



# American Committee On Africa

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

## MEMO

### FINANCIAL CONSEQUENCES OF DIVESTMENT FROM SOUTH AFRICA

Prepared by

Jennifer Davis

Executive Director

November, 1983

In twenty-five states, legislation is pending to prohibit the investment of public pension funds in U.S. corporations operating in South Africa. Connecticut and Massachusetts are the first states to pass this legislation and have started the divestment process. Preliminary data indicates that these states are not losing money through divesting but rather are realizing a net gain. This experience together with previous computerized projections should meet frequently raised fiduciary reservations about divestment.

There are two methods of assessing the financial consequences of divestment: by examining the results obtained by those entities which have already divested, and by theoretical models, using modern portfolio theory to construct models to project the long term performance of portfolios with and without South Africa-related stocks. We have assembled and are enclosing both kinds of evidence, all leading to the same conclusion; divestment can be carried out without adverse financial consequences.

#### Entities Which Have Divested

##### The State of Connecticut

The State of Connecticut passed divestment legislation on June 9, 1982. As of July 30, 1983, the state had divested itself of \$39,025,078 worth of equities and fixed income investments, and realized a total gain of \$5,716,817.00. The State Treasurer's Office further reports that as of July 30, state funds remained



page two

invested in 56 corporations covered by the divestment law with an inventory value of \$274,821,288.00 and a current market value of \$344,610,271.00.

The list of securities which have been sold to date are on the next page.

#### The State of Massachusetts

In January 1983, the State of Massachusetts passed legislation to sell from their public pension fund portfolio all investments in firms doing business in South Africa. 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 transactions. However, we are enclosing a letter from Governor Michael Dukakis stating, in part, "It has been our experience that divestiture not only makes a strong moral statement against apartheid but divestiture has proven to have had no significant impact on our pension earnings."

We are also enclosing a projection by Franklin Research that through arbitrage (bond swapping) Massachusetts could realize a \$2,377,987.00 net gain through divestment if the transactions had been effective as of November 30, 1982. We are also enclosing a commentary on this research in Business and Society Review.

#### Michigan State University

In 1979 Michigan State University sold all \$12,075,492.00 of South Africa related investments in its portfolio. In 1980 they produced an analysis which we enclose comparing the sales proceeds with the 1980 value of the stock and evaluating the replacement investments by deducting their total cost from their 1980 value. The report concludes that the University had made \$100,092 more on the sale of the South Africa related investments than they would have been worth in 1980 and that the value of the replacement stocks in 1980 exceeded the total cost of acquiring them by \$2,034,355.00. It is therefore safe to say that Michigan State University had made a profit of over \$2,000,000 by divesting from South Africa-related corporations.

page three

## The City of Philadelphia

In June of 1982 Philadelphia became the first major American city to pass an ordinance calling for the sale of all investments in South Africa-related corporations. In testimony before the Washington D.C. City Council, Philadelphia City Councilmember Joan Specter declared that the law affects securities valued at approximately \$80 million out of the city's \$600 million portfolio. She testified that although the law allows two years to complete the divestiture about one-half the sales required had been completed in the first nine months after the law took effect. The city treasurer reported no difficulty in trading the South African-related holdings for equally profitable securities, Mrs. Specter testified.

## Portfolio Projections

The other major means of assessing the financial consequences of divestment is to examine projections of probable portfolio performance once South Africa-related securities have been excluded. We have access to three studies in which an investment service was asked to examine the probable consequences of divestment for a particular fund. Described below are projections for the California Retirement Systems, and the pension funds of Connecticut and Washington, D.C.

## State of California

In 1980 the Council on Economic Priorities issued a report on the possible consequences of excluding securities of corporations which were Equal Employment Opportunity violators or who invested in South Africa from the California State Teachers' Retirement System and the Public Employees Retirement System.

The Council constructed a computer model to evaluate the performance of a portfolio without the South Africa-related corporations or EEO violators. They compared the Standard & Poor (S&P) 500, a widely used stock market proxy, with the S&P

page four

500 minus 132 corporations excluded by these standards. They then studied the degree of diversification of the two portfolios, the amount of non-market risk, and the expected return on the post-exclusion portfolio. On diversification they concluded that "over 99% of the movement of each portfolio can be accounted for by movements in the market. In the practical world of portfolio management, this is an extremely high degree of diversification."

They then compared the amount of non-market risk in the excluded portfolio with that found in mutual funds designed to perfectly track the S&P 500. They found that while these mutual funds usually have a non-market standard deviation of around 1.5% the excluded portfolio's non-market deviation would be 1.9% effectively increasing the non-market risk by .4%. In contrast the median non-market deviation for all institutional portfolios is about 6%.

They concluded that "the expected annual returns on the post-exclusion portfolios are not lower than the baseline portfolio's (S&P 500) expected return." Actually the projected returns were a little higher (1.01 times return on the market versus 1.00 times the market). The study found that the increase in non-market risk for exclusion in a bond portfolio will be even less than with the equity portfolio. They said the lost opportunities for diversification in the bond market would be smaller than with stocks.

In summarizing their findings, the Council reported that "Exclusion only produces a very small increment of unnecessary risks. The universe of still available securities remains large enough to construct a highly efficient portfolio." This study, Pension Funds & Ethical Investment, is available for \$35 from the Council on Economic Priorities, 84 Fifth Avenue, NYC, 10011.

The State of Connecticut

The United States Trust Company did a similar analysis of the considerably smaller Connecticut state pension fund in 1982, prior to the passage of that state's divestment legislation.

page five

They concluded that if all South Africa -related stocks had been sold at the end of 1981 the state would have realized a net gain of \$17,125,893. "Consequently we assume that there would have been no adverse accounting consequences which would have required larger future contributions from the taxpayers."

They felt the more significant question was that of finding suitable alternative investments. They explored this question by comparing the performance over the past ten years of the S&P 500 and the 380 companies in the S&P 500 which do not do business in South Africa. They found that the 380 had outperformed the entire index for the past ten years but not to a statistically significant extent. They concluded that "there is no more risk in owning the 380 than in owning the entire 500."

Washington D.C.

Washington D.C. passed a divestment ordinance in October of this year. Before doing so they asked Franklin Research and Development Corporation to prepare an analysis of the consequences for their portfolio. Franklin Research reported that the pension fund would have to sell their investments in the common stock of 31 companies. If those stocks had been sold as of December 31, 1982 a gain of about \$2,000,000 would have been realized.

They further ran nine year comparisons of the performance of the companies investing in South Africa versus those that did not. The result was that while the South Africa-related corporations had a growth in earnings and price appreciation of 8% a year, those that did not invest in South Africa averaged 11.2% a year. The South Africa-related stocks were selling at about 17 times earnings while those not involved in South Africa were selling at 24 times earnings.

Noting that of the approximately 6,350 companies listed on the major exchanges in this country, fewer than 400 do business in South Africa, Franklin Research stated, "In our opinion there is no material investment disadvantage created by excluding less than 1% of the listed companies from the approved investment list."

page six

Companies like Waste Management, Polaroid, Wang Labs, Signal, Ralston Purina, Quaker Oats, and Digital Equipment come to mind as alternatives."

#### Risk of Investing in South Africa

In considering divestment one must also weigh the risks posed by continued investment in South Africa. We are enclosing a document from Business Environment Risk Information (BERI S.A.), a Geneva-based firm specializing in risk analysis for international firms.

BERI S.A. feels that operational and socio-political problems will become more acute in South Africa throughout the 1980's. They cite continued black labor unrest, the expense of protecting against sabotage, the increased cost of labor, and increasing bureaucratic interference by the government, especially "security" measures which prohibit local managers from reporting many aspects of their operations to headquarters abroad.

They recommend that management: 1. de-emphasize South African operations and prepare to shift production elsewhere if possible; 2. protect industrial sites and personnel against violence; 3. consider the costs of exclusion from other African markets because of South African operations, and the cost and management difficulties of handling stockholder initiatives and adverse publicity from anti-apartheid groups; 4. examine the possibility of an orderly withdrawal early in the decade to avoid financial losses.

This report suggests another factor in the divestment equation: the risk to a pension fund of reliance on South Africa-related investments. Certainly this is something that must be carefully weighed by anyone who proposes to maintain South Africa-related corporations in their pension fund portfolio.

## CONNECTICUT

### REPORT TO THE INVESTMENT ADVISORY COUNCIL ON SOUTH AFRICAN INVESTMENT LAW.

(7/1/82 to 1/31/83)

On June 9, 1982 Governor William O'Neill signed into law Public Act #82-324, "An Act Concerning the State Investment Policy in Relation to South Africa." The new state law directs the Treasurer of the State to disinvest all state funds invested in companies doing business in South Africa that do<sup>^</sup> meet three specific guidelines, as follows:

NOT

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

The passing of the South African investment law distinguished Connecticut and established the state as a role model for other public pension funds in the area of social responsibility. The Treasurer, recognizing the importance of meticulous analysis and implementation, assigned the South African project to his executive assistant, and hired a Yale University School of Organization and Management graduate student as a summer intern, charging them with the responsibility of reviewing the state's portfolio for compliance with the new investment law, and developing an ongoing method of monitoring corporate activity. These efforts to analyze the portfolio and establish procedures were coordinated with the Investment Division and the Investment Advisory Council.

Discussions were held with a number of data gathering organizations that provide much of the research in the broad area of social responsibility, including monitoring U.S. corporate activity in South Africa. Many of these organizations are assisting in developing the Treasury Department's research files which are basic to the implementation of the law. In addition to developing an ongoing data exchange network, invaluable advice and information has been received from the following organizations:

African American Labor Center  
American Committee on Africa  
Corporate Data Exchange  
Center for Economic Organizing

Council on Economic Priorities  
Connecticut Anti-Apartheid Committee  
Interfaith Center on Corporate Responsibility  
Investor Responsibility Research Center  
International Council for Equality of Opportunity Principles, Inc.  
Washington Office on Africa  
United Nations Centre on Africa

Corporations in the state's portfolio have been sorted according to their Sullivan performance rating and a preliminary review of the products and services offered in South Africa has been conducted. Information about their compliance with Standard III, recognizing the right to organize and strike, will take longer to gather and will be conducted in a company by company review. This initial review revealed that on July 30 Connecticut had investments in 230 corporations, 70 or 30% of them doing business in South Africa.

At the end of July, 1982, the Treasurer sent letters to the Chief Executive Officers of the 230 corporations in the portfolio advising them of the law and requesting an official company response. The 70 identified South African investors were requested to return a questionnaire dealing with the three specific guidelines in the law. Companies were given a period of five weeks to respond, allowing them the time to present the request to their Boards, if desired. By the end of the September, 75% of the companies contacted had responded, at which time a second request was made to companies doing business in South Africa that did not respond to the first. Each of the 70 corporations was reviewed for compliance.

An in-house system of reviewing prospective new buys for compliance was established to assist the state's professional investment managers, and to ensure that current and future purchases would be in compliance with the law.

A new position, Investment Officer - Social Compliance, has been established in the Investment Division and is accountable for the development, implementation and management of the Treasurer's Corporate Social Responsibility Program. The appointment of a candidate has been made, and clears the way for a systematic approach to divesting the State's portfolio of all investments which fail to meet compliance guidelines.

The intent of the legislation is to encourage positive change in the social and environmental practices of companies. The Investment Officer-Social Compliance has the initial responsibility of meeting with targeted companies to determine their continued eligibility and develop a schedule of divestment for those that cannot or will not comply.

The Investment Advisory Council, which has monitored the process monthly, has established a sub-committee on social responsibility that will assist in policy and make recommendations concerning the schedule of divestment and other social responsibility issues such as proxy voting.



Of the 70 corporations reviewed for compliance with the law, 56 are currently held in the portfolio. Total dollar values for portfolio held securities of corporations that are in South Africa:

	<u>Inventory</u>	<u>Market</u>
7/30/82 Equities	219,711,700	210,713,500.
7/30/82 Fixed Income	<u>140,232,300.</u>	<u>118,870,700.</u>
7/30/82 TOTALS	359,994,000.	329,584,200.
1/31/83 Equities	206,267,434.	273,562,989.
1/31/83 Fixed Income	<u>87,826,138.</u>	<u>76,060,767.</u>
1/31/83 TOTALS	294,093,573.	350,423,756.

Of the 70 corporations identified as doing business in South Africa, and reviewed for compliance with the law, 42 are in compliance, while 28 corporations have not met the requirements of the law and have been placed on an "Avoid List." Being on the "Avoid List" means that our position in the corporation will not be increased, and if we cannot convince the corporation to comply with the law, the security will be sold.

To date, eight corporations have been sold off the "Avoid List". Total dollar values for sales, as follows:

	<u>Inventory</u>	<u>Redemption</u>	<u>Gain/(Loss)</u>
Equities	18,126,043.	22,565,774.	4,439,731.
Fixed Income	<u>2,619,210.</u>	<u>2,421,145.</u>	<u>(193,065.)</u>
TOTALS	20,745,253.	24,986,919.	4,241,666.

The remaining 22 corporations on the "Avoid List" have total dollar values, as follows:

	<u>Inventory</u>	<u>Market</u>
Equities	66,125,904.	83,809,813.
Fixed Income	<u>32,439,548.</u>	<u>30,048,327.</u>
TOTALS	98,565,452.	114,658,140.

CONNECTICUT  
SALE OF SECURITIES NOT IN COMPLIANCE WITH SOUTH AFRICAN INVESTMENT LAW

<u>Corporation</u>	<u>Units/ Par Value</u>	<u>Inventory</u>	<u>Redemption</u>	<u>Gain/Loss</u>
<u>EQUITIES</u>				
Air Products & Chemicals (Non-Signatory)	159,127 shs	\$ 5,040,079.	\$ 5,153,392.	\$ 113,313.
Alexander & Alexander (Non-Signatory)	100,900	2,723,208.	2,301,065.	(422,143.)
American Home Products (Non-Signatory)	56,900	1,716,104.	2,543,431.	827,327.
Coca-Cola Company (Rating)	85,000	3,283,550.	4,441,151.	1,157,601.
Dun & Bradstreet (Non-Signatory)	25,000	1,659,000.	1,939,460.	280,460.
Eli Lilly & Company (Rating)	52,000	2,908,880.	2,728,824.	(180,056.)
Martin Marietta Corporation (Non-Signatory)	60,000	2,187,000.	1,380,554.	(806,446.)
Nabisco Brands (Rating)	50,000	1,600,000.	1,708,443.	108,443.
VF Corporation (Non-Signatory)	106,000	2,282,180.	4,664,752.	2,382,572.
Warner Communications (Rating)	90,000	2,332,800.	4,155,361.	1,822,561.
TOTAL EQUITIES		<u>\$25,732,801.</u>	<u>\$31,016,433.</u>	<u>\$ 5,283,632.</u>
<u>FIXED INCOME</u>				
Martin Marietta Corporation (Non-Signatory)	2,800,000. 7% 3/15/11	\$ 1,507,380.	\$ 1,507,520.	\$ 140.
Motorola, Inc. (Rating)	1,250,000. 8% 10/1/07	1,111,830.	913,625.	(198,205.)
Upjohn Company (Rating)	5,000,000 14% 6/1/91	4,956,250.	5,587,500.	631,250.
TOTAL FIXED INCOME		<u>\$ 7,575,460.</u>	<u>\$ 8,008,645.</u>	<u>\$ 433,185.</u>
TOTAL EQUITIES & FIXED INCOME (6/9/82 to 7/30/83)		<u>\$33,308,261.</u>	<u>\$39,025,078.</u>	<u>\$ 5,716,817.</u>

Schedule A

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	\$ 562,078	\$ 494,241	\$ 67,837
Capital Holding	38,520	22	20	847,440	770,400	77,040
Citicorp	15,540	25	22	388,500	341,880	46,620
Coca Cola	11,780	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	218,500	38,000
Exxon	19,268	56	66	1,079,008	1,271,688	(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	58	53	368,416	310,156	58,260
Houghton Mifflin	23,605	33	33	778,965	778,965	-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.	18,714	30	28	561,420	523,992	37,428
Northwest Airlines	13,300	28	27	372,400	359,100	13,300
PepsiCo	17,925	25	24	448,125	430,200	17,925
Polaroid	4,665	28	23	130,620	107,295	23,325
Procter Gamble	5,680	78	71	443,040	403,280	39,760
RCA	16,945	25	23	423,625	389,735	33,890
Sears Roebuck	4,400	18	17	79,200	74,800	4,400
Tampa Electric	16,343	18	15	294,174	245,145	49,029
Upjohn	13,350	43	48	547,050	640,800	(93,750)
Xerox	2,655	57	65	151,335	172,575	(21,240)
Weyerhaeuser	12,675	30	35	380,250	443,625	(63,375)
TOTAL:				<u>\$12,075,492</u>	<u>\$11,975,400</u>	<u>\$ 100,092</u>

✓ - (U.S. Companies with subsidiaries in South Africa).

\* Including Albert Case Fund

Schedule B1979 COMMON STOCK PURCHASES  
MICHIGAN STATE UNIVERSITY PORTFOLIOS

<u>COMMON STOCK</u>	<u>NUMBER OF SHARES</u>	<u>PER SHARE PUR. PRICE</u>	<u>2/8/80 PRICE PER SHARE</u>	<u>TOTAL COST</u>	<u>2/8/80 HOLDING VALUE</u>	<u>2/8/80 VALUE MINUS TOTAL CO</u>
Air Products	17,600	\$33	\$40	\$ 500,800	\$ 704,000	\$ 123,200
American Hospital Supply	6,500	29	33	188,500	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	18,500
Burlington Northern	8,050	63	79	507,150	635,950	128,800
Champion International	21,100	25	26	527,500	548,600	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	18,200	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	28	19	464,800	315,400	(149,400)
Panhandle Eastern Pipeline	11,950	47	66	561,650	700,700	227,050
Texas Eastern Corp.	4,800	59	74	283,200	355,200	72,000
				<u>\$7,206,404</u>	<u>\$9,240,759</u>	<u>\$2,034,355</u>
				TOTAL:		

SALE OF SECURITIES NOT IN COMPLIANCE WITH SOUTH AFRICAN INVESTMENT LAW

<u>Corporations</u>	<u>Units/ Par Value</u>	<u>Inventory</u>	<u>Redemption</u>	<u>Gain/(Loss)</u>
<u>EQUITIES</u>				
Air Products & Chemicals	159,127 shs	5,040,079.	5,153,392.	113,313.
Non-Signatory				
American Home Products	56,900	1,716,104.	2,543,431.	827,327.
Non-Signatory				
Dun & Bradstreet	25,000	1,659,000.	1,939,460.	280,460.
Non-Signatory				
Eli Lilly & Company	52,000	2,908,880.	2,728,824.	(180,056.)
Rating				
Martin Marietta Corporation	60,000	2,187,000.	1,380,554.	(806,446.)
Non-Signatory				
V F Corporation	106,000	2,282,180.	4,664,752.	2,382,572.
Non-Signatory				
Warner Communications	90,000	2,332,800.	4,155,361.	1,822,561.
Rating				
TOTAL EQUITIES		<u>18,126,043.</u>	<u>22,565,774.</u>	<u>4,439,731.</u>
<u>FIXED INCOME</u>				
Martin Marietta Corporation	2,800,000.	1,507,380.	1,507,520.	140.
Non-Signatory	7% 3/15/11			
Motorola, Inc.	1,250,000.	1,111,830.	913,625.	(198,205.)
Rating	8% 10/1/07			
TOTAL FIXED INCOME		<u>2,619,210.</u>	<u>2,421,145.</u>	<u>(198,065.)</u>
TOTAL EQUITIES & FIXED INCOME		<u>20,745,253.</u>	<u>24,986,919.</u>	<u>4,241,666.</u>

As Of 1/31/83



THE COMMONWEALTH OF MASSACHUSETTS

EXECUTIVE DEPARTMENT

STATE HOUSE • BOSTON 02133

MICHAEL S. DUKAKIS  
GOVERNOR

August 8, 1983

The Honorable Marion S. Barry  
Mayor, District of Columbia  
District Building  
Washington, DC 20004

Dear Mayor Barry:

In April of this year I had the honor of hosting a reception for state and local officials attending a weekend conference on the issue of divestiture from South Africa.

I met and talked with officials from throughout the nation including John Ray of the District of Columbia, where I understand you are about to consider a divestiture bill.

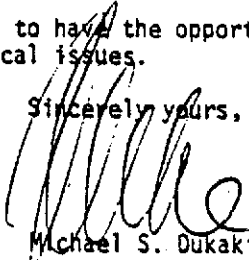
We here in Massachusetts are proud to have been the first state in the nation to vote to sell from our public pension fund portfolio all those investments in firms doing business in South Africa.

This landmark action was the result of a four year coalition effort that brought together representatives of labor, religious, civic and Black community organizations. Although the legislation was vetoed by the prior administration, the veto was overridden by an overwhelming margin -- 23 to 5 in the Senate and 132 to 2 in the House.

I urge you as Mayor of the District of Columbia and as one long active in the pursuit of civil rights to give serious consideration to both the moral and the financial arguments surrounding the divestiture debate. It has been our experience that divestiture makes not only a strong moral statement against apartheid but divestiture has proven to have had no significant impact on our pension earnings As the attached analysis shows, timely and careful divestiture can result in net increases in pension earnings.

Thank you for your interest. I hope to have the opportunity to talk with you personally about this and other critical issues.

Sincerely yours,

  
Michael S. Dukakis

MSD/saf  
attachment

Combined holdings of State Employees' and Teachers' pension funds in South Africa related companies and banks (paper loss or gain calculated as of Nov. 30, 1982)

<u>Industrial Bond</u>	<u>Book Value</u>	<u>Current Market Value</u>	<u>Loss or (Gain)</u>
Abbott Labs	\$2,131,500	\$1,472,625	
Borden, Inc.	200,500	152,000	
Caterpillar Tractor	1,650,250	1,255,000	
Dow Chemical	3,382,609	2,537,690	
Exxon Pipeline	2,173,800	1,800,000	
Ford Motor Co.	3,736,943	2,727,800	
General Electric Co.	1,300,000	1,072,500	
General Motors Acc. Corp.	(see bank bonds, below)		
Minnesota Mining & Manuf.	1,000,000	806,000	
Pfizer, Inc.	1,094,500	922,000	
Union Carbide	2,595,200	1,904,000	
Warner-Lambert	895,000	709,000	
Xerox	1,197,000	956,000	
<u>Bank Bond</u>	<u>Sub-total=</u>	<u>21,357,302</u>	<u>16,596,365</u>
Bankamerica Corp.	6,769,302	5,138,275	
Bankers Trust	1,847,625	1,381,460	
Central National Bank of Cleve.	(sold or not on most recent list)		
Chemical Bank	4,522,915	3,346,440	
Citicorp	5,347,508	3,963,500	
Crocker National Bank	2,255,500	1,691,600	
First Pennsylvania Bank	482,900	268,400	
General Motors Acc. Corp.	3,073,771	2,434,500	
Manufacturers Hanover	5,116,473	5,079,936	
Wells Fargo Bank	2,000,000	1,709,500	
<u>Sub-total=</u>	<u>31,415,994</u>	<u>25,013,611</u>	<u>Bank Bonds sub-total loss = \$6,402,383</u>
<u>Bank Stocks</u>			
Bankamerica Corp.	(sold)		
Citicorp *	(sold)		
Citizens & Southern Nat'l Bank	(sold or not on most recent list)		
Continental Illinois	(sold since Aug. 31)		
Crocker National Bank	(sold)		
Fidelcor	(sold)		
First Chicago Corp.	(sold)		
First City Bancorporation - Texas	(sold)		
First National Boston Corp.	5,442,259	8,128,125	
Harris Trust & Savings	(sold or not on most recent list)		
Manufacturers Hanover	(sold since Aug. 31)		
Maryland National Bank	(sold since Aug. 31)		
Mellon Bank	5,154,516	7,975,000	
Morgan, J.P. & Co.	7,728,063	11,347,500	
Northwest Bancorporation	6,698,280	5,600,725	
Philadelphia National Bank	(sold since Aug. 31)		
Republic National Bank - Texas	5,969,000	6,900,000	
Security Pacific Corp	5,002,925	9,585,000	
Western Bancorporation *	(sold or not on most recent list)		
<u>Sub-total=</u>	<u>35,995,043</u>	<u>49,536,350</u>	<u>Bank Stocks sub-total</u>
<u>Total =</u>	<u>\$88,768,339</u>	<u>\$91,146,350</u>	<u>gain = \$13,541,307</u>
*now First Interstate			
<u>Total net gain = \$2,377,987</u>			

Final Draft  
MASSACHUSETTS

The Financial Implications of Divestiture  
Prepared by Franklin Research

In late December 1982, outgoing Governor Edward King vetoed a bill that would have made Massachusetts the first state to completely divest its pension funds from corporations with affiliates or subsidiaries in South Africa. The Governor, while publicly supporting the intent of the legislation, cited a State Treasurer's Office estimate that the bill would decrease the value of the State's Pension Funds by over \$16 million as the rationale for casting his veto. This note will show that when the Massachusetts legislature overrode the Governor's veto 133 to 2 in the House and 23-5 in the Senate, the value of the State's Pension Funds actually increased.

When one purchases a bond, one receives a fixed annual return ('the coupon') plus a pledge from the company that they will pay you \$1,000 for each bond you hold at some specified time in the future ('the maturity date'). For example, the owner of a bond which has an 8% coupon and matures in 20 years would receive \$80 in coupon payments for each of the next 20 years plus \$1,000 when the bond reaches maturity. When interest rates rise, bond prices fall. This occurs because investors place less value on a fixed annual income stream if higher returns can be earned by investing in some other instrument (such as money markets or T-Bills). Correspondingly, when interest rates fall, bond prices rise because investors are now willing to pay more for a fixed annual income stream.

Massachusetts State Pension Funds purchased many bonds in the 1960's and early 1970's when interest rates were low. In the early



1980's when interest rates skyrocketed, bond prices plummeted. Accordingly, by December 1982 the market value of the State Pension Funds bond portfolio had significantly decreased. The Treasurer's Office, however, in their analysis presented to the Governor, did not use December 1982 market prices for bonds. Instead the 'maturity' value (\$1,000 per bond) that the State's bonds would be worth 20 to 30 years in the future was used to calculate the current value of the State's bond portfolio! The Treasurer's Office \$16 million-plus deficit was achieved by subtracting the current December 1982 market value of the State's Bond portfolio from the value that these bonds would achieve when they reach maturity in the future.

Three days after the Governor had vetoed the bill, the State Treasurer's Office admitted, after being pressured by several citizen-economists, that 1) the \$16 million-plus drop in the worth of the State Pension Funds Bond portfolio had already taken place and was not due in any respect whatsoever to the South African Divestiture legislation; and 2) through a series of "bond swaps" no financial losses would be incurred by the State Pension Funds. "Bond Swaps" in this case would mean the simultaneous selling of bonds in corporations with South African connections and the purchasing of other bonds on the State's "Approved Purchase List" that did <sup>not</sup> ~~not~~ operate in South Africa.

An example of a bond swap available to the Massachusetts Public Employee Pension Funds would be to sell Minnesota Mining and Materials ("3M") bonds and to use the proceeds to purchase Texas Instruments ("TI") bonds. 3M Corporation's South African subsidiary extracts

and markets South Africa's strategic and lucrative diamond, gold, silver and uranium mines. TI has no South African connections and is on the state's "Approved Purchase List."

On December 23, 1983, Massachusetts Public Employee Pension Funds owned 1,000 3M bonds. These bonds had an annual coupon of 8.85%, matured in 2005 and were priced at \$812.50 each. Thus, each 3M bond yielded \$88.55 a year and would be worth \$1,000 in the year 2005. If sold on December 23, 1982, these 1,000 3M bonds would fetch \$812,500. (There are no brokerage commissions incurred when buying or selling bonds.)

On December 23, 1983, "TI" bonds matured in 2005, yielded a coupon of 12.7% and sold for \$1,032 each. The \$812,500 the state could obtain from selling its 1,000 3M bonds could purchase 787 TI bonds ( $\$812,500 \div \$1,032 = 787$ ). These TI bonds would provide an annual yield of \$99,949 and would be worth \$787,000 in the year 2005. As Table 1, Columns A-C show, such a bond swap would increase the state's Pension Funds value by over \$50,000.

But this guaranteed \$50,000 gain significantly understates the increased value that would occur due to a 3M-TI bond swap. Each year from 1983 to 2005 the TI bonds would yield \$11,449 more than the 3M bonds. This extra money could be reinvested. Column D shows that the value of this bond swap would increase by \$483,484 if a conservative 8% nominal reinvestment rate is assumed.

The above analysis may cause you to ask why anyone would buy 3M bonds if TI bonds offer a higher rate of return. The answer is taxes. As mentioned earlier, bonds yield two types of return--an

annual coupon dividend and a lump sum payment of \$1,000 when the bond reaches maturity. The coupon income is taxed at the normal tax rate (over 50% for individuals and corporations in the highest tax brackets). Any appreciation in the value of the bond obtained when it reaches maturity is taxed at the much lower long-term capital gains tax rate (only 20%). Taxpaying entities therefore pay a premium for deep-discounted bonds due to the fact that a larger proportion of the income they receive from the bond is taxed at the lower long-term capital gains rate. In the above cited 3M and TI example, 3M bonds offer \$187,500 in long-term capital gains, while TI provides a long-term loss of \$25,500. The Massachusetts Pension Funds are, however, tax-exempt institutions. They derive no extra benefit from owning deep-discounted bonds. Accordingly, it would make economic sense for the Massachusetts Pension Funds to sell their deep-discounted bonds that taxpaying entities are willing to pay a premium for, and to use the proceeds for non-discounted bonds that have no tax shielding attributes. Making such swaps is called arbitrage, and is a standard practice used by all reputable financial advisors.

The Massachusetts Treasurer's Office claimed that such bond swaps could not be implemented because of a non-binding, non-public Treasury Department regulation that no bond could be sold for less than was paid for it, unless all of the deficit could be recouped in 10 (or less) years' time by increased coupon payments. Since most of the state Pension Funds bonds have over 20 years to go before reaching maturity and are selling well below par, the Treasurer's Office claimed that they were legally prohibited from making financially advantageous bond swaps.

This Treasury Department non-binding rule was instituted years before when interest rates were low and not volatile. A dozen senior financial analysts and Harvard Business School professors I contacted could provide no rationale for this non-binding rule. Neither could officials from the Treasury Department.

The Massachusetts South African divestiture bill superceded this Treasury Department's non-binding rule. It thus enabled the state Pension Funds to take advantage of arbitrage on one-third of its \$125 million dollar bond portfolio. By 2005, these bond swaps should increase the value of the state's Pension Funds by at least \$5 million, and perhaps much more. Perhaps one day this Treasury Department non-binding, non-public archaic rule will be overturned for the remaining two-thirds of the state's Pension Funds bond holdings that are not invested in corporations that do not profit from apartheid. If this occurs soon, the state Pension Fund's value will increase by at least another \$5 million.

TABLE 1

	(A)	(B)	(C)	(D)
	3M	Texas Instr.	gain(loss) obtained via bond swap	change in value in 2005 dollars***
1983	\$88,300	\$99,949	\$ 11,449	\$ 62,189
1984	88,300	99,949	11,449	57,582
1985	88,300	99,949	11,449	53,317
1986	88,300	99,949	11,449	49,367
1987	88,300	99,949	11,449	45,710
1988	88,300	99,949	11,449	42,325
1989	88,300	99,949	11,449	39,189
1990	88,300	99,949	11,449	36,286
1991	88,300	99,949	11,449	33,398
1992	88,300	99,949	11,449	31,109
1993	88,300	99,949	11,449	28,805
1994	88,300	99,949	11,449	26,671
1995	88,300	99,949	11,449	24,695
1996	88,300	99,949	11,449	22,866
1997	88,300	99,949	11,449	21,172
1998	88,300	99,949	11,449	19,604
1999	88,300	99,949	11,449	18,152
2000	88,300	99,949	11,449	16,807
2001	88,300	99,949	11,449	15,526
2002	88,300	99,949	11,449	14,409
2003	88,300	99,949	11,449	13,342
2004	88,300	99,949	11,449	12,354
2005	88,300	99,949	11,449	11,439
Value at Maturity in 2005	\$1,000,000	\$787,000	\$(213,000)	\$(213,000)
Total	\$3,035,500	\$3,085,827	\$50,327	+ 483,483

\*\*\* Assumes conservative 8% nominal discount rate. Between 1980 and 1982 the nominal discount rate exceeded 13%.

## THE MASSACHUSETTS PORTFOLIO PURIFICATION

by MILT MOSKOWITZ

**H**OW DO YOU like this portfolio:

<i>Stocks and Bonds</i>	<i>Market Value</i>
Abbott Labs	\$1.5 million
Dow Chemical	2.5 million
Ford Motor	2.7 million
Chemical Bank	3.3 million
Citicorp	3.9 million
Manufacturers Hanover	5.0 million
Mellon Bank	7.9 million
J.P. Morgan	11.3 million
Security Pacific	9.5 million

\* Not bad, huh? Well, the state of Massachusetts doesn't think so. It's in the process of selling out every one of these positions from its public employee pension funds. Some already may have been sold by the time you read this. During the last half of 1982 the funds also eliminated from their portfolios the securities of Bank of America, Citizens & Southern National Bank, Continental Illinois, Crocker National, Fidelcor and First Chicago. Among others ticketed to be sold, in addition to the ones listed above, are securities of Borden, Caterpillar Tractor, Exxon Pipeline, General Electric, General Motors Acceptance, 3M, Pfizer, Union Carbide, Warner-Lambert, Xerox, Bankers Trust, First Pennsylvania, Wells Fargo, Republic National Bank of Texas, and Northwest Bancorp.

It looks like a blue-chip clearout. What's going on here? This is very simply a portfolio purification. Every one of the companies named above has something to do with South Africa. The banks loan money there, often to the government itself. The industrial companies have subsidiaries there and/or sell their products there. Early in 1983 Massachusetts became the first state in the union

to take the position that it did not want any public funds invested in the securities of companies which did business in a country "whose official government policy is based on a flagrant system of racist laws." The bill, passed by the legislature, directs that all stocks and bonds of companies involved in South Africa be sold within the next three years. Since it seemed clear in late 1982 that such legislation would pass, the pension funds began selling out these positions even before the bill passed, taking advantage of a rising stock market to pocket some profits.

The anti-apartheid action in Massachusetts was a victory for a broad-based coalition called Mass. Divest (Massachusetts Coalition for Divestment from South Africa). More than 100 labor, religious, and community organizations backed the campaign, among them the Massachusetts Federation of Teachers, the Greater Fall River Central Labor Council, the Massachusetts Council of Churches, the Brandeis Undergraduate Student Government, the Justice and Peace Office of the Sisters of Notre Dame, and the Irish Republican Club of Boston.

The argument frequently used against such divestment is that it would be ruinous financially. Mass. Divest effectively countered this argument by showing that even bonds on which the pension funds were showing a paper loss could be swapped for other depressed bonds without any financial sacrifice. For example, the funds held 1,000 3M bonds with a redemption value at maturity in 2005 of \$1 million; the bonds paid 8.85 percent interest; their market value, as of December 22, 1982, was \$812.50 each. Mass. Divest analyst John Gordon Weiss showed that with the \$812,500 proceeds from the sale of the 3M bonds, the pension funds could purchase 787 Texas In-

**Race Mixing Is Still Taboo***Segregation in Various State University Systems*

	<u>% Black</u>		<u>% Black</u>
<b>Alabama</b>		<b>Maryland</b>	
University of Alabama	12.0	University of Maryland	7.7
Alabama State University	99.5	Morgan State University	92.1
<b>Arkansas</b>		<b>Mississippi</b>	
University of Arkansas	5.7	University of Mississippi	7.1
U of Ark. at Pine Bluff	84.8	Alcorn State University	96.9
<b>Florida</b>		<b>North Carolina</b>	
University of Florida	5.1	U of N.C. at Chapel Hill	8.4
Florida A & M University	89.8	Fayetteville State University	86.3
<b>Georgia</b>		<b>Tennessee</b>	
University of Georgia	4.5	University of Tennessee	13.0
Albany State University	94.3	Tennessee State University	72.6
<b>Kentucky</b>		<b>Texas</b>	
University of Kentucky	3.5	University of Texas	2.5
Kentucky State University	66.1	Prairie View A & M University	98.0
<b>Louisiana</b>		<b>Virginia</b>	
Louisiana State University	6.2	University of Virginia	7.2
Southern University	93.0	Virginia State University	95.2

—*Chronicle of Higher Education*  
December 15, 1982

strument bonds whose value at maturity in 2005 would be \$786,925; that's considerably short of \$1 million, but the Texas Instrument bonds have a 12.7 percent coupon, giving an annual yield of \$99,939 (as against the 3M annual yield of \$88,500); so the pension funds would come out all right in the end. Texas Instruments does not have operations in South Africa. (Let's not ask whether it would if it could.)

The South African divestment bill sailed through

the Massachusetts legislature but was vetoed by outgoing Governor Edward J. King; it was one of his last acts as governor. The legislature then overrode the veto. The vote to override in the Senate was 23-5. The vote to override in the House was 123-2. Senator Jack Backman, one of the sponsors of the legislation, said the vote "will send a strong message to the rulers of South Africa." It's also a strong message to U.S. corporations. □

**PIZZA POWER**

The American Society of Mechanical Engineers figures the U.S. could put a permanent space station in orbit for the same sum—\$9 billion—that Americans spent on pizza in 1981.

—*The Wall Street Journal*  
November 19, 1982



**BUSINESS ENVIRONMENT RISK INFORMATION**

**SUMMARY OF REMARKS INTENDED FOR THE STATE OF CALIFORNIA, CONFERENCE  
ON INVESTMENT AND SOUTH AFRICA**

By Mary McCarthy, Ph.D, Vice President Research  
BUSINESS ENVIRONMENT RISK INFORMATION (BERI) S.A.

Background. BERI S.A. is a Geneva-based firm specializing in risk analysis for the international firm. The company has been in business since 1966 and has over five hundred clients in Europe, North America, and Asia. Fifty-five countries are monitored continually and forecasts are updated three times per year. Two separate panels are used to collect expert opinion: one is composed of businesspeople located around the world who rate operating conditions according to a set of fifteen criteria; the second is a panel of socio-political experts, many of whom are diplomats, who assess socio-political risks according to a set of internal and external factors. Both panels are approximately 70% non-United States based. BERI S.A. uses a third measure of risk which is a statistical model and is designed to assess a country's ability to allow remittances in hard currency.

Conclusions on South Africa. BERI S.A. feels that operational and socio-political problems will become more acute throughout the 1980s. Therefore, no long-term commitments in South Africa are recommended. The situation



indicates a trade only, or a transaction by transaction, relationship.

For firms currently operating in South Africa, BERI S.A. recommends that management:

- \* deemphasize South African operations and prepare to shift production elsewhere, if possible.
- \* protect industrial sites and personnel against violence.
- \* consider the costs of exclusion from other African markets because of the South African operations, and the costs and management difficulties of handling stockholders initiatives and adverse publicity from anti-apartheid advocacy groups.
- \* examine the possibility of an orderly withdrawal early in the decade to avoid financial losses.

#### Operational Risks

The Operations Risk Index is currently at moderate levels, but the panel foresees a decline to high risk within five years. Major factors are the increased cost of labor and interruptions to operations which result from the growing militancy. Management will be able to do very little toward resolving industrial disputes as many will concern issues outside the workplace, such as housing, education, etc. Bureaucratic interference is another negative factor in this rating. Firms will be caught between militant labor movements and government pressure to resist black demands. Firms will also be constrained in the amount of information that can be relayed to home offices; the government is already using security laws to stem the flow of financial information. Added costs will be necessary to protect plant sites against deliberate attack by armed groups as well as spontaneous labor violence. South African law makes each company responsible for establishing adequate self-protection.

(Information on costs of security installations cannot be transmitted to the parent company under South African security laws.) Government interference is already substantial and will grow as tensions rise.

### Socio-Political Risks

The major risks have an obvious cause: blacks, who represent 72% of the population, have no rights, land, or even citizenship. The whites are determined to resist any significant change; modifications being currently discussed are designed to increase and prolong control, rather than liberalize the system. The government must fight change from without as well as from within. Thus, a democratically-ruled Namibia will be delayed as long as possible. The aim of the government is destabilization of the rest of the region, particularly Mozambique, Angola, and Zimbabwe. Frequent military operations, most of a clandestine nature, will hinder economic growth and political cohesion in the entire region.

Within South Africa, the whites will retain control only as long as they remain united. BERI S.A. has developed a scenario in which this situation persists for about the next fifteen years. Afrikaners are becoming more educated, prosperous, and urbanized. Many no longer hold the "rule by divine right" philosophy. The Dutch Reformed Church is splitting. Afrikaner students are resisting military service and questioning traditional values. Those in power are as single-minded as ever, but the weakening of resolve is less than one generation away. The question remains of whether or not the whites can allow change at a pace sufficient to avoid violent upheaval. BERI S.A. concludes that present trends indicate that this is not probable; thus, while socio-political forces will not

produce conditions disastrous to business within the next five years, the situation is evolving in that direction.

The Political Risk Index panel rates South Africa in the prohibitive risk category with further deterioration in their +5 Years forecast.

#### Financial Risks

The R Factor rating (R is for "repatriation and remittances") has declined from low to moderate risk within the last eighteen months. Firms will have more difficulty remitting earnings during the next year as South African hard currency reserves are at minimum levels. Over the longer term, the country's financial position depends on the price and market for gold. The R Factor rating should improve slightly in 1984 as the worldwide economy improves. However, a number of countries which hold substantial gold reserves are incurring heavy hard currency debt and will attempt to sell off gold later in the decade in order to service their debts. This will depress the price considerably and will cause tremendous pressure on the rand. Socio-political tensions will be increasing in South Africa simultaneously, and capital flight will be substantial, causing government restrictions on divestment.

(A thorough analysis of this complicated issue is available in the FORCE report on South Africa; the 1983 report will be published in March, 1983 and the 1982 report, published in May, 1982, is still available. BERI S.A. also offers a special monitoring service which includes forecast statements and statistics and is intended for international lenders, including firms offering export credit.)