What campus protesters get wrong about divestment

One-third of Ivy League graduates end up working in finance or consulting. So perhaps it is unsurprising that campus protesters are providing investment advice: they want university endowments to get rid of assets linked to Israel. At Columbia University, for instance, a coalition of more than 100 student organisations is demanding that administrators divest from companies that "publicly or privately fund or invest in the perpetuation of Israeli apartheid and war crimes". Another longer-running campaign by green types hopes to push fossil fuels out of portfolios.

Divesting from something has obvious symbolic value. But many protesters hope to have a real-world impact, too. Divestment campaigns may exert influence by starving their targets of capital. Scare enough investors from an industry or country and, so the argument goes, companies will find it harder to raise or borrow money, which will force them to change their behaviour. If enough Israeli firms begin to suffer, perhaps Binyamin Netanyahu will rethink his campaign in Gaza. How likely is this to work?

The choice of target makes a difference. Take the campaign against coal power in America. People agree on the industry's harms, its economic importance is waning and firms involved have historically relied on a handful of banks for financing. Accordingly, when these banks pulled back from new projects, the sector struggled. A study by Daniel Green and Boris Vallée of Harvard Business School estimates that bank exits from coal between 2015 and 2021 cut carbon-dioxide emissions by a gigatonne, an amount equal to the lifetime emissions of 20m Volkswagen Passats.

Unfortunately for protesters, things are less straightforward in other industries. Even when they succeed in encouraging some financial institutions to withdraw, there tend to be other less socially motivated sources of capital willing to step in. American university endowments hold only a sliver of global financial assets; together they are perhaps the same size as the world's seventh-largest sovereign wealth fund. When pension funds, which are much larger, sold oil stocks at the height of the environmental, social and governance craze a few years ago, hedge funds were happy to scoop them up. Things would really have to snowball for divestment from Israeli assets to influence Mr Netanyahu's calculations.

This is made less likely by the perplexing demands of protesters. They have run into a problem: university endowments hold vanishingly few shares in Israeli firms. So the focus has shifted to companies doing business in Israel. Campaigners at the University of Michigan are demanding divestment from firms including Google, McDonald's and Toyota, and the severance of ties with financial giants such as Andreessen Horowitz and Blackstone. Cull all these from a portfolio and there will not be much left. And what next? Would an endowment be allowed to hold Treasuries given the American government's aid to Israel? Judging by the expanding ambition of those manning the barricades, it seems unlikely.

Meanwhile, divestment carries a cost for the institution withdrawing its money. Many of the industries targeted in campaigns are handy when building a resilient portfolio. Commodities and energy stocks, for instance, are good inflation hedges; shares in defence firms provide some insurance against geopolitical risk. At a time when universities are leaning on endowments to meet day-to-day running costs, avoiding big crashes becomes especially important. Brigitte Roth Tran, an economist at the Federal Reserve, has even suggested that they may want to over-allocate to fossil-fuel firms. If the green transition slows, they would benefit, which would provide extra funding for clean-energy research.

Fees would probably be another drag for the divesting institution, as indicated by those paid by retail investors. BlackRock's exchange-traded fund (ETF) tracking the S&P 500 index of big American firms charges just 0.03% in fees. If you add a basic screen to exclude companies in industries such as oil, tobacco and weapons, the fee jumps to 0.08%. For an ETF that selects the most virtuous American companies, the fee hits 0.25%. Similarly, if divestment campaigns succeed, endowments' needs will become more bespoke, and thus more expensive.

These are not the sorts of issues that trouble activists. But resisting magical thinking about how financial markets work would help them better direct their efforts today. And it might even help a few of them in their careers tomorrow.