POLITICAL RISK INSURANCE AND
U. S. INVESTMENT IN SPANISH-SPEAKING SOUTH AMERICA:
An Inquiry into the Rationale of
Investment Insurance and the Climate
for U.S. Direct Investment

by

KEITH WARD WHEELOCK
B.A., Yale University
(1955)
M.A., University of Pennsylvania
(1957)

SUBMITTED IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE
DEGREE OF MASTER OF
SCIENCE
at the
MASSACHUSETTS INSTITUTE OF
TECHNOLOGY

Signature of Author

Alfred P. Sloan School of Management, April 15, 1972

Certified by

Thesis Supervisor

Accepted by

Chairman, Departmental Committee on Graduate Students

JUN 13 1972
ABSTRACT

POLITICAL RISK INSURANCE AND
U. S. INVESTMENT IN SPANISH-SPEAKING SOUTH AMERICA:
An Inquiry into the Rationale of
Investment Insurance and the Climate
for U. S. Direct Investment

by
KEITH WARD WHEELOCK

Submitted to the Alfred P. Sloan School
of Management on April 15, 1972 in
Partial Fulfillment of the Requirements of
the Degree of Master of Science in Management

My intention, in this thesis, is to examine the objectives and
actual operations of the political risk insurance program. Using
Spanish-speaking South America as a geographical data base, I describe
the environment, the scope, and the technical style of the program, then
set forth conclusions and specific recommendations.

The similarities between the evolution of the "Investment Insurance
Program," the Penn Central, and Federal Housing subsidies are striking.
The crisis started with shoddy staff work. Their managements either sought
to conceal or did not recognize the potentially calamitous implications of
their actions. Their crises broke on the public with little forewarning.

The government insurance program started modestly in 1948 in sup-
port of Marshall Plan countries. By 1971 it dealt only with developing
countries, coverage was extended to include nonconvertibility, expropria-
tion, war, and insurrection, and reserves of under $100 million covered
contingent liabilities ("expropriation exposure") of more than $3.5
billion. Economic nationalism which led to Chilean expropriations will
not soon subside. Expropriations are likely to occur with increased
frequency, and OPIC is carrying a high risk world-wide portfolio.

The great bulk of new investments covered by OPIC insurance would
have been made in any event. The objectives against which insurance
applications are evaluated and, thus, the actual purposes of the "Invest-
ment Insurance Program" are unclear. Though projections related to
developmental impact are included in the insurance application, OPIC
apparently does not scrutinize them carefully. The program provides a
huge potential public subsidy to American businesses operating in less
developed countries. The Executive has an obligation to demonstrate that
government acceptance of enormous contingent liabilities serves valid
public interests.
In 1973, there will probably be a full review of investment insurance by Congress. Large U. S. investments in extractive industries are particularly vulnerable to expropriation. The massive intermingling of multinational funds in large projects would appear more prudent than bilateral guarantees. Investment insurance on lower profile projects should be issued against strict criteria of need, with flexibility to encourage "new modes" of investment.

Investment insurance is only a policy flowing from a basic strategy, and, until a U. S. strategy towards South America is thought through and clearly formulated, it is sterile to seek to establish a series of detailed priorities on peripheral issues. This insurance may prove to be unnecessary, even an impediment complicating the sorting out of a mature new relationship between the United States and South America. As aid levels diminish and the U. S. Government edges toward a less activist posture abroad, it would be more fruitful to adopt a lower profile, let mutual interests develop, then slowly permit a new relationship to evolve.

The structural change in treatment of U. S. capital in South America is a good indicator of likely future trends elsewhere. Whether they become clear in two or twenty years will depend largely on the internal dynamics of the region concerned. The prospect that Congress will commit the "full faith and credit of the United States" to still greater expropriation exposure without a searching re-evaluation of private foreign investment is unlikely.

Thesis Supervisor: Dr. Richard D. Robinson
Title: Senior Lecturer
# TABLE OF CONTENTS

Acknowledgements  
Preface  

**Chapter 1: A SPECIAL U. S. RELATIONSHIP IN THE AMERICAS**  
The Roosevelt Era  
The Postwar Period  
Polycentrism and the Third World  
Prelude to the Alliance

**Chapter 2: THE EVOLUTION OF THE INVESTMENT PROGRAM:**  
PRELUDE TO OPIC  
From Infant to Giant  
Problems of Program Administration  
Investment Insurance and U. S. Direct Investment

**Chapter 3: THE INVESTMENT AMBIENTE OF SPANISH-SPEAKING SOUTH AMERICA**  
The U. S. Presence  
An Over-View of Spanish-speaking South America  
Highlights of the Individual Countries

**Chapter 4: ELEMENTS IN THE CHANGING SHAPE OF LOCAL DEVELOPMENT**  
The ECLA Overview  
Increasing Restrictions on Foreign Investors  
Multinational and Institutional Financing  
The Andean Common Market

**Chapter 5: THE RATIONALE, RISKS, AND REALITIES OF INVESTMENT INSURANCE**  
OPIC Brings a New Style  
Chile Forces the Pace  
The Rationale for Encouraging U. S. Private Investment in LDCs  
Impact of Investment Insurance on U. S. Direct Investments  
U. S. Obligations to Direct Investment Abroad  
Unforeseen Benefits from Investment Insurance?  
The Role and Responsibility of U. S. Business  
The Assessment of Political Risk for Foreign Investment  
Possible Keys to an Expropriation-Prone Environment  
Tailoring Investment Insurance by Sector and Country  
The Evaluation of Expropriated Properties

**Chapter 6: NEW STRATEGIES AND A NEW RELATIONSHIP?**  
New Modes: Joint Ventures and "Fade Outs"  
A Multinational Approach?  
A New Style for U. S. Businessmen Abroad  
South America's Suspicions and Aspirations  
Fundamental U. S. Interests Reassessed

**Chapter 7: CONCLUSIONS AND RECOMMENDATIONS: THE "INVESTMENT INSURANCE PROGRAM"**

**Bibliography:**
ACKNOWLEDGEMENTS

I greatly appreciate the close cooperation provided by the Overseas Private Investment Corporation (OPIC) during the initial stages of this study. I regret OPIC's decision to withdraw this cooperation upon receiving my draft thesis. OPIC's continued participation would have resulted in a more balanced final thesis.

Many individuals from business, government, and universities shared with me their experiences. Their frankness in interviews and their willingness to review critically the first draft contribute significantly to whatever merits the final product may possess. Many of the persons interviewed spoke freely with the understanding that they would remain anonymous in the text. I shall respect their wishes and simply identify them as "personal interview" in the thesis.

Kenneth Guenther, a member of Senator Jacob Javits' staff, went to extraordinary lengths in an effort to expose me to the multiple facets of the insurance program. Benjamin Welles of the New York Times sought to introduce me to the principles of good writing. The results reflect the bad habits of the student, despite the excellent instruction. My thesis supervisor, Dr. Richard D. Robinson, displayed wisdom and patience in seeking to guide me to a successful conclusion.

These persons are in no way responsible for the shortcomings in the final product.
PREFACE

My interest in criteria for government underwriting of private sector risk developed during my assignment to the American Embassy in Chile. When copper company renegotiations in 1969 highlighted the tremendous contingent liabilities assumed by the U. S. Government through the political risk insurance program, I sought, unsuccessfully, to understand the process which had led to this massive government involvement. Working on housing in the Lindsay Administration, I was unable to find satisfactory answers to similar questions on the network of housing subsidies.

At the Sloan School of Management I had difficulty in defining a suitable structural framework within which to explore the issues attendant with a government subsidy program. I did not wish to undertake a theoretical study or a general survey of the subject, because in my view the actual practice is the only valid yardstick against which to measure the utility of stated objectives and goals. I also rejected the possibility of a narrowly defined case study on Chile, because the unique circumstances of a particular situation limit the general applicability of any conclusions. I selected political risk insurance and U. S. investment in Spanish-speaking South America. Focus on risk insurance provides an opportunity to examine the evolution of a significant government subsidy program. Spanish-speaking South America provides a suitable data base in which to examine the changing environment towards foreign investment and the implications of these changes for the investment insurance program.

Little relevant published material is available which relates directly to the core of my intended thesis topic. The academic community fails to address the fundamental issues of profitability and government criteria in a professional manner. My efforts are further complicated by the uneven reliability of available statistical data, the special U. S. relationship in South America, and the time constraints imposed by the Sloan Fellowship Program. Time priorities obliged me to exclude the important country of Brazil from this study. Similarly, I was unable to explore in depth many significant factors which would benefit from rigorous examination by qualified university research groups.

An understanding of U. S. dealings in the Southern Hemisphere and an appreciation for the investment climate in South America is essential to an intelligent assessment of political risk insurance. I treat in a thematic, even superficial manner topics that properly are the subjects of entire books. Readers seeking more detailed information on subjects peripheral to the central core of this thesis are invited to explore the sources referenced in the footnotes.

My intention, in this thesis, is to examine the objectives and actual operations of the political risk insurance program. It is legitimate to question whether such a program should function on a strictly
economic basis or exist principally to support U. S. Government political objectives. The strategy selected should determine the shape of the organization created to implement these policies. After describing the environment, the scope, and the technical style of the program, I set forth conclusions and specific recommendations.
Chapter I

A SPECIAL U. S. RELATIONSHIP IN THE AMERICAS

The Roosevelt Era

The United States traditionally has assumed the Americas to be within her sphere of influence. Manifestations of this presumption include the Monroe Doctrine, the Roosevelt Corollary, and sporadic military interventions during the opening third of the twentieth century. After the First World War the United States replaced the United Kingdom as the largest foreign investor in Latin America.¹ U. S. holdings of Latin American bonds and stocks almost doubled in the 1920's,² and by 1929 Latin America represented nearly one half of total U. S. foreign direct investments, while South America represented one fifth.³

The depression caused Latin America to default virtually all of its foreign indebtedness,⁴ and the foreign investment climate turned sharply downward for over a decade. The depression also brought a new American president, who revoked his cousin's corollary and initiated the Good Neighbor Policy. Secretary of State Cordell Hull's support, at the Montevideo Conference, of the proposition that "no state has the right to intervene in the internal or external affairs of another" established a cordial atmosphere with Latin America,⁵ which was reinforced by Franklin Roosevelt's attendance at the Inter-American Conference in Buenos Aires and his visit to Brazil. Roosevelt's and Hull's suggestion that friction and hostility might be avoided if some U. S. private investments in public utilities and basic resources were to be withdrawn from such countries as Mexico and Venezuela⁶ contrasted sharply with the policy of previous
administrations.

Bolivian expropriation of Standard Oil of New Jersey properties in 1937 and Mexican action against foreign oil interests the following year tested the sincerity of the Roosevelt policy. Despite the traditional liturgy of "prompt, adequate, and effective compensation," the President facilitated settlements which did not favor the oil companies.

World War II altered U. S. priorities towards Latin America. The Southern Hemisphere contained resources essential to the war effort, and the United States spent freely to facilitate their flow. At the same time, however, Roosevelt fixed commodity prices which prevented windfall Latin American profits that otherwise could result from the world situation. Moreover, Latin American neutrality was unacceptable to the United States, and intense pressure was applied in an effort to maintain the security of the hemisphere. Ruffled local sensitivities resulted from American counter-espionage tactics and from recruitment of some reluctant governments to the Allied cause.

The Postwar Period

With Europe prostrate, the dollar supreme, and the Soviet Union landlocked, the United States emerged from the Second World War with a virtual monopoly of influence in Latin America. The reconstruction of Europe, the impending U. S. - Soviet confrontation, and, to a lesser degree, the China situation became postwar policy imperatives for the United States. Latin America's demands for stable commodity prices, lower U. S. tariffs, and more financial aid encountered indifference in Washington. By sharply reducing hemispheric assistance so soon after the
war, the United States exposed herself to the charge of being an unreliable ally.  

While Marshall Plan funds flowed to Western Europe, the Export-Import Bank financed exports at close to commercial rates to the South. Though Assistant Secretary of State Dean Acheson, in 1944, had noted the complimentary nature of private and public foreign lending and stated that private investment should be part of postwar American economic policy, Latin Americans complained of geographic discrimination. U. S. direct investment increased sharply in South and Latin America by 1950; in Europe, during the same period, it played no significant role. The raw statistics support the Latin American complaint, but in fact publicly-financed reconstruction of war-ravaged Europe in the late 'forties provided the infrastructure for massive foreign capital investment in the fifties.

Latin American countries participated freely at the 1948 Havana Conference convoked to establish ground rules for the treatment of private foreign investments. Fifty-three countries signed the Charter of the International Trade Organization, but the United States Senate failed to ratify it, in part because of the vague protection accorded foreign capital and the considerable rights granted to capital-receiving countries. Also in 1948 twenty American nations signed a multilateral agreement on treatment of foreign investments and earnings in Bogota. Assurances to foreign investors were diluted by provisions which subjected foreign investments to "the conventional laws of each country" and "to the jurisdiction of the national courts."
Polycentrism and the Third World

The Seventh United Nations General Assembly proved a harbinger of a new geopolitical era. Uruguayan Senator Cusano introduced his "Right to Exploit Freely Natural Wealth and Resources" resolution. Communist delegates vigorously supported his proposal, the Second Committee (economic and financial questions) approved an Indian redraft 31 to 1 (the United States), with 19 abstentions, and on December 21, 1952 the United States lost its first vote on a final resolution in a plenary session of the United Nations General Assembly. The Latin American bloc joined the majority of UN delegates in recommending, inter alia, that all member states "refrain from acts, direct or indirect, designed to impede the exercise of the sovereignty of any State over its natural resources." Developing countries, while actively soliciting U. S. private capital, publicly expressed resentment at America's heavy reliance on private investment as a substitute for aid. The Mutual Security Program of 1951 incorporated Gordon Gray's recommendations that "private investment should be considered as the most desirable means of providing capital and its scope should be widened as far as possible" and that no new assistance program for Latin America be enacted. President Eisenhower, in his inaugural address, encouraged the flow of American investment capital abroad, and subsequently appointed Clarence Randall to chair the Commission on Foreign Economic Policies. The Randall Report 1) recommended that public aid funds be keyed to national defense, 2) sought to shift other development problems onto the private sector, and 3) stated that "underdeveloped areas are claiming a right to econo-
mic aid from the United States ... We recognize no such right."

By the mid-fifties the United States had done little to shore up her "special relationship" with Latin America. A pledge to expand the Export-Import Bank, support in Rio for the creation of the International Finance Corporation (an affiliate of the World Bank intended to serve as a catalyst for private foreign investment), and Point IV assistance did not meet Latin American needs. The United States strongly supported the International Monetary Fund's (IMF) insistence on monetary stability, and major U. S. efforts in Argentina, Chile, and Bolivia were to this end.

The fifties was a turbulent decade. Former colonies became independent, and Guatemala was an awkward counterpoint to Bandung, Suez, and the "neutralist" bloc. The Twentieth Soviet Communist Party Congress and the post-Stalinist surge in Soviet and Communist bloc relations with and aid to developing countries paralleled the re-emergence of Western Europe and China and Japan. International economic and political competition rekindled, and, as Pax Americana proved a fleeting moment, the United States was sluggish in adjusting to polycentric communism and polycentric nationalism.

Latin America no longer was isolated. The search for national and, often, regional identity became a common experience throughout the developing world. Conservative power elites, both civilian and military, with whom the United States often seemed most comfortable came under nationalist attack. While America's high degree of involvement in the area's economic life continued, U. S. political influence sharply declined in Latin America.
Prelude to the Alianza

Sputnik, then Vice President Nixon's hostile reception in Lima and Caracas, and Soviet overtures to Brazil were hallmarks of a new phase in U. S. - Latin American relations. A municipal government in Argentina expropriated an American power economy, and baiting the gringo was de moda. Seesawing natural resources prices, two minor recessions, and U. S. - imposed import quotas also contributed to a disquiet which Washington no longer could ignore. Milton Eisenhower's fact-finding trip to Latin America demonstrated the level of this concern.

Brazilian President Juscelino Kubitschek's proposal for Operación Pan América provided the spur for swift American action. By early 1959 the United States agreed to fund a major portion of a new Inter-American Development Bank (IDB), and in the Fall the Act of Bogotá provided the basis for a more concerted U. S. - Latin American assault on economic and social problems that had long been festering. Castro's entrenchment in Cuba after the Bay of Pigs aberration provided further impetus to what President Kennedy presented as the Alliance for Progress.

The decade ended with U. S. direct investments in Europe exceeding for the first time those in South America while direct investments in Canada outstripped total U. S. direct investments in Latin America by a wide margin.
Chapter 1: Source Notes


8 Whitman, op. cit., p. 19.

9 OBE, Business Investments, 1960, p. 92.

10 Whitman, op. cit., p. 45.


14 Wagner, op. cit., p. 86.

15 Whitman, op. cit., pp. 24-25.

16 Wagner, op. cit., p. 89; Whitman, op. cit., p. 25.


Chapter 2

THE EVOLUTION OF THE INVESTMENT PROGRAM: PRELUDE TO OPIC

From Infant to Giant

The House, despite objections in the Senate, included authorization for an Investment Guaranty Program* in the 1948 Economic Cooperation Act. This permitted issuance of a maximum of $15,000,000 of convertibility insurance a year and no more than $300,000,000 over fourteen years of new U. S. investments in Marshall Plan countries. The legislation mandated bilateral treaties. Funds required to back fully this insurance would reduce by an equal amount the sums available for low-cost loans under the Marshall Plan, and a maximum annual fee of 1 percent was established.

During the fifties coverage gradually expanded to include expropriation, war, revolution or insurrection. The program was extended to the rest of the world (once treaties were negotiated), and full annual fees increased to a maximum of 4 percent, quickly to be reduced to 1.5 percent. The insurance limit rose to one billion dollars in 1959, and

*When Congress authorized the creation of the Overseas Private Investment Corporation (OPIC) in December 1969, it distinguished between what were formerly called AID Specific Risk Guarantees (renamed Investment Insurance) and AID Extended Risk Guarantees (renamed Investment Guarantees). I shall only discuss Investment Insurance, which eventually permitted insurance against the specific risks of inconvertibility, expropriation, and war, revolution, and insurrection. In order to ease the reader's already tortuous journey, I shall pre-empt Humpty Dumpty's prerogative ("When I use a word, it means just what I choose it to mean - neither more nor less") and refer to the legal entity, the Investment Guaranty Program, as the "Investment Insurance Program" in this thesis.
legal reserve requirements fell sharply. The Senate protested each expansion of the political risk guarantees, its objections founded on gut instinct, since suitable data did not exist.\textsuperscript{2}

The Economic Cooperation Agency (with Export-Import Bank kibitzing), the Mutual Security Agency, the Foreign Operations Administration, and subsequently the International Cooperation Administration successively assumed administrative responsibility for the program during its first decade. A lack of clear direction resulted. Of the $400,000,000 in insurance, including double counting, issued through 1959, $321,000,000 went to Western Europe.\textsuperscript{3} The Senate succeeded in excluding Japan and much of Western Europe from further participation in the program as of January 1, 1960, and the focus shifted entirely to the less developed countries (LDCs).

The Foreign Assistance Act of 1961 further liberalized the "Investment Insurance Program," and relaxed the previous requirement that foreign governments recognize the U. S. Government's right to subrogate claims. The Cuban expropriations and the establishment of the Agency for International Development (AID) under the Kennedy Administration contributed to a sharp increase in insurance of new investment in the early sixties. Congress raised the exposure ceiling to $2.5 billion in 1963 and, more important, removed any legal reserve requirement. By law all investment insurance now became "contingent obligations backed by the full faith and credit of the United States."

The U. S. Government issued investment insurance totalling $1,399,069,351 during the program's fifteen years, of which $744,200,000
was for convertibility, $594,600,000 for expropriation, and $59,200,000 for war risk; some issued insurance was cancelled and, of $1,070,715,082 still outstanding in 1963, either in a current or stand-by status, the great bulk covered investments in developing countries. It is misleading to consider total risk exposure as the amount of insurance outstanding in each category. Earlier legislation obliged AID to total the various types of coverage on the same investment in calculating maximum liability. In fact, pay outs at more than face value of an investment, while theoretically possible, were highly unlikely. The possibility of such multiple payments was legally excluded for insurance written after 1969. Since much of the convertibility insurance initially written for Western Europe has lapsed, expropriation exposure provides the most relevant measure of maximum potential U. S. liability. In 1963, for instance, effective U. S. insurance exposure was about half a billion dollars, of which some was being held in a stand-by capacity. Applications for about $2 billion of expropriation insurance were pending, but only a small fraction of this would be issued.

Problems of Program Administration

The "Investment Insurance Program" now deeply committed in the developing areas, retained substantial reserves voted by Congress. It also collected annual fees with no significant insurance claims. The sole payment through 1964, a convertibility claims for $77,175.77 from a firm in the Congo, actually resulted in a small bookkeeping profit for AID, when it sold the blocked Congolese francs to a U. S. Government agency. There were, in fact, no clear criteria with which to estimate potential
risk.

The fact that U. S. firms were increasingly ready to pay risk premiums suggested that some danger existed. In 1964 the American Actuarial Association noted that "you are not really selling insurance. It might look like insurance, but there is no actuarial basis. You are constantly intensifying your risk," by shifting from Western Europe to the relatively unsafe developing countries.⁸

It would have been unprofessional to project possible risk on the basis of the initial European experience. Businessmen and professors were uncertain what impact government-sponsored investment insurance, issued after host governments had approved might have in Latin America and elsewhere.⁹ Scholars could point to the experience of the British Export Credits Guarantee Department which, after years of no claims, lost its entire working capital of $36,000,000 in 1952 and had to seek Treasury assistance to pay off claims arising from Brazilian Government action.¹⁰ But proponents of the program could take heart in the German and Japanese decision to establish their own investment insurance programs.

AID continued to facilitate U. S. private investment abroad in accordance with statutory as well as Executive Branch policy. AID guidelines for the "Investment Insurance Program" were not designed to block potential investments. The application process was streamlined, with heavy reliance on "letters of waiver." These letters granted approval in principle to potential investors, before their insurance applications were fully processed. One senior AID official scoffed at the prospect of rejecting an investment insurance application, but he then noted that most
oil projects had long been automatically rejected. A State Department officer associated with the program commented that investment insurance had been issued indiscriminately, but this he ascribed to the strong business lobby in Washington.

AID not only kept inadequate records on insurance exposure, but also made no serious effort to analyze exposure by country and sector. More important was the psychology that dominated government actions. Ambassadors and other top officials outside the "Investment Insurance Program" pointed to "overriding political considerations" to support new investment proposals.

Herbert Salzman, a competent businessman appointed AID Assistant Administrator for Private Resources in 1966, quickly became aware of the danger of over exposure in a country and sought to take precautionary measures. When AID decided not to approve a Kennecott Copper Corporation application for more than $80,000,000 insurance, Senator William Fulbright invited AID Administrator William Gaud to an executive session of the Senate Foreign Relations Committee. After the meeting, Fulbright informed Gaud by letter that he should not take action on the basis of the senators' comments during the closed session, since the Kennecott position had not been presented. After some lobbying, and direct White House pressure, the insurance was issued. (It is now the basis for a Kennecott claim against OPIC for $84,600,000).

In 1968 Congress rescinded authority previously granted the "Investment Insurance Program" to borrow $200,000,000 during a year when the program was adding more than $1,000,000,000 to its expropriation
exposure.\textsuperscript{17} By June 30, 1971, shortly after OPIC officially assumed responsibility for the program, OPIC records documented expropriation exposure totalling $3,732,812,162 of which $2,473,064,604 was current.\textsuperscript{18*} Congress, in the Foreign Assistance Act of 1969, authorized the creation of OPIC and authorized the issuance of a further $7,500,000,000 of investment insurance. A substantial portion of this already has been committed.

\textbf{Investment Insurance and U. S. Direct Investments}

There are no fully satisfactory statistics available on U. S. foreign investments. The U. S. Department of Commerce series on direct investment, which over the years has established pragmatic definitions by which portfolio investment is factored out, is generally accepted as the single most useful measure of U. S. investment abroad.\textsuperscript{19} These figures are a by-product of a "voluntary" reporting program designed for balance of payments purposes, and off-shore financing, such as Eurodollars, by the foreign subsidiary of an American firm, would not be reflected in the direct investment calculations.\textsuperscript{20} Commercial bank loans and use of financing sources such as the Export-Import Bank also would not necessarily affect reporting on direct investment.\textsuperscript{21}

Like GNP computations, it is difficult to establish any firm bench-mark against which to measure changes in direct investment. Special Commerce Department censuses in 1950, 1957, and 1966 provide bench-mark

\textsuperscript{*This included coverage for some projected investments and for retained earnings not yet accumulated. Subsequent to June 30, 1971 OPIC sought to readjust some of its past statistics to reflect an administrative decision to separate out disputed coverage of Anaconda holdings in Chile.
years, but the figures are not precisely comparable, which minimizes the value of close historical analysis of changes in direct investment. Actual gross capital expenditure is far greater than measured by changes in direct investment, since depreciation and tax accounting has a significant impact, particularly in the petroleum industry. Indeed, individual companies can and do vary their depreciation reporting practice. In petroleum and occasionally in mining, exploration is charged off against expenses, then it may be redefined as direct investment once production commences. The fact that the Commerce Department is not a regulatory agency, and the Internal Revenue Service has no access to companies' quarterly balance-of-payments reporting, may facilitate such bookkeeping changes.

To understand the significance of detailed U. S. direct investment data, it is necessary to know the background in each country. For example, a company may be actively pursuing a disinvestment policy, but this need not appear immediately in direct investment figures because local assets, including retained earnings, may not be freely transferable.

Despite the specific shortcomings of the data, Commerce Department statistics on U. S. direct investments provide a valuable measure of general changes in the magnitude of U. S. investment abroad over time. Information on the petroleum industry should be treated with particular caution. Of course these figures do not represent the present value of U. S. foreign investments.

From 1950-1970 U. S. direct investment abroad increased 562 percent ($11,788 million to $78,090 million), with U. S. investment in Europe
recording the most spectacular growth, 1,312 percent ($1,733 million to $24,471 million). Canada increased 537 percent, ($3,579 million to $22,801 million) all areas except Europe, Canada, Japan, Oceana, and the Union of South Africa increased 312 percent, and Spanish-speaking South America increased only 175 percent ($2,227 million to $6,114 million). During this period Spanish-speaking South America's share of world-wide U. S. direct investment fell from about 19 percent to below 8 percent. The shift in U. S. foreign investment patterns include a strong emphasis on developed countries, a dramatic surge in manufacturing investment, and a sharp rise in the petroleum industry.

There is no clear, measurable correlation between investment insurance and annual changes in U. S. direct investment. About $3,000,000,000 of $3,732,812,162 expropriation exposure outstanding on June 30, 1971 was incurred since 1965, more than half since 1967. Individual insurance can total 200 percent of the new investment, if the provision on up to 100 percent of retained earnings is exercised fully. It is rather common that only a portion of the investment is insured. Particularly in large projects registered insurance may reflect investments intended over a series of years, and waiver letters may permit initial investments before investment insurance is formally approved.

In 1970 Latin America accounted for 69 percent ($14,683 million

---

* The following calculations are based on Commerce Department data, including provisional figures for 1970. The 1970 total for Spanish-speaking South America is marginally understated, since U. S. direct investments are not listed for Bolivia, Paraguay, and Uruguay. These probably total less than $100 million. The developing countries figure e.g. 312 percent is inflated by inclusion of the full $3,563 million listed as "international, unallocated" by the Commerce Department. This is not included, however, in the calculations on individual regions.
of $21,417 million) of U. S. direct investments in developing countries. Expropriation exposure in the area represented 57 percent of world-wide U. S. exposure, ($2,145,644,685 of $3,732,812,162). Mining and smelting, excluding refining and the petroleum industry, totals 12 percent ($2,481, million of $21,417 million) of U. S. direct investment in developing countries. Expropriation exposure in the copper, bauxite, iron, nickel, tin, and zinc extractive industries amounts to 60 percent ($1,463,300,000 of $2,481,000,000) of 1970 U. S. direct investment in mining and smelting in developing countries. This represents 40 percent ($1,463,300,000 of $3,732,812,162) of world-wide U. S. expropriation exposure. 26*

*These figures include $235,400,000 of disputed insurance for copper in Chile which OPIC excludes from its total.
Chapter 2: Source Notes


2 Personal interview, January 11, 1972.

3 Whitman, op. cit., p. 84.


6 Whitman, op. cit., p. 95.

7 Lillich, op. cit., p. 163.

8 Whitman, op. cit., p. 115.


11 Personal interview, December 21, 1971.

12 Personal interview, January 12, 1972.

13 Personal interview, January 5, 1972.

14 Personal interview, January 13, 1972.


Ibid.

Ibid.

Ibid.

Ibid.


Chapter 3

THE INVESTMENT AMBIENTE OF SPANISH-SPEAKING SOUTH AMERICA

The U. S. Presence

The United States has been a dominant element in the affairs of each of the Spanish-speaking South American nations over the past generation. U. S. military missions have been stationed in most of these countries during this period; U. S. aid, including funds from international institutions strongly influenced by the United States, has been an important supplement to these countries' local economies; and the United States has been a prominent trading partner with all except Paraguay.

Most of these countries depend heavily on one or two exports for the bulk of their foreign exchange, and U. S. quotas, price setting, and commodity policies have posed difficulties for copper (Chile and Peru), petroleum (Venezuela), cotton (Peru), meat products and wheat (Argentina) and tin (Bolivia). U. S. efforts to support IMF criteria on monetary policy have drawn local political criticism in various countries including Argentina, Bolivia, Chile, and Colombia. The great majority of foreign investment in the area is American, and the United States Government generally is closely identified with American business.

Under the Alliance for Progress the United States pledged to commit major public and private funds to a joint effort with Latin American countries intended to attack hemispheric economic and social problems. Although significant public funds flowed to Spanish-speaking South America until the close of the decade, unilateral suspension of aid in some countries, an uneven flow of new private capital, and the
The general failure to achieve ambitious Alliance goals stirred local criticism against the United States. Congressional action to lower aid levels in recent years contributed to the demise of the Alliance.

The largest U.S. direct investment in Spanish-speaking South America is in Venezuela, principally in petroleum. Argentina experienced the sharpest rise in U.S. direct investment in the sixties, (from $472 million to $1,288 million). Colombia and Peru each have about $700,000,000 in U.S. direct investments, as did Chile until the 1971 expropriations.

As of June 1971 OPIC expropriation exposure was $631,843,314* in Chile, $121,805,369 in Argentina, and about $200,000,000 in the rest of the area. Uruguay never signed an agreement to participate in the "Investment Insurance Program," and Chile's agreement on expropriation never was approved by the Chilean Congress, thus prompting the United States to waive this requirement in Chile's case.

Almost all the investment insurance written for this area was issued by June, 1968. By the end of 1971 OPIC was accepting, but not

*OPIC officials take exception to this figure, which comes directly from OPIC's own tabulation of political risk insurance outstanding as of June 30, 1971. This figure overstates current expropriation exposure. The validity of the bulk of Anaconda's insurance included in this figure is in dispute. Moreover, the July 16, 1971 Chilean constitutional reform which facilitated expropriation of copper holdings effectively excluded the possibility that further new copper investments or accumulated retained earnings would be covered. Apart from copper, the $631,843,314 includes other industries in which the option to cover substantial amounts of new investment and retained earnings will not be exercised.
approving, further applications from Colombia and Ecuador. Applications are not being accepted from Bolivia, Chile, and Peru. In recent years there has been expropriation of American companies without payment of adequate compensation in Bolivia, Chile, and Peru, and the ground rules for foreign investment in Andean Pact countries have given OPIC pause.

An Overview of Spanish-speaking South America

<table>
<thead>
<tr>
<th>Country</th>
<th>Population</th>
<th>%Urban</th>
<th>%Illiterate</th>
<th>GNP</th>
<th>Per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>24,300,000</td>
<td>79</td>
<td>9</td>
<td>$21b.</td>
<td>$871</td>
</tr>
<tr>
<td>Bolivia</td>
<td>4,931,000</td>
<td>35</td>
<td>68</td>
<td>$911m.</td>
<td>$190</td>
</tr>
<tr>
<td>Chile</td>
<td>8,834,820</td>
<td>74</td>
<td>11</td>
<td>$6. 1b.</td>
<td>$674</td>
</tr>
<tr>
<td>Colombia</td>
<td>21,791,818</td>
<td>48</td>
<td>25</td>
<td>$6.6b.</td>
<td>$300</td>
</tr>
<tr>
<td>Ecuador</td>
<td>6,194,000</td>
<td>46</td>
<td>32</td>
<td>$1.5b.</td>
<td>$213</td>
</tr>
<tr>
<td>Paraguay</td>
<td>2,400,000</td>
<td>40</td>
<td>26</td>
<td>$496m.</td>
<td>$192</td>
</tr>
<tr>
<td>Peru</td>
<td>13,600,000</td>
<td>48</td>
<td>39</td>
<td>$4b.</td>
<td>$241</td>
</tr>
<tr>
<td>Uruguay</td>
<td>2,900,000</td>
<td>82</td>
<td>9</td>
<td>$1.6b.</td>
<td>$537</td>
</tr>
<tr>
<td>Venezuela</td>
<td>10,800,000</td>
<td>73</td>
<td>24</td>
<td>$10.3b.</td>
<td>$779</td>
</tr>
</tbody>
</table>

There has been at least one military coup in every country except Chile and Uruguay since 1950, and political instability is common in the area. While military regimes and conservative civilian governments generally have enjoyed cordial relations with the United States, recent left-wing military coups are a break in this pattern. Regional disunity is a hallmark of an area renowned for its historical national feuds. Efforts to form a Latin American Free Trade Area (LAFTA) have faltered, and the cohesiveness of the recently formed Andean Common Market, including Bolivia, Chile, Colombia, Ecuador, Peru, and possibly Venezuela, is uncertain. Intra-area trade has increased significantly in recent years, a development which could benefit the major manufacturing centers in Venezuela, Argentina, Colombia, and Chile.
Only Paraguay has been spared serious inflation over the past generation, and the cost of living often is a heated political issue. Foreign exchange crises are common, except in Venezuela, and periodic import restrictions and additional levies on foreign businesses are customary. Many of the countries have a large foreign debt, including Argentina, Bolivia, Chile, and Peru. Frequently a country will attempt to reschedule its debt repayment, and the existence of this burden contributes to tight exchange control regulations.

Highlights of the Individual Countries

Argentina

In 1946 Juan Peron was elected president following a campaign in which the U. S. ambassador publicly declared his opposition to Peron. President Peron initiated a campaign against "foreign shackles," and relations with the U. S. Government and foreign businessmen were testy during his administration.¹ His populist policies cost the country heavily, and in 1953 he modified legislation on foreign investment in an unsuccessful effort to reverse the sharp decline of new foreign capital.² In 1955 Peron signed a contract with Standard Oil of California to form a mixed company; petroleum is a touchy political issue in Argentina, and furor over this contract may have contributed to a coup in September.³

Following several military governments, Arturo Frondizi was elected president in 1958. Frondizi strongly favored encouraging local and foreign capital and, although he did not reverse a municipal government's expropriation of an American and Foreign Power subsidiary, he did arrange for the payment of fair compensation.⁴ President
Eisenhower and Kennedy favored Frondizi, and during his tenure Argentina received substantial aid; some of the first investment insurance issued in Latin America went to Argentina, and U. S. direct investments more than doubled.

In 1957 oil production, managed entirely by Argentinians, was one half that of 1935. Faced with annual oil imports costing nearly $300 million, President Frondizi signed a series of petroleum contracts with foreign companies. Oil production nearly tripled in four years. These agreements, which Frondizi and the oil companies regarded as legal services contracts rather than concessions, stirred political controversy. There were unsubstantiated reports of bribery during the protracted negotiations. Years later Frondizi said that he had fully intended to renegotiate these contracts to secure better terms for Argentina once the full investments had been made. In 1962 the military removed President Frondizi from office.

Arturo Illia, campaigning on the promise to cancel all foreign oil contracts and to break all ties with the IBRD and IMF, was elected to the presidency in 1963. Then-Under Secretary of State Averill Harriman journeyed to Buenos Aires in an effort to prevent annulment, and Ambassador Robert McClintock reportedly said that cancelling the contracts "would have the effect of blocking future U. S. investments." Illia declared the contracts void in November 1963. During subsequent compensation negotiations, U. S. aid funds were held up. President Illia was reported as being "dismayed" at the oil companies' attempts to take advantage of his government's difficult position.
In 1964 The Conference Board characterized the investment climate in Argentina as poor, pointing to Illia's waning popularity, inflationary and balance-of-payments problems, and the unilateral cancellation of contracts.\textsuperscript{12} The Argentinians were balking at the "Investment Insurance Program," contending that the requisite bilateral investment treaty demonstrated that local legislation was not considered sufficient assurance by American investors.\textsuperscript{13}

The military government that replaced Illia in 1966 relied heavily on the free market and on private capital, both local and foreign.\textsuperscript{14} President Juan Carlos Ongania moved swiftly to settle the oil contracts dispute, and most companies emerged with a profit.\textsuperscript{15} He also pressed for a new hydrocarbon law; the 1967 law permitted the government to grant oil concessions including commercialization to private companies, but in fact these concessions probably were less favorable to foreign companies than were Frondizi's oil contracts.\textsuperscript{16}

Though the Ongania regime was heavy-handed, particularly in its dealings with political parties and students, the United States maintained warm relations with the regime and welcomed severe efforts to attain fiscal stability. Foreign investment, including American, quickly increased and businessmen flourished in 1967.\textsuperscript{17} There were constraints, however, as demonstrated by Argentina's rejection of U. S. Steel's bid to buy $15,000,000 minority interest (and perhaps effective control) in an Argentine steel firm.

Inflation was curbed and reserves rose, at the cost of draconian economic policies, and another general replaced Ongania in 1970. General
Roberto Levingston flew from his post as military attache in Washington to assume the presidency. His dedication to "Argentinization" of the economy eased the restraints on inflation. He implemented new foreign investment legislation which gave preference to foreign investments associated with local capital in joint ventures and to foreign interests who reinvest profits in Argentina.\textsuperscript{18} He nationalized the telecommunications industry, including ITT and RCA, in September.

Still another general seized the presidency in March 1971. Prices seemed likely to rise at a 40 percent annual rate, and oil companies, who had discovered considerable new reserves faced new contract terms from the government. Tighter control over new foreign investments was exemplified by the government's harsh treatment of Dow Chemical Company. In 1968 there appeared to be agreement in principle that Dow would have majority interest in a proposed $120,000,000 petrochemical complex. Three years later, offered only 20 percent of equity, Dow backed out.\textsuperscript{19} The new government position reflected an increasing economic nationalism.\textsuperscript{20}

**Bolivia**

There had been sixty presidents in one hundred twenty-five years of independence before 1952; no legally elected president had served out his full term between 1925 - 1950; and there were sixty armed revolts in the nineteenth century. Victor Paz Estenssoro's revolutionary government nationalized the country's three largest tin mines in 1952, then the following year dissolved the army and enacted agrarian reform.

Administrative ineptness, wild fluctuations in world mineral prices, and political confrontations with organized labor contributed to
economic malaise. In 1962 the GNP, in constant pesos, exceeded the 1952 GNP for the first time,\(^1\) while the price index rose from 100 in 1952 to 8320 twelve years later.\(^2\) After Milton Eisenhower had visited Bolivia in 1953 and reported that the regime was Marxist - but not communist - the U. S. Government embraced President Paz. Over $300,000,000 in non-military U. S. aid flowed to Bolivia between 1952 - 1964, including assistance for the deficit-ridden nationalized tin mines.\(^3\) U. S. assistance helped maintain the National Revolutionary Movement in power during its first years and indirectly permitted payment of compensation for the expropriated tin mines.

President Kennedy, despite O. A. S. rejection of Bolivia's Ten Year Development Plan submitted for Alliance for Progress approval, strongly supported Paz's "state capitalism" and increased the flow of U. S. aid.\(^4\) Paz was receptive to foreign private capital during this period. After unilaterally revising constitutional electoral provisions and declaring martial law, Paz campaigned for re-election in 1964. The U. S. ambassador and AID director frequently shared the campaign platform with him.\(^5\) He won "unanimously" in June, following the withdrawal in protest of his opposition, then was deposed by a military coup in November.

A new petroleum code in 1955 facilitated the entry of the first U. S. oil companies since the expropriation of Standard Oil of New Jersey in 1937. Although the total value of Bolivian industrial production was only $56,000,000 in 1963,\(^6\) considerable foreign investment began to flow, especially into petroleum and mining. The last Paz initiative in
state capitalism was the 1959 expropriation of the railroads, but
dismal state management prompted the government to return railroad
operations to their previous owners within two years.27

President René Barrientos provided vigorous leadership and his sup-
port from the Indian population suggested the basis for a new populist
base. Following his tragic death in a helicopter accident, military coups
occurred in 1969, 1970, and 1971. During the first "revolutionary" regime,
state control of basic industries such as petroleum and mining was
announced policy, and the important Gulf Oil operations, valued at well
over $100 million, were seized. Following complex negotiations, which
included Spanish participation and World Bank pressure, agreement in
principle was reached on compensation just before the October 1970 coup.
The second left-wing military regime negotiated a long-term settlement with
Gulf, then expropriated a new American-owned zinc mine (covered by
$16,720,000 of investment insurance issued in 1967)28 before a right-wing
coup in August 1971. The new government, while not reversing previous
expropriations, initiated efforts to attract foreign capital for mining.

Chile

Copper, inflation, and political gyrations are all intensely Chilean.
Gabriel Gonzalez Videla, elected president of Chile in 1946 by a Popular
Front, expelled the Communists from his cabinet within a year and out-
lawed the Communist Party in two. By the end of his term many of his ini-
tial supporters considered him a right-wing American supporter. During his
administration inflation flourished and copper prices plummeted. They rose
sharply during the Korean War until the United States established a fixed
purchase price, then finally soared through that barrier. The price of copper was a useful barometer of the country's foreign exchange prospects and not uncommonly affected Chile's relations with the United States and with the two principal Chilean copper producers, Anaconda and Kennecott.

A squeeze on Gran Minería profits reduced the average yield on these two companies' assets from 14 percent in 1948 to 2 percent in 1953, and the companies insisted upon a more favorable tax situation before embarking on an expansion program. By 1953 the Chilean Government, headed by President Carlos Ibañez - who had rules as dictator a generation earlier-, recognized that Chile's copper policies were retarding growth and not maximizing potential benefits. A deal was struck in the Nuevo Trato of 1955.

Prices increased 88 percent in 1954, and the following year Ibañez invited a team of U. S. financial experts to Chile. The result was an austerity program, in accordance with IMF principles, which slashed inflation and provoked predictable anti-American political attacks. Economic slowdown preceded the 1958 presidential campaign. In 1946 a candidate elected by the left turned right, in 1952 an ex-dictator elected as a strong man proved soft, and in 1958 an austere businessman was running against a Marxist. Socialist Salvador Allende, losing in a cliff hanger, blamed his defeat on the CIA.

President Jorge Alessandri further tightened the belts of the Chilean working class, and inflation remained in check for several years. Early in his administration U. S. copper companies offered to expand production in return for lower taxes. When this failed, both Anaconda
and Kennecott invested heavily instead in Montana and Utah. The United States, toward which Alessandri acted correctly but not warmly, poured in aid following an earthquake disaster. U.S. investment, however, flowed elsewhere.

Inflation again took hold, and this contributed to a shift of the political mood to the left. The two principal candidates in the 1964 presidential campaign were Christian Democrat Eduardo Frei and Socialist-Communist standard-bearer Salvador Allende, pitting the "revolution in liberty" against the "Marxist revolution." The United States viewed the contest as critical for the Alliance for Progress and acted accordingly.

Copper was a major campaign issue, and Frei won handsomely. While Frei had a broad program for reform, the key was copper. The copper companies sensed that the alternative to "Chileanization" was expropriation. Anaconda, though the most vulnerable, maintained 100 percent ownership of its major mines; it and Cerro Corporation agreed to minority Chilean Government participation in new mines, and Kennecott accepted 49 percent interest in its existing mine. A program to almost double copper production by 1971 was part of a complex deal that included major copper company capital, tax reductions, Export-Import Bank loans, and Chilean investment.

In June 1971 Chile had the highest expropriation exposure, $631,843,314, with OPIC of any country in the world. Almost all of this insurance was written between July 1965 and June 1968, including the record amount for any country in one year, $452,803,013 in 1968, principally for copper.

In 1967, when the U.S. Government's optimism for its Christian Democratic "show case" still prevailed, a senior officer of W. R. Grace
the American company with the longest, most diverse experience in Latin America, informed businessmen assembled at a State Department meeting that Grace had decided that Chile was on the way to a statist economy where business couldn't prosper. At that time Grace had actually decided to divest in Chile as fast as possible.\textsuperscript{30} The divestiture was virtually completed by December 31, 1969. A 1965 business report on Chile referred to the climate of uncertainty in 1962-1964, the strong stabilizing factor of the 1964 election, and the optimism of foreign investors by 1965.\textsuperscript{31} In October 1967 a reliable businessmen's newsletter on Latin America reported that the business climate in Chile was not conducive to new investment by local entrepreneurs, much less by foreign investors.\textsuperscript{32} The report cited political and economic uncertainties. Few new U. S. investments in Chile were initiated after 1967.

The U. S. ambassador who went to Chile shortly after Frei's election did not disguise his Christian Democratic sentiments. The United States, between July 1960- June 1967, extended about one billion dollars in loans and grants for Chilean economic and social development, making Chile the largest recipient of U. S. assistance per capita in the Latin American region.\textsuperscript{33} When copper prices soared to heights unimagined by Chileans or Americans, it became increasingly difficult to justify massive aid.

As the United States associated itself with Christian Democratic successes, so too was it identified with Christian Democratic failures. Frei initiated an ambitious program and, though his achievements were considerable, by mid-term national resentment was high and the political
opposition grew stronger. Inflation quickened, public expenditures continued upward, and there was a budgetary squeeze, despite the extraordinary price of copper. One remedy was a "voluntary loan" from Anaconda and Kennecott, despite the recent guarantee that copper taxes would remain unchanged for twenty years.34

In 1969 the political clamor for further moves against the big copper companies was difficult to resist. The Peruvian expropriation of Standard Oil of New Jersey's property together with the "windfall" profits accruing to the companies set the stage for the forced renegotiation of the copper agreements in 1969. Chile obtained majority ownership of all major producing mines, with the right of total ownership on or after January 1, 1973.


Allende and his coalition did not march lock step to revolution. There were some initial excesses, but there was pragmatic realism too. Anaconda and Kennecott were expropriated. The Chilean Government, in considering compensation value, claimed that book value was more than offset by past "excess profits" and the present poor condition of the properties. Cerro Corporation, only recently in production was treated differently, as was Continental Copper and Steel, still in the development stage. Cerro has not been compensated. The World Bank and the Export-Import Bank are not approving further loans and credits to Chile, because of the expropri-
ations without compensation. Several U. S. firms, negotiating under duress, accepted management services contracts as part of the compensation deal. Others accepted a variety of pay back schemes.

Copper production has fallen as have world copper prices. Inflation is on the rise, the budgetary deficit is enormous, and in little more than a year Allende has managed to dissipate almost all of Chile's $345,000,000 in foreign reserves. His representatives convened in the New York offices of the First National City Bank to seek renegotiation of scheduled debt payments coming due. Other outstanding debt exposure includes about $550,000,000 owed AID, about $400,000,000 from the Export Import Bank, and $159,000,000 in World Bank funds. 35

Allende, like Frei before him, is being pressured by persons both more and less moderate than he. He, like Chilean presidents before him, is discovering that it is far easier to destroy than to achieve positive accomplishments and that his political supporters are fickle in their loyalties.

Colombia

The Columbian ruling strata are the Brahmins of South America. Proud that the military have seized power only three times in over a century, the traditional political parties negotiated a unique alliance under which the Liberals and Conservatives alternated in the presidency. Initiated in the wake of Gustavo Rojas Pinilla's military dictatorship, the National Front dissolves in 1974.

This gentlemen's agreement barely withstood a Rojas resurgence in the 1970 presidential election and stands in counterpoint to brutal intern-
al violence within the past generation. Social problems are staggering, as reflected by flash points of unemployment, student strife, and political disorder.

Colombia has been a "show case" for U. S. and other international public funds in the sixties. The AID program, the largest in Spanish-speaking South America, has provided over one billion dollars in economic and military assistance between 1962-1970, and support during this period from the World Bank, the Inter-American Development Bank, and others totalled at least another billion. U. S. support has not been without difficult moments; AID suspension in December 1964 in an effort to compel application of austere IMF-approved deflationary measures prompted Colombian President Guillermo León Valencia to lash out against "foreign dictation" before eventually capitulating. Rojas remained steadfast in his anti-American posture.

Colombia is the world's second largest producer of coffee, and a one cent change in the price of coffee costs the country about 1 percent of its annual foreign exchange earnings. Between 1954 and 1961 the price per pound fluctuated between $0.436 and $0.88. Efforts at diversification include enticement of foreign capital for a budding industrial sector and the development of petroleum and mineral resources.

U. S. direct investment has risen to $691 million in 1970, of which $334 million is in petroleum. Though U. S. firms are expected to participate in a joint venture to exploit ferrornickel deposits, to date none of the $70,938,428 expropriation exposure outstanding in June 1971 is in petroleum or the extractive industries.
In 1969 the 1956 petroleum contract signed by Rojas with Texaco-Gulf, the major U. S. oil group operating in Colombia, was revised to increase royalties, reduce the concession area and depletion allowance, and set a firm termination date. Subsequently there have been further adjustments in Texaco-Gulf operations in Colombia, and the government, in granting new exploration contracts, has pressed for direct participation and stricter control over foreign companies.

Though the generous profit remittance terms obtained by the U. S. consortium selected to develop ferronickel deposits reflect Colombia's anxiety to exploit her mining resources, the government generally is tightening the rules binding foreign investors. New regulations were being developed to exclude private foreign capital from sectors readily adaptable to local investment, to oblige foreign investors to display a social concern, and to insist on a significant transference of technology. 41

In 1971 Colombia initiated action against three American firms for failure to abide by existing contracts or local law. 42 In 1960 Chrysler received a tax exemption for a project intended to produce 37,348 vehicles in ten years; only 10,697 vehicles were produced, and the issue of back taxes was raised. The government accused Hilton Hotels International of failure to obtain the requisite legal permits and of seeking a higher royalty than that specified in the initial contract; action was taken to liquidate the Hilton holding. The U. S.-owned Colombian Petroleum Company was accused of operating in violation of its written agreement.

**Ecuador**

During its first ninety-five years of independence, Ecuador
experienced forty different leaders. Charismatic José María Velasco Ibarra, again elected president in 1968, only completed his four-year constitutional term once in his four previous elections to the presidency. In 1970, faced with a budgetary crisis and an uncooperative parliament, Velasco, with military support, suspended the Constitution. The military again ousted Velasco in February 1972.

Despite substantial undeveloped resources, Ecuador remains impoverished. For many years, the world's largest banana exporter, light industry is just now beginning to develop within a predominately agricultural economy.

U. S. companies discovered substantial petroleum reserves in the sixties and, according to Oil and Gas Journal, petroleum will be contributing $500 million to the economy by the second half of the 'seventies (twice the current national budget). The Government has granted drilling rights to a number of foreign companies, and the companies' expenditures on petroleum activities were estimated to rise from $13 million in 1969 to $160 million in 1970.

Velasco renegotiated the government's arrangement with the Texaco-Gulf consortium, by far the largest, in 1969. Claiming that the 1964 contract was invalid, because the government was "illegal," President Velasco forced a change in the profit distribution, reduced the concession acreage, and obliged the consortium to bear the costs of a major new pipeline. The willingness of other companies to take over the concession compelled Texaco-Gulf to accept the new terms. In addition to petroleum, the government is encouraging foreign participation in mining joint
ventures, and a Japanese group is exploring the possibilities for the extraction of copper and molybdenum.47

In 1968 total foreign investment in Ecuador was estimated at about $150 million, of which the U. S. share was perhaps $65 million.48 The United States, which has provided $132 million in aid to Ecuador between 1946 and 1969, periodically has experienced difficult relations with the Ecuadorian Government. Ecuador declared a U. S. ambassador persona non grata in the 'sixties, and Ecuador's claim to 200 mile oceanic territorial rights has provoked controversy between the two countries. During the first five months of 1971 Ecuador, continuing its past practice, seized and forcefully licensed twenty-six U. S. fishing vessels within the 200 mile limit. The United States suspended sales of military equipment to Ecuador for one year, and Ecuador ordered the U. S. military group stationed in Quito to leave the country.49

Paraguay

Landlocked Paraguay is the least populated and poorest country in Spanish-speaking South America. Despite a welcome mat out for foreign investment, the small local market and the apparent absence of significant mineral deposits or petroleum reserves has attracted little foreign capital. Outstanding U. S. exposure risk in June 1971 totalled $251,781, and less than 500 non-official Americans reside in Paraguay. Between 1961-1969 Paraguay received more than $90 million in loans and grants from the World Bank, the Inter-American Development Bank, and AID, some of these funds helped finance the national budget, which in 1968 amounted to about $78 million.
Peru

Peru's "forty families," with occasional military respites, long dominated the national government. Left-of-center APRA, despite its public popularity, was denied the presidency, and reformist tendencies were not encouraged. Foreign investments, especially new capital to take advantage of the Industrial Promotion Law and the enticing 1950 copper mining legislation, flowed to Peru. The country enjoyed an annual economic growth of over 6 percent from 1950 to the early 'sixties.

When forward-looking Fernando Belaúnde Terry assumed the presidency in 1963, he, like some of his predecessors, stumbled over the issue of the International Petroleum Company (IPC), owned by Standard Oil of New Jersey. Though the U. S. Government was planning substantial assistance to his government, his inaugural announcement that the IPC affair would be settled within ninety days triggered a temporary freeze by AID. Kennedy's death and a change in State Department personnel resulted in a continued freeze for more than two years.50

Exceptional circumstances marked the IPC's acquisition and ultimate title registration of the "La Brea y Pariñas" oil fields. These circumstances fueled political opponents of IPC, and a partisan U. S. Government posture further complicated the issue. Two months after Belaunde "settled" the IPC affair in August 1968 the military took power. In their first days they expropriated the IPC refinery, then later other IPC installations.

The military regime headed by General Juan Velasco Alvarado may well have resented American aid suspension and withholding of diplomatic
recognition at the time of the 1962 military takeover. U.S. efforts to block Peruvian purchase of Mirage planes also rankled. Velasco's immediate concern, however, was to prevent the "special case" of IPC from forcing a stark confrontation with the United States Government and foreign investors. More than three years later no compensation is in the offing, the Hickenlooper Amendment is not imposed nor the U.S. sugar import quota revoked, and the issue is off the front pages.

The Velasco Government has initiated major economic and social changes. A record balance of payments surplus helped it weather the initial suspension of international capital flows, as the World Bank and Inter-American Development Bank, together with the international financial community, stepped to the side lines. A series of expropriations of U.S. companies further shattered the local investment climate. But, as the no compensation policy towards IPC did appear to be a "special case," business negotiations again seemed possible. Transactions, however, were conducted under government coercion. ITT sold its telephone operations and invested in the hotel business and in an equipment plant.\textsuperscript{51} W. R. Grace "offered" some of its properties for sale, throwing a management services contract into the deal.\textsuperscript{52} The Peruvian Government reportedly bought out Chase Manhattan's share in the Banco Continental for three times the 1964 purchase price.\textsuperscript{53} Then finally U.S. bankers agreed to roll over outstanding Peruvian debt.\textsuperscript{54}

New Peruvian legislation encouraged joint ventures, especially with the government, and established partial divestiture procedures for foreign firms. In industrial companies employees were gradually to accumulate
Before the 1968 military takeover, U. S. copper companies had ambitious expansion plans by which they would more than double Peru's copper production. Negotiations stretched out with the Velasco regime, but new mining legislation together with the difficulties of obtaining massive international financing ultimately brought these plans to naught. There were reports that Belgian, and perhaps British and Canadian capital, might participate in new copper programs. 56

In the immediate aftermath of the IPC seizure, no foreign petroleum companies accepted the military regime's offer to enter into operating contracts with the government oil company. In 1971, however, seven companies signed such contracts with Petroperu and more were expected. 57 The basic conditions call for each company to drill a minimum of ten exploratory wells within seven years, each expending about $40 million. If wells are brought into production, the crude will be shared 50-50, or 52-48 for Petroperu above a specified volume, with only minor taxes.

There have been no further annual AID appropriations for Peru since the IPC expropriation. Mrs. Nixon, when she accompanied emergency shipments of earthquake relief to Lima in 1970, received a friendly reception, in contrast to then-Vice President Nixon's San Marcos University visit in 1958. The Peruvians never accepted the expropriation portion of the "Investment Insurance Program," thus OPIC has no expropriation exposure in Peru.

Uruguay

Vicious inflation, an outrageous pension program, a mammoth
government bureaucracy, and low productivity have brought this once
delightful country to the edge of bankruptcy. Swift and Armour closed
down their huge meat packing plants in 1957, after losing money for
several years. U. S. direct investment in Uruguay has declined over the
past twenty years. U. S. aid to Uruguay over the past decade has been
relatively modest, and the Uruguayan Government has refused to sign the
bilateral agreement requisite for U. S. investment insurance.

Venezuela

The first popularly elected president to complete his term in office
achieved this singular distinction in 1963. The country's previous arbi-
trary and often venal tradition of government impeded the development of a
professional cadre of civil servants. Vindictive policies forced many
political leaders to choose between safety abroad or possible detention at
home. The military became accustomed to a privileged status, and it has
been a delicate task to establish civilian authority throughout all sectors
of the government.

Petroleum provides about 93 percent of Venezuela's foreign exchange,
and oil taxes and royalties furnish nearly two-thirds of the government's
income. Venezuela enjoys the highest per capita income in Latin America
because of its oil. The fact that the petroleum industry only employs
about 1 percent of the labor force poses serious problems of employment
and of equitable income distribution.

For years foreigners ran the petroleum industry with little inter-
ference from Venezuelans. In the mid-fifties, oil companies, dealing
personally with then-dictator Marcos Pérez Jiménez, arranged approval for
a major expansion. Some oil company cash payments ended up in Swiss banks rather than in the national treasury. A revenue gap soon after Jimenez's ouster prompted his military successors to increase the tax levy on oil. In 1959 a civilian government effected legislation to ban future oil concessions and further squeezed the companies. Exploration then fell off precipitously, and of $13 billion spent world-wide on petroleum development from 1960 to 1965, only $200 million was committed to Venezuela.58

The same phenomenon occurred in the iron ore industry, the country's second largest producer of foreign exchange. Retroactive taxes demanded in 1960 together with a pricing dispute increased short-term government revenue at the cost of expansion investment, and exports actually declined during part of the decade.

In 1967 the Venezuelan Congress approved petroleum service contracts, and four years later the first contracts were let for exploration in Lake Maracaibo. The maximum length is twenty years, and the government petroleum company reserves the right to buy an equity stake. In 1970 a further retroactive tax hike gave Venezuela the highest petroleum tax rate, with the lowest yield per well, of any major oil-exporting country. The oil reversion law of 1971 requires that, when 75 percent of the existing concessions expire in 1983-1984, oil companies turn over all their equipment and installations to the state entirely without compensation.

Since 1960 the manufacturing sector has expanded rapidly with the assistance of foreign capital and management. Insistence on a joint venture, together with uncertain markets, however, has postponed the
development of a petrochemical complex. The principle of a maximum 49 percent foreign ownership may spread rapidly.\textsuperscript{59}

Economic nationalism is strong in Venezuela, and President Rafael Caldera has boosted his popularity by his tough policy on foreign control.\textsuperscript{60} In recent years the domestic political struggle over foreign private investment has been heated. As the 1973 presidential campaign approaches further restrictions on private foreign investment seem likely.

Although the United States does not provide significant direct financial assistance to Venezuela, its policies strongly effect the Venezuelan economy. U. S. oil quotas established in 1959 favor Canadian and Mexican petroleum imports over Venezuelan, and Venezuela's revenues suffered during an easing of the world petroleum demand in 1960-1961. U. S. environmental controls against high sulphur oil also can deny to Venezuela a valuable market or further raise the cost of its already relatively expensive crude. U. S. direct investments of $2,696 million in Venezuela are the largest in South America, and manufacturing investment has nearly tripled during the past decade. Venezuela is an important hard currency trading partner, and its continued development provides a market for American capital goods.\textsuperscript{61} U. S. expropriation exposure outstanding with OPIC as of June 1971 was a relatively modest $55,930,999.
Chapter 3: Source Notes


3 Herring, *op. cit.*, pp. 761-762.


6 Ibid., p. 164.

7 Ibid., p. 169.

8 Ibid., p. 72.


10 Mikesell, *op. cit.*, pp. 174-175.

11 Bernstein, *op. cit.*, pp. 210-211.


13 Ibid., p. 46.


16 Ibid, p. 185.


18 Ibid, p. 5 (70/III).


23. Ibid, pp. 190-191; Department of State, Bolivia, p. 5.


27. Ibid, p. 76.


39. Department of State, Colombia, p. 5.


42. Ibid, p. 9(71/III).


44. EIU, Colombia and Ecuador, p. 13 (71/100).

45. Roper, op. cit., p. 16.

46. EIU, Colombia and Ecuador, pp. 11-12(70/II).

47. Ibid, p. 12(70/II).


49. Ibid, p. 5.


55. The Economist Intelligence Unit, Peru and Bolivia (Ecuador included up to January 1, 1968) (London: Quarterly Economic Review), p. 3 (70/III) and p. 8(71/II). Hereafter cited as EIU, Peru and Bolivia.

56. Ibid, p. 7(71/I) and p. 7(71/III). Also, Business Latin America, p. 59 (1971).


60. EIU, Venezuela, p. 1(71/III).

Chapter 4

ELEMENTS IN THE CHANGING SHAPE OF LOCAL DEVELOPMENT

The ECLA Overview

The United Nations Economic Commission for Latin America (ECLA) and its original mentor, Dr. Raul Prebisch, have strongly influenced thinking on the process of development in Latin America. The fear or economic exploitation and external political domination is in large part the product of historical experience in various Latin American countries. A residue of suspicion permeates the ECLA view of private foreign capital, and this feeling extends to bilateral assistance, though to a lesser degree.

According to the ECLA schema, foreign investment is much overrated as a source of capital. Foreign funds have financed less than 10 percent of total Latin American investments during the past decade, and more stable international commodity markets would provide Latin America significantly more foreign exchange. Dr. Prebisch contends that the net inflow of funds from abroad has progressively diminished, and in many cases a net outflow of resources occurs long before essential changes in Latin American countries are affected. He believes that, if the burden of financial remittances were eased, it would not be necessary to obtain a larger gross inflow of foreign capital than was achieved in 1966-1968. A complimentary argument is that the net transfer of real resources flowing from foreign investment is substantially less than the increase in equity, since additional investment is often financed, at least in part, with locally retained earnings and from local banks.

The ECLA position is that foreign private investment should help to
overcome the technological and financial handicaps of Latin American enterprise, rather than contribute to their perpetuation. Prebisch believes that Latin America can expand its industrial exports at an annual rate of 15 percent. He believes that local association with foreign private enterprise -- in import substitution industries and especially in export-oriented industries -- would be valuable in cases where the technology is not readily accessible or where heavy investment is required. However, foreign exploitation of natural resources and participation in areas such as banking and public utilities could prove dangerous.

The state is considered principally responsible for certain types of investment, though in many case joint ventures would be permissible. Foreign takeover would be opposed for enterprises which, in national hands, use technologies already available or easily accessible. Moreover, in Prebisch's view, if there are national enterprises capable of such activities, it is preferable to give them international loans with lengthy amortization and an interest rate lower than likely profits.

Prebisch looks to the cooperation of international credit institutions, together with bilateral assistance, to alleviate the "external bottleneck." To limit external payments to what is "absolutely necessary," he prefers low interest international credit, unless investors are willing to limit their remittances abroad and to reinvest their profits during an extended period. Heavy amortization and debt repayment together with flight of domestic capital overseas makes it essential to stretch out the amortization period, "adjusting it to the capacity for external payment." Such institutions as the World Bank and Inter-American Development, according to the ECLA scenario, are expected to provide massive social and state
industry capital, hopefully at the 2 percent interest rate recommended in the Pearson Report.

**Increasing Restrictions on Foreign Investors**

Virtually every country in the world, including the United States, places some restrictions on foreign investment. In many South American countries basic industries such as oil extraction, mining, public utilities, communications, and banking and insurance increasingly are being placed into the public sector. More selective criteria are being employed to direct foreign investment towards capital intensive or high technology areas. There is a greater reluctance to pay for royalties or patents that do not transfer technology, and discrimination is evident in favor of the local investor.

In the past foreign firms financed many of their short-term operations through local borrowing, and often enjoyed better access to credit than did businessmen of the host country. Strict limits now exist on such borrowing in most South American countries. There had been a proliferation of foreign companies in some industries. This situation is now being rationalized, as evidenced by the consolidation of auto construction and assembly operations.

Overt economic nationalism is on the increase in Bolivia, Chile, Peru, and Venezuela and remains potent in Colombia, Argentina, and even Ecuador. The result is a change in the foreign investment ground rules that had previously obtained.

One manifestation is direct government participation in a broad range of business enterprises. This is not a new departure. State develop-
ment or industrial agencies have functioned for over a generation in Argentina, Chile, Colombia, Peru, and Venezuela. Now, their activities range far beyond the basic industries. State enterprises are not preponderant in any country, save for a few sectors. They tend to participate with private (and, on occasion, foreign) investors, in some instances providing technical services to the private sector for a fee.

Multinational and Institutional Financing

The World Bank, Inter-American Development Bank, and Export-Import Bank have provided major resources to South America. The World Bank, applying conservative banking criteria, supports productive projects. The IDB, especially through its Social Progress Trust Fund, specializes in infrastructure needs. The Ex-Im provides credit for American exports.

One common complaint is that these institutions are responsive to U. S. policy considerations, a charge given substance by the strong U. S. minority position in the first two and total control of the third. At one time the World Bank clearly denied loans to countries that had engaged in expropriating foreign properties without arranging compensation in a reasonable time. There was further tangential evidence that the United States could block specific loans. Recently, however, the World Bank, on Bolivia and Guyana, in the face of U. S. abstentions approved loans to countries that had unsettled questions of compensation for expropriated properties. In the IDB the U. S. representative on occasion tabled indefinitely a specific loan application, and Ex-Im is a direct agency of the U. S. Government.
The forementioned institutions do not provide equity capital, nor do they specialize in the private sector, especially small and medium-sized South American enterprises. The International Finance Corporation, an affiliate of the World Bank, is mandated to invest in essentially private undertakings. Its equity participation has proved a catalyst for private foreign development in the LDCs. Though it invests in productive enterprises without government guarantees, the host country does hold a veto over its participation.

The Atlantic Community Development Group for Latin America (ADELA), established in 1964, is a private organization financed by up to a maximum of $500,000 capital from a number of companies and banks. An apostle for private investment in Latin America, it takes minority equity positions, arranges public offerings, and has generated about a billion dollars of investment, of which only a small portion has come directly from ADELA. ADELA does not seek special concessions, operating on the principle that dependence on special privileges not available to local businessmen eventually will cause problems. ADELA pursues an active divestiture policy.

The Andean Common Market

The creation of a Latin American Free Trade Association (LAFTA) was initiated some years ago with considerable enthusiasm. LAFTA has since stalled, and attention turned to the possible creation of smaller regional groups. The May 1969 agreement to create an Andean Common Market (ANCOM) was a fruition of this effort. Initially conceived to include Bolivia, Chile, Colombia, Ecuador, Peru, and Venezuela, to date Venezuela has not committed itself to membership. A scheduled reduction of tariffs
between ANCOM states was approved, and special provisions were granted Bolivia and Ecuador, the smallest and least industrialized members.

The drafting of an ANCOM investment code has placed into sharp focus the potential role of foreign investment in the economic development of the Andean group. Although Colombia and Ecuador forced the exclusion of petroleum or mining from the code, and a distinction was added to separate new from existing investment, the ratified code places severe restrictions on the use of foreign capital in ANCOM countries.

The principal provisions include:

1. All new foreign investment and existing companies wishing to enjoy ANCOM concessions must gradually relinquish at least 51% ownership; the transition period is fifteen years in Chile, Colombia, and Peru, twenty in Bolivia and Ecuador.

2. The state has first purchase option; ventures in which the government has equity and a part in decision-making may be exempted from the divestiture requirements.

3. Firms exporting more than 80% of their production do not have to divest, but they then would not benefit from ANCOM concessions.

4. New foreign investment is prohibited in banking, insurance, internal transport, advertising, radio and television broadcasting, publishing, and local marketing.

5. Acquisitions will be permitted only under rare circumstances.

6. No payments will be made for intangible technology.

7. Restrictions will be imposed on foreign borrowing in local markets.

8. A 14 percent ceiling will be established on annual remittances.

9. The right of repatriation of capital is not guaranteed.

The enactment of this code resulted in OPIC suspension of further investment insurance in ANCOM countries pending clarification of the practical implications of these new regulations. The reaction of the
American business community has been less equivocal. Howard C. Peterson, a prominent banker and one-time adviser to the White House during the Johnson administration, dismissed the ANCOM countries as not attractive for further foreign investments. The Council of the Americas received responses from fifty-six member companies in a poll on the ANCOM investment code; fifty-one members replied that they would be negatively affected, thirty-nine "very negatively" and twelve "mildly negatively." The members reported that, because of the ANCOM code, they had postponed fifty definite and thirty-four potential projects in ANCOM countries; the geographic distribution was: thirty-seven in Colombia, twenty-two in Peru, twelve in Chile, nine in Ecuador, and four in Bolivia. They expressed greatest concern with the "fade out" provisions. ADELA officials were quoted as saying that where the basic structure of private enterprise was put in jeopardy, private investment would not continue.

The creation of ANCOM flows in good measure from the assumption that regional integration is a requisite for future industrial development. In part influenced by the European Common Market experience, one might envisage major new investment opportunities in a regional common market. This indeed may prove correct, but it is necessary to analyze the nature of the market and the possible centers of production. The ideological thrust of the ANCOM investment code, together with uncertainties in its administration, complicates the task of economic analysis.

The great difference that exists between South American countries

*To the casual observer it seems surprising that fifty-six U. S. companies had been on the verge of making so many new investments in the ANCOM countries.
reflects the varying levels of industrial development already achieved by the individual countries and not the specialization in particular areas based on the country's natural resources and other factors. The five ANCOM countries have a combined population more than double that of Argentina, though its combined GNP is $2 billion less that Argentina's GNP.

ANCOM's initial launching has not been auspicious and its future success is not yet assured. While Venezuela's entry would strengthen its economic base, the possibility remains that some of the charter members will become disenchanted with ANCOM strictures. The government that assumed power in Bolivia in August 1971, for example, already has sought modifications in the ANCOM investment code ratified only two months previously.
Chapter 4: Source Notes

1 Blasier, op. cit., p. 97.
2 Gordon, op. cit., p. 249.
5 Blasier, op. cit., p. 98.
6 Prebisch, op. cit., p. 136.
7 Ibid, p. 94, p. 121.
8 Ibid, p. 156.
9 Ibid, p. 65.
10 Ibid, p. 120.
15 Roper, op. cit., p. 20.
16 Ibid, p. 31.
17 Prebisch, op. cit., p. 166.
22 EIU, Colombia and Ecuador, p. 11 (71/II).
24 EIU, Peru and Bolivia, pp. 11-13 (71/II).
Chapter 5

THE RATIONALE, RISKS, AND REALITIES OF INVESTMENT INSURANCE

OPIC Brings a New Style

The Foreign Assistance Act of 1969 provided for the creation of the Overseas Private Investment Corporation (OPIC). The corporation, with six of its eleven directors to be selected from the private sector, was charged with the responsibility of the "Investment Insurance Program," which previously had been administered by AID's Office of Private Resources. Even before the January 19, 1971 Executive Order officially creating OPIC, new operating guidelines began to emerge during the administrative hiatus before OPIC President Bradford Mills formally assumed command. By mid-1971 OPIC had clearly established a personality distinct from the program's previous AID image.

OPIC's top positions are staffed almost entirely by businessmen, whose concern is focused far more intently on profitability, credibility, and minimizing risk than specifically on the process of economic development in the developing world. An immediate imperative, when OPIC's continued existence is not assured, is a business-like administration. The present management team is competent especially when measured against AID standards. Its members capitalize on the direct responsibility legislated to OPIC by Congress.

OPIC inherited a high risk portfolio and unprofessional bookkeeping procedures from AID. Initially operating more from basic instinct than from careful, and time consuming, analysis, OPIC swiftly established its authority to say no. Whereas traditionally "political expediency" tele-
grams from embassies carried considerable weight in the loosely organized State-AID command structure, OPIC presented a far stiffer back to such pressure. Moreover, since ultimate responsibility for new investment insurance rested with a board of directors, rather than with a government agency, OPIC occupied a unique position.

OPIC, in fact, is a semi-autonomous government organization. Dependent on Congressional funds and Congressional review, OPIC also cannot be divorced from the government establishment. OPIC's president serves as chief executive officer. The Administrator of AID is chairman of the OPIC board, which includes three other representatives of government departments, and, perhaps more important, OPIC can not ignore the State Department or AID. The Treasury Department, through representation on the board and independently, also plays an influential role.

OPIC formally seeks political guidance from State, and AID also has the right to express official opinions. If State or AID strongly objects to further insurance in a particular country or to a specific project, it is extremely unlikely that OPIC would exercise its legal prerogative to override such advice. If State is equivocal, the absence of the political protection provided by State approval almost certainly would prompt the OPIC board not to act unilaterally. A strong State endorsement is treated as a precedent to OPIC's serious examination of any project. During the first seventeen months of OPIC's "informal" existence, nearly 20 percent of the insurance applications received were rejected.

It is not clear the extent to which the Executive Branch can influence OPIC. On Taiwan, for example, President Nixon has made
clear his policy to encourage continued U. S. investment in this island. This political priority was accorded extraordinary treatment within the State Department, and it seems unlikely that OPIC would stand firm against the President's expressed wish.⁵

Though only one of the executives currently with OPIC played a major role in the drafting of OPIC legislation, the effort by program administrators to alter the nature of the "Investment Insurance Program" is not a recent development. Internal guidelines established new operating criteria in several vital areas, and subsequently OPIC consciously sought to advertise its insurance facilities throughout the business community.

Chile Forces the Pace

OPIC's efforts to rationalize gradually the investment insurance program were upset by the expropriations initiated by the Allende Government in Chile. Through the first twenty-three years of the "Investment Insurance Program" claims totalling $4,100,000 had been paid,⁶ part of which had been recovered by subsequent U. S. Government action. Potential claims from Chile threatened to drain all available insurance reserves and still require a request to Congress for additional funds.

Against available reserves of about $100,000,000 OPIC received a series of claims which included:⁷

<table>
<thead>
<tr>
<th>Company</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Telephone and Telegraph</td>
<td>$108,500,000</td>
</tr>
<tr>
<td>Kennecott Copper Corporation</td>
<td>84,600,000</td>
</tr>
<tr>
<td>Cerro Corporation</td>
<td>14,200,000</td>
</tr>
<tr>
<td>The Anaconda Company</td>
<td>11,000,000</td>
</tr>
<tr>
<td>The Anaconda Company</td>
<td>159,000,000</td>
</tr>
<tr>
<td></td>
<td>$377,300,000*</td>
</tr>
</tbody>
</table>

*This is an approximate figure. The Anaconda claim for $159,000,000 is disputed by OPIC.
Although legal action and negotiations are not yet concluded, it is possible that OPIC will face claim settlements on the above in excess of $200,000,000. Anaconda, in a decision that is difficult to comprehend when viewed apart from the corporate psyche of this unusual company, elected stand-by coverage totalling $235,400,000 in 1969. Although Anaconda has initiated legal action in an effort to redress this situation, it appears virtually certain that its decision to skimp on an insurance premium, perhaps in the expectation that President Frei would be politically unaffected by the expropriation of IPC in neighboring Peru, will cost its shareholders grievously.

Other possible expropriation claims from American companies in Chile, while less spectacular, are not unsubstantial. OPIC could have received valid claims for nearly $400,000,000. Because of Anaconda's peccadillo and the possibility that some companies can work out arrangements that, at a minimum, will postpone the requirement for OPIC compensation, OPIC is not faced with the immediate prospect of technical insolvency. OPIC currently is requesting from Congress additional reserves of $85,000,000.

The Rationale for Encouraging U. S. Private Investment in LDCs

Some thoughtful observers contend that all U. S. private investment abroad may not be in the national interest. A high OPIC official, in riposte, commented that the "theory of national interest" was not worth discussing. He was aware of President Nixon's October 25, 1971

*According to press reports, the Allende regime has agreed to honor its debt of $84,600,000 to Kennecott. The fulfillment of such a pledge, however, is not assured.
statement, "I am a strong believer in the importance of private investment to the development process. It is the most effective way of transferring the financial resources, technology, and management skills which play so vital a role in stimulating development in the poorer nations."  

A January 1972 State Department telegram reiterated that it was United States Government policy that private investment facilitates economic and social development in the LDCs. The telegram continued that impeding the flow of private capital would deter the growth of countries, pointing to Korea, Singapore, and Taiwan as examples of LDCs that had flourished with private foreign investment.

The OPIC charter calls for the fostering of "private initiative and competition," adding the caveat that, to the greatest degree possible, the balance-of-payments objectives of the United States should be furthered. In the mid-sixties, a major businessmen's group reported that many U. S. executives believed it necessary to cut back drastically on U. S. foreign aid and channel funds into U. S. foreign investments. About the same time an AID source was quoted as saying, "A project's contribution to the economy of the host country is not, as the ["Investment Insurance Program's"] statute intimates, the sole or even primary criterion."  

OPIC is a pragmatic organization. It does not have a large economic staff doing research in the abstract and essentially isolated from the hard day-to-day business decisions. To date the study of the economics of development has proved an imprecise science. Clear measurement of the impact of foreign investment, both on the investor country and on the recipient, also requires far greater empirical effort. One helpful contribution to the literature is a recent Harvard Business School study
commissioned by the Department of Commerce which concludes that in the aggregate, U. S. direct foreign investment in manufacturing creates, rather than destroys, jobs in the United States. It further states that most such direct investment is apparently "defensive," designed to substitute for an export market that otherwise would be lost.\textsuperscript{15}

It is difficult to quantify the economic, social, and political impact of all forms of U. S. direct investment abroad. In Latin America, for example, it would be difficult to deny the strong impact of U. S. investment on manufacturing; sales of U. S. affiliates increased 147 percent to $6,548,000,000 between 1957 and 1966, accounting for 37 percent of Latin American manufactured goods.\textsuperscript{16} A study commissioned by the Council of the Americas seeks to demonstrate that, during the period 1965-1968, U. S. private investment bolstered Latin America's balance of payments position by an average of $8.55 billion annually, including estimated foreign exchange savings from import substitution.\textsuperscript{17}

**Impact of Investment Insurance on U. S. Direct Investments**

In the abstract there is no precise way to judge how much U. S. investment would be made in the absence of investment insurance. According to a senior OPIC executive, in the early 'sixties there was little concern about investment insurance. Now, however, he contends that it is treated like casualty insurance and that few companies, given the opportunity, would forego it.\textsuperscript{18} Another OPIC official states that, in many cases, such as development of natural resources in Latin America, investment insurance is the critical factor.\textsuperscript{19}

A series of polls, conducted over the past decade by various
organizations, suggest the enhanced importance of investment insurance. In 1948, at the start of the "Investment Insurance Program" in Europe, business seemed generally opposed to the restricted insurance available.  

Five years later, according to a Department of Commerce survey, none of 366 respondents considered investment insurance a critical factor in the investment decision process. In 1958 a small Harvard Business School survey of companies utilizing investment insurance resulted in 20 percent of the respondents saying that they would not have made that particular investment without insurance. The proportion increased in another survey conducted several years later.  

In 1971 a responsible businessmen's information clearing house, commissioned by OPIC to conduct a survey based in part on OPIC lists, reported 329 responses to a question on the necessity of political risk insurance as follows:  

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>necessary</td>
<td>5.8 %*</td>
</tr>
<tr>
<td>desirable but not essential</td>
<td>47.6 %</td>
</tr>
<tr>
<td>not important</td>
<td>5.9 %</td>
</tr>
<tr>
<td>not reported</td>
<td>1.0 %</td>
</tr>
</tbody>
</table>

Over 75 percent of the respondents were engaged in manufacturing.

More recent, though limited, empirical evidence would seem to contradict the conclusions of the surveys cited above. This writer conducted a series of interviews in January 1972 with senior officers of major U. S. companies; all the companies have significant involvement in Spanish-speaking South America; all carry at least some insurance with OPIC; and several have major claims outstanding against OPIC. None of those interviewed expressed the view that the availability of investment

*Because of rounding, the responses do not total precisely 100.0%.
insurance was critical to their company's investment decision-making process. The following statements accurately reflect the tenor of their personal opinions:

The decision to invest is made apart from investment insurance. The fundamental question is, is it a good long-term investment? Investment insurance may be an element in the actual terms of the project, but it is not on the burner. [My company's] pro forma policy is to insure. The insurance is low cost, South America fluctuates regularly, so why not? U. S. business generally invests for the long term. If risk doesn't stand up to financial analysis, then, insurance or no, why bother?25

The investment decision is made apart from the availability of investment insurance. If it seems to be a good investment, then go ahead. If insurance is available, it's cheap so take it. [He] doubts that insurance encourages much investment that otherwise wouldn't be made.26

The decision to invest is made by companies, then details, including financing and investment insurance, are considered. [He] doubts that 5 percent of current investments would be lost by absence of insurance. In high risk areas where issuance of new insurance has been suspended, for many of the same reasons business would be hesitant to invest.27

The decision to invest or not is taken apart from insurance. If the investment is highly risky, we won't go in. Insurance does not compensate for the investment. Insurance is O. K. if it is available.28

It appears that when convertibility is most in question, the government won't approve insurance. Under such circumstances, [he] is not sure that [his company] would incur a major initial risk, insurance or no. [His company] has a major technological advantage and is not particularly involved in the insurance program. [He] had meant to look into the possibility of self-insuring. One drawback is that in the event of one big loss where they could have been covered, this would bring embarrassing questions from the boss.29

There were also statements about the delays in processing the insurance, the extensive paperwork on small investments that don't make it worth the effort, and difficulties in obtaining approval from the host government.
It seems possible that in many instances companies that have become accustomed to the availability of investment insurance have an unconscious tendency to bias their formal written comments on the subject of risk insurance. In possible contrast, a book in the mid-sixties devoted entirely to the foreign investment decision process did not once mention investment insurance; the author relied extensively on personal interviews. While it is possible to point to isolated cases where unquestionably the investment would not have been made without insurance, the availability of investment insurance does not appear to have been the critical factor in the great majority of positive investment decisions in recent years.

The existence of other national investment insurance programs at times is given as evidence that such a program has significant value and that, to compete abroad, the United States must stay in the forefront with investment insurance. While there may be validity in these arguments, other countries can use the same arguments more forcefully about the U.S. program. The United States has written about ten times more insurance than has been issued by all the other national programs. The U.S. program is by far the oldest, and the others generally seemed to be patterned after it. Many of the other programs began only recently, the Japanese and Germans have the largest exposure of these ten nations. The Japanese propose a ten-fold increase over the coming five years, with particular focus on ensuring access to mineral resources. Representatives of the various programs meet regularly to exchange views, and there does not appear to be a strong sense of competition between them.
United States remains the only country that from the outset of its program has insisted on host country approval before issuance of insurance. The Japanese may now require similar approval.

There has been no successful effort at quantitative analysis to date to test for possible correlations between investment insurance and U.S. direct investments abroad. It appears unlikely, given the nature of the data, that such a test would prove conclusive. It is interesting to note, however, that in Peru, where the host government only approved of convertibility insurance, between 1965 and 1969 a substantial amount of new U.S. investment was recorded. On June 30, 1971 there was $81,884,399 in convertibility insurance outstanding.

There are also some interesting, though not necessarily conclusive observations that can be drawn from the Mexican situation. Mexico has a history of expropriations prior to World War II and has established tight controls over foreign investors. To date it has not participated in the "Investment Insurance Program." From 1950 to 1970 U.S. direct investments in Mexico rose from $415, to $1,466 million, an increase of 253 percent. By far the greatest increase occurred during the 'sixties, a period when investment insurance was rapidly expanding in South America. During the same twenty years U.S. direct investment in Spanish-speaking South America rose only 175 percent, including a major investment in Venezuelan petroleum.

U.S. Obligations to Direct Investment Abroad

U.S. companies abroad have varied recourse to American support and assistance when confronted with possible expropriation or inconvertibili-
lity. Apart from the investment insurance program, potentially perhaps
the most forceful U. S. support comes from the government's bilateral
position against expropriation without prompt and adequate compensation.
On January 19, 1972 President Nixon restated U. S. policy, spelling out
the punitive measures at hand in the event that countries did not respect
the requirement for compensation of expropriated properties.35 The
President's statement, however, also indicated considerable flexibility
in treating with specific situations when good faith or overriding U. S.
interests could be demonstrated.36 Pressures in Congress for a tougher
stand against expropriations prompted the President to issue this policy
statement in an effort, only partially successful, to block unilateral
congressional action.

Nixon's announcement underscored the principle embodied in the
Hickenlooper Amendment of 1962, which legislated the suspension of
bilateral assistance to any country which, within six months of expro-
priating American property, had not taken "appropriate steps" to pay
adequate compensation.37 The failure to make prompt settlement following
the expropriation of a Brazilian subsidiary of ITT was an immediate cause
of this amendment.38 At the time Secretary of State Dean Rusk, speaking
in opposition to the amendment, told the Senate Committee on Foreign
Relations that the United States could not "afford to stake its interests
in other countries on a particular private investment in a particular
situation . . . [Such] a provision would create severe complications in
our relations with other governments."39 Then- Under Secretary Averill
Harriman stated his opinion more graphically: "You can't dictate to
people. If the United States threatens to take away aid under these conditions [e.g. Hickenlooper Amendment], there is not a country in the world that would not tell us to go to hell."\textsuperscript{40}

With the exception of Ceylon, the Executive managed to avoid application of this amendment. In October 1968 the Peruvian expropriation of the International Petroleum Company, with no apparent intention to pay compensation, posed a difficult problem for President Nixon in subsequent months. He did not wish to enforce the Hickenlooper Amendment as his first significant policy move in Latin America, but nor could he openly flout the law of Congress. When the application of the Hickenlooper Amendment appeared inevitable, Nixon dispatched John Irwin (later appointed Under Secretary of State) to negotiate with the Peruvians. Though no significant change in the Peruvian position was obtained, the cut-off deadline was extended, then the matter was postponed indefinitely. Three years later the issue remains in suspense and no regular AID program functions in Peru, but Nixon had skillfully avoided application of this amendment.

The amendment was viewed with distaste by many North Americans and Latin Americans. Gordon Levin, commenting on it in 1963, stated: "This conflict between the needs for structural change in Latin America and the needs of American business as a system of power may be irreconcilable . . . Since corporation ideology is entrenched in the heart of the Alliance for Progress by Section 620(e), the chances are that these business values will exert a final veto on the social change this country will be willing to underwrite in Latin America."\textsuperscript{41} While this seemed an overstatement,
these sentiments were echoed in Latin America. Following Nixon's action on Peru, many lawyers believed that the Hickenlooper Amendment was dead. Subsequent Congressional activity and Nixon's recent policy statement on expropriation have resurrected its spirit.

In addition to the explicit threat to suspend financial assistance to defend the interests of American business (in fact it seems unlikely that such action would have the desired effect), the United States is employing the Internal Revenue Service to provide partial compensation to some expropriated companies. Congress voted special tax relief for companies who lost assets in Cuba. Recently the IRS ruled that Anaconda, Kennecott, and Cerro Corporation may treat their uncompensated Chilean losses as ordinary rather than capital losses, thus permitting an offset for some years against taxable earnings. A critical issue is the year in which such deductions are permitted. While it seems unlikely that Standard Oil of New Jersey, which has written off $85 million of total IPC assets valued at $170 million during negotiations, can benefit from a similar tax ruling, since petroleum taxes are treated in a special fashion, this principle would seem to offer potential relief to a number of other companies.

Unforeseen Benefits from Investment Insurance?

There are ramifications in legislation and government rulings that the drafters understandably may have failed to consider. Several such exist in the provisions for investment insurance. The expectation was that the existence of such insurance might deter precipitate action by the host country. Evidence of this to date is not persuasive.
are isolated instances, however, which suggest that the insurance may legally be employed in ways not initially intended.

If one considers the situation of Anaconda immediately after President Frei's election, it seems surprising that the U. S. company did not relinquish part ownership of its major operating mines. Instead, in return for a tax reduction, it agreed to expand significantly its copper producing facilities. The new investment was covered by insurance, which easily could have been maintained current. Such insurance served to extend a continuing return on a previous investment, and the extraordinary rise in copper prices added handsomely to Anaconda's profits.

Had the investment insurance been operative, Anaconda well could have benefited from these additional profits; it could have obliged the U. S. Government to bear the cost for the new investments which had occasioned the Chilean Government to provide tax concessions; and it could have taken advantage of an IRS ruling to recover further assets. Though of course the situation is hypothetical, such a policy could have resulted in maximization of Anaconda's profits in an expropriation environment, to the financial detriment of the U. S. Treasury.

In the case of ITT, its Chilean subsidiary had long been functioning on the margin. When presented with the opportunity of an expropriation claim, it legally could protest the action, resist efforts to strike a deal, then bill the United States for $108,500,000 which, in fact, is substantially less than the value ITT places on its Chilean assets. In other countries U. S. companies, when faced with government encroachment, have often negotiated with the host country in good faith in an effort to
salvage the bulk of their assets and maintain a local viability. Indeed in Peru, where ITT was not covered by investment insurance, ITT recently negotiated a complicated arrangement whereby it accepted minimal direct compensation and invested in other local enterprises.

Certainly such an alternative is distasteful to a company that has invested in good faith, as has ITT, but the possibility remains that the existence of investment insurance can make a U. S. company less willing to seek a pragmatic local solution to a difficult situation. In such a circumstance, the United States may actually contribute to a company's intransigent position. It appears likely that one small American company in Chile, producing a quality product overpriced for the market, may have welcomed, even encouraged expropriation. It carries investment insurance and stands a good chance of collecting on its claim.

The Role and Responsibility of U. S. Business

The United States Government generally is ignorant about the sensitive details of American business operations abroad. In part this is because embassy personnel generally don't understand business and, not infrequently, give the impression that there is something distasteful about the profit motive. U. S. businessmen, who often deal with embassies on routine matters, sense this professional reserve and often view embassy personnel as a pampered and generally ill-informed group.

This lack of mutual respect and of easy rapport is unfortunate, since the embassies have the implicit responsibility to support U. S. business endeavors overseas. In difficult situations the U. S. representative too often is obliged to accept a businessman's "facts" and
associate the prestige and credibility of the United States with them. On the occasions where an individual business's activities may jeopardize the legitimate interests of other U. S. businessmen and those of the United States, it is regrettable that a more open interchange has not been established.

While the great majority of American companies abroad do credit to their country, the folklore about occasional bribery, political involvement, and slick business practices is not without foundation. In Chile, for example, Chileans were well aware that Anaconda had financed members of a local political party in years past. This activity influenced informed Chilean opinion, and it most certainly contributed to the hostility displayed towards Anaconda in the delicate negotiations and ultimate pressures for expropriation in recent years.

Perhaps the embassies should not and cannot monitor U. S. business activities abroad. This could become a legitimate function of U. S. business associations abroad. It seems unfortunate that business appears to enjoy the indiscriminate umbrella of U. S. official representation, when full knowledge of specific situations might suggest a different posture. Almost no career officer in the Foreign Service feels authorized to investigate situations in which misdeeds of an American company appear in evidence. Though it may only be an illusion, these officers believe that if forced to a showdown by Congressional action, the State Department would not defend their efforts.

In time of difficulty, American companies do stay in touch with the State Department. Though company executives visit Foggy Bottom, their real political "clout" clearly rests elsewhere. Any substantial
corporation can count on support from friendly Congressmen, and the shadowy world of Washington influence provides leverage which, in specific cases, can dictate the State Department's position.

The Council of the Americas, founded with the active support of David Rockefeller, is an organization financed by over two hundred companies associated with Latin America. A person associated with the Council states with sincerity that the Council senses U. S. Government "hostility" towards business and suggests that this might be explained in Galbraithian terms; namely that intellectuals and businessmen are opposed in vying for power. 47

The Council provides useful services to the business community and is an articulate spokesman for a point of view that deserves a wide audience. It is possible, however, that business is the only major interest group that consistently presents its viewpoint on Latin America to the Executive and to the legislative branch, 48 and thus by default Council members may exercise inordinate influence. Similarly, when Council representatives journey to various countries, host nationals may be awed by the professional and economic resources represented within the Council. This in turn can lead to exaggerated local sensitivities, as when the Colombian Minister of Development accused a visiting Council group of unsolicited interference in Colombia's internal affairs. 49 In fact, this "incident" occurred over a difference of opinion on the Andean Foreign Investment Code during a discussion in which Council members were representing the legitimate interests of private foreign investors.
The Assessment of Political Risk for Foreign Investments

Surprisingly little attention has been given to serious analysis of the risks of expropriation and the propensity to expropriate private foreign investment. At least one American company employs a probability approach to political risk investment appraisal in which the potential profit-reducing efforts of political alternatives are measured. Literature on the subject is almost nonexistent, and this statistical approach to analyzing investment risks still encounters considerable skepticism among company executives. This type of analysis is rather expensive, and it is too sophisticated to be applied on a casual basis.

While the petroleum companies are well known for their attempts to analyze and predict political changes in areas of interest, few if any other industries commit a similar magnitude of funds in an effort to conceptualize and forecast political risk. ITT, for example, despite its multinational nature, is so transfixed by the current necessity to better each previous quarter's earnings that efforts to formulate sophisticated projections divorced from short-term operations have modest priority within the organizational structure. A brief inquiry into the forecasting abilities of several major companies suggests that seat-of-the-pant instincts are the rule. Ofttimes an interested executive, employing an informal information network, will make a recommendation on the risk feasibility of a particular proposal. A recent survey of multinational companies concludes that they too seldom undertake a systematic evaluation of political risks and their consequences for company operations.
Political instability is not necessarily the same as political risk, and what entails risk for one firm, may not affect another. There are often short-term advantages in doing business with a dictator or an autocratic regime. Agreements, once negotiated with such governments, generally are handled discreetly. By contrast, democratic governments must be more sensitive to public opinion, and political pressures may necessitate actions which are in the economic interests of neither the host country nor the foreign company. In view of the political cycles that are common in South American countries, it seems unlikely that special advantages obtained from a particular regime will normally be upheld by successor governments, however legal the agreement may appear. A common situation is for a regime in financial trouble to provide attractive incentives in an effort to encourage significant foreign investments. Local ground rules are often changed unilaterally shortly after the influx of foreign capital that such "incentives" generate.

When discussing political risk insurance it is important to be clear about terms. Confiscation is not a wide-spread phenomenon. There are even relatively few incidents of expropriation world-wide, especially when measured against total foreign investment, and the majority have occurred since 1945.\textsuperscript{53} There are a relative handful of expropriations, outside the Communist countries, where more than token compensation has not been paid. In Latin America historically the psychological repercussions of possible expropriation on a potential foreign investor may well have alarmed him unduly.\textsuperscript{53} Recent events in South America, however, suggest that the dangers of expropriation have become a valid concern for
responsible foreign investors.

There can be a sharp difference between direct confrontation leading to the takeover of an entire foreign-dominated industry and the wide spectrum of tactics available to a government desirous of targeting one nationality or one particular company. Expropriation is fundamentally a political act which may appear to be irrational if viewed in purely economic terms. A moderate government may feel obliged to expropriate foreign investment in order to appease the political opposition, an expropriation in a neighboring country may set off a "ripple" effect; or expropriation may serve as an emotional release to what seems to be almost a random event or circumstances, either international or internal. The emotional effect of expropriation is reflected in the remark of a conservative Chilean to the Allende Government's expropriation of U. S. copper companies who said: "I'm glad that Chile finally has a government with guts."55 The underlying emotion almost certainly is a deep resentment against the dominant role long exercised in Chilean affairs by the United States.

Convertibility, though also covered by political risk insurance, may prove to be an entirely different issue. While the blocking of foreign exchange transfers can be politically motivated, it often results from a chronic balance of payments deficit or from mismanagement by an inept, though well-intentioned government. The terms of convertibility generally are negotiable, if the affected company has the patience and the wit to sort out the situation.
Possible Keys to an Expropriation-Prone Environment

There are some general institutional or structural characteristics that assist in identifying the existence of an expropriation-prone environment. These are not absolute, nor are they necessarily applicable without modification throughout distinct geographic regions.\textsuperscript{56}

A list of economic activities vulnerable to expropriation, ranked from most likely to least likely, is set forth below:\textsuperscript{57}

1. Public utilities; communications; the exploitative sector (plantation or extractive agriculture, mining and crude petroleum and natural gas production)
2. The service sector (distribution and trade, banking and finance, insurance, etc.)
3. Non-plantation agriculture and agriculture-related services.
4. Non-basic manufacturing sector (basic industries probably would be reserved as a public enterprise.

In ranking nations according to their propensity to expropriate, as measured by GNP and human resource characteristics, empirical analysis has suggested the following order, ranked from high to low propensity.\textsuperscript{58}

"1. Level II ('partially developed') nations with a Composite Index of Human Resource Development significantly greater than Per Capita GNP.
2. Level II ('partially developed') nations.
3. Level III ('semi-advanced') nations.
4. Level I ('underdeveloped') nations.
5. Level IV ('developed') nations."

Other rankings of expropriation exposure, giving the highest and lowest potential exposure range include: in marketing, a fragmented company in a freely competitive sector to a world-wide marketing monopoly; in ownership characteristics, a joint venture with home government participation to a joint venture with the host government as partner.\textsuperscript{59}
Activities with a high transfer of technology assume an added protection against expropriation.

The preceding guidelines do not particularly assist in estimating the vulnerability of a specific proposed investment. Neither are the 1-3 year political projections produced by State Department country directors of great relevance to the predictive process. It may be possible, however, to develop a general feel for the ranking and pace of change for a particular area, according to these criteria. Applied to Spanish-speaking South America, they place into sharp focus the structural change towards foreign investment that is occurring and suggest a high potential of expropriation and other inconveniences for the more exposed foreign investments.

It is difficult to affix a specific value to risk. Most U. S. firms have a high aversion to risk and take out insurance even when political risk is perceived as moderate or low. The more experienced petroleum companies, denied risk insurance, have developed a sang-froid in dealing with turbulent situations. During the period of new investment, their bargaining position is at a peak, and this often is reflected in the terms of their exploration and exploitation agreements. Once the major new investments are completed and production commences, the bargaining advantage shifts to the host government. The companies recognize and tend to accept this phenomenon, though if profits are squeezed too badly output may even fall and confrontation is likely.

Despite the huge sums at stake, no one had developed a refined model which permits the application of quantified correlations to the
probabilities and costs of various levels of political risk. Indeed, it would even be difficult to hypothesize the amount of direct compensation expected, following expropriation, much less the size and nature of financial relief provided by the U. S. Government. Thus, at present one must rely on instinct and experience, sharpened, one hopes, by the establishment of rough parameters developed through careful analysis.

**Tailoring Investment Insurance by Sector and Country**

OPIC is fully aware of the problems of coverage and exposure posed by the investment insurance program and has moved swiftly to adapt to changing circumstances. The eligibility criteria modified in July 1970 to deal with large or sensitive projects demonstrates OPIC's competent and pragmatic response to a difficult problem. Special treatment was ordered for any project of approximately $25,000,000 or more, and for high risk sectors including utilities and other public facilities, protected industries, and natural resources. It has long been the policy, with a few exceptions, not to consider insurance for oil exploration and production facilities because of the size and distinct nature of the petroleum industry. Though legislation permits insurance to be issued for twenty years, OPIC established a normal limit of twelve years for high exposure projects, and this limitation subsequently has been extended to other sectors. Moreover, as a matter of administrative policy, OPIC is instituting declining coverage, on both initial new investment and retained earnings; coverage for 90 percent is permitted the first year, with a sliding scale down to 50 percent by the twelfth year.
This policy of restricting the exposure time is consonant with, though not identical to, the common practice of major New York banks in their foreign operations. The First National City Bank's policy, with few exceptions, is to lend abroad for a maximum of five years. The Citibank seeks additional collateral when this policy is breached. The Citibank seeks to cover its risk in part by limiting direct exposure in any one country and by sharing major loans with other banks. OPIC is similarly concerned with country and sector exposure. Though it cannot legally renege on insurance issued by its predecessor agency, it is quick to apply the "less developed friendly countries" provision of the 1969 legislation to suspend processing of further applications for countries experiencing difficulties with the United States.

For many years investors, for a minimal fee, were permitted to retain the option to switch from "stand-by" to current status on issued insurance. This option seemed to provide companies almost a free ride until local circumstances might merit payment of a somewhat higher annual premium in order to activate full coverage. Anaconda's experience rendered such a strategy less attractive to client companies. This stand-by provision is no longer offered to new applicants.

The establishment of premium rates is a situation for which there is no useful historical precedent. OPIC officials are fully aware that their fee schedule is not based on historical experience. In fact, were such the case, the fee for the first two decades would have been infinitesimally small, then a high speed computer would have been necessary to calculate a rapidly changing rate over the past year. Obviously
this would be absurd, and no more scientific than the current system. Granted that a single rate, raised from 1.125 to 1.5 percent annually for full coverage, is not sophisticated, changes in the terms of newly written insurance in fact represent a rate change.

The suggestion that OPIC adopt the Export-Import Bank's system of assigning one of four risk categories to countries has superficial appeal. Ex-Im, however, is using common banking criteria to determine commercial risk, while the determination of political risk is highly subjective and instinctive. An annual risk ranking of countries would be exceedingly difficult to defend, given the imprecise criteria, and in any case current events may or may not determine the risk of an investment over time. Publication by the U. S. Government of such a ranking certainly would spark political controversy in those countries designated in the upper range of the risk scale.

An alternative is to establish diversified rates by investment sector. This is more feasible to administer and, assuming that the rate structure for investment insurance may influence potential investors, this provides policy flexibility to OPIC administrators. In fact a similar policy currently is being pursued.

In the aftermath of the Chilean expropriations, OPIC has stated that "the insurance reserve was not intended by the Congress to cover large extraordinary losses, such as when a country, heavily endowed with foreign investment, nationalizes, as a matter of policy, all private investment without compensation in disregard of international law and practice."63 Whether this indeed was the intent of Congress will become clearer in coming months. One issue to be considered is the criteria for
subsidizing investment insurance on other than commercial grounds.

**The Evaluation of Expropriated Properties**

There are no broadly accepted criteria which can easily be applied to expropriated properties for the purpose of establishing compensation. President Nixon referred recently to the need for "adequate and swift compensation."64 This is consonant with the official U. S. position at the time of Ceylonese expropriations: "The established principle of international law is that in evaluating vested property all elements or interests of value which make up the total worth of the property must be evaluated and compensated."65 In response to 1953 expropriations in Guatemala the State Department declared that "just compensation" means compensation which is "prompt, adequate, and effective." 66

Developing countries often dispute the U. S. definition of "just compensation." Some countries contend that expropriation initiated for "reasons of public benefit or social interest" merit radically different compensation consideration.67 Efforts to deduct from the compensation price of an expropriated property penalties for alleged "excess profits" and exploitative practices is becoming more common. The position of developing countries towards payment of compensation often is shaped by pragmatic considerations of ability to pay.

In actual practice, the State Department often serves as "honest broker" in expropriation cases, seeking to obtain maximum compensation for its client. In the case of Bolivia's 1937 expropriation of Standard Oil of New Jersey's properties, the company's initial claim for $17,000,000 was settled for $1,750,000. Lump sum confiscation settlements
negotiated by the State Department with Eastern European countries often totalled a mere fraction of outstanding claims, but full commercial relations, including in some cases bilateral aid, are being maintained with these nations.

As a practical matter it is impossible for the State Department to make an official evaluation of expropriated property, although the Internal Revenue Service may be obliged to establish a figure for tax purposes. There is normally wide variation between the western commercial concept of ongoing market value and what a U. S. company ultimately feels compelled to accept. It is unrealistic to view expropriations simply as an economic phenomenon. Specific circumstances, including the political environment, the record of the expropriated firm, and the dependence of the host country on international capital, impact on the valuation process. Ignoring this fact, some academics have experimented with the application of capital budgeting to the problem, with predictably absurd results. 68

Efforts to establish international machinery for the arbitration of expropriation disputes have served little useful purpose to date. The United States has found little value in the arbitration provisions normally included in bilateral investment treaties. Though Argentina permitted the assistance of a World Bank adviser to facilitate the resolution of a compensation dispute, 69 in 1964 Latin American countries unanimously voted against a plan, proposed by the World Bank and supported by the United States, to establish international arbitration machinery. 70 The International Centre for Settlement of Investment
Disputes (ICSID), established under World Bank patronage, in 1971 had been ratified by fifty countries. The first dispute was brought before it early in 1972. No South American country was included among those who had either ratified or signed the ICSID agreement.

The fact that OPIC can acquire the assets of an expropriated U. S. firm as part of the claim agreement places the United States in the position of negotiating directly with host countries over compensation for these assets.

The current formal U. S. position on what under international law constitutes "just compensation" is clearly stated and narrowly defined. Once the U. S. Government directly negotiates compensation agreements with foreign countries for its own account, this could establish common law precedents which weaken the traditional U. S. official position. This is particularly relevant in an area in which there are no commonly accepted principles of international law which lend themselves to effective enforcement.

OPIC also faces a difficult problem as it negotiates settlements of insurance claims by American companies. Misconduct by the company, if proved by OPIC and shown to have affected materially the expropriation action, could provide the basis for a discounted settlement. Perhaps more germane, OPIC currently is placing great importance on the "material aspects" of an insurance application. These aspects include the anticipated economic and social impact of the project and the physical nature of the investment. OPIC clients are receiving statements with their annual bills reminding them that they are responsible for fulfilling the "material aspects" which provided a basis for the approval of
investment insurance. Since many foreign investment projects change substantially from the planning stage to actual implementation, it is possible than grounds are being established for OPIC negotiating leverage in the event that claims are filed. Current and past OPIC officials hold conflicting views on the legality of such a negotiating technique.
Chapter 5: Source Notes

1 Personal Interview, January 5, 1972.

2 Personal Interview, January 12, 1972; personal interview, January 10, 1972.

3 Personal Interview, January 12, 1972.


5 Personal interview, January 12, 1972.

6 OPIC, Annual Report, p. 6.

7 Ibid, p. 34.

8 Forbes Magazine, January 15, 1972, pp. 24-25. (from article entitled From Riches to Rags).


10 Personal Interview, January 12, 1972; Blasier, op. cit., p. 109.


12 OPIC, Annual Report, p. 3.


14 Lillich, op. cit., p. 162.

15 OPIC, Rejected Applications.

16 Roper, op. cit., pp. 16-17.


18 Personal Interview, January 13, 1972.

19 Personal Interview, January 10, 1972.

20 Whitman, op. cit., p. 103.
21 Ibid, p. 106.
23 Ibid, p. 108.
26 Personal Interview, January 26, 1972.
27 Personal Interview, January 26, 1972.
33 Personal interview, January 10, 1972.
34 Ibid.
37 Lillich, op. cit., pp. 121-122.
38 Truitt, op. cit., p. 275.
40 Lillich, op. cit., p. 146.
42 Personal Interview, January 11, 1972.
45 The Economist, November 6, 1971.
46 Personal Interview, January 19, 1972.
47 Personal Interview, January 19, 1972.
48 Levinson and de Onis, Alliance, p. 160.
49 Business Latin America, p. 122.
51 Personal Interview, January 25, 1972.
52 Robock, Political Risk, p. 6.
53 Truitt, op. cit., p. 18.
56 The most comprehensive analysis of these characteristics is included in John Truitt's dissertation on expropriation, upon which the following paragraphs draw heavily.
57 Truitt, op. cit., p. 100.
58 Ibid, p. 77-80.
59 Ibid, pp. 100-103.
60 Robock, Political Risk, p. 18.
61 OPIC, Eligibility of Project-Large or Sensitive Projects, OPIC memorandum, dated July 1, 1970.
62 Personal Interview, January 26, 1972.
63 OPIC, Annual Report, p. 6.
Chapter 6
NEW STRATEGIES AND A NEW RELATIONSHIP?

The President, in 1940, [recounted] that when he had visited Rio de Janeiro in 1936, President Getalio Varga had told him that the bus lines in the capital were owned in Montreal and Toronto and has asked: "What would the people of New York City do if the subways were all owned in Canada?" Roosevelt's reply had been: "Why there would be a revolution." The President went on to say that he thought that, when foreign capital went into a Latin American country, the country should gain control of the utility or other business after the investment had been paid off in a period that might be set at twenty-five or thirty years. Thus, the country could look forward to gaining ultimate control of utilities and perhaps other foreign-financed corporations through having what Roosevelt called 'an option in the equity.'

New Modes: Joint Ventures and "Fade Outs"

OPIC officials believe that "new modes" for investment can be found for South America. Variations on the joint venture are included in this category. In their view these should be encouraged as being less risky.2 The businessmen's advisory board to OPIC, however, believes that it is too soon to plunge into this area and recommends that OPIC maintain a "reactive" posture.3 Although virtually every form of ownership arrangement has experienced expropriation, this has been a rare event for joint ventures.4 OPIC already enjoys legislative authorization to insure joint venture

Some of the reticence among the business community in 1965 towards minority participation in joint ventures apparently has subsided. One recent survey of most of the Fortune "500" companies reported strong approval for joint ventures as general policy, though with somewhat less enthusiasm for minority interest.6 Another extensive survey reported that two-thirds of the respondents held the view that joint ventures
reduced political risk. 7

Senior executives of various major U. S. companies interviewed in New York preferred not to generalize about the attractiveness of joint ventures. All sorts of arrangements were theoretically possible, but the key lay with the individual project. In a small operation there probably would not be sufficient profit to spread around. Management was seen as a critical problem, and some of those interviewed believed that managing less than a 100 percent-owned operation may require more sophisticated managers, since responsibility is divided. Using profitability as the principal yardstick, they agreed that a minority interest in a large operation, such as a petrochemical complex, probably would be worth the headaches.

Their comments on joint participation with the host government were mixed. One executive, soured by host country intervention in the technical aspects of business, strongly opposed local government involvement. He illustrated how a government partner, even with minority interest, could exercise a veto power and could apply political criteria to such matters as price increases and profit levels. 8 In the same country Kennecott enjoyed an excellent minority position relationship with the Chilean Government. The American manager was exceptionally effective, and President Frei had great confidence in his judgment. This, however, did not prevent renegotiation of Kennecott's terms with the Frei administration, then expropriation by Allende. Iron ore companies in Venezuela resisted participation with the government, in part because of the government's insistence on marketing guarantees. 9 A survey of companies that had entered into a joint venture with the government of a
LDC indicated that a slim majority of them would repeat such an experience.  

Joint ventures in the politically sensitive extractive industries may prove viable. A major new mining venture generally requires at least $100 million initial investment, and the World Bank and other international institutions normally don't loan capital to governments for developing mineral resources. Moreover, successful production requires access to international markets. An excellent arrangement for the government and foreign mining company could include payment in product, rather than encounter bookkeeping problems and "high profit exposure." Such an arrangement should minimize the usual risks of disputes over refining, pricing, and marketing.

The draft State/AID legislation on the creation of OPIC included a provision for $30 million in equity to permit OPIC to participate in, and profit from, joint ventures. This would have permitted OPIC to play an active role in the supervision of management. The House deleted this provision.

The Peterson Task Force Report recommended that OPIC, in combination with other countries, encourage international joint ventures. In the belief that U. S. capital is especially vulnerable in Latin America, some American firms have sought a European or Latin American protective umbrella. Multinationality has provided some protection against expropriation. It was the cohesive element behind the creation of ADELA. Though ADELA's participation in the Northern Indiana Brass Company did not prevent its expropriation by the Chilean Government, ADELA did
receive favored treatment. ADELA has also served as a middle man between the Allende regime and several expropriated U.S. companies.

Of the "new modes" of investment currently receiving attention, the most controversial is the "fade out" or divestiture. Proposals on the subject have circulated for many years. Professor Paul Rosenstein-Rodan envisages a 12-15 year sliding-scale joint venture at the end of which the foreign investor should have recovered his capital and an adequate profit and, at the discretion of the host government, have no further involvement. The requirement for the "trembling" function - the possibility of personal loss which, in turn, spurs a better performance - would oblige the investor to commit some of his own funds, even if the arrangement were a management services contract. A more extreme proposal by Professor Albert Hirschman for U.S. divestiture in Latin America recommends that public U.S. funds support such a scheme. Senator Jacob Javits, a prime mover in the creation of ADELA and OPIC, predicts "politically explosive implications in the U.S. Congress" were such a disinvestment program initiated. Reactions from the American business community are generally unfavorable, at times vociferously so.

A Multinational Approach?

In the early sixties the idea of a multinational investment insurance program, funded perhaps through the World Bank, received considerable attention. Even today the idea of World Bank involvement in investment insurance is under review. OPIC, consonant with legislation which encourages it to share its insurance risk, recently has
signed a reinsurance agreement with Lloyds of London as a one-year experiment. While this arrangement might encourage the impression that OPIC is now running a commercially viable operation, in fact Lloyds' participation is extremely limited. Lloyds will reinsure half the expropriation claims in each country, up to $7 million per country and a global total of $250 million.\textsuperscript{22} Recent expropriations and Chile as a country are excluded. Detailed information on the reinsurance fee has not been made public.

While discussions on a broader multinational insurance scheme continue intermittently, more exciting are the possibilities for massive intermingling of international funds in LDC investment projects.\textsuperscript{23} Countries that might accept a financial confrontation with the United States, West Germany, Japan, Italy, France, or the United Kingdom would be reluctant to challenge the group collectively. The mingling of capital from banks and businesses, portions of which could be insured by individual countries, would seem an effective method of doing business in a developing country. Capital goods export guarantees for commercial banks would keep any possible confrontation at the commercial level, and few LDCs can afford to lose access to short-term suppliers' credits.

**A New Style for U. S. Businessmen Abroad**

U. S. business has lost many opportunities abroad because of a lack of flexibility. In the 'sixties it was doing what was necessary in the 'fifties, and the same time lag exists today. The greatest shortcoming of U. S. business today in South America is probably the paucity
of managers who can deal effectively in the local environment. Their own colleagues criticize them for being parochial, tongue-tied in a foreign language, comfortable in a foreign ghetto, and prone to favor social stability and financial orthodoxy.

The American corporation in South America must learn how to plan for "selective impermanence." Risk taking should be the gut of their profession, and this requires an understanding of today and tomorrow, not only yesterday.

A series of interviews conducted with executives of companies that had been expropriated reveal an insensitivity to or ignorance of, the impact of the company's foreign exchange operations on the host country. This failure to view their company from the host country's point of view has proved costly. Generally these companies have conducted appalling public relations efforts abroad. By contrast, the two companies with outstanding public relations received markedly preferential treatment after expropriation. Business Latin America recently provided its readers good advice on how to conduct abroad:

1. Act, don't react; establish firm lines of communications with the host government.
2. Demonstrate that private investment a positive tool for development.
3. Avoid the "we-they" syndrome.

South America's Suspicions and Aspirations

South America's sensitivities towards the United States are a reality, and they will remain an important factor for years to come. A profound and probably very painful readjustment is in process in South
America. The United States may be able to exert influence on the periphery, but it can neither dominate or direct these forces. The common assumption in South America is that U. S. business and government are intertwined, and that this combination has tremendous economic influence. While South Americans cannot compete, they yearn to reposte against past injustices, imagined or not. Theory and emotion are essential South American weapons, and these often appear to be irrational to the insensitive American observer. In South America a love-hate relationship exists with the United States, and it will take time and patience and understanding to avoid a psychological confrontation.

There are "good economic reasons for anticipating increasing conflict between the goals of national development and the foreign investment community, even after the latter has thoroughly purged itself of the excesses that marred its early career." The coming years may alternate between openness to foreign influences and periods of nationalism and withdrawal.

**Fundamental U. S. Interests Reassessed**

Investment insurance is only a policy flowing from a basic strategy, and until a U.S. strategy towards South America is thought through and clearly formulated, it is sterile to seek to establish a series of detailed priorities on peripheral issues.

This insurance may prove to be unnecessary, even an impediment complicating the sorting out of a mature new relationship between the United States and South America. Current insurance commitments form part of a heritage of deep involvement that reaches back for generations.
Formerly the "Free World" struggle, traditional U. S. security interests, the exclusion of potentially hostile extraterritorial powers, plus outlets for surplus capital formed the liturgy of U. S. interests in South America. These trite phrases do injustice to the genuine basis for U. S.-South American mutual interests that does exist.

U. S. assistance may have facilitated the export of considerable American capital. As aid levels diminish and the threat of denying such aid becomes increasingly hollow, the flow of further private investment may be affected. The question whether the United States Government should underwrite the flow of private investments that otherwise would not be considered viable almost assumes philosophical overtones. The past pattern has been to encourage major investments to "friendly" regimes, then weather the eventual storm as the local political scene experience cyclical change.

It would be more fruitful to adopt a lower profile, let mutual interests develop, then slowly permit a new relationship to evolve. The United States enjoys an edge in capital goods and technology -- resources that will be in urgent demand throughout South America. Recent Mexican history demonstrates how long fissures can take to heal, but time has proved generous, even to new private investment there.

There are major investment opportunities in other areas of the world; it would be undignified and unrewarding were the United States to attempt to force its attentions upon a reluctant South America. South America, where the "Investment Insurance Program" once flourished, may prove fatal to OPIC. Businessmen are openly speculating whether OPIC
will pay off outstanding insurance claims, and the prospect that Congress will commit the "full faith and credit of the United States" to still greater expropriation exposure without a searching re-evaluation of private foreign investment is unlikely. Once the presidential election campaign terminates, it may be possible to sort out those priorities upon which a strategy towards South America can be constructed.

South America does not represent, in present detail, the environment extant in other developing areas. The structural change in treatment of foreign capital, however, in some aspects is evident in other regions. The South American experience, the psyche of the gringo apart, probably is a good indicator of likely future trends elsewhere. Whether they become clear in two or twenty years will depend largely on the internal dynamics of the region concerned.
Chapter 6: Source Notes

1 Hirschman, op. cit., p. 225.
2 Personal Interview, January 11, 1972.
3 Ibid.
4 Truitt, op. cit., p. 206.
5 Conference Board, Obstacles, p. 5.
7 BIC, Corporate Policy.
8 Personal Interview, January 26, 1972.
9 Mikesell, op. cit., p. 342.
10 BIC, Corporate Policy.
11 Roper, op. cit., p. 29; Mikesell, op. cit., p. 11.
14 Roper, op. cit., p. 8.
15 Truitt, op. cit., p. 205.
17 Professor Paul Rosenstein-Rodan, in interviews on November 24, 1971 and December 6, 1971.
19 Senator Jacob K. Javits, in a speech delivered before the American Management Association, New York, on February 1, 1971.


24. Hirschman, Divest, p. 333.


28. Levinson and de Onis, Alliance, p. 324.

29. Hirschman, Divest, p. 322.


Chapter 7

CONCLUSIONS AND RECOMMENDATIONS: THE "INVESTMENT INSURANCE PROGRAM"

The similarities between the evolution of the "Investment Insurance Program," the Penn Central, and Federal housing subsidies are striking. They all started with shoddy staff work. Their managements either sought to conceal or did not recognize the potentially calamitous implications of their actions. Their crises broke on the public with little forewarning.

The insurance program started modestly in 1948 in support of Marshall Plan countries. It provided limited insurance coverage, required 100 percent reserves, and had a $15,000,000 annual ceiling. By June 30, 1971 it issued coverage against the political risks of nonconvertibility, expropriation, war, and insurrection. It was only available for the developing countries. "The full faith and credit of the United States" substituted for significant reserve requirements. Contingent liabilities ("expropriation exposure") totaled more than $3.5 billion, two thirds of which were assumed in the preceding six years.

Claims paid during the program's first twenty-three years totalled $4,100,000. Then expropriations in Chile resulted in claims of nearly $400,000,000, far exceeding OPIC's resources even after exclusion of Anaconda's disputed claims. Protracted negotiations and the probability of stopgap arrangements protect OPIC from the immediate prospect of technical insolvency. The economic nationalism which led to the Chilean seizures, however, will not soon subside. Expropriations are likely to occur with increased frequency, and OPIC is carrying a high risk world-
OPIC President Bradford Mills, in testimony before the Senate Foreign Operations Subcommittee on March 1, 1972, described one of his corporation's two objectives as follows: "to stimulate economic and social progress through U. S. private investment in developing countries which officially welcome it but whose political or economic uncertainties otherwise discourage U. S. investors." The implication that, in the absence of political risk insurance, the investments covered by the OPIC portfolio would not have been made is untrue. The great bulk of these investments would have been made in any event, and the availability of cheap political risk insurance simply provided a convenient anchor to windward.

The objectives against which insurance applications are evaluated and, thus, the actual purposes of the "Investment Insurance Program" are unclear. Congress authorized OPIC to undertake "to encourage and support only those private investments in less developed friendly countries and areas which are sensitive and responsive to the special needs and requirements of their economies, and which contribute to the social and economic development of their people." OPIC does not appear constrained by the language of this legislation. Though projections related to developmental impact are included in the insurance application, OPIC apparently does not scrutinize them carefully.

It is possible that virtually all private investment contributes to the development process. This conclusion is implicit in President Nixon's introductory letter included in OPIC's first annual report. Were
OPIC involvement limited to the encouragement of investment that, in the absence of political risk insurance, would not be made, then the establishment of screening criteria would require data currently not available to OPIC. Strengthening the U. S. balance-of-payments position is another possible purpose. OPIC's president recently described to senators the great potential markets of tomorrow and the critical natural resources available in the developing world.

Only when the purposes of political risk insurance are clearly defined can results be measured against objectives. The program provides a huge potential public subsidy to American businesses operating in less developed countries. "Insurance" is a misnomer for the OPIC service provided to U. S. investors. Insurance agents distinguish between risks, which are statistically probable and statistically predictable, and hence insurable, and uncertainties, which are neither, and the bearing of which traditionally has been the function of the entrepreneur. Businessmen welcome the opportunity to limit their possible losses from uncertainty. The Executive has an obligation to demonstrate that government acceptance of enormous contingent liabilities serves valid public interests.

In the 'sixties businessmen considered political risk insurance a bargain, a fact demonstrated by the alacrity with which they sought coverage. Perhaps the Executive, faced with Congressional determination to cut back direct foreign economic assistance, may seek to rationalize these bargain rates as a substitute form of aid. In 1965 Marina von Neumann Whitman, currently a member of the Council of Economic Advisers,
concluded that the "Investment Insurance Program" provided only modest leverage for public assets. This remains true today.

Political risk insurance is somewhat akin to fire insurance. No responsible businessman expects to make a profit from it, but it helps reduce losses when misfortune strikes. There are possible nuances to investment insurance, however, that the drafters of authorizing legislation could not foresee. The placing of government insurance on new investments might extend the flow of dividends from older, non-insurable investments. The existence of insurance can make a U. S. company less willing to negotiate a pragmatic local solution in a difficult situation. A further dimension is that the U. S. Government, through this insurance, tends to underwrite the activities of American businesses abroad. The government generally is ignorant of the sensitive details of such business operations, and can find itself financially committed to a company that has acted irresponsibly.

OPIC, officially created in January 1971, inherited a large insurance portfolio from AID. While it is possible to debate the wisdom of the acquisition policies employed by the loosely organized State-AID command structure within which "political expediency" was a common justification, the legal obligation to honor this insurance was unassailable. OPIC initiated operations with modest reserves to cover contingent liabilities in excess of three billion dollars.

Established as a semi-autonomous government agency with direct responsibility for its activities, OPIC quickly displayed a businessman's acumen in approaching the management of investment insurance. Higher fees, reduced coverage, special treatment of high risk situations,
probationary reinsurance of part of its portfolio, and tighter management
control were evidence of the distinct OPIC style. The expropriations in
Chile began during OPIC's first six months. The Senate, historically
reluctant to approve House-initiated expansions of the "Investment
Insurance Program" moved quickly to monitor OPIC activities.

In 1973 there will probably be a full review of investment
insurance by Congress. Given the strong opposition of leading senators
such as William Fulbright and Mike Mansfield, an attempt to withdraw
OPIC's authority to issue further insurance is likely. If the effort to
scuttle OPIC fails, persuasive arguments can be made to reshape drasti-
cally existing programs.

Large U. S. investments in extractive industries are particularly
vulnerable to expropriation. Bilateral U. S. Government insurance does
not reduce significantly the political risk, and massive multinational
reinsurance of such investments seems unlikely. The United States should
encourage the massive intermingling of international funds in large pro-
jects. International consortiums, with equity or loan capital from
various developed countries, could also arrange capital export credits
from major commercial banks. A mixture of investment insurance and
credit guarantees would further broaden the base of such an enterprise.

Investment insurance on lower profile projects should be issued
against strict criteria of need. In those cases where an investment is
contingent upon the availability of political risk insurance, approval
should depend upon clear demonstration of the U. S. public interest. The
term and degree of coverage can be tailored to the specific situation.
While a ranking of political risk by country is neither desirable nor technically feasible, a staggered fee schedule can be established in various sectors such as mining, manufacturing, turnkey operations, and management services contracts which include some capital investment. This could permit flexibility to encourage "new modes" of investment.

There is a clear danger that, as the Export-Import Bank perceives businessmen to be its clientele and acts accordingly, OPIC also will instinctively tend to identify with the business community. Major public subsidies have developed in agriculture, housing, and elsewhere without an effective accountability of the utility of such investments. This should no longer be permitted in the "Investment Insurance Program."
Bibliography

Books

Aharoni, Yair, *The Foreign Investment Decision Process*, (Cambridge: Graduate School of Business Administration, Harvard University, 1966).


Bernstein, Marvin (ed.), *Foreign Investment in Latin America: Cases and Attitudes*, (New York: Knopf, 1966.)


---


Roper, Penelope, Investment in Latin America, (London: The Economist Intelligence Unit, 1970).


Articles, Memoranda, and Miscellaneous


Council of the Americas, 1972 Program.
Business International Corporation, Business Latin America, a weekly publication.


The Economist, published weekly.

The Economist Intelligence Unit, Argentina, published quarterly.

__________, Chile, published quarterly.

__________, Colombia and Ecuador, published quarterly.

__________, Peru and Bolivia, published quarterly.

__________, Uruguay and Paraguay, published quarterly.

__________, Venezuela, published quarterly.


Forbes Magazine, published weekly.


Javits, Senator Jacob K., speech delivered before the American Management Association in New York City, February 1, 1971.


Mills, Bradford, President of OPIC, statement before the Foreign Operations Subcommittee of the Senate Committee on Appropriations, March 1, 1972.


__________, Political Risk Insurance Outstanding as of June 30, 1971.

__________, Involvement with Extractive Industries, as of September 30, 1971.

__________, Eligibility of Project-Large or Sensitive Projects, memorandum dated July 1, 1970.


__________, An Introduction to OPIC, July 1971.


Setlow, Carolyn Eve, The International Petroleum Company in Peru, written for the Case Study Project in Public Diplomacy of the Edward R. Murrow Center of the Fletcher School of Law and Diplomacy, Tufts University, unpublished draft, August 26, 1970.

Standard and Poor's Corporation, New York Stock Exchange Stock Reports.


, Invest in Chile, 1960.


U. S. Department of State, Argentine Republic, Background Notes, May 1969.

, Republic of Bolivia, Background Notes, May 1969.

, Republic of Chile, Background Notes, May 1968.

, Republic of Colombia, Background Notes, November 1970.

, Republic of Ecuador, Background Notes, May 1971.

, Republic of Paraguay, Background Notes, March 1970.

, Republic of Peru, Background Notes, March 1970.

, Republic of Venezuela, Background Notes, December 1969.


U. S. Senate, Hearings on S. 2996 Before the Senate Committee on Foreign Relations, 87th Congress, 2nd Session, 1962.

The Wall Street Journal.