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the inevitable cost and potential harm to affected beneficiaries. The conflict between disinvestment legislation and laws prescribing the obligations and duties of trustees is likewise analyzed elsewhere. Nor will this chapter review the validity of disinvestment statutes, ordinances and activities under the state constitutions.

The broad question under consideration here is the constitutionality of disinvestment laws, in general,[4] under the Constitution of the United States.

II. CONCLUSION

Disinvestment laws are of such doubtful constitutionality that legal counsel should *presently* advise against their passage and, where enacted, caution against their enforcement.

Such conclusion is not predicated upon professional theory or law review commentary, although neither can be excised from the thinking on the subject. The unconstitutionality argument is real. It has been raised. And as long as it remains unresolved, disinvestment activities are better consigned to the proverbial back burner.

Here is a compendium (with comments) on the uncertain status of the constitutionality of disinvestment laws:

1. The unconstitutionality arguments have been publicly advanced—and well publicized.

   a. Undoubtedly the most scholarly statement is that of Prof. Gordon B. Baldwin of the University of Wisconsin Law School, based on his analysis of the Wisconsin disinvestment statute.[5] This is incorporated in a student note in the Wisconsin Law Review.[6]

   b. The most comprehensive study is that of Larry M. Eig, which was prepared for the Congressional Research Service (CRS) of the Library of Congress.[7] This is predicated upon the District of Columbia Act and is included in the 1984 Congressional hearings on resolutions to "reject" that act.[8]

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[4]Likewise not under consideration are possible constitutional disabilities based on the *differences* between the various disinvestment statutes. The Connecticut, Massachusetts and Nebraska statutes, for example, deal with state pension funds, the Maryland statute is concerned with bank deposits and the Michigan statute with university endowments. *See*, Schotland, p. 48.

[5]Wis. Stat. ¶36.29(1) (1975).

[6]Note, Constitutionality of the No Discrimination Clause Regulating University of Wisconsin Investments, 1978 Wis. L. Rev. 1059, authored by Kevin Wade Guynn.

[7]Analysis of Whether the District of Columbia South Africa Investment Act (D.C. Act 5-76) Violates the Commerce Clause of the Constitution and the Exclusive Federal Power to Conduct Foreign Relations. Congressional Research Service, The Library of Congress, Jan. 31, 1984. Prepared by Larry M. Eig, Legislative Attorney, American Law Division.

[8]South Africa Divestment. Hearings and Markups before the Subcommittee on Fiscal Affairs and Health of the Committee on the District of Columbia, House of Representatives, 98th Cong., 2d Sess. on H. Con. Res. 216 and H. Res. 372, Ser. No. 98-14, Jan. 31 and Feb. 7, 1984, pp. 72-107. These resolutions were, "To reject the District of Columbia Act 5-76 to Prohibit the Investment of D.C. Funds in Financial Institutions and Companies Making Loans to or Doing Business with the Republic of South Africa or Namibia."

c. Certainly the most publicized is the article by John H. Chettle on "The Law and Policy of Divestment of South African Stock."[9] Mr. Chettle is the Director, North and South America, of the South Africa Foundation.

None of these three studies is conclusive. As aptly pointed out in a memorandum by the Washington Council of Lawyers on the District of Columbia Act ". . . the CRS Memorandum never actually concludes that the South African Investment Act is unconstitutional—it only states that such argument could be made."[10] (Whether a CRS memorandum could or should resound more conclusively is another type of question; this one did not.)

The Chettle statement is overly brief. It does present the major arguments and does list the major precedents, but it wants of adequate analysis. And the memorandum of the distinguished Professor Baldwin has three infirmities: (a) its public presentation has been filtered through the law review editing process on its way to publication; (b) its arguments could be distinguished as being solely applicable to the Wisconsin statute and the Wisconsin facts; and (c) it was written back in 1977, prior to some important Supreme Court decisions which some think controlling and at least essential to analyzing the issue. These are discussed below under the heading, "Participant or Regulator."[11]

2. Opinions of attorneys general and other government counsel are in short supply. Letters requesting their views—officially or unofficially—were sent by this author to all fifty of the state attorneys general on January 11, 1985, but no responses of any significance were received.[12]

On the public record are the following—either noncommital, inconclusive or sketchy, but recognizing and acknowledging constitutional problems:

a. Now being widely circulated is a U.S. Department of Justice letter of January 4, 1984,[13] containing (and sustaining) this sentence: "The question you pose is a novel one for which no direct precedent seems to be available." While the letter states and restates the point that the

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[9]15 Law and Policy in Int'l Bus. 445 (1983). Pages 515 to 525 are devoted to "Constitutional Issues."

[10]The Washington Council of Lawyers Memorandum, also referred to as the memorandum from the Lawyers Committee on Civil Rights, was submitted "in concert" with the prestigious Washington law firm of Arnold and Porter. Supra, Note 8, at 239-42.

[11]See *infra*, pp. 80-84 and accompanying notes.

[12]From Wisconsin came the 1978 Department of Justice opinion letter directed to the president of the University of Wisconsin system, supra n. 14; and from Iowa came the 1984 governor's veto message, infra n. 89. Nebraska reported that it had done some research but "have not at this time issued any formal opinion of the subject." One attorney general said that it was against the policy of his office to respond to such inquiries. The other half-dozen responses said that the question had not arisen.

[13]Letter from U.S. Department of Justice, Office of Legal Counsel, Office of the Deputy Assistant Attorney General, signed Robert B. Shanks, to Ms. Kathleen Teague, Executive Director, American Legislative Exchange Council, 418 C Street, N.E., Washington, D.C. 20002, January 4, 1984.

Department is not authorized to provide legal opinions or legal advice save to the president and heads of executive departments, it does provide (in its own phrase) "a few general observations." And such observations suggest a number of constitutional "arguments."

b. Two opinions were rendered by the Wisconsin attorney general in 1977 and 1978, but these are likewise inconclusive and of little value as precedent. And they have a cloudy history.[14] While they sustain the constitutionality of the Wisconsin disinvestment law, they rest largely on the proposition that "the statute will not place an unlawful burden on interstate commerce since the percentage of total dollars in interstate commerce that is controlled by the Board of Regents is so small."[15]

c. The best reasoned governmental (or quasi-governmental) statement is the one submitted as the position of the District of Columbia at the January 1984 Congressional Hearings on the District's disinvestment act.[16] This was the memorandum of the Washington Council of Lawyers.[17] And while it is a thoughtful summary, it must be classified a brief (four-page) adversary document, responding to the Congressional Research Service analysis.[18] It is not and is not meant to be an opinion sustaining constitutionality.

d. The "opinion" of Michigan's attorney general is in a document of advocacy (a brief) in current litigation. See point 3.

3. The matter is before the courts, and a precedent on point is expected. Cross motions for summary judgment on the constitutionality issues surrounding disinvestment have been submitted to the Michigan Circuit Court[19] and it is wise for legal counsel to await their resolution.

As explained in the University of Michigan brief:

> "By enacting 1982 PA 512, the Michigan Legislature, amended the [State] Civil Rights Act. . . to prohibit public educational institutions from making or maintaining after April 1, 1984, equity or stock investments in organizations operating in the Republic of South Africa. . .[or] in the Union of Soviet Socialist Repubics. . . . The Regents seek a declaratory judgment that Act 512 violates both the Michigan and United States Constitutions."[20]

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[14]The Wisconsin attorney general construed the statute twice. The first time was in an informal opinion submitted to the secretary of the Board of Regents on May 19, 1977. The attorney general was subsequently requested to "reconsider his opinion in light of the constitutional questions raised by Professor Baldwin's memorandum." The second construction was in the formal opinion submitted to the President of the University of Wisconsin System on January 31, 1978. 67 Wis. Op. Att'y Gen. (1978) Supra, note 6, at 1061-62.

[15]Id. at 1062.

[16]Supra, note 8.

[17]Supra, note 10.

[18]Supra, note 7.

[19]The Regents of the University of Michigan v The State of Michigan. In the Circuit Court for the County of Ingham, Michigan, File No. 83-50309-C2.

[20]Brief of the Regents of the University of Michigan, pp. 1-2. (Footnotes omitted.)

There is also current litigation in Oregon[21] but the court decided in a ruling on December 4, 1984, that it "did not find it necessary to reach . . . the constitutional issue." However, the court pointed out that such issue was "preserved for the record . . . [and] it can be urged on the Appellate Court and they [sic] may find it dispositive."[22] As of this writing findings of fact and conclusions of law were still awaited.

Resolution of the constitutional uncertainties is a laudable goal—for everyone included on all sides of the disinvestment question. It cannot be done via any opinion of an attorney general—no matter how well reasoned and how divorced from the inevitable charges that it is "political." And there is no point in the preparation of fifty such opinions, plus the opinions of municipal counsel The wheel needs not reinvention.

There is also ample reason for the nation as a whole to await the outcome in one or a few jurisdictions. In the oft-quoted words of Justice Brandeis:

> "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[23]

Admittedly, this approach gives small solace to those who see in disinvestment a means to combat human rights violations in South Africa, the Soviet Union, Iran, Zimbabwe, etc. How long *will it take* (for example) for the Michigan trial court to reach a decision? How long *it will* take for the completion of the inevitable appeals!

But the disinvestment supporters would seem to have no alternative. Laws on disinvestment are *probably* unconstitutional and are at the very least of questionable constitutionality.

III. THE CONSTITUTIONAL ARRAY

Involved here is the tension between the Tenth Amendment on one hand and the Commerce Clause and the conduct of foreign relations on the other. Involved here is the Supremacy Clause and the doctrine of federal preemption.

On its face, a divestment statute is constitutional since it involves "fiscal management of state funds, a function which is not specifically delegated to the federal government by the United States Constitution."[24] This conforms to the dictate of the Tenth Amendment: "The powers not delegated to the

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[21]Associated Students of the University of Oregon et al. v. Oregon Investment Council et al. In the Circuit Court of the State of Oregon for the County of Lane, Case No. 78-7502.

[22]Ruling of the Hon. George J. Woodrich, Tuesday, December 4, 1984. Transcript of proceedings by the Official Court Reporter, p. 5.

[23]Dissenting in New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932). Justice Holmes expressed similar views, referring to "social experiments ... in the insulated chambers afforded by the several states. Dissenting in Truax V. Corrigan, 257 U.S. 312, 344.

[24]Supra, note 6, at 1060.

United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

But this power is not unlimited. State discretion and state conduct, pursuant to the Supremacy Clause,[25] is unconstitutional when it conflicts with the Commerce Clause. It is Congress which has been given the power "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."[26]

Disinvestment laws may also run afoul of the Privileges and Immunities Clause: "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States."[27]

Nor may the state interfere with the federal foreign relations power. All agree that there are inherent limitations upon the power of states in matters of foreign affairs that go beyond the Commerce Clause.

IV. PARTICIPANT OR REGULATOR

Whether the enactment of a disinvestment law is an exercise of state sovereignty protected by the Tenth Amendment is not easy to answer. But whatever the ultimate conclusion, the threshold determinant is whether the state is acting as a *participant* (in a *proprietary* capacity) or as a *regulator* (in a *governmental* capacity).[28]

The black letter law is that state and local governments are not restrained by the Commerce Clause when they engage in commercial transactions as market participants rather than as regulators. Regardless of the burden on interstate commerce (so the theory runs) the market participant is immune from the Commerce Clause. Indeed, the Commerce Clause is not even implicated. The participant is investing its own market funds; it is spending its own money. This is not the business of the federal government.

This is all very new law. It sounds strange to ears (and years) attuned to *Gibbons* v. *Ogden*[29] and its myriad progeny, interpreting the Commerce Clause broadly and expansively. The new cases give credence and credibility to the Tenth Amendment; they give new recognition to dual federalism. But do they cover the issue at hand? Are disinvestment laws proprietary, representing only the acts of participants? Is there immunity from interstate

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[25]Art. vi, cl. 2. "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

[26]Art. I, ¶8, cl. 3.

[27]Art. IV, ¶2.

[28]See Wells and Hellerstein, the Governmental-Proprietary Distinction in Constitutional Law, 66 Va. L. Rev. 1073 (1980). "The small body of case law under the commerce clause consistently holds that a state's action in its proprietary capacity gives rise to no constitutional objection." At p. 1122.

[29]22 U.S. (9 Wheat.) 1 (1824) See especially 22 U.S. at 34.

commerce strictures? Does immunity from the reach of interstate commerce apply equally to foreign commerce? Will immunity from the Commerce Clause extend to immunity under the Privileges and Immunities Clause? And even if the participant-regulator distinction is made and disinvestment laws are held to be in the participant-proprietary category for the Commerce Clause, may such laws still conflict with the federal government's supremacy in foreign relations?[30]

There are no cases directly on point. On this all will agree. Likewise, all will agree as to the five cases to be parsed in arguing the applicability of precedent and judicial thought on this aspect of the constitutionality issue. The cases are: (1) *Hughes* v. *Alexandria Scrap Corp.*, 1976;[31] (2) *National League of Cities* v. *Usery*, 1976;[32] (3) *Reeves, Inc.* v. *Stake*, 1980;[33] (4) *White* v. *Massachusetts Council of Const. Employers*, 1983;[34] and (5) *United Building and Construction Trades Council of Camden County and Vicinity* v. *Mayor and Council of the City of Camden, 1984*.[35]

The seminal case is *Hughes* v. *Alexandria Scrap Corp.*[36] Its facts, holding and essential language are well-stated in the Congressional Research Service report:[37]

> "There the Supreme Court upheld a Maryland statute that clearly favored in-state businesses in the payment of State bounties to scrap processors for each vehicle abandoned in Maryland that they destroyed. There appeared to be no question that favoring State Businesses in the expenditure of State funds for the bounties had the effect of reducing the flow of abandoned car hulks in interstate commerce to out-of-state businesses, who could not pay as high a price for the hulks because of difficulties in obtaining Maryland bounties. Nevertheless, the Court held that the Commerce Clause did not apply. According to the Court, Maryland did not interfer[e] with the national functioning of the interstate market either through prohibition or burdensome regulation. 426 U.S. at 806. Rather it had entered into the market itself as a purchaser, in effect, of a potential article of interstate commerce. *Id.* at 806, 808. The court concluded that [n]othing in the purposes animating the Commerce Clause prohibits a State . . . from participating in the market and exercising the right to favor its own citizens over others. *Id* at 810."[38]

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[30]See F. Frankfurter, The Commerce Clause Under Marshall, Taney and Waite, at 40 (1964—first published 1937).

[31]426 U.S. 794 (1976).

[32]426 U.S. 833 (1976).

[33]447 U.S. 429 (1980).

[34]460 U.S. 204 (1983).

[35]___ U.S.___, 104 S. Ct. 1020 (1984).

[36]426 U.S. 794 (1976).

[37]Supra, n. 7.

[38]Supra, n. 7 at 19-20. It is also reprinted in the House of Representatives hearings, supra, note 8, at 92-93.

National League of Cities v. *Usery*[39] dealt with amendments to the federal Fair Labor Standards Act extending wage and hour provisions to almost all employees of States and their political subdivisions. Striking down these amendments, the Court held that Congress may not, pursuant to the Commerce Clause, "directly displace the State's freedom to structure integral operations in areas of traditional governmental functions."[40]

In *Reeves* v. *Stake*,[41] the Supreme Court (in a 5-4 vote) upheld South Dakota's refusal to sell cement produced by a state-operated plant to non-South Dakotans. Such preferential treatment of its own citizens was sustained on the ground that the state was acting in a proprietary capacity. Here was the crucial language:

> "[T]he Commerce Clause responds principally to state taxes and regulatory measures impeding free private trade in the marketplace. There is no indication of a constitutional plan to limit the ability of the states themselves to operate freely in the free market."[42]

These cases are followed in *White* v. *Massachusetts Council of Construction Employers*.[43] There the Court considered the validity of an executive order of the Mayor of Boston requiring that at least 50 percent of all jobs on construction projects (funded in whole or in part by city funds) be filled by bona fide city residents. The executive order was held to be "immune from scrutiny under the Commerce Clause because Boston was acting as a market participant rather than as a market regulator."[44]

United Bldg. & Const. v. *Mayor & Council of Camden*[45] dealt with a municipal ordinance which required that at least 40 percent of the employees of contractors and subcontractors working on city construction projects be Camden residents. On the basis of the *White*[46] case, the Commerce Clause challenge to the Camden ordinance was abandoned, but not so the contention that the ordinance was a violation of the Privileges and Immunities Clause.[47] Remanding the case for necessary findings of fact, the Court came to this conclusion:

> "In sum, Camden may, without fear of violating the Commerce Clause, pressure private employers engaged in public works projects funded in whole or in part by the city to hire city residents. But that same exercise of power to bias the employment decisions of private contractors and subcontractors against out-of-state residents may be

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[39]426 U.S. 833 (1976).
[40]426 U.S. at 852.
[41]447 U.S. 429 (1980).
[42]447 U.S. at 437.
[43]460 U.S. 204 (1983).
[44]Quoted in United Bldg. & Const. v. Mayor & Council of Camden, ___ U.S. ___, 104 S. Ct. at 1025.
[45]___ U.S.___, 104 S. Ct. 1020 (1984).
[46]Supra, n. 43, 460 U.S. 204 (1983).
[47]U.S. Constitution, Art. IV, ¶2.

called to account under the Privileges and Immunities Clause."[48] The Court's reasoning was as follows:

"Our decision in *White* turned on a distinction between the city acting as a market participant and the city acting as a market regulator. The question whether employees of contractors and subcontractors on public works projects were or were not, in some sense, working for the city was crucial to that analysis. The question had to be answered in order to chart the boundaries of the distinction. But the distinction between market participant and market regulator relied upon in *White* to dispose of the Commerce Clause challenge is not dispositive in this context. The two Clauses have different aims and set different standards for state conduct.

"The Commerce Clause acts as an implied restraint upon state regulatory powers. Such powers must give way before the superior authority of Congress to legislate on (or leave unregulated) matters involving interstate commerce. When the State acts solely as a market participant, no conflict between state regulation and federal regulatory authority can arise.... The Privileges and Immunities Clause, on the other hand, imposes a direct restraint on state action in the interests of interstate harmony.... This concern with comity cuts across the market regulator-market participant distinction that is crucial under the Commerce Clause. It is discrimination against out-of-state residents on matters of fundamental concern which triggers the Clause, not regulation affecting interstate commerce. Thus, the fact that Camden is merely setting conditions on its expenditures for goods and services in the marketplace does not preclude the possibility that those conditions violate the Privileges and Immunities Clause....

"The fact that Camden is expending its own funds or funds it administers in accordance with the terms of a grant is certainly a factor—perhaps the crucial factor—to be considered in evaluating whether the state's discrimination violates the Privileges and Immunities Clause. But it does not remove the Camden ordinance completely from the purview of the Clause."[49]

The Privileges and Immunities argument played no part in the Memorandum of the Washington Council of Lawyers[50] or the brief of the State of Michigan.[51] Reason: *United Bldg. & Const.* is of later vintage. But it was upon the first four cases that both the memorandum and brief largely based their position: that the Commerce Clause simply does not apply because disinvestment statutes are proprietary rather than regulatory. Certainly,

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[48] ___ U.S. ___, 104 S. Ct. at 1029.
[49] ___ U.S. ___, 104 S. Ct. at 1028-1029.
[50] Supra, note 10.
[51] Surpa, note 19.

such argument can be made based on an expansive reading of these cases. Certainly, the dicta are attractive if not the facts. But...

All four cases simply stand for the proposition that a state can protect its own citizens—i.e. can discriminate in favor of its own citizens—in matters proprietary rather than regulatory in *interstate commerce*. And they hold it is proprietary when the state is in the process of spending its own money.

Of course, a state can spend its own money. But nowhere is there a judicial statement that a state has an *unlimited* right to spend as it pleases. *United Bldg. and Const.*,[52] for example, has now invoked the Privileges and Immunities Clause. Further, even if the four cases deny limits in *interstate commerce*, they are certainly not holdings applicable to *foreign commerce*. On the contrary, *Reeves*[53] makes a point of that distinction in what will undoubtedly become an oft-quoted footnote:

> "We have no occasion to explore the limits imposed on state proprietary actions by the "foreign commerce" clause.... We note, however, that Commerce Clause scrutiny may well be more vigorous when a restraint on foreign commerce is alleged."[54]

And even assuming that the broad scope of these cases would provide immunity from the constitutional mandate on foreign commerce, disinvestment laws would still interfere with the conduct of foreign affairs. How could they not? They represent official statements of disapproval of the internal policies of foreign sovereign nations. Their very purpose is to affect American foreign policy; their passage is specifically geared to pressure the State Department to do something about apartheid or Soviet human rights violations.

V. INTERSTATE COMMERCE

Assuming (and a valid assumption it is) that the participant-regulator distinction does not provide immunity from the Commerce Clause here, inquiry must first be directed to the "negative" aspects of the Clause, the so-called "dormant commerce clause." Here is the rule: the absence of Congressional action on a matter does not free the individual states to regulate as they will.[55]

The best statement on this point is made in one of the two key cases on the Commerce Clause objection, *A & P Tea Co.* v. *Cottrell*.[56]

"We begin our analysis by again emphasizing that '[t]he very purpose of the Commerce Clause was to create an area of free trade among the several

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[52]___ U.S.___, 104 S. Ct. 1020 (1984).

[53]447 U.S. 429 (1980).

[54]447 U.S. at 438, n. 9.

[55]See for example, Raymond Motor Transportation, Inc. v. Rice, 434 U.S. 429, 440 (1978) and City of Philadelphia v. New Jersey, 437 U.S. 617, 623 (1978).

[56]424 U.S. 366 (1976).

States.' . . . And at least since *Cooley* v. *Board of Wardens*, 12 How. 299 (1852), it has been clear that 'the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. . . . [T]he Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States.' "[57]

However, this does not mean that the States may *never* legislate upon an aspect of commerce that is within the Congressional regulatory power. *A & P Tea Co.* v. *Cottrell* also contains this language:

> "It is no less true, of course, that under our constitutional scheme the States retain broad power to legislate protection for their citizens in matters of local concern such as public health, . . . and that not every exercise of local power is invalid merely because it affects in some way the flow of commerce between the States. . . . Rather, in areas where activities of legitimate local concern overlap with the national interests expressed by the Commerce Clause—where local and national powers are concurrent—the Court in the absence of congressional guidance is called upon the make delicate adjustment of the conflicting state and federal claims, . . . thereby attempting the necessary accommodation between local needs and the overriding requirement of freedom for the national commerce."[58] (Citations omitted.)

But how—and when—does the Court make that "delicate adjustment" or "necessary accommodation," or, in other words, apply a balancing test. This was not clearly set forth in *A & P Tea Co.* v. *Cottrell*. In its application, however, the Court struck down a Mississippi regulation that required reciprocity in the sale of milk and milk products produced in other states. The mandatory character of the regulation was held to be violative of the Commerce Clause.

The case which provides the guidelines is *Pike* v. *Bruce Church, Inc.*[59] Here also, on the basis of the Commerce Clause, a state directive was declared unconstitutional. At issue was an order prohibiting an Arizona company from shipping its cantaloupes outside the state unless packed as directed by the official charged with enforcing the Arizona Fruit and Vegetable Standardization Act.

Pike v. *Bruce Church, Inc.* teaches that there are two threshold criteria before a court can assess the burden which the state law might impose upon interstate commerce: 1) the state promulgation must credibly advance a legitimate local public interest; and 2) the state promulgation may not discriminate against interstate commerce. Only then can the courts consider

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[57]424 U.S. at 370-371.

[58]424 U.S. at 371. See Congressional Research Service analysis, supra, note 7 at 9-10, supra, note 8 at 82-83.

[59]397 U.S. 137 (1970).

whether the promulgation is a tolerable burden on interstate commerce or whether the state's interest can be promoted as well with lesser impact on interstate activities.[60] In other words, only then can the balancing test be used.

The actual words of *Pike* v. *Bruce Church, Inc.* bear repetition: "Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate actvities. Occasionally the Court has candidly undertaken a balancing approach in resolving these issues, . . . but more frequently it has spoken in terms of "direct" and "indirect" effects and burdens.[61] (Citations omitted.)

Based on these rules/tests/criteria, the disinvestment statutes run afoul of the Commerce Clause. Of course, human rights can be deemed a legitimate concern of commerce But are discriminatory practices in South Africa, the Soviet Union, Iran, etc., a matter of "local public interest"?[62]

Nor could it be concluded that the state disinvestment laws have only an incidental effect on interstate commerce. Too much money is at stake; investment portfolios of state pension funds, universities, etc., are not inconsequential.

Yes, there are cases which can be parsed to extract enough factual snippets and sufficient dicta to formulate legal argument. But there is no holding which sustains any state action remotely resembling disinvestment. And the weight of authority and judicial analogy is on the side of unconstitutionality.

VI. FOREIGN COMMERCE

What has been said relative to interstate commerce can be said even more forcefully in regard to foreign commerce. This was not always so (or may not have been always so)—at least up to 1979, and at least by way of dicta.

For example, the words of Chief Justice Taney: "The power to regulate commerce among the several States is granted to Congress in the same

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[60]This analysis is used in the University of Michigan brief, supra, note 20, at 37. See also McCarroll, "Socially Responsible Investment of Public Pension Funds: The South Africa Issue and State Law," 10 N.Y.U. Rev. of Law and Social Change 407, 425 (1980-81).

[61]397 U.S. at 142.

[62]See Huron Cement Co. v. Detroit, 362 U.S. 440, 443 (1960) and Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945) cited with approval in Pike v. Bruce Church, Inc., 397 U.S. at 142. See also City of Philadelphia v. New Jersey, 437 U.S. 617, 623 (1978).

clause, and by the same words, as the power to regulate commerce with foreign nations, and is coextensive with it."[63] And here is Justice Field fifty years later: "The power to regulate commerce among the several States was granted to Congress in terms as absolute as is the power to regulate commerce with foreign nations."[64]

But the important holding is *Bob-Lo Excursion Co.* v. Michigan,[65] "cited as principal authority for the view that states are not absolutely precluded from enacting regulations which affect foreign commerce."[66] Yet this was an unusual case which thirty years later the Supreme Court in *Japan Line, Ltd.* v. *County of Los Angeles*[67] could limit to its peculiar facts.[68]

Defendant in *Bob-Lo* was a Michigan corporation which transported passengers from Detroit to its amusement park on a nearby Canadian island. Having refused passage to a black woman, defendant was prosecuted and convicted under the Michigan Civil Rights Act. On appeal, defendant took the position that the Michigan enactment constituted state regulation of foreign commerce in violation of the Commerce Clause.[69] While agreeing that "appellant's transportation of its patrons is foreign commerce"[70] the Supreme Court nonetheless upheld the state statute and affirmed the conviction.

There are four significant differences between the application of the Michigan Civil Rights Act in *Bob-Lo* and the application of disinvestment laws affecting South Africa, *et al.*:[71]

1) "[T]he appellant conducted 'foreign commerce' in name only. The sole business on the island was the amusement park, and it catered solely to American patrons. . . . the island was 'economically and socially . . . an amusement adjunct of the city of Detroit.'"[72]

2) Michigan's Civil Rights Act was in conformity with both federal legislation and Canadian enactments.

3) The Michigan statute affected Michigan residents almost exclusively.

4) Since Canadian law was harmonious with the Michigan enactment, "Relations with foreign nations" would not be "adversely affected by applying Michigan's statute to these facts."[73]

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[63]License Cases, 5 How. (46 U.S.) 504, 578 (1847).
[64]Pittsburgh & Southern Coal Co. v. Bates, 156 U.S. 577, 587 (1895).
[65]333 U.S. 28 (1948).
[66]Lansing, "The Divestment of United States Companies in South Africa and Apartheid," 6 Neb. L. Rev. 304, 316 (1981), citing Recent Decisions, 6 Tex. Int. L. F. 134, n. 84 at 140-41 (1970).
[67]441 U.S. 434 (1979).
[68]441 U.S. at 456.
[69]333 U.S. at 34.
[70]Ibid.
[71]See also analysis in Lansing, supra, note 66, at 316-17.
[72]441 U.S. at 456 and 333 U.S. at 35.
[73]333 U.S. at 40.

But South Africa, *et al.* are (1) not adjuncts of American states or cities; (2) disinvestment laws are not in conformity with the laws of the nations where disinvestment is being sought; (3) state and city disinvestment laws and ordinances do not only affect their own citizens—they affect foreign citizens; and (4) since the human rights objectives of American states and cities are so different from those of South Africa, the Soviet Union, Iran, etc., our national relations with those nations would necessarily be affected by disinvestment laws.

This is why the 1979 Court in *Japan Line, Ltd.* took such pains to argue that "appellee's reliance" on *Bob-Lo* is "misplaced" and to conclude that *Bob-Lo* "is consistent with both the analysis and the result" of the latter case.[74]

The controversy in *Japan Line, Ltd.* involved an ad valorem tax that California had imposed on the shipping containers of a foreign corporation. The State argued that the tax was constitutional since it met the four-fold requirements of *Complete Auto Transit, Inc.* v. *Brady*.[75] (1) the Containers had a "substantial nexus" with California because some of them are present in that state at all times; (2) the tax was "fairly apportioned" since it was levied only on the containers' "average presence" in California; (3) the tax did not "discriminate" since it fell "evenhandedly" on all personal property in the State; and (4) it was "fairly related to the services provided by" California.[76]

The Court agreed: "We may assume that, if the containers at issue here were instrumentalities of purely *interstate commerce*, *Complete Auto* would apply and be satisfied, and our Commerce Clause inquiry would be at an end."[77] However, "[w]hen construing Congress' power to 'regulate Commerce with foreign Nations,' a more extensive constitutional inquiry is required."[78] Again: "Foreign commerce is preeminently a matter of national concern. ... Although the Constitution ... grants Congress power to regulate commerce 'with foreign Nations' and 'among the several States' in parallel phrases, there is evidence that the Founders intended the scope of the foreign commerce power to be the greater."[79]

Then, applying the "additional tests that a tax on foreign commerce must satisfy ..."[80] the Court struck down the California statute. The Court concluded that the tax had resulted in "multiple taxation of the instrumentalities of foreign commerce" and prevented the "Nation from speaking with one voice' in regulating foreign trade."[81]

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[74]441 U.S. at 456.
[75]430 U.S. 274 (1977).
[76]441 U.S. at 445.
[77]Ibid. (Emphasis supplied.)
[78]441 U.S. at 446.
[79]441 U.S. at 448 (cited cases and footnotes omitted).
[80]441 U.S. at 451.
[81]441 U.S. at 451-52.

That foreign commerce requires "a more extensive constitutional inquiry" is (as noted earlier)[82] reaffirmed in the important participant-regulator case of *Reeves* v. *Stake*: "We have no occasion to explore the limits imposed on state proprietary actions by the foreign commerce Clause. . . . We note, however, that Commerce Clause scrutiny may well be more rigorous when a restraint on foreign commerce is alleged."[83]

It could be and has been argued that *Japan Line, Ltd.* "is inopposite because it involved a state taxation scheme which is *clearly* regulatory, not proprietary, in nature."[84] Some court in the future, ruling on the constitutionality of disinvestment laws might distinguish *Japan Line, Ltd.* and so conclude. But it is certainly not clear! On the contrary, it is extremely doubtful.

In support of the proprietary nature of disinvestment laws is the contention that such statutes are facially valid since they do not deal directly with foreign commerce. The State is only determining the criteria for the securities which it purchases with its own funds. In doing so, it is not intruding upon the federal government in the area or breaching federal statutes or treaties, or influencing trade with any foreign country.

There is, however, a narrow reading of the word "regulate," and the Supreme Court has never had it so. It was more that 150 years ago that Court decided *Brown* v. *Maryland*,[85] holding that a state license fee on importers was an unconstitutional regulation of foreign commerce. The lesson of that case and its progeny is aptly summed up in the Congressional Research Service Report in this language: "The Supreme Court also has made clear that the power to regulate foreign commerce includes not only the control of the terms and conditions of passage of items of commerce (e.g., capital, securities, financial obligations, services, and goods) between the United States and foreign countries, but also the control of the terms and conditions of the domestic markets for foreign items of commerce that Congress has allowed into this country."[86]

Disinvestment laws inevitably work to the detriment of American firms having investments in the proscribed countries; and disinvestment laws inevitably work to the detriment of commerce with those countries. It is not stretching analysis to conclude that such laws are *regulating* commerce; and it does not require an expansive reading of *Brown* v. *Maryland* (or the myriad other cases on the subject) to reach the conclusion that such laws are unconstitutional.

State and municipal disinvestment enactments can also prevent "this Nation from 'speaking with one voice' in regulating foreign trade."[87] At

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[82]Supra, p. 84.
[83]447 U.S. 429, 438 n. 9 (1980).
[84]Supra, note 10; supra, note 8 at 241. (Emphasis supplied.)
[85]12 Wheat. (25 U.S.) 419 (1827).
[86]Supra, note 7 at 15; see supra, note 8 at 88.
[87]Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 452 (1979).

least five states and more than a dozen cities have such laws;[88] the vast majority do not. Iowa's governor vetoed such legislation in May, 1984.[89]

In addition there exists a conflict or possible conflict with federal legislation restricting trade with these proscribed nations. And to the extent that such conflict may exist, it involves federal preemption pursuant to the Supremacy Clause as well as the Commerce Clause. This is discussed beginning at page 30 under *Foreign Relations*.

Military exports to South Africa, for example, have been prohibited by the federal government since 1964, in compliance with a voluntary arms embargo established by the United Nations. Such ban was made mandatory in 1977 and in 1978 the U.S. Department of Commerce prohibited all exports to that country "that the exporter knows or has reason to know are destined for use by the South African military or police."[90]

Such restrictions, according to a commentary in the American Journal of Internation Law, "are not simply a response by the U.S. Government to an international mandate. They also serve the recognized foreign policy purpose of firmly disassociating the United States from the apartheid policies of the South African regime. . . . At the same time, however, the fact that the U.S. Government has not gone so far as to adopt more expensive trade restrictions is recognition of the importance of U.S. commercial interests in South Africa."[91]

An America where the federal government has one set of laws on trade exports and its states and cities have a variety of other laws on the subject is not "speaking with one voice" in regulating foreign commerce.

VII. FOREIGN RELATIONS

Even if some court at some time might impose the participant-regulator role as a ban to unconstitutionality in the foreign commerce context, disinvestment enactments would still have to pass the hurdle of federal government supremacy in the conduct of foreign relations.

Here is some of the Supreme Court language on this point: "That the supremacy of the national power in the general field of foreign affairs . . . is made clear by the Constitution, was pointed out by the authors of The

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[88]Supra, notes 3 and 4.

[89]Message of Iowa Governor Terry E. Branstad to the Secretary of State, May 19, 1984, disapproving disinvestment provisions in House File 2521. The veto was not based on constitutional considerations but rather the Governor's position that disinvestment would be counterproductive. "Instead of the negative approach reflected in House File 2521, I believe we would benefit blacks in South Africa far more with a positive effort to achieve racial equality. This can best be accomplished, not by divesting our ability to exercise influence, but by capitalizing on it." (At p. 4.)

[90]Mehlman, Milch and Toumanoff, "United States Restrictions on Exports to South Africa," 73 Am. J. Int'l. L. 581 (1979).

[91]Ibid.

Federalist in 1787, and has since been given continuous recognition by this Court."[92]

Also oft-quoted is this statement of Justice Frankfurter: "Although there is in the Constitution no specific grant to Congress of power to enact legislation for the effective regulation of foreign affairs, there can be no doubt of the existence of this power in the law-making organ of the Nation. . . . The States that joined together to form a single Nation and to create, through the Constitution, a Federal Government to conduct the affairs of that Nation must be held to have granted that Government the powers indispensable to its functioning effectively in the company of soveriegn nations."[93]

The oft-cited opinion of *Hines* v. *Davidowitz*[94] involved a conflict between a state alien registration law and a federal statute covering the same subject. The oft-cited opinion of *United States* v. *Pink*[95] involved a conflict between a New York judicial decree refusing to honor a Soviet claim to assets of a nationalized Russian company and an Executive Agreement which had recognized the right of the Soviet Union to nationalized property.

But while these and similar cases have been cited as authority for the unconstitutionality of disinvestment laws, they are readily distinguishable. As the Congressional Research Service report correctly points out, "because of the conflicts between explicit federal and State authorities in these cases, the results in them perhaps may be explained as much by the Supremacy Clause as by any inherent inability of the States to act in any manner affecting foreign affairs."[96]

But what of the situation where—as can be argued in the disinvestment controversy—there is no conflicting exercise of federal power. The answer turns on interpretations of the 1968 decision in *Zschernig* v. *Miller*,[97] which has emerged as the single most important case on the constitutionality issue.

As Professor Louis Henkin has pointed out, the Supreme Court had long found limitations on state regulation or taxation of foreign commerce implied in the Commerce Clause. "The Court never asked whether such state actions might run afoul also of some larger principle limiting the States in matters that relate to foreign affairs."[98] "[I]t was never suggested that [state actions] might run afoul of an *implicit* constitutional limitation barring state impingement on the federal domain of foreign relations even when the

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[92]Hines v. Davidowitz, 312 U.S. 52, 62 (1941). (Footnote references omitted.)

[93]Perez v. Brownell, 356 U.S. 44, 56 (1958). While this case was later overruled by Afroyim v. Rusk, 387 U.S. 253 (1967), neither the dissent in Perez nor the overruling majority in Afroyim questioned the validity of the Frankfurter formulation.

[94]Supra, note 92.

[95]315 U.S. 203 (1942).

[96]Supra, note 7 at 28; see supra, note 8 at 101.

[97]389 U.S. 429 (1968).

[98]L. Henkin, Foreign Affairs and the Constitution (1972), at 238. (Emphasis supplied.)

federal government had not acted."[99] However, Professor Henkin explains, this was before 1968 and the *Zschernig* case. He continued: "Such a larger principle—*how large is yet to be determined*—has now become part of the Constitution."[100]

In *Zschernig*, the Supreme Court was interpreting a so-called "Iron Curtain Act." The Court invalidated an Oregon statute which provided for escheat in cases where a non-resident alien heir or legatee claimed property in Oregon unless such beneficiary could (1) establish that his country would permit United States citizens to receive monies from an estate in his country on a reciprocal basis and (2) that his country would permit him to receive proceeds "without confiscation." Admittedly, there was an absence of any "relevant exercise of federal power" and "no basis for deriving any prohibition by 'interpretation' of the silence of Congress and the President. The Court tells us that the Constitution itself excludes such state intrusions even when the federal branches have not acted."[101]

On its face, *Zschernig* covers disinvestment enactments. Certainly it provides precedent for arguing and sustaining unconstitutionality. And this is further supported by Justice Douglas' language: "As one reads the Oregon decisions, it seems that foreign policy attitudes, the freezing or thawing of the cold war, and the like are the real desiderata. Yet they of course are matters for the Federal Government, not for local probate court."[102]

The statute was found to represent the "kind of state involvement in foreign affairs and international relations" which involve "matters which the Constitution entrusts solely to the Federal Government."[103] Again: "The statute as construed seems to make unavoidable judicial criticism of nations established on a more authoritarian basis than our own."[104] Finally: "The Oregon law does, indeed, illustrate the dangers which are involved if each State . . . is permitted to establish its own foreign policy."[105]

Certainly disinvestment laws manifest "criticism of nations established on a more authoritarian basis than our own." Certainly, they are expressions of foreign policy. Examine, for example, some of the language of the Connecticut enactment, "Sec. 3-13g. *Investments in corporations doing business in Iran*. The state treasurer shall review the major investment policies of the state for purposes of ensuring that state funds are not invested in any corporation engaged in any form of business in Iran which could be considered to be contrary to the foreign policy or national interests of the

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[99]Ibid.
[100]Ibid.
[101]Id. at 239.
[102]387 U.S. at 437-38.
[103]387 U.S. at 436.
[104]387 U.S. at 440.
[105]387 U.S. at 441.

United States, particularly in respect to the release of all American hostages held in Iran."[106]

But does *Zschernig* go so far as to hold that statutes critical of the policies of a foreign nation are unconstitutional *per se*? Is the *per se* argument strengthened in light of a finding of unconstitutionality despite the Justice Department brief as *amicus curiae* stating that it "does not . . . contend that the application of the Oregon escheat statute in the circumstances of this case unduly interferes with the United States' conduct of foreign affairs"?[107]

Answers will not be found in restudying opinion[108] which at this writing is more than sixteen years old, nor by second-guessing the case commentaries.[109] The *Zschernig* analysis does not end with *Zschernig*.

Of course there are numerous decisions which have applied the *Zschernig* rationale, particularly in New York. But, whether the facts of such cases are dispositive of the constitutionality of disinvestment laws is questionable. In one case, the New York Court of Appeals held unconstitutional the application of an anti-discriminative ordinance which would have barred the *New York Times* from publishing advertisements for employment in South Africa.[110] While none of these advertisements referred to race or racial discrimination, the New York City Commission on Human Rights concluded that because South Africa mandated apartheid that the advertisements were automatically violative of the ordinance.

Another New York case saw an attempt by a state agency to apply its state civil rights laws to the South African Airways (owned by the Republic of South Africa) and to the South African consulate in respect to its visa granting practices. The Supreme Court in New York County issued a writ of prohibition, asserting that "[f]oreign policy is a federal concern, not amenable to state action."[111]

The most important *post-Zschernig* case, however, was the 1977 New Jersey Supreme Court decision[112] upholding the state's "Buy American" Act. In sustaining a law requiring use in government purchase contracts of materials produced in the United States, reliance was placed on the propri-

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[106]Conn. ch. 32, ¶3-13g, P.A. 80-431, S. 3, 4 (1980).

[107]387 U.S. at 460.

[108]Opinion of the Court by Justice Douglas, concurring opinion of Justice Stewart, joined by Justice Brennan, concurring opinion by Justice Harlan and dissenting opinion by Justice White.

[109]See, for example, Note, the Supreme Court, 1967 Term, which contended that Zschernig might eventually result in the application of a balancing test as in the Commerce Clause cases. 82 Harv. L. Rev. 244, 245 (1968).

[110]New York Times Co. v. City of New York Commission on Human Rights, 41 N.Y.2d 345, N.E. 393 N.E.S.2d 312 (1977).

[111]South African Airways v. New York State Division of Human Rights, 64 Misc.2d 707, 711 (Sup. Ct., N.Y. Cty., 1970).

[112]K.S.B. Tech. Sales v. No. Jersey Dist. Water Supply, 75 N.J. 272, 381 A.2d 774 (1977), appeal dismissed, 435 U.S. 982 (1978).

etary distinction made in *Hughes* v. *Alexandria Scrap Corp.*[113] "Under the principle of *Alexandria Scrap*, the state agency's limitations with respect to purchases of materials and equipment for that plant, to be owned and operated as a government institution, do not offend the Commerce Clause. The New Jersey Buy American provisions are not measures regulating private business."[114] And the New Jersey Court also concluded, "[t]hat this case involves foreign commerce, and not interstate commerce, does not disturb our analysis."[115]

On the other hand, the decision contained these dicta: "The Buy American provisions apply without any discrimination based on the ideology of the seller's county. Nor is there any evidence to suggest that the political climate in a potential foreign bidder's nation has ever motivated the inclusion of the Buy American condition in an invitation for bids or that its inclusion is predicated on an assessment of the internal policies of any foreign country. If refined inquiries into foreign ideologies entered the decision to apply or not to apply the condition, there would, of course, be little difficulty in finding a constitutional infirmity of the type condemned in *Zschernig*."[116]

And where is the disinvestment statute not based on the ideology of the country affected? Where is the disinvestment statute that does not involve the internal policies of the foreign sovereignty in which disinvestment is sought? Do such dicta negate the reliance on *Alexandria Scrap* and the holding that statutes involving foreign relations can still sometimes be sustained as proprietary?

VIII. FINAL WORD

The answer to the question whether disinvestment laws are constitutional is that there is no one certain answer. Perhaps there are too many answers to permit certainty. The Tenth Amendment makes such laws facially constitutional unless they are held to be in conflict with the interstate commerce provision of the Commerce Clause, the foreign commerce provision of the Commerce Clause, or the federal government's supremacy in foreign relations.

The participant-regulator (or proprietary-governmental) distinction, if held valid in this context, may make disinvestment statutes immune from the interstate commerce proscription. But the ultimate issue is whether this distinction will be extended to foreign commerce. Of course there is argument that can be made, and it is being made in litigation now before the courts—contending both for and against constitutionality.

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[113]426 U.S. 794 (1976). See text, p. 81, accompanying notes 31 to 40.
[114]75 N.J. at 300, 381 A.2d at 788.
[115]75 N.J. at 299, 381 A.2d at 788.
[116]75 N.J. at 291-92, 381 A.2d at 783-84.

DIVESTMENT IS NOT THE ANSWER*

by

WILLIAM G. MILLIKEN
Former Governor of Michigan

The United States is under increasing domestic political pressure to help effectuate changes in the internal policies of other nations. South Africa comes immediately to mind and the strategy of divestment of securities in corporations doing business there is the proffered tool

Current U.S. policy towards South Africa is the widely misunderstood "constructive engagement." President Reagan defined that policy in congratulating Bishop Tutu on receiving the 1984 Nobel Peace Prize, saying; "The United States has heard the appeal for justice voiced by South Africans who suffer under apartheid rule. We continue to urge the South African government to engage in a meaningful dialogue with all its citizens aimed at accomplishing a peaceful transition away from apartheid."

Despite this, the United States is now seen as adopting a position of neutrality regarding South African whites and blacks. However, U.S. policy officially rejects as morally wrong apartheid and its consequences—the attempts to denationalize the black majority and relegate blacks to citizenship in tribal "homelands," and the repression of individuals and organizations through such practices as detention and banning. Nevertheless, there is the growing feeling among those seeking change that the United States is more interested in retaining the good will of the South African government than it is in using its political and economic influence against apartheid.

In my visit to South Africa earlier this year, I learned that present U.S. policy, with its perceived emphasis on accommodation and its seeming willingness to embrace any government, however repressive, which declares itself opposed to communism, is playing into the hands of a regime that has no intention of abandoning its apartheid policies. Indeed, the harsh security laws—ostensibly to control communism—have served their real purpose, which is to control and destroy any kind of opposition to apartheid.

What can the United States do to help effect change? We should, at the very least, leave no doubt whatever that we are unalterably opposed to apartheid. That signal should come through clearly and be constantly sounded. There must be no misunderstanding of the U.S. position on this point. There is now.

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*Governor Milliken has written more fully on South Africa in two Op-Ed articles in the Detroit Free Press, April 19 and 20, 1984.

More can be done. The Rockefeller Foundation-financed Study Commission on U.S. Policy toward Southern Africa has recommended promoting political power-sharing by exerting influence on the South African government by diplomatic moves; barring export of certain U.S. goods, technology (particularly oil-drilling technology) and services; broadening the arms and nuclear embargos; withholding diplomatic recognition and economic aid from the independent homelands, and supporting organizations inside South Africa working for peaceful change such as multiracial labor unions, educational programs, public-interest, self-help and other organizations.

Some of these objectives were contained in bills passed by Congress recently. Others will be considered during 1985. What is significant is that there is a growing interest in South Africa and a recognition that the United States has a moral obligation to exert what pressure it can to bring about reform.

Divestment is continuously being urged with divestment advocates claiming increasing momentum. Eleven cities and five states have passed some form of divestment law. Some 20 states are expected to consider such laws in the next year.

I did not talk with a single individual in South Africa—white or black—who supports this approach. The fact is, most U.S. companies are operating in an enlightened, responsible way. Since 1977, with the announcement of the Sullivan principles (a code of business conduct relating to desegregating facilities, equal pay for equal work, equalization of benefits for all races and a number of other goals), more than 120 companies have become signatories. Were commercial ties cut and U.S. companies to pull out, the United States would lose part of what leverage it has to exert pressure on the South African government for change and with the loss of jobs the first to suffer would be blacks, not whites.

Although I oppose an outright ban on all South African investment, an action I took in my last year as governor of Michigan may appear inconsistent with this position. At that time I signed a bill into law requiring Michigan public colleges and universities to divest themselves of any holdings in companies doing business in South Africa. It was a difficult decision. At the time I was fully aware of the arguments on both sides but believed there was symbolic importance to the act and that a statement needed to be made through our public institutions. I still do. A total pullout of U.S. investments would serve no one's purpose. The action itself had little impact. It did, however, send a signal—and I think American public officials must constantly signal their abhorrence of apartheid.

It is in America's own interests to give such signals. It is in America's own interests to signal its adherence to principles of justice and to a higher moral order whether dealing with South Africa or the U.S.S.R., Poland or Iran. Divestment will leave the U.S. with less, not more, influence and with less ability to assist in the struggle for justice. Just by meeting the goals of the Sullivan principles, U.S. companies are in the forefront of change.

Late in 1983, and again this year, the representatives of the signatory companies met in New York to work out a strategy to improve the quality of employees' lives in such areas as education, housing, health facilities, recreation and transportation. Even as he increasingly relies on the skills and services of black labor, the Afrikaner has relentlessly continued to deny opportunity to blacks. To the extent U.S. companies achieve equal pay for equal work, advance blacks into management positions, end all segregation on the job and seek to improve conditions behond the workplace, they will give the Afrikaner reason to worry that what he has created cannot last forever.

Divestment is not the answer, although the U.S. should do more because hopes for genuine reform of the South African government are fading among blacks and others. Desmond Tutu said: "Our people are rapidly despairing of a peaceful resolution in South Africa. Those of us who still speak of 'peace' and 'reconciliation' belong to a rapidly diminishing minority." The central issue of South African life, that of political rights for the more than 21 million blacks, is simply not on the government's agenda.

There is not much time left.

And as Alan Paton reminds us in his "Cry, the Beloved Country": "'I have one great fear in my heart,' a black minister says, 'That one day when they (the whites) turn to loving, they will find we are turned to hating.'"

STATEMENT OF DEREK BOK ON INVESTMENT POLICY*

by

PRESIDENT DEREK BOK
Harvard University

On May 9, 1984, the Advisory Committee on Shareholder Responsibility (ACSR) submitted a report on the subject of Harvard's investments in American corporations doing business in South Africa. The Harvard Corporation's Committee on Shareholder Responsibility has today issued a detailed reply to the ACSR report, agreeing with some of its proposals and disagreeing with others. I will not repeat all that is said in that reply. But I will express some thoughts of my own on the subject of divestment, since it represents the point of greatest disagreement in this community concerning the response of the University to the injustices of apartheid.

Let me begin by making clear that this is not a dispute about apartheid or the record of the South African government. All of us on every side of the divestment issue agree that apartheid is a cruel and shameful form of racial exploitation that has no conceivable justification. Nor does this debate simply reflect a difference of opinion over tactics or money—though I do believe that the tactics of divestment will not succeed and that they would cost the university money. At bottom, this is also a dispute about the nature of the university itself and the ways in which it should and should not respond to evil in the outside world.

Harvard has taken a number of steps in response to apartheid. We have cast our ballot with care in shareholder resolutions concerning South Africa, often voting to urge corporations to subscribe to the Sullivan Principles, sometimes voting to have a company withdraw entirely from South Africa. We have engaged in intensive dialogue with corporations to persuade them to improve wage and employment practices for black South African employees and to improve the quality of life outside the workplace for these employees, their families, and nonwhites in general. A number of companies have taken such steps. We have also initiated a program to bring nonwhite students from South Africa to study each year at Harvard. Finally, I have helped to organize a nationwide effort of universities, corporations, and foundations which has brought over 300 black South African students to study in colleges and professional schools across the country.

Many members of this community would like Harvard to take a different

*Reprinted with permission. First appearing in the Harvard Gazette of Oct. 5, 1984.

course and divest all of its stock in American companies doing business in South Africa. I have disagreed with this view, and I continue to do so. Much as I oppose apartheid, I strongly believe that universities should not attempt to use their power to press their political and economic views on other organizations and individuals beyond the campus. This is essentially what Harvard would be doing by divesting—boycotting the stock of American companies to bring the pressure of this institution to bear against them to have them cease doing business in South Africa.

My views on this matter are not casual; they involve the essential purposes of the university and the terms on which it exists and does its work in our society. Universities have the distinctive mission of promoting discovery, new ideas, understanding, and education. These activities depend on experimentation, self-expression, and the widest opportunity for debate and dissent. They require insulation from outside pressures that would impose an orthodoxy of "safe" ideas or use the university for ends other than learning and the pursuit of truth. In this respect, the university is quite unlike other institutions, such as governmental bodies, which are designed to exert power over others and to be subject in turn to outside pressures from groups seeking to influence the uses of power in a democracy.

In order to protect the process of learning and discovery, universities must maintain a reasonable autonomy in the conduct of their internal affairs. They must persuade the outside world to refrain from exerting pressure that would limit the freedom of their members to speak and publish as they choose. They must also preserve the freedom to select the best teachers and scholars for the faculty regardless of their opinions or political activities and to set their own policies without external control save by the government in behalf of established public ends.

Today, these freedoms are generally respected in the society. But this was not always the case. The autonomy of academic institutions was resisted for many decades by those who thought it too dangerous to allow universities to exist without some control over what was written or taught within their walls. Even now, our freedom exists within limits. Like all freedoms it has reciprocal obligations. We cannot expect individuals and organizations to respect our right to speak and write and choose our members as we think best if we insist on using institutional sanctions to try to impose on them those policies and opinions that we consider important.

The obligation I perceive in no way inhibits individual members of this community from expressing themselves on issues such as apartheid or from engaging in political efforts to promote their views. Indeed the right to act in this way is an essential part of academic freedom. There is likewise no reason why the university should not perform the function entrusted to it as a shareholder under our laws by voting on issues of social responsibility. The university may even communicate its views through discussions with the officials of companies whose stock it holds. But the line is crossed when a university goes beyond expressing opinions and tries to exert economic

pressure by diverting stock or engaging in a boycott in order to press its views on outside organizations.[1]

The more the university acts in this way the more it risks disturbing the implicit arrangements under which institutions of learning can continue to function with the freedom they need to carry out their essential mission. If Harvard insists on exerting leverage on issues we care deeply about, individuals, corporations, and other organizations are likely to exert economic pressure against us on matters they feel strongly about, such as the radical opinions of particular professors, or Harvard's position toward ROTC, or the University's policies concerning involvement in covert CIA activities.

Every year, shareholder resolutions are introduced to bar corporate support to universities on grounds such as those just mentioned. These resolutions are regularly defeated because most shareholders are persuaded that corporations should not use economic leverage to influence the internal policies of universities. It would be unreasonable to expect such attitudes to continue if we begin boycotting products or selling shares to press particular policies on corporations and other organizations.

Some of the strongest proponents of divestment are not deterred by this prospect. Indeed, they have organized a fund to be given to Harvard only if it agrees to sell its stock in companies doing business in South Africa. I could not disagree more with this approach. Once we enter a world in which those with money and power feel free to exert leverage to influence university policies, we should not be surprised to find that universities have lost much of their valuable independence. Nor should we complain when we discover that those who wield the most power are not necessarily those whose policies are congenial to our own.

Critics may reply that I am putting the private interest of the University ahead of the plight of the black majority that suffers under the heel of apartheid. In response, I would begin by resisting the charge that the interests just described are merely self-serving. In carrying out its tasks of education and research, a university is performing public functions of great importance to society. The freedoms universities seek, like their buildings and endowments, are not private assets but resources essential to the accomplishments of a vital public mission.

In addition, I reject the suggestions that a policy against divestment will perpetuate injustice, since I see no realistic possibility that having universities sell their stock in American companies will make a noticeable contribution to ending apartheid or improving the lot of black South Africans.

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[1]The University may occasionally sell the stock of a corporation because of a disagreement with its policies. Such action, however, is not taken to pressure the company into conforming with Harvard's views but occurs because the University does not wish to continue an association with a firm that fails to live up to minimum ethical standards and offers no reasonable prospect of doing so in the future.

Divestment can make a significant contribution to overcoming apartheid only if all of the following questions can be answered affirmatively:

1. Will selling stock offer a significant chance of persuading American firms to leave South Africa?

There is no indication that sales of stock will put sufficient economic pressure on the management of American companies to induce them to withdraw, since such stock will be purchased by others with no permanent economic consequences to the firm. Nor is there any evidence that the publicity engendered by sales of stock will lead companies to incur the losses entailed by abandoning their South African operations. In fact, no American company has left the country because of divestment actions taken by various states and municipalities over the past few years.

2. Is divestment a more effective way of inducing companies to withdraw than voting in favor of corporate resolutions to withdraw?

There is no evidence to indicate that this is so. Neither divestment nor shareholder resolutions have caused any American company to withdraw, and neither tactic holds much promise of doing so in the future. Shareholder resolutions and dialogue with company executives have at least led to some tangible corporate actions to improve the lives of black South Africans. Divestment has not had even this effect.

3. Even if divestment could somehow help persuade American companies to leave South Africa, would their withdrawal materially help in overcoming apartheid?

In fact, if American companies left South Africa, it is virtually certain that their operations would be taken over either by local interests or by foreign concerns. Since the business would continue operating, it is not clear just how withdrawal would pressure the government into reforming the apartheid system.

4. Would corporate withdrawal, assuming it somehow occurred, contribute more to the defeat of apartheid than efforts by American companies to improve wages, employment opportunities, and social conditions of nonwhite workers?

At bottom, this question raises the difficult issue of how major social change can come about in a country like South Africa. Those who support corporate activity on South Africa argue that economic development will eventually undermine apartheid as the needs of the economy force the Nationalist regime to give more education, economic opportunity, and

ultimately power to nonwhites. Proponents of divestiture believe that real change will never occur by evolutionary means, whereas the withdrawal of American companies could produce widespread unemployment and economic distress that would either force the government to institute reforms or lead to a successful revolution.

Both these theories leave many questions unanswered, and it would be difficult to choose between them or to assert that either will prove to be correct. In response to proponents of divestment, it seems most unlikely that corporate withdrawal would cause an economic collapse, since other companies would presumably take over the operations abandoned by American firms. Even assuming that withdrawal did hurt the economy substantially, the question still remains whether this result would bring about the end of apartheid or simply cause more suffering, black unemployment, and repression. This question seems all but impossible to answer. Proponents of divestment argue that blacks and their leaders favor withdrawal of American companies. In fact, some do, but others don't. In the words of the American columnist William Raspberry, writing from Capetown, "If the Harvard students find the questions easy, black South Africans are by no means unanimously agreed."

In summary, divestment can have a constructive effect on South Africa only if we can answer all four of the preceding questions affirmatively. In reality, it is far from clear that one can give a positive answer to *any* of these questions. The likelihood that *all four* can be answered affirmatively is vanishingly small. Hence, I find no basis for concluding that universities will help defeat apartheid in South Africa by agreeing to divest. As a matter of principle, therefore, I see no reason for departing from the basic norms that define the role of the university in society. Even apart from the special constraints on universities, I do not believe that we can know enough about the future of a distant country to insist to the point of public boycott that American companies will do more for black South Africans by leaving the country than by remaining and instituting better employment and social conditions. And I find it difficult to support in good conscience a decision that would jeopardize resources given to us for education purposes to pursue a strategy that neither furthers the academic ends of the institution nor offers a realistic chance of achieving its objectives.

Despite these conditions, some critics contend that Harvard should divest rather than continue its practice of voting on shareholder resolutions and communicating with corporate managements because the present practice has failed to overcome apartheid or to close the gap in wages and working conditions between black and white workers. This argument misconceives the current policy. The University did not adopt this policy because it felt that its actions—or any actions that universities could take—would have substantial effect on apartheid. Harvard decided on this course of action in the conviction that it should vote shares as conscientiously as possible, even if the effects are only limited, and because of a strong belief in the principle

that voting and communicating views are appropriate forms of behavior for a university while efforts to exert pressure through boycotts and divestment are not.

Others who advocate divestment have suggested that the University's normal policies as a shareholder need not apply because South Africa is such a special case—the only nation that institutionalizes racial discrimination and practices it on a massive scale. Recognizing the enormities of apartheid, Harvard has gone beyond its normal practices by communicating directly with corporate officials to persuade them to alter their employment practices and by creating special scholarship programs for black South Africans. But it is one thing to make efforts of this kind and quite another to disregard one of the University's basic principles, especially when such action is urged in pursuit of a strategy that has no significant chance of affecting the course of events in South Africa.

Those who seek a more effective way of putting pressure on the Afrikaner government need not look far. Last year, for example, bills were introduced in Congress, and passed the House of Representatives, to mandate fair labor practices, limit bank loans, impose export controls, and forbid all new American investment in South Africa. Whatever one may think of these bills, those who favor divestment must concede that such legislation would be a vastly more effective means of achieving their objective. Nevertheless, I have not observed substantial numbers of persons on this campus working actively for the passage of these measures.

Other critics take a very different tack and argue that we should divest, whether or not it will have any practical effect, because it is simply immoral to hold stock in any firm that does business in South Africa. This argument would have more force if Harvard owned stock in companies doing all or most of their business in South Africa. But that is not the case. The companies from which we are asked to divest typically do less than one percent of their business in South Africa. We do not invest in these concerns because of their South Africa operations; it would be more nearly correct to say that we invest despite those operations.

The point, therefore, must be that Harvard should sell stock on principle if it is tainted, however slightly, by the stain of doing business in South Africa. This is a troublesome argument. It suggests that morality lies in trying to avoid all contact with the wrongs of the world and that it is better to sell one's stock and simply turn away from the injustices of South Africa than continue working as a shareholder to persuade companies to improve the wages and conditions of their black employees.

We should also recognize that far more than divestment would be needed to sever all our links to South Africa. If it is wrong to hold stock in an American company doing a tiny share of its business in South Africa, one would suppose that it is also immoral to hold shares in the many companies that buy goods from South Africa or sell goods to it, since they too benefit from the South African economy and presumably help to sustain it. One

would also suppose that Harvard should not accept gifts of money derived in some demonstrable part from South African operations, since they would also be tainted. Accepting tuitions from South African students would likewise seem suspect; even tuitions from American students paid for in part by dividends from companies doing business in South Africa could be questioned. In short, the ramifications of such a rigorous policy are far-reaching indeed.

Before we insist on such a drastic moral standard, we should ask ourselves not only whether it is practical but whether we are willing to apply it to our own lives. How many of us have examined the purchases we make to see whether they come from companies that do business in or with South Africa? How many students have inquired whether their tuitions are paid in part from the dividends of companies with a South African subsidiary? For that matter, how many of us have stopped buying goods or using funds that can be traced to Guatemala, Salvador, Iran, Uganda, or other countries where thousands of innocent people have been killed with no justification? The truth is that virtually no one follows such a policy or regards it as a feasible standard to follow.

Finally, some have argued that Harvard should divest because divestment is a particularly dramatic, affirmative way of expressing the University's opposition to apartheid as a system at war with our ideals of freedom and justice. Such people often stress the pervasive influence of Harvard on the society and argue that the effects of our divestment on world opinion could be substantial. My experience leads me to doubt this view. Harvard may command great respect for what it has accomplished in pursuit of its central mission of research and education; it does not have much influence, even with its own alumni, when it makes institutional statements on political questions such as corporate involvement in South Africa. Like it or not, the public knows that the University cannot claim any special wisdom in expressing itself collectively on issues of this kind.

It is also important to note that Harvard has already stated its clear and complete opposition to apartheid on various occasions. In what respect, then, is divestment a more effective, more forceful expression of disapproval? Because it will continue in some significant way to ending apartheid? We have seen that this is most unlikely. Because the stock of American companies in South Africa is peculiarly tainted? That rationale is also unrealistic. The argument that divestment will be a peculiarly effective gesture must presumably rest on the belief that divestment will cost Harvard money and thus represent a sacrifice which will reveal the depth of our convictions.

This too is a highly questionable argument. Presumably, Harvard could also demonstrate its convictions by giving funds to the African National Congress or some other opposition group. Such a grant would certainly be a dramatic gesture and might well do more than divestment to further the struggle against the Nationalist regime. And yet, despite our revulsion

toward apartheid, the fact remains that Harvard's resources were entrusted to us for academic purposes and not as a means of demonstrating our opposition to apartheid or to other manifest injustices and evils around the world. This is one reason why we have supported the expenditure of University funds to educate nonwhites from South Africa at Harvard but have opposed a policy of divestment.

In making these arguments, I am acutely aware of the contrary views expressed by those who strongly favor divestment. I respect their convictions. I hope that they will respect mine. It is never a pleasant task to disagree with others who care deeply about injustice. In the case of South Africa, the injustice is so monstrous that the heart aches for some opportunity to resist effectively. Nevertheless, such feelings cannot bring me to support a course of action that would force this University to deviate from its proper role, jeopardize its independence, and risk its resources in behalf of a dubious strategy that has no realistic prospect of success. As a result, having thought about the issues as carefully as I could, I continue to believe, as I did in 1978, that the arguments for divestment are not convincing and that Harvard should not adopt such a policy.

CONCLUDING SUMMARY

by

ROBERT J. D'AGOSTINO

"But the pension fund was just sitting there." (See, Schotland, p. 31).

Once again, groups pursuing their own political goals, having failed to win assent through the appropriate political or legislative processes, attempt to claim public jurisdiction over yet another facet of private choice—that of economic investments (See Langbein, p. 8). What's actually at stake in accepting a policy of divestment, or social investing (Langbein) or divergent investing (Schotland), is obfuscated by the hysterical level of attacks on both South Africa and United States policy towards South Africa. As reprehensible as apartheid is (See Milliken, p. 95), it is neither the most repressive of the totalitarian systems nor is it unique. The Soviet Union, Cuba, Iran, Ethiopia all have systems less respectful of human rights or more brutal in their lack of concern for human life. All could or should be, if we are to follow the logic of the divestment advocates, subject to divestment, boycotts and the like. It would be foreign policy by pressure group.

In addition, pressure is being increasingly brought to bear on state and local government and union pension fund managers to invest "locally" for the stated rationale of job creation or stimulating the local economy in some way. Again and like the pressure for divestment of shares in companies following someone's definition of social irresponsibility the rationale is based on factors other than what is a prudent investment decision.

In all of this whether dealing with countries whose internal policies are thought unacceptable, or localism, or allegedly socially irresponsible companies, fiduciary responsibility to those who have entrusted their savings or retirement income to others is ignored in favor of political criteria.

Is Divestment Moral?

The answer to this question involves two issues. The first is a consideration of whether withdrawal from countries whose internal policies we disapprove is more or less likely to bring about the change desired. Is responsible involvement really *immoral*? (See, Schotland, p. 63).

For example, U.S. companies were the first to bargain with black labor unions in South Africa, generally are signatories to the Sullivan Principles (See, Schotland, p. 60), and are leaders in offering educational opportunities to blacks. Withdrawal from South Africa will most assuredly harm the very persons advocates of divestment claim they wish to help.

Given such facts, it is most certainly wrong to call responsible investment immoral, and more logically to call it moral because it is a more effective way to influence policy and because it demonstrably enhances life. (See, Schotland, p. 62).

The second issue is a consideration of just who is setting the social investment agenda compared with who is paying the price. Many divestment proposals are directed at pension funds, not in order to further the interest of pensioners, but in disregard of their interests. By taking advantage of the separation of ownership and control, pressure groups attempt to politicize the investment process. The adoption of a political investment strategy carries with it the risks of lower returns on investment and a higher investment risk. (See, Langbein, p. 20). Is it moral to ask the elderly to surrender retirement income? When people are directly confronted with adopting social or divergent investing voluntarily, they generally refuse. Stockholders routinely vote no on motions to withdraw investments in South Africa; the mutual funds which limit investments to "socially responsible" companies are small. (See Langbein, p. 16 Schotland, p. 42).

In responding to pressure for Harvard to divest stock, President Derek Bok discussed the proper role of a university and the importance of its remaining as free from outside political pressure as possible. Is the threat to academic integrity posed by the advocates of divestment moral?

Is Divestment Legal?

The Constitution leaves the conduct of foreign policy exclusively in the hands of the federal government. The impact on foreign nations for an effort to sever American economic involvement with them has potentially significant impact on relations with the target countries. However, laws which focus on corporate behavior are more insulated from Constitutional challenge (See, Schotland, p. 65, Blaustein, p. 79).

In addition, state and local divestment or investment acts likely violate the Commerce Clause. The test is whether a state statute, on balance, promotes legitimate local concerns without interfering or interfering unduly with national concerns. Divestment does not promote local economic concerns since it does not reflect concern for the stability of the investments, rather it purposely interferes with foreign and interstate commerce. (See, Schotland, p. 66).

Aside from Constitutional challenge, a trustee who sacrifices the beneficiary's financial well-being for any social cause violates both his duty of loyalty to that beneficiary and the prudent investment standard. A trust must be administered solely in the interest of the beneficiary. The Employee Retirement Income Security Act (ERISA) codified these duties of loyalty and prudent investing in its sole interest and exclusive purpose rules. (ERISA does not apply to state and local pension plans, hence they and not

private plans are the targets of the divestment lobby.) (See, Langbein, p. 6).

Is Divestment Productive?

Whether dealing with divestment as a foreign policy strategy, a social strategy, or a way to keep investments local, the futility of most such private efforts are clearly manifest. Simple substitution effects demonstrate that someone else is there to fill the gap. U.S. laws forbidding the exportation of military or police equipment to South Africa have resulted in European and Japanese equipment being substituted, costing U.S. jobs. Localism laws have resulted in retaliatory localism laws or shifts of other investors to the forgone investment opportunities. In those instances where local investing has increased the sum total of such investing, it has done so at the cost of accepting lower rates of return for the invested funds, harming the beneficiaries.

Unless the U.S. has a substantial position in a market (as in the international grain market) withdrawal of investments from a country merely reduces our influence and harms those we try to help since U.S. companies have shown the most sensitivity for issues of fairness and justice. (See, Schotland, p. 61).

Conclusion

The formulation of foreign policy should be left where the Constitution placed it. An individual, voluntarily, has a right and should press his views, control his own investments, and make whatever gestures for which he might be willing to take the consequences. Asking beneficiaries or investors to pay the costs of pressure-group-induced decisions is unjust and hypocritical.

Similarly, localism threatens to interfere with both interstate commerce and prudent investment decisions.

The advocates of divestment or any other policy have access to government. To pressure universities, pension funds, and foundations to politicize their decisions, leaving them open to never ending political demands while potentially jeopardizing their missions is in itself immoral. Social investing is a matter of individual choice. One man's definition of social justice may well be another man's definition of tyranny. Although, the result desired from divestment in, for example, a South Africa or Nicaragua, may seem desirable, advocates of divestment are ignoring the full consequences of what they propose.

National Legal Center for the Public Interest

Publications List

Venue at the Crossroads, by Senator Paul Laxalt, Linden H. Kettlewell, Nicholas C. Yost and David P. Currie with an Introduction by Senator Dennis DeConcini (1982 - $3.50)*

Enforcing the Fourth Amendment by Alternatives to the Exclusionary Rule, by Judge Malcolm R. Wilkey with an Introduction by Senator Orrin G. Hatch (1982 - $3.50)*

Antitrust Contribution and Claim Reduction: An Objective Assessment, by Griffin B. Bell with an Introduction by Senator Paul Laxalt and a Preface by Congressman Jack Brooks (1982 - $3.50)*

Fourteen Years or Life: The Bankruptcy Court Dilemma, by Judge Robert E. DeMascio, Judge William L. Norton and Richard Lieb, Esq. with an Introduction by Senator Strom Thurmond and a Preface by Congressman Peter W. Rodino, Jr. (1983 - $3.50)*

Abolition of Diversity Jurisdiction: An Idea Whose Time Has Come?, by M. Caldwell Butler and John P. Frank with Observations by Chief Justice Vincent L. McKusick, Maine Supreme Judicial Court (1983 - $3.50)

Activism by the Branch of Last Resort: Of the Seizure of Abandoned Swords and Purses, by Judge Malcolm R. Wilkey and a Foreword by the Honorable Sam J. Ervin, former U.S. Senator (1984 - $3.50)

Judicial Wage Determination . . . A Volatile Spectre, perspectives on comparable worth, by Frank C. Morris, Esq. et al with a Foreword by Linda Chavez of the U.S. Commission on Civil Rights (1984 - $3.50)

Edited Proceedings of the 1981 National Conference on *Workers' Compensation and Workplace Liability*. (currently unavailable)

Edited Proceedings of the 1982 National Conference on *Product Liability Tort Law Reform*. (currently unavailable)

Edited Proceedings of the 1983 National Conference on *Health Related Claims: Can the Tort and Compensation Systems Cope?* (1984 - $35.00 Law Libraries; $50.00 all else)

Judicial/Legislative Watch Report - an update report service of NLCPI on legislation and activities affecting the judiciary and the judicial system, (published while Congress is in session, $25.00 per year)

*Demand has exhausted the supply of the original printings. However, Xerox copies are available.

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Divestment is continuously being urged with divestment advocates claiming increasing momentum. Eleven cities and five states have passed some form of divestment law. Some 20 states are expected to consider such laws in the next year.

Former Governor William G. Milliken

The fact remains that Harvard's resources were entrusted to us for academic purposes and not as a means of demonstrating our opposition to apartheid or other manifest injustices and evils around the world.

President Derek C. Bok
Harvard University

The formulation of foreign policy should be left where the Constitution placed it. An individual, voluntarily, has a right and should press his views, control his own investments, and make whatever gestures for which he might be willing to take the consequences. Asking beneficiaries or investors to pay the costs of pressure-group-induced decisions is unjust and hypocritical.

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South Africa Divestment Drive Has U.S. Firms Worried

By Michael Isikoff
Washington Post Staff Writer

William Broderick of the Ford Motor Co. has spent much of the past year flying to state capitals and testifying on a subject that makes most corporate executives cringe. His mission: to defend the role of U.S. corporations in the legally segregated state of South Africa.

"It's not exactly a motherhood issue," says Broderick, acknowledging that few corporations want to be publicly identified with his activities.

"All the surface pros and cons are running against us. . . But we're totally convinced that nothing good will come to black South Africa if we all get out."

As director of Ford's international operations, Broderick has served as the corporate general in a high-stakes battle over South Africa that is heating up in dozens of statehouses and city council chambers and creating new headaches for the approximately 300 U.S. corporations that have operations in that nation.

So far, 11 cities and five state governments—Connecticut, Maryland, Massachusetts, Michigan and Nebraska—have passed some form of divestment laws, which generally require that pension or other government funds be withdrawn from some or all of the U.S. companies that do business in South Africa.

Divestment advocates say their campaign is gaining momentum, drawing strength from public reaction to South Africa's current crackdown on dissidents and from protests at the South African Embassy in Washington, led by U.S. congressmen and civil rights leaders.

As many as 20 states are expected to consider such proposals in their 1985 legislative sessions and "four or five" will probably pass, say such pro-divestment lobby groups as the Washington Office on Africa and the American Committee on Africa.

"It's clear the whole campaign is growing all over the place," says Jennifer Davis, executive director of the New York-based American Committee.

"We're getting calls coming in from all over—from Texas, from Vermont—asking for copies of bills and information."

An even greater number of cities will probably pass divestment laws in 1985, Davis adds, joining New York, Philadelphia, Boston and the District of Columbia in the ranks of municipal governments that are unloading stocks and bonds in the targeted companies.

"I think companies looked at divestment as sort of a minimal do-gooder protest vote a couple of years ago," says Davis.

"Now they're beginning to see it as a serious national campaign that they can't just shrug off—and it's not going to go away."

It is difficult to determine how much the campaign has hurt U.S. companies so far, but divestment advocates say they see signs it is beginning to work.

The U.S. Commerce Department reports that U.S. private investment in South Africa has dropped more than 10 percent—down from $2.6 billion in 1981 to $2.3 billion last year—although analysts say this may have more to do with the depressed state of the South Africa economy as a response to pressure from U.S. activists.

Last week, the U.S. corporate community in South Africa was jolted by a report in a South African newspaper that Ford was selling off its auto plants there to Amcar, the automotive division of a South African-owned Anglo-American conglomerate. The story was swiftly denied at company headquarters in Dearborn, Mich., but a Ford spokesman said that the company, which has been laying off workers at the plants, was engaged in talks of "mutual interest" with Amcar with an eye toward "rationalizing" its operations.

Meanwhile, state and city governments that have joined the divestment movement have been busy selling off their stock in Ford and other big U.S. companies in an effort to implement their divestment laws. Massachusetts, which passed a complete divestment law in January 1983, sold off the entire $90 million in corporate stocks and bonds affected by the act within a year.

The trustees of the D.C. pension system recently reported that, within the four-month period between April 30 and Sept. 30, they had sold off $34.9 million of the $46.9 million in corporate assets affected by the city's new law—with no measurable impact on the solvency of the city pension system.

As a result, U.S. corporations have decided to fight back. An unnamed committee of about 25 major U.S. companies, including Ford, General Motors, Mobil and others, has been organized to oppose divestment proposals at the state level.

Another closely related group—called the Corporate Committee for Change in South Africa—was recently formed by about a dozen U.S. corporations to lobby against divestment proposals before cities and other local governments.

"We're organizing to fight this on every level we can," said one corporate executive involved in these efforts.

The new corporate committee, which is being chaired by Mobil executive Sal Marzullo, is making its first stand in New York City, where it has retained the lobbying firm of Peter Piscitelli, a former top aide to Mayor Edward Koch. A few months ago, the trustees of the the New York City Employes Retirement System became the largest pension fund to approve divestment to date, passing a resolution that will require the city to sell off more than $600 million in assets in U.S. companies doing business in South Africa.

Now, U.S. companies fear that the city pension systems for policemen, firemen and teachers will follow suit. In addition, Piscitelli has been asked to deflect a new weapon in the arsenal of anti-South Africa groups: a bill introduced in the New York City Council that would penalize companies with South Africa operations when they bid on city contracts.

"If they could get a bill like that through the City Council, it sends a message that could get picked up across the country," said Piscitelli.

One of the problems in this new corporate lobbying effort, however, is that the companies are so reluctant to be seen as standing up for apartheid that few want to be publicly associated with the campaign, its organizers said. Piscitelli and Marzullo, for example, both refuse to name the members of the corporate committee other than to say they are all signators of the Sullivan Principles—a code propounded by civil rights leader Rev. Leon Sullivan that pledges U.S. companies operating in South Africa to eliminate segregation in the workplace, provide equal pay for equal work, and take steps to improve black workers' training and housing.

"These are the good companies in South Africa. . . . I've got the white hats on this one," says Piscitelli. "But it's a difficult issue. All these guys are interested in doing the right thing, but people think you're identifying with apartheid. None of them want to be identified even with a good bill."

At least one reason for this skittishness is that the companies fear their own efforts will become confused in the public mind with separate antidivestment lobbying activities that are financed by the South African government. The South Africans currently have two politically well-connected Washington law firms—the firm of Sears, Hare, Kelley and Ward and the firm of Smathers, Symington and Herlong—that receive annual retainers of $500,000 and $300,000, respectively, to represent their interests in the United States, including monitoring the status of divestment legislation, according to foreign agent registration records on file with the Justice Department.

MAJOR U.S. FIRMS IN SOUTH AFRICA

July 1983 Data

Firm	Investment (millions)	Workers	Products
Caltex (Texaco and Standard Oil of California)	$334	2,238	petroleum
General Motors Corp.	$243	4,300	automotive
Ford Motor Co.	$213	5,000	automotive
Goodyear Tire & Rubber Co.	$97	2,797	tires, tubes and rubber products
General Electric Co.	$93	5,130	industrial and electrical equipment
IBM Corp.	$88.6	1,800	computer and office products
Ingersoll-Rand Co.	$40	520	industrial and mining equipment
Xerox Corp.	$38.7	800	reprographic and office equipment
Control Data Corp.	$26.1	330	computer products and marketing
Dresser Industries Inc.	$23.2	955	construction, mining and industrial equipment

Source: The American Committee on Africa and the Pacific Northwest Research Center.

In addition, the South African consulate in the United States has spent thousands of dollars financing the trips to South Africa by state legislators in key battleground states. At least 18 lawmakers in Nebraska, Maryland, Illinois, Wisconsin and Nevada have thus far been on such trips, according to records compiled by Dumisani Kumalo, a former South African journalist who supervises the divestment campaign for the American Committee on Africa.

The South African government shares information on the antidivestment effort with some American companies, according to a South African lobbyist. But representatives of the American companies say their opposition to divestment does not indicate support for the policies of the South African government. Broderick, for one, describes U.S. companies as agents for social change in South Africa. He says they are "chipping away" at the racist underpinnings of apartheid through their implementation of the Sullivan Principles.

"A lot of the support for divestment is based on a perfectly legitimate revulsion with the way that government treats black people," says Broderick. But, he also says, "I haven't found anybody who can give me a scenario that will get me from a) we pull out of South Africa to z) the end of apartheid. . . . All that would happen is that 70,000 to 80,000 black employes would lose their jobs."

As Broderick's comments suggest, divestment touches on a complex mix of moral, social and foreign policy issues. Underlying them all is economics: U.S. companies employ a total of about 120,000 people, most of them black, in South Africa and many of the companies' operations are significant.

Some 25 U.S. companies—including such major firms as International Business Machines Corp., U.S. Steel Corp., General Electric Co., Union Carbide Corp. and Goodyear Tire and Rubber Co.—have investments exceeding $20 million apiece in South Africa. Mobil Corp., with more than 3,300 employes in South Africa, owns or supplies about 1,300 service stations that hold an estimated 20 percent of the retail gasoline market, according to the company's figures.

A few companies have controversial contracts with the South African government. For example, General Motors, which has more than 4,300 workers, supplies cars and trucks to the government and police. Control Data Corp., with more than 300 employes, sells computers and computer parts to a variety of government agencies, including some that critics say are used in the maintenance of internal security. (A Control Data spokesman says that all its computer sales are regulated closely by the Commerce Department to ensure they are not used for the "perpetuation of apartheid.")

"These companies are there for one reason: to make money," says D.C. Council member John Ray, who sponsored the District's divestment law. "Ford is not operating in South Africa to stir up social unrest. . . . If you you look at this as an employment issue, we already have

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the answer—its slavery. That's full employment. But this is not about jobs. Its about human rights."

In response to such charges, most of the major U.S. firms have signed onto the Sullivan Principles and currently spend a total of more than $20 million a year on housing, schools, health services and other programs designed to benefit South African blacks. The 128 signators are also required to pay annual fees, ranging up to $9,000 apiece this year, to finance a $285,000 contract to the Arthur D. Little Inc., a management consulting firm, which puts out an annual report grading each of the the firms on a sliding curve according to their diligence in implementing the principles.

But the Sullivan Principles themselves have been beset by controversy, with some companies objecting to the fee structure and others complaining about the need to submit to an outside monitoring system they feel is inherently arbitrary. "We're responsible to our shareholders—and nobody at Sullivan is," says James F. Hill, vice president of corporate relations for Newmont Mining Corp., one of the U.S. firms that has refused to join.

"The companies basically feel it's corporate blackmail," adds Kathleen Teague, executive director of the American Legislative Exchange Council, a conservative group that distributes antidivestment bulletins to state legislators.

Meanwhile, Sullivan himself is stepping up his pressure on the companies. While issuing Arthur D. Little's latest report last month, Sullivan also said he was expanding his principles to include a requirement that U.S. companies support the abolition of apartheid laws within South Africa—a provision that some U.S. firms fear would place them in the sensitive position of being forced to lobby a foreign government.

But pro-divestment groups still aren't satisfied. "We feel that the Sullivan Principles are a public relations exercise by these companies to justify their investments," says Kenneth Zinn, associate director of the Washington Office on Africa.

Item			
	Inland Fisheries and Game Fund	0.2%	
	State Recreation Areas Fund	0.5%	
0612-1100	For cost of living increases to former teachers, municipal, county and district employees whose retirement expenses are assessed upon cities and towns, and state employees; provided that such increases to the above-mentioned groups shall not exceed three per cent, and provided further, that subject to rules and regulations promulgated by the treasurer, the state board of retirement and each city, town, county or district shall verify the cost thereof and the treasurer shall be authorized to make such payments		$20,483,122
	Local Aid Fund	80.0%	
	General Fund	15.0%	
	Highway Fund	5.0%	
0612-1500	For a reserve to meet the full cost of the commonwealth's share in financing the state employees' and teachers' retirement systems; provided, that the amounts herein shall be paid from and not exceed the revenues dedicated by clause (a) of the last paragraph of section twenty-one of chapter one hundred and thirty-eight of the General Laws; and, provided further, that no funds will be eligible to receive moneys from such reserve if such funds are invested in any company doing business in or with the Republic of South Africa after September first, nineteen hundred and seventy-nine		14,000,000
0612-1550	For a reserve to meet the full cost of the commonwealth's share in financing the state employees' and teachers' retirement systems; provided, that no funds will be eligible to receive moneys from such reserve if such funds are invested in any company doing business in or with the Republic of South Africa		20,000,000
0612-1600	For authorization of payment of retirement benefits pursuant to chapter seven hundred and twelve and seven hundred and twenty-one of the acts of nineteen hundred and eighty-one, respectively		26,000
0612-2000	For the compensation of veterans who may be retired by the state board of retirement and for the cost of medical examinations in connection therewith		14,451,300
	Highway Fund	22.0%	
	General Fund	78.0%	
	Pensions for Retired Justices.		
0612-3000	For pensions of retired judges or their widows		1,776,000
0612-5000	For retirement allowances of certain employees formerly in the service of the administrative division of the metropolitan district commission; provided, that said commission's share of this item shall be assessed by methods fixed by law		58,800
	MDC Sewerage District Fund	25.0%	
	MDC Water District Fund	25.0%	
	Highway Fund	25.0%	
	MDC Parks District Fund	25.0%	
0612-6000	For retirement allowances of certain veterans and police officers formerly in the service of the metropolitan district commission; pro-		

Original Wording
no new investment provision
adopted in 1979

THE COMMONWEALTH OF MASSACHUSETTS

ADVANCE COPY 1982 ACTS AND RESOLVES

MICHAEL JOSEPH CONNOLLY, SECRETARY OF STATE

Chap. 669. AN ACT ENDING THE INVESTMENT OF PUBLIC PENSION FUNDS IN FIRMS DOING BUSINESS IN OR WITH SOUTH AFRICA.

Be it enacted, etc., as follows:

Paragraph (d) of subdivision (1) of section 23 of chapter 32 of the General Laws, as most recently amended by section 1 of chapter 491 of the acts of 1980, is hereby further amended by adding the following paragraphs:-

(vi) After January 1, 1983, no public pension funds under this subsection shall remain invested in any bank or financial institution which directly or through its subsidiaries has outstanding loans to the Republic of South Africa or its instrumentalities, and no assets shall remain invested in the stocks, securities or other obligations of any company doing business in or with the Republic of South Africa. Any proceeds of sales required under this paragraph shall be invested as much as reasonably possible in institutions or companies which invest or conduct business operations in Massachusetts so long as such use is consistent with sound investment policy.

(vii) Notwithstanding the provisions of the preceding paragraph, if sound investment policy so requires the investment committee may vote to spread the sale of such investments over no more than three years so that no less than one-third the value of said investments is sold in any one year. So long as any funds remain invested in any bank, financial institution or firm referred to in paragraph (vi), the investment committee shall annually, on or before January thirty-first, file with the clerk of the senate and the clerk of the house of representatives a report listing all South Africa-related investments held by the fund and their book market value as of the preceding December first.

(This bill returned by the Governor, to the Senate, the branch in which it originated, with his objections thereto, was passed by the Senate, January 3, 1983, and, in concurrence, by the House of Representatives, January 4, 1983, the objections of the Governor notwithstanding, in the manner prescribed by the Constitution; and thereby has "The force of a law".)

American Committee On Africa

198 Broadway, New York, N.Y. 10038 / (212) 962-1210 / Cable AMCOMMAF

MUNICIPAL ACTIONS AGAINST APARTHEID

Investment Restrictions

Date	Municipality	Action Taken	Amount Affected	Divested
11/84	Oakland, California	No new investment		
10/84	Newark, New Jersey	Divestment	?	?
10/84	Amherst, Mass	Divestment	?	?
8/84	New York, New York	Divestment	$665,000,000	None
6/84	Boston, Mass	Divestment	$29,000,000	None (waiting on home rule bill)
10/83	Washington, DC	Divestment	$56,300,000	$34,900,000
10/82	Grand Rapids, Mich	Prohibition of deposit of idle funds in banks lending to SA govt or corporations operating in SA		
7/82	Wilmington, Delaware	Divestment	$400,000	$400,000
6/82	Philadelphia, Penn.	Divestment	$104,000,000	$100,000,000
5/80	Berkeley, California	Divestment	$4,500,000	?
2/80	Cambridge, Mass	No new investment		
1980	Davis, California	No new investment		
1980	Hartford, Conn	No new investment		

Selective Purchasing

Date	Municipality
10/84	Newark, New Jersey
8/77	East Lansing, Michigan
12/76	Madison, Wisconsin

Passed Non-Binding Resolutions

11/84	San Francisco (ballot initiative)	
10/84	Detroit, Michigan	
9/84	New Rochelle, New York	
8/84	Gary, Indiana	(1975 first city resolution calling on city to stop doing business with IBM, ITT, Motorola, Control Data).
1982	Atlanta, Georgia	(removal city pension funds from banks lending to SA govt. or corporations operating in SA).

**Note: September 1984 Executive Council of the National Conference of Mayors passed a unanimous resolution supporting divestment.

Compiled November 1984

SOUTH AFRICA DIVESTMENT

HEARING AND MARKUPS

BEFORE THE

SUBCOMMITTEE ON FISCAL AFFAIRS
AND HEALTH

OF THE

COMMITTEE ON
THE DISTRICT OF COLUMBIA
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

H. Con. Res. 216 and H. Res. 372

TO REJECT THE DISTRICT OF COLUMBIA ACT 5-76 TO PROHIBIT THE INVESTMENT OF D.C. FUNDS IN FINANCIAL INSTITUTIONS AND COMPANIES MAKING LOANS TO OR DOING BUSINESS WITH THE REPUBLIC OF SOUTH AFRICA OR NAMIBIA

JANUARY 31 AND FEBRUARY 7, 1984

Serial No. 98-14

Printed for the use of the
Committee on the District of Columbia

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33-231 O

If there are grounds of supervening national policy which would deny the District of Columbia local determination, then that policy similarly invalidates Philadelphia's legislation as well as the divestment legislation in States such as Massachusetts and Connecticut and in the cities of Berkeley, Calif., and Wilmington, Del.

One of the basic tenets of federalism is to allow States rights and local rights. This has been one of the most basic precepts of the Reagan administration—that is, to return decisionmaking to the States and the local communities. That is the very principle of block grants, of our education policy, and indeed the total thrust of our avowed policy to eliminate Federal control over a wide range of issues which ought to be decided by the State and local governments.

The investment policy of local governments is surely an issue which those local governments have every right to and must determine for themselves.

I would like to thank you for the opportunity to appear before you today. Once again, I would like to assure you that the divestment process can be undertaken in a fiscally responsible manner, without deleterious effects on local pension funds, and to reiterate that the District of Columbia, as a home rule city, is endowed with and deserves the right to determine its own investment policy.

I urge you to carefully consider the points I and others have made this morning, and to vote against the resolutions of disapproval before you today.

Thank you.

[The prepared statement of Mrs. Specter follows:]

PREPARED STATEMENT OF JOAN SPECTER

JANUARY 31, 1984

GOOD MORNING, I AM JOAN SPECTER, AND I AM A PHILADELPHIA COUNCILWOMAN. I AM HERE TO TESTIFY ON THE RESOLUTIONS DISAPPROVING THE DISTRICT OF COLUMBIA'S DIVESTMENT BILL. YOU ALREADY ARE FAMILIAR WITH THE HORROR STORIES WHICH DEPICT LIFE IN SOUTH AFRICA FOR THE BLACK MAJORITY. I SHALL NOT DWELL AT LENGTH ON THIS POINT. I AM HERE, RATHER, TO MAKE TWO POINTS, AND TO MAKE THOSE POINTS BASED ON THE PHILADELPHIA DIVESTMENT EXPERIENCE. THE TWO POINTS I WISH TO MAKE ARE THAT (1) DIVESTMENT NEED NOT BE A FISCALLY UNSOUND MEASURE, AND (2) THE CITIZENS OF THE DISTRICT OF COLUMBIA, AS A HOME RULE CITY, DESERVE THE SAME RIGHT AS THE TAXPAYERS OF OTHER JURISDICTIONS TO CONTROL THE MANNER IN WHICH THEIR TAX DOLLARS ARE INVESTED.

I SPEAK FROM A POSITION OF EXPERIENCE AS THE LEGISLATOR WHO INTRODUCED THE DIVESTMENT PLAN IN THE CITY OF PHILADELPHIA WHERE WE ARE PRESENTLY COMPLETING THE DIVESTMENT PROCESS.

DIVESTMENT BECAME LAW IN PHILADELPHIA IN JUNE OF 1982. OUR GOAL WAS TO DIVEST $90 MILLION OUT OF A $650 MILLION PENSION FUND. IN THAT YEAR, 1982, MORE THAN $21 MILLION WORTH OF BONDS OF 11 CORPORATIONS WERE SOLD. AS OF NOVEMBER 15, 1983, ONLY $9 MILLION WORTH REMAINS TO BE SOLD. OUR CITY TREASURER DISPOSED OF THOSE BONDS AS MARKET CONDITIONS ALLOWED FOR REASONABLE TRANSACTIONS. DURING 1980 AND 1981 IN ANTICIPATION OF PENDING LEGISLATION IN CITY COUNCIL, THE FINANCE DEPARTMENT DIVESTED $36 MILLION WORTH OF BONDS WITH CORPORATIONS DOING BUSINESS IN SOUTH AFRICA.

THE PHILADELPHIA EXPERIENCE HAS NOT BEEN A HASTY DUMPING OF CORPORATE BONDS, BUT A SERIES OF CAREFUL DECISIONS MADE WITH AMPLE TIME TO SEEK SAFE AND REASONABLE INVESTMENTS IN CORPORATIONS THAT

DO NOT DO BUSINESS IN SOUTH AFRICA. THE QUESTION IS, OF COURSE, HOW OUR PENSION FUND FARED AS A RESULT OF THE DIVESTMENT PROCESS.

PRIOR TO DIVESTMENT, THE ACTUARILY ASSUMED BENCHMARK RATE FOR THE PHILADELPHIA PENSION FUND WAS 9 PER CENT. THROUGHOUT THE DIVESTMENT PROCESS, AND INDEED, AT THE PRESENT TIME, THE EARNINGS RETURN OF THE INVESTMENTS OF OUR PENSION FUND HAS REMAINED AT 9 PER CENT. AS WE ALL KNOW, IT IS VIRTUALLY IMPOSSIBLE TO ESTABLISH A VALID COST COMPARISON BETWEEN THE PERFORMANCE OF OUR PORTFOLIO DURING THE DIVESTMENT PROCESS AND ANY COMPARABLE PERIOD, BECAUSE OF MARKET FLUCTUATION, OR TO DETERMINE HOW THE PORTFOLIO WOULD HAVE FARED HAD OUR TREASURER NOT BEEN CONSTRAINED BECAUSE OF THE DIFFICULTIES OF COMPUTING OPPORTUNITY COST. THE BOTTOM LINE IS, HOWEVER, THAT OVER THE PERIOD OF LESS THAN 5 YEARS, THE PHILADELPHIA PENSION FUND HAS DIVESTED ITSELF OF MORE THAN $125 MILLION WORTH OF BONDS IN CORPORATIONS THAT DID BUSINESS IN SOUTH AFRICA, AND DID NOT SUFFER FINANCIALLY.

THE LAST POINT I WOULD LIKE TO ADDRESS IS THE RIGHT OF THE CITIZENS OF THE DISTRICT OF COLUMBIA TO CONTROL THE MANNER IN WHICH THEIR TAX DOLLARS ARE INVESTED.

THE DISTRICT OF COLUMBIA, LIKE THE CITY OF PHILADELPHIA, IS A HOME RULE CITY. THE CITY COUNCIL OF THE DISTRICT OF COLUMBIA, LIKE THE CITY COUNCIL OF THE CITY OF PHILADELPHIA, VOTED TO DIVEST ITS PENSION FUND OF ITS HOLDINGS IN SOUTH AFRICA.

IF THERE ARE GROUNDS OF SUPERVENING NATIONAL POLICY WHICH WOULD DENY THE DISTRICT OF COLUMBIA LOCAL DETERMINATION THEN THAT

POLICY SIMILARLY INVALIDATE PHILADELPHIA'S LEGISLATION AS WELL AS THE DIVESTMENT LEGISLATION IN STATES SUCH AS MASSACHUSETTS AND CONNECTICUT, AND IN THE CITIES OF BERKELY, CALIFORNIA AND WILMINGTON, DELAWARE.

ONE OF THE BASIC TENETS OF FEDERALISM IS TO ALLOW STATES RIGHTS AND LOCAL RIGHTS. THIS HAS BEEN ONE OF THE MOST BASIC PRECEPTS OF THE REAGAN ADMINISTRATION, THAT IS, TO RETURN DECISION MAKING TO THE STATES AND THE LOCAL COMMUNITIES. THAT IS THE VERY PRINCIPLE OF BLOCK GRANTS, OF OUR EDUCATION POLICY, AND INDEED THE TOTAL THRUST OF OUR AVOWED POLICY TO ELIMINATE FEDERAL CONTROL OVER A WIDE RANGE OF ISSUES WHICH OUGHT TO BE DECIDED BY THE STATE AND LOCAL GOVERNMENTS.

THE INVESTMENT POLICY OF LOCAL GOVERNMENTS IS SURELY AN ISSUE WHICH THOSE LOCAL GOVERNMENTS HAVE EVERY RIGHT TO, AND MUST DETERMINE FOR THEMSELVES.

I WOULD LIKE TO THANK YOU FOR THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY. ONCE AGAIN, I WOULD LIKE TO ASSURE YOU THAT THE DIVESTMENT PROCESS CAN BE UNDERTAKEN IN A FISCALLY RESPONSIBLE MANNER, WITHOUT DELETERIOUS EFFECTS ON LOCAL PENSION FUNDS AND TO REITERATE THAT THE DISTRICT OF COLUMBIA, AS A HOME RULE CITY, IS ENDOWED WITH AND DESERVES THE RIGHT TO DETERMINE ITS OWN INVESTMENT POLICY.

I URGE YOU TO CAREFULLY CONSIDER THE POINTS I AND OTHERS HAVE MADE THIS MORNING, AND TO VOTE AGAINST THE RESOLUTIONS OF DISAPPROVAL BEFORE YOU TODAY.

THANK YOU.

Mr. FAUNTROY. I wish to thank you for your expert and very meaningful testimony. I want to tender my personal appreciation for your testimony as a woman and as a wife of one who has been a strong supporter of self-determination for us in the District of Columbia, the Senator of the United States.

I have no questions.

Mr. DELLUMS. I would like to join in the comments made by the distinguished Chair. This gentleman has no questions. You have anticipated the questions I would ask and have answered them very clearly in your opening remarks.

I thank the gentleman.

Mr. FAUNTROY. Mr. Parris.

Mr. PARRIS. I would join with my colleagues in expressing our high regard for your husband in his personal and professional capacity. He is a delight to work with.

Mr. FAUNTROY. Mr. Gray.

Mr. GRAY. I want to welcome Councilwoman Joan Specter from Philadelphia, who is a council person at large in our distinguished city council and still lives in the Second Congressional District and whose husband is the U.S. Senator from the great Commonwealth of Pennsylvania, and certainly commend her for the leadership she has demonstrated on the city council on this issue.

I received a telephone call from the president of the city council who hoped he might be able to be here because of the bipartisan nature of the legislation passed, and I wish to express his regrets for not being able to be here with you.

On page 3, you make a very interesting statement in your second paragraph about the basic tenets of federalism, and particularly with regard to this legislation. Are you suggesting that to disapprove this action by the city of Washington, D.C. would be going in the opposite direction of the administration, from your viewpoint?

Mrs. SPECTER. Yes, I would say that is true. The most basic tenet of President Reagan has been States rights, and I think that all good Republicans would understand that and would decide in favor of disapproval.

Mr. GRAY. I think that is a clarion call for bipartisan disapproval from someone who should know, both from a local level and from a national level, since you have both the Senate and the council in one household.

Can you elaborate, Councilwoman Specter, on the treasurer's approach in Philadelphia to divestment? Was this with the assistance of divestment managers? And did you have any problem in Philadelphia finding alternative investments?

Mrs. SPECTER. My understanding is that we did not have problems finding alternative investments.

In our bill, as I believe the D.C. bill is structured similarly, we gave the treasurer from the city ample time in which to divest, and said in the bill that if he could not divest within the 2-year period, they could come back to council and ask for more time. So we were very careful in giving the treasurer enough time to wait for market conditions to change somewhat. And she did slowly divest with—as far as we are concerned—with no harm to the pension system's portfolio.

Mr. GRAY. What percentage of the pension fund were you talking about?

Mrs. SPECTER. Approximately one-sixth.

Mr. GRAY. So far you have found no ill effects as a result of the passage of the divestment bill in the city of Philadelphia jeopardizing the future pensions of workers in that city?

Mrs. SPECTER. That is correct; and we have the unanimous support of every member of the pension committee—firefighters, police. Everyone was supportive of this when they understood that in fact there would be no loss to the pension fund and that their employees would be secure. So they all voted unanimously.

I am going to leave behind me a letter that I have from the executive director of our pension fund stating that the pension fund was able to divest and maintain the 9 percent interest that they had in prior times.

Mr. FAUNTROY. If the gentleman will yield, we will include that communication in the record at this point.

[The letter follows:]

CITY OF PHILADELPHIA,
BOARD OF PENSIONS AND RETIREMENT,
Philadelphia, Pa, January 27, 1984.

Ms. LORI STERN,
Legislative Assistant, Councilwoman Specter's Office,
City Hall, Philadelphia Pa.

DEAR MS. STERN: This will confirm our recent conversation wherein I indicated to you that it was my understanding from conversations with the former City Treasurer, Gay P. Gervin, that we had consistently achieved or bettered our assumed actuarial investment return rate of 9 percent in our transactions divesting our portfolio of fixed income securities of firms doing business in South Africa

I trust this is what you desire.

Very truly yours,

ANTHONY WITLIN, Esq.,
Executive Director.

Mr. GRAY. Are you telling us that at the time of the hearings and the voting on the divestment of pension funds from those doing business in South Africa, that it was not simply the members of City Council unanimously, but you are saying also that the pension board members and even the labor people involved, whose pensions were affected, were supportive of this action?

Mrs. SPECTER. That is correct; and that is why I was so surprised that in the District of Columbia the pension board members were not supportive. We had total unanimity in their support, and that is because we made it clear to them that they were not going to be losing money.

They all found apartheid to be an anathema. And when we convinced them the dollar was there, they were with us.

Mr. GRAY. Were there any forces in opposition arguing on the grounds of potential financial loss? Do you remember any such arguments?

Mrs. SPECTER. No, there were not. We had 2 days of the cleanest hearings I have ever sat in. People really came in supporting it. And there just was not a problem that I see that the District of Columbia is having, which is very unfortunate.

Mr. GRAY. Of course, councilwoman, you know that Philadelphia is a city of brotherly love and sisterly affection.

Mrs. SPECTER. Sometimes.

The Massachusetts law which was enacted only after the legislature overrode a veto by Government Edward King as the year ended, may have the greatest long range significance. It is the most comprehensive divestment legislation passed by any state and is likely to become the model for bills in other states and cities. All Massachusetts state pension funds will be required to sell stocks and bonds in companies doing business in South Africa. It is estimated that $100 million worth of securities will be sold.

On June 4, 1982, the Philadelphia City Council unanimously decided to make Philadelphia the first major American city to pass a divestment ordinance. Mayor William Green promptly signed the ordinance which the city finance department estimates will result in the sale of $60 to $70 million in securities from the city's pension funds.

Michigan adopted legislation in December requiring public educational institutions in the state to sell all investments in corporations operating in South Africa. Michigan law already prohibited depositing state funds in any banks making loans to South Africa. Michigan legislators are planning to introduce a bill dealing with public pension funds, similar to the one passed in Massachusetts, this year.

In June, Connecticut passed a law which is expected to result in the sale of $70 million worth of securities in South Africa related Corporations. The state has already announced plans to sell $13.4 million in stock in four companies. The legislation directs state pension funds to sell the securities of all companies providing strategic products or services to the South African government or whose South African affilintes do not recognize the right of black workers to organize and strike.

These are but a few instances which indicate the extent to which the movement is rapidly gaining momentum across the country. Each year the passage of similar divestment legislation extends the base of support by adding key states and several other cities. Many colleges and universities, religious organizations and labor unions have acted to withdraw funds from businesses involved in South Africa.

These victories in the divestment movement are a reflection of the growing outrage and organized opposition to the increase in U.S. collaboration with the apartheid regime since the Reagan administration assumed office. While repression in South Africa has increased considerably over the past three years, the United States, under President Reagan, has continued to broaden its friendship with the regime by: defending it in the United Nations; violating the spirit of the U.N. Arms Embargo; allowing South Africa to enlarge the size of its defense attache here in Washington and increase the number of South African consulates in the United States; starting to renew nuclear cooperation with Pretoria; training the South African Const Guard; tolerating South African stalling tactics in the negotiations for Namibian independence; lifting export restrictions agninst South Africa's military and police; supporting a $1.1 billion IMF loan to South Africa and shipping 2,500 shock batons to the white minority regime.

In light of these actions the importance of adding the District of Columbia to the growing list of cities and states substantively opposing apartheid in South Africa is even greater. We cannot overemphasize the national and international significance that the passage of this bill would mean. Not only is the District a 70 percent black city and the nation's capital, but it is also an international city playing host to the entire diplomatic community including, unfortunately, the Embassy of the Republic of South Africa. The passage of this bill will become known to all the embassies present in our city, to all the federal employees, Members of Congress, students from around the country and from other countries, the children in our public schools, our city workers, and to all of us who live and work here and dutifully pay our taxes to the city government. The City Council stand reflects the sentiments of District residents and it is imperative that the House Subcommittee on Fiscal Affairs and Health uphold the Council's stance vis-a-vis the investment of City funds in South Africa.

The issue is simple. Majority rule in South Africa is inevitable. Therefore it is in the best interest of the United States to position itself clearly on the right side of the growing challenge to apartheid. This cannot be done as long as American businesses help to fulfill the needs of the white minority regime for significant capital infusions and sophisticated technology.

It is the task of all those who support the African struggle for justice and liberation to act now to stop the continuing flow of U.S. dollars to apartheid.

Thank you.

Mr. FAUNTROY. And the subcommittee has invited a number of witnesses for this hearing in response to a request of Congressman Parris for the addition of three witnesses, and the hearing record

will include the Chair's letter to Congressman Parris indicating that his request will be accommodated.

[The information follows:]

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE DISTRICT OF COLUMBIA,
Washington, D.C., January 20, 1984.

Hon. STAN PARRIS,
U.S. House of Representatives, Cannon House Office Building, Washington, D.C.

DEAR STAN: I understand that you desire to have three witnesses added to the witness list for the January 31st Subcommittee hearing and mark-up on H. Con. Res. 216 and H. Res. 372. Of course your request will be accommodated, and the following three witnesses have been invited:

Mr. Frank Higgins, Chairman, D. C. Retirement Board.
Professor Roy Schotland, Georgetown University Law Center.
Mr. Dave Eager, Senior Vice President, Neibinger, Inc.

Letters of invitation have been sent to each of them on this date.

As you know, in consideration of the twelve veto resolutions introduced in the House in the past 9 years, the Committee has considered three main questions:

(1) Has the City Council clearly exceeded the powers granted to it by the Home Rule Act?
(2) Has the City Council violated the Constitution?
(3) Has the City Council obstructed the Federal Interest?

Because the witness list has now become rather extensive, it is my hope that we can focus the upcoming hearing in the same way we have focused past hearings.

Thank you for your cooperation.

Sincerely,

WALTER E. FAUNTROY,
Chairman, Subcommittee on Fiscal Affairs and Health.

Mr. FAUNTROY. The following statements have been submitted for the hearing record. First, a letter to the House District Committee chairman, Mr. Dellums, from the D.C. Divest supporting Council act; a memorandum from the American Committee on Africa; and third, a memo from the Congressional Research Service, indicating that it is unlikely that exclusion of South African investments would have more than a marginal effect on overall portfolio performance of the pension assets over a period of years; fourth, we have a statement by the President of Namibia Democratic Coalition, opposing the Council's act on the basis Namibia does not practice apartheid; and fifth, a letter from the State Chair of the Republican Committee for the District of Columbia opposing the Council's act.

All of those documents will be entered in the record.

[The information referred to above appears on pages 293, 337, 277, 490, and 497.]

Mr. PARRIS. Mr. Chairman, could I ask a question for clarification?

Mr. FAUNTROY. Yes.

Mr. PARRIS. I have a document prepared by Mr. Kerina. Is this the document you just entered in the record?

Mr. FAUNTROY. Yes. May we now move to our final panel for the hearing, Dr. Robert Schwartz, vice president of Shearson American Express of New York, and Dr. Schwartz is an economist and an investment adviser who specialized in socially responsible investments.

He has testified before the City Council and has agreed to join us here today.

Ms. Joan Bavaria, president, Franklin Research and Development Corp. Her testimony provided important professional assist-

Africa. That time will come when we can see divesting companies from portfolios, because they are in South Africa, will prove as solid an investment path as has been this earlier statement that I made on nuclear utilities.

You are all aware of the number of States and localities that have recently considered, and in many cases passed, laws relating to divestment of public moneys from firms doing business in South Africa.

I have acted as an adviser to several of these and have testified before many others. The city of Philadelphia, State of Michigan, Minnesota, Massachusetts, Oregon, and Rhode Island, as well as the District of Columbia are among the entities that we have assisted with legislative deliberations over investments in South Africa.

Further, we have been invited to speak at literally dozens of universities where the issue has arisen. There is presently pending legislation in 25 States and 33 universities have divested in various degrees.

The central theme of the three questions you have posed is, can fiduciaries execute the public trust and responsibility they inherently hold as the guardians of money that is the source of retirement benefits for D.C. employees or retirees while excluding investments of U.S. companies in South Africa?

The legal and moral duties are quite explicit: Action, no matter how desirable, should not be taken that would hinder the return earned on the D.C. Retirement Board's investments.

The question then becomes quite simple: Would laws barring investment of these pension funds assets in U.S. corporations that do business in South Africa prevent earning the highest return possible on the investments?

My experience, and my staff's, with both institutional and individual clients indicates that the answer is "No." Without separating the three questions posed, let us examine the issue and recognize the interrelations of the questions.

We manage money with a much greater series of restrictions placed upon us than those under consideration today. Additional restrictions include nondefense, nonnuclear, poor employee relations and environmental pollutants, among others.

However, the remaining universe of investment opportunities available to us is sufficiently broad to permit the latitude to be in or out of the stock market, or in long- or short-term bonds as we see fit.

If we, or selected other money managers, were given the task of managing funds within the framework under discussion today, we would not have problems in finding suitable alternatives to those investments that would be prohibited.

There is no industry, automobile, computer or pharmaceutical included which would be completely barred because of South Africa.

Performance in the management of assets is a function of the accuracy of judgments about the overall market and, the future course of interest rates, and the ability to select investments that appreciate over time.

In this fundamental approach and with the availability of some companies in every industry, I believe performance would not be hindered, limited or adversely affected by the restrictions of avoiding investments in companies that do business in South Africa.

A significant percentage of any pension fund investments are in fixed-income securities and cash equivalents and include in some instances mortgages. While I do not have a current copy of the D.C Retirement Board's portfolio, there is no reason to assume that fixed-income area is neglected or that all investments are in equities.

A restructuring of a portfolio to exclude debt of corporations with activities in South Africa, I believe, could be done in a reasonable period of time, with no adverse effect on the return earned by the funds.

Bonds that are presently valued below their cost could be swapped for other bonds with similarly depressed prices and the fund would recover the taken loss when the bond matures at par value. There would not necessarily be any loss of income or any additional risk with regard to this part of the portfolio.

In my view, the diversity of available options in the debt area permits the exclusion of companies with South Africa operations. Similarly, because of the many substitutes available, the proposal to end commercial banking relations with banks that make loans to the Government of South Africa would not appear, in my opinion, to present any serious obstacle to the efficient conduct of the District retirement fund.

It seems a logical position to take that a reduction in the universe would narrow the selection and also increase the risk. However, an examination of what is being eliminated might result in a different conclusion.

For example, in the investment area, if one were to eliminate all nuclear utilities as an investment, it would restrict the investment availability but would increase the performance by eliminating securities of greater risk and poorer performance.

This same conclusion has been demonstrated to be correct in regard to the exclusion of investment in companies heavily involved in South Africa.

The two citations of specific periods of time that the previous panel gave were periods in which there was appreciation in those equities which excluded South Africa, compared with their total universe.

Several studies have been conducted that have attempted to verify quantitatively what has or would happen to large portfolios which exclude investments of companies in South Africa.

Each of the studies has in their own way found that for virtually any given period of time in the past, portfolio performance would have been no worse, and in some cases would have been better, if a screen of avoiding investments in South Africa had been placed on a fund.

While one cannot and should not predict the future investment returns based upon past performance, we should look at past records of performance and studies.

This committee should be familiar with the reports prepared by the Council on Economic Priorities for the State of California Retirement Systems entitled, "Pension Funds and Ethical Investment," the report by Franklin Research and Development of

ance, and she has agreed to help us today with this complex subject.

Mr. Moody will not appear this morning, but his testimony is here, and he unfortunately was unable to be here. He was snowed in in Boston.

STATEMENTS OF ROBERT SCHWARTZ, VICE PRESIDENT, SHEARSON AMERICAN EXPRESS, NEW YORK; AND JOAN BAVARIA, FRANKLIN RESEARCH & DEVELOPMENT CORP., ACCOMPANIED BY DONALD FALVEY, JR., PRESIDENT, FRANKLIN MANAGEMENT CORP., BOSTON, MASS.

Mr. SCHWARTZ. Mr. Chairman, distinguished and very able members of this committee, I should like to begin by addressing the two questions that the chairman posed that we all address before we begin out testimony.

One, do I support the bill? I respond to that, that whether I support the bill or not is not pertinent to my testimony, that I am here as an investment adviser, and that is the area I will direct my testimony to.

The second question, will passage of this bill affect more than marginally the investment? My answer to that is no, unless some of the 61 of the 73 investment counselors that the Meidinger report said, and I quote, "That is would be negatively impacted on their performance."

To add a little clarification, investment counseling is a serious business, and if you were to start with a negative attitude, then I don't think you are going to get good results.

In accepting the invitation, I will direct my remarks principally to three investment areas that were cited in a letter to me of January 17, and I also will abbreviate what is rather brief testimony, and in the interest of saving time and complying with the chairman's suggestion, so I will not repeat those three questions.

They are really interrelated and they are all addressed to the investment aspect of the bill.

I would like to make clear at the outset, that although I am a corporate vice president of Shearson American Express, I appear here as an individual and do not represent any company or any institution.

I am an economist, and I have been engaged in advising investors on how they can make profitable and also socially responsible investments for a decade and a half.

The views and data which I present are not intended to represent the views of American Express, nor its wholly owned subsidiary Shearson American Express.

This is not to imply that these companies have no concern about investments in South Africa. The companies have corporately expressed an abhorrence to the system of apartheid, and believe, however, that a better opposition to this system would come from a continued presence in South Africa of American companies which attempt in their various fields of endeavor to improve the situation of the black population.

The American Express Co. has also supported the Sullivan Principles while recognizing and stating that there are weaknesses in them.

The two companies are engaged in the area of finance and internationally oppose the practice of apartheid and have taken a number of public actions, including the discontinuance of all advertising for the sale of Kugerrands and not extending loans to the South African Government or its agencies.

Since my views are my own here, I would say that I consider this as many of my public appearances to be a demonstration of corporate freedom as related to academic freedom.

I have, for 15 years, been working in the area of socially responsible investment, developed a small staff which specialized in the area.

We have a growing volume of business and accounts, and for our specialization, we have brought a good deal of new business and attention to Shearson and to the area of socially responsible investing.

I did my first public article in 1972 on socially responsible investing and doing good and going well at the same time. The entire area of socially responsible investments extends much beyond South Africa.

My experience has been in a broad area and with special attention in regards to South Africa for those accounts which want to eliminate any investments in companies that are in South Africa.

I should like to take an extra minute and point out that one of those other areas of concern is nuclear utilities. The reason I pause to make this special observation is the current problem of utilities in the United States that are engaged in nuclear power.

There are six major utilities in deep financial difficulties because of nuclear reactors under construction or having discontinued construction.

On February 28, 1980, I testified before a special New York State Assembly Committee on Nuclear Power and Investment, and in that testimony, I concluded that aside from socially responsible values, "my concerns with straight investment decision, is the nuclear utility a good investment?"

The increasing costs through high safety factory requirements and the long periods of discontinued operation of existing reactors raises serious questions as to whether this industry is a prudent investment.

Based upon factors which I will describe, it is my opinion that it is not.

At that time, I was looked upon as an extremist and received many searching questions from members of that State assembly committee.

My projections have proved to be fact and it is with satisfaction that I state not a single bond or stock in any of my accounts have been invested in any nuclear utilities and there has been no loss because of such failures as the $2.5 billion Washington Public Power default or the more recent Marble Hill Public Service and Cincinnati Gas and Electric Zimmer nuclear facilities.

I cite this because it is to me comparable to the questions raised with regard to divesting holdings of American companies in South

Boston prepared for the Washington, D.C. Retirement portfolio, and an internal study by Chemical Bank that reviewed Chemical's own "buy list" with corporations doing business in South Africa left out.

I think that when Ms. Bavaria testifies later today, she will have updated some of those figures, and that is very specific, getting down to the portfolios involved here.

Each of these studies has documented the statistical fact that, all other things being equal, a portfolio that avoided stocks of U.S. companies in South Africa would have outperformed a portfolio that had included these companies.

The Council of Economic Priorities report on the two large California public funds is important to this consideration, because of the size of the funds, which were referred to earlier this afternoon as $23 billion and my figures show them to be approximately $20 billion in 1980 when this study was done, and the depth of the study included simulated computer portfolios and the exclusion of two areas of investments, South Africa and poor employee relations.

Both funds have policies that address the ethical consequences of their investments.

The Council report entitled, "Pension Funds and Ethical Investment," was published in late 1980 and its 165 pages were summarized in a release of November 17. The report finally concludes:

> CEP did discover that divestment and/or exclusion would not have significant financial consequences for the pension funds themselves. Therefore, basic fiscal and legal concerns need not stop PERS/STRS from taking these actions.

A Franklin research and development report was prepared specifically for the District of Columbia, March 4, 1983, hearings before its City Council Committee on Consumer and Regulatory Affairs.

I see no differences, no conflicts between that specific analysis and what I am reporting.

There are two generic problems with all of the studies of the sort mentioned above. Most importantly, the past is not prolog, and the fact that a certain group of stocks behaved in one way in the past cannot be used to make a case that they would perform similarly in the future.

Nevertheless, the fact remains that past performance would not have been made worse if South Africa-related stocks had been omitted.

The second problem with these studies is that for the majority of the time periods covered, smaller companies have performed better in the stock market than have the larger capitalized multinationals that tend to have operations in the Republic of South Africa.

For reasons of liquidity, volatility, and occasional investment restrictions, large institutional investors do not always have the luxury of investing freely in all of the smaller capitalization companies remaining when the U.S. corporations in South Africa are excluded.

In response to that, the trend, I would say, throughout the community of public pension funds is toward lifting restrictions on investing in smaller growth companies, and, second, we are not

aware of a single industry that a fund would be prohibited from investing in if companies in South Africa were left out.

Third, the large position of pension funds invested in fixed-income mortgages and cash equivalents is not affected.

A frequent objection raised to divestiture proposals is that funds would have to incur abnormally large transaction costs. Since the District of Columbia Act allows a period of 2 years for the retirement funds and 5 years for the Housing Finance Agency within which to make sales, the argument that extra commissions would have to be paid does not really apply.

Institutions like the retirement board normally pay low negotiated rates of 5 or 6 cents a share and somewhere between 25 and 75 percent of a portfolio may turn over each year in the normal course of events.

Thus, a program of divestiture could be instituted over a time period so that many of the required sales are done when independent investment judgments would have warranted sale anyway. Commissions are a negligible part of portfolio cost.

In evaluating the effect upon portfolios of the divestment of securities of companies making loans to or doing business in the Republic of South Africa, one should also examine the risk in making such investments. It is a country which is becoming increasingly more politically and militarily explosive.

A man well known to the Washington scene, former Secretary of Defense and former President of the International Bank for Reconstruction and Development, Robert McNamara, in a speech in October 1982 at the University of Witwatersrand in South Africa, drew attention to the escalating social tensions created by apartheid and stated that "South Africa may become as great a threat to the peace of the world in the 1990's as the Middle East is today."

The references this morning to risk did not cite in any instance the risk in investing in South Africa itself. If this is a risk, firms with large fixed investments face the risk that armed conflict in the country will destroy property and have a negative impact on earnings.

The experience of those funds which have divested is public information and a demonstration of improved investment performance. I refer to such diverse portfolios as those of the University of Wisconsin, the city of Philadelphia and the States of Connecticut and Massachusetts.

We will probably have some questions raised about these entities that have divested.

In conclusion, it is my view that a decision on divestiture should be made on the basis of whether the appropriate officials wish to take a stand on the question of investing in companies that do business in South Africa.

The facts and figures on divestment of securities of companies operating in the Republic of South Africa I believe clearly established that performance need not be lowered.

Therefore, a decision about divestment should not be cluttered by arguments in regard to investment performance, but be based upon the political, moral issues and as to whether the decisionmakers believe that divestment will have an effect on ending the system of apartheid.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Schwartz follows:]

SUBCOMMITTEE ON FISCAL AFFAIRS AND HEALTH OF THE DISTRICT OF COLUMBIA COMMITTEE

Chairman Fauntroy and members of the committee; you have asked me to testify this morning during hearings on House Committee Resolution 216 and House Resolution 372, resolutions disapproving the District of Columbia Act 5-76 "Prohibiting of the Investment of Public Funds in Financial Institutions and Companies Making Loans to or Doing Business with the Republic of South Africa." You have also requested in your letter of January 17, to me that my testimony be restricted to three major points, namely "whether restricting investments will increase risk, decrease return and impair liquidity of the funds invested, (2) that the restrictions will eliminate whole sectors of the S&P 500 companies such as auto companies, computer and pharmaceutical companies, (3) that the restrictions are manageable for small funds but not for funds as large as the District of Columbia Retirement Board fund of $370 million."

In accepting your invitation I will be directing my remarks principally to the three areas cited in your letter.

First, I would like to make clear that although I am a Corporate Vice President of Shearson/American Express, I appear here as an individual and do not represent any company or institution. I am an Economist and have been engaged in advising investors on how they can make profitable and also socially responsible investments. The views and the data which I will present are not intended to represent the views or policies of the American Express nor its Shearson/American Express subsidiary. This is not to imply that the American Express Company and Shearson/American Express have no concern about investments in South Africa. They have expressed an abhorrence of the system of apartheid and believe that a better opposition to that system would come from a continued presence in South Africa of those American companies which attempt in their various fields of endeavor to improve the situation of the black population. The American Express Company has supported the Sullivan Principles even while recognizing that there are some weaknesses in them.

American Express is opposed to divestiture because it believes that the presence of forward looking companies will be beneficial to the majority population. In joining those opposed to the practice of apartheid the American Express Company and its subsidiaries have taken a number of public actions including the discontinuance of all advertising for the sale of Kugerrands and not extending loans to the South African Government or its agencies.

I consider my appearance here as demonstration of corporate freedom as related to academic freedom. For fifteen years I have been involved in socially responsible investments and now ha[illegible] a small staff which specializes in this area. We have a growing volume of busi[illegible]ss and accounts. Through our specialization we have brought a good deal of new business and attention to Shearson and have helped develop the entire area of socially responsible investment which now has adherents not only in this country but abroad. However, it is not my intention nor would it be appropriate for me to take a position here with regard to any moral issue with respect to the apartheid regime in South Africa. My concern is with the investment area and the questions which you have posed to me.

The entire area of socially responsible investments extends much beyond South Africa. My experience has been in a broad area and with special attention in regard to South Africa for those accounts which want to eliminate any investments in companies that are in South Africa. I should like to take an extra minute and point out that one of those other areas of concern is nuclear utilities. The reason I pause to make this special observation is the current problems of utilities in the United States engaged in nuclear power. There are currently six major utilities in deep financial difficulties because of nuclear reactors under construction or where construction has been discontinued. On February 28, 1980, I testified before a special New York State Assembly Committee on Nuclear Power safety and in that testimony I concluded that aside from social responsible values, "my concern is with a straight investment decision: Is the nuclear utility industry a good investment? The increasing cost through the high safety factor requirements and the long periods of discontinued operation of existing reactors raises serious questions as to whether this industry is a prudent investment. Based upon factors which I will describe, it is, my opinion that it is not." At that time I was looked upon as an extremist and received many searching questions from members of that committee. My projections

have proved to be fact and it is with satisfaction that I state not a single bond or stock in any of my accounts have been invested in any nuclear utilities and there has been no loss because of such failures as the $2.5 billion dollar Washington Public Power default or the more recent Marble Hill Public Service and Cincinnati Gas and Electric Zimmer nuclear facilities. I cite this because it is to me comparable to the questions raised with regard to divesting holdings of American companies in South Africa.

You are all well aware of the number of states and localities that have recently considered, and in many cases passed, laws relating to divestment of public monies from firms doing business in South Africa. We have acted as an advisor to several of these and have testified before many others. The city of Philadelphia, the State of Michigan, Minnesota, Massachusetts, Oregon and Rhode Island, as well as, the District of Columbia are among the entities that we have assisted with legislative deliberations over investments in South Africa. Further, we have been invited to speak at literally dozens of universities where the issue has arisen. There is presently pending legislation in 25 States and 33 universities have divested in various degrees.

The central issue of the three questions you have posed is, can fiduciaries execute the public trust and responsibility they inherently hold as the guardians of money that is the source of retirement benefits for District of Columbia employees or retirees while excluding investments of U.S. companies in South Africa. The legal and moral duties are quite explicit: action, no matter how desirable, should not be taken that would hinder the return earned on the District of Columbia Retirement Board's investments. The question then becomes quite simple: would laws barring investment of these pension funds assets in U.S. corporations that do business in South Africa prevent earning the highest return possible on the investments?

Our experience with both institutional and individual clients indicates that the answer is no. Without separating the three questions posed, let us examine the issue and recognize the interrelations of the questions.

We manage money with a much greater series of restrictions placed upon us than those under consideration today. Additional restrictions include non-defense, non-nuclear, poor employee relations and environmental pollutants among others. However, the remaining universe of investment opportunities available to us is sufficiently broad to permit the latitude to be in or out of the stock market, or in long or short term bonds as we see fit. If we, or selected other money mangers, were given the task of managing funds within the framework under discussion today we would not have problems in finding suitable alternatives to those investments that would be prohibited. There is no industry, automobile, computer or pharmaceutical included which would be completely barred because of South Africa.

Performance in the management of assets is a function of the accuracy of judgments about the overall market and, the future course of interest rates, and the ability to select investments that appreciate over time. In this fundamental approach and with the availability of some companies in every industry, I believe performance would not be hindered, limited or adversely affected by the restrictions of avoiding investments in companies that do business in South Africa.

A significant percentage of any pension funds investments are in fixed income securities and cash equivalents and include in some instances mortgages. While I do not have a current copy of the District of Columbia Retirement Board's portfolio, there is no reason to assume that fixed income area is neglected or that all investments are in equities. Consideration of divestment of the fixed income portion of a portfolio is relatively simple.

A restructuring of a portfolio to exclude debt of corporations with activities in South Africa, I believe, could be done in a reasonable period of time, with no adverse effect on the return earned by the Funds. Bonds that are presently valued below their cost could be swapped for other bonds with similarly depressed prices and the Fund would recover the "loss" when the bond matures at par value. There would not necessarily be any loss of income or any additional risk with regard to this part of the portfolio.

In my view, the diversity of available options in the debt area permits the exclusion of companies with South Africa operations. Similarly, because of the many substitutes available, the proposal to end commercial banking relations with banks that make loans to the government of South Africa, would not appear, in my opinion, to present any serious obstacle to the efficient conduct of the Retirement Fund.

It seems a logical position to take that a reduction in the universe would narrow the selection and also increase the risk. However, an examination of what is being eliminated might result in a different conclusion. For example, in the investment area, if one were to eliminate all nuclear utilities as an investment, it would restrict the investment availability but would increase the performance by eliminating secu-

rities of greater risk and poorer performance. This same conclusion has been demonstrated to be correct in regard to the exclusion of investment in companies heavily involved in South Africa

Several studies have been conducted that have attempted to verify quantitatively what has or would happen to large portfolios which exclude investments of companies in South Africa. Each of the studies has in their own way found that for virtually any given period of time in the past, portfolio performance would have been no worse, and in some cases would have been better, if a screen of avoiding investments in South Africa had been placed on a fund. While one can not and should not predict the future investment returns based upon past performance, we should look at past records of performance and studies. This committee should be familiar with the reports prepared by the Council on Economic Priorities for the State of California Retirement Systems entitled "Pension Funds and Ethical Investment", the report by Franklin Research and Development of Boston prepared for the Washington D.C. Retirement portfolio, and an internal study by Chemical Bank that reviewed Chemical's own "buy list" with corporations doing business in South Africa left out. Each of these studies has documented the statistical fact that, all other things being equal, a portfolio that avoided stocks of U.S. companies in South Africa would have outperformed a portfolio that had included these companies.

The Council of Economic Priorities report on the two large California Public funds is important to this consideration because of the size of the Funds, totalling $17 billion in 1980, the depth of the study including simulated computer portfolios and the exclusion of two areas of investment, South Africa and poor employee relations. Both funds have policies that address the ethical consequences of their investments

The Council report, entitled "Pension Funds and Ethical Investment," was published in late 1980 and its 165 pages were summarized in a release of November 17. The report finally concludes:

"CEP did discover that divestment and/or exclusion would not have significant financial consequences for the pension funds themselves. Therefore, basic fiscal and legal concerns need not stop PERS/STRS from taking these actions."

A Franklin Research and Development report was prepared specifically for the District of Columbia March 4, 1984 hearings before its City Council Committee on Consumer and Regulatory Affairs. I understand that Joan Bavaria of Franklin Research and Development will be testifying today. Not only the committee but the D.C. Retirement Board should benefit from the detailed analysis of the Retirement Board's funds which Ms. Bavarin has done. I see no differences, no conflicts between that specific analysis and what I am reporting.

There are two generic problems with all of the studies of the sort mentioned above. Most importantly the past is not prologue and the fact that a certain group of stocks behaved in one way in the past cannot be used to make a case that they would perform similarly in the future. Nevertheless, the fact remains that past performance would not have been made worse if South Africa related stocks had been omitted. The second problem with these studies is that for the majority of the time periods covered smaller companies have performed better in the stock market than have the larger capitalized multinationals that tend to have operations in the Republic of South Africa. For reasons of liquidity, volatility, and occasional investment restrictions large institutional investors do not always have the luxury of investing freely in all of the smaller capitalization companies remaining when the U.S. corporations in South Africa are excluded. Our response is threefold: One, the trend throughout the community of public pension funds is toward lifting restrictions on investing in smaller, growth companies; two, we are not aware of a single industry that a fund would be prohibited from investing in if companies in South Africa were left out. Third, the large position of pension funds invested in fixed income, mortgages and cash equivalents is not affected.

A frequent objection raised to divestiture proposals is that funds would have to incur abnormally large transaction costs. Since the District of Columbia Act allows a period of two years for the Retirement funds and five years for the Housing Finance Agency within which to make sales the argument that extra commissions would have to be paid does not really apply. Institutions like the Retirement Board normally pay low negotiated rates of five or six cents a share and somewhere between 25 to 75 percent of a portfolio may turn over each year in the normal course of events. Thus, a program of divestiture could be instituted over a time period so that many of the required sales are done when independent investment judgments would have warranted sale anyway. Commissions are a negligible part of portfolio cost.

In evaluating the effect upon portfolios of the divestment of securities of companies making loans to or doing business in the Republic of South Africa, one should also examine the risk in making such investments. It is a country which is becoming increasingly more politically and militarily explosive. A man well known to the Washington scene, former Secretary of Defense and former President of the International Bank for Reconstruction and Development, Robert McNamara, in a speech in October 1982 at the University of Witwatersrand in South Africa—drew attention to the escalating social tensions created by apartheid and stated that "South Africa may become as great a threat to the peace of the world in the 1990's as the Middle East is today."

If this is correct, firms with large fixed investments face the risk that armed conflict in the country will destroy property and have a negative impact on earnings.

The experience of those funds which have divested is public information and a demonstration of improved investment performance. I refer to such diverse portfolios as those of the University of Wisconsin, the City of Philadelphia and the States of Connecticut and Massachusetts.

In conclusion, it is my view that a decision on divestiture should be made on the basis of whether the appropriate officials wish to take a stand on the question of investing in companies that do business in South Africa. The fact and figures on divestment of securities of companies operating in the Republic of South Africa, I believe clearly established that performance need not be lowered. Therefore, a decision about divestment should not be cluttered by arguments in regard to investment performance, but be based upon the political, moral issues and as to whether the decision makers believe that divestment will have an effect on ending the system of apartheid

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Dr. Robert J. Schwartz

Dr. Robert J. Schwartz is an economist and investment advisor who for over a decade has specialized in socially responsible investments (S.R.I.). He received his M.A. from Columbia University and Ph.D. from the American University. He is a former U.S. Treasury official and has participated in international conference abroad and at the United Nations. He is a retired Captain, the U.S. Marine Corps, and served in the Pacific during World War II. In 1953, Dr. Schwartz returned to New York as a senior officer of the Amalgamated Bank and, since 1966, has worked for two major Wall Street companies. He has also been an Adjunct Associate Professor at Baruch College teaching a graduate class in Finance, a guest lecturer at a number of universities, in this country and abroad and written many articles concerned with economics and in recent years, particularly, socially responsible investments.

He is a Vice President of Shearson/American Express, Inc., having joined the, predecessor firm of Shearson in 1969. Dr. Schwartz is a member of the American Economic Association; Board of Trustees, Inter-Racial Council for Business Opportunity; member, American Arbitration Association; a member of the Board of Advocates for Children and the National Board of the Committee for a Sane Nuclear Policy.

Dr. Schwartz is married to Josephine Diaz Martin (M.D.) and they reside in Manhattan and East Hampton.

Mr. FAUNTROY. Thank you very much, Dr. Schwartz.

We will now hear testimony from Mrs. Bavaria. I would be very pleased if you would identify the gentleman to your left to whom you have been looking with such admiring glances.

STATEMENT OF JOAN BAVARIA

Ms. BAVARIA. The gentleman to my left is Don Falley, president of Franklin Management Corp., the parent company of the Franklin Research Corp., which does screen, account work.

He is also my husband.

Mr. FAUNTROY. Oh, I understand.

Mrs. BAVARIA. We do not support House Resolution 216 and 372. We do not believe that the divestiture of companies involved in South Africa will have significant impact on portfolio performance.

In the testimony that we prepared, which I will try to abbreviate as best I can, because it has been a long day, we address the most commonly posed argument against divestiture and discuss and refute them, and add some financial thoughts of our own.

Mr. Chairman, and what remaining committee members we have, I thank you for the opportunity of testifying on the proposed legislation.

The movement to divest pension funds of the stocks and bonds of companies doing business in South Africa has sparked widespread public debate and in the process, raised fundamental questions regarding the financial implications of such actions.

These concerns, while very legitimate, have tended to shift the agenda for debate away from its primary focus, how we can best affect a change in South Africa's apartheid system. We hope that today's testimonies will serve to quiet these financial concerns and return the debate to its proper arena.

The proposed bill raises three economic issues in arguing against divestment. These issues are:

One, whether the pension funds will be exposed to greater risk and/or lower return because of the smaller list of available investments; two, whether the restrictions will create significant added expenses in terms of transaction costs and increased staff time; and, three, whether the restrictions are manageable for a fund as large as the D.C. Retirement Board's fund. I will respond to these issues in that order.

The argument has been made on both a technical and hypothetical basis that by disallowing investment in the around 400 firms doing business in South Africa—out of 6,350 companies on the major exchanges—that risk and return will be negatively affected.

The basis for this argument is that many of the country's largest companies—this is going to be another percentage figure that is going to be debated, because it waffles around the 30-percent figure of the market—capitalization of the S&P 500, are included among this group.

Further concern is expressed over the fact that these restrictions will eliminate certain sectors of the S&P 500, such as automobiles, chemicals, and drugs, from investment consideration.

While hypothetically convincing, a series of studies have not supported these fears. Rather, they have shown that over time South Africa Free companies have outperformed the restricted stocks with a minimal amount of added risk.

The Chemical Bank of New York, the U.S. Trust Co. of Boston, and Trinity Investment Management Corp. of Boston, have each conducted historical studies indicating that SAF portfolios have performed consistently--retroactively—better than unrestricted portfolios.

In the Trinity Management study, their SAF universe of 439 companies enjoyed a 3-percent absolute annual return superiority over the restricted stocks. This increase in return occurred with an insignificant increase in risk. The beta—measure of risk, a volatility measure—for the SAF universe was 1.16 as against 1.12 for the restricted stocks.

The 16 percent number that has been used, it was a 16-percent riskier number that was used and came from a study done last

spring by a well-known financial publication that attempted to measure trading liquidity in smaller companies versus large companies in small lots versus large numbers.

It was the very worst case for the very smallest companies in the largest blocks. With intelligent trading, there is no reason that that risk number should apply to the D.C. portfolio.

The variance is always very high in any given period, as managers attempt to anticipate economic cycles and the stock market.

As Mr. Ray suggested, most assumptions made by those opposed to divestiture center on S&P, Standard & Poors, 500 proxy accounts. In reality, investment advisers do not index accounts to any measure but rather attempt to guess which market sectors are going to outperform others.

Our own retrospective study of the District of Columbia Retirement Board's fund further supports these findings. Over the past 9 years, the restricted stocks in this portfolio had a growth in earnings and price appreciation—ex-dividends—of 8 percent per year.

The unrestricted stocks, meanwhile, experienced earnings growth of 11.2 percent with price appreciation of 21.5 percent per year—ex-dividends—over the same period.

It should not be surprising that these studies have shown that SAF companies have grown faster than South Africa-related firms. The companies in South Africa tend to be heavy industrial or mature firms who by virtue of their size do not have the incremental growth potential of smaller companies.

I cite as corroborating evidence the 1982 edition of "Stocks, Bonds, Bills, and Inflation:" " The Past and the Future", by Roger Ibbotson and Rex Sinquefield.

According to this study, the compound annual return from 1926 to 1981 of small stocks—their definition—was 12.1 percent, while the return for all stocks was 9.1 percent.

These figures are consistent with the Trinity and Franklin Research studies, which have shown a 3-percent higher return for the relatively smaller, South Africa free companies.

It might also be pointed out that to diminish risk, we can purchase bonds issued by agencies of the U.S. Government at this time, that equal or exceed historical returns of all other assets including, most stocks, bonds, real estate or even inflation.

We have gotten all hung up on common stocks here, but we might focus on the fact that there are other instruments available to pension managers.

While often conceding this point of return, critics of divestment have raised concerns over a decrease in quality due to the lowered capitalization of SAF companies. These fears, though, are also unfounded.

The Trinity study has exhibited that an SAF portfolio creates insignificant overall additional risk while maintaining an adequate rate of capitalization. The average net worth of the 439 companies included in this study was $1.2 billion.

The Digital example that was given this morning, normally a portfolio will hold any one stock to less than 5 percent of the total portfolio, this is prudent and has been mandated by ERISA.

If you were to buy Digital up to 5 percent of the portfolio in the D.C. portfolio, you would have a holding Digital equipment of about

$11 million, which is larger than any holding in reality has been bought to date by any of the managers of the fund.

That $11 million holding would be two-tenths of 1 percent of the total of Digital's capitalization of $5 billion, taking in good faith the number that they gave us here. That in no way represents a threat to the liquidity of Digital stock. That is just one example.

Likewise, there is no reason to believe that quality should be threatened. As even the Meidinger report states in its conclusion, the preponderance of all issues falls above an "A" rating, acceptable by almost any standard.

The Retirement Board's current managers have not found it necessary to stick to even this standard, as we heard from Mr. Ray's testimony this morning.

Since not many managers hold more than 50 securities in any one fund, the maintenance of a quality highly capitalized, and diversified portfolio is possible.

The second argument raised is that these restrictions will create significant added expenses in terms of transaction costs and increased staff time. Our analysis and experience indicates that neither factor is a problem in the case of South Africa screens.

However, the monitoring of Sullivan signatories probably would add cost to the investment process.

Under the divestiture proposal, using as a point of reference the December 31, 1983 holdings of the funds, the common stock of 33 companies would be sold. Since, in some cases, more than one of the stock managers holds a security, the total common stock sale transactions would be 43.

Brokerage commissions, using 6 cents per share, would total about $210,000 to both buy and sell the necessary securities. This figure is .09 percent of the approximately $226 million now invested in common stocks, which is a very low transaction rate in our industry.

Also, since the average turnover in the equity portion of an institutional portfolio annually runs from 25 percent to 75 percent, a significant portion of the transaction costs related to the divestiture can be considered normal costs of doing business.

With the divestiture plan allowing 2 full years for the sale of restricted stocks, we do not feel that the turnover or transaction costs can be considered excessive.

We do not feel that the imposition of this restriction will significantly add staff time in managing the funds. We have managed restricted individual portfolios for a number of years, and have found the South Africa restriction the easiest and least time consuming.

The final concern is that the fund will be too large to be efficiently managed under this restriction. Again, while this concern is legitimate, there is no evidence to substantiate the fear.

We are dealing with this fund and shouldn't be hypothecating into California and other States that might follow suit.

I feel that we and others have provided data indicating that it is quite feasible to find quality, growth-oriented investment opportunities in SAF companies.

Several cities and States have enacted divestment legislation over the past 2 years that will force the divestment of at least $300 million, nearly the current size of Washington, D.C.'s fund.

No problems have been encountered thus far with the orderly divestment of restricted bonds or stocks or the efficient management of these funds.

For example, contrary to rumor, the fund of the State of Massachusetts, though different from that of Washington, has had no problems in enacting South Africa-related restrictions with their $1 billion fund—nearly three times the current size of Washington's.

Seventy-five percent of the necessary $90 million was successfully divested during the first year. The swaps implemented last spring improved the quality of the portfolio, improved current cash flow by over $2 million per year, decreased volatility and risk, and will ultimately gain the fund up to $36 million over the life of the new bonds. The swap also "saved" the portfolio up to $15 million last year in possible market value erosion due to falling bond prices.

We were asked to look over the divestiture and give some numbers, and I believe all of these numbers have the stamp of official approval on them.

The manager of the funds had the presence of mind to go into par bonds. Anyone who knows bonds management knows last year was a bad year for discount bonds and prices fell significantly.

My colleague, Steve Moody, of the U.S. Trust, cannot be here today; but I have been asked to read just a couple of paragraphs of his testimony, because they supplement by own testimony.

He is the vice president for Investments at U.S. Trust Co., colleague of Robert Zubin's; and he manages $350 million of assets along with five other managers.

The overwhelming determinant of a portfolio's long-run risk and return is asset allocation. Asset allocation refers to what proportions of a portfolio are invested in various major asset types. Those major classes of assets are common stocks, bonds, real estate, and money market instruments.

There is no reason to believe that the South Africa restrictions would interfere with these broad asset allocation decisions which are the most fundamental dimension of portfolio management.

A second significant issue when considering the restrictions of the City Council's act are the potential effects on common stock diversification.

South Africa restrictions should not prevent a common stock portfolio from being extremely well diversified. Our conclusion is supported by an analysis Mr. Litvak performed 4 years ago for the State of California.

Using a specialized computer program, he measured the extent to which an investor could construct a portfolio as diversified as the whole S&P 500 out of the non-South Africa related stocks in the S&P 500. The measure of diversification was a more sophisicated one than that of industry distribution.

This study showed that using these acceptable companies, one in fact can construct a portfolio as diversified as the whole S&P 500. I have attached a detailed summary of this study.

A key assumption of this study—and a highly realistic one—is that the investment manager can pick and choose from the acceptable companies so as to actively reconstruct a portfolio most closely resembling the universe of stocks before any exclusions.

Studies that simply compare the financial characteristics of the "average" excluded and nonexcluded company will always overemphasize the impact of exclusion since they do not take into account this rebalancing.

We have done such a study where rebalancing was not permitted, for the Treasurer of the State of Connecticut when that State was entertaining a similar divestiture bill.

That study compared the performance of a portfolio consisting solely of those equities in the Standard and Poors 500 Index with that same portfolio purged of the equities of companies with known lending or operations in South Africa over a 10-year period.

Performance was superior for the smaller purged portfolios, for the 10 years chosen, 1972 to 1981, but there is so much variation from year to year that one can only say with confidence that there was no statistically significant difference in performance between the two portfolios.

Not surprisingly the smaller, purged portfolio did have somewhat greater volatility, that is the returns each calendar quarter varied more than did the total returns to the whole Standard and Poors 500.

Some observers do not understand how diversification is possible, given that a few whole industries represented in the S&P 500, such as auto manufacturers, would be effectively excluded.

There are two reasons why the impact is not as great as it would seem.

First, the traditional definition of industries does not adequately encompass the groups of companies whose economic and stock performance tend to move together. For example, when auto companies do well, the businesses that supply components to these companies along with firms that produce other consumer durables, for example, appliances, tend to do well also.

By investing in economically related sector, an investment manager can usually capture the benefits of any more narrowly defined individual industry.

Second, industry distribution is only one of several factors that determine stock portfolio diversification. Other important issues in determining an appropriate level of diversification include growth orientation, financial condition, market capitalization, and interest rate sensitivity.

A good mix of these qualities can be found in the companies passing the South Africa restrictions.

In summary, an investment community generally opposed to political interference, sensitive to pension law obligations, and unfamiliar with considering the social implications of their actions, has raised several financial questions regarding divestiture.

To date, however, there is no evidence that divestiture has negatively impacted a pension fund. In fact, there is a growing accumulation of studies and real examples that show the opposite.

Therefore, given prudent execution by the fund's managers, we conclude that the divestiture of stocks and obligations of companies doing business with South Africa would itself cause no economic damage to the pension funds of the city of Washington, D.C.

Given this reality, we stress that the divestiture issue is not one of economics, but one of conscience and political judgment.

[The prepared statement of Mr. Moody follows:]

TESTIMONY BY STEPHEN K. MOODY, VICE PRESIDENT, INVESTMENTS AND LAWRENCE LITVAK, INVESTMENT OFFICER, UNITED STATES TRUST CO

(This testimony is submitted in regard to H. Cong. Res. 216 concerning District of Columbia City County Act 5-76.)

My name is Stephen Moody. I am Vice President for Investments in the Asset Management Division of the United States Trust Company, in Boston, Massachusetts. Together with five other portfolio managers, I am responsible for managing approximately $350 million in assets, representing pension funds, endowments and individual accounts. Our institution has more than a decade of experience in managing investment portfolios subject to social criteria. For several years, we have offered a special investment management service for those investors who wish to have conventional financial objectives and criteria supplemented by social ones.

This testimony was prepared by Lawrence Litvak and myself to comment solely on the question of how South Africa-related restrictions in City Council Act 5-76 are likely to effect the investment performance of the District's retirement funds. (Mr. Litvak was unable to join me today.) I believe that as a practical matter a portfolio manager subject to South Africa restrictions can achieve investment performance quite competitive with what would be achieved in the absence of these restrictions. On a theoretical level, it can always be said that limiting the range of choice in investment management will always impair performance. But with regard to the restrictions imposed by City Council Act 5-76, I do not believe the impairment to be significant.

The overwhelming determinant of a portfolio's long-run risk and return is asset allocation. Asset allocation refers to what proportions of a portfolio are invested in various major asset types—those major classes of assets are common stocks, bonds, real estate and money market instruments. There is no reason to believe that the South Africa restrictions would interfere with these broad asset allocation decisions which are the most fundamental dimension of portfolio management.

A second significant issue when considering the restrictions of the City Council's Act are the potential effects on common stock diversification. South Africa restrictions should not prevent a common stock portfolio from being extremely well-diversified. Our conclusion is supported by an analysis Mr. Litvak performed four years ago for the State of California. Using a specialized computer program, he measured the extent to which an investor could construct a portfolio as diversified as the whole S&P 500 out of the non-South Africa related stocks in the S&P 500. The measure of diversification was a more sophisticated one than that of industry distribution. This study showed that using these acceptable companies one in fact can construct a portfolio as diversified as the whole S&P 500. I have attached a detailed summary of this study.

A key assumption of this study—and a highly realistic one—is that the investment manager can pick and choose from the acceptable companies so as to actively reconstruct a portfolio most closely resembling the universe of stocks before any exclusions. Studies that simply compare the financial characteristics of the "average" excluded and non-excluded company will always over-emphasize the impact of exclusion since they do not take into account this rebalancing.

We have done such a study where rebalancing was not permitted, for the Treasurer of the State of Connecticut when that state was entertaining a similar divestiture bill. That study compared the performance of a portfolio consisting solely of those equities in the Standard & Poor 500 Index with that same portfolio purged of the equities of companies with known lending or operations in South Africa over a ten-year period. Performance was superior for the smaller purged portfolio, for the ten years chosen (1972-1981), though there is so much variation from year to year that one can only say with confidence that there were no statistically significant difference in performance between the two portfolios. Not surprisingly the smaller, purged portfolio did have somewhat greater volatility, that is the returns each calendar quarter varied more than did the total returns to the whole Standard and Poor 500.

Some observers do not understand how diversification is possible given that a few whole industries represented in the S&P 500, such as auto manufacturers, would be effectively excluded. There are two reasons why the impact is not as great as it would seem. First, the traditional definition of industries does not adequately encompass the groups of companies whose economic and stock performance tend to move together. For example, when auto companies do well, the businesses that supply components to these companies along with firms that produce other con-

sumer durables, e.g. appliances, tend to do well also. By investing in economically-related sectors, an investment manager can usually capture the benefits of any more narrowly defined individual industry. Second, industry distribution is only one of several factors that determine stock portfolio diversification. Other important issues in determining an appropriate level of diversification include growth orientation, financial condition, market capitalization and interest rate sensitivity. A good mix of these qualities can be found in the companies passing the South Africa restrictions.

I now would like to turn to another issue which is often raised when South Africa restrictions are being discussed. A large retirement fund like that of the District's is already restricted to, widely traded, usually larger, companies for greater liquidity; won't these additional social restrictions lead to a too small a universe of sufficiently liquid stocks? A simple measure of a stock's liquidity is its market capitalization, the product of the number of shares outstanding and the price per share. Assume that the $370 million of D.C. retirement funds would on average be 50 percent in common stock and that on average this stock portfolio will be distributed across 50 stocks. Further assume that for liquidity reasons this $3.7 million average stock position should never represent more than one percent of each stock's total market capitalization. This means the retirement fund would be restricted to companies with market capitalizations of $370 million (by coincidence the same figure as the system's total assets). There are about 865 publicly traded companies with market capitalizations at least this high. About 350 of those would be on a South Africa restricted list. Even if all of these companies were among the 865 companies with market capitalization above $370 million (many of them are not), it would still leave over 500 companies in which the portfolio readily could invest.

As a final point I would like to report that our experience at United States Trust Company in managing portfolios with social criteria has been positive. Of our $350 million in assets under management, approximately $55 million are managed under social as well as financial criteria. Most of these accounts are subject to social considerations far more extensive than South Africa, including labor relations, equal employment opportunity performance, environmental impact, product purity and safety and other criteria. We have separately monitored the performance of these socially sensitive accounts since 1980. I have attached a sheet summarizing the performance of these socially sensitive accounts in the three and three-quarters years through September 30, 1983. For this period, the typical socially sensitive account had an annualized return of 19.7 percent. This was insignificantly higher than our typical conventional account, which had an annualized return of 19.1 percent. We would suggest that investment management quality and investment approach are the major factors in determining performance.

Our performance is, parenthetically, significantly higher than the major stock, bond and money market indices over this period. Also, the 25th percentile fund in the largest survey of such balanced funds in the country had an annualized return of 16.8 percent over the same period, some 2.9 percent below that of U.S. Trust's median socially sensitive account.

I would be happy to try to answer any questions the Members of the Committee might have.

UNITED STATES TRUST CO. PERFORMANCE COMPARISONS—TOTAL RETURNS

	UST socially sensitive accounts [1]	United States Trust Co [2]	Top quartile Becker universe balanced funds	Dow Jones industrial average	S&P 500	Corporate bonds: 90 day Treasury bill	Corporate bonds: (Salomon Bros. AAA/AA index)	Inflation (GNP deflator)
1974		0.0	−13.6	−21.0	−26.4	7.9	−3.0	5.9
1975		36.0	26.3	44.7	37.2	5.8	14.6	9.3
1976		18.1	20.1	22.6	23.6	5.0	18.6	5.7
1977		2.1	−0.2	−12.9	−7.4	5.3	1.7	5.8
1978		5.1	7.0	2.8	6.4	7.2	−0.1	7.4
1979		6.4	14.8	10.5	18.2	10.0	−4.2	8.6
1980	22.4	19.7	24.1	19.8	32.3	12.4	−2.2	9.3
1981	8.4	10.7	5.1	−3.6	−5.0	14.7	−1.0	9.4
1982	27.7	26.2	27.2	27.2	21.4	10.7	43.7	6.0
1983 [3]	15.9	16.2	17.1	22.1	20.7	6.5	4.8	3.0
Annual rate, 1980–83 [3]	19.7	19.4	16.8	16.9	17.7	11.8	10.6	7.4

UNITED STATES TRUST CO. PERFORMANCE COMPARISONS—TOTAL RETURNS—Continued

	UST socially sensitive accounts [1]	United States Trust Co [2]	Top quartile Becker universe balanced funds	Dow Jones industrial average	S&P 500	Corporate bonds: 90 day Treasury bill	Corporate bonds: (Salomon Bros. AAA/AA index)	Inflation (GNP deflator)
Growth of $1 million invested, 1980–83	$1.964	$1.943	$1.790	$1.796	$1.842	$1.570	$1.458	$1.306
Annual rate, 1974–83 [3]		13.9	9.8	9.4	10.6	8.7	6.6	7.2
Growth of $1 million invested, 1974–83		$3.562	$2.489	$2.333	$2.677	$2.262	$1.871	$1.962

[1] Median discretionary account. Prior to 1980, socially sensitive accounts are included in the median discretionary accounts of United States Trust Company. Asset allocation actively managed among stocks, bonds and money market instruments.

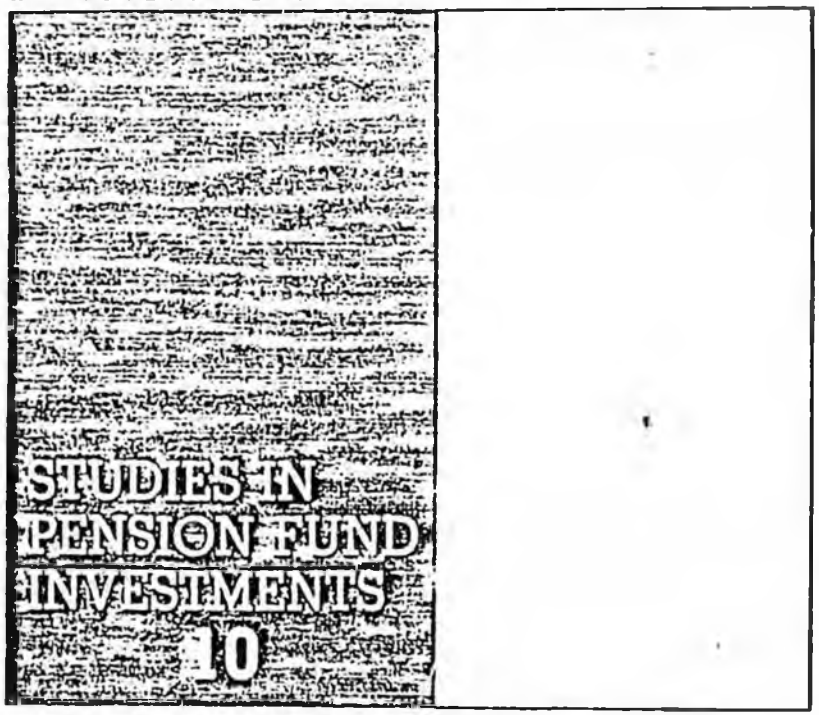
[2] Median discretionary account through 1980. UST pooled pension and profit sharing account, thereafter. Asset allocation actively managed among stocks, bonds and money market instruments.

[3] Through the Third Quarter of 1983 for all but the A. G. Becker results. These are annual compounded rates based on the returns shown for the whole period.

[4] A. G. Becker, the rate is the annual compounded return of the fund which was at the 75th percentile, of those funds which have been tracked for the whole period.

DIVESTING FROM SOUTH AFRICA:

A PRUDENT APPROACH FOR PENSION FUNDS



COMMUNITY ECONOMICS, INC.
CONFERENCE ON ALTERNATIVE STATE AND LOCAL POLICIES

III. HOW EXCLUDING A CORPORATION'S SECURITIES WILL AFFECT A PENSION FUND PORTFOLIO*

Whether excluding certain securities will substantially impair portfolio performance is a question of fact. But like many questions which seem straightforward, it is difficult to answer without knowing what information about your pension fund to gather and how to analyze it. This section lays out the basic investment concepts needed to trace potential portfolio effects and explains what the likely qualitative and quantitative impacts will be under various assumptions. It is intended that any reader could then assess which assumptions and thus which effects are most probable for his or her retirement system.

We begin by explaining what good portfolio effects and bad portfolio effects are. Next, we describe some common errors in thinking about how exclusion will influence portfolio performance. Against these examples of what not to do, the correct approach to analyzing financial effects is described. We proceed through the major determinants of portfolio performance, considering how each will be changed as a result of excluding some corporations from the investment universe. The section concludes with a checklist of facts to consider in evaluating exclusion effects and in designing measures to minimize the possibility of adverse effects.

It is sometimes argued that "there are so many potential investments that excluding any group will have no negative impact on expected performance due to the alternatives."[22] As the Department of Labor's ERISA administrator Ian Lanoff has correctly noted, "... as a practical matter this 'so many fish in the sea' argument is only persuasive when you know you haven't eliminated the big fish. Exclusion of a significant segment of the investment universe without consideration of investment merit, would generally not be prudent."

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* Portions of this section are based on research by Lawrence Litvak as part of a Council on Economic Priorities study of investment practices and opportunities for the State of California Retirement Systems: Baldwin, Tower, Litvak, Karpen, Pension Funds and Ethical Investment, 1980.

With this thought in mind we take the reader through an exercise in determining whether "a good catch" is possible given different degrees of exclusion. We will be focusing particularly on the exclusion of U.S. companies which invest in or loan to South Africa, but the general framework for thinking about exclusion effects is more generally applicable.

A. What Portfolio Effects Should We Be Concerned About?

Before we can talk about how exclusion will affect a pension fund portfolio, one has to know what represents a "good" portfolio effect and what represents a "bad" portfolio effect.

When a pension fund makes a portfolio investment, there are two chief concerns. One is how much money can be gained. Normally periodic payments will be received through interest on debt investments and dividends on equity investments. In addition, there may be a judgement that the market value of the investment will increase, generating a capital gain, although it can also fall, creating a capital loss. The combination of interest or dividend payments and changes in market value represents the measure of return which ultimately concerns the investor.

The pension fund can think only in terms of an investment's expected return, however, since the actual or realized return will depend on events that cannot be completely predicted. This uncertainty regarding future economic events gives rise to the other major concern in making any financial investment, risk. The possibility that actual returns will differ from the expected returns is what we commonly refer to as risk. The risk of an investment will depend on both the characteristics of the corporation being financed (for example, its sensitivity to the business cycle and the number of competitors) and on the terms on which the money is invested. A debt investment providing fixed interest and known principal repayment will normally be less risky than common stock paying an uncertain dividend and unknown capital appreciation.

The good effect of higher expected return is normally accompanied by the bad effect of higher risk.[23] Riskier enterprises can only raise capital if they can promise a higher return than less risky ones; thus, there is an association between pursuing higher return and having to bear greater risk as an investor.

Two other performance dimensions are important to a pension fund because they affect return and risk. They are liquidity and management/transaction costs.

Liquidity is the ease with which a portfolio investment can be converted to cash. The need for liquidity will depend on the degree to which the investor needs to draw on its portfolio for operating funds (benefit payments in the case of a retirement system) and/or sell investments quickly in order to correct portfolio management mistakes or take advantage of new information.

Management and transaction costs are the expenses incurred in evaluating, purchasing, monitoring, and selling investments.

B. What are Some Common Errors in Thinking About Exclusion Costs?

Many people considering the effects of investment exclusion on portfolio performance make false or naive assumptions. Let's take a recent study of the impact of securities' exclusion as an example of the types of errors to avoid.[24]

The study took a list of companies in which pension funds commonly invest (the 99 top holdings of institutional investors' equity portfolios), and compared the past returns of excluded companies and non-excluded companies. The penalty for exclusion would be evidenced in any superior return for the excluded securities. Those companies excluded were 39 which had appeared on the Corporate Data Exchange list of socially undesirable corporations.[25] The 60 acceptable stocks produced an average appreciation of 76.8%, excluding dividends, over the previous five years, while the 39 unacceptable ones produced an appreciation of 83.5% over the same period. The analysis concluded that exclusion would hurt fund performance; the precise cost would depend on how the portfolio would normally be weighted between the two groups of companies.

This approach to estimating exclusion costs is simple but completely invalid. To begin with, it focuses on only one dimension of performance -- return -- and neglects the other factors, such as risk, which may vary between and explain the differences between the excluded and non-excluded companies.

If a particular stock has given a relatively high return over another stock in the past, it may be due to its being a fundamentally riskier holding. Riskier investments must compensate their owner with higher return. So the exclusion or inclusion of such stocks may not give you a better or worse portfolio at all -- just a different one with return differences being balanced out by risk differences.

Second, this approach incorrectly relies upon historical returns to estimate future returns. Whether a stock or

group of stocks has produced a superior or inferior return in the past in itself gives virtually no information about how it will do in the future. If a stock has done well this year, then whatever positive indication of future superior performance that gives will cause the present price of the stock to rise to the point where its expected future returns are just normal for its degree of risk.

Third, this approach does not allow for the obvious fact that investors can substitute for excluded firms many companies not presently in their portfolios. It is clearly false to assume that an investor, considering foregoing certain investment possibilities, would not try to look for and select out of the still available securities those most like the ones it otherwise would hold.

C. What is the Correct Way to Estimate the Portfolio Effects of Exclusion?

We will analyze potential portfolio effects of exclusion by using the framework and evaluation techniques of modern investment theory. Modern investment theory offers a systematic method for classifying, estimating, and controlling the sources of investment risk and return.[26] It will enable us to identify ways in which portfolio performance could be impaired, and to gauge the seriousness of these effects under different exclusion scenarios.

This approach avoids the errors discussed in the previous section. It takes into account the risk dimension of security and portfolio performance when evaluating the impact of exclusion, instead of ignoring it. It bases its estimates of future security returns on fundamental relationships between risk and return in the financial markets, instead of just relying upon returns that the relevant securities have produced over some recent period of years. And it recognizes that investors have a large universe of companies not currently in their portfolios to draw upon.[27]

The modern investment approach to judging whether a portfolio has been adversely affected by a particular constraint (such as corporate exclusions) focuses on whether the portfolio is still competitive: What is the ratio of the portfolio's desirable characteristic (return) to its undesirable characteristics (risk, liquidity, management/transaction costs). A non-competitive or concessionary portfolio is one where the expected return is not commensurate with the other undesirable characteristics of the portfolio. It may be that the portfolio is of average return but above average risk or of below average return but average risk, etc.

In addition to being competitive, a fund's portfolio should be suited to its particular preference for higher return versus lower risk, and other financial characteristics. In other words, it must be appropriate to the financial needs of the pension fund.

Modern investment theory suggests that there are four major determinants of whether a portfolio will be competitive and whether it will be suited to the specific needs of the investor, in this case a pension fund:

1) Diversification of the portfolio: Some risk in investing can be diversified away by the proper portfolio holdings. This risk is known as non-systematic risk. A portfolio that has not eliminated it will be less than ideal since investors on average are not compensated for this avoidable risk. Will sufficient diversification be possible if some corporations are excluded?

2) Achievement of the desired risk level: A well diversified portfolio's return will overwhelmingly depend on its overall systematic risk level. This risk level in turn primarily depends on the asset allocation of the portfolio: the percent in bonds, stocks, real estate, and other major asset categories. Will excluding some corporations interfere with achieving the desired risk level?

3) Selection of "good" stocks and bonds: Picking stocks and bonds that end up doing better than similar risk investments is another factor in portfolio performance. Although this "beating the market" is not something that overall portfolio performance has risen or fallen on, it is the focus of much attention.

4) Minimization of transaction and management costs: Buying and selling securities involves transaction costs, and analyzing them for certain characteristics involves management costs. Divestment will involve additional buying and selling, and may require analyzing additional information. Will transaction and management costs get too high?

We will now turn to each of these questions. In some cases the effect of exclusion can be estimated quantitatively, in other cases it can only be projected qualitatively.

1) Will Sufficient Diversification be Possible?

Investors do not normally hold just one or a handful of securities, but scores of them at any time. These collections of financial securities are known as portfolios. The modern

theory of investment focuses first on the aggregate of securities -- the portfolio -- in thinking about the financial investment rather than on how to pick good individual investments. The reason for this focus is that the effective risk of individual securities is partly determined by what other investments are in the portfolio.

Some risk, or variability of return, can be avoided by constructing portfolios of securities in an appropriate way. This is commonly referred to as diversification. In simple terms, the upswings of some securities and the downswings of others at any particular time tend to cancel each other out. A portfolio manager can take the available securities, each having its expected return and variance, and combine them in such a way as to minimize the variability of the portfolio. In more technical terms, because the movements of the returns of different securities are not perfectly correlated, combining them in a portfolio causes the variance of its aggregate return to be less than a weighted average of the variances of its component securities.

Think of two companies. Both are in the railroad tie business and have fairly identical balance sheets and operations. They are competing for a contract to supply the reconstruction of the Northeast Corridor lines. The firm that gets the contract can expect an increase of its earnings; the one which does not will lose out on this increase. By investing equal amounts in these companies, the investor can hedge against the particular risk presented by the contract competition.

Note the word "minimize," as opposed to "eliminate." Unfortunately, not all risks are specific to some companies or industries and not others. Even if an investor owned a portfolio containing a representative share of all risky assets (stocks, bonds, etc.) in the economy, some risk would remain. The return on the entire portfolio would still end up at levels that could not be completely foreseen, due to phenomena, such as the business cycle, that link all investments. This uncertainty about the future value of the whole collection of risky assets cannot be eliminated through diversification and is known as systematic risk. However, all variability in the returns of individual securities that is not tied to the movements of the market can be diversified away by holding a portfolio that contains a large number of securities whose returns are only partially correlated. This portion of risk is known as non-systematic risk.

Research has shown that about 90% of the possible reduction in non-systematic risk of common stocks can be accomplished through holding a few dozen securities. But the remaining

fraction is important since non-systematic risk typically represents about 67% of the total risk associated with an individual stock. As one noted portfolio theorist has written, "A little diversification goes a long way, but not nearly far enough. The differences can swamp you."[28]

Since exclusion limits the number or types of companies a pension fund may invest in, an obvious question is how diversification opportunities will be affected. Will a pension fund be forced to bear unnecessary non-systematic risk because diversification opportunities have been wiped out?

The basic procedure for analyzing the diversification problem is to delete the companies which are to be excluded from the list of stocks available to the portfolio and to then come up with the combination of stocks that eliminates the most non-systematic risk.[29]

The diversification of this portfolio can then be compared to the optimum portfolio constructed from the entire relevant universe of equity securities, including the excluded firms. In the following analysis, the "market" that we are trying to replicate as closely as possible with our post-exclusion portfolio is the Standard and Poor's (S&P) 500, a widely used stock market proxy. The universe of stocks available to the portfolio will be the S&P 500 minus the proscribed companies. A computer program known as an "optimizer" enables us to find the best post-exclusion combination of stocks without an endless hunt-and-peck search.

Computer programs used to choose the portfolio of still available securities most resembling the market as a whole deals with diversification in a sophisticated way.[30] A post-exclusion portfolio could potentially diverge from the S&P 500 because it was exposed to (that is, would not respond to) economic events that affect: certain industry groups, certain groups of firms with other common characteristics, or specific, individual companies. When a particular stock is excluded from the portfolio, the optimization program assesses the degree to which the portfolio is then exposed to these various non-systematic return factors. The basis of this assessment is a so-called "multi-index model" of non-systematic risk including fundamental and historical information relating to industry movements, financial risk, growth orientation, immaturity and smallness, unsuccess and low valuation of earnings, earnings variability and market variability. It then expands the holdings of the remaining stocks to cover underweighting of non-market risk factors.

For example, to the degree that industry factors in this model are an important component of non-systematic return, the

pre-exclusion industry share will be maintained. Nevertheless, industry holdings may not match the pre-exclusion shares even when there are sufficient stocks still available to do so. This is because there are other group factors -- such as the ratio of debt to equity in the corporation's financing -- that are of equal or greater importance to non-market return. Therefore, in selecting the better-off corporations -- in terms of minimum total non-market risk and departing from the initial industry weightings to ensure these other characteristics are properly reflected -- the optimizer will do so.

There will be two key indicators of diversification problems due to exclusion. One is a significant decrease in a measure called R^2. R-squared (R^2) indicates the proportion of the movements in one variable, the pension fund portfolio's return, which can be explained by the concommitant movements of another, the S&P 500's return. The other problem indicator would be a significant rise in the total standard deviation. Standard deviation estimates the variability of future portfolio returns around the expected return; in other words, it measures the likelihood that the portfolio will earn less than expected.

Table I shows the results for our post-exclusion diversification analysis of four scenarios -- three exclusion scenarios and one base scenario. (See the Appendix for the listings under each scenario.)

Scenario A is the base case, with all of the Standard and Poor's companies available.

Scenario B is a case of moderate exclusion. Eighteen companies which had judgments of employment discrimination against them in federal court between July 1978 and June 1979 were excluded.[31] It can be thought of as portraying a highly targeted policy of exclusion against a handful of recalcitrant companies.

Scenario C is a case of intermediate exclusion. Sixty-four companies were proscribed. Fifty-four of these firms had operations in or made bank loans to South Africa, eighteen had major settlements against them before the EEOC in fiscal year 1977, and thirteen had such judgments against them between June 30, 1978 and June 30, 1979.[32] This scenario can be thought of as portraying a more comprehensive, but still selective policy of exclusion.

Scenario D is a case of extreme exclusion. One hundred and thirty-two companies were proscribed. This includes all companies in the S&P 500 that had wholly-owned or partially-owned subsidiary operations in South Africa, or a branch or

representative office there, and all banks that have made loans to the government, parastatal corporations or private firms of South Africa.[33] It can be thought of as portraying a blanket policy of exclusion against all firms who have committed a particular social injury. Alternatively, it may suggest the combined effect of highly targeted exclusion, shown in Scenario B, across a whole series of social responsibility criteria (EEO, OSHA, etc.).

TABLE I

Optimum Post-Exclusion Portfolios

Portfolio Profile	R^2	Total Standard Deviation[34]	Non-systematic Standard Deviation	Beta*
A No Exclusion	1.0	21.03%	0.0%	1.00
B Moderate Exclusion (18 companies)	0.998	21.15%	0.82%	1.01
C Intermediate Exclusion (64 companies)	0.991	21.33%	2.05%	1.01
D Extreme Exclusion (132 companies)	0.992	21.24%[35]	1.90%	1.01

* Beta is a measure of systematic risk, usually applied to common stock. A stock with a beta of 1.0 has the same volatility as the market; a 1.1 beta has a volatility 10% greater, etc.

The exclusion scenarios all produce a measureable but minute increase in risks of the type that an investor cannot expect to be compensated for by higher returns.

The R^2 (or measure of correlation) remains extremely high. Over 99% of the movement of each scenario portfolio can be accounted for by movements in the market. In the practical world of portfolio management, this is an exceedingly high degree of diversification. Given the return on the stock market as a whole, these portfolios will have highly predicatable returns.

These R^2's are also very high when measured against the degree of diversification found in a typical pension fund equity portfolio. For example, the median R^2 of the pension fund sample tracked by Merrill Lynch is 88.7%. This comparison is less revealing than one might think, however, because the pension funds in practice are laboring under other practical constraints that limit the number of different stock issues they want to hold.

To gauge better the meaning of the increase in non-systematic risk produced by exclusion one can compare it to the amount found in commercially marketed mutual funds intended to perfectly track the S&P 500 -- so called index funds. Even these portfolios usually have some small non-systematic standard deviation: 1.5% or less. So scenario B results in a portfolio that is within the index fund class, and scenarios C and D both produce ones that are very close. In contrast, the median annual non-systematic standard deviation of all institutional portfolios is about 6%.[36]

Finally, the change in standard deviation can be expressed in terms of how this changed the certainty of achieving the expected return on the equity portfolio. Approximately two-thirds of possible annual returns for a portfolio will lie within one standard deviation either side of the expected annual return, and 95% will be within two standard deviations. Using this measure, we see that the worst case outcomes are virtually identical for all the portfolios. For the baseline scenario A, the 95% confidence interval ranges 42.06% either side of the expected return. For scenarios B, C, and D, the corresponding figures are 42.10%, 42.55%, and 42.58%.

These quantitative estimates of exclusion's impact on risk diversification apply to the common stock portfolios of pension funds. While generating similar estimates for bond portfolio effects was not practical, the following extensions from the equity portfolio analysis can be made. Increases in non-systematic risk for the bond portfolio would be even smaller than those estimated in our analysis of the equity portfolio. A much smaller proportion of the total risk in an individual bond is non-systematic, and therefore diversifiable, risk. Thus the penalty for excluding a bond issue from a portfolio in terms of lost opportunities for diversification will be smaller.

In addition, it is important to understand that non-systematic risk penalties observed within either the bond or equity portfolio tend to overstate the problem. Some of this non-systematic variability will be eliminated when the bond and equity portfolios are combined with each other and with the mortgage portfolio. This added diversification will occur because the returns on the different asset categories are much less than perfectly correlated.

2. Will the Risk Level of the Portfolio be Appropriate?

If it is well-diversified, a pension fund portfolio's return will primarily be a function of its systematic, or market, risk level. Accordingly, the most important decision in investment management is not what individual securities to buy and sell. Rather, it is what level of systematic risk to assume, with its accompanying long-run expected return.

A pension fund's decision regarding the systematic risk level is primarily implemented through overall asset allocation decisions. Asset allocation refers to what proportions of a portfolio are devoted to the various asset types: corporate equities, fixed income securities, like bonds and mortgages, real estate equities and short-term notes. In general, the risk-return differences between the different asset categories dwarf the differences within them. This is why the amount of money an investor devotes to say, stocks versus bonds, will be more important in determining the portfolio results than the type of bonds or stocks purchased. There is no reason to believe that any foreseeable exclusion scenario would interfere with these broad asset allocation decisions which are the most fundamental characteristics of a portfolio.

However, there are significant systematic risk differences among securities within asset types as well, such as a BB rated corporate bond versus a government bond, or a growth stock versus a utility stock. So investment choices among asset subcategories have an impact on the portfolio's systematic risk level as well. This is particularly true of the stock portfolio make-up, since the stocks can differ substantially in their risk. Suppose the equity portfolio of an investor was composed of stocks averaging a beta of 1.0, with 50% of the overall portfolio in stocks and 50% in Treasury bills. If the stock beta was increased to 1.2, then the allocation to stocks would have to be reduced from 50.0% to 41.6% if the initial overall risk level was to be maintained.

Our quantitative analysis of common stock exclusion in the previous section assumed that the target portfolio was one which had the systematic risk characteristics of the market, a beta equal to 1.0. Thus, the actual expected annual returns on the Table I post-exclusion equity portfolios in Table I are almost identical to the baseline portfolio's (A) expected return. Actually the beta coefficients of portfolios B, C, and D are actually a little bit higher (1.01 versus 1.00) leading to expected returns a little bit higher (1.01 times the return on the market versus 1.00 times it).[37]

Pension funds do tailor the systematic risk level within their different asset categories in order to achieve a higher

return-higher risk posture. One-half of pension funds have a common stock portfolio beta of more than 1.01 and a quarter have beta above 1.11.

This throws a subtle new dimension into our analysis of exclusion effects. The individual, higher risk, stocks concentrated on in such a portfolio usually have a greater than average proportion of non-market risk in their total risk. This means that diversifying a higher market volatility equity portfolio from a post-exclusion universe of securities may be more difficult than is suggested by the case where a portfolio of average volatility is to be constructed.

The optimization runs in Table I have been done again, with a portfolio beta target of 1.13 set in the computer program. The results are shown in Table II. The benchmark portfolio (A), to which others can be compared to see the added complications of exclusion when pursuing a high beta portfolio, is also shown. This portfolio has the entire S&P 500 available to it and is targeted to achieve a beta of 1.13 with minimum residual risk.

As expected, the added constraint of a high target beta adds non-market risk across the board. But again, the relative increase due to various degrees of exclusion is very small.[18] The pursuit of a high beta portfolio does not appear to increase the penalty for excluding companies for social responsibility reasons.

TABLE II

Optimum Post-Exclusion Portfolios

Portfolio Profile	R^2	Total Standard Deviation	Non-Systematic Standard Deviation	Beta
A No Exclusion*	---	---	---	---
B Moderate Exclusion	0.992	23.81%	2.13%	1.13
C Intermediate Exclusion	0.987	24.02%	2.71%	1.14
D Extreme Exclusion	0.987	23.94%	2.71%	1.13

To recapitulate our answer to the question of whether a suitable systematic risk level can be achieved after excluding

* The program would not run under these conditions. However, we know through hand calculations that the standard deviation of scenario A will be between 23.75 and 25.94%.

corporations for social reasons: Yes, the desired risk level and appropriate expected return can be achieved. There is nothing that will prevent a pension fund from implementing its desired asset allocation, the main vehicle for setting the risk level. Nor should achieving the desired risk level within a particular asset category be complicated by exclusion, as we have just seen.

3. What will happen to picking good stocks and bonds?

A third major factor in portfolio performance is what many lay-people regard as the essence of money management. This performance factor is choosing stocks and bonds that end up paying returns better than would be expected simply on the basis of their systematic risk level; what many call outperforming the market. In fact, these decisions are relatively unimportant in determining the performance of most pension fund portfolios.

Clearly in those instances where a pension fund is prevented from buying (or forced to sell) a security that goes on to outperform others of its risk level, its performance will have suffered. But missing out on these winners will be a trivial or non-existent cost for most pension funds for two reasons. First, pension funds have shown neither a consistent nor a significant ability to pick out the winners. Second, the securities that pension funds trade in tend to be priced pretty fairly; that is, the opportunities for big winners and losers in the long-run are not that great.

A pension fund's approach to choosing individual stocks, bonds, etc., largely depends on an assessment of how efficient the relevant security markets are in pricing securities. The less active strategy assumes that pricing of securities in capital markets, or at least the ones open to the pension fund, is quite efficient. That is, at any particular time securities tend to be appropriately priced in relation to their expected risk and returns, given the judgments of investors as a group based on all available information. In other words, the best estimate of the proper value of a security is the composite view, represented by its current price. This philosophy implies that a portfolio should contain a highly diversified list of securities and keep its market risk level at the desired long-term average.

What is referred to as the more active management strategy assumes an ability to price individual securities better than the composite view on a consistent basis, and/or an ability to forecast the direction of the market better than the composite view. It implies, respectively, concentrating holdings in selected potentially undervalued securities rather than diversifying broadly and/or shifting the portfolio risk above or below

the desired long-term average depending on whether one forecasts the relevant market more up or more down than the composite view.

When a pension fund buys a security because it thinks it is under-valued or sells one because it is perceived as overvalued, it believes that the price that it is paying (receiving) for the security is less (more) than it is really worth. This assumes that the seller is getting less or the buyer paying more than the true price. For this situation to exist there must be significant differences of information or analytic ability among the investors trading securities.

In the preceding sections we have assumed that pricing is efficient. If this hypothesis is true, then a pension fund does not have to worry that an excluded security may turn out in the future to be undervalued, therefore preventing the funds from investing in assets that promise a return over and above what similar risk investments pay. It may turn out that some boycotted securities end up yielding extraordinary return, but the pension fund, like other investors, would not have known about these ahead of time and would not have been able to act on this information.

Many portfolio managers reject the pricing efficiency argument, believing they can consistently price securities better than the market and do a better job of anticipating the direction of its movements. Given this view there could be costs to active management, as a result of exclusion interfering with the selection of individual securities.

Excluding specific securities should not impinge on one of the two variants of active management -- market timing. What matters in market timing is an ability to shift investment among securities that have different market sensitivity: toward more sensitive ones when an upswing is anticipated and less sensitive ones when a downswing is foreseen. It is difficult to imagine circumstances where securities exclusion would prevent adjusting the beta of the common stock portfolio, the maturity/duration of the bond portfolio, or the mix between equities and bonds.

What is more likely to be interfered with is securities selection. To properly estimate penalties resulting from interference with securities selection, we need to know two things: (1) the size, and distribution among securities, of the return available from active management; and (2) how effective the relevant investor is at identifying and responding to this mis-pricing. The first piece of data is known in finance terminology as "alpha," and the second is the "information coefficient." If the total alpha available to a pension fund

were equal to a 5% additional return on the portfolio, and its information coefficient were equal to 0.5, then an added return of 2.5% could be obtained. To assess the impact of exclusion on this extra return, one would need some knowledge of what proportion of the total alpha came from the alphas of excluded securities.

This latter piece of information probably would have to be assessed on a social issue-by-social issue basis. However, if one believes that in general, investors tend not to adequately incorporate the negative implications of poor corporate social performance in their pricing of securities, then it may be that there is actually a positive correlation between good social performance and under-valuation.[39] If this is true, then exclusion could actually produce increased returns to active management. Alternatively, one might argue that excluded firms are more likely to be underpriced, especially if enough investors boycott them for non-financial reasons.

In assessing what opportunities for active securities selection will be lost, one should also keep in mind that the characteristics that make one stock or bond outperform others of the same risk level are not all company specific. They may be industry-related or related to other characteristics like degree of financial leverage. In these frequent cases, a pension fund unable to bet on company A because of exclusion can bet on company B which may have most of the same characteristics expected to produce exceptional performance.

Consideration must also be given to the segment of the financial market where the relevant securities are issued and traded. While no one argues that pricing in securities markets is completely efficient, there is a consensus that certain companies grouped together constitute a relatively large and efficient sub-market. These are the securities of companies that have large capitalizations, exhibit regularly substantial trading volume with small daily price fluctuations for their equity issues, and attract a large number of research reports and much financial press.

What will be the likely losses to pension funds? While we cannot make any quantitative estimates of the reduction in active management returns due to varying degrees of security exclusion, certain qualitative observations can be made.

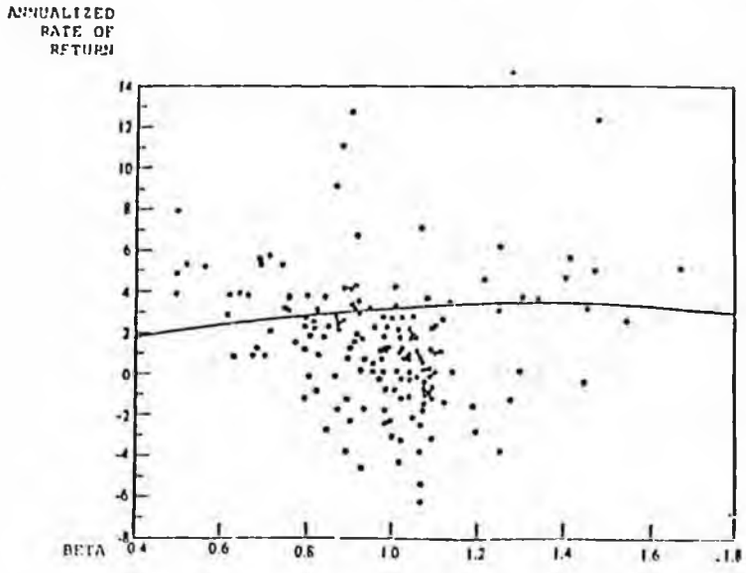
Institutional investors generally do not have a good record of producing extra returns through active management. This situation results from the combined effect of having to invest in the most efficiently priced segments of the market, due to legal and practical considerations, and of not being able

to respond quickly when opportunities do present themselves, due to organizational problems. Moreover, they not only have to outguess the market a little bit over time, but must do so consistently if they are to make up for the added transaction costs, management fees, and inevitable bad security selections produced by active management.[40]

Figure I shows the return and risk characteristics of a representative sample of bank and insurance company managed pension portfolios over the seven-year market cycle 12/31/71 to 12/31/79.

FIGURE I

Risk-Adjusted Equity Portfolio Returns
12/31/72 - 12/31/79



(Peat, Marwick, and Mitchell, 1980)

Nearly three out of four funds failed to outperform the risk-adjusted market return over this period. This research has been confirmed in a number of studies. Moreover, there does not seem to be much stability.

Similar performance measures for pension fund bond portfolios are not available. It is possible that active management had a better payoff in this arena, since it is generally believed that efficient pricing in the bond market is somewhat less prevalent than in the equity market, though it is still the rule. However, by and large, active bond portfolio strategies are not dependent on the availability of certain companies, but on choices of maturity, coupon, sector, and quality. Only in the much more limited trading based upon judgments about specific bond issue undervaluation could exclusion directly interfere. And only in the case of those companies excluded will this type of trading be restricted.

In summary, the effects of exclusion on active management are likely to be very limited. Active management which is implemented through market timing or betting on particular industries, bond maturities, and other characteristics not specific to one or a handful of companies will be unaffected. Selection based on company specific factors, e.g., Acme, Inc. is coming up with a great new widget-making process, can be impaired. But given the relative efficiency of the markets in which pension funds trade and their record at producing added return through securities selection, this adverse effect should typically not be significant.

4. Will transaction and management costs get too high?

Besides increased risks or decreased return, pension funds must also consider the transaction costs which might arise from a policy of exclusion. Transaction costs include both brokers' fees and the bid-ask spread.

Brokerage commissions on stock transactions for large pension funds average about 0.22¢ of the dollar amount traded. **** Long-term bonds are usually traded net of broker commissions, so we assume no separate fee.

Each round trip (sale and replacement purchase) also involves absorbing the bid-ask spread; the difference between what a buyer pays and what the seller gets. It includes both the profit made by the securities specialist making the transaction, and the price shift caused by the imbalance of supply and demand when a large sale or purchase is made. This spread depends on how actively the issue is traded, the size of the

**** Today this figure would be considerably below this amount.

transaction, and whether the sale is perceived as being in response to some special information regarding the value of the securities. A reasonable round trip bid-ask spread would be 0.5% to 2.5% of the market value of the transaction for stocks and 0.15% to 0.45% for bonds.[41]

These costs would occur in the following instances:

- o when the funds sell any proscribed securities currently in their portfolios;
- o when the funds buy securities to replace the divested ones;
- o when buying or selling beyond these two cases is made necessary by the challenge of diversifying from a smaller universe of permissible securities;
- o when average transaction costs rise over the long-term due to the fact that the average security positions of the portfolios will be smaller and in somewhat smaller companies, with the bid-ask spreads for these securities normally larger.

Neither the first nor second instances of costs would be present if the funds simply halted new purchases of proscribed securities, as opposed to purging existing holdings. The third and fourth instances of costs will be virtually immeasurable if exclusion is selective as opposed to extensive.

Using the above estimates, for every dollar of stock divested there will be a basic round-trip transaction cost of approximately 0.99 to 2.99 cents. For every dollar of bonds divested, there will be a basic round-trip cost of approximately 0.15 to 0.45 cents.

These figures may well overstate the basic costs. A pension fund would have some control over these costs. First, if there is no strict deadline for the purging of the proscribed holdings, the securities could be slowly phased out, permitting smaller individual sales of each holding over time to depress the bid-ask spread. Second, phased divestment would also possibly permit the funds to locate other large institutional investors who happen to be interested in acquiring large blocks of particular stocks or bonds. Third, to the extent that a pension fund makes clear that the securities are being sold for potentially non-economic reasons, the bid-ask spread will shrink.[42]

The analysis so far applies to the first two of our four possible instances of added transaction costs. The latter two

instances, which persist over time, are harder to pin down: portfolio rebalancing and trading in less actively traded securities.

Our portfolio optimization model suggests that in the interest of further balancing the portfolio to minimize risk, it may be necessary to replace some non-proscribed holdings in the portfolio once others have been sold for social responsibility reasons. It is not enough to simply replace the excluded holdings.[43] However, if a fund has large net inflows of money as the typical pension fund will continue to experience for many years to come, much of this additional restructuring of the portfolio can be accomplished through the allocation of new security purchases.

In addition, extensive exclusion would force the funds to trade in relatively smaller, less actively traded securities with higher bid-ask spreads.

To summarize: For every equity dollar the funds divest, there will be a one-time transaction cost of approximately 1.99 cents. For every bond dollar the funds divest there will be a one-time transaction cost of approximately 0.30 cents. All else constant, this would depress the return on the total funds that year by the sum of (a) 0.199 times the stock divested, as a fraction of the value of the entire fund, and (b) 0.0030 times the bonds divested, as a fraction of the value of the entire fund. In addition, there will be indeterminate costs relating to portfolio restructuring and long-term increases in the bid-ask spread.

21. Business Week, op. cit.

22. This conclusion has so far been borne out in the experience of the University of Wisconsin endowment fund, which cannot invest in any companies which do business with or have employees located in South Africa. See "South African stock is dumped, but no ill effect yet: Heritage," Pensions and Investments, November 5, 1979.

23. Roger Ibbotson and Rex Sinquefield, "Stocks, Bonds, Bills, and Inflation: An Update, Financial Analysts Journal, July-August, 1979.

24. Pensions and Investments, "Social Investing Could Hurt Fund Performance," November 19, 1979, describing study by Computer Directions Advisors, Inc.

25. Corporate Data Exchange, Pension Investments: A Social Audit, 1979.

26. For a look at the expanding use of modern investment theory in pension fund management, see the special section, "MPT: Second Generation," in Pensions and Investments, February 18, 1980.

27. For a more detailed account, see William Sharpe, Portfolio Theory and Capital Markets, McGraw Hill, New York, 1970.

28. James Lorie, "Diversification: Old and New," Journal of Portfolio Management, Winter, 1975.

29. The use of this methodology was inspired by and draws upon the work of Andrew Rudd. See A. Rudd, "Divestment of South African Securities: How Risky?", Journal of Portfolio Management, Spring, 1979.

30. This software is used by a number of large money managers including PERS' equity advisor, Citicorp Investment Management. PERS regularly receives analyses of its portfolio based on these programs, which incorporate modern portfolio theory.

31. Corporate Data Exchange, Pension Investments: A Social Audit, 1979.

32. Baldwin, Tower, Litvak, Karpen, Pension Funds and Ethical Investment, 1980.

33. American Consulate General, Johannesburg, American Firms, Subsidiaries and Affiliates, South Africa, July, 1979. Corporate Data Exchange, U.S. Bank Loans to South Africa.

1978. We did not proscribe news organizations if they only had local bureaus in South Africa.

34. Because of the statistical independence of systematic and non-systematic (residual) risk, the total risk of a portfolio is less than a simple sum of the systematic risk and non-systematic risk. Rather,

$$\text{total portfolio standard deviation} = \sqrt{(\text{systematic risk})^2 - (\text{residual risk})^2}$$

Thus when residual standard deviation goes up by one unit, total standard deviation increases by less than that.

35. The fact that the standard deviation of C is larger than D even though a similar number of companies are being excluded is an artifact of the computer program. The program only produces approximations of the optimum portfolio. Because of certain idiosyncracies in the program a closer approximation can c ten be reached when starting further away from the optimum, as is the case in Scenario D. If the program was allowed to produce the true optimum portfolio we would find that the standard deviation of Scenario C would be slightly lower than that of Scenario D instead of the reverse, as pictured in Table I. For the same reasons, the coefficient of determination in Scenario C is slightly lower than that in Scenario D. In reality, the reverse would prove true. This same artifact will be seen in Tables II and III.

36. Rudd, op. cit.

37. Of course, market risk is 1.01 times higher as well.

38. In fact, the risk measures for Scenarios B, C, and D in Table II are all slightly lower than in Table I. One would expect them to be slightly higher. Again, we see the fact that the computer program only produces very close approximations of the optimum post-exclusion portfolios. When the risk characteristics of the optimum portfolios are very similar, it may produce a closer approximation when starting further away from the optimum, as is the case here. This is an additional testament to the small impact of exclusion on risk reduction.

39. A case in point may be the often incorrect view that good pollution control is associated with relatively low corporate earnings. See J.A.T. Marlin and J.H. Dragdon, Jr., "Is Pollution Profitable," Risk Management, April, 1972.

40. For a review of evidence on this point, and on the efficient market hypothesis, see Frank Reilly, Investment Analysis and Portfolio Management, Dryden Press, Hinsdale, IL, 1979; Jerome Cohen, et al, Investment Analysis and Portfolio Management, Irwin, Homewood, IL, 1977; and James Lorie and Mary Hamilton, The Stock Market: Theories and Evidence, Irwin, Homewood, IL, 1973.

41. Ranges for bid-ask spreads taken from: Yale University, Report of the Ad Hoc Committee on South African Investments, April 15, 1978, and Stanford University, Exclusion of Investments in Securities of Corporations With Assets Within the Republic of South Africa, October, 1977.

42. "This follows because the trades are 'informationless'; in other words, they arise out of necessity rather than superior information as to the future prospects for these companies. For this reason, the dealers need not protect themselves from an information disadvantage by demanding a substantial spread. Instead, they could be handled in a similar manner to index fund transactions with a similar cost." Andrew Rudd, "Impact of Non-Traditional Investment Criteria on Portfolio Performance," Testimony presented to the President's Commission on Pension Policy, December 11, 1979.

43. Any transaction costs involved in expanding the number of companies in the equity portfolio could be considered part of this rebalancing category as well.

44. The implementation of constructive investing is dealt with in much greater detail in Lawrence Litvak, Pension Funds and Economic Renewal, Council of State Planning Agencies and Studies in Pension Fund Investments, published by the Conference on Alternative State and Local Policies. Especially consult the following Conference publications: Investing in Ourselves, by Coltman and Metzenbaum; Revitalizing New York City's Economy: The Role of Public Pension Funds, by Ruth Messinger and Municipal Research Institute; Public Employee Pension Funds: New Strategies for Investment, by Webb and Schweke; Pension Funds: The Issue of Control, by Marc Allan Weiss; Investing in Minnesota: A Proposal to Use State Moneys for Maximum Benefit; by Tripplet; Packaging Housing Mortgage Loans: Strategies for California, by Harrington; Reforming Public Investment Policies: Proposals for San Diego, by Walker; and Redirecting Public Funds: A Strategy for the City of Berkeley, by Berkeley Citizens Committee on Responsible Investments.

[The prepared statement of Ms. Bavaria follows:]

TESTIMONY BY JOAN L. BAVARIA, PRESIDENT, FRANKLIN RESEARCH & DEVELOPMENT CORP.

Mr. Chairman and committee members, thank you for allowing me the opportunity to testify on the proposed legislation. The movement to divest public pension funds of the stocks and bonds of companies doing business in South Africa has sparked widespread public debate and in the process, raised fundamental questions regarding the financial implications of such actions. These concerns, while very legitimate, have tended to shift the agenda for debate away from its primary focus—how we can best affect a change in South Africa's apartheid system. We hope that today's testimonies will serve to quiet these financial concerns and return the debate to its proper arena.

The proposed bill raises three economic issues in arguing against divestment. These issues are: (1) Whether the pension funds will be exposed to greater risk and/or lower return became of the smaller list of available investments, (2) whether the restrictions will create significant added expenses in terms of transaction costs and increased staff time, and (3) whether the restrictions are manageable for a fund as large as the District of Columbia Retirement Board's fund. I will respond to these issues in that order.

The argument has been made on both a technical and hypothetical basis that by disallowing investment in the around 400 firms doing business in South Africa (out of 6350 companies on the major exchanges), that risk and return will be negatively affected. The basis for this argument is that many of the country's largest companies, representing 30.1 percent of the market capitalization of the S & P 500, are included among this group. Further concern is expressed over the fact that these restrictions will eliminate certain sectors of the S & P 500, such as automobiles, chemicals, and drugs, from investment consideration.

While hypothetically convincing, a series of studies have not supported these fears. Rather they have shown that over time South Africa Free (SAF) companies have outperformed the restricted stocks with a minimal amount of added risk.

The Chemical Bank of New York, the U.S. Trust Company of Boston, and Trinity Investment Management Corporation of Boston, have each conducted historical studies indicating that SAF portfolios have performed consistently (retroactively) better than unrestricted portfolios. In the Trinity Management study, their SAF universe of 439 companies enjoyed a 3 percent absolute annual return superiority over the restricted stocks. This increase in return occurred with an insignificant increase in risk. The beta (measure of risk) for the SAF universe was 1.16 as against 1.12 for the restricted stocks.

Our own retrospective study of the District of Columbia Retirement Board's fund further supports these findings. Over the past nine years the restricted stocks in this portfolio had a growth in earnings and price appreciation (ex dividends) of 8 percent a year. The unrestricted stocks, mean-while, experienced earnings growth of 11.2 percent with price appreciation of 21.5 percent per year (ex dividends) over the same period.

It should not be surprising that these studies have shown that SAF companies have grown faster than South Africa-related firms. The companies in South Africa tend to be heavy industrial or mature firms who by virtue of their size do not have the incremental growth potential of smaller companies. I cite as corroborating evidence the 1982 edition of Stocks, Bonds, Bills, and Inflation: The Past and the Future, by Roger Ibbotsdon and Rex Sinquefield. According to this study, the compound annual return from 1926 to 1981 of small stocks (their definition) was 12.1 percent while the return for all stocks was 9.1 percent. These figures are consistent with the Trinity and Franklin Research studies, which have shown a 3 percent higher return for the relatively smaller, South Africa Free companies.

While often conceding this point of return, critics of divestment have raised concerns over a decrease in quality due to the lowered capitalization of SAF companies. These fears, though, are also unfounded. The Trinity Study has exhibited that an SAF portfolio creates insignificant overall additional risk while maintaining an adequate rate of capitalization. The average net worth of the 439 companies included in this study was $1.2 billion.

Likewise, there is no reason to believe that quality should be threatened. As even the Meidinger Report states in its conclusion, the preponderance of all issues falls above an "A" rating—acceptable by almost any standard. The retirement board's current managers have not found it necessary to stick to even this standard. Since

not many managers hold more than fifty (50) securities in any one fund, the maintenance of a quality highly capitalized, and diversified portfolio is possible.

The second argument raised is that these restictions will create significant added expenses in terms transaction costs and increased staff time. Our analysis and experience indicates that neither factor is a problem in the case of South Africa screens.

Under the divestiture proposal, using as a point of reference the December 31, 1983 holdings of the funds, the common stock of 33 companies would be sold. Since, in some cases, more than one of the stock managers holds a security, the total common stock sale transactions would be 43.

Brokerage commissions (using 6¢ per share) would total about $210,000 to both buy and sell the necessary securities. This figure is .09 percent (.0009x) the approximately $226 million now invested in common stocks, which is a very low transaction rate in our industry. Also, since the average turnover in the equity portion of an institutional portfolio annually runs from 25 percent to 75 percent, a significant portion of the transaction costs related to the divestiture can be considered normal costs of doing business. With the divestiture plan allowing two full years for the sale of restricted stocks, we do not feel that the turnover or transaction costs can be considered excessive.

We do not feel that the imposition of this restriction will significantly add staff time in managing the Funds. I have managed restricted individual portfolios for a number of years, and have found the South Africa restriction the easiest and least time-consuming.

The final concern is that the Fund will be too large to be efficiently managed under this restriction. Again, while this concern is legitimate, there is no evidence to substantiate the fear. I feel that we and others have provided data indicating that it is quite feasible to find quality, growth-oriented investment opportunities in SAF companies.

Several cities and states have enacted divestment legislation over the past two years that will force the divestment of up to $300 million, nearly the current size of Washington D.C's fund. No problems have been encountered thus far with the orderly divestment of restricted bonds or stocks or the efficient management of these funds. For example, contrary to rumor, the fund of the State of Massachusetts, though different from that of Washington, has had no problems in enacting South Africa-related restrictions with their $1 billion Fund (nearly 3 times the current size of Washington's). Seventy five percent of the necessary $90 million was successfully divested during the first year. The swaps implemented last spring improved the quality of the portfolio, improved current cash flow by over $2 million per year, decreased volatility and risk, and will ultimately gain the fund up to $36 million over the life of the new bonds. The swap also "saved" the portfolio up to $15,000,000 last year in possible market value erosion due to falling bond prices.

In summary, an investment community generally opposed to political interference, sensitive to pension law obligations, and unfamiliar with considering the social implications of their actions, has raised several financial questions regarding divestiture. To date, however, there is no evidence that divestiture has negatively impacted any pension fund. In fact, there is a growing accumulation of studies and real examples that show the opposite. Therefore, given prudent execution by the Fund's managers, we conclude that the divestiture of stocks and obligations of companies doing business with South Africa would itself cause no economic damage to the pension funds of the City of Washington D.C. Given this reality, we stress that the divestiture issue is not one of economics, but one of conscience and political judgment.

QUESTIONS FOR MS. BAVARIA AND DR. SCHWARTZ

1. Could you draw the distinction for us between asset allocation and portfolio diversification and explain how the South Africa restriction would effect the asset allocation aspect of portfolio management?
2. How is divestiture possible if whole industries, such as auto manufacturers, would be effectively excluded?
3. If the District's retirement fund is already restricted to larger companies, won't the S. Africa restrictions result in limiting portfolio diversification?

Mr. FAUNTROY. Thank you.

The Chair would like to do two things before commencing questioning of the panel, and the first is to yield to our distinguished colleague, Mr. Stark of California, to enter into the record a statement which he would wish to make at this time.

Mr. STARK. I thank the Chair, and I do not want to slow down the proceedings. I want to commend the Chair and the committee for their approach to this delicate matter, and as someone who was here with the Chair when the home rule bill was written, I think that we are approaching this quite properly.

I don't think it is an investment decision, but a question of constitutional rights and whether or not the District is within the purview of their charter, and I think they were, and I support the Chair's position and ask unanimous consent to have that statement on the record.

Mr. FAUNTROY. Without objection, so ordered.

The second thing I would like to do prior to a brief recess is to say to Dr. Schwartz and Ms. Bavaria that the members of the committee have read with great care your testimony before this committee, and also your testimony before the City Council, and when we return for questioning, we would like—I would like you to be prepared to answer for me whether or not the analysis which you did were those which were described earlier as being perhaps somewhat deceptive and distorting.

Would you be prepared to answer that for us? The hearing will recess.

[Recess.]

Mr. FAUNTROY. Dr. Schwartz, I assume?

Mr. SCHWARTZ. I assume there will not be further hearing.

Mr. FAUNTROY. We want to complete this hearing.

Mr. SCHWARTZ. I would find it extremely difficult to be here tomorrow.

Mr. FAUNTROY. We are going to complete the hearing now.

Let me say in that regard, you have been extremely patient. You have been here throughout the day. You have provided your testimony in advance and as I indicated, we have had the opportunity to read your testimony before this committee, and before the City Council itself, and are very much impressed, and I recall when an earlier witness indicated that the announcements on which the judgments were made by the City Council were in fact made, in some instances distorted and deceptive.

Would you clear me up on that?

Mr. SCHWARTZ. Yes, I had made notes during the testimony of David Eager and Professor Schotland, and if I take them in these broad comments that I have, without being personal, but looking at the facts, I conclude that the testimony was in sweeping generalization, and to go down each item, rather than their looking at the facts and computer run.

First, there was reference to a survey and the response was 73 institutions questioned. Now, that survey reminds me of many of the letters which I received which ask to fill out a questionnaire to give my views and then says at the end, "You will enclose $25 in order for this to be registered, because we want to publicize the view of the recipients of this letter."

And obviously, that is bought testimony because in most instances, I don't support an organization that sends that kind of a fund-raising letter to me so that the questionnaires that they asked were not based in terms of the answers on investment counselors working in the field of socially responsible investing.

Quite the contrary, the area, even the geographic area covered was the Central part of the United States and Southeastern part of the United States were quite different than the results you would get from New York or Boston, Massachusetts, or California, or Wisconsin or those areas that would be concerned with this and have had investment advisers.

Similarly, the negative attitude toward taking on responsibility where you have divestment limitations or direction, I testified in, before the board of trustees of the University of Minnesota—I remembered that listening to the testimony this morning—where there were three investment advisers for that university fund, and they were all present and all testifying.

One of them said that if divesting was approved by the Board that he didn't think his firm could go on handling the investments. The other two said the restrictions might hamper us, but if these are directions, we will be glad to see what we can do; and when I testified, I said I would be delighted to take on investing part of that portfolio with whatever restrictions they wanted to put.

Similarly, in the University of Wisconsin, and that is one of the earlier divestment decisions. Two years following divesting in that portfolio showed a remarkable improvement in performance, and that is public record which is available. I wrote to the investment council for the University of Wisconsin when I got those reports of performance, and I asked about their doing additional funds, and the reply I got was that they were not interested in doing special social responsible investing, that they did it because their client asked them to. Here was, for the record, really a very good performance.

Another point that was used was referenced by both Professor Schotland and David Eager to say if a portfolio investment impreves 1 percent, then the return is a 10 to-15 percent increase permitted in pension fund payments. That is true. It is almost a truism.

But there is no indication in the funds that were being examined that there would be less than a 1-percent improvement relative to the fact of divestment or not. What I am saying is they cited actuarial figures without any basis of investment analysis on actual portfolios.

Referring to the 10 largest banks and 10 largest insurance companies and investment managers, I would like to say my record is quite public in this area, and I think that the Boston company which is a wholly owned subsidiary of Shearson/American Express is among the 10 largest investment counselors, and I saw no questionnaire of any kind, no telephone call coming to me, nor was I aware of anything going to the Boston company.

So I wonder what were the 10 largest? Even assuming they were the 10 largest, they are exactly the ones that don't want to be in divesting. Look at who they are and where they are. That seems to me to be asking the right question in the wrong place.

Mr. FAUNTROY. Thank you.

Ms. Bavaria, could you draw the distinction for us between asset allocation and portfolio diversification and explain how the South African restrictions would affect the asset allocation aspect of portfolio management?

Ms. BAVARIA. It shouldn't affect the asset allocation aspect. The asset allocation refers to the choice that managers make between holding their assets in money market or cash equivalents which are higher liquid or hard assets like gold and real estate, in fixed income vehicles, Treasury vehicles, versus common stocks.

When managers make the decision to invest in common stocks, then they diversify and choose which sectors of the market they want to be in. But asset allocation refers to the broader macroeconomic decision process.

Mr. FAUNTROY. Dr. Schwartz, Mr. Eager suggested to us that this measure would totally restrict investments in chemicals, drugs, and metal holding machinery. Do you agree with that?

Mr. SCHWARTZ. No, I don't think that we would find many large companies in a few of the industries he cited, but I know there is no industry that would be completely excluded, that you couldn't find some company or companies that would be appropriate investments. Recognizing, of course, that first you determine whether it is a good investment and then you determine whether it fits the social responsible criteria.

Take the computer industry, which is now coming back again, and look at the record of IBM which in the last year and a half has had a very significant increase in the value of the stock, but there was a long period of time, years before that, recent years, in which the stock was a nonperformer. In the—IBM is excluded because of activities in South Africa.

But there is Wang, Apple, and Tutronics and a series of others, not the size of IBM, that are available. There are whole industries which are not excluded because of South Africa.

There was a discussion with the other panel about the exclusion of real estate in investments. Now, it so happens that the construction industry is the largest industry by capitalization in the United States. It is the major industry in terms of money going in. If you look at housing, public roads, public buildings, at all construction, and mortgaging and real estate ownership, and it is a very significant part of asset allocation in the pension fund.

There are other industries, like the entertainment industry, where there are very few companies in South Africa, and that has been a good performing industry of recent times.

The retail industry, and then areas of manufacturing, of significant manufacturing areas which do not enter into South Africa at all. I find no problem in structuring a portfolio that would be representative of what I think would be the area for appreciation.

Mr. FAUNTROY. Thank you.

Ms. Bavaria, one witness today spoke of the cumulative effect of State and local and other divestment of major U.S. corporations, implying that it would hurt our domestic economy.

I wonder if you would care to comment on that?

Ms. BAVARIA. Well, I can't draw that correlation at all. I don't understand the statement. I would disagree with the statement simply because I don't understand it.

Mr. FAUNTROY. The idea was that the District's action may not have an impact on the national economy, but if more Philadelphias and Massachusetts and Michigans and so on come along, it could wreck our economy.

Ms. BAVARIA. Well, ultimately at some point if there were huge funds that divested, there might be interesting asset allocation questions that would be raised, but they might be more interesting than negative.

Mr. FAUNTROY. I think so.

Mr. SCHWARTZ. In that regard, two companies of fair size have withdrawn from South Africa and a number of banks have made commitments, and banks of fair size, not to make new loans to South Africa. So if this divesting grew and became significant, it is much more likely that those companies which are in South Africa, and where it is probably less than 1 percent of their total operation, would have another look at what they are doing and say, "Well, maybe we don't belong there, this is such a small part of our operation, and it is a risk, there are problems in South Africa, and maybe we should withdraw," and then follow the decision that Poloroid and that Chrysler has made.

Mr. FAUNTROY. Thank you very much.

I would yield to the distinguished gentleman from Pennsylvania, Mr. Gray.

Mr. GRAY. Thank you, Mr. Chairman, thank you very much. I just have three quick questions, and any one of you can answer them.

Are you aware of any legal precedent under either the commerce or supremacy clauses which have ruled disinvestment unconstitutional or, similarly, have held such actions to be constitutional? I know that is not in your area of expertise, but are you familiar with any?

Ms. BAVARIA. The case law on social divesting is nil. I think there is something pending in California on union pensions where mortgages were deliberately placed under market rate, but that is not what we are talking about here. I don't think there is anything like that.

Mr. GRAY. Given the opinions and——

Mr. SCHWARTZ. Excuse me, a Washington attorney about 2 years ago, Michael Leibig, did a study of social responsibility from investing from a legal point of view, and it is a very interesting little pamphlet that the article has now been separately printed from, and his conclusion, after going through the history of legal changes, when, for example, in early investing in New York and Massachusetts you couldn't invest in bonds. You couldn't invest in banks or in utilities or in railroads.

Then the whole turn-around historically from what is considered the prudent person occurred. His conclusion was if you want to assume fiduciary responsibility, you had to look at the social impact of the investment, that it was a necessary part. That may be kind of an extreme, but it is a very significant approach because a company that disregards in the community all the social aspects, or in their employee relations, may be quite negative in relatively short time in their income and investment activity.

Mr. GRAY. Given the studies, opinions, and actual evidence of alternative investments in restricted portfolios which have demonstrated actuarially sound investments, how do you explain the reluctance and reservation of the D.C. Retirement Board and the Meidinger Co. to support this action? Given basically your testimony, your testimony is that there is no evidence of lack of soundness or huge losses or threat to the pension funds or the workers of the city of Washington, D.C. Given that, can you perhaps shed some light on how you explain the reluctance and reservation of the Board, Pension Board, and also their consultant in their study?

Ms. BAVARIA. There are a bunch of reasons for that; the first may be unfamiliarity. They are not equipped or they have not done this. They have not divested and realized it is doable.

We instituted socially screened portfolios in reaction to clients, and we didn't start selling it to clients in the beginning. We had it proved to us that it could be done. I think the investment managers like to act with as few encumbrances as they can. This is just one more restriction that causes one higher degree of difficulty.

Dr. Schotland is making some macroeconomic assumptions I think that we discussed.

Mr. GRAY. What about the Meidinger study? Can you explain why? Or is it just a client relationship there?

Mr. SCHWARTZ. First, I really don't feel it appropriate for me to become involved in directing the answer to the D.C. Pension Board. As it is, I am known as the Maverick of Wall Street, and I don't suppose I want to create more problems. So I say, in generalization, that those who oppose divesting do so from one of two bases: One is a lack—as Ms. Bavaria said—of understanding, a lack of knowledge of what the facts are, what the performance measurement is and just not understanding it.

A second is using the investment area as an excuse, because fundamentally they are opposed to divesting and that this is an easy out. Those are the two principles, two principal reasons.

The third is that it does require more work, a good investment manager has to put more time in, put time in finding and working in a more limited universe. Certainly, if you exclude all the things I do for some of my Quaker portfolios, it does take a little more work, and I don't know that all money managers are interested in making that additional effort.

Mr. GRAY. Very interesting on that last comment in terms of your perception of those two reasons. Very fascinating. I have experienced the exact same thing.

Could you explain, then, the comment made by the representative of the Meidinger Co. that when I asked the question about Chemical Bank, and the company in Boston, their response was that, well, that is not really a good example. They really didn't handle much in terms of South Africa and that it really didn't have an impact on their evaluation of the negative implications.

Mr. SCHWARTZ. I certainly can address those two institutions from personal experience.

The Chemical Bank would be one of the 10 largest banks. I don't think that generally in regard to their corporate clients they want to take an open public position on divesting.

I do know that until 2 years ago—because that is the last time I was in touch with the people involved—they had an endowment division that handled accounts that didn't want any investments in South Africa, and when I cited the internal report of Chemical Bank that I had objected to, I was told by somebody working in the area that it would be uncomfortable if I used names, and now I

don't know where Chemical Bank is on this, but it is certainly correct when Mr. Eager said they are not large amounts. It is Center of Endowment funds, and we are not talking about a really large amount, like a half billion or more than that.

I am a coadviser on a fairly large-sized pension fund with the Chemical Bank, and I have dealings with them, and I know quite well what their operation is.

In regard to the U.S. Trust Co., Bob Scivin, who is really the vice president that I think began this area of work at the U.S. Trust Co., has been very positive about the funds that they handle in the social responsible area, and he is, or their unit is an adviser to the Calvert fund, which is one of the new mutual funds concerned with the exclusion of certain areas of investment from their portfolio. Some of the testimony that Joan Bavaria read came from Mr. Moody, who is part of the U.S. Trust Co. in Boston.

There is an article in the New Age Journal in November that has—it is a magazine that has a large report from the U.S. Trust Co. with a picture of Bob Scivin and it is a very, very positive report in terms of this special kind of investment. In fact, I may have a copy of it.

Mr. GRAY. Are you saying, in essence, that Mr. Eager's viewpoint was incorrect when he said that Chemical Bank and U.S. Trust, both of which have concluded that South African free investments performed better in unrestricted portfolios, and that was his answer in light of the evidence that the committee has which seemed to suggest otherwise? Why would evidence come up with such an evaluation if Chemical Bank and U.S. Trust of Boston show a different pattern? Does the committtee have the wrong information?

Mr. SCHWARTZ. I repeat, Chemical Bank, I have not been in touch with that unit for 2 years. I know that 2 years ago they had a small group handling endowment funds, they were quoted in a Barron's article, and their performance was reported as superior in the unit for funds that excluded South Africa.

In terms of the U.S. Trust Co., you could say that their universe is maybe 300 million, and that is not a very large figure when you look at total pension funds which approach—if they are not in excess of—$1 trillion now, public and private pension funds included.

I have been on panels with people from the U.S. Trust Co., and I have heard them say, and I have read in articles that their performance and their specialized funds have been superior to their own funds. I think that Ms. Bavaria may have something to add to that.

Mr. GRAY. Would you like to comment on that, Ms. Bavaria?

Ms. BAVARIA. I think we have to deal with reality, they are extrapolating into huge sums of money, billions and billions of dollars, when they are talking about this. The reality is there have been no funds managed for a period of time that are measurable that restricted South Africa stocks.

I think the more credible studies are those that project what the characteristics of companies and the expected performance on the basis of—we used 40 financial characteristics when we screened the D.C. portfolio last spring. We found in almost all the 40 areas the companies that would be left, the nonexcluded companies, were superior.

There just isn't enough evidence to support any statement one way or the other pertaining to huge funds.

Mr. GRAY. In the——

Mr. SCHWARTZ. Except some studies have been done of the S&P 500 separating companies out in South Africa and over 10 years, ending October 1983, the remaining S&P 500 performed better in every section of the time period of that 10-year stretch, and the figures that were cited this morning by Mr. Eager were correct in terms of—generally correct in terms of the percentage of the S&P 500 that were affected by investing in South Africa.

But he didn't say that there have been computer runs and that performance by the exclusion of these companies was superior.

There are—and I talk as an economist—certain reasons for that that may not be repetitive, such as for a stretch of 3 years of petroleum companies, major companies in South Africa, had a poor performance and they skewed that result.

Also, better performance were normally during the period from smaller companies, although that wouldn't affect the S&P 500. Those computer runs done with the 500 S&P's stand firmly in support of what we are testifying to now.

Mr. GRAY. Two last questions, and I will be finished, Mr. Chairman, if I may.

Therefore, in your opinion the District Council's action does not necessarily mean higher risk investments and lower rates of return; that actuarily sound alternatives exist for the pension fund investment, is that correct?

Ms. BAVARIA. That is correct.

Mr. GRAY. Would that be a correct summary of your combined testimony here today?

Mr. SCHWARTZ. I think so. I would like to see there—I would like to see them have ability to invest in real estate, but I assume they can purchase bonds and stocks of companies that are on the public market in the real estate area and take advantage of it that way.

Mr. GRAY. Why do you say that?

Mr. SCHWARTZ. Well, because there is—certainly among public funds now, there is a growing interest in helping develop local industry as against runaway industry or companies that invest abroad in order to get low-cost labor.

One of the local industries is construction and housing. So we have directed mortgages of some of the local pension funds to see that housing is built in the community, and I think that makes sense. There is more of that developing now called target investment. New York City has been developing that for the last few years.

Mr. GRAY. The last question, one of those who testified earlier made this statement: Massachusetts has the most poorly funded State fund in America. Only this month Governor Dukakis signed emergency legislation introducing major change to try to bring that fund up near normal.

Second, the fund's chief investment officer reported in May that the fund had lost $14 million as a result of a law passed only months earlier.

southern africa
PERSPECTIVES

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U.S. CORPORATIONS IN SOUTH AFRICA:

A Summary of Strategic Investments

There are more than 350 U.S. corporations operating in South Africa today with direct investments totalling nearly US $2 billion.[1] In addition, there are more than 6,000 U.S. firms doing business in South Africa without having subsidiaries there. While Citibank is the only U.S. bank with a number of branches in South Africa, more than 125 U.S. banks have made loans to South Africa totalling nearly US $2.4 billion,[2] much of it to the government. U.S. firms and individuals have also invested at least US $2 billion[3] in South African stock, mainly gold, although with the recent surge in the price of gold this figure has most certainly increased. This makes total U.S. investments in South Africa well over US $6 billion. These figures represent no less than a tripling of U.S. investments since 1960, making the U.S. the largest foreign investor in South Africa next to Britain.

The U.S. share of foreign investments in South Africa has been steadily increasing over the years. In 1960, the U.S. held 11% of total foreign investments, but by 1978 it was at least 20%.[4] It must be noted that these figures are only estimates which could even be higher since figures on U.S. investments in such strategic areas as mining and smelting, petroleum and transportation are suppressed by both the South African and U.S. governments • • •

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South Africa has also recently managed a trade balance-of-payments surplus and the U.S. has greatly assisted by steadily increasing its South Africa imports each year to the current level of US $2.3 billion. U.S. exports to South Africa have also grown to US $1.1 billion.[5] However, the fact that the U.S. now imports over twice as much as it exports is a reversal of previous trade patterns and indicates a clear dependency on South African raw materials as well as contributing to the U.S. trade deficit.

This enormous growth in U.S. investments in South Africa began in the last decade, precisely when apartheid was becoming even more repressive following the Sharpeville massacre of 69 blacks peacefully protesting against apartheid. Fearing further black unrest, the apartheid regime tightened its pass laws and other means of control while using increased foreign investments to build up white military and police protection. The investments of U.S. corporations and bank loans and credits have been absolutely crucial in building South Africa's economic and military power.

U.S. INVESTMENTS IN STRATEGIC SECTORS

The most significant aspect of U.S. investment in South Africa is its strategic importance in maintaining apartheid. The U.S. provides high level technology that South. Africa does not presently possess. These investments are concentrated primarily in the manufacturing sector, with U.S. corporations producing sophisticated capital-intensive equipment that lessens the dependence upon African labor. South Africa's foreign technology dependence in the manufacturing sector is best illustrated by the fact that the official Fanzen Commission report indicated that 40% of South Africa's manufacturing was controlled by foreign interests.[6]

It is estimated that at least three-fourths of direct U.S. investments in South Africa are in the hands of 12 companies, all of them in strategic sectors such as energy, computers and transportation.

ENERGY

1) **Oil**[7] is the one resource that South Africa must almost totally import. Since all OPEC nations have agreed to an oil embargo against South Africa, the apartheid regime is desperate for oil or alternative fuel supplies. U.S. oil companies dominate this sector, controlling at least 40% of the petroleum market in South Africa. Mobil and Caltex (a joint venture of Standard Oil of California and Texaco) monopolize U.S. control. Caltex has 20% of the petroleum market with over US $500 million in sales (in 1976) and nearly 1,000 service stations around the country. Mobil controls 18% of the South African market, also with sales of over US $500 million in 1976 and close to 1,000 service stations. More current figures on total sales of U.S. oil companies in South Africa are not readily available as oil is considered a 'munition of war' by the South African government and oil statistics are protected under the Official Secrets Act. However, since South Africa appears to continue obtaining oil despite the loss of 90% of its imports from Iran, U.S. companies have almost certainly increased their significance to the South African government. Recent reports in the *Journal of Commerce* (New York), indicate that U.S. oil companies and independent U.S. oil traders have attempted to increase shipments of oil to South Africa.[8]

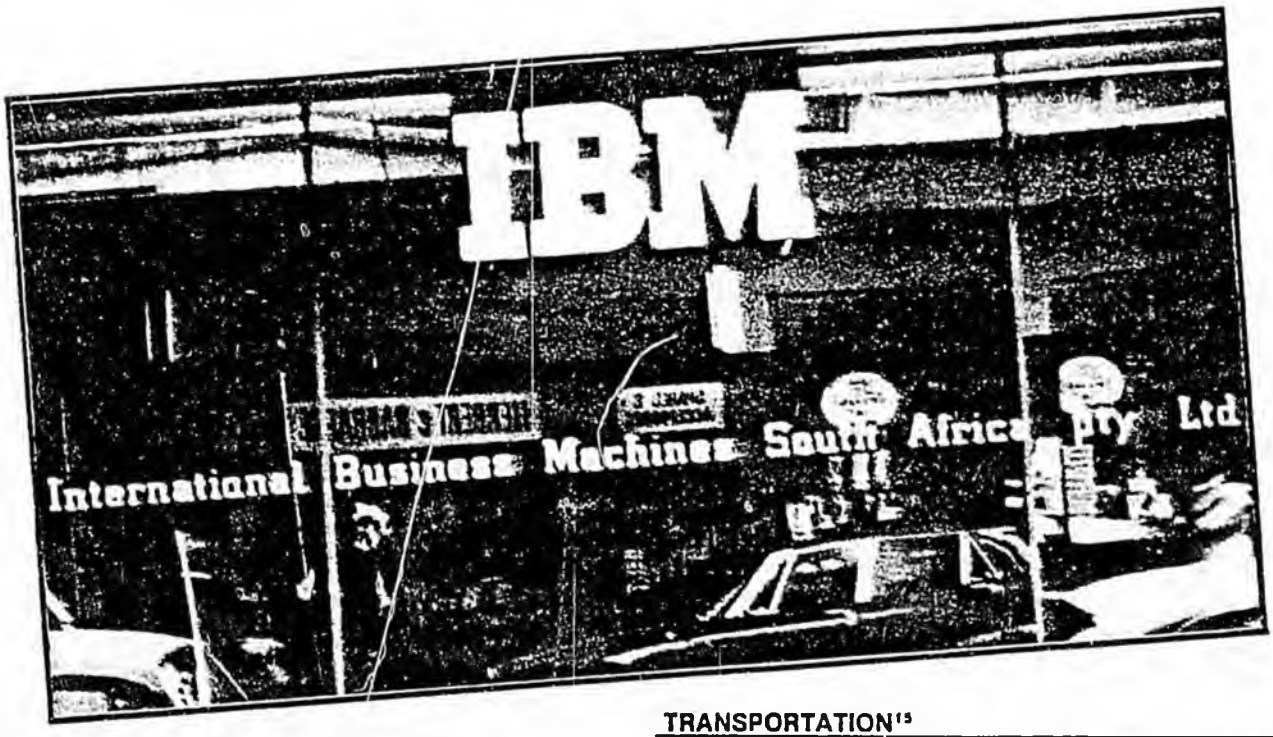
In addition to controlling 40% of the petroleum market, Mobil and Caltex also control 42% of South Africa's refining capacity. Much of this oil is supplied to the South Africa military and to the police as required by South African law.

2) **Coal**, unlike oil, is abundant in South Africa. While the country's major coal producers are Anglo-American, General Mining, Rand Mines Transvaal and SASOL, none of which are U.S. firms, the Southern Company continues to import South African coal and the trend is likely to increase. Apartheid labor makes South Africa's mining costs extremely cheap, US $4-5 per ton, compared to at least US $20 per ton in the U.S.[9]

With the threat of total international oil sanctions against South Africa, the government is relying heavily on coal to become energy self-sufficient. The South African government's present US $6 billion project to expand its SASOL coal-to-oil facility represents the largest industrial contract in South Africa's history.[10] By way of comparison, the government's total budget for fiscal year 1979-80 is US $13 billion.

U.S.-based Fluor Corporation, one of the world's largest engineering and construction firms, has a US $4.2 billion contract to oversee the expansion. Numerous other U.S. firms have smaller contracts in the project's construction including Allis-Chalmers, Badger, Chicago Bridge, Combustion Engineering, Control Component, Inc., Coopers & Lybrand, Babcock and Wilcox, Honeywell, Lenape Forge and Goodyear.[11]

In addition to the SASOL expansion, Fluor Corporation has also been attempting to market SASOL's coal-to-oil technology in the United States. This not only would represent increased



profits for the South African government, but also is a questionable energy alternative for the United States. Even if synthetic fuels prove to be a partial solution to the energy crisis, other coal-to-oil technologies are available and reportedly less expensive.

COMPUTER INDUSTRY[12]

Computers are, perhaps, the most strategic of all U.S. investments. Computers make it possible for 5 million whites to control more than 22 million non-whites. Among the most important uses of computers for the apartheid regime are in enforcing 'influx control' pass laws, for military tracking systems against guerrillas and for police communications. U.S. computer companies dominate the South African market, controlling an estimated 70%.[13] IBM is clearly the leader, with estimates of its market share ranging from 38-50%.[14] At least one-third of IBM's sales are with the South African government including sales to the South African Department of Defense, the Department of Prisons and the Atomic Energy Board.

Control Data has an estimated 13% of the computer market and Control Data computers have been reported at both ISCOR (South African Iron and Steel Corp.) and ECSOM (Electrical Supply Commission), both government parastatals.

Other U.S. computer companies include: Burroughs, whose computers have been supplied to Bantu Administration boards around South Africa; NCR Corporation, whose computers have been sold to many local government administrations; and Sperry Rand, which has supplied computers for SASOL. Computers are also produced and sold in South Africa by Hewlett-Packard, Data General, Datapoint, and Computer Automation.

TRANSPORTATION[15]

Not only do American corporations dominate this sector of the economy, but it is a critical sector since American firms supply the South African military and police with vehicles. U.S. automative plants are so strategic that General Motors has been designated a National Keypoint Industry, which means that General Motors would be part of a contingency plan in the event of a 'national emergency.' In two important secret General Motors memos, obtained by the American Committee on Africa in 1977,[16] these plans were outlined. The documents indicate the identical interests between U.S. corporations and the South African government. GM would cooperate fully with South African troops in the event of 'civil unrest.' According to the memos, in addition to supplying the South African military with vehicles, those plant personnel with military training were encouraged to join the Citizen Force Commando system, a government para-military institution. As G.M. Board chairman T.A. Murphy proudly stated, "Any of our plants can be converted to war production as clearly demonstrated in the United States in 1941."[17]

The three major U.S. firms, Ford, GM and Chrysler account for about one-third of all motor vehicle sales in South Africa. In 1976, Chrysler, by merging its South African operations into a new South African-managed firm, Sigma, provided the nucleus for what is now the country's largest motor company. According to 1977 figures, Ford held nearly 17% of the total South African market, GM nearly 11% and Chrysler/Sigma over 11%. Together these three firms account for nearly one-fifth of all direct U.S. investments in South Africa.

As for sales to the South African police and military, GM claims that through 1978 it supplied

"In the area of 1500 units" annually. Ford said that between 1973-1977 it sold 128 cars and 683 trucks directly to the South African Department of Defense and 646 cars and 1,473 trucks to the South African police.

U.S. auto firms have also demonstrated their long term commitments to the apartheid regime with increased investments each year. GM, for example, increased its investments in 1978 from US $119 million to US $157 million,[18] and there have been reports that GM has plans to build a new bus and truck facility in South Africa.

BANK LOANS

The significance of U.S. bank loans to South Africa was most clearly seen in the period of 1974-76 when South Africa was suffering from a severe recession. In 1974, total South African debt liabilities were only US $2.7 billion, but by 1976 these had nearly tripled to US $7.6 billion.[19] U.S. banks were able to mobilize nearly US $2 billion dollars during that period to rescue South Africa, with U.S. loans providing nearly one-third of the credit needed. Citibank is clearly the world leader in lending to South Africa participating in loans totalling at least US $1.6 billion.[20] Other major U.S. banks lending to South Africa include Bank of America, Chase Manhattan, Chemical, Manufacturer's Hanover, Morgan Guaranty, First National of Chicago and Irving Trust.[21]

In addition to direct loans, most of which are to the government or parastatals, many of these same banks are involved in trade financing. Trade financing figures cannot be precisely obtained, but as an example, Chemical Bank claims that it finances trade with South Africa totalling anywhere from US $23-35 million in a given month.[22] Trade financing is mostly short-term, 180 day loans involving a variety of products from catsup to automotive spare parts.

Some U.S. banks, including Citibank and Chemical Bank have claimed that they have a current policy not to make new loans to the South African government or related agencies, nor will they roll-over old loans. However, no U.S. bank has categorically stated that it will not consider new loans some time in the future while South Africa is still under minority rule.

Further, there are other means of lending money to South Africa without making it a direct transaction. For example, hundreds of U.S banks have correspondent relationships with South African banks, ostensibly to facilitate trade financing and to handle corporate accounts. Yet, through these correspondent relationships, U.S. banks can approve letters of credit, interbank loans and the like which could provide money requested by a South African customer. U.S. banks exercise very little, if any, control over such transactions and

would consequently be unaware if this money went to the government.

An example of this relationship is Chemical Bank's correspondence with Volkskas Bank of South Africa. This relationship is a direct support of apartheid since Volkskas is a government bank, known as the 'cashbox of the nation' and a depository for government, military and police accounts.

MILITARY AND NUCLEAR BUILDUP[23]

1) **Military**—U.S. policy states that military equipment of U.S. origin cannot be exported directly to South Africa. However, despite the embargo, U.S.-made military equipment, particularly aircraft, is being supplied to the South African Defense Force. In most cases, sales are being made to South Africa as 'civilian' aircraft, not covered under the embargo. These so-called 'civilian' planes are easily convertible for military use.

Lockheed has supplied South Africa with L-100 Cargo planes, which are almost an exact replica of the Lockheed C-130 which is used by the American military. This plane is capable of transporting up to 90 troops.

Avco-Lycoming aircraft engines have been spotted in many aircraft in the South African Air Force, including the Piaggio P-166, the AerMacchi AM-3C

and the Atlas C-4M. These craft are principally built in Italy where the American engines are mounted. U.S. aircraft engines are particularly strategic because, although South Africa has its own aircraft industry, it still does not produce aeronautical engines and must import them.

Cessna 'Skywagons' have been sold as 'civilian' aircraft to South Africa, but according to *Paratus*, the South African military magazine, Skywagons "keep the 1,000 mile border under constant surveillance." Light and maneuverable, this plane can fly low to the ground carrying guns. Also used by the South Africans are Cessna Golden Eagles, Conquests and Citations.

Other U.S.-made aircraft known to be used by the South African include **Piper** SuperCub, **Rockwell** Turbo-Commandoes, and **Beechcraft** A36's.

2) **Nuclear Collaboration**[24]—Since 1953 the U.S. has almost single-handedly given South Africa its present nuclear potential. The 50-year agreement to exchange technology and raw materials in the nuclear field under the infamous "Atoms for Peace" program, is a prime example of the absurdity of claiming that increased trade with South Africa will influence that government to end apartheid.

While apartheid has only become more repressive, the South African regime has acquired the technology from the U.S. to be virtually nuclear self-sufficient. Previously South Africa's only strength was an abundance of uranium. However, the U.S. has trained nearly 100 South African nuclear scientists which has enabled the South Africans to build their own reactor which is not safe-guarded by International Atomic Energy Association (IAEA) regulations. South Africa has refused to sign the Nuclear Non-Proliferation Treaty and 1977 satellite photographs detected testing plans in the Kalahari desert. More recently, there have been suspicions of testing off the coast of South Africa.

But the real success for the South African regime has been the development of their own enrichment plant, which means that they no longer must depend upon the U.S. to supply them with enriched uranium. This has been accomplished primarily with West German technology and U.S.-made equipment.

U.S. corporate involvement in nuclear collaboration with South Africa began in 1965 when **Allis-Chalmers** built South Africa's first nuclear reactor, SAFARI I, at Pelindaba. Since then many other corporations have lent assistance. **Foxboro International** has supplied computers to regulate the enrichment facility. **Honeywell** has provided electronic components and **Hewlett-Packard** supplied at least one computer for the enrichment plant. **General Electric** has supplied geothermal turbines to power a reactor and has often applied to the NRC to supply more equipment. Others include

US stake in SA keeps on rising

By John D'Oliveira

WASHINGTON — Despite the campaign against increased economic links with South Africa, United States trade with, and investment in South Africa is climbing.

This is clear from the latest statistics prepared by the United States Department of Commerce for the House of Representatives Sub-Committee on Africa.

The sub-committee asked for wide-ranging statistics on United States trade with Africa in general and with South ... in particular — ...

R178m (in 1977).

Total United States investment in Africa by the end of 1978 was R4 504m—only a very small proportion of the United States direct foreign investment of R140 067m.

United States imports from South Africa increased from R1 051m in 1977 to R1 892m in 1978 and R1 419 for the first eight months of 1979.

However, South Africa was only third in terms of US imports from Africa.

Imports from Nigeria ran at R5 127m in 1977, R3 928m in 1978 and R3 930m in the first eight months of the year.

Imports from Algeria ... at R2 725m for 1977. ... in 1978 and first eight

Federal Products supplying precision equipment; **Varian MAR**, isotope gauging equipment; and **Leeds & Northrup**, electronic components.

U.S. FIRMS IN SA UNDER APARTHEID[25]

Many major U.S. corporations operating in South Africa have signed the "Sullivan Principles" to justify their claim of being an avenue for change in South Africa. Similar to the EEC Code of Conduct, corporations are supposedly involved in massive reforms in the workplace.

In reality it is clear that even the most progressive reforms imaginable will not alter the power structure of on-going white domination in South Africa, yet U.S. corporations have demonstrated that they will not jeopardize profitable partnerships with apartheid by implementing even the most modest of reforms.

Initial reforms were to include such things as integrating all eating, comfort and work facilities. Nearly 75% of U.S. corporations claim to have integrated facilities. In actuality only 27% of all black laborers in U.S. subsidiaries work in integrated circumstances. Corporate excuses for not integrating fully, range from Uniroyal's claim that "separate facilities have traditionally been provided and forced integration will only lead to disaster," to Hewlett-Packard and Monsanto's contention that they cannot integrate because they share buildings with South African companies.

U.S. corporations have moved at a "snail-like" pace, according to the *Financial Mail*, in raising

black wages and hiring blacks above the unskilled and semi-skilled level. For example, GM employs only four blacks in salaried positions out of a workforce of 4,500. IBM has only four black managers out of 1,443 employees.

U.S. firms claim that salaries for blacks have increased by a greater percentage than for whites, but even the smaller increases for whites have been enough to increase the average wage gap between black and white workers from US $250 in 1974 to US $280 in 1978.

African laborers in U.S. firms are paid according to minimum levels established by South African organizations. In 1973, realizing the inadequacy of the established minimum levels as a wage standard, the U.S. State Department recommended that all U.S. firms pay a minimum wage 50% above the South African standard, or US $256 per month for 1978. However, 95% of U.S. companies responding to a survey reported paying a minimum wage under US $238, well below the proposed minimum level.

Many companies were not even paying the absolute poverty wage of US $192. Masonite reported that it pays its 165 male migrant workers on its forestry plantations US $36 a month and 338 women are paid US $32 a month. The company's managing director unashamedly said, "There has been a big improvement since 1972."

Even some statistics submitted by companies are open to question. The third report on the signatory companies to the Sullivan Principles, released in October 1979 by Arthur D. Little, Inc., notes that nearly 3,000 employees were "missing" in company reports. In addition, when reporting the integration of work areas, some companies included blacks and whites who are in the same job category, but *not* necessarily the same location.[26]

Regardless of the degree to which U.S. companies institute workplace reforms, these are of minor significance to blacks--compared to the strategic importance of U.S. investments in strengthening white minority rule in South Africa •

by Truman Dunn

(adapted from a paper presented by the American Committee on Africa at the "International Seminar on the Role of Transnational Corporations in South Africa" sponsored by the British Anti-Apartheid Movement in cooperation with the United Nations Special Committee Against Apartheid, London, November, 1979.)

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southern africa
PERSPECTIVES
No. 2-80

U.S. Business in South Africa:

"Voices for Withdrawal"

Steve Biko

Twice in the last four years hundreds of thousands of Black South Africans have joined in mass actions demanding an end to the apartheid system, which defines them as non-persons in their own country. Under apartheid Blacks are not citizens but labor units, controlled by the economy's need for labor. When the white-owned mines, farms and factories run out of jobs, Blacks find themselves driven from the 87% of South Africa classified as white, back into tiny reservations, where they have no way to support themselves. No Blacks in South Africa can vote, choose a job freely, buy a house or be certain of living peacefully with husband, wife or children.

That is apartheid. It is not, say Blacks, a system that can be patched up or reformed into acceptability. They are determined to destroy it completely, replacing it with a society in which all men and women, irrespective of color, will be able to participate fully.

The courage Black South Africans have shown in pursuing their freedom in the face of police bullets, mass arrests, torture and constant harassment has won them new American allies in student, union, black, church and other communities. These Americans looked to see whether there were US structures buttressing the apartheid system. They found the US corporations. Several hundred such companies now supply critical capital, sophisticated technology and vital equipment to a system which, in turn, rewards them with profits much greater than they can earn at home.

By 1980, US investment and loans had grown to an estimated $5 billion. Opposition to such investment, both inside the country and among US activists has also grown. Some US businessmen now believe their plants may become the battlegrounds of the future. "Foreign companies are going to be the target," Goodyear Tire and Rubber Co.'s South African managing director told a Business Week reporter this fall. Other executives dealing with South Africa talk openly about the mounting "hassle factor" they have to contend with as groups mobilize to get the corporations to stop supporting apartheid.

In spite of these dangers and pressures, US companies are not yet ready to retire from the field. Business Week reported, "Some US companies are finding that their South African holdings are among their more profitable—estimated payback for many companies is just five years. . . opportunities for expansion there are nearly irresistible."

Rather than withdraw, US companies have launched an energetic public relations campaign to persuade their opponents that economic growth is producing reform, that apartheid is crumbling, and that the corporations are playing a vital role in the whole process.

The Africa Fund (associated with the American Committee on Africa)
198 Broadway, New York, N.Y. 10038

The South African government encourages such talk of "reforms" as it tries to promote an image of itself as a flexible institution bent on change. But the limits of its flexibility are clearly delineated. Describing "my vision for the next ten years in South Africa", Prime Minister P.W. Botha recently told white students that "one man one vote in a unitarian state was out. . . " "Not now, not ever," he told a group of Black leaders.

Examined closely, the reforms turn out to be mechanisms for streamlining and modernizing the system of apartheid, making it more responsive to the needs of an economy which now requires skilled labor for its sophisticated production lines and fewer pick and shovel workers.

The reforms suggested by US corporations under the Sullivan banner fit neatly into this context. They avoid dealing with the overriding problem of white power and Black subservience, the real issue of apartheid, and confine themselves to proposals for "equal opportunity" type improvements inside the factory gates. Even at that level they are woefully inadequate and rely on the word of the corporation as to the progress being made. The whole procedure is somewhat akin to asking the fox to report on its behavior among the chickens.

But Black criticism of US involvement reaches far beyond the Sullivan principles and whether these are effectively implemented on the factory floor, to the fundamental issue of who really gains from this corporate presence in South Africa.

It is a crime called terrorism—punishable by a minimum five years in jail—to call for foreign companies to pull their investments out of South Africa. Yet despite such penalties Blacks have found powerful ways of voicing their views without breaking the law. A year ago, Bishop Tutu, a leading Black churchman and Secretary-General of the South African Council of Churches, commented on the issue to a reporter, "Some say that if we get out of South Africa, others will invest. I want to say very respectfully that the moral turpitude of that argument is breath-taking. It's like saying, 'Hey, your wife is going to be raped and if I don't, someone else is waiting.'"

Those are strong words for a Bishop. They reflect the passions generated among Blacks by the continuing presence of US and other foreign companies in South Africa. This presence is seen as providing economic, political and strategic support to the apartheid system in ways which can only raise enormously the cost in Black lives as the struggle to achieve liberation intensifies.

The following is a small sampling of the many voices now calling for an end to all US investment in South Africa.

THE SOUTH AFRICANS:

"I firmly believe if disinvestment could start it could bring a hastened end to apartheid. Perhaps an exodus of American companies from South Africa could bring about change."

- *Tozamile Botha, leader of the 1979 strike at the Port Elizabeth Ford Motor Company plant. Interview in* Sunday Post *(Johannesburg), December 9, 1979.*

"I appeal to South Africa's strongest allies, Britain and America. In the name of what we have come to believe Britain and America stand for, I appeal to those two powerful countries to take decisive action for full-scale action for sanctions that would precipitate the end of the hateful system of apartheid."

- *The late Chief Albert J. Luthuli, president of the African National Congress and Nobel Price winner, June 12, 1964.*

"The argument is often made that the loss of foreign investment would hurt Blacks the most. It would undoubtedly hurt Blacks in the short run, because many of them would stand to lose their jobs. But it should be understood in Europe and North America that foreign investment supports the present racist system of political injustice. . . If Washington is really interested in contributing to the development of a just society in South Africa, it would discourage investment in South Africa. We Blacks are perfectly willing to suffer the consequences! We are quite accustomed to suffering."

- *Steve Biko, Black consciousness movement leader, in 1976 interview with Bernard Zylstra,* Canadian Forum, *December-January 1977-78.*

Oliver Tambo

Donald Woods

Tozamile Botha

"If I said that the only way to bring change would be total economic sanctions, I would be liable to go to jail. So let's just be cagey. Let's just say that I support 'pressures,' and leave it at that."

- *Dr. Nthato Motlana, chairman of the Soweto Committee of 10, in an interview in the* New York Times, *April 4, 1978.*

"What we in the ANC want to see is what the people of South Africa want to see—our people are not only ready and willing to accept the consequences of action against the regime on the economic front, but they have themselves demanded the total political, economic, cultural and military isolation of the racist regime. We demand total isolation of the racist regime—no investment and withdrawal of existing investment."

- *Oliver Tambo, Acting President-General of the African National Congress, South Africa, in an interview with the* Guardian *(US), March 22, 1980.*

"...disengagement might not itself deal lusty economic blows against a very wealthy country such as South Africa, but it will deal a firm psychological blow against the structure and the system of apartheid. The white government in South Africa is terribly conscious of world opnion—it affects not to be, but it is extremely conscious of it..."

- *Donald Woods, South African editor, in remarks at Yale University reported in the* Yale Graduate Professional, *February 3, 1978.*

Albert Luthuli

"Advocates of continued investment claim that if foreign investors withdraw this would result in large scale unemployment of Blacks. Withdrawal can only mean the downfall of the Vorster regime...

Black people in general are prepared to suffer any consequences if this means ultimate Black freedom...

Foreign investors claim their presence in this country contributes toward the development of the Black community. This claim is disputed by the reality of the Black experience in this country. We resolve therefore...

To call upon foreign investors to disengage themselves from this white-controlled exploitative system."

- *Statement adopted by the Black People's Convention Congress, 1972.*

"Governmental insistence on enforcing apartheid and its rejection of normal negotiation with freely chosen Black leaders, have produced a situation in which there are few ways of preventing the escalation of violence and bloodshed into a major confrontation. One of the few remaining methods of working peacefully is through economic pressure, which could help to motivate the changes needed to bring justice and peace in South Africa. The Christian Institute therefore supports the call for no further investment in South Africa because:

1. Strong economic pressure is of vital importance in bringing about as peaceful a solution as possible.

2. Investment in South Africa is investment in apartheid, and this is immoral, unjust and exploitative.

3. Attempts to change the situation through pressure by investors have proved inadequate.

4. The argument that economic growth can produce fundamental change has proven false. Many Black organizations have opposed foreign investment in South Africa, and this would be the opinion of the majority of South African Blacks if their voices could be heard."

- *Christian Institute in South Africa, 1976 statement.*

Note: The African National Congress was banned in 1960. Steve Biko was killed while in police custody in September 1977. The Black People's Convention and the Christian Institute were among many organizations and individuals banned by the South African government in October, 1977. Dr. Nthato Motlana was detained at that time. He was released in March 1978. Donald Woods was banned at that time and now lives in exile. Tozamile Botha, detained and banned in 1980, escaped into exile.

U.S. Churches:

"*Resolved*, That the American Lutheran Church again express its unequivocal rejection of apartheid and all other forms of racial discrimination in our own society as well as in other nations, and declare apartheid to be a matter of 'status confessionis': and be it further

Resolved, That the ALC again declare its strong commitment to work for the elimination of these abhorrent evils and to support those who suffer under such oppression through unremitting prayer and deliberate action; and be it further

Resolved, That the ALC declare its judgement that at this moment in history in South Africa, divestiture is the most legitimate strategy in opposing apartheid and the most effective consequence of a declaration of 'status confessionis.'

- *Resolution adopted by American Lutheran Church in convention, October 4, 1980.*

"The governing board of the National Council of Churches of Christ in the United States of America, recognizing the grave injustices in Southern Africa and guided by its commitment to Christian principles and its own affirmations of human rights, declares its support for the following actions. . .

—Support efforts to end all economic collaboration between South Africa and the United States government and its private institutions involved in banking, commerce and industry until Black majority rule is a reality. . .

—Undertake to withdraw all funds and close all accounts in financial institutions which have investments in South Africa or make loans to the South African government or businesses and urge constituent membership to adopt this policy."

- *National Council of Churches governing board statement adopted November 10, 1977.*

"We have been attempting as a denomination to vote our stocks in such a way as to bring about changes in corporation policy. We've tried to vote our stocks in order to encourage corporations to withdraw. It is our conclusion that attempts on the part of corporations to bring about changes are very minimal. It (the Reformed Church in America's action) calls all of the church to follow the leadership of the General Synod. . . and to support the necessity for divestiture from stocks in companies that do business with South Africa."

- *Reverend Dr. Donald Van Hoeven, campus minister, Western Michigan University, following a vote by the General Synod of the Reformed Church in America to divest its stocks and interests in companies and banks that do business in South Africa.* Kalamazoo Gazette, *June 21, 1980.*

Black Americans:

"The United States should take measures to sever all economic, diplomatic, political and cultural relations with South Africa. These measures should include a ban on new investment by United States companies, a program of tax penalties designed to require withdrawal of current investments, a ban on new bank loans to South African borrowers, and termination of all exportation to and importation from South Africa."

- *The National Black Agenda for the '80's. Adopted March 2, 1980, in Richmond, Va., by more than 1,000 Black leaders representing over 300 organizations.*

"The NAACP should call upon US corporations to withdraw their investments in South Africa. . . The conduct of American firms to date. . . has failed to make a significant impact on the elimination of the total concept of apartheid. . . The NAACP should maintain its call for economic sanctions against South Africa until all vestiges of apartheid are eliminated."

- *NAACP policy proposal adopted by the Board of Directors January 16, 1980.*

"We believe, without qualification, that the United States should unilaterally totally disinvest its corporate money and break all connection with South Africa."

- *Randall Robinson, Executive Director of TransAfrica.* Africa News, *September 1980.*

"This policy of 'friendly persuasion' is a myth. The United States has used that argument for years to justify its refusal to support United Nations sanctions against South Africa. I think they have to be isolated in the world. I think that there are 35 million Black people in this country who support that and their view ought to stand for something in US foreign policy."

- *Representative Ronald Dellums, 1977.*

U.S. Trade Unions:

"Since the AFL-CIO has repeatedly called for an end to the system of apartheid practiced by the government of South Africa, it is deplorable that the subjugation and repression of the non-white citizens of South Africa by a white minority government has escalated. . . US corporations should immediately divest themselves of South African affiliates, and sever all ties with South African corporations."

- *AFL-CIO Executive Council statement, February 24, 1978.*

"We have no illusions that the relatively small holdings our trusts have in those corporations are going to cause a major turnabout in their activities in South Africa. We do think, however, that it is incumbent upon our union and other organizations sharing our point of view to keep the pressure on.

Most important, our members have every right to insist that pension money negotiated by the union and held in trust on their behalf be used wisely, morally and in ways that are socially useful and reflect their interests."

- *Letter from International Officers of the International Longshoremen and Warehousemen Union to trustees of the Union's negotiated pension funds. February 16, 1978.*

"We of the CBTU. . .

Call upon the American trade union movement to withdraw their bank accounts including pension funds from banks that make loans to South Africa and also from banks that loan money to companies that invest in South Africa."

- *Coalition of Black Trade Unionists. Adopted at national convention, May 25, 1980.*

"Apartheid provides a powerful incentive for US companies to make South Africa a haven for runaway plants. It is the interest and obligation of American unionists to fight the corporations' immoral support for the racist South African regime."

- *United Radio, Electrical and Machine Workers Union, resolution adopted by 1977 national convention. The union withdrew a $4 million payroll account from Chase Manhattan Bank, a major lender to South Africa.*

"Loans and investments from the United States that prop up South Africa's repressive regime are an insult to all Americans who believe in justice and fair play."

- *Leon Davis, President, District 1199, National Union of Hospital and Health Care Employees, RWDSU/AFL-CIO, January 29, 1978, after the adoption of a resolution mandating that "no pension funds should be invested in any manner that would financially assist or aid or support the present government or economy of South Africa."*

City and State:

"The Legislature of the State of Nebraska declares that investment of Nebraska state funds in institutions which support the apartheid system of South Africa is contrary to Nebraska's principles of human rights and social equality and ca the Nebraska Investment Council to remove approved list for investment of Nebraska t ds corporations and banks that invest in South Africa."

- *Nebraska State Legislature adopted March 31, 1980.*

"The people of Berkeley, California declare that public monies should be removed from banks and other financial institutions doing business in or with South Africa and reinvested according to a policy that takes ethical, social and economic considerations into full account."

- *Referendum passed in Berkeley, California, April 17, 1979.*

"RESOLVED BY THE HOUSE OF REPRESENTATIVES (The Senate concurring) That the Michigan Legislature urge the Congress of the United States and the President of the United States to impose immediate sanctions against the South African government in response to that country's disregard for human rights and dignity."

- *Resolution 462 adopted by the Michigan Legislature, February 6, 1978.*

Other Voices:

"Although we realize that one agency cannot materially affect socio-economic change in South Africa, numerous other agencies and institutions are also taking similar affirmative action. As our collective voice grows stronger, we hope that our influence will be felt and that the path to freedom and equality will be made a little easier for those suffering under the yoke of apartheid."

- *Joyce Phillips Austin, Executive Vice-President, Federation of Protestant Welfare Agencies, following that organization's decision to divest its portfolio of all stocks in corporations doing business in South Africa, March 4, 1980.*

"After a two-week stay in South Africa I concluded that to invest in this country is to boost the confidence of the Whites, to secure perhaps decades of further humiliation for Blacks and, in effect, to support ideals that run completely counter to the democracy of which Americans are rightly so proud. To suggest, I concluded, that by investing in South Africa one is helping to bring about change and the improvement of the condition of Blacks is to seek an excuse for supporting racists because it is financially profitable."

- *Frank Vogl, US Economic Correspondent for the* Times *of London,* The Sun, *May 11, 1980.*

"US policy . . . cannot cling to the naive notion that international economic forces are, or can be expected to be, agents of change. At most such forces will bring a certain number of Africans into the existing system, perpetuating thereby a degree of Western control that cannot help but result in continued internal and potentially international conflict."

- *George Houser, executive director, American Committee on Africa,* Christianity and Crisis, *September 9, 1977.*

"In my judgement, financial support of apartheid should no longer be tolerated. The current policy of the United States Government should be changed from one of neither encouraging nor discouraging foreign investment in South Africa to one of active discouragement."

- *Dick Clark, former U.S. Senator. The* New York Times, *February 21, 1978.*

"Everyone who invests in South Africa is voluntarily involving himself in organized theft. Everyone who buys South African apples, or wine, or gold or any other goods, is benefiting from the brutality and exploitation suffered by the non-whites of South Africa under the present system."

- *Julius Nyerere, President of Tanzania, in an address to the Paasikivi Society of Finland, quoted in* Christianity and Crisis, *March 13, 1978.*

International Organizations:

"The General Assembly . . . calls on all Governments concerned

a) To sever diplomatic, military, nuclear, economic and other relations with the racist regime of South Africa;

b) To take measures to prevent transnational corporations, banks and other institutions under their jurisdiction from collaborating with the apartheid regime;

c) To take all necessary action to terminate credits by the International Monetary Fund and other bodies to South Africa;

d) To prohibit the sale of krugerrands;

e) To deny any facilities to airlines or ships travelling to and from South Africa;

f) To terminate all government promotion of, or assistance to, trade with or investment in South Africa;

g) To support effective international sanctions against the racist regime of South Africa."

- *United Nations General Assembly Resolution 34/93 adopted December 12, 1979.*

"The Council . . . finds that the measures adopted by the *Apartheid* regime in the wake of the United Nations mandatory arms embargo renders foreign companies operating in South Africa to being integrated into the *Apartheid* regime's military programme. Already such western corporations provide South Africa with virtually all of its petroleum, computer, automotive, and high technology supplies. Hence any action short of total western corporate withdrawal would be inadequate."

- *Organization of African Unity, Council of Ministers, June 1980.*

PUBLIC INVESTMENT AND SOUTH AFRICA

NEWSLETTER

Number 5 May 1984

ALABAMA

State Action: On February 7, 1984, Representative James Buskey reintroduced a bill modeled on the successful Massachusetts legislation requiring divestment of state pension funds from banks and corporations investing in South Africa. There have been hearings in the House Ways and Means Committee, but a vote has not yet been taken.

ARIZONA

State Action: Representative Art Hamilton and Senator Tony West introduced legislation which has been attached to HB 2020 which prohibits the investment of public funds in enterprises headquartered in or who have the majority of their interests based in South Africa. This includes a prohibition on the purchase of precious metals from South Africa. The bill is awaiting action by the Senate.

CALIFORNIA

State Action: Assemblywoman Maxine Waters reintroduced Assembly bill 808 which stipulates that after January 1, 1989, no state funds shall remain invested in any corporation or any bank doing business in South Africa.

A public hearing in the Assembly Finance and Insurance Committee was held on January 10, 1984. The bill was defeated by a vote of 5 to 8. Assemblywoman Waters will introduce the bill again next year.

City Action: Santa Cruz: On November 8, 1983, Mayor John Laird of the City of Santa Cruz signed an ordinance which prohibits the investment of public funds in banks doing business in or with South Africa. The divested funds will be reinvested to create jobs, housing, and other services for local residents.

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