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BILL ANALYSIS

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Senate Fiscal Agency

Lansing, Michigan 48909

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Senate Bill 171 (Substitute S-5 as reported)
House Bill 4395 (Substitute S-2 as reported)
Sponsor: Senator Dan L. DeGrow (Senate Bill 171)
Representative Virgil Smith (House Bill 4395)
House Committee: Civil Rights (House Bill 4395)
Senate Committee: Judiciary

Date Completed: 6-7-88

RATIONALE

Considerable controversy exists over the role U.S. corporations play in the economy of the Republic of South Africa, a country that promotes the principle of white supremacy through its laws and social structure (commonly referred to as "apartheid"). Some people believe that American investment bolsters the apartheid system by strengthening the South African economy. Furthermore, they argue that it is unconscionable to obtain profits from business operations in a country where that profitability derives from economic factors, such as artificially cheap labor, that exist in large part due to a repressive and discriminatory political system. Opponents of the South African government have argued that ostracism of the country, through economic sanctions and otherwise, could be an effective way of bringing about change from the outside. According to many, a step that Michigan could take in this direction would be to prohibit public employee retirement systems from making or maintaining investments in firms operating in South Africa.

CONTENT

The bills would amend Public Act 314 of 1965, which regulates the investment of the funds of public employee retirement systems, to forbid any new investment by Michigan's public employee retirement systems in a national corporation of South Africa or a United States firm doing business in South Africa (as designated by the State Treasurer), and to require divestiture of the retirement systems' assets in investments of such firms. Senate Bill 171 (S-5) would apply to the Michigan Legislative Retirement System, a fire and police department pension and retirement system, the State of Michigan Judges' Retirement System, the State of Michigan Probate Judges Retirement System, and the Michigan State Police Retirement System; House Bill 4395 (S-2) would apply to the Michigan Public Schools Employees' Retirement System and the State Employees' Retirement System.

The bills specify that an investment fiduciary for a retirement system could not "encourage or condone legally required discrimination against an individual on the basis of race or color" by making or maintaining the forbidden investments. ("Investment" would mean "utilization of money in the expectation of future returns in the form of income or capital gain", and would not include the importation or exportation of goods.) Current investments would have to be divested according to a schedule under which a minimum of 40% of the assets were divested within two years after the appropriate bill's effective date. The

remaining assets would have to be divested over the next three years, as follows:

- 60% within three years after the appropriate bill's effective date.
- 80% within four years after the appropriate bill's effective date.
- 100% within five years after the appropriate bill's effective date.

If the State Treasurer determined that divestment would jeopardize the fiscal integrity of a retirement system, the Treasurer could extend these deadlines for up to one year.

The provisions prohibiting investment and requiring divestiture would apply only until the State Treasurer determined and notified the investment fiduciaries that both of the following applied:

- Full citizenship and equal political rights regarding national policy had been granted and were in effect for all South African people, regardless of race.
- Legal restrictions on the freedom of all South Africans to live, travel, and work anywhere in their country no longer existed.

The State Treasurer would be required to develop and maintain a register of United States companies that had an investment in South Africa, and/or a franchise, licensing agreement, or management agreement with an individual or company located in South Africa. The Treasurer would have to provide the register to each retirement system board at least annually and whenever a change was made in the register. The Treasurer also would have to notify a board of those investments that the retirement system had in a company included in the register.

Not less than 90 days before the register was provided to the retirement systems' boards, the State Treasurer would have to give the Legislature and the chief executive officer of each company in the register the following information:

- Notice that the company was being placed on the register.
- The reason for that placement.
- The current value of system assets invested in the company.
- Any other information that the Treasurer considered necessary or appropriate.

The State Treasurer also would have to report to the Legislature annually on divestment under the bills. The report would have to include at least all of the following:

OVER

S.B. 171 & H.B. 4395 (6-7-88)

- The progress of systems in implementing the divestment of assets.
- The register.
- The reason companies had been added to the register.
- The names of companies the Treasurer was considering adding to the register.
- The amount of retirement system assets invested in companies included in the register.
- The financial cost to the State of divestment under the bill.
- Any other information the Treasurer considered necessary or appropriate.

The bills specify that they would "not alter or diminish the existing fiduciary or statutory obligations...on the investment of retirement system assets". The investment fiduciary of each retirement system would be required annually to report to the Governor and the Legislature any gains or losses in the value of the system's investment portfolio and its investment performance attributable to the divestment process. Any gains resulting from divestment would have to be recorded annually and used to compensate for any losses or diminution in value that resulted from the process in subsequent years.

The bills are tie-barred and would take effect on January 1, 1989. The bills also are tie-barred to Senate Bill 228, which would ban surrogate parenting contracts for pay.

Proposed MCL 38.1133c (Senate Bill 171)
38.1133b (House Bill 4395)

BACKGROUND

Previous Divestment Measures House Bills 4770 and 4771 of 1985-86 would have adopted divestment measures similar to those in Senate Bill 171 and House Bill 4395. House Bill 4395 and Senate Bill 171 differ from the 1985 bills in that they cover all public employee pension systems rather than only the State Employees' Retirement System and the Michigan Public School Employees' Retirement System. House Bills 4770 and 4771 passed the House and were reported from the Senate Committee on Economic Development, Travel, and Tourism, but never passed the Senate. The bills were on the Senate calendar when the 1985-86 legislative session ended.

In 1985, the Governor appointed an implementation commission to study the effects of selling State pension fund investments in firms that operated in South Africa. The commission reported that, at that time, a five-year divestiture process would cost about \$23 million and that a seven-year schedule would reduce initial transaction costs by 44%, bringing the total cost of divestiture down to approximately \$16.4 million over seven years. The commission also recommended "back-weighting" the divestment process. ("Back-weighting" refers to a schedule whereby divestiture is weighted toward the later years of the schedule.) The Senate Committee on Economic Development, Trade, and Tourism incorporated the back-weighted concept into House Bills 4770 and 4771 of 1985-86.

The Sullivan Principles

The Sullivan Principles are adhered to by many American companies doing business in South Africa. These principles require: nonsegregation in all eating, comfort, and work stations; equal and fair employment practices for all employees; equal pay for equal or comparable work; training programs to prepare a substantial number of blacks and other nonwhites in management and supervisory positions; and improving the quality of

employees' lives outside of the work environment, such as in housing, transportation, schooling, recreation, and health facilities.

FISCAL IMPACT

The bills would have an indeterminate impact on the funds of the State's employee retirement systems to which it would apply, and on the State's General Fund.

Although detailed information as described below is not currently available, costs or gains to the affected

- 1) The portion of the retirement systems' portfolios currently invested in South African companies or U.S. firms doing business in South Africa;
- 2) The estimated yield of those investments over a one- to five-year time span;
- 3) The costs and estimated yield resulting from reinvesting the funds identified in point 1) in comparable firms without ties to South Africa; and
- 4) The estimated difference between the yield of current investments (point 2) and the yield of the reinvested

ARGUMENTS

Supporting Argument

United States businesses supply vital goods to the government of South Africa, thereby assisting the government in continuing its apartheid practices. Withdrawing technical and financial assistance would hamper the South African government's ability to carry out its policies and would destabilize the economy. Direct U.S. investment in South Africa is concentrated in strategically important sectors of the economy, and U.S. companies control much of the nation's computer, oil, and auto markets. All the companies in these sectors lend critical support to the South African government and its military and police apparatus. The police use commercial cars and trucks to make pass law arrests, maintain surveillance of black political groups, and remove unwanted Africans to homelands. Many U.S. firms are designated "key points", which means that in the event of civil unrest they must follow orders of the South African Defense Force. These are only a few examples of how U.S. firms operating in South Africa support the apartheid system. The bills would require action aimed at upsetting this economic network.

Supporting Argument

The measures contained in the bills would make a clear statement on behalf of the Michigan Legislature as to its disapproval of apartheid. The measures are consistent with the U.S. and Michigan policy of encouraging respect for human rights around the world. To allow continued involvement in the South African economy under the rationale that change can be implemented from within is a self-serving argument that strains the credibility of United States and Michigan policy on human rights. Further, should the situation in South Africa improve and all citizens receive full citizenship and equal political rights, and if restrictions on travel, work, and living conditions were lifted, the provisions of the bills would be suspended.

Opposing Argument

It is true that the apartheid system violates many standards of human rights that Americans feel must be upheld. The bills, however, would seek to pursue this ideal by discriminating against retirees. The public pension funds would be used as an instrument for making a political

statement. The investment performance of the funds (and the retirees who benefit from them) would be left to suffer the financial consequences. Other avenues for fighting apartheid should be pursued; divestment of pension funds' assets would be economically detrimental.

Response: Divestment of interest in firms operating in South Africa may prove to be an economically prudent step. Considering the mounting unrest in South Africa and the political backlash against the country's policies, from both domestic and international sources, it may be wise to divest now in order to avoid future losses. If the volatile situation in South Africa continues on its present course, corporations could be nationalized as a precaution against revolution or counterrevolution. In the event of such an action, Michigan's public pension funds could suffer heavy losses, if its assets remained invested in those companies. South African investment is just too risky. Divestment procedures should be pursued. In addition, the experience of educational institutions, cities, and other states has shown that prudent divestment can be carried out without harming the value of investment portfolios.

Opposing Argument

The bills would fail to distinguish between companies that have agreed to the Sullivan Principles and those that have not. Companies that have adopted the Sullivan Principles have been addressing fair employment practices in South Africa and are bringing about change in the political structure. Without the presence of these companies, blacks would be the hardest hit as the economy worsened.

Response: The Sullivan Principles are ineffective, as they only address fair employment practices in the work place; they do not address the social and political consequences of apartheid that are causing the problems in South Africa. Also, only a portion of U.S. corporations have implemented the Sullivan Principles in their companies. Further, Rev. Sullivan, himself, set a deadline of May 31, 1987, for the evolution of the Sullivan Principles' influence on the abolition of apartheid. Since that date, even he has supported the use of sanctions such as divestiture. As for the argument that withdrawal of U.S. corporations would hurt blacks the most, the work force of U.S. corporations is composed of 98% white persons, 1% Indian and colored workers, and only .4% black workers. Twenty-six million black people in South Africa live under harsh conditions because of the apartheid system. The small number who would be subject to loss of employment is negligible compared with the 22 million who live under modern-day slavery. Further, U.S. corporations, many of which have operated in South Africa for decades, are not effective in changing the political structure. The apartheid system is as oppressive now as it has been at any time in its history; if U.S. corporations are attempting to influence the demise of that system by continuing to operate in South Africa, then their results have been dubious at best. Finally, in the last two years many American corporations have decided to pull out of South Africa rather than help to sustain that country's oppressive policies.

Opposing Argument

Divestment of pension funds' assets committed to corporations operating in South Africa would be ineffective. When stocks are sold, they aren't simply "dumped"; rather, someone else buys them. Neither the corporations nor the South African government would suffer from such an occurrence. Selling the stocks held by Michigan's public pension funds, contrary to common perceptions, would not adversely affect the South African economy.

Response: More than an economic concern, divestment is a moral imperative. South Africa is particularly the object of outrage because the conspicuous lack of freedom there for the 85% of the population that is nonwhite is the result of years of calculated legislation enacted by the representatives of the 15% of the population that is white. It is unconscionable for the State to profit from investments in corporations that operate in a nation whose laws demand discrimination against nonwhites to keep them politically disenfranchised and economically disadvantaged.

Opposing Argument

The situation in South Africa is a foreign policy matter. It is inappropriate for the Michigan Legislature to mandate provisions to deal with foreign affairs. To enable the Federal government to establish consistent foreign policies, matters such as sending signals or statements to governments of other countries should be left to the jurisdiction of the Federal government.

Response: Certain aspects of the situation in South Africa are indeed foreign policy matters, but the question of proper avenues for investment of Michigan's public pension funds is certainly an issue to be resolved by the Michigan Legislature.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.