The Uneasy Case for Foreign Private Investment in Developing Countries

William Loehr

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The purpose of this paper is to develop a case for foreign private investment in underdeveloped areas. The policy in developed countries toward such investment has exaggerated the favorable aspects of private investment while all but ignoring the detriments. This policy has caused undesirable positions to be assumed by both the investing and the host countries. For expositional purposes this paper will concentrate on investments originating in the United States destined for Latin America. First, will be an examination of the general magnitude of foreign investment. Second, the cases both for and against foreign investment, paying special attention to Latin American attitudes, will be presented. Third, will be a close look at major U.S. policy, especially as it has added to international tension. Finally, some suggestions will be made for policies which would reduce the potential for international conflict and maximize whatever benefits might accrue to Latin America from foreign investments.

Latin America has long been a target of U.S. investors. Prior to 1930, foreign capital entering the Latin republics was largely unrestricted. In response to increasing world demands for raw materials needed for industrial development, large amounts of capital were invested in Latin America, mostly in extractive industries. The great depression reversed this trend temporarily, but renewed resource scarcity during World War II stimulated the inflow of private capital and guided many Latin American countries through what for some has been their period of most vigorous growth. Since then these countries in the aggregate have been able to finance over 90% of their investment from their own resources. Most external capital continued to come from private sources until the late 1950's when declining private capital was matched by that available through international development agencies and bilateral aid.

In 1929 almost one-half ($3.5 billion) of all foreign direct
private investment from the United States ($7.5 billion) was located in Latin America. Since then other areas of the world have increased their relative attractiveness to U.S. investors. Throughout the 1960's for example, earnings on investments in other developing areas averaged from 5% to almost 9% higher than in Latin America, and even Europe offered over 2% more. Thus, the book value of U.S. private investment has increased by about 4.5% per year in Latin America but at a 9.0% rate for all other regions combined. Today, only about 1/5 of U.S. private direct investment is in Latin America.

The main outflow of private capital from the United States to Latin America is in the form of direct private investment. Generally, direct investment refers to the commitment of resources by U.S. residents to foreign firms controlled by U.S. interests. The magnitude of these and other forms of investment appear in Table 1. In 1962, net direct investment outflow from the United States to Latin America was actually negative due to

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<td>1962</td>
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<td>245</td>
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<td>278</td>
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<td>1963</td>
<td>69</td>
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<td>183</td>
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<td>1965</td>
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<td>508</td>
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<td>308</td>
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<td>1967</td>
<td>184</td>
<td>191</td>
<td>365</td>
<td>84</td>
<td>449</td>
<td>258</td>
<td>180</td>
<td>438</td>
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<td>1968</td>
<td>677</td>
<td>358</td>
<td>1035</td>
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Source: SURVEY OF CURRENT BUSINESS (various issues)

repatriation of capital from extraordinarily large investments in the petroleum industry in Venezuela. Since investment activity in that single country is large enough to affect the picture for Latin America as a whole, we present data in columns 6-9 with the Venezuelan influence removed. Outflows of capital from the United States are not the only source of direct investment. Each year a large amount of the earnings on already existing direct investments are retained and reinvested in Latin America, in-

instead of being repatriated for distribution among interest holders in the United States. The sum of these two sources of direct investment appears in column 3. The purchase of Latin American securities by U.S. residents can be added to total direct investment to obtain total yearly investment in column 5 (Col. 9, without the influence of direct investment in Venezuelan petroleum).

One cannot assume that U.S. investors make a net contribution to Latin American enterprise as investments give rise to earnings, some portion of which are repatriated to be distributed among the original contributors of capital. Indeed, the incentive to investors is some assurance that they will eventually receive more than their original contribution, and a steadily increasing book value of investments implies that in the long run a steadily increasing flow of funds to the original source will be observed. Table 2 shows that earnings remitted to the United States on investments in Latin America far exceed the new investment flow in the opposite direction. The net annual average outflow of funds from Latin America to the United States over the period shown is about $1 billion. It is worth noting here that should the investment inflow to Latin America stop entirely the outflow to the United States would continue (at a decreasing rate) due to continued earnings on already existing investments. Latin America is, therefore, in a very difficult position if she decides that foreign private investment is no longer desired. Exclusion of new foreign investors will aggravate the net outflow of earnings on existing investments since part of that outflow would no longer be matched by private capital imports. On this basis alone one would expect to find

**TABLE 2**

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<th>Latin American Remissions to the U.S. (Millions $)</th>
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<td>Earnings on Dir. Private Investment</td>
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<td>1963 956</td>
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<td>1967 1190</td>
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<td>1968 1248</td>
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<td>1969</td>
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*Net direct investment inflow plus Net Portfolio Investment (from Table 1)

Source: SURVEY OF CURRENT BUSINESS
policies restricting new foreign investment to be accompanied by efforts to capture a larger share of earnings before they are repatriated to the investing country (e.g., expropriation, increased taxation, exchange controls, etc.)

ARGUMENTS FAVORING FOREIGN PRIVATE INVESTMENT

Economists have long worked under the assumption that, on balance, benefits would accrue to countries successful in attracting large amounts of foreign private investment. These benefits, it was reasoned, would stem from the resulting increased productive capacity and productivity of the recipient countries as well as from various external economies and a favorable effect on balance of payments. The reasoning behind this point of view remains unproven. The generalities underlying this point of view are examined here and opened to criticism in the next section.

Underdeveloped countries have, almost by definition, a low capacity to generate equity investment. Borrowing funds for equity investment is one possible source of capital, but it depends in large part upon pre-existing equity and, therefore, it does little good to speak of local businessmen obtaining loans in international capital markets. Investment by foreigners can be considered as a substitute for investment by businessmen who are unable to raise capital. One might argue that rates of investment could be improved through public borrowing since official government organizations may have greater access to loans. This however would raise the problem of selecting productive uses for the publicly raised funds and increases the probability that unproductive investments will be made. Private investment by foreigners is preferable since there is no problem of selecting productive investments and no drain on government resources where irrational decisions are made.

Foreign investors, in addition to bringing their capital, are usually connected with world-wide distribution systems for their respective outputs. Access to these markets is desirable where production is accompanied by economies of scale which cannot be exploited within the limited markets of most Latin American economies. Again, there is an advantage in private foreign investment over domestic public investment in that the latter is less likely to have ready access to wide international markets.

4 G. Meier, The International Economics of Development Ch. 6 (1968).
Foreign investors, in addition to their capital, contribute to productivity growth in less developed countries by introducing modern technology and administrative techniques. Should such improvements be actively sought without the help of private foreign investment, the recipient would be forced to pay for use of patents, consulting fees, management contracts, etc. It is obvious, of course, that these benefits will accrue to the recipient country only where there are no major institutional barriers, and where the technology in question is relevant to other sectors of the developing economy. Some of the major complaints of Latin Americans are that foreign investors employ few local people and only a small portion of them in technical jobs thereby limiting the transfer of new technology to other sectors. An example is the Venezuelan petroleum industry which at times has produced as much as 32% of the Venezuelan Gross Domestic Product while employing only 2.6% of the active population.\(^5\) There is reason to doubt that the technology employed in petroleum extractions can generally be applied to other sectors of the Venezuelan economy.

Foreign investment exerts a multiplier effect stemming first from the original injection of capital and secondly from what Brazilian economist Helio Jaguaribe has called the "germinative" effect.\(^6\) This effect refers to the development of new investment possibilities arising from the linkages between the original investment and other sectors of the economy. Domestic demands for raw materials or other inputs may increase, making investments in those fields profitable. If the product of the foreign owned enterprise is to be marketed locally, opportunities for development of a local distribution system will appear. The foreign producer may also supply some input such as fertilizer or construction materials—which would normally have to be imported at a higher price—and thereby increase the profitability of production employing these inputs.

Increased investment from abroad will provide jobs locally and serve to shift the distribution of income in favor of labor. As local capital stock increases, the marginal productivity of capital will fall and, assuming competitive markets, the return to capital will also fall. Assuming a less than perfectly elastic supply of labor this tendency will be accompanied by a simultaneous increase in the marginal productivity of labor and,


\(^6\) Jaguaribe, supra note 3.
therefore, wages. The importation of capital can then be an integral part of the programs of many countries which are designed to alleviate the extreme inequality of income and wealth.

Foreign investors produce for local markets some of the items which would otherwise be imported, thereby saving scarce foreign exchange. Also, the original capital import provides foreign exchange and exerts a favorable influence on the balance of payments. This argument seems extraordinarily weak in that we have already observed that capital investment inflows in one year lead to capital outflow in future years. Secondly, it is not clear that items purchased locally from foreign owned firms would have been imported had those firms not existed. It is possible that these purchases simply represent an increase in consumption due to the increased availability and lower prices of the items concerned. The so called “international demonstration effect” has often been accused of creating demands in developing countries for new items which are traditionally unavailable in those countries.7 The generalization can not, therefore, be made that items produced for local consumption by foreign investors would have been imported had the investment not been made. It may simply be that these items would not have been in demand and, therefore, not consumed.

Opposition to Private Foreign Investment

Most arguments against foreign private investment in Latin America claim that the value of the benefits from this activity are exaggerated, are at best short-run, and are outweighed by factors working to retard the recipient countries. This is especially true where the benefits are difficult to evaluate, such as those accruing from availability of modern technology, patents, etc. Claims are often made that these contributions do not warrant the high profits extracted from investments in the area. It has ever been argued that, in the long run, if private investment is effective in providing the benefits that its proponents claim, e.g., missing inputs, modern technology, etc., its continued presence in Latin America becomes increasingly unjustified.8

There seems to be little integration of the foreign investments into the recipient economies. Often technology is transferred directly from the investing country with little or no

attempt to adapt it so as to improve its impact upon local economic growth. Host country employees are usually not given positions which allow them to develop the administrative skills needed to manage a large business venture and technical information is often a guarded secret, only released in doses sufficient to accomplish the task at hand. The importation of foreign managers and rejection of local capital participation confirm Latin American opinion that foreign investors do not want to become part of the local society.  

Some of the most often heard complaints about the presence of foreign investors in Latin America have to do with their unfavorable effect on local competition. These accusations are usually based upon the effective monopoly power of foreign firms or upon their superior technical and financial abilities. In the short run, local businessmen are at a disadvantage and, in the long run, if they succumb to or simply accept the competitive superiority of foreigners, they may fail to develop into an active local entrepreneurial group. There is a tendency in the United States to brush aside this complaint with the comment that such losses are well compensated for by the contribution of foreign owned firms to the general welfare.

Special concessions offered by governments overly anxious to attract modern technology and improve employment can provide foreign investors with a monopoly position. These concessions may take the form of tax holidays or exclusive right to engage in certain activities, thereby eliminating potential competition and raising the probability of profit for those lucky enough to obtain such concessions. These concessions are not the fault of private investors per se, but an indication that Latin Americans themselves have been unsure of exactly what they want from private investors.

In some cases the very nature of the firms which seek investments abroad implies some degree of monopoly. In the case of the petroleum industry there are important economies of scale available in crude oil exploration and distribution. Suppliers of oil are hesitant to use price reductions to adjust production and scales since other suppliers can respond with offsetting reductions. To secure stable markets, producers try to

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develop vertically integrated refining and marketing facilities.\textsuperscript{11} Potential oil producers in Latin America have little choice in developing that resource for export since access to oil markets is only available through the large international oil companies and at a price determined by the few firms involved. In most cases markets are blocked to new oil producing countries, unless the rights to oil extraction are granted to the large international oil firms.

Latin Americans particularly resent the displacement or absorption of their domestic enterprise by foreigners. For instance, manufacturing firms are usually concerned with capturing markets and, with this security, maximizing profits.\textsuperscript{12} Such a process is illustrated by the absorption of "Adesite," a Brazilian adhesive tape factory, by the Union Carbide Corporation. "Adesite" was a Sao Paulo firm which grew from a simple workshop into a factory with monthly output exceeding 500 million Cruzeiros. Minnesota Mining & Manufacturing Company, also selling tape on the Brazilian market, began cutting prices by up to 40\%, causing the sales of "Adesite" to fall precipitously. Under these circumstances, Union Carbide was able to buy out "Adesite" and enter into an agreement with Minnesota Mining & Manufacturing to divide the Brazilian market in half and to raise the price of their adhesive tapes by about 50\%.\textsuperscript{13} One may argue that there was not necessarily a conscious attempt by these North American firms to establish a more oligopolistic market favoring themselves, but the fact remains that such takeovers do occur, and they do discourage local investors as well as stimulate political resistance to private foreign investors.

Investors from developed countries are assisted in taking over local business by a high incidence of business recession in Latin America countries. During these crises, local firms are unfavorably affected by declining sales, unavailability of domestic credit, and, at times, devaluation of national currencies which can aggravate externally held debt. Foreign firms can weather these situations more easily because they have access to wider markets and to external credit sources. Thus, under such circumstances, local firms can be obtained easily by


\textsuperscript{12} V. \textit{Urgüdi, The Challenge of Development in Latin America} 103 (1964).

foreign owners at prices which are sometimes considered extraordinarily low, but, nevertheless, are acceptable to owners on the verge of bankruptcy. This process has been observed in such countries as Argentina during the 1962-63 recession and Brazil during the Castelo Branco anti-inflationary drives.14

There are strong foreign elements in the dynamic sectors of Latin American economies and there seems to be a direct correlation between such dynamism and foreign participation.15 Among Latin Americans this is interpreted as an indication that foreign firms, due to their technical and financial advantages, can and do move into those sectors promising greatest profits thereby eliminating opportunity for domestic businessmen and transferring abroad many of the fruits of development. This leads to a continually decreasing autonomy for the host country since growth becomes increasingly dependent upon foreigners, and more growth implies less autonomy. This concern over control of the productive processes of the host country is not limited to the countries of Latin America. Canada, Europe and Australia are also hosts to large amounts of foreign investment particularly from the United States, and all have expressed concern over foreign ownership of important economic sectors.16

Special concern exists in Latin America over the foreign domination of exports of petroleum, mineral ores and metals. Nearly all exports of these items are produced by relatively few foreign owned firms. For example, two U.S. companies, Kennecott and Anaconda, before their expropriation in 1971, produced about 90% of Chile's output of copper. In Peru, three American firms, the Southern Peru Copper Company, Cerro de Pasco and Northern Peru Mining Company, accounted for 83% of copper mined and 99% of smelted copper.17 The reasons for this domination are that the principal markets for these items are in the developed countries and the search for sup-

14 C. KINDBERGER, AMERICAN BUSINESS ABROAD 159-60 (1969); FERRER, EL CAPITAL EXTRANJERO EN LA ECONOMIA ARGENTINA, EL TRIMESTRE ECONOMICO, Abril-Junio 1971, at 314.
15 For an Argentine example, see Ferrer, supra note 14, at 302.
16 Fear of foreign control expanding from important economic sectors into domestic politics is very prevalent in Latin America and increases their distaste for large foreign investors. Latins "know" that firms such as ITT attempt to influence local politics through extra-legal means. Allegedly, that firm attempted to prevent the inauguration of freely elected Marxist Salvador Allende as President of Chile in 1970. N.Y. TIMES, Mar. 24, 1972, at 1, col. 6.
pliers of these resources has usually originated in developed countries. Firms from the developed countries also control the international markets for most of these materials making it difficult for newcomers to enter the field. Secondly, the technology employed in petroleum and minerals extraction is difficult to acquire and often is not available without the cooperation of the international firms already possessing it. Latin American countries attempting to extract such materials on their own often encounter technological difficulties which can be remedied only by making concessions to foreign investors.  

Thirdly, the international companies have relatively enormous amounts of capital at their disposal and are able to reduce the risk involved in exploration through diversification of their efforts. In most Latin American countries, the road to development is seen to be through industrialization and so this exploitation of mineral resources by foreigners is thought of as a raid on industrial inputs which will be needed for future economic growth. Latin Americans charge that concessions used to attract investors into these fields have been excessive, causing the cost of mineral extraction to appear too low to those parties acquiring the rights to these resources. As a result, reserves are depleted so rapidly and so completely as to leave nothing as an input for domestic industry.

UNITED STATES POLICY REGARDING PRIVATE INVESTMENT IN LATIN AMERICA

Most North Americans feel that the advantages of private investment are so evident that the case for it is seldom made explicit. It is often pointed out that the United States own rapid development in the 19th and early 20th century was dependent upon foreign capital. Also, like most developing countries now, the U.S. had to cope with the vagaries of world demand for a few agricultural products such as cotton and tobacco. It is implied that since the early experience of the United States and the current situation in Latin America are so similar, the developmental success of the U.S. can be duplicated simply by imitating U.S. economic policy. Private foreign investment was good for U.S. development and, therefore, is recommended for others.


19 Mikesell, supra note 17; Loehr, The Supply of Risk Bearers in Underdeveloped Countries: A Comment (unpublished article being revised for publication at GSIS, University of Denver).
Impressive economic advances made by Puerto Rico are sometimes alluded to as an indication that Latin Americans can accelerate economic development by employing similar techniques which rely heavily upon investment by foreigners—particularly upon investment originating in the United States. Latin Americans would argue that Puerto Rico has paid the unacceptable price of complete loss of political independence. They reject the Puerto Rican model for exactly the same reasons that the United States urges them to reject the techniques which have led to the economic gains of countries within the Soviet orb.

U.S. policy makers point out that in addition to the advantages of private investment indicated above and the success of the U.S. development model, private enterprise yields the additional return of political stability and democracy. In their opposition to private investment, Latin Americans fail to "appreciate fully the connection between private enterprise and political freedom." This connection is found in, first, the support that private enterprise lends to the development of a broad middle class of managers, property owners and small capitalists. It is assumed that this middle class would then function in much the same way as it does in the United States; through relatively well informed expression of political opinion. Second, by diffusing economic power and decision making throughout the economy, private enterprise would provide a bulwark supporting individual freedom against the rise of an arbitrary centralized power.

This argument has been particularly unpalatable to Latin Americans. Instead of leading to the development of a solid middle class, foreign investment is observed to create relative economic giants. Foreign investors, they argue, stunt the development of local businessmen because of their superior competitive position and, therefore, they retard the development of an articulate middle class. Latin Americans are fearful of a loss of personal freedom to an arbitrary, centralized power. Many countries are already strongly influenced by decisions made externally, beyond the control of their national gov-

20 E. Hanson, Puerto Rico: Ally for Progress (1962).
ernments. Experience has also shown that where foreign capital has been relatively unimpeded, the benefits to the host country are distributed in favor of a few local businessmen who come to wield inordinate economic power. Rather than diffuse private economic power, unimpeded foreign private investment may enhance its concentration. While this phenomenon can be observed in varying degrees in different countries, nowhere is it more obvious than in one of Latin America’s poorest countries, Nicaragua. Not only has private economic power been concentrated in the hands of very few members of the Somoza family and their friends, but those same hands hold the political reins as well. United States cooperation in allowing the Somoza dynasty to develop and continue in power, perpetuates the impression in other Latin American countries that this is the type of political stability and democracy the United States advocates.

United States policy regarding private investment in Latin America seems to be based upon an ignorance of the possible detrimental effects of such investment. The unquestioning support offered to private investors is reflected by the main policies in this area: the Hickenlooper Amendment to the Foreign Assistance Act and the U.S. Investment Guarantee Program. An examination of these policies leads us to discover that they build rigidities into our mixture of policy instruments which often lead us to results which are neither in the interests of the United States nor of Latin America.

HICKENLOOPER AMENDMENT

The Hickenlooper Amendment, originally attached to the Foreign Assistance Act of 1961, and later in a modified form to the same Act of 1964, seeks to improve upon the investment climate in less developed countries by using foreign aid as a threat. The Amendment requires the President to terminate foreign aid and sugar quotas to countries which expropriate (or levy taxes which are expropriationary on) the property of U.S. citizens and, fail within six months to take steps toward equitable compensation in convertible foreign exchange. Support for this policy developed during the aftermath of the Cuban expropriation of U.S. properties valued at over $1 billion, and during negotiations concerning the expropriated

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23 It is of interest that U.S. investors in Cuba felt so secure that none had obtained investment guarantees which were available from AID or its predecessors. See Derkaash; Nationalism in South America: Adios to U.S. Investors?, May 1971 (Occasional Studies No. 5, Division of Research, College of Business Administration, University of Denver).
The 1964 revision of the Amendment dealt with adjudication in U.S. courts in cases of alleged injustices done to U.S. investors in foreign countries. Known also as the "Sabbatino Amendment," it provided that:

No court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or another right is asserted by any party . . . by an act of that state in violation of the principles of international law, including the principles of compensation.25

Supporters of these measures claimed that they would protect U.S. property owners from arbitrary expropriation and thereby encourage more private investment in less developed countries. Secondly, they argued that it would not be wise to provide aid to countries which violated the rights of U.S. citizens.26

One can easily question the authority of the United States in the application of the 1964 Amendment. Rather than a strengthening of international law this Amendment appears as an attempt by the U.S. Congress to create international law. It is quite doubtful that this attitude will foster an increasingly orderly world based upon a strong system of international law since it serves to divide the countries concerned rather than create a consensus on the solutions to problems. It is also rather naive of the supporters of this policy to imagine that they have the power to make and enforce legal decisions in another country. In the event that U.S. courts ruled in favor of an expropriated U.S. investor in another country, how could the U.S. effect a settlement?

The Hickenlooper Amendment has been criticized by both the State Department27 and U.S. businessmen with interests in Latin America.28 They maintain that the Amendment is self-defeating since it polarizes and hardens the positions of the parties concerned and makes unlikely a settlement which is favorable to U.S. interests. In an atmosphere in which most

24 Shortly after the Amendment was passed, a settlement between Brazil and ITT was reached. LEGISLATIVE REFERENCE SERVICE, LIBRARY OF CONGRESS, FOR THE COMMITTEE ON FOREIGN AFFAIRS, EXPROPRIATION OF AMERICAN-OWNED PROPERTY BY FOREIGN GOVERNMENTS IN THE Twentieth Century, Comm. Print No. 20-821 Cong., 1st Sess. 20 (1963).
26 This attitude implies that aid is a form of reward for behavior agreeable to the U.S.
27 EXPROPRIATION, supra note 24, at 27.
Latin American countries are attempting to build national pride, most people and politicians are sensitive to outside pressures. The U.S. threat to discontinue aid to enforce compensation for expropriated properties is likely to solidify local support against compensation. Attempts to force compensation are likely to create a situation which, from the point of view of the political decision maker in the expropriating country, compensation is viewed as politically impossible. The deadline proposed by the Amendment creates a tense negotiating atmosphere and gives the impression of a presupposition by the United States that other governments will not honor their obligations according to international law. Rather than impose sanctions within the stated six months, it would be better to leave the issue unresolved. As long as the issue remains unresolved there is at least a possibility of a mutually acceptable solution.

An indication that the Hickenlooper Amendment is not deeded and is probably detrimental to U.S. interests can be seen in recent cases of expropriation in Latin America. In Argentina, rights to petroleum exploitation have been in and out of the hands of private foreign investors.\(^{29}\) Foreigners were invited to exploit oil reserves during the last few months of the Peron regime only to have their contracts revoked during the post-Peron era. Foreign firms, invited back by President Frondizi, beginning in 1958, found their contracts annulled and properties expropriated in 1963 by the Illia government. By 1965, the latter realized that the Argentine YPF (Yacimientos Petroliferos Fiscales), the publicly owned petroleum company, was unable to supply the country with enough petroleum products and so again foreign investors were invited to exploit that resource. The important thing about this series of expropriations of, and invitations to, foreign investors is that in none of the cases were agreements reached on compensation. Compensation for the 1963 expropriations was still being negotiated when the firms were invited back. Rather than losing, the firms concerned may have gained; because in each case when they were invited back they were able to secure contracts much more favorable to themselves. Had the Hickenlooper Amendment been invoked the matter would have been settled after six months, with the companies receiving only partial compensation—or in some cases nothing. In none of these cases did

\(^{29}\) Gardner, The Y.P.F., Spring 1969 (a paper prepared for Economics 587 at the University of Colorado).
the "investment climate" seem to be damaged, since each time they were invited back foreign investors were willing to bid for new explorations contracts.

United States reaction to the expropriation of the International Petroleum Company (IPC) by Peru in 1968 involved the use of the Hickenlooper Amendment as a threat—an empty threat it turned out since compensation was not forthcoming and aid has not been officially discontinued (but substantially reduced). This crisis was a result of a long dispute between the IPC and Peru, with claims and counter-claims asserted in both directions. During the latter years of the Belaunde administration negotiations broke down repeatedly. Pressure for settling in favor of the IPC was exerted by the U.S. by reducing aid to Peru to a mere fraction of what it had been before the dispute. The main point at issue seemed to be the way in which profits would be split. The fact that an agreement was not reached and that the aid reductions of about $150 million during a four year period far exceeded the profits to be gained by Peru had they reached a settlement favoring themselves, indicates that control over the Peruvian petroleum industry was of greater importance to the Peruvian government than mere monetary reward. Eventually President Belaunde reached an agreement with the IPC which was proven politically unacceptable by his overthrow in late 1968, and the almost immediate expropriation of the IPC by his successor, General Velasco.

Negotiations between the Velasco government and the United States quickly polarized. The U.S. took up the IPC claim without question and wielded the threat of suspending aid. General Velasco assumed the only politically acceptable role—indeed the one which brought him to power—demanding that the IPC pay its back debts to Peru and telling the United States, in almost so many words, that they may keep their aid. Due to this intransigence on both sides, the IPC has been banished from Peru and any hope for compensation for property seized has vanished. In the end the Hickenlooper Amendment was not applied since Latin American sympathies were strongly on the side of Peru, elevating General Velasco to near hero status. Suspension of aid would simply make the United States appear more of a bully in the eyes of most Latin Americans.30

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30 For an excellent account of the IPC story and the events leading to its expropriation by General Velasco, see Goodwin, Letter from Peru, New Yorker, May 17, 1969.
What did the use of the Hickenlooper Amendment as a threat accomplish? It did not protect the IPC properties, and may have helped in creating an atmosphere in which compensation was impossible. It did not improve the investment climate for U.S. investors, but does not seem to have damaged Peru as a host to international corporations of other nationalities. British Petroleum has recently been granted an exploration contract to develop oil in the Amazonian territories and a British-Canadian partnership\(^3\) has been contracted to exploit the potentially large Cerro Verde copper deposits. Seven companies, mostly European were competing for contracts to produce diesel engines and seven more to manufacture tractors.\(^2\) Other U.S. political interests have suffered, since in response to the U.S. attitude General Velasco has become increasingly allied with the Soviet Union. Also, the realization by other countries that the Hickenlooper Amendment was really a bluff could have been the final straw leading to further expropriations by Peru, as well as similar moves by Chile, Colombia, Ecuador and Bolivia.

U.S. INVESTMENT GUARANTEE PROGRAM

The U.S. Investment Guarantee Program (IGP) began in 1948 as an inducement to U.S. businessmen to invest in Europe. Initial coverage of currency conversion risks was expanded to include protection against confiscatory expropriation (1950) and risk of loss from war and insurrection (1956). The list of countries in which investments could be secured gradually expanded so as to place greater emphasis upon investments in less developed countries. These latter have become the primary area covered since 1959.\(^3\)

In principle the concept of investment guarantees for new investments in less developed countries seems sound. Conflict between expropriated companies and host countries stemming from disagreement over "prompt, adequate and effective" compensation may be avoided. What is compensation to a government may not be considered compensation by a private business firm. Subrogation by the U.S. government may allow compensation in a form which is in the national interest but which could never have been acceptable to the private claimant. The

\(^{31}\) Partnership composed of British Smelter Construction and Wright Engineering of Vancouver.


\(^{33}\) For greater detail on coverages and qualifications for coverage, see Glick & Tozier, Government Guarantees for Your Investments Abroad, Mergers and Acquisitions, Fall 1965 and Winter 1966.
U.S. government may be willing to accept such things as long term obligations, payment in "soft" currencies or other intangibles not directly related to the expropriation dispute. In the IPC case, the United States might have been willing to accept a resolution of the long standing dispute over commercial fishing rights in waters off the Peruvian coast as a quid pro quo for claims arising out of the expropriation. Thus greater flexibility could be acquired in the handling of compensation problems.34

In practice, U.S. investment guarantees have proven to be a potential source of tension and political influence. The IGP only covers investments in countries which have signed bilateral investment guarantee agreements with the United States, under the auspices of AID. There is evidence to indicate that where countries were reluctant to sign such agreements, pressure was exerted on them to cooperate.35 In testimony before the U.S. Congress' Subcommittee on Inter-American Affairs, when asked whether there has been a strong coercive element in the investment guarantee program, Joseph A. Silberstein36 responded:

"I know there was a coercive element for a period of time — that if by such and such a date a country had not entered into an investment guarantee agreement, we would have to terminate aid."37

In fact, it exists as a presumption in the legislation that there should be such agreements, leaving to the President the question of continuing aid.38 One official interpretation states that where host countries are "unwilling or unable" to put an end to the "domestic risks of expropriation," government guarantees should be employed to ease the uncertainties of private investors.39 "Unwillingness" and "inability" to end expropriation risk are two entirely different matters. The latter implies that attempts are being made unsuccessfully, while the former implies a definite choice to include expropriation as a potential means to control foreign investors. In effect, this attitude advocates stimulation of U.S. investment even in the countries which do not want U.S. investors and which would find the presence

34 Groves, Expropriation in Latin America: Some Observations, 23 INTER-
AMERICAN ECON. AFFAIRS 60 (1969).
35 Wionczek, supra note 9, at 14.
36 Director, Office of Regional Economic Policy, Bureau of Inter-American
Affairs, Department of State.
37 Hearings, supra note 28, at 13.
38 Id.
39 JOINT ECONOMIC COMMITTEE, SUBCOMM. ON INTER-AMERICAN ECONOMIC
RELATIONSHIPS, PRIVATE INVESTMENT IN LATIN AMERICA, J.C. Doc. No. 59-
of such investors in conflict with their national interests. Such a policy can only add to the tensions between already existing U.S. investors and their host countries, increasing the probability that expropriation will be used as a tool for bringing about economic institutional arrangements acceptable to the host country.

With the above in mind it is not difficult to see why the IGP has been another source of resentment among Latin Americans. They see it as simply one more instrument with which the United States can extend its influence in their countries, even when those countries are trying to resist such extension. They are angered by reference to the IGP as part of the "... residual responsibility of the U.S. Government to protect its investors abroad and the degree of pressure which we can exercise, with or without legal means, including the AID program." It is difficult to see the IGP as simply another form of aid in view of such evidence as to the program's political content.

Proposals for multilateral investment insurance, directed through some international agency, seem far preferable to the IGP. In this manner political objectives of parties concerned would be moderated by force of international agreement. Also, both host country and capital exporting country would share in the insurance burden. Countries which did not want to attract foreign capital would simply choose not to participate. Participation by a potential host country would be a clear sign to investors that that country wanted foreign investors and was taking steps to attract them. Since payment for claims would be borne in part by all signatories, irresponsible acts by one host country would clearly be felt by other hosts, thereby providing stimulus for each host country to exert their influence on other hosts to minimize claims. This is just the opposite of the present situation where, if anything, an expropriating host is supported by other host countries. These proposals would help minimize the development of the attitude that neither the host nor the company will suffer, since the U.S. government would pay the claim.

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40 Ambassador Milton Barall, Head, Caribbean Study Group, Dept. of State, AID. Statement in Hearings, supra note 28, at 235.

41 There is some indication, political factors aside, that the IGP is not needed. Since the beginning of the program in 1948, there have been so few claims paid, four as of 1969, as to leave these events actuarially insignificant. That U.S. private investment in Mexico is greater than in any other Latin American country, and that investment guarantees are not available there, throws further doubt on the need for the IGP.

42 For some details on the special features of multilateral investment insurance proposals, see Martin, Multilateral Investment Insurance, 8 Harv. Int'l L.J. 230 (1967).
CONCLUSIONS

The case for private investment in Latin America or any developing region is indeed uneasy. Potentially, advantages can accrue to countries hosting foreign private investors in the form of improved technology, increased productive capacity, greater employment and short run balance of payments improvement. The presence of such investment, however, can have an unfavorable impact upon local entrepreneurs, long run balance of payments and upon the ability of the host country to control its own economic destiny. Which forces predominate is unclear. No generalization can be made that private foreign investment is “good” or “bad” for the host country since each investment-host combination will differ in its overall economic properties.

United States policy toward private investment in Latin America has been based upon the assumption that it is always to the hosts’ advantage to have more foreign private investment than less. Policies based upon this unrealistic assumption have not and cannot be successful in improving the so called “investment climate” in Latin America nor in protecting U.S. investors from expropriation. The government of the United States should neither promote nor discourage private investment flowing from the U.S. to Latin America. Investment decisions should be made solely by the firms concerned, taking into account the economic soundness of the venture, the laws of the host country and its reputation for keeping its promises. The U.S. government should neither insure investment nor participate in any private insurance plan.

What might be called a “market” solution to the private investment problem should be sought in that an environment lacking distortions caused by unrealistic policies either on the part of investing or host countries is most preferable. Sound foreign investment practices will occur in the future only through arrangements mutually satisfactory to host governments and investors. Countries convinced that foreign private investment will benefit them will soon discover the measures necessary to attract the attention of investors. Hosts, convinced that on balance they are being harmed by the investments of foreigners, will be free to follow policies which exclude them. Under the current system, these latter are often forced to host investors which they consider contrary to their national interests, and are at the same time chastened for their sometimes harsh acts against these investors. Such harshness can only be
expected in these cases and could have been avoided in the first place had the unwilling host been free to exclude the objectionable investor. By experience countries will learn that if there are benefits to be gained from private foreign investment, certain activities (e.g. expropriation) will severely limit their ability to enjoy those benefits. On the other hand, if such investment places an uncompensated cost upon the host, it will simply be excluded.

Investing firms will be under constraints similar to host countries. They will soon learn which modes of behavior are compatible with their own interests and those of the host. Should those modes be violated in ways injurious to the latter, settlement in host country courts is clearly necessary. Firms will quickly discover where they are welcome and where they are not. Investment decisions could, therefore, be made with a clearer assessment of the “investment climate” than is now possible.

One might ask whether the adoption of such a policy of non-interference by the United States would mean a rash of expropriations of property now owned by U.S. interests in Latin America. Surely there will be expropriation in some cases where the investments are particularly disliked by their Latin American hosts. But is this not what is taking place anyway in Peru, Chile, Bolivia, etc.? Expropriations will not increase significantly because each country would realize that a policy of wholesale expropriation would be a clear sign to foreigners that they are not wanted. Host countries would not generally want to give such an impression since most of them realize that under some circumstances private foreign investors can be of benefit to them. They would not want to jeopardize their option of attracting certain kinds of investors by creating the general impression that they are against all private foreign investment. Only those investments clearly contrary to national interests are likely to be expropriated, and only those countries which do not want any private foreign investment are likely to pursue general expropriation policies. In this latter case the overall investment climate would be improved since investors would know precisely where and under what circumstances they were welcome.

\[41^{*}\] Much of the trauma and international conflict associated with expropriation could be avoided through the use of an international divestment mechanism as suggested by Albert O. Hirschman. How to Divest, supra note 8.