non-whites.
- Identify and channel high management potential Blacks and other non-white employees into management development programs.

PRINCIPLE VI: Improving the quality of employees' lives outside the work environment in such areas as housing, transportation, schooling, recreation and health facilities

Each signator of the Statement of Principles will proceed immediately to:

- Evaluate existing and/or develop programs, as appropriate, to address

the specific needs of Black and other non-white employees in the areas of housing, health care, transportation and recreation.

- Evaluate methods for utilizing existing, expanded or newly established in-house medical facilities or other medical programs to improve medical care for all non-whites and their dependents.
- Participate in the development of programs that address the educational needs of employees, their dependents, and the local community. Both individual and collective programs should be considered, in addition to technical education, including such activities as literacy education, business training, direct assistance to local schools, contributions and scholarships.
- Support changes in influx control laws to provide for the right of Black migrant workers to normal family life.
- Increase utilization of and assist in the development of Black and other non-white owned and operated business enterprises including distributors, suppliers of goods and services and manufacturers.

Increased Dimensions of Activities Outside the Workplace

- Use influence and support the unrestricted rights of Black businesses to locate in the Urban areas of the nation.
- Influence other companies in South Africa to follow the standards of equal rights principles.
- Support the freedom of mobility of Black workers to seek employment opportunities wherever they exist, and make possible provisions for adequate housing for families of employees within the proximity of workers employment.
- Support the recension of all apartheid laws.

With all the foregoing in mind, it is the objective of the companies to involve and assist in the education and training of large and telling numbers of Blacks and other non-whites as quickly as possible. The ultimate impact of this effort is intended to be of massive proportion, reaching and helping millions.

Periodic Reporting

The Signatory Companies of the Statement of Principles will proceed immediately to:

- Report progress on an annual basis to Reverend Sullivan through the independent administrative unit he has established.
- Have all areas specified by Reverend Sullivan audited by a certified public accounting firm.
- Inform all employees of the company's annual periodic report rating and invite their input on ways to improve the rating.

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DISINVESTMENT—THE CONSTITUTIONAL QUESTION

by Albert P. Blaustein*

I. INTRODUCTION

In justifiable outrage against patterns of human rights violations throughout the world, American states, cities, universities and both public and private funds are now engaged in the process of disinvestment¹ from firms doing business in the offending nations.

At year's end 1984, at least half of the states of the United States (plus the District of Columbia) had introduced legislation compelling South African disinvestment²—and such laws had been enacted in Connecticut, Maryland, Massachusetts, Michigan and Nebraska. In addition, New York City, Boston, Philadelphia and possibly another dozen or so major municipalities had passed ordinances to that effect—"with officials in Chicago, Detroit, Los Angeles and Seattle apparently contemplating comparable moves."³

Nor is South Africa the only target. Disinvestment laws and ordinances have been enacted with regard to the Soviet Union (Michigan), Iran (Connecticut), Northern Ireland (Massachusetts), Namibia (Boston and Oregon endowments) and Zimbabwe (Oregon endowment). Poland is a secondary target in proposed legislation in Kansas, and Massachusetts is considering the addition of Sri Lanka to its prohibitions.

Whether disinvestment will achieve its human rights objectives—or, indeed, be counterproductive—is discussed elsewhere in this volume. Ditto

¹In this context, the word "disinvestment" is used interchangeably with the terms "divestment" and "divestiture." Technically speaking, however, "disinvestment" more correctly applies to the act of withdrawing money that has previously been invested [while] "divestment" applies to the more active procedure of ridding oneself of something, including certain stocks in a portfolio." Chettle, *The Law and Policy of Divestment of South African Stock*, 15 *Law and Policy in Int'l. Bus.* 445 (1983), n. 1.

²The April, 1984, *Legislative Update* of the American Legislative Exchange Council reported on more than 66 South African disinvestment bills pending in 22 states. Legislative action in 26 states and the District of Columbia is compiled in Appendix II of the New Jersey Public Hearings before the Assembly State Government, Civil Service, Elections, Pensions, and Veteran's Affairs Committee on Assembly Bills 1308 and 1309, held in Trenton, N.J., September 24, 1984. (State Actions on Legislation Concerning Divestment of State Funds in the Republic of South Africa, pp. 72x-77x.)

³Olson, *Introduction* to this volume, p. vii and n. 1.

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