



How best to deal with Iran? Why divestment is the *WRONG* solution.

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- **In attempting to address serious international political problems, divestment produces a lot of pain for no gain.**

Iran's behavior when it comes to terrorism is abhorrent, and its actions regarding proliferation are troubling and potentially very dangerous. Both issues must be dealt with fully. But you need to ask, is divestment the right way to address these serious problems? Divestment harms retired firefighters, police and teachers, would alienate U.S. allies, and threatens to set a dangerous precedent in the area of capital market sanctions, all without having an effect on the behavior of the countries in question.

- **Divestment harms retired police, firefighters and teachers and entire state retirement systems.**

Broad divestment provisions would require pension funds to divest millions or even billions of dollars of investments in major multinational companies and would impart a mandate contrary to the fiduciary responsibility of the pension funds. For example, Florida officials estimate that divestment would cost its state pension funds \$800 million a year in lost financial returns under one scenario. California's State Teachers retirement fund, CalSTRS, estimates that mandatory divestment from Iran's energy sector will cost their fund \$1 billion in opportunity costs over the next five years.

As the *Sacramento Bee* noted in April 2007: "None of us is for terrorist countries," said Anne Sheehan, board representative for California's finance director Michael Genest, but she warned a broad Iran investment ban could wreak havoc in the fund's \$163.5 billion portfolio. "...It is amazing what we would have to divest." Divestment imposes immediate transaction costs to sell identified holdings, and in some cases may force fund managers to seek lower quality investments because of state regulations.

- **Politicizing U.S. capital markets is a slippery slope.**

However laudable the social or political objective of the divestment movement, mandating divestment on any subject is a slippery slope. States or Congress could require divestment regarding any issue it chooses. Yesterday it was Sudan, today it is Iran, tomorrow it could be Russia or China. In 2001, the *New York Times* editorial board said about Sudan legislation under consideration at the time, "Tampering with America's capital markets on political grounds -- even sound political grounds -- would set a dangerous precedent." Divestment is a dangerous intrusion into the area of capital market sanctions.

While there is a strong moral case for divestment - particularly with regard to Sudan - even some of its backers recognize the danger here. Daniel Millenson, head of the Sudan Divestment Task Force, said recently that "We understand the slippery slope argument and that it [divestment] should be used only rarely," and added that his organizations are not advocating any other issues. He said, "Genocide meets a threshold that a lot of other things don't."

- **Divestment would "create chaotic conditions" by allowing states to make their own foreign policy.**

Statutes aimed at affecting foreign policy at the state and local levels - as divestment seeks to do - threaten to create a complex web of restrictions and regulations that impede the President's ability to conduct foreign policy. The President's Special Envoy to Sudan Andrew Natsios noted the Administration's opposition to state divestment legislation (in April 11 testimony before the Senate Foreign Relations Committee), saying, "There is a reluctance to support this because the fear is that to have each state or municipality conducting its own foreign policy could create chaotic conditions."

- **Divestment poses serious constitutional questions about the involvement of states in foreign policy.**

In February 2007, an Illinois judge struck down the state's "Act to End Atrocities and Terrorism in Sudan" in *NFTC v. Giannoulas*. The judge's decision took account of the catastrophic genocide in Darfur, but found the law unconstitutional because "the Act violates federal constitutional provisions that preclude the states from taking actions that interfere with the federal government's authority over foreign affairs and commerce with foreign countries."

In a 2000 decision, *NFTC v. Crosby*, the Supreme Court found that state sanctions that go beyond existing federal sanctions on any country intrude on the exclusive power of the national government to regulate foreign affairs subvert the policies and objectives of the federal

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sanctions regime. The court ruled that “It is implausible to think that Congress would have gone to such lengths to empower the President had it been willing to compromise his effectiveness by allowing state or local ordinances to blunt the consequences of his actions.” This ruling resulted in the repeal or suspension of a number of selective purchasing restrictions on Burma at the state and local level. Both decisions set limits on the ability of state governments to impose foreign policy sanctions.

• **By targeting European and Asian companies, the divestment movement alienates the very countries whose cooperation we need to ensure a successful outcome to these difficult situations - and takes attention away from the behavior of the Iranian government.**

• **Actions by individual states are highly unlikely to influence the behavior of the current government in Tehran or benefit the people of Iran.**

• **Engagement combined with multilateral pressure is a better approach.**

America’s values, security and prosperity are best advanced by sustained public and private sector involvement in world affairs. Engagement at all levels - political, economic, religious, educational and cultural - is the best tool to advance America’s interests overseas. State sanctions impede engagement and undercut efforts to attract international investment that supports jobs and economic growth. Foreign policy sanctions by states not only undermine the ability of the U.S. to speak with one voice, but also frustrate cooperation with U.S. allies and trading partners who often see them as a violation of U.S. international commitments.

Here are two legislative approaches that would attempt to alter state divestment legislation. It would be much less intrusive from a foreign policy and precedent-setting perspective to suggest an alternative bill to the sponsor or another concerned member that uses hortatory language instead of compelling divestment.

1. Require a study. There are surely thoughtful legislators out there who want to consider the costs to retired teachers, firefighters and police of divestment. Calpers studied the costs of divesting from Sudan a while back. Kansas required the same thing of one of its pension funds. Florida has done some analysis as part of its legislative analysis of HB 2142, and there is a bill in Virginia right now to require a study on Sudan divestment. There should be a serious cost analysis by people who are qualified to crunch numbers and run models that factor in immediate transaction costs as well as potential lost return scenarios for divestment. The analysis could be tied to companies making a \$20 million dollar or greater investment in Iran’s energy sector, which would tie with federal policy (the Iran Sanctions Act standard) and limit the scope and impact of the study and potential future legislation.

2. Offer a hortatory resolution that offers encouragement instead of a mandate. Oregon did this. Resolutions should also include some additional specifics which narrow the scope and tie the language to certain investments in Iran. Such a resolution could use the Florida standard of examining investments made over \$20 million in Iran’s energy sector, and use language from a New York bill which provides discretion to divest in accordance with fiduciary responsibilities.

For more information, sample resolution language or contact information of experts who can testify in your state legislature, please contact:

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Even the Bush administration itself opposes State divestment. Below are three quotes by high-ranking administration officials.

“There is a reluctance to support this [State divestment] because the fear is that to have each state or municipality conducting its own foreign policy could create chaotic conditions.”

- The President’s Special Envoy to Sudan Andrew Natsios, during April 11, 2007 testimony before the Senate Foreign Relations Committee

“Some have asked if further measures should be considered to increase pressure against Iran. Members of Congress are considering a number of legislative options, including application of U.S. sanctions to the business activities of foreign subsidiaries of American companies; mandatory divestment from companies doing business with Iran; and having the government “name and shame” firms both domestic and foreign – that do business with Iran. While these proposals are certainly well intended, they could have significant counter-productive policy implications. Our shared goal is to pressure the Iranian regime to change its behavior, and the best way to achieve this objective is to keep the focus on illicit conduct and maintain as broad an international coalition as possible. Yet many of these proposed measures may be seen by our allies as extraterritorial U.S. Government action and could affect our ability to obtain their cooperation on mutual action with respect to Iran.”

- Deputy Secretary of the Treasury Robert Kimmitt, May 10, 2007, Speech to the Washington Institute for Near East Policy

“The administration opposes proposals to authorize divestment by state and local governments, which impair the ability of the president to act on behalf of the nation as a whole and risk creating a multiplicity of foreign policies.”

- Adam Szubin, director of Treasury’s Office of Foreign Asset Control, in testimony in October.