

THE FINANCIAL IMPLICATIONS OF DIVESTMENT:
A REVIEW OF THE EVIDENCE

by

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INTRODUCTION

Over the last twenty years, a growing number of Americans have criticized the wisdom and morality of investing in the South African economy and making profits out of apartheid. After the events in Soweto, the murder of Steve Biko, the ongoing forced removals of some 3 million black Africans to the bantustans and South Africa's continued aggression of the front-line states, there is an increasing demand by numbers of religious institutions, universities and colleges, unions, and human rights groups to do something about American investments which help prop up the South African regime.

Events demand that the United States and other countries take a new approach toward South Africa rather than the "constructive engagement" approach of the Regan Administration. A more effective strategy would be to cut all economic, political, military and cultural ties -- or to say it in another way, to "disengage" from South Africa. In taking this step, the United States would not be alone. Several other western states appear to be evaluating new options in their relationship to apartheid. The United Nations has increased its traditional opposition to racism in South Africa with an arms embargo of South Africa and a call for an end to economic collaboration with apartheid. But voluntary compliance with this kind of boycott is unlikely without a major commitment not only by the American people but by their President, administration, and Congress.

In attempting to move the country closer to the eventual goal of disengagement, those in favor of such action have proposed a strategy of "divestment." The purpose of divestment, obviously, is to pressure companies and banks to withdraw from South Africa; it says to the company, "we're taking our pension money or endowment out of your operations as long as you continue to do business in South Africa." It leaves little room for compromise, partial steps, or "constructive engagement". It responds directly to the call from major exiled South African leaders for total isolation and withdrawal of support for the apartheid regime. By taking this stand, proponents of "divestment" hope to send the strongest possible message both to the U.S. companies being divested and to the people in South Africa that they wanted their pension money out of any investment that could directly or indirectly support apartheid.

This report summarizes the findings of several studies made on portfolio performance when stocks and bonds are divested from corporations doing business in South Africa. The report, prepared on behalf of the New World Foundation, is divided into three parts. Part I includes a summary of several divestment studies commissioned by the States of Massachusetts, Connecticut, Ohio, Nebraska and the District of Columbia. The overall conclusion reached by these studies is that prudent divestment can be carried out without any financial risk to the pension funds. The studies also point out that there are alternative investment options available for portfolios that exclude South Africa related stocks and securities.

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Part II presents a review of arguments supporting divestment and examines the merits of different criteria leading to divestment. Based on a review of the arguments, a list of companies in the "divest/no buy " category is included. The terms "AVOID", "divest/no buy" are interchangeably used and should be interpreted to mean corporations that do substantial and strategic business in South Africa and recommended for exclusion.

Part III describes South Africa's government position with regard to the divestment campaign in the United States. The activities of the South African lobby in the U.S. and South Africa's position vis-a-vis the South African Council of Churches with regard to divestment is described in detail. Despite all such efforts by the South African lobby, states, municipalities and universities are joining the growing divestment movement by withdrawing their funds from corporations doing business in or with South Africa.

PART I

FINANCIAL IMPACT OF DIVESTMENT

Many Americans who are repulsed by South Africa's apartheid system feel frustrated by their inability to pressure the South African government for change. Perhaps these frustrations explain the popularity of a growing movement within this nation to restrict state, cities and universities from investing public funds in banks lending to or companies investing in South Africa. Legislation to prohibit investment of public funds in companies in South Africa is pending in some 25 states, and the list of cities and counties considering similar legislation is growing. This section summarizes the results of several studies on portfolio performance when stocks and bonds are divested from corporations doing business in or with South Africa.

STATE OF MASSACHUSETTS

In January 1982, Massachusetts became the first state to vote to fully divest its public employee pension funds. The Pension Fund sold an estimated \$130 million invested in some 43 corporations and banks doing business in South Africa. The Massachusetts investment legislation reads as follows:

After January 1, 1983, no public funds 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 (Bill) 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.

As a first step in the process, the state treasury sold approximately 75% of South Africa related stocks and bonds in the amount of \$75 million from the following corporations and banks:*

General Motors	Central National Bank of Cleveland
BankAmerica Corporation	Citicorp
Citizen Southern Bank	Continental Illinois
Crocker National Bank	Fidelcor
First Chicago Corp.	First City Bancorporation-Texas
Harris Trust & Savings	Manufacturers Hanover Trust
Maryland National Bank	Philadelphia National Bank
First Interstate Bank	

*SOURCE: Franklin Research & Development Corporation, The Financial Implications of Divestiture, (November, 1982)

In support of the divestment campaign, a study conducted by Franklin Research and Development Corporation (1982) concluded that, through "bond swapping", Massachusetts would have realized an additional net gain of \$2.377 million if the entire South Africa related portfolio had been divested as of December 30, 1982. We do not have exact financial information on the results because the State Treasurer has taken the position that Massachusetts law forbids him to report the results of individual pension fund transaction. However, the governor of the state, Michael S. Dukakis explained that "divestment makes not only a strong moral statement against apartheid but divestiture has proven to have had no significant impact on our pension earnings" (see Appendix A).

TABLE I
Projected Performance of South Africa Related
Portfolio (December 30, 1982)

	Book Value	Current Market Values	Gain or (Loss)
Industrial Bonds (1)	21,357,302	16,596,365	(4,760,937)
Bank Bonds (2)	31,415,994	25,013,611	(6,402,383)
Bank Stocks (3)	<u>35,995,043</u>	<u>49,536,350</u>	<u>13,541,307</u>
Total Net Gain	38,768,339	91,146,350	2,377,987

SOURCE: Compiled from Franklin Research Study, The Financial Implications of Divestiture, (November, 1982)

NOTE ON TABLE I: Among stocks held were:

- (1): Abbot Laboratories (\$2.1 million), Dow Chemical (\$3.4 million), Caterpillar (\$1.5 million), Ford Motor (\$3.7 million), Exxon (\$2.2 million), General Motors (\$3.3 million), DuPont (\$14.1 million), Pfizer (\$1.1 million), Union Carbide (\$2.5 million), Xerox (\$1.2 million).
- (2) BankAmerica (\$6.8 million), Chemical Bank (\$4.5 million), Manufacturers Hanover (\$5.1 million), Crocker National Bank (\$2.3 million), Wells Fargo (\$2 million), Citicorp (\$5.35 million), Bankers Trust (\$1.85 million).
- (3) List of banks and corporations in the "excluded" Massachusetts portfolio available on request from ICCR.

STATE OF CONNECTICUT

The State of Connecticut, which passed divestment legislation on June 9, 1982, is moving ahead with its partial divestment plan. As of July, 1983 the State had sold pension stocks valued at \$39 million and made a profit of \$5.7 million, a figure that convincingly rebuts the argument that divestment will cost tax payers.

A study conducted by the United States Trust Company prior to the enactment of the divestment law projected a much higher profit of \$17 million if all South Africa-related stocks had been sold at the end of 1981. The key issue raised in the report was finding suitable alternative investments. Using statistical models, 380 "non-South Africa" stocks in the S & P 500 index were sorted out first. Then their performance was compared to the performance of the S & P 500 over a ten year period. The report concluded that the 380 companies in the "Approved" list outperformed the entire S & P 500 index and that there is acceptable risk in owning the stocks in the "Approved" category.

Operational Criteria

The Connecticut public investment law directs the State Treasurer to disinvest all state funds invested in companies doing business in South Africa that do not meet the following guidelines:

- (a) corporations must be a Sullivan signatory with a rating in the top two categories;
- (b) corporation does not supply strategic products and services for use by the South African government, police and military;
- (c) corporation must recognize the right of all South African workers to organize and strike for economic and social objectives.

Of the 230 corporations in which the State had invested, 70 or 30% of them were found to be doing business in South Africa. The 70 identified South Africa investors were then sorted according to their Sullivan performance rating. Accordingly, 42 corporations are in compliance while 28 have not met the requirements of the law and have been placed on an "AVOID" or no buy list. Being on the "AVOID" list means that the State cannot increase its investment in these corporations until they comply with the Sullivan Code. Non-compliance by the companies result in the withdrawal of state funds.

While Connecticut was one of the early states to pass divestment legislation, clearly the "Sullivan" criteria for divestment is a very weak one. The Sullivan Code basically is a work place reform and does not force corporations to challenge apartheid laws. Criteria such as "substantial" or "strategic" involvement (fully discussed later on) are a more significant basis to judge companies.

Secondly, corporations that are signatories to the Sullivan Code are let off the hook too easily. The Code allows large corporations such as Mobil, Texaco, GM and Ford, with substantial and strategic involvement in South Africa, to escape pressure. Their work place performance rather than apartheid thus becomes the focus of the debate.

There is no doubt that the inclusion of the "Sullivan Compliance" criteria diminishes the effectiveness of the Connecticut legislation. Nevertheless, stocks and securities valued at \$39 million have been sold from 10 corporations in the "AVOID" list as of July 31, 1983. The dollar values for sales are as follows.

TABLE II

	<u>Inventory</u>	<u>Redemption</u>	<u>Gain/(Loss)</u>
Equities	25,732,801	31,016,433	5,283,632
Fixed Income	<u>7,525,460</u>	<u>8,008,645</u>	<u>433,185</u>
Totals	33,308,261	39,025,078	5,716,817

SOURCE: State Treasurer's Office, 1/13/83.

The State Treasurer's Office reports that as of July 30, 1983, state funds remained invested in 56 corporations covered by the divestment law with an inventory value of \$274,821,288 and a current market value of \$344,610,271. Stricter application of the two criterias on strategic sales could place more companies in the "AVOID" category.

In March 1984, the State Treasurer's office received additional authorization to begin selling stock in seven companies that do not meet the state's South Africa related investment guidelines. The seven companies include Baker International, Celanese, Loctite, Measurex, NCR, Nalco Chemical and A.C. Nielsen. According to Arthur D. Little's October 1983 report on the Sullivan signatory companies, Baker, Loctite and A.C. Nielsen have "unsigned" themselves from the Sullivan principles, while the other four companies were rated in category III, "needs to become more active."

GOVERNOR'S TASK FORCE ON SOUTH AFRICAN INVESTMENT POLICY

The State Treasurer selected three consultants to perform individual and aggregate studies on the state's portfolio and determine the impact of divestiture of common stock holdings of companies doing business in South Africa would have on the State of Connecticut's Trust Funds. In general, all three consultants (listed below) were in agreement that the measure of risk increased as the available universe of common stock selection was shrunk and that although the performance of the remaining stocks was better over the last three year and five year periods, a prediction of similar performance cannot be made for the future. In addition, while computer analysis showed that there were sufficient alternatives to the excluded stocks, the realities are that many times this type of diversification may not be achieved in the practical day to day management of large portfolios. The following is a brief synopsis of their findings (their full reports are contained in the Appendix B,C & D).

Capital Management Sciences (CA)

This report states that the elimination of common stock holdings of companies doing business in or with South Africa does impact the portfolio behavior. Reducing the universe of common stock of non-trading corporations substantially increases portfolio risk while potentially increasing returns. Possibly of greater importance is that it removes the larger more financially stable companies as potential alternatives for selection by the state's investment manager which could have a substantial negative impact on the portfolios future behavior.

Danies & Bell Capital Management Company (New York)

This report concluded that the exclusion of unacceptable companies from the Mutual Equity Fund will not have any negative impact. The study shows that the "sanitized" portfolio outperformed both the original portfolio and the market over the latest three year and five year periods. The report also points out that there is a marked increase in volatility in the "sanitized" portfolio over the original portfolio and a decrease in the portfolio diversification. The report goes on to say that there would seem to be little risk to the State of Connecticut if it sold all of its securities with companies which held investments in South Africa. Conversely, the direct impact of divestiture on the South African government or companies operating there will be miniscule, they argued.

United States Trust Co. (Boston)

A summary of their study also indicates that during the three year and five year periods measured, the portfolio with excluded stocks performed better than the original portfolio but that there was also a commensurate increased risk. The report argues that, on paper, there are enough alternative investments in the various groups and industries so that the risk could be diversified but went on to admit that this was a difficult task.

Thus, two of the three Connecticut studies (done by sympathetic investment advisors) came to similar conclusions while the third argued more dire consequences.

MICHIGAN STATE UNIVERSITY

In March 1978, the Board of Trustees decided to sell their stock in corporations and banks doing business with South Africa. In 1979, the university sold all \$12,075,492 of South Africa related investments in its portfolio. The evidence presented by the university indicates that the university had made \$100,000 on the sale of South Africa related stock. Furthermore, the university bought replacement stocks from "APPROVED" companies whose value exceeded the total cost of acquiring them by \$2,034,355. As a result, the university had made a profit of over \$2 million by divesting from South Africa related corporations.

The table below indicates that the companies MSU divested from included the largest U.S. investors such as Citicorp, Exxon, Ford, General Motors and IBM. Citibank is one of the largest U.S. lenders to the South African government. Its controversial participation in a 1980 \$250 million loan to the South African government touched off a wave of withdrawals by churches and universities. A list of organizations which participated in the withdrawal of accounts from Citibank is included in Appendix E.

TABLE III
1979 COMMON STOCK SALES
MICHIGAN STATE UNIVERSITY PORTFOLIOS*

COMMON STOCK	NUMBER OF SHARES	PER SHARE SALE PRICE	2/8/80 PRICE PER SHARE	TOTAL PROCEEDS	2/8/80 HOLDING VALUE	SALE PROCEEDS MINUS 2/8/80 VALUE
American Tel. & Tel.	9,691	\$58	\$51	\$ 562,070	\$ 494,241	\$ 67,837
Capital Holding	30,520	22	20	847,440	770,400	77,040
Citicorp *	15,540	25	22	388,500	341,000	46,620
Coca Cola *	11,700	40	34	471,200	400,520	70,680
Delta Airlines	9,750	39	37	380,250	360,750	19,500
Dow Chemical *	22,700	26	39	590,200	885,300	(295,100)
Eastman Kodak *	4,750	54	46	256,500	210,500	46,000
Exxon *	19,260	56	66	1,079,000	1,271,680	(192,680)
Federated Dept. Stores	13,400	26	26	340,400	340,400	-0-
Ford *	10,125	41	32	415,125	324,000	91,125
General Motors *	5,852	50	53	368,416	310,156	58,260
Houghton Mifflin	23,605	33	33	770,965	770,965	-0-
Household Finance	17,603	17	17	299,251	299,215	-0-
IBM *	13,706	70	67	959,420	918,302	41,118
Minnesota Mining & MFG	9,250	54	50	499,500	462,500	37,000
National Detroit Corp.	10,714	30	28	561,420	523,992	37,428
Northwest Airlines	13,300	20	27	372,400	359,100	13,300
PepsiCo *	17,925	25	24	440,125	430,200	10,925
Polaroid	4,665	20	23	130,620	107,295	23,325
Procter Gamble	5,600	70	71	443,040	403,200	39,840
RCA	16,945	25	23	423,625	389,735	33,890
Sears Roebuck	4,400	10	17	79,200	74,000	4,400
Tampa Electric	16,343	10	15	294,174	245,145	49,029
Upjohn *	13,350	43	40	547,050	640,000	(92,950)
Xerox *	2,655	57	65	151,335	172,575	(21,240)
Weyerhaeuser	12,675	30	35	300,250	443,625	(143,375)
TOTAL:				<u>\$12,075,492</u>	<u>\$11,975,400</u>	<u>\$ 100,092</u>

* - U.S. companies with subsidiaries in South Africa.
Excluding Albert Case Fund

SOURCE: MSU, Trustees Investment Committee Report, (1979).

Many reputable financial analysts explain that, by careful selection, the exclusion of companies in South Africa may be replaced by more profitable investments. MSU officials followed the above rule of thumb and made good profits.

TABLE IV
1979 COMMON STOCK PURCHASES
MICHIGAN STATE UNIVERSITY PORTFOLIOS

COMMON STOCK	NUMBER OF SHARES	PER SHARE PUR. PRICE	2/0/00 PRICE PER SHARE	TOTAL COST	2/0/00 HOLDING VALUE	2/0/00 VALUE MINUS TOTAL C
Air Products	17,600	\$33	\$40	\$ 500,000	\$ 704,000	\$ 123,200
American Hospital Supply	6,500	29	33	100,500	214,500	26,000
Archer-Daniels-Midland	26,407	22	37	500,954	977,059	396,105
Atlantic Richfield	500	66	103	33,000	51,500	10,500
Burlington Northern	0,050	63	79	507,150	635,950	120,000
Champion International	21,100	25	26	527,500	540,600	21,100
Communications Satellite	13,300	44	41	505,200	545,300	(39,900)
CONOCO	24,900	35	56	871,500	1,394,400	522,900
Du Pont	11,250	40	40	540,000	450,000	(90,000)
General Signal	9,500	36	36	342,000	342,000	-0-
Gulf Oil	10,200	33	47	600,600	855,400	254,800
Hughes Tool	16,350	33	65	539,550	1,062,750	523,200
Liberty National Life	16,600	20	19	464,000	315,400	(149,400)
Panhandle Eastern Pipeline	11,950	47	66	561,650	700,700	227,050
Texas Eastern Corp.	4,000	59	74	203,200	355,200	72,000
TOTAL:				<u>\$7,206,404</u>	<u>\$9,240,759</u>	<u>\$2,034,355</u>

SOURCE: MSU, Trustees Investment Committee Report, (1979)

MSU officials explained that the university did better by simply getting out of those stocks in big industrial firms (not doing as well during that period of time) and into other relatively smaller companies doing better. This conclusion is confirmed by Bob Schwartz, an investment counselor at Shearson-American Express who argued that the best portfolio results were obtained from holdings in smaller companies at that time. Obviously, market conditions change and large companies fare better at different economic times. However, the Michigan case again demonstrates that there are alternatives available for institutional investors not interested in investing with corporations doing business in South Africa.

OHIO PUBLIC PENSION FUNDS

In 1980, five State of Ohio Pension Funds held securities in at least 73 American corporations which had business operations in South Africa. The pension funds involved are:

Public Employees Retirement System
The Police and Firemen's Disability and Pension Funds
The School Employees Retirement System
The State Teachers Retirement System
The Highway Patrol Retirement System

The holdings of these five pension funds, amounting to \$1.98 billion, represented 17% of the total assets of the 73 corporations identified as doing business with South Africa. Eighty-eight percent of the \$1.98 billion invested was with corporations who are signatories to the Sullivan Principles.

In June 1983, members of the Ohio Retirement Study Commission presented the findings of their study with regard to the financial consequences of divestment. The conclusions of the study, obviously different from the conclusions reached by other analysts, were as follows:

- (1) A total divestment and exclusion policy, affecting 16-20% of the Ohio Retirement Systems' combined funds, could have significant consequences and might result in lowered returns, higher risks, and less diversification.
- (2) A very selective divestment/exclusion policy, which becomes operative if certain social investment criteria are not met, -- e.g., the company is a non-Sullivan signatory-- would probably not have significant cost consequences.

Clearly, opinions vary regarding whether divestment or exclusion results in a lower rate of return, higher risk ratios, or less diversification. However, even studies which advocate total divestment/exclusion strategies often caution that higher risk ratios and less diversification, especially in very large portfolios, could result when comprehensive divestment strategies are taken. Rates of return could decline if the divested securities (mainly large U.S. multinationals) did well during the year divestment is to be carried out. This study recommends the state implement partial divestment similar to the one in the State of Connecticut. The Ohio State Assembly has yet to pass a divestment legislation. Given the trend in Massachusetts, Connecticut and Nebraska, enactment of a partial divestment legislation in the near future is a real possibility.

THE DISTRICT OF COLUMBIA

The District of Columbia divestment bill is patterned after those enacted by other states and cities and most closely resembles the Philadelphia law. It states that "no public funds shall be invested or remain invested in the stocks, securities, or other obligations" of banks and financial institutions which lend money to the government or the national corporations of South Africa or to U.S. corporate subsidiaries in South Africa. It prohibits the investment of public funds in U.S. companies and subsidiaries which do business in South Africa. And it provides a two-year time limit to accomplish divestiture, with provisions for extending the period if necessary to protect investment income.

The statute would apply to the commercial and investment banking activities of the D.C. Office of Financial Management and to the investment activities of the Housing Finance Agency and the D.C. Retirement Board. The board administers the Teachers Retirement Fund, the Policemen and Firemen Retirement Fund, and the Judges Retirement Fund.

The financial consequences of divestment with regard to the D.C. funds were analyzed by two investment firms. The results of these studies contradicts one another. A summary of these studies is presented below.

(a) Meidinger Asset Planning Service Inc.

The firm studied the investment implications of total divestment as it pertained to the portfolio of the City of Washington, D.C. The report focused on a study of Standard and Poor companies, centered around capitalization and quality, and survey of banks, investment advisors, and insurance companies. Meidinger concluded that divestiture would eliminate more than 90% of the securities of the market of agricultural, machinery, automobile, publications, soft drink beverages and hospital supplies industries. Total stocks representing 59% of the market capitalization of the S & P's 500 stock index would be restricted from investment.

In addition, Meidinger concluded that the average market capitalization of the 139 S & P 500 companies that would be restricted by the legislation is \$3.3 billion, compared with an average market capitalization of \$1.3 billion for non-restricted S & P 500 companies. The restricted stocks are only 88% as volatile as the SP 500 stock index, which the non-restricted SP 500 stocks as 112% as volatile, Meidinger predicted that a 1% reduction in the pension plan's performance over 21-year period could result in a \$750 million loss of funds. This probability index does not take into account social and economic factors at all.

The weakness of the report is that it relied heavily on the opinions of the managers surveyed. Those that were actually managing restricted portfolios such as Shearson-American Express were less apt to predict negative consequences. None of the managers actually managing part of the Washington portfolio said they would refuse such an account. The South African lobby has extensively quoted this study in their propaganda campaign against divestment legislation. No mention is made by the South African government of the results of the Franklin Research which contradicts the findings of the Meidinger report. Also, the predictive model employed in the Meidinger report is one that is commonly used to measure the past performance of corporations rather than their projected performance.

(b) Franklin Research and Development Corporation (Boston)

In a testimony to the D.C. City Council, Joan L. Bavaria, president of Franklin Research Group stated that she and her colleagues conducted computer analyses of the impact of Bill 5-18 on the holdings of the D.C. Retirement Board, as listed in the Board's December 31, 1982 portfolio statements. She stated:

"We have concluded that the divestiture of the 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 responsible, prudent execution by the funds' managers."

The findings of the study were as follows:

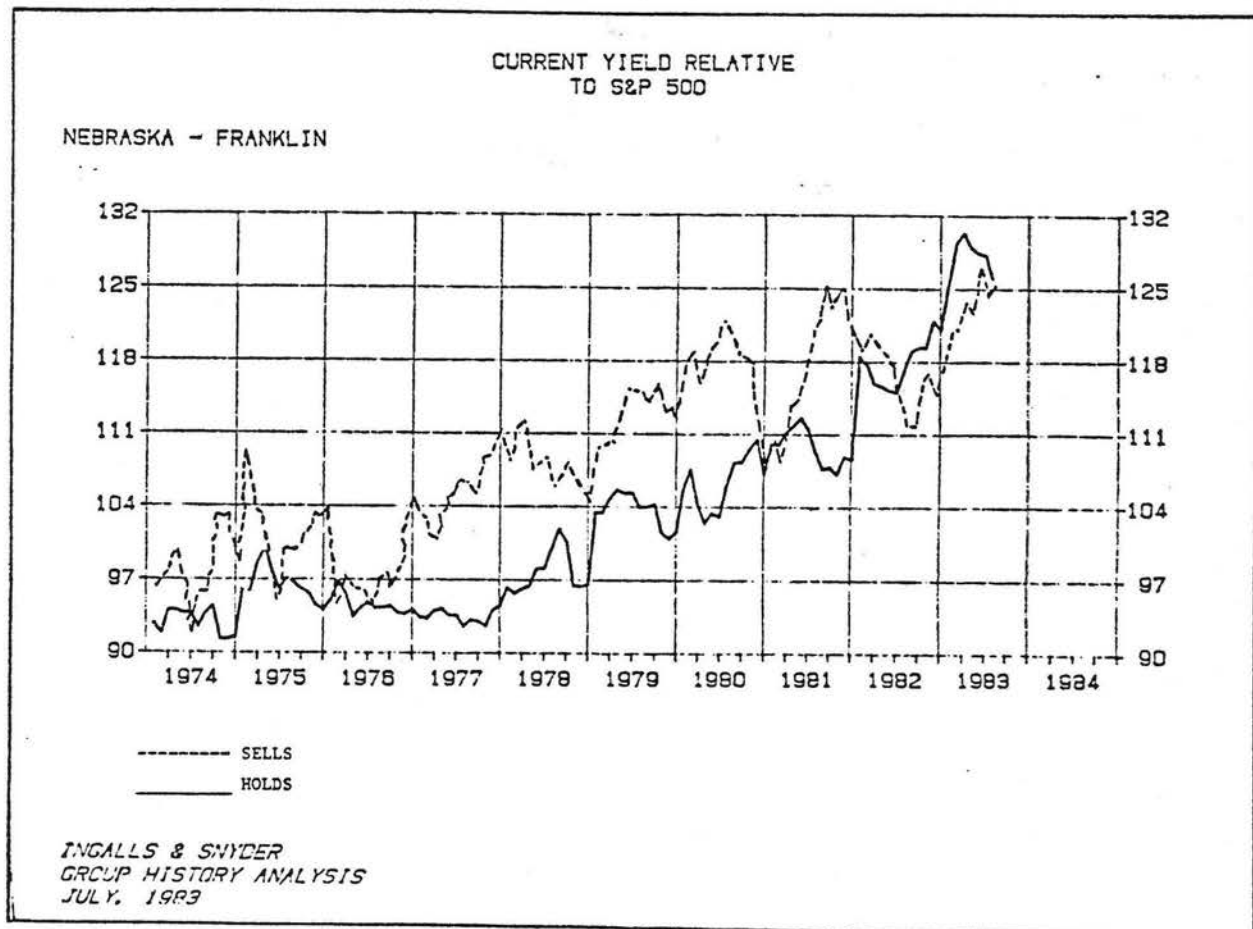
- 1) if the 1,022,400 common stocks had been sold as of December 31, 1982, a gain of \$2 million would have been realized.*
- 2) Of the approximately 6,350 companies listed in the major U.S. stock exchanges, fewer than 400 do business in South Africa (i.e., more opportunity and room for alternative investment). The report concluded that "no material investment disadvantage created by excluding less than 1% of the listed companies from the approved investment list. Companies like Waste Management, Polaroid, Wang Laboratories, Signal, Ralston Purina, Quaker Oats, and Digital Equipment come to mind as alternatives."
- 3) Subsequent to the hearings, Franklin Research conducted additional studies of the impact of Bill 5-18. Those subsequent findings confirm that over the past 9 years, the D.C. stocks related to South Africa had a growth in earnings and appreciation of 8% a year while those not involved in South Africa averaged 11.2% a year.

*Copy of the study on file with ICCR.

THE STATE OF NEBRASKA

On April 9, 1984, Nebraska became the first Midwestern state to enact divestment legislation. The bill will phase in over a three-year period ending in 1987 and requires the state to divest its public funds from any companies with operations in South Africa that do not sign the Sullivan Principles and companies that are signatories to the principle but do not obtain a performance rating in the top category. Thus, using the most recent Arthur D. Little report published in October 1983, the Nebraska law would require the state to divest of securities held in all but 29 of the 120 Sullivan signatories. The law also calls on the state to withdraw its deposits from financial institutions with loans outstanding to the South African government and its parastatal corporations; prohibits new investments in the bonds of such financial institutions; and requires the state to sell the stock of any financial institutions with loans outstanding to any American-based corporation doing business in South Africa.

Franklin Research and Development Corporation analyzed the effects of divestment on the Nebraska state portfolio in 1983, prior to the passage of the divestment law. Using the S & P 500 as a proxy for all stocks, 40 financial variables selected by Ingalls & Snyder were operationalized to evaluate the Nebraska portfolio. There were mixed results when comparing the securities to be "maintained" with those to be "sold". In general, the study concluded that the divested securities would have



a lower dividend yield, higher price/earnings ratio, and lower sales growth. But a closer examination of the study reveals the following conclusions:

(a) Stock Trading

According to the study, 26 common stocks would be eliminated by the law. These securities were in the form of 871,000 shares. If the stocks had been sold as of December 9, 1983, a gain of \$7,770,000 would have been realized*

(b) Bond Trading

The report also made a projection that 31 industrial bonds would be eliminated by the law. Accordingly, bond losses might total over \$9 million. Net losses from the combined portfolio (i.e., \$9 million minus \$7.7 million) total a little under \$1.3 million. However, these losses are "paper" losses since the identical invested position can be maintained by repurchasing like or better securities. Usually, a good investment manager can upgrade income with good bond trading (or swapping) to negate trading costs and maintain invested position. A hypothetical operationalization of such practice is presented below.

<u>SELL</u>	<u>Issue</u>	<u>Quality</u>	<u>Income</u>	<u>Proceeds</u>	<u>Current Yield</u>
\$179,000	Goodyear Tire & Rubber 8.60% 9/30/95	A3	\$15,394	\$137,830	11.169%
\$180,000	AT & T, 8.75% (5/15/2000)	AA1	15,750	^{Cost} 136,350	11.551%

The purchase of a high quality bond for \$180,000 in exchange for a \$179,000 bond generated more income (\$356) with the proceeds of the sale. The current yield of the low quality bond was 11.169% while the corresponding figure for the high quality bond was 11.551%. By careful selection, the exclusion of companies in South Africa may be replaced by a more profitable investment.

The Nebraska study further pointed the attractiveness of alternative investment options. The report pointed to the expected social benefits from making mortgages within the state since mortgages are collateralized investments. Government or U.S. government agency bonds can be utilized to limit risk and increase yield.

*SOURCE: Franklin Research and Development Corporation, The Effects of Divestiture-State of Nebraska, (December, 1983)

PART II

APPROACHES TO DIVESTMENT

The issues and questions concerned with alternative or "socially" responsible investment are complex, controversial and emotional. Legislators, pension fund managers, labour unions, churches and universities are just beginning to respond to the issue. The most common and frequently asked questions are:

- 1) would a restrictive investment strategy result in lower rate of return on the investment and thus jeopardize future pension benefits?
- 2) would the use of restrictive investment criteria violate the legal responsibilities of pension fund trustees?
- 3) would a restrictive investment strategy by pension funds, etc., influence U.S. corporate policy regarding South Africa?
- 4) would corporate withdrawal or limiting investment in South Africa put pressure on the South African government to end apartheid?

The answers to these questions obviously vary depending whom you talk to. Those who favor the withdrawal of foreign investment from South Africa contend that such investment support and perpetuate the white minority government at the expense of the well-being and human rights of the black majority. A recent Carnegie Corporation study found a continued and growing gap in real terms between white and non-white incomes. The report argues that continued economic boom and increased foreign investment have not significantly changed the policies of apartheid. Furthermore, U.S. corporations employ only less than 100,000 blacks and Coloreds.

Those who advocate the continuation of foreign investment argue that such investment in South Africa's economy actually breaks down apartheid by providing opportunities for blacks to improve their economic lot and thus acquire political power as labor union members, entrepreneurs and consumers. However, several research reports, including the one mentioned above, conclude that there is no clear correlation between the improvements in South Africa's economic fortunes and the economic, social or political fortunes of its black population. In fact, the opposite is true.

Continued expansion in South Africa's economy has coincided with an equally sustained effort to entrench white supremacy and racial separation in the political and social institutions of South Africa, thereby providing a stability that foreign investors find attractive. The November 1983 referendum which granted limited voting rights to Coloreds and Asians while excluding the black majority is one important indication that South Africa is not willing to change the structures of apartheid. The most effective strategy to break apartheid would be to cut all economic, political, military and cultural ties -- i.e., to "disengage" from South Africa.

Selected Criteria for Divestment

Many institutions have decided to divest from all companies/banks investing in or lending to South Africa. Others have devised specific guidelines or criteria for divestment. Among those frequently used are the followings:

I - Substantial Involvement

On the basis of available information on asset holdings and sales in South Africa, the following corporations are found to be doing "substantial" business in that country. We suggest the term "substantial" be interpreted to mean \$25 million or more of investments in South Africa.

TABLE V

	<u>Assets/or sales</u> <u>\$ Millions</u>	<u>Employment</u> <u>Including Whites</u>
Mobil Oil	426	3,577
Caltex (SOCAL + Texaco)	334	2,238
General Motors	243	5,038
Good-Year	97	2,797
Union Carbide	55	2,465
SOHIO (Kennecott)	343	2,259
Ford	213	6,509
Newmont Mining Co.	127	13,553
General Electric	93	5,130
U.S. Steel	80	4,500
Phelps Dodge	130	210
Ingersoll-Rand	40	538
International Harvester	43	498
Control Data Corp.	28	330
Xerox	39	810
Dresser Industries	24	1,003
Fluor	4.700*	17,500
IBM	262 ann.sales	1,800
Exxon	132 ann.sales	400

SOURCE: South Africa Fact Sheet, Africa Fund, 1/84
IRRC Report, 1982

NOTE: The Fluor Corporation was the managing contractor for South Africa's coal-liquefaction plants, Sasol II and Sasol III. The cost of Sasol III alone was \$4.7 billion. The project was completed in 1982, enabling South Africa to become energy-independent. Fluor's involvement has helped South Africa to ignore international oil embargo.

Another indicator of size is the number of employees in South Africa. One could argue that a company with over 100 employees has a substantial involvement in South Africa's economy.

While the following corporations have not disclosed the amount of investment in South Africa, other related information would imply that their presence is over \$25 million. This information can be verified by corresponding with the respective corporations.

<u>Electronic Firms:</u>	ITT	377 employees	
	Eastman-Kodak	523	
	Hewlett-Packard	235	
	Motorola	275	
	Westinghouse	100	
	NCR	626	
	Burroughs	542	(\$75 million sales)
<u>Automobile Related:</u>	Borg-Warner	550 employees	
<u>Rubber/Tire:</u>	Firestone	2,622	
<u>Heavy Equipment:</u>	Eaton Corp.	294	

II - Strategic Involvement

Despite the arms embargo and restrictions on sales to South Africa, U.S. multinationals continue to supply the Pretoria regime and outfit the country's military-industrial complex. These include the computer, mining, automobile, engineering firms and banks. Technical assistance and financial support by the following U.S. corporations has enabled South Africa to attain nuclear capability. "Strategic involvement" should also include companies that help South Africa in strategic industries or in any way that supports the military-industrial complex. Accordingly, the following corporations should be listed in the "divest"/do not buy category due to their past and present strategic involvement.

a) Nuclear /strategic collaboration

Uranium mining in South Africa *

Allied Chemical Co. (IL)	American Metal Climax (CT)
Bechtel (CA)	Exxon (NY)
Gulf Oil (PA)	Interpace (NJ)
Arthur K. McKee (OH)	Newmont Mining (NY)
Superior Oil (TX)	Tektronix (OR)
Terradex Corp. (CA)	Texas Nuclear
Union Carbide (NY)	US Borax & Chemical CO. (CA)
US Steel (PA)	United Technologies (CT)
Utah Mining	

*SOURCE: Stop the Apartheid Bomb, The Washington Office on Africa, (February, 1983)

Technical Assistance to South Africa Koeberg Nuclear Power Plant

Babcock & Wilcox (NY)	Combustion Engineering (CT)
Edlow International (DC)	General Electric (CT)
Swuco (MD)	Trans-Nuclear (VA)
Westinghouse (PA)	

Aid for South Africa Safari I Research Reactor

Allis-Chalmers (WI)	Babcock & Wilcox (NY)
Gulf General Atomic (PA)	US Nuclear Inc. (TN)
Union Carbide (NY)	

Nuclear Byproducts (components) Exporters to South Africa

Beckman Instruments (CA)	Kerr-McGee (OK)
Picker International (OH)	US Steel (PA)
Autoclave Engineers Inc. (PA)	Control Data (MN)

Help Finance South Africa Nuclear Energy/Weapons Program

Chase Manhattan Bank (NY)	Citibank (NY)
European-American Banking Corp.	Marine Midland (NY)
First Pennsylvania Bank	

b) Sales to the police or military (preliminary list)

Oil Industry: Mobil
SOCAL (Caltex + Texaco)

Auto Industry: Ford
General Motors

Electronic: IBM
Burroughs
Motorola
Control Data
Sperry-Rand

While weapons sales to the South African government are still restricted by law, under the Regan Administration, many other forms of equipment are approved for sale. And in South Africa, many companies sell to the police and military as a regular part of their sales in the country. Under South Africa security laws, much of that information is difficult to find.

III - Bank Loans to South Africa

Since 1970, international bank loans to South Africa have provided a large portion of the money needed to finance South Africa's drive toward greater economic self-sufficiency. The majority of these loans were made by the large multinational financial institutions of North America, Europe and Japan. In the recent Centre Against Apartheid publication, "Bank Loans to South, 1972-1980", it was estimated that total foreign lending to South Africa in that period amounted to \$5.5 billion, with the principal lending countries being the Federal Republic of Germany, the United States, the United Kingdom, France and Switzerland, although other western countries were significant leaders as well.

A large portion of South African production is organized into large state-owned corporations which encompass iron and steel production, power related industries, railways, roads, and other industries as well as a number of mining and manufacturing industries. The fact that the majority of international credits are extended to the public sector means that these loans are centrally managed by the government towards realizing its desires to maintain its overall economic strength in the face of partial or total economic sanctions. Thus, despite the fact the banks continue to describe the specific nature of their loans as not being militarily or strategically related, the overall state control of many of these enterprises allows for considerable transfers of capital with a loan to one project freeing resources to be used in other areas.

In a recent study compiled by ICCR, nearly all the banks surveyed stated that they do not and will not make loans to the South African government, its agencies and instrumentalities.* Among them, however, nearly all of the larger banks holding this position refused to apply a similar stringent policy to either loans to the private sector or trade-related loans. This policy is based on a questionable bank premise that failure to extend loans to the private sector could cause considerable hardships on all South Africans, especially the blacks who will suffer as a result of economic contraction in the country. They choose to disregard evidence that the benefits resulting from such loans are overwhelmingly absorbed by the white minority regime. Furthermore, they ignore the fact that loans extended to parts of the private sector could indirectly be used by the government, particularly to strengthen paramilitary forces. There are also a third and much smaller group of banks who do not share this policy of "constructive accommodation" with the apartheid system and refuse to make loans to the private sector on the grounds that such loans strengthen the apartheid system. Finally, of all the banks surveyed, only Citibank maintains a fully chartered operation with branches while North Carolina National Bank has a small office.

If the policy goal is to require a position by the bank of a stated position of no loan to the South African Government and its agencies, then the following banks and finance houses would be on the "divest/no buy" list:

Citibank	Marine Midland
Texas Commerce	Manufacturers Hanover Trust
Paine Webber	North Carolina National Bank
Phibro	Republic of New York
J.P. Morgan	Security Pacific National Bank
Wells Fargo	Smith Barney
Goldman Sachs	Kidder, Peabody & Co.
Lazard Freres & Co.	

*should have
no re: Fed
Chartered - State
Chartered - State*

*Fantu Cheru & Jim Winkler, What the Banks Say on South Africa, ICCR Publications (March 1984).

TABLE VI
U.S. PRIVATE BANK LOANS TO SOUTH AFRICA
December 31, 1982

RANK	NAME OF BANK	AMOUNT \$ (Millions)
***	1. BankAmerica	
*	2. Citicorp	
***	3. Chase Manhattan	
**	4. Manufacturers Hanover	
**	5. J.P. Morgan	
***	6. Chemical N.Y.	
***	7. Continental Illinois	
***	8. Bankers Trust	
**	9. First Chicago	
Country Exposure Lending Survey 9 Largest U.S. Banks		2,374 (1)
	10. Security Pacific	
	11. Crocker National	
**	12. Wells Fargo	
	13. First Interstate	
***	14. Mellon National	
*	15. Marine Midland	
***	16. Irving Trust	
***	17. First National Boston	
	18. Bank of New York	
	19. Interfirst of Texas	
	20. Republic Bank of Texas	
	21. National Bank of Detroit	
*	22. Texas Commerce	
	23. First City Bancorp (TX)	
*	24. SeaFirst Corporation (WA)	
Country Exposure Lending Survey Next 15 Banks		693
Total of top 24 banks		3,067

* Open to active lending to the government

** Policy allows loan to the government, but in practice no such loan made for over 5 years

*** No loan to the government, but open to private sector lending

(1) U.S. Federal Reserve Board, Country Exposure Lending Survey, (December, 1982)
- Amount = government, private and trade related loan

South Africa's profitability is directly related to the exploitation of its black population. The work force is paid extremely poorly, thereby offering foreign investors returns on their investments that are generally higher than in other parts of the world. The prospect of greater returns on investments and loans overshadow the volatile political climate which would otherwise be expected to make South Africa too risky an investment climate.

U.S. bank loans also provide tremendous moral boost for White South Africa from what they call the "white anti-communist Christian West." Western verbal criticism of apartheid in the halls of the United Nations are undercut by the willingness of these same governments to do business with South Africa. South Africa knows that it can count on the U.S. and other western nations to provide them with needed capital and that public condemnations of apartheid will not inconvenience essential business relationships. Given this historical relationship, economic disengagement appears to be an essential strategy that will force the white minority government to share power with the black majority.

Part III

SOUTH AFRICA and THE DIVESTMENT CAMPAIGN

South Africa has been using law and public relations firms to make its case in the United States since the early 1970's. According to reports on file in the Justice Department's Foreign Agents Registration Office, South Africa paid its American lobbyists more than \$7 million since 1974. These expenditures are in excess of the government's own information budget for films, speakers and publications that are widely distributed to American schools and civic organizations. The \$7 million does not include the budgets of the South African Foundation, which spends over \$200,000 annually in the U.S., or the International Gold Corporation, which spends up to \$1.5 million per month to promote and sell the South African gold coins known as Krugerrands in this country.

The South Africans have chosen their agents carefully, specially insuring ties to both Republican and Democratic parties. The Washington Post (4/12/84) reported that 31 agents, some close to the Reagan Administration, now represent South African interests, compared with 22 in 1979. Nine of the 31 directly represent either the government, the embassy or Pretoria's Consulates in the U.S. South African lobbying strategy embraces a wide array of social and official contacts on Capitol Hill and in the Reagan Administration. As anti-apartheid sentiment and divestment legislation has gained ground across the country, South Africa has increased its lobbying significantly. In 1983, the total paid to its agents in the U.S. exceeded \$1.5 million.

In recent years, the South Africans have successfully enlisted the help of the American Chamber of Commerce in South Africa to lobby on their behalf on specific issues. In February, 1984, the Chamber mailed a 20-page, pro-investment document to all U.S. Senators, Representatives and 50 governors and state house leaders, (See Appendix). The Chamber has specific goals. At the local and state level, it hopes to reach persons in more than 25 states and cities that are considering withdrawing pension fund investments from companies with South Africa connections. At the national level, the Chamber wants to fend off legislation pushed by Congressman Stephen Solars - an amendment to the Export Administration Act. The amendment would forbid U.S. bank loans to the South African government, ban the import of Krugerrands, and make compliance with the Sullivan Principles mandatory.

The high level of lobbying activity by South Africa confirms the importance the government attaches to U.S. corporate investments as a pillar of its apartheid policy. Despite public condemnations, U.S. corporations have in fact developed symbiotic relations with the apartheid system which allows them to earn high profits from their investments. Consequently, economic considerations have overshadowed human rights in the determination of U.S. foreign policy vis-a-vis South Africa.

The growing divestment movement in the United States has shaken the confidence of the South African government in its attempt to forge constructive economic and political relationships with the United States. The South African government has taken ruthless measures to punish those in South Africa who support the divestment movement. Any persons or organization who publicly advocate divestment and economic sanctions can be charged with economic sabotage. One organization which appeared to be in favour of divestment (without publicly advocating for it) is the South African Council of Churches (SACC). In recent years, the government has intensified its propaganda campaign against the churches in an attempt to discredit them in the international community where the churches draw much of their financial support.

In 1981, the South African Government ordered an investigation into the South African Council of Churches. A special Commission of Inquiry was formed initially in response to alleged financial irregularities in the bookkeeping of the SACC. However, it was soon clear that the Eloff Commission had received a much broader mandate and was asked to examine the inception, development, objective, history and activities of the council as well as the organization and people connected with the financial support of the SACC.

The Eloff Commission organized a series of hearings during which people of various backgrounds were invited to give witness on their experience with and knowledge about the SACC. One of the key witnesses was General Johan Coetzee, the chief of the South African security police. He recommended, inter alia, that the SACC be declared an "affected organization". This would make it impossible for the SACC to receive funds directly or indirectly from overseas. Since more than 96% of the income of the SACC comes from overseas funds, this would severely restrict and limit the work of the SACC.

On the 15th of February, the Eloff commission presented its report to the South African parliament. The report delivers harsh judgement on the aims, activities, tactics and strategies of the SACC, saying it is revolutionary, destabilizing, secretive and confrontational. The SACC is attacked for not restricting itself to spiritual work and advocating a radical transformation of society.

According to the Eloff Commission report, it is inappropriate for a church or church body to make pronouncements on political or economic policies (such as the promotion of disinvestment). If the SACC continues in this direction, it would have to accept being seen as a political activist or pressure group. Some of the actions of the SACC are inconsistent with the national interest, the report says. The Eloff Commission has further found that political considerations, rather than Christian compassion, motivated the spending of large sums by the Council. The financial administration of the SACC is also severely criticized.

In the face of growing harassment and intimidation by the government, SACC's general secretary, Bishop Desmond Tutu, has repeatedly called upon the international community to put economic pressure on the South African government.

Decoding the Sullivan Principles

The Sullivan Principles, developed and refined since March 1977, have come to be viewed by many corporations and investors as basic guidelines to be pursued by corporations operating in South Africa. The principles called for:

- . non-segregation of the races in all eating, comfort and work facilities;
- . equal and fair employment practices for all employees;
- . equal pay for all employees doing equal or comparable work for the same period of time and minimum wages well above the minimum living level;
- . initiation of and development of training programs that will prepare, in substantial numbers, Africans and other blacks for supervisory administrative, clerical and technical jobs;
- . increasing the number of Africans and other blacks in management and supervisory positions;
- . improving the quality of employees' lives outside the work environment in such areas as housing, transportation, schooling, recreation and health facilities.

U.S. churches have consistently raised questions about decency and lessening discrimination in the workplace with U.S. corporations. Of course, we are relieved when racist signs are removed or black employees receive training and make a decent wage or scholarships are provided. But, the real question in South Africa for the 1980's is not decency in the workplace. It is the sharing of political, economic, social and legal rights with all citizens, regardless of race. Do these workplace principles address that reality? Sadly not!

In fact, Dr. Sullivan himself has supported a variety of economic pressures on South Africa in addition to the principles. He has backed limits on bank lending, no further corporate expansion, and an end of sales to the police and military. He has also stated that, if apartheid does not change within a reasonable time, he will reissue his call for withdrawal.

Unfortunately, too often, corporations cynically refer to the principles as a way of diverting debate from other, more contentious, issues related to their South African investments. IBM and Sperry would rather have us talk about the principles than their sales of computers to Government agencies. GM and Ford, Mobil and Caltex would prefer not to discuss their ongoing sales to the police and military. GM would rather discuss the principles and the work situation for its 966 African employees than the fact that they stated in a South African designed contingency plan that, in a time of emergency, it was likely that the South African Department of defense would take over their plant because of its strategic importance. Mobil would prefer to discuss the principles rather than the reality that its business is cloaked in secrecy by the South African Official Secrets Act and that details of its purchases,

refining and sales of petroleum are unavailable to top management in the U.S. A. These are issues that the principles do not address, and yet they cry out for attention.

The position of ICCR is that the Six Principles are not a formula for change. They are simply a prescription for decency in the workplace. What we need to address are the ways in which U.S. corporations and U.S. Government policy can be a catalyst for the basic social change so drastically needed in the land of apartheid.

APPENDIX B

STATE OF CONNECTICUT
PORTFOLIO ANALYSIS

CAPITAL MANAGEMENT SCIENCES
10920 WILSHIRE BOULEVARD, SUITE 1203
LOS ANGELES, CALIFORNIA 90024

- B. Increasing earnings variance (the instability of earnings)
 - C. Increasing the Beta (relative market volatility)
 - D. Reducing the activity to diversify the overall portfolio
 - E. Focusing on lower market capitalization (smaller) companies
2. Elimination of Trading Nations on the other hand increases exposure to historically higher growth companies including
- A. Higher dividend growth
 - B. Higher earnings growth
 - C. Higher reinvestment rates

The alteration of the fundamental factors can best be described in terms of historic returns. By weighting the various portfolios with and without Trading Nation holdings and Trading Nations holdings alone, we find a substantial difference in the risk-return characteristics over the period 1977 through 1981..

The performance results clearly demonstrate the impact of eliminating Trading Nations from the actual portfolio and Standard & Poors 500.

Returns of the portfolios excluding Trading Nations exceeded the total portfolio over the five-year period analyzed. The commensurate risks increased in a corresponding fashion.

Summary

The elimination of Trading Nations common stock impacts portfolio behavior. Reducing the universe of stocks to non-trading corporations substantially increases portfolio risk while potentially increasing returns. Possibly of greater importance is that it removes the larger, more financially stable companies as potential alternatives for selection by the State's Investment Managers. This hinderance could have a substantial negative impact on the portfolio's future behavior.

Daniels & Bell Capital Management Co.

REGISTERED INVESTMENT ADVISOR UNDER THE INVESTMENT ACT OF 1940

20 EXCHANGE PLACE
NEW YORK, NEW YORK 10005
(212) 422-1700

March 17, 1982

Honorable Henry E. Parker
Treasurer
State of Connecticut
Office of the Treasurer
Hartford, Connecticut

Dear Mr. Parker:

We have just completed our study on the December 31, 1981 common stock holdings of the State of Connecticut Mutual Equity Fund.

Two separate reports have been prepared. The first report is on stocks held currently and the other one makes use of a "sanitized" list of stocks which excludes investments in the unacceptable companies. Both reports assumed a \$100 million investment on December 31, 1976 divided among the stocks and assumed the same proportions as represented in the December 31, 1981 portfolio. No changes were made in the list of stocks. Proportions were adjusted at each calendar quarter end to balance with December 31, 1981 proportions.

Five stocks were not included from the study because of inadequate five year history of quarterly prices and dividends. Those stocks were: Connecticut Nutmeg, Digicon, Provident Life & Accident, Seagull Pipeline and Student Loan Marketing. Their aggregate market value represented only 0.46% of the December 31, 1981 portfolio. This exclusion made little difference in the study.

In the "sanitized" list of studies, the portion invested in each unacceptable company were allocated equally among the other acceptable companies in the same industry. Where there were no similar securities the amount invested in the deleted stock were spread proportionately over all the stocks in the sanitized list.

Since Daniels & Bell is this nation's only Black investment banker, we also take this opportunity to present an idea to you we have conceived to alter the economic balance in South Africa. It is our professional opinion that a shift in economic assets and resources will quickly lead to a respected participation by the Black populist in that country.

The State of Connecticut would allocate five percent of its assets to be managed by the Daniels & Bell Capital Management fund for the express purpose of Daniels & Bell making competitive investments directly in South Africa in co-ordination and co-operation with selected South African Blacks. The State of Connecticut could profess a public policy of continuing to invest in companies who have investments in South Africa so long as a percentage of that company's pension assets, which would be based on its volume of earnings from South African operations, also was allocated to Daniels & Bell for competitive investments directly in South Africa. This could also provide leadership to many other public pension assets for a method of directly affecting the economic viability of South African Blacks while continuing the focus on return on investments for pension assets.

If, for example, such investments were concentrated in the coal production and supply area, this would leave the current South African government less concern because of their continued dominance in other industry areas.

Having a specific segment of the economy depended on by Black South Africans will promote co-operation from many international companies, who already have investments in that country. Black South Africa's independent resources and financial expertise through the capital investment fund managed by Daniels & Bell will provide the necessary ingredient to enable this group to compete in world commerce on a profitable basis.

A structure to provide the general South African treasury a percentage of the profits from these economic projects will promote co-operation from the white run government and foreign investment will continue. This will not necessarily provide the mechanism for acceptance of Whites to Blacks but as economic strength is built and participation for the general treasury is experienced, it is our belief that the fruits of that country could then be examined on a real basis, and that is economic acceptance and respect.

We not only compared the original portfolio to the "sanitized" portfolio, but we also compared both portfolios' performance against different stock indexes and fixed income indexes. The report compared rates of returns on a quarterly basis and a yearly basis from the portfolios' inception on December 31, 1976 to December 31, 1981.

The original portfolio was 1.26 times as volatile as the S&P 500. The sanitized portfolio was 1.35 times volatile compared to the S&P 500. The increase in volatility in the sanitized portfolio was due to the fact that the stocks excluded were larger capitalization companies making the "sanitized" portfolio slightly riskier. But during the sharp drop of the market in 1981 both portfolios performed identically. Upon comparing both portfolios the "sanitized" portfolio outperformed the original portfolio over the latest 3-year and 5-year periods. Although both portfolios did way better than the various market averages.

The "sanitized" portfolio was 39% as diversified as the S&P 500 while the original portfolio's diversification was 91%. The exclusion of the 54 stocks in the "sanitized" list accounted for the decrease in diversification.

On a risk adjusted basis, the "sanitized" portfolio has done 15.1% better than expected on an annual basis. The original portfolio did 10.9% better than expected. Clearly the "sanitized" portfolio is more superior on this basis.

In conclusion, the exclusion of the unacceptable companies from the mutual equity fund will not have any negative impact. In fact, the study has shown the "sanitized" portfolio to outperform both the original portfolio and the market.

The numerical analysis presents a clear result if investments in unacceptable issues were made into alternative industry investments.

However, one must consider the impact on the lives of the laborers in South Africa if a liquidation of South African investments is implemented.

Further, we believe that a prudent approach must also include alternative methods of investments in South Africa which could bring a more balanced economic relationship between all parties in South Africa along with providing the State of Connecticut a good rate of return on its investments.

Foreign investment, both direct and indirect, has played a key role in the development of the South African economy, and remains an important factor in maintaining a high rate of economic growth.

Many people in South Africa see it as the hope of the future and the source of liberalizing social and political developments. Others see economic growth as continuing to benefit whites almost exclusively while making little or no contribution to changes that would significantly benefit the other population groups.

According to the World Bank's 1980 listing South Africa is only a "middle-income developing country," a category that includes over forty-five nations, among them Argentina, Brazil, Israel, Nigeria, and Spain. As measured by most of the important economic indicators of development, South Africa still lags far behind the major industrialized countries.

The country's economy, like many other aspects of South Africa, is a study in contrasts and inequality. South Africa has modern cities like Johannesburg and Cape Town, but many areas outside the cities are characterized by the rural poverty of an underdeveloped country. The economy is, in fact, a dual economy, divided not only between an urban industrial sector and a rural subsistence sector but also, as the enormous differences between income levels and living standards show, between black and white.

Today, the public sector controls 58 percent of South Africa's fixed capital stock and contributes 26 percent of the country's GDP. Many of the country's largest industrial entities are the government-owned and -run corporations. The government is especially active in energy development and exploration, operating the South African Coal, Oil, and Gas Corporation (SASOL) and the Southern Oil Exploration Corporation of South Africa (SOEKOR).

Total foreign investment in South Africa at the beginning of 1979 was \$26.3 billion, an amount equivalent to 20 percent of the value of South Africa's industrial plant. Of this, approximately 40 percent was direct investment--primarily foreign company ownership in South African subsidiaries or affiliates--and 60 percent was indirect investment--international bank loans and foreign ownership of stock in South African firms.

At the beginning of 1979 direct foreign investment was \$11 billion, with \$8 billion held by Europe and \$2 billion held by the United States. Britain, which for historic reasons has had the closest economic ties with South Africa, may have as much as \$6 billion directly invested in the country. In the past decade

foreign direct investment in South Africa has increased only negligibly in real terms. Fifty percent of this investment is in manufacturing, 25 percent in finance, 15 percent in trade, and less than 10 percent in mining. Many of the world's major automobile and oil companies are represented in the manufacturing sector. The bulk of the investment in finance is held by subsidiaries of British banks, notably Standard Chartered and Barclays Bank International.

U.S. direct investment in South Africa has increased an average of \$100 million a year since the mid-1960s.

Portfolio investment, especially the foreign ownership of South African gold-mining stock, is also an important component of indirect investment. Americans alone hold 25 percent, or \$2 billion, of South Africa's total gold-mining stock, and foreign ownership overall is approximately \$3 billion.

A return on investment point of view through the enclosed analysis clearly shows alternative industry investments would have provided a better rate of return while only moderately increasing volatility risk. There would seem to be little risk to the State of Connecticut if it sold all of its securities which companies held investments in South Africa, however it also would have miniscule direct impact on the South African government and companies who have investments and operations there. There is significant value to the public attitude and suasion if the State of Connecticut implements its sale of companies with investments in South Africa and "jawboning" by the State Administrative representatives could provide the basis of a new direction and new leadership in addressing the issues of apartheid.

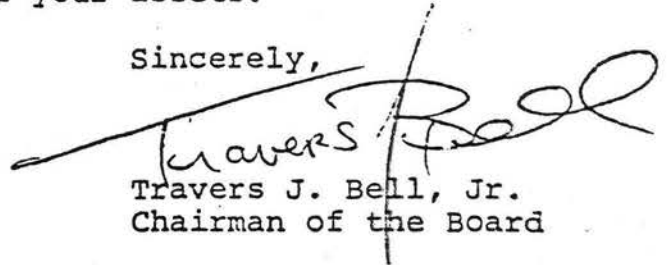
South Africa as shown by the previous statistics continues to require substantial foreign investment and continued foreign investment allows the government to remain self-sufficient. The systematic withdrawal of foreign investment and restraint of new investment will force more dependency on imports of all categories thus making the government more reliant or perhaps responsive to exporter governments concerns on apartheid. Undoubtedly the contraction of the South African economy will strike hard at the Black and Coloured population and this must be clearly understood as the current disparity in laborers wages and employment is quite wide.

There could be a more concentrated impact on the South African government if all U.S. firms sold their gold stocks. This would cause specific hardship for earning foreign exchange, thus increasing the risk of external lending to the government which could lead to more concessions from the white dominated government. It would in our opinion have a lesser negative impact on Black and Coloured workers over the short term.

APPENDIX C (Continued)

We are pleased at the opportunity to provide you with our analysis on the impact of divesting unacceptable investments in your portfolio and to share with you some other perspectives that could result in alternative investing of your assets.

Sincerely,

A handwritten signature in dark ink, appearing to read "Travers J. Bell, Jr.", is written over a horizontal line. The signature is stylized with a large, looping "B" and a long, sweeping underline that extends to the left.

Travers J. Bell, Jr.
Chairman of the Board

TJB:mc

United States Trust Company

March 22, 1982

Mr. Lee Van Meter
Deputy Treasurer Investments
State of Connecticut
Office of the Treasurer
20 Trinity Street
Hartford, CT 06511

Dear Mr. Van Meter:

In response to your letter of February 11, I am pleased to present the first portions of our analysis of the impact on Connecticut's Mutual Equity Fund portfolio which would result from the divestment of firms doing business in or with the Republic of South Africa.

In the first instance we have made some minor refinements to your list of such companies. Schedule A contains the names of ten additional firms in the S&P 500 which are the sole or major owners of South African subsidiaries. In addition, Schedule A contains two deletions from your list, American Broadcasting Company, and CBS, both of which have only news bureaus in South Africa.

Schedule B lists each of the securities which were in your portfolio at the end of 1981 that would have to be sold under the proposed policy. The schedule lists the cost basis, the proceeds, before commissions, at the closing prices on March 11, and the gain or loss for each security as well as totals for these three amounts. Many of these positions are clearly too large to be liquidated in a single day, or perhaps over a few weeks. Nevertheless, as you can see, if all of the securities had been sold at March 11 prices, there would have been a net, realized gain for the portfolio. Consequently, we presume that there would have been no adverse accounting consequences which would have required larger future contributions from the taxpayers. The same calculation, with the prices prevailing at the end of 1981, would yield a somewhat larger net realized gain of \$17,125,893.

The more important question, is whether the securities which would be sold could be replaced with suitable alternatives. At one level this is simply a question of whether or not adequate representation could still be obtained in various industries. Following is a list of conventional S&P industry groups each of which accounted for more than 1% of total S&P 500 capitalization on 12/31/81 and each of which contains firms doing business in or with South Africa whose capitalization is 50% or more of the industry total. In some cases, we have combined a number of smaller but closely related groups.

<u>Industry Group</u>	<u>Market Capitalization as % of S&P 500 (12/31/81)</u>	<u>% of Market Value Excluded by South African Criterion</u>
Aerospace	1.63%	81%
Autos, Trucks & Parts	2.62	82
Banks (combined)	2.32	73
Chemicals (combined)	3.51	87
Drugs	4.37	100
Electronics: Major Companies, Instrument, Semiconductors, Components, Electric equipment, Communications equipment	4.82	61
Hospital Supplies	1.80	82
Machinery: Agricultural, Construction-material handling, Industrial/specialty	1.80	67
Miscellaneous	4.40	70
Office and Business Equipment	6.05	81
Oil-Integrated Int'l	8.88	100

In our judgement, it would be difficult or impossible to make prudent and advantageous investment selections out of those industry groups where the percent excluded exceeds 80%. However, the elimination of international oils does not strike us as a very serious problem since there are large and well managed companies in the integrated domestic, and crude-producing industries which would be eligible for purchase and which accounted for 9.63% of the S&P 500 at the end of 1981. Moreover, numerous and sometimes substantial additional opportunities exist for investment in firms engaged in off-shore drilling and the supply of oil well equipment as well as other areas of the natural resource industry. In our opinion, the only diversification which would be lost by excluding the international oils is similar to what is already lost in many other areas by excluding foreign companies. There would still be ample opportunity to participate fully and efficiently in the stock market's reflection of changes in the relative prices of oil and other sources of energy.

The exclusions in the categories of Banks, Electronics, and Miscellaneous should effect many of the largest companies in America with excellent financial strength and industry leadership. In the case of banks, we believe that ample opportunities exist among the remaining banks and numerous banks which are not part of the S&P 500. In addition, similar portfolio results can readily be obtained in other components of the financial services industry.

Mr. Lee Van Meter
March 22, 1982
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APPENDIX ^D (Continued)

These restrictions appear to be unacceptably severe for fiduciaries who are responsible for investing on behalf of numerous other persons. However, we would like to suspend any definitive judgement on the effects of these exclusions until we complete a statistical study of the quarterly returns and variability of the S&P 500 over the past 10 years with and without the South Africa-related firms. Our preliminary results indicate that the 380 companies in the S&P 500, that do not do business in or with South Africa, have produced a total return over the last ten years in excess of the entire index. This "sanitized" group accounts for only about one half of the market capitalization of the S&P 500. Nevertheless its beta, estimated against the entire index from quarterly data, is exactly one with a very small standard error. The same analysis suggests that the superior performance of the 380 is not statistically significant. The standard deviation of quarterly results suggests, like the beta, that there is no more risk in owning just the 380 than there is in owning the 500.


If the restrictions appear to expose the Fund, to impaired returns or increased risks which are imprudent, you may wish to consider a more relaxed set of standards which we have applied for a number of ERISA accounts whose trustees were concerned about South African investments. Under these standards, first preference is still given to the firms which have not been excluded in the previous discussion. However, whenever we believe that we cannot achieve optimal portfolio diversification under these restrictions, we have the right to consider in addition those firms which do business in South Africa but which 1) have adopted the Sullivan Principals and 2) have been judged to perform according to the highest standards under those principals according to the annual report, prepared by Arthur D. Little Inc., On the Signatory Companies to the Sullivan Principals.

We hope to complete the remaining portion of our analysis somewhat ahead of schedule. After we have mailed it to you and you have had a chance to study both reports, we look forward to a face to-face discussion on the ways in which you can be responsive to the moral concerns of the citizens of Connecticut without sacrificing the investment objectives of your portfolio.

Sincerely,



Robert B. Zevin
Economist & Vice President, Investments



Stephen K. Moody
Vice President, Investments