FOREIGN DIRECT INVESTMENT AND
POLITICAL RISK

THESIS

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By

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This paper will show that, despite the need for extension of foreign direct investment in the form of multinational corporations to capital-scarce, less developed countries, political risk creates a gap between the demand and supply of foreign investments.

In Chapter II, the patterns of foreign direct investment are analyzed. Chapter III reviews the various sources of political risk and concludes that the existence of political risk is an obstacle to the formation of optimum level investment. Chapter IV discusses the relative positions of the less developed countries and the multinational corporations. Chapter V shows the problems caused by the absence of a universal, regulatory institution. Chapter VI presents case studies of corporations based in Chile, Peru, and Angola. Chapter VII suggests ways that political risk can be minimized.
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CHAPTER I

INTRODUCTION

The expansion of multinational corporations is a remarkable development of this century. At present, foreign direct investment accounts for more than $165 billion, 80 per cent of which originates from the U. S., France, Germany and Switzerland. Two-thirds of this 80 per cent comes from U. S. based corporations. U. S. foreign investment was $12 billion in 1950, $33 billion in 1960, and over $100 billion in 1974, illustrating the striking growth of the multinational corporation (MNC) during the last 25 years.

However, a global look will show a different picture of development. Despite the rapid growth and diffusion of technology, only a small segment of the world is technologically developed. These capital-scarce developing countries need international capital movement, which nowadays takes the form of direct investments carried out mostly by multinational corporations.

This paper will show that, despite the need for extension of MNCs to overseas markets and the need for foreign financial, technological and managerial sources in the relatively capital scarce countries, political risk creates a gap between the demand and supply of foreign investments.
In the second chapter, foreign direct investment (FDI) is analyzed according to its patterns of development through the years. Different theories are compared and briefly reviewed. FDI is explained with regard to the MNCs' and host country's interests.

In Chapter III, sources of political risk are discussed. Political risk may be caused by diverse subjective and objective factors coming from the host country or from the home country, which can restrict or put an end to MNCs' operations. Political risk may take the form of expropriation of a corporation, nationalization of a sector, or operations restrictions. Firms must evaluate the risk factor in determining the return on investment (ROI), and the techniques for doing so will also be reviewed in this chapter.

Chapter IV is a synthesis of foreign investment and political risk. The reasons for national measures and MNCs' positions are discussed. During the independence movements, MNCs collaborate with the future government and obtain long-term agreements from the liberators. However, in time, these contracts become subject to renegotiations. The lack of experience in the new independent countries leads to impasses. By the time experience is gained, many corporations can be hurt.
As a consequence of interventions, all the capital becomes state property and foreign invested capital turns to accumulated capital. When new independent developing countries ask for the foreign capital that they have hitherto rejected, the past experiences of the corporations lead to forgo possible investments. Thus, the manner in which the property is acquired is the most risky part for both the host country and the MNCs. This chapter also shows that the flow of investments is mostly to developed countries (DCs), rather than to less developed countries (LDCs).

Chapter V discusses the problems caused by the lack of legal tradition in international law. It compares theories favoring national law as the sole jurisdiction with theories favoring international law. In this chapter, international arbitration is also explained, in addition to the unilateral, bilateral and multilateral measures against nationalizing countries. Appendix A provides the measures of the European Economic Community (EEC) on Prohibited Practices and Abuse of Dominant Market Position. Appendix B provides the communication of the third world countries (Group of Seventy-Seven) to the United Nations (U, N.) concerning operations and activities of MNCs. Appendix C covers the areas of concern of developed countries.

Chapter VI presents various case studies which illustrate the effects of political risks on F.D.I. Case studies on
Chile--Kennecott, Anaconda and ITT--explain the process of nationalization in Chile. The case study of Peru concerns the nationalization of Marcona, a U.S.-based company which operated in the iron industry. The case of Guyan-Alcan relates the nationalization of aluminum mines after the independence of Guyana. The Angola case reviews a policy of MNC (Gulf) during the civil war in 1974. The last case study is about the evaluation of foreign investment law.

Chapter VII suggests ways that political risk could be minimized. The measures that home and host countries could take to diminish political risk are outlined. In addition, the ways in which corporate and affiliates' strategies in host nations can minimize political risk is analyzed.

Finally, the conclusion of the research briefly summarizes the role of political risk in Foreign Direct Investment.
CHAPTER ENDNOTES

1There is also foreign investment in the form of lending, but this topic will not be covered in this thesis.

CHAPTER II

FOREIGN DIRECT INVESTMENT: AN OVERVIEW

In order to have a complete understanding of the operations of multinational corporations, it is best to begin with a summary of the chronological development of Foreign Direct Investments. A review of the various theories concerning FDI is also helpful.

International Investment Before FDI

Before the 1930's, foreign investments were mostly of the portfolio type. Portfolio investment refers to "the transactions in or holdings of stock, bonds, and money market instruments involving independent firms or individuals." These transactions were mostly based on the difference in interest rates. For instance, when the interest rates in country A exceed the interest rate in country B, one would invest his money in country B. Portfolio investments are mostly done by individuals buying or selling bonds, and/or money certificates.

International Investment After WWI

After the 1930's, international capital movements took on a new form, foreign direct investments (FDI). FDI may be
defined as the investment process of creating and of controlling an affiliate located outside of the corporation's headquarter country.²

FDI is not only in the form of capital but also includes technology and know-how. Before World War I, direct investments in less developed countries (LDC's) were limited to exploitation of natural resources. After WW II, FDI increased for several reasons. First, it was necessary to rebuild Europe, and the application of the Marshall Plan played an important role in stimulating the flow of U. S. capital into overseas markets. Second, the needs of LDC's increased the demand for foreign financial resources, as well as the supply of capital to invest in virgin markets.

In summary, at the beginning of the century, the majority of investments were of the portfolio type. For example, in 1914, 90 per cent of the capital movements were portfolio investments.³ However, at the second half of the century, 75 per cent of all private capital flow was of the direct type.⁴

Different Theories Concerning FDI

International trade has been examined by diverse economic schools. One of the first attempts to explain FDI came from Heckcher (1919) and Ohlin (1933).⁵ Their theory is based on a two-country, two-goods model. It assumes that
1. Resources are fixed (including capital and labor);
2. Factor endowments of countries are different;
3. Production functions are exogenously given, and are different from each other;
4. Production functions describe a constant return to scale technology;
5. Markets are costlessly efficient;
6. Government is neutral, and seeks after Pareto's optimum;
7. Production is perfectly competitive within and between countries.

This theory proposes that a country exports the goods which it produces at a lower cost and more efficiently, and imports the other goods from the country which produces them more efficiently. For instance, if Turkey has cheap labor and does not have enough capital, it should specialize in the production of, for example, wheat (labor intensive production) while the U.S., which has abundant capital, should specialize in the production of paper (capital intensive good). Accordingly, both parties would gain from the free trade.

However, these assumptions are unrealistic and too general to explain foreign direct investments. With these assumptions, capital movements could be explained by the Ricardian Approach based on "the scarcity of a factor in one country and the abundance of the other, and the differences in the interest rates." In accordance with this
suggestion, the location of the operations would be in the country where the costs are lower.9

When the information is costless and the trade is barrier-free and when the markets are perfectly efficient without external economies, the only solution to the international exchanges of goods would be trade.10

However, FDI does not occur in a perfectly competitive market. There are other factors such as governments, know-how, education, economic integration, tariff barriers, socialist regimes, and wars, which change competition. These factors may constitute market failures.

Thus, neither the investment nor the operational goals are based on the maximization in a general equilibrium model. Indeed, foreign investment theory should also emphasize institutions, including the Multinational Corporations (MNCs) which carry the capital flow, technology, and know-how.11

Investment Decisions of MNCs in Imperfect Markets

MNCs have double personalities in that they operate under the laws and norms of the host countries, yet belong to a multinational network.12 A MNC may be defined as a firm which operates under the laws and norms of different societies, having its headquarters in the parent country but activities in several other host countries through its local
subsidiaries. The purpose of a MNC may be assumed to be to reach maximum profits, not in one operation, but globally from the whole network of activities.

MNCs' investment decisions are based on market share, production cost, competition, breaking custom barriers, and potential return on investments. Supplying the market with production at the location of the demand creates an advantageous position for the MNC. Custom barriers, for instance, ceterus paribus, is a determinant for FDI. By investing inside the market, the firm can avoid the protective taxes on imported goods. Accordingly, the firm which made the investment has a bigger share of the market than its competitors. In fact, the other firms which are not producing within the market have to set a higher price on their products since they must pay import taxes; therefore, they are not competitive.

The saturation of the local market is another incentive for foreign investment. When the local demand for a given good ceases, corporations supply that good to a new market and capture an additional rent from their product. The first corporation which enters into a new market is followed by the others, the bandwagon effect.

Hymer (1972) and Kindleberger (1969) emphasize the special advantages that a country or a company has over the host country firms. These advantages in terms of technology, know-how, information possibilities, and economies of scale
stimulate corporations to invest elsewhere. Firms accordingly can experience larger profits than host locals in the foreign market. Possessing a unique asset helps the MNCs to recognize higher revenues and profits in an overseas market than in their home country where the competition is more perfect. In addition, information about technology is getting more and more sophisticated, which makes it "less prone to be imitated." The MNC can develop this information to increase its dominance over the market. These advantages which MNCs have over host country firms have contributed to their growth and continuing geographical distribution.

Although their rapid extension has been a phenomenon which has helped to shorten the distances between continents and lead to economic integration and economic vitalization of the world, MNCs also have given rise to much controversy with the host countries where they operate. While FDI through MNCs can be beneficial to the host countries, there are also disadvantages which must be considered.

Multinational Corporations:
Advantages and Disadvantages for Host Countries (LDCs)

Some argue that FDI is the only way to improve the poor conditions of an LDC. Others interpret FDI and its carriers, MNCs, as the imperialistic agents of capitalism. (Hymer, Baran, Sweezy). Both views will be analyzed here, but neither
of these extreme approaches will be followed. Rather, the pros and cons of FDI for host countries will simply be presented.

Advantages of FDI and MNCs for LDCs

LDCs need to create (or develop) their industries, open job opportunities, and train and educate the nationals, thus forming a class of elite technocrats and managers. They also need to export goods and gain powerful foreign currencies, satisfy the local demand as it increases, diversify with the development process, and exploit national resources. LDCs rely on foreign financial and technological capacities to accomplish the above goals.

The development of the LDCs depends on the transfer of technology and capital since LDCs lack the financial resources or the research and development opportunities to create an industrial revolution. LDCs have natural resources and available cheap labor but cannot exploit or employ them. Thus, foreign capital and managerial know-how can be imported as a factor of production. It is true that LDCs need to create their own technocrats and managers so that their dependency upon the countries which have the know-how will diminish over time, and they can do this with the help of the MNCs. Thus, the MNCs' primary contribution is the transfer of technology and know-how.
LDCs need to import capital to fill the gap between the desired level and the accumulated capital and local savings. MNCs can mobilize capital for productive purposes. On the other hand, they help the LDCs to improve their capital accumulation and production capacity. Of course, with increased production comes stimulation of the job market, a strong advantage for LDCs, who cannot create enough job opportunities to handle the employment problem.

In summary, MNCs help to improve the income level of the host country by stimulating the development of various business environments. FDI, through MNCs, benefits the host countries by developing urbanization, transferring know-how to local employees, stimulating the transportation media, constructing highways, creating a market for local suppliers, and vitalizing the host economy in general. MNCs, then, have the capacity to satisfy the needs of the developed and less developed world and to alleviate the financial difficulties of the LDCs. However, the effects of MNCs on host countries are not always positive.

Disadvantages of MNCs

MNCs can have negative effects on the host country. These disadvantages can affect the economic, social, and political life of the host country. The foreign direct investment and the MNCs can be economically harmful to the host country in the case of a foreign investment which
makes less contribution to the host economy than a project which would operate in its absence. Also, MNCs can send out more than what comes into the host economy. In the "Dependencia Model" Previch & Hymer maintain that,

The flow of wealth and benefits are flowing from the global, underdeveloped periphery to the centers of industrial power and decision. It is an exploitative system that produces affluent development for some and dependent underdevelopment for the majority of mankind.

Accordingly, there will be a central decision located in the "financially and industrially developed cores such as New York, London, Tokyo, etc, which will control the periphery." The rich countries will develop more, and will become more wealthy by "exploiting the poorer countries and making them poorer."

Technically, profit remittances and capital repatriations may affect the stability of the host economies. The desired results of the host countries from foreign investments (increase exports, create jobs, train the local staff, etc.) were mentioned earlier. However, some corporations may deprive the locals of responsible positions; may not offer training programs; may not use local supplies, and the corporation may use tax pricing policies. Then, the expectation of positive effects of the FDI may not be as when the decision to import capital was made. The sharpest case is the attempt of the MNCs to maximize their profits with different tax rates in different locations of investment. This is called transfer pricing policy. The MNCs
transfer its earnings to the country that offers the best tax rate. Thus the MNC enables itself to increase profits. Accordingly, the host country will lose opportunity to benefit from the second best alternative.

Another possible disadvantage of MNCs is that they can block the development of local business, the growth of infant industry in the host country. Because they possess advanced technologies and managerial know-how, MNCs experience lower costs of production. In addition, their supplies are better quality, and they have powerful information and communications systems to develop and market their goods.

In conclusion, they have advantages over the locals in competition. In addition, MNCs may cause problems in the redistribution of income. Since the investors cooperate with the elite in the host country, the distribution of wealth may be altered to favor one social class.

The social effects of the diffusion of MNCs has been discussed in the literature and in such organizations as OECD (Istanbul, 1971). In conformity with the promotion of new technologies, MNCs also diffuse their home country's culture, their ethics and values. This fact is the cause of the formation of a dual society.

One part of the society will adopt the new values and identify itself with the incoming culture while the rest
will refuse to accommodate their lifestyles. There will be a rupture between the two parts of the society. This split is a very common result of modernization, which is westernization.

Bribery is also a problem area of conflict. Sometimes it is part of the host country's culture and is not really solely due to the nefarious MNC. Still, whoever is at blame, it is a critical problem which needs to be resolved for MNCs to find popular acceptance in host countries.

Politically, MNCs may harass the national will (see case study on Chile). When a MNC serves as the diplomatic agent of its home country and uses its economic power to alter the politics of the host country for a good of its home country, it challenges the sovereignty concept of nation-states.

Power of the MNCs vs. National Sovereignty

Possible political and economic control by the foreign interest is a fear of host countries. The Dependencia Theory mentioned earlier is developed on this basis. Liberal thinkers, such as Raymon Vernon a priori admit the power of the developed economies. (However, it concludes that this power is beneficial to the welfare of the world, globally.) Kindleberger admits also the capacity of the MNC "to exploit LDCs in a partial laissez faire, to the extent of their appetite." In fact, some MNCs are so
large that their financial capacities are greater than the
host countries where they operate. The sales of many
MNCs exceeds the GNP of most nations. In the light of
these approaches, one can distinguish two main views on the
power of control.

The first one is based on the theory that the more
assets the MNC has in a country, the more the MNC can
intervene in the national affairs of the host country and
influence its economic and political environment to benefit
the company. The second view, which is the antithesis of
the first one, maintains that the host country may exercise
pressure on a corporation in proportion to the size of its
assets and strategic importance of operations that a MNC
holds in the host economy. Both views are valid to some
extent. Ideally, both parties are seeking their interests:
global profit maximization for the MNC and the national
welfare for the host government. The bargaining power of
the specific country and the business policies of the MNC
will form the resultant of the two forces. They may be on
the same planes, or on the same line or in slightly differ-
ent directions. (Figure 1)
Accordance on common and mutual interest disagreement.

The question of which one, the MNC or the host country, will be the dominant power over time does not have a general answer. This is also a struggle between "the priority of national interests over the global economic efficiency" and vice versa. The LDCs are becoming more and more determined to achieve their goals such as expanding trade, managing their economy, and exporting unemployment rather than being dependent on international economic policies. For instance, in the United Nations (U.N.) a group of 77 LDC's acted as a whole body against the MNC despite their conflict in other areas. India and Pakistan, Sudan and Libya, Zaire and Angola, which have very fatal conflicts, voted together in the block.

Nations-states have not lost their power or will to act when they believe the MNCs are threatening their power or their perceived national interests and sovereignty.
They can expel, expropriate, impose taxes, legislate regulations and are ultimately sovereign powers. Thus the power of the MNC is not absolute.

If there is a conflict, referring to Figure 1, there may be several alternatives.

1. The bargaining power of the host country may be greater than the power of the MNC or vice versa.
2. The host country may take a definite measure like expropriation, nationalization, or confiscation of the MNCs' assets.
3. The MNC may ask for its country to intervene diplomatically or with armed force.
4. Both parties may ask for international arbitration.

Summary

Most of the FDI is made through MNCs. This obviously has advantages and disadvantages for both host countries and MNCs. Since their interests, at times conflict, this can result in problems for the MNC in terms of profit making and growth and can even result in significant loss. Therefore, it is important that the MNC understand the risks involved.
CHAPTER ENDNOTES


4Connor, p. 5.


6Pareto’s optimum is characterized as a situation whereby the welfare of one entity cannot increase without decreasing the welfare of anyone else.

7The theory explains to some extent the on-site production, if the factor immobility assumption is removed. Accordingly, through the vertical integration export sale subsidiary production plants (see Vernon's product cycle theory), in a perfectly competitive model, capital can flow to places where the production cost is low.

However, the theory implies that the factor prices would be equalized, when the two countries specialize in the production of goods A (capital intensive), and B (labor intensive). Accordingly, Spain, for instance, would produce B and decrease the production of the good A. The U. K. would do the opposite. In Spain, the labor will be concentrated on the production of B. The demand for the labor will increase, and the demand for capital would be limited. Factor prices will change in favor of wages and the interest rates will drop.

In the U. K., the opposite will occur. By decreasing the production of B, the supply of labor will be too high relative to its demand. However, demand for capital—necessary for the production of the good A will increase. Wages will drop; interest rates will increase.

In summary, international capital movements cannot be explained by this model.

8Kindleberger, pp. 13-14, and Connor, p. 5.


13 An example of crossing custom barriers is General Motors' (GM) decision to invest in Germany in 1920. When the German government decided to increase import taxes and limit the quota, GM decided to start producing in Germany.

14 Perry, p. 28.

15 Calvet, p. 49.

16 Buckley and Casson, p. 71.


18 Calvet, p. 49.

19 Calvet, p. 44.

20 Seyidoglu, p. 181.


22 Gilpin, p. 358.

23 Gilpin, pp. 358-359.

24 MNCs' personal policies may be grouped into four categories: First, ethnocentric policy which gives
responsible job opportunities only to the parent nationals. Second, regiocentric policy suggests to assign prime posts to the regional citizens and to the host country. Third, polycentric policy gives all the responsible positions to the locals. This may diminish the political risk, but has probable damages to the links between the subsidiary and the parent company. Finally, geocentric policy gives opportunities to all capable people to hold the responsible position without making differences between nationalities. For instance, a company may have a French executive for a subsidiary operating in Norway or a Nigerian for a subsidiary operating in Mexico. (David Heaney, pp. 29-32).


26A company which has several plants of production in different locations exports its goods with high cost of production to the country where the cost of production is lower. Connors, p. 20.

27Seyidoglu, p. 171.

28The second best alternative is the solution for the LDCs which lacks the technological facilities. They import capital and they gain from the taxes and royalties.


31Raymond Vernon, Sovereignty at Bay (New York, 1971).

32Hymer, p. 7.

33Kindleberger, p. 205.

34Of course, as referred to above with regard to bribery, certain public officials in the host country and employees of the MNC may seek self aggrandizement.

35Gilpin, p. 359.

36Gilpin, p. 364.
CHAPTER III

THE ROLE OF POLITICAL RISK IN FDI

Political risk is a factor which modifies the optimum level and structure of investment in the world. Various types of political risk are expropriation, nationalization, confiscation, damage to foreign properties, war, inconvertibility and similar events. Expropriation is the takeover of a single unit of an industry by the host country, while nationalization is a general takeover of an entire industry, changing ownership from private to public. Both, theoretically, require compensation to the owner. On the other hand, confiscation is a takeover without any compensation. In addition to these, social conflicts within a country may cause the interruption of a business environment. There is no doubt that wars, discrimination against foreigners, or a ban on repatriation of the profits are risks that foreign investments run. This chapter will consider the role of political risk in FDI.

First, the sources of political risk are analyzed and classified. Second, the risk, as the firms perceive it, is discussed.
Sources of Political Risk

Although it is highly difficult to measure the political risk objectively (as every observer adds his point of view to the analysis, thus becoming more or less subjective), the sources of political risk are classified here according to their nature (objective, subjective) and their issues and objectives (Table 3.1). There are sources of political risk which could be directed to both host governments and the corporation; and some which could be interpreted both as objective and subjective.

As observed in Table 3.1, social unrest constitutes a source of political risk which may harm the MNC and/or the host government. Social unrest may be defined as the conflict of two or several parts of the society. This conflict may cause an accumulation of power in one of the parts and change the balance in its favor. During or after this change the government (which represents one or two interest groups in the society) may lose its power, which in turn could affect the business environment. Further, the MNC, which may not operate conveniently under the new (or changing) circumstances, can be hurt. Evaluation of the social unrest factor may be done by comparing other similar cases in the past or by taking into consideration the particular case of the host country, specifically
### TABLE 3.1
**SOURCES OF POLITICAL RISK**

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**Social Unrest**

- Reactions of local business
- Local business
- Ideological conflicts

**Type of operation**

- Ideological conflicts
- Ineffective law enforcement
- Norms of the society

**Integration**

**Public Interests**

- Type of authority
- Nationalism
- Nationalistic attitudes

**MNCs behavior**

- MNCs behavior
- Type of authority

**War**

- War
the power of the internal and external forces influencing the resolution of the social unrest.

**Political interests** are mainly subjective factors, but might be analyzed objectively under the guidance of social scientists, with surveys, and statistics. Huntington perceives the interpretation of public interest as follows:

Traditionally, the political interest has been approached in 3 ways: It has been identified with either abstract value and norms such as natural law, justice or right reason; or with the specific interest of the particular individual (L'etat C'est Moi), group, class (Marxism) or majority; or with the result of a competitive process among individuals (classic liberalism), or groups (Bentleyism).

Corporations may interpret political interests according to the criteria of their ideological point of view, and so may the host governments or interest groups within the host country. The public interests may contradict each other, which can cause an inconvenient environment for doing business in the host country. The conflict may manifest itself as an expulsive attitude toward the whole private and/or private-foreign sector, or toward only one branch of the sector. It may also come from a massive group within the people who are against the private sector, and/or foreign operations, and/or foreign holdings in some sectors. This reaction might change the operation of the government, which was pro-MNC's, throughout the revolutionary or democratic process.
Reactions of local business may be based on the inconvenience of competition with the MNCs. As mentioned in Chapter II, MNCs have the advantage in competition. As a result, the infant industry may come to the edge of bankruptcy, or may be obliged to merge with the guest corporations. On the other hand, local industry may be aided by the large MNC projects, as for instance a glass maker making bottles for the MNC pharmaceutical plant. This may cause a reaction against the foreign corporations and pressure on the government to take measures against the MNCs. Local labor unions also might participate in or lead a movement supporting the small industry.

Type of authority is an important source of political risk, when the socioeconomic and political condition of each host country is also taken into consideration. Examining the political conditions may give an idea of the life cycle of the host authority. For instance, a democracy may only live a few troubled "childhood years" in a host country, where different social or ethnic groups are in severe conflict; where the political culture is under-developed; where the poverty and hunger of masses is the dominant picture. The same may be relevant for a dictatorship, but it also depends on its power and popularity.

Economic integration is another source of political risk. The constructing countries of a political or economic pact may prevent the non-members from operating within the
boundaries of the integrated area. This may cause limitations on the profit margins on ownership percentages or on time for the permission of operations. For instance, members of the Andean Common Market (1969, Columbia Equador, Peru, Bolivia and Chile and in 1973 Venezuela being the co-signers) on December 31, 1970 created a Standard Regime for the Treatment of Foreign Capital (SRTFC). According to this decision, 80 per cent of the ownership of some sectors should be transmitted to the locals. Repatriation of capital on profit margins was limited to 14 per cent and 5 per cent. Economic integration is one of the reasons for FDI, by stimulating MNC to introduce a plant within the borders of the area since there are custom barriers for imported goods. MNC invests in this area to pass the import restriction and capture the market.

Nationalism is one of the main motives of conflicts between MNCs and host countries. There is no doubt that nationalism may reach dangerous dimensions in its application. It may lead to discrimination of all non-nationals. As a political risk effect, governments may find it necessary to intervene in the economic system and confiscate, expropriate or restrict the foreign investors' operations.

Nevertheless, nationalism is not always a source of political risk. On the contrary, it may be a source of a
very convenient environment for the MNCs' operations when it advocates cooperation with foreigners as beneficial to the nation.

Emotional nationalism, usually the result of newly acquired independence, should be considered separately as another source of political risk. Mostly in countries who have achieved independence recently, MNCs are identified with the ex-colonists, which "often adapted policies to slow down the rates of growth and arrest the development of either a native capitalist class or native proletariat which could overthrow them." Thus, the MNCs are viewed as agents of imperialism who want to exploit the ex-colonies through economic dependence.

Attempts on the part of MNCs to intervene in national affairs gives issue to emotional arguments also. For example, installation of a very important quantity of MNCs from the same parent nationality may precipitate nationalist reaction in the host country. In Canada, for instance, U.S. based investments are over $26 billion, which "implies a control of half of Canada's manufacturing by Americans." So the Canadian government wanted to show that they are the master at home, not the MNCs.

It can be concluded that the fear of loss of sovereignty and the creation of economic dependency may create nationalism and reactions toward the foreign investors which may cause an interruption of the business environment.
Norms of a society are also factors to be taken into consideration as a source of political risk. The values of the host society are formed by a number of factors such as religion, economy, land, climate, and education. This makes norms constant in the short run. However, these factors as a whole may form a strong opposing force toward MNCs and their concepts. Even though the government or the leader favors foreign investments, condemnation of the MNCs and home country's philosophy by a massive part of the society is a power to change the business environment or overthrow the regime which supports the foreign investors. For instance, in Iran, the Shah was a pro-western leader with considerable authority in his country. However, his overthrow was due to the power of orthodox conservative Muslims who knew how to gather and manipulate forces against the Shah. The revolution of Iran was against the regime of the Shah but mostly against the "western values" of his reforms.

In fact, societies with dual bodies, traditional and modern, have two conflicting value standards. This conflict is a source of political risk for MNCs.

The type of industry (operation) alters the probability of occurrence of risky events. Most labor intensive and extractive industries are especially vulnerable to political risk. Refer to Table 3.2.
### TABLE 3.2
DISTRIBUTION OF 118 MAJOR DISPUTES BETWEEN JANUARY 1961 AND JANUARY 1975

<table>
<thead>
<tr>
<th>Industry</th>
<th>Latin America</th>
<th>Africa</th>
<th>Middle East</th>
<th>Asia</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Petroleum &amp; Related</td>
<td>26</td>
<td>23</td>
<td>28</td>
<td>7</td>
<td>84</td>
<td>32</td>
</tr>
<tr>
<td>Mining &amp; Processing</td>
<td>35</td>
<td>9</td>
<td>-</td>
<td>-</td>
<td>44</td>
<td>17</td>
</tr>
<tr>
<td>Banking &amp; Insurance</td>
<td>6</td>
<td>17</td>
<td>5</td>
<td>10</td>
<td>38</td>
<td>15</td>
</tr>
<tr>
<td>Public Utilities</td>
<td>13</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td>14</td>
<td>5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>20</td>
<td>5</td>
<td>-</td>
<td>10</td>
<td>35</td>
<td>14</td>
</tr>
<tr>
<td>Others</td>
<td>18</td>
<td>21</td>
<td>3</td>
<td>3</td>
<td>45</td>
<td>17</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>118</strong></td>
<td><strong>75</strong></td>
<td><strong>37</strong></td>
<td><strong>30</strong></td>
<td><strong>260</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Percent</strong></td>
<td><strong>45</strong></td>
<td><strong>29</strong></td>
<td><strong>14</strong></td>
<td><strong>12</strong></td>
<td><strong>100</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: U.S. Department of Private Investments

As shown in Table 3.2, 49 per cent (128 of 260) of known disputes between January 1961 and January 1975 involved extractive industries. Governments of developed countries promote secure and cheap supply of these commodities. One of the countries which is vitally interested in securing such commodities is the U.S.
Ownership of some sectors is considered vital for the host country's economic independence. Some governments prefer national control over the extraction of natural resources. Of course, mining and petroleum (and petroleum related) are vulnerable industries.

Political Risk as Perceived by MNCs

Investment strategies of the corporations are related to the environment where they intend to operate. In accordance with the risk facing the firms, investment decisions will be modified. Investment alternatives would be limited by the risk involved versus the return on investment (ROI) in a project. This risk factor alternates with the cost of the investment, thus modifying the required rate of return.

For simplicity, assume that FDI formation is risk free (Figure 1).

![Cost & Utility](#)

Po Risk = 0

Figure 1
When the political risk in introduced into this situation, the amount of the FDI becomes smaller (Figure 2).

\[ S = \text{marginal opportunity} \]

\[ \text{Cost of } D_1, \text{ elsewhere} \]

\[ D = \text{marginal benefit to host country} \]

![Figure 2](image)

Again, for simplicity, assume that the amount of risk is proportional to the amount of FDI (Kindleberger, p. 184), so each unit of foreign investment entered in a country has a certain risk which equals to AB for amount of FDI = Q2 in Figure 2.

When the country is risk free (Figure 1), the total FDI is shown by 0Q1. However, as the risk intervenes, the amount of FDI desiring to enter into that country diminishes, since the utility of the investment decreases. Supply represents appropriate cost and demand represents return and benefits. In fact, corporations tend to locate in countries where legal and political conditions contribute to their benefits.\(^1\)
Although risk tends to be balanced by market potential, high political risk causes firms to forego profitable investments (Figure 3).\textsuperscript{11}

![Diagram showing investment areas and risk levels](image)

**Figure 3**

- Zone of favorable investment areas
- Zone of unacceptable risk

**Explanation**

On the horizontal axis, demand to invest increases with the market potential, i.e., Turkey is a bigger market than Belgium; thus, investment demand is higher for Turkey.

On the vertical axis, risk is presented; the curve RR defines the risk limit that corporations can undertake; thus
when the risk existing in a country exceeds RR, despite the potential of the market, firms forego investments.

After evaluating the risk factor, firms determine the rate of Return on Investment (ROI). The rate of return of a project is formed by the interest rate, "reflecting society's time preference as well as a premium for inflation," and a risk premium. In other words, \( ROI = i + \text{risk premium} \), where \( i = \text{riskless interest} \) (for example, on a treasury bill).

Techniques Used to Measure Political Risk

What are the techniques employed to assess the risk factor? While political risk is included in the context of non-business risks or in the body of unsystematic Alpha risks, it is possible to use a systematic approach to assess political risk. First, political risk, in this context, is a business risk because it concerns the social and political environment of operations; therefore, this discussion refers to political risk only as business risk.

In general, the assessment of political risk involves various methods. Both subjective opinions and more objective quantitative techniques are used. According to Robert B. Stabaugh Jr.'s survey of 40 MNCs, the methods used to analyze political risk are the following: (1) go/no/go; (2) premium for risk, (3) range of estimates, and (4) risk analysis. The "go/no go" approach is one of the methods
that many executives are still using despite the biased results. It consists of dividing the markets into two categories. One part is eligible for investment, and the other is not, based only on one or two characteristics, such as the rate of devaluation of the currency. This political risk assessment method is too narrow for the complex nature of the problems and potential of operations.

Premium for risk is a method which introduces several criteria such as capital repatriation, profit remittances, economic stability, and political stability. Then the executive grades these criteria. One main drawback of this method is that the rating scale may be wrong. For instance, when 0 is the worst and 10 is the best, one may assess 10 to an economic factor such as low inflation rate. Nevertheless, it is not always true that a low inflation rate, for example, 1 per cent inflation, is a good sign of an economy. Another disadvantage of this method is that it is too general to be applied to each specific investment project.

The third method is range of estimates. The executive estimates values for various factors affecting profitability. This technique first requires the identification of elements influencing the foreign investment project. For instance, the tendency of the armed forces or frequency of violent rebellions are these kinds of elements. Another element to be included is the likelihood of state interventions in the private property sector. After the elements
influencing the FDI have been identified, the second step is to interpret these elements. Experts find an optimal way to unite their opinions. They may form an index which could be very helpful in forecasting political risk if the elements are correctly chosen. However, the index may give false impressions when the variables are incorrectly evaluated or weighted.

The risk analysis method is a sophisticated version of probability theory. Estimates are made of the possible results of different events. For example, changes in foreign investment can be analyzed according to a decision tree (Table 3.3).15

Explanation

Year "one" (1) is 1982. If the executive is 100 percent sure about a policy change, he can assess different levels of foreign ownership allowances.

Foreign direct investment flows from capital abundant countries to capital importing countries, and this continues in accordance with the investment climate of a particular market. While host countries are taking measures to benefit from the capital flow, multinational corporations are investing mostly in more stable countries.
Summary of outcomes

<table>
<thead>
<tr>
<th>Compensation</th>
<th>[0.030]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inadequate</td>
<td>[0.045]</td>
</tr>
<tr>
<td>No compensation</td>
<td>[0.075]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Plant nationalized</th>
<th>[0.500]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant not nationalized</td>
<td>[0.150]</td>
</tr>
</tbody>
</table>

New government, left wing [0.600]

Will government be overthrown?

Yes

New government, right wing [0.400]

Compensation adequate [0.100]
Compensation inadequate [0.400]

No compensation [0.500]

Plant nationalized [0.200]

Plant not nationalized [0.800]

No

Plant not nationalized [0.500]

Plant nationalized [0.500]

Compensation inadequate [0.400]

No compensation [0.500]

Plant not nationalized [0.800]

[000] = Probability

Regrouping outcomes:

Plant not nationalized [0.810]
Plant nationalized [0.190]

- with adequate compensation [0.034] [0.500]
- with inadequate compensation [0.061] [0.500]
- with no compensation [0.095] [0.500]

Total [1.000]

Table 3.3
CHAPTER ENDNOTES

1 Paul Sigmund, Multinationals in Latin America, (Wisconsin, 1980), p. 29.

2 Luis Turner, Invisible Empires: Multinational Companies and the Modern World, (New York, New York, 1970). Juan Peron of Argentina, Vargas of Brazil, Charles DeGaulle of France were leaders who followed extreme nationalistic policies. Vargas devoted his life to the national development of Brazil. When he chose to die, he left a suicide note which bitterly opposed the "international financial groups."


4 For instance, the Phillipine and South Korean Governments' understanding of nationalism includes largely accepting multinational operations in their territories. This kind of nationalism has mostly problems with human rights.


9 The area represented by the triangle FBD is the net loss due to risk. This is a "dead weight" which represents the investments which could pay off but which are not made despite the fact that marginal benefit is more than the opportunity cost of s' (capital supply) elsewhere.

10 The market strategy policies may depend upon the risk adverseness of the executives, but the risk influences the FDI decision.
11 Figure derived from John Fayerweather, *International Business Strategy* (Massachusetts, 1978), p. 268.


13 Alpha (α) risk is the unsystematic risks (non-business) involved in an operation.


15 Ibid., p. 108.
CHAPTER IV

A SYNTHESIS OF THE SOURCES OF POLITICAL RISK: THEIR APPLICATION

The sources of political risk were outlined in the previous chapter, but their application has not been considered in detail. In this chapter, the perspective of governments in the case of takeovers of foreign properties by discriminatory and non-discriminatory intervention will be reviewed. Some political decisions which are political risks for companies are explained from the standpoint of host governments. Finally, patterns of FDI are also discussed.

Reasons for Intervening with Foreign Investment

Why do governments expropriate, nationalize, or take other measures against foreign investments? One answer is that policies of participation in the economic life of a country may be designed to "increase national control over the MNC-led industrialization." The government may intend to increase the welfare through direct ownership, or may desire to secure the country's control over strategic or key ventures. In LDCs, governments intervene in the market to achieve socioeconomic objectives for
their people, such as full employment, balance of trade, and income distribution.

As proposed by Brofenbrenner,\textsuperscript{2} in countries such as the USSR, China or other socialist-communist countries, expropriation or confiscation of foreign capital has been a tool to develop their industries. By doing that, these countries transferred the income to developmental investments from other expenses such as repatriation of profits and in the case of expropriation, repayment of principal. Also, these nations were able to transfer from unproductive investments, luxury, or consumption goods to productive investments after the revolution. In fact, private firms are inconsistent with the socialist regime. Socialism does not make a difference between foreign and national, but rather between private and public investments.\textsuperscript{3} Thus socialism, especially in its revolutionary stage, creates political risk for domestic private investment as well as foreign private investment. However this depends on the conditions.\textsuperscript{4}

MNCs' policies in their operations may be another cause of expropriation, confiscation, or restriction. If a MNC does not fulfill the host country's expectations concerning such benefits as providing responsible job opportunities to locals, this can irritate local interest groups of different levels; unions, political parties, government militaries,
and students. These local interest groups may call for reactions against the foreign investors.

The Patterns of FDI

It is for good reason that an overall three quarters of the total foreign investments are located in developed countries. Europe itself absorbs 40 per cent of foreign investment.\(^5\) (See Table 4.1.)

**Explanation for Table 4.1**

The percentage of the stock of FDI decreases in the LDCs and increases in the DCs. This may be related to the risky environment existing in these markets. On the other hand, under the heading of "developing market economies," one may observe that the incentives host governments offer, such as tax havens, were independent of the accumulation of FDI.

The prime reason for the accumulation of FDI in DCs is based on the economic and political stability of these countries. On the other hand, the number of conflicts and disputes between the governments and the MNCs has been larger in the LDCs despite the relatively lower quantity of investments in these countries. (See Table 4.2.)

**Explanation for Table 4.2**

The table suggests under the subheadings, "very poor," "Number of Countries," and "Percent of Total Countries
TABLE 4.1

STOCK OF DIRECT INVESTMENT ABROAD OF DEVELOPED MARKET ECONOMIES BY HOST COUNTRIES 1967-1975

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Value of Stock ($b.)</td>
<td>105</td>
<td>156</td>
<td>259</td>
</tr>
<tr>
<td>Distribution of Stock Percentages</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed Market Economies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>18%</td>
<td>17%</td>
<td>15%</td>
</tr>
<tr>
<td>U. S.</td>
<td>9%</td>
<td>9%</td>
<td>11%</td>
</tr>
<tr>
<td>Germany</td>
<td>3%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Other</td>
<td>30%</td>
<td>32%</td>
<td>33%</td>
</tr>
<tr>
<td>Developing Market Economies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OPEC</td>
<td>9%</td>
<td>7%</td>
<td>6%</td>
</tr>
<tr>
<td>Tax Havens</td>
<td>2%</td>
<td>9%</td>
<td>3%</td>
</tr>
<tr>
<td>Other</td>
<td>20%</td>
<td>17%</td>
<td>17%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

### TABLE 4.2

**ECONOMIC GROUPS AND RATE OF CONFLICTS**

<table>
<thead>
<tr>
<th>Economic Group</th>
<th>Number of Countries</th>
<th>Number with Conflicts</th>
<th>Percent of Total Countries Affected</th>
<th>Number of Conflicts in Groups</th>
<th>Rate of Conflicts for All Nations in Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Poor (Under $100)</td>
<td>38</td>
<td>32</td>
<td>87</td>
<td>72</td>
<td>1.9</td>
</tr>
<tr>
<td>Poor ($100-249)</td>
<td>32</td>
<td>22</td>
<td>69</td>
<td>41</td>
<td>1.3</td>
</tr>
<tr>
<td>Middle Income ($250-749)</td>
<td>37</td>
<td>18</td>
<td>48</td>
<td>40</td>
<td>1.1</td>
</tr>
<tr>
<td>Rich (Above $750)</td>
<td>27</td>
<td>10</td>
<td>37</td>
<td>11</td>
<td>.4</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>134</td>
<td>82</td>
<td>61%</td>
<td>164</td>
<td>1.2</td>
</tr>
</tbody>
</table>

Affected," that as poverty increases, the number of conflicts increases in the modernization process.

There is a correlation between legitimacy, the stability of a country, and FDI decisions, which support also the actual flow of FDI mostly to DCs with better stability and legal tradition. The sources of many problems are the very ineffective structures of the LDCs. Their socio-political, historical, and legal background creates an uncomfortable environment for MNCs: Besides the low level of gross national product (GNP), the income distribution is uneven. In addition, the population growth rate is sometimes higher than the growth rate of the economy. Illiteracy is a problem which reaches 40 to 50 per cent of the whole population. The governments of LDCs want to generate rapid economic growth to close the development gap, but the unstable legitimacy of the LDCs causes a problem for investments.

Problems with Modernization

During the modernization process, the social and economic structures of LDCs shake. Contrary to the finding of the study shown in Table 4.2, the relation between economic poverty and instability is not as relevant. (See Table 4.2.) According to Huntington, countries of middle level income are less stable than very poor undeveloped countries.
Unlike Robert McNamara's statement which finds "an irrefutable relationship between violence and economic backwardness," the problem of violence in the LDCs is the result not of poverty but of the desire to overcome the condition of underdevelopment. With urbanization, an "urban middle class appears and begins to struggle against rural elite." The process of struggling may continue with changing shifts of dominance and end with revolution.

Rapid Economic Growth and Political Instability

Rapid economic growth and political instability are also related. Very poor countries are too poor to be unstable. People mostly think of overcoming hunger, rather than getting in a political power struggle. On the other hand, when social mobilization occurs, the desires, values and forms of life change. However, the ability to satisfy these desires still does not increase as fast as the desires themselves. The climate of political regimes then begins to rise. The characteristics of the political system in developed countries differ from the characteristics of the political system in LDCs. Political systems in LDCs lack institutional power. LDCs have "less majesty and no resiliency--where, in many cases, governments simply do not govern." This causes ineffectiveness of governments and thus the loss of legitimacy.
For instance, countries such as the U. S., Sweden, China, the Soviet Union, Yugoslavia, and Germany, which apply very different political forms, all have stable governments. However, in more unstable countries, governments may change as a result of unexpected events, such as coup d'etat. For instance, since World War II, 85 per cent of all takeover attempts were successful. Accordingly, legitimacy becomes a very fragile concept in many LDCs and provides a circular problem with regard to the interventions of the foreign properties. Unstable regimes which lack constitutional tradition imply a short-term life expectancy for politicians and administrators. Because of their short life expectancy of power, political leaders cannot establish business ethics favorable for both foreign investors and the host country. For instance, they cannot fight against the tradition of bribery, nor can they create institutions to standardize business procedures between MNCs and governments. In turn, to protect themselves from this kind of inefficient environment, MNCs may oppose these governments by becoming involved in politics.

In summary, unbalanced social, political, legal, and economic conditions of the LDCs increase the political risk for FDI. Accordingly, the rates of return expected from the foreign operations increase (see Table 4.3), and the level of investments flowing to these areas diminishes.
<table>
<thead>
<tr>
<th>U.S. Direct Investment End of Year, 1976 ($mil.)</th>
<th>Adjusted Rate of Return on Investments (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Countries</td>
<td>137,244</td>
</tr>
<tr>
<td>Petroleum</td>
<td>14.2</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>14.4</td>
</tr>
<tr>
<td>Other</td>
<td>14.6</td>
</tr>
<tr>
<td>Developed Countries</td>
<td>101,150</td>
</tr>
<tr>
<td>Petroleum</td>
<td>10.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>11.9</td>
</tr>
<tr>
<td>Other</td>
<td>13.4</td>
</tr>
<tr>
<td>Developing Countries</td>
<td>29,050</td>
</tr>
<tr>
<td>Petroleum</td>
<td>29.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>25.2</td>
</tr>
<tr>
<td>Other</td>
<td>18.7</td>
</tr>
<tr>
<td>International &amp; Unallocated</td>
<td>7,044</td>
</tr>
</tbody>
</table>
Explanation of Table 4.3

The level of ROI ranges by 14.3 on the average (sub-heading "All Countries"). The difference of the ROI is double in the LDCs, and much higher in the petroleum industry.
CHAPTER ENDNOTES

1. Andrew Ritchel, Multinational Corporations, Local Businessmen and


4. Governments' desires to participate in equity requirement of nationals in the management, i.e., nationalization, were alleged to be communist activities. But many countries chose economic nationalism. This rising movement can no longer be called the consequence of communist influence as country after country took control over foreign economic activities. On the other hand, a socialist regime should not be seen always as a source of political risk; for instance, Arman Hammer, the president of Occidental Petroleum, took the risk of dealing with the USSR after the Russian Revolution and established strong business relations with that country. In fact, the Soviet Union was then, and is now, a stable socialist country which recognizes the need for FDI. So, a stable established socialist regime can recognize the need for FDI and be a sound climate.


7. Rural elite is the economically and socially powerful group in the rural areas of agriculturally oriented (still almost a feudal system) societies.

8. Huntington, p. 41.

9. Ibid., p. 54.

10. Ibid., p. 2.
Ibid., p. 3.

CHAPTER V

INTERNATIONAL LAW AND THE MNCs

Multinational corporations are relatively new phenomena which are not covered completely by international law. This lack of legal tradition constitutes further risk to MNCs.

In this chapter, first, the inadequacy of international law dealing with the MNC and the attempts to create traditions are analyzed. Second, the results of the necessities to create norms are studied according to the LDCs' and DCs' point of views. Third, unilateral and bilateral attempts to protect foreign direct investment (The Overseas Private Investment Corporation) are contrasted with multilateral measures. Fourth, the creation of Common Markets and foreign investments' protection are covered. Fifth, international organizations codes and guidelines to fulfill the gap of tradition are presented. Finally, it is concluded that the creation of standardized norms and laws with regard to foreign investment would diminish the political risk, which is a transaction cost for the optimum level of investments supplied and demanded,
The Lack of Norms and Results: Inadequacy of International Law to Deal with Multinational Corporations

The Lack of Norms and Results

The formation of a law necessitates solid sources from previous laws, established ethics and norms. However, these norms and ethics are not yet sufficiently stabilized to give birth to an international law which would embody the MNCs. Both parties (capital-exporting and capital-importing) countries try to establish traditions and alter international regulations to protect themselves and to increase their bargaining power as a regional, political or economic group. Both parties want international regulations to favor them in resolving issues involving nationalization, expropriation and similar takings of foreign properties.

Inadequacies of International Law Regarding the MNCs

From the point of view of a lawyer, a MNC is a "number of firms, each of them operating under "a particular national jurisdiction." MNCs are subject to the laws of the host countries, yet they are tightly related to the legal restrictions of their own homeland.

Don Wallace, Jr. of George Washington University points out that there are many technical and conceptual obstacles to applying international law to issues dividing the nationals and the MNCs, since the second is multi-faceted. Being
related to the home country makes it difficult for a MNC to be subject to international law instead of the parent judicial system. In fact, "international law does not govern the relations between nations and their own nationals. As a result, there can be no international law with respect to the relationship between the MNC and its home state." At the present, there is no law which can regulate the establishment of a firm overseas; legislate the issues about their operational techniques--such as "standardization of taxation." nor their rights and duties. There is often no law for regulating nation states which host FDI. However, host country discrimination and their takeover of alien property despite bilateral agreements are subject to international law.

"The sole exception" for the application of international law "is of cases in which the law has viewed the nationality of shareholders of the subsidiary as relevant, thus bringing the subsidiary within the rules that govern the responsibility of a state (i.e. the Developed Home Country) for injury to aliens.

This is the way that the state can approach the protection of investors (MNCs) against the consequences of host countries measures (nationalization, expropriation and confiscation).

This view, however, is not favored by the developing countries which act under the influence of the Calvo Doctrine (see next subtitle). Many LCDs do not adopt the "standard,
prompt, adequate and effective compensation" of confiscated foreign properties. They emphasize the dominance of national jurisdiction with regard to compensation. This approach has also been supported by the Sabbatino Decision of the U. S. Supreme Court, which proclaimed that "for technical 'act-of-state' reasons, a U. S. court should not review the adequacy of the compensation for, or the legacy of, a taking of U. S. property by a foreign government." 

The Development of International Law

The Calvo Doctrine is one of the first contributions to the relevant international law of FDI. It was developed by Carlos Calvo (1824-1906), an Argentinian diplomat with respect to Latin America. The Doctrine specified that a foreigner should be treated equally with nationals where an alien holds property. It requested that aliens not ask for diplomatic protection or forceful intervention from their home government in the event of controversy, since this would provide unnecessary violation of the sovereignty and judicial independence of "less powerful" countries. As a matter of fact, the Calvo Doctrine provided a separation of commercial and political relations among countries.

Reactions to the implications of the Calvo Doctrine were divergent. The capital exporting countries found that the Calvo Clause increased political risk while capital importing countries, mostly Latin American, considered the
Calvo Clause a keystone to ensure their sovereignty. Although the Calvo Doctrine was first adopted by Latin American countries, its "non-intervention" spirit has been largely adopted by the third world countries. In addition, the Calvo Doctrine has been formally and openly embodied in several international regulations or investment contracts. It is even called the "Calvo Clause." For instance, in 1975, some Latin American members of the Organization of American States (OSA) developed a set of guidelines including the Calvo Doctrine.\textsuperscript{10}

Moreover, the Peruvian and Mexican Constitutions contain the Calvo Clause. Article 17 of the Peruvian Constitution provides for the resolution of "investment disputes in domestic courts."\textsuperscript{11} (The case study, Peru-Marcona)

Mexico required that alien investors "consider themselves as Mexican nationals with regard to these properties and do not involve the protection of their government with respect to such properties, under penalty, in case of violation of forfeiting to the nation the properties so acquired,"\textsuperscript{12}

In addition, Mexico required, in its constitution, that the alien "could acquire property with the permission of the Secretariat for Foreign Affairs and after signing the agreement in accordance with Article 27, Section 1 and Paragraph 4
of the constitution, namely, the Calvo Clause . . . "13 to preserve the validity of the implications of the Calvo Clause, versus Western and international arbitrate tribunals and jurists who want to apply the principle of pacta sunt servanda to contracts between nation-states and foreign investors.14

In fact, developed nations find that the "Calvo Doctrine would immunize states from potential responsibility by denying claimants the right to seek the diplomatic protection of their states." While many developing countries support "full sovereignty," capital-exporting developed countries emphasize the rights of the operating MNC according to the contract and search for an international arbitration. In its absence, sometimes, corporations ask for help from their home countries to solve the dispute. This help could vary from diplomatic to military maneuvers and forceful interventions.15

Unilateral Measures

Unilateral measures are taken to improve the strength of negotiations for one of the two parties' benefit involved in FDI (home or host country). The policy attempted is based on the use of force.16 The force may be military, political or economic. Many think that the host country is not responsible for having the accord of the parent country
for its behavior toward foreign investors. On the other hand, "from the viewpoint of many Americans, it is tempting to consider a policy in which the home country uses its bright bargaining power unilaterally through channels of its own choosing. . . ." 17

A confiscation by the host country of the aliens' property and home country military intervention to assure the security of its nationals are both unilateral measures. The U. S. Hicken Amendment, 18 for instance, was imposed to cut foreign aid to an expropriating country.

U. S. military intervention has been one way of protecting American investors in the Caribbean and in Central America. 19 This was continued until President Roosevelt adopted a new "Good Neighbor" policy. So bilateral protection measures became more important than they were previously. 20

Nevertheless, recent history provides examples of unilateral measures in both developed and underdeveloped nations. For instance, the U. S. reacted to confiscation in 1962 of the United Fruit Company's banana plantations in Honduras by threatening to invoke the Hickenlooper Amendment, and this threat alone was enough to convince the Honduran government to modify its plans. 21 Canada also took a unilateral measure in response to excessive FDI, especially by the U. S. The Foreign Investment Review Act
recently adopted (1974) requires the approval of the Canadian federal government for FDI establishing in the country and brings other tax, capital repatriation and ownership restrictions.  

Bilateral Protection

Bilateral agreements provide host countries' rights and foreign investors' protection to promote FDI. Bilateral agreements are signed between the two states to set conditions of expropriation or nationalization, (or similar events), and/or taxation. The U. S. alone has over thirty bilateral friendship, commerce and tax treaties. The United Kingdom also has treaties with other countries for purposes of protecting and promoting its nationals' properties. (1976 Indonesia, 1975 Egypt, Singapore, Zaire, Yugoslavia, 1972 Senegal, 1971 Ivory Coast, etc.). Bilateral agreements suggest the use of international law for settling disputes between the parties and to provide prompt, adequate and effective compensation of nationalized properties. It is suggested that compensation "shall be in an effectively reasonable form and shall represent the full equivalent of the property taken, and paid in the home country's currency. Adequate provision shall have been made at or prior to the time of taking for the determination and payment thereof."
The U. S. Treaty of Friendship, Commerce and Navigation is "an important bilateral instrument for establishing favorable legal conditions for private investment between the United States and other individual countries."¹²⁵ This treaty may have strong effects on the establishment of a favorable business environment between the U. S. and the host country. As for the host countries, they offer different incentives such as tax havens through bilateral agreements, which break the competitiveness of the markets. This kind of special agreement makes it difficult to adopt standard rules for MNCs.

Multilateral Protection Programs

As mentioned earlier, international law needs the support of established norms and practices for its application to multinational operations. In fact, multilateral guarantee and protection programs could create a coordination of policies toward the host nations. The practices and worldwide adoption of bilateral treaties could provide such sources. Their wide acceptance in the home nations would ease the resolution of disputes and could lower the prestige of the countries which do not follow the signed rules.²⁶

Thus, such coordinated policies can cause a weakened position of non-compliant host countries concerning their further capital demands. Since the multilateral protections
provide more "threats of coercion for the host country, they may be more effective than bilateral agreements."²⁷

Multilateralization of protection may be economically unbiased, and may lead to increase capital flow to LDCs. However, it may not be seen as politically feasible. As a matter of fact, multilateral protections stemming from a developed country's philosophical dominance may turn into blackmail of a host country. In contrast to bilateral programs, the conflict is no longer between two countries. One country may find itself in disfavor vis-a-vis developed countries and vis-a-vis other LDCs.

Thus, adopting multilateral protections has not been very attractive for the LDCs. For example, most of the Latin American countries refuse to adopt such treaties, since it is against the principle of full sovereignty. They, in fact, refuse the "principle of international minimum standard."²⁸

Examples of the Multilateral Protections

The Convention of Paris, 1883, and the Inter-American Convention on Inventions, Patents, Designs and Models (1910) are the beginning of the multilateral measures of protection that have been taken in late nineteenth and early twentieth centuries. Multilateral protections have been either sponsored by one country involving some other countries on their side and by asserting their power in
international organizations or by internationally based organization with the support of the members. Thus, protections may be arbitrary or may be aggressive in order to punish the expropriating country. After WW II unilateral protection measures increased.

The Havana Charter

The Havana Charter was signed in 1948 by fifty four nations. Its purpose was to solve problems between capital-exporting and importing countries concerning foreign investments. The charter was addressed to the members of International Trade Organization:

The host country is recognized to have the right of expropriation and nationalization of the aliens' properties "with something less than prompt, adequate and effective compensation." The charter also provided that the host government would choose its own policy on the FDI and its restrictions, but it strengthened the support to the established rules of compensation.

Gonzalez Amendment

"Named after Congressman Henry Gonzalez of Texas," the Gonzalez Amendment, 1972, was designed to exert pressure on the expropriating countries by voting against any loan or aid purposed funds at the World Bank, International Development Agency, the Inter-American Development Bank, or Asian Bank.
Despite the opposition of the State Department, which was in favor of "situational response," the Treasury Department received the Banking and Currency Committee of the House of Representatives' support to pass this policy statement to multilateral aid authorizations.

International Convention on the Settlements of Investment Disputes (ICSID)

With the Corporation of the World Bank, Organization for Economic Cooperation and Development (OECD) and the Bank for Restrictions and Development (IBRD), the ICSID was created in October 14, 1966, with the purpose of providing arbitration between host nations and MNCs, and of contributing to the flow of capital to LDC's.

ICSID arbitration required the written application of both parties involved in a dispute on foreign properties. Once both parties apply, "the arbitration rulings are legally binding." However, ICSID did not receive the attention it needed until 1973 when its members reached the number of 68 countries: "Latin American countries, Austria, Iran, India, Saudi Arabia, Canada, Warsaw pact countries and other socialist countries, except for Yugoslavia, did not sign the ICSID convention." The reason for this refusal to sign
was the suggestion that the Convention could provide advantages to foreigners over nationals and the "principle of national treatment" should be predominant in solving disputes between nationals and foreigners in the host country.  

Between 1966 and 1974 ICSID resolved only one case. After 1974 a few more disputes, such as one between the U. S. and the Jamaican governments, have been brought to the ICSID. This court did not receive much attention from the LDCs either, since it is claimed to be against the "principle of national jurisdiction."

On the other hand, the Permanent Court of Arbitration located at Den Hague (Netherlands) could handle international disputes over FDI issues. Nevertheless, many developing third world countries do not participate in the court. In addition, the decisions of the Permanent Court of Arbitration are not binding.

International Investments Insurance Agency (IIIA), the World Bank and the Organization for Economic Cooperation for Development (OECD)

The former Development Assistance Group attempted to form a multinational insurance program. The OECD provided the "report on the Establishment of a Multilateral Investment Guarantee Program." This report was used by the International Bank of Reconstruction and Development (also
known as the World Bank) (IBRD) to build the body of the "Articles of Agreement of International Investment Guarantee Programs" (IIIA). Measures taken by IIIA would be an expansion of policies. The report of the General Accounting Office (GAO)\(^3\) explains that in 1972 another draft of IIIA Articles of Agreement were prepared by the World Bank. Since the member countries did not cooperate, the Board of Directors expressed the desire that the World Bank would not do any further research on that matter unless countries were willing to show a real interest. The same year, the President of the U. S. called for early establishment of IIIA.\(^4\) The permanent representatives of the U. S. at the U. N. expressed during one of his speeches the necessity of multinationalizing foreign investment insurance through the participation of less developed countries. This would ensure the host governments' attitudes toward foreign properties, since they would be responsible for their own financial losses. GAO, in its 1977 Annual Report, suggested that the U. S. government work on the IIIA project.

The IIIA project seems to be slashed because of the divergent approaches of the developed and less developed countries. For instance, many opposing forces converged on the arbitration case. Less developed countries objections to international arbitration were based on the sole
rights of local judiciary institutions to solve conflicts occurring within their national territories. Distribution of voting rights and financial participation were other sources of conflict.

Guidelines and International Organizations

Always referring to the insufficiency of international law, regulations and guidelines are a potential source of norms, ethics and laws. They are issued with respect to the behavior of host countries and/or MNCs' duties and responsibilities. For instance, a guideline may be published for "the workers' freedom, the collective bargaining right, non-discrimination of host or home nationals."41

Besides corporations, the International Organizations also prepare reports and guidelines regarding these issues. This preparation contributes to the formation of traditions between the states, and between companies and states. In addition, they provide protection to the MNCs against discriminating attitudes.

OECD Guidelines

OECD guidelines were prepared at the insistence of the U.S. They are specific on foreign direct investments and have the general coverage of international law. Although OECD guidelines, like any others, are not legally binding, they provide protection for both investors and host countries.
These contributions are recognized first by providing restrictions on governments to discriminate against foreign based MNCs. On the other hand, OECD guidelines provide improved negotiation standards for both parties during the establishment process of the MNC, or during the disputes. The guidelines benefit the MNCs by including restrictions against discrimination by host countries. They can also help the host countries by restricting the conduct of MNCs. Finally, the guidelines are mutually helpful by contributing to the development of norms which will, hopefully, influence the conduct of both parties.

The OECD also facilitates the flow of capital. In 1967, the OECD prepared a draft convention on double taxation followed by the 1969 Convention of foreign property.

In December 12, 1961, the OECD issued the code of Liberalization of Capital Movements which has been reviewed several times and is still in force.

OECD decision authorizes the community to make decisions concerning International Investment and MNE. It is hoped that through the guideline, a better environment would be created.

OECD's Declaration on International Investment and MNC of June 21, 1976 (see Appendix) provided two principles. First, treatment of the international company would be similar to treatment of national companies. Second, it
suggests that the corporation follow voluntary guidelines (see Appendix) concerning its operations. (See Appendix). With these guidelines, the MNCs should formulate their attitudes toward taxation, employment-training, and competition. 47

The national treatment principle suggests that "Member countries should, consistent with their needs to maintain public orders, protect their essential security interests and fulfill commitments relating to international peace and accord to enterprises operating in their territories and owned and controlled directly or indirectly by nationalists of another member country. 48 Member countries should also comply with international law and be no less favorable to MNCs than in like situations to domestic enterprises in their treatment, regulation and administrative practices.

OECD's decision authorized its Committee on International Investment and MNC (CIMC) "to periodically review the application of national treatment." 49 These norms may be found in other guidelines or declarations. 50

Common Markets

The existence of common markets brings additional multilateral restrictions on the foreign investors' operations. (See Appendix on Decision 24 of Andean Pact, EEC, Article 85 and 86). Member countries regulate the business environment to benefit their own needs. For instance, the
European Economic Community issued guidelines for operating or developing MNCs, including problems of taxation, employment and competition. Articles 85 and 86 of the Treaty of April 18, 1967 provided regulations on prohibited practices and Abuse of Dominant Market Position. (See Appendix). In accordance with Article 85, MNCs are prohibited from sharing the market between them.

MNCs are forbidden to limit their production and to "apply dissimilar conditions to equivalent transactions." (Article 86) MNCs have to accept these two articles.

The Andrean Common Market, in turn, suggests restrictions on ownership, repatriation of capital and reinvestment of earnings. "Alien investors must reexport the capital invested as they divest and must secure approval for new investment." 

The United Nations (U. N.)

and Its Approaches to FDI

The United Nations contributes to the development of standardized and coordinated policies concerning FDI: its vehicles, MNCs', and the host countries. These contributions are made throughout the channels of the U. N. This international organization has always favored international law. Sometimes its decisions contradict the desires of the capital-exporting countries. Nevertheless, the U. N. is an
organization reflecting viewpoints of all nations. Its decisions should at least be considered with the highest attention. In 1952 the United Nations' resolution on issues involving MNCs, host countries and international law called for reactions from the capital exporting countries. After twenty-nine sessions, the General Assembly passed the following resolution in December 1952 specifying the right of sovereignty of the host nations:

The General Assembly,

Bearing in mind the need for encouraging the underdeveloped countries in the proper use and exploitation of their natural wealth and resources,

Considering that the economic development of the underdeveloped countries is one of the fundamental requisites for the strengthening of universal peace,

Remembering that the right of people freely to use and exploit their natural wealth and resources is inherent in their sovereignty and in accordance with the purposes and principles of the Charter of the United Nations,

1. Recommends that all Member States, in the exercise of their right freely to use and exploit their natural wealth and resources whenever deemed desirable by them for their own purposes and economic development, to have due regard, consistently with their sovereignty, to the need for maintaining the flow of capital in condition of security, natural confidence and economic cooperation among nations;

2. Further recommends all member states to refrain from acts, direct or indirect, designed to impede the exercise of the sovereignty of any state over its natural resources,
This resolution recommends that proper expropriation to achieve economic development -- or satisfy a country's own purpose -- is the right of a nation state. On the other hand, the 1952 resolution suggests the advantage of mutual confidence of the investor and host countries. Capital-importing countries interpreted this resolution as a carte-blanche in their territories. In June 1953 Guatemala referred to this regulation as the justification of the party "takeover of United Fruit Company against payments of Guatamalan government bonds." In 1955, the Third Committee of the United Nations General Assembly had adopted another resolution suggesting that "in no case may a people be deprived of its own means of subsistence." (U. N. Document A/C 3/6 489, 1955).

The United Nations Economic and Social Council (ECOSOC) demanded that its secretariat work on issues involving the disputes and problems related to foreign private investments. ECOSOC, in 1972, "called for the appointment of 'Eminent Persons' to study the role of the MNCs." In accordance, the 'Eminent Group' was formed. In their report on the MNCs, the group underlined the necessity of a suborganization to the U. N. to work specifically on the MNCs. In fact, with the Resolution LVIII in 1975, the Committee on Transnational Corporations (See Appendix) and a U. N. Center on Transnational Corporations was established.
The U. N. Center on Transnational Corporations provides information to the host governments for the formation of their legislation and policy with regard to MNCs. It serves also to inform host countries about the aspects of FDI projects and trends of negotiations. 58

National Sovereignty and the United Nations

In December 12, 1974, the U. N. General Assembly adopted the "Charter of Economic Rights and Duties" (CERD) by a 120-6 vote. The U. S. opposed this resolution because it diverges from the international arbitration view of taken foreign property. In fact, CERD suggests that "each state has the right to nationalize, expropriate or transfer ownership of foreign property in which case appropriate compensation should be paid by the state adopting such measures, taking into account its relevant law and regulations and all circumstances the state considers pertinent. In any case, where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing state and by its tribunals." (U. N. General Assembly Resolution 3281-1974). The resolution is a combination of the Calyo Doctrine and the U. S. approach of the prompt, adequate and effective compensation. In fact, since the accession of Raul Prebisch 59 to United Nations Conference on Trade and Development (UNCTAD) in 1964 as Secretary
General, the idea of dependencia and the Calvo Doctrine gained a wider forum within the organization.

The recommendations of the Group of Eminent People suggest non-discrimination from host country policies; however, the Group offers the option that "attitudes should be nondiscriminatory, unless specific exceptions are made in the national interests." 

The group also "unequivocally condemns subversive political intervention on the part of MNCs directed toward the overthrow or substitution of a host country's government or the fostering of internal or international situations that stimulate conditions for such action" and suggests the application of national jurisdiction in the case of such events.

The U. N. is presently promoting a "code of conduct," which could in the long run evolve into a General Agreement on Transnational Corporations. The number of codes and guidelines grow progressively in favor of the host country's interests. In 1978, the Commission on Transnational Corporations recommended the adoption of a permanent accounting body under the protection of the U. N. This may not be very effective in solving the problems raised by tax pricing policies, but it certainly contributes to the formation of a legal environment within which MNCs may operate.
The creation of an institution which could be accepted by all countries could facilitate the flow of capital and the improvement of international cooperation for development. It would also be a unanimously accepted criteria of arbitration to solve the issues between host and home countries, and the MNCs. In fact, this court could provide a constitutional code, perhaps prepared by the nation states and the United Nations. The World Court could be located in one of the LDCs, or could be relocated every so often at specified times, or it could be located in several places representing each group of countries, for instance, one court in the Soviet Union, one in the U. S., and one in Latin America. Since all the courts would apply the same constitution, with the will of all the participating countries, a generally accepted conduct would be created.

An alternative would be that the constitutional law concerning international investment be applied in the national courts, but this might create some problems in countries where the legal tradition is not sufficiently developed or where the national courts are corrupt.

Another problem with regard to a world court-like institution is the difficulty LDCs have in accepting arbitration. This difficulty stems mostly from national politics, Demagogy and popularity becomes the prime desire and aim of the political leaders to exhibit their power. Furthermore,
acceptance of arbitration is a difficult issue because it can bring a charge of selling out the country. If the world court-like institution were publicized around the world and if it were somehow destructive for a country to refuse the arbitration of this world court, perhaps acceptance would be viewed as a practical step.

Certainly it may be difficult to adjust arbitration through such an institution within the near future. This kind of institution is created either vertically (through revolution, reforms, or radical changes) or horizontally by developing some norms in an evolutionary process.

Summary

Nowadays, nationalization and takeovers of foreign properties are on the increase. In 1980, the number of disputes of U. S. firms reached 106 in thirty-nine host countries of Asia, Latin America and Africa. On one hand, there is a need for efficient international law to solve the problems. On the other hand, there are national jurisdictions which must be taken into account. As a matter of fact, technically, MNCs have difficulties adjusting to one or the other. The struggle to create an international law beneficial to multinational corporations is sponsored mostly by the DCs. The "system of public international law as it is known today is largely a product of the Western world through Western values." However, the host LDCs want to
increase their strength in the formation of international law. They have found support in international organizations such as the United Nations. Some have found that solving problems with the host countries should be "through channels of the home countries' own choice and by reducing participation of such organizations as GATT, the World Bank, IMF." 66

What Should Happen?

The harmonization of international rules would contribute to the world's welfare. The development of world trade, diffusion of technologies and the increase of world production depend on stabilized legal infrastructures. 67 Development of international measures may lead governments to take more coherent attitudes. Since international law is unsatisfactory at present, the guidelines of conduct currently being outlined by the United Nations are the second best for this function. This way both participants, the investing and the host countries, will find the protection they need.

Establishment of ethics and law concerning MNCs and the host countries' duties and rights will bring coherence to international investment projects. Accordingly, the risk involved in FDI will diminish, leading to an increase in foreign investments to the desired level,
1. Robert O. Keohane and Van Doorn Doms, "The Multinational Firm and International Regulations," Transnational Corporations and World Order, ed. George Modelski (San Francisco, 1979), p. 275. One may apply this fortification of power to the model offered in Chapter II with force-vectors concerning the bargaining powers of the MNCs and host countries.


6. "Under this body of law, a state is entitled to expouse the claims of its nationals against other states and treat them as injuries to itself. However, it requires that the local judicial remedies be exhausted in the state committing the alleged injury. Technically, once the state has espoused the claim of a corporation of which property has been expropriated by a foreign government and that claim becomes the legal claim of the espousing government ceases to be the claim of the multinational corporation. In practice, the multinational corporation would presumably benefit from the espousal of the claim, to which international law might be applied. (Wallace, Jr., 1976, p. 86)

7. The Supreme Court decision stated that nationalization may be a political rather than a legal issue." Founder, p. 141.


10. Sigmund, p. 326.

11. Sigmund, p. 201.
12 Article 3 of Foreign Investment Law, Akinsanya, pp. 337-338.

13 Akinsanya, p. 338.

14 The Principle of pacta sunt servanda is about "an alien's right to apply for the diplomatic protection of his government does not absolve him from specific performance of obligations with the contracting state." Ian Brownlie, Principle of Public International Law (Oxford, Claredon Press, 1973) p. 529 as cited in Akinsanyo, p. 342, endnote #10.


17 Vernon, p. 255.

18 The Foreign Assistance Act of 1961, as amended by the Foreign Assistance Acts of 1962, 1963, and 1964, provided: The President shall suspend assistance to the government of any country to which assistance is provided under this Act when the government of such country of any governmental agency or subdivision within such country on or after January 1, 1962--

1. has nationalized or expropriated or seized ownership or control of property owned by any United States citizen or by any corporation, partnership, or association not less than 50 per centum beneficially owned by the United States citizens, or

2. has imposed or enforced discriminatory taxes or other exactions, or restrictive maintenance or operational conditions, which have the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property so owned,

and such country, government agency or government subdivision fails within a reasonable time (not more than six months after such action or after the date of enactment of this subsection, whichever is the later) to take appropriate steps, which may include arbitration, to discharge its obligations under international law toward such citizen or entity including equitable and speedy compensation for such property in convertible foreign exchange, as required by international law, or fails to take steps designed to provide relief from such taxes, exactions, or conditions, as the case may be, and such suspension shall continue until he is satisfied that appropriate steps are
being taken and on other provision of this Act shall be
construed to authorize the President to waive the provisions

19In 1904 to the Dominican Republic; in 1906 to Cuba,
in 1908, 1912, 1918 to Panama; in 1915 to Haiti; in 1916
to Cuba and the Dominican Republic and in 1926 to Nicaragua.

20Paris Convention 1883, Inter-American Convention of
Interventions, Patents Designs and Models, 1910 were signed
before President Roosevelt made these decisions.

21Akinsanya, p. 222.

22Bert Twaalhoven, "Foreign Investment Review Act:
Comments by a Concerned Dutch Party." The Business Quarterly
(Spring, 1978), p. 60.

23Keohane and Doms, p. 274.

24Akinsanya, p. 328.

25Carl Nisser and Don Wallace, Jr., "National Treatment
for Multinational Enterprises: Will the OECD Governments
Meet the Challenge," Columbia Journal of World Business
(Fall, 1978), p. 17. Nisser and Wallace explain that the
Treaty of Friendship, Commerce and Navigation is concerned
with "the rights and privileges of citizens and firms from
one state who are living, doing business or owning property
with the jurisdiction of another." Basically, it protects
foreign investors from discrimination.

26Sigmund, p. 10, and Keohane and Doms, pp. 271, 273.

27Keohane and Doms, p. 273.

28Akinsanya, pp. 203, 239. Principle of international
minimum standard is: "A state is under no obligation to
admit an alien to its territory, but when it does admit
him, it does not, in any way, guarantee his life and pro-
erty probably beyond the point up to which its laws may
guarantee them to its own nationals." (Akinsanya, 1980,
p. 208). This is the "Principle of national treatment"
which opposes the "Principle of international minimum
standard" evolved by investing countries. (Akinsanya, p.
208.

29Richard Robinson, International Business Policies
The amendment provides inter alia. The President shall instruct the United States Executive Director of the Bank to vote against any loan or other utilization of the funds of the Bank for the benefit of any country which has:

1. nationalized or expropriated or seized ownership of property owned by any United States citizen or by any corporation, partnership, or association not less than 50 per centum of which is beneficially owned by the U. S. citizens;
2. taken steps to repudiate or nullify existing contracts or agreements with any U. S. citizen or any corporation partnership, association not less than 50 per centum of which is beneficially owned by U. S. citizens; or
3. imposed or enforced discriminatory taxes or other exactions, or restrictive maintenance or operational conditions, or has taken other actions, which have the effect of nationalizing, expropriating, or otherwise seizing ownership of property so owned; unless the president determines that
   a. an arrangement for prompt, adequate and effective compensation has been made,
   b. the parties have submitted the dispute to arbitration under the rules of the Convention for the Settlement of Investment Disputes, or
   c. good faith negotiations are in progress aimed at providing prompt, adequate and effective compensation under the applicable principles of international law.

ICSID is located at the headquarters of IBRD. (World Bank)
GAO was created sixty two years ago in 1921 by the Budget and Accounting Act. The purpose of GAO is to "assist the U. S. Congress in legislative and oversight responsibilities, audit and evaluate programs, activities and financial operations of Federal departments and agencies; and carry out financial control and related functions with respect to most Federal government programs and operations including legal services, accounting, and claims settlement work."


Don Wallace, Jr., p. 181.

Keohane and Doms, p. 245.

Canada does not adhere to the code and its liberation do not apply to Greece nor Turkey, nor the overseas provinces of Portugal. O Keohane and Van Doorn Doms, p. 245.

Don Wallace, Jr., p. 201.


Nisser and Wallace, p. 15.

Nisser and Wallace, p. 19.

For instance, the guidelines of the General Agreement on Tariff and Trade (GATT) in its Article III that imported goods will be treated equally (if not better) to the national products, GATT's multilateral guideline makes allusion to certain restrictions at the Article XVIII to protect infant industry.
In reality, the formation of 'Eminent Persons' to study the role of the MNCs was due to the demand of Salvador Allende's government of Chile for a U. N. inquiry into the attitudes of MNCs. Accordingly, in 1973, the secretary general assessed a group of Eminent Persons, which submitted its report in 1974. The group suggested that a commission on transnational corporations should be created as an "advisory body to ECOSOC." Thomas Gladwin and Ingo Walter, Multinationals Under Fire (New York, 1980), p. 552.


Raul Prebisch from Argentina has been the executive secretary of Economic Council for Latin America (ECLA). He related Latin America's problems on structural problems in agriculture and in industry. He gave issue to dependencia theory. (Sigmund, p. 28).

As explained in Chapter II, Dependencia Theory previews a development of underdevelopment. In other words, LDCs would continuously suffer from underdevelopment for the development of the developed world. It is assumed that this fact is promoted by the DCs through FDI and MNCs.

Sigmund, p. 28.

Ibid.
63 Sigmund, p. 29.
64 Sigmund, p. 7.
65 Robinson, p. 50.
66 Vernon, p. 255.
67 Keohane and Doms, p. 271.
CHAPTER VI

CASE STUDIES

Chile: Political Risk, Political Intervention, Coup d'état, OPIC

Although unique and complicated, the Chilean case offers several examples of risks involved in MNCs' operations. At the same time, it gives us examples of contradictions between national jurisdiction and international law as well as examples of inter-governmental conflicts caused by the disputes over MNCs. Besides, it gives a sad example of how MNCs could be involved in clandestine plots to overcome their nationalization. In addition, it constitutes the largest claim of insurance covered by Overseas Private Investment Corporation. No political judgment on the Chilean case is intended here. However, there are some "facts" which are political in nature, but which must be mentioned for the purpose of bringing lucidity to the Chilean case.

The Chilean case involves a network of communication and of extractive industry (copper) companies: ITT (International Telephone Telegram), Kennecott, Anaconda and Cerro. (Cerro is not analyzed in this case study because of its relatively small investments.) All four
companies operate in telecommunication and extractive industries, which are, as stated earlier, strategic and more likely to attract host state interventions.

Second, this case involves a nationalization program succeeding an unsatisfactory liberation [Nuevo Trato (New Deal), 1955]. Third, the nationalization program immediately follows the election of a socialist president in Chile, Salvador Allende Gossens. Some of the companies tried to prevent this outcome of the election by clandestine activities. The conflicts became greater when their filed compensation claims were not fulfilled as desired by the new government. Accordingly, they took "measures" in the international arena as well as in their home country, the U.S.A. ITT, which had funneled huge sums of money to support the CIA's efforts to prevent Allende's election, continued after his election to keep in contact with the CIA and Washington. In a letter to Dr. Kissinger, ITT proposed that the U.S. government cut off U.S. aid funds to Chile if necessary. The conflicts ended with the overthrow of the socialist government as a result of a coup d'etat backed by the United States government.  

Initiation into the Copper and Telecommunication Market by the MNCs in Chile

In the late nineteenth century and the beginning of the twentieth century, the importance of copper increased
in accordance with the growth of the electrical industry. In 1915, Kennecott took over El Teniente mines (a mountain in the Andes about 100 miles from Santiago, the capital), which became the most important copper mines in the world. In 1923 Anaconda bought Chicquiconnata, which "became and has remained the world's largest open-pit copper mine." In the following years Anaconda set up its production lines in Potrerillos and moved also into the cable industry (Anaconda Wire and Cable Company). At the same time, Kennecott acquired the Chase Brass and Copper Company. Both companies expanded their industrial activities.

ITT, on the other hand, entered into the Chilean Telephone Company (CTC) operations in 1930 by receiving a contract for fifty years which also guaranteed its monopoly and "provided its repurchase at a price approximately equal to the book value of the corporation."

Chilean Attitudes toward the MNCs

At the beginning of operations, the Chilean government was very generous to the foreign investors. The Chilean government was highly satisfied by the technological, capital and managerial skills introduced in the mining industry through foreign investment.

However, after World War II, the theory of "dependencia" was widely accepted throughout the Latin American
world. As a result, Chile's underdevelopment was related to the high profits of the companies. In 1952, the Chilean Congress asked the Comptroller General of the Republic to prepare a report on "the conditions of the industry." The Comptroller General claimed that he was incapable of interpreting the conditions of the industry because of contradictory figures in different state departments. In fact, none of the figures were consistent which were presented by the corporations to the Ministry of Mines, Internal Revenue Service, Office of Ports and Customs, the Commission of Foreign Trade. Following this in 1955, referring to Nuevo Trato Law, the Chilean Copper Department had started to provide the necessary price and production information for the copper industry. The Copper Department worked as a regulatory mechanism between the companies and the government's goals of training nationals, pricing and local purchasing. While nationalistic attitudes grew after the end of the 1950s, the Allessandri government (1958-1964) knew how to proceed. In fact, the right wing nationalists aimed to hold Anaconda and Kennecott hostage by threatening them with nationalization in order to get them to grant concessions, providing the resources necessary for land reform. Allessandri did not take this avenue but chose to increase taxes on copper operations. When the Christian Democratic Administration came to power in 1964, he emphasized its copper policy.
He wanted to increase production and increase Chilean equity participation in the companies.\textsuperscript{10}

\textbf{Chileanization and Nationalization of Copper Operations}

The government desired to recognize its Chileanization program gradually rather than immediately. This implies that nationalization of foreign corporation was just a matter of time since both right and left wings were against the MNCs' operations in the copper industry.

During the Allessandri government when Kennecott realized that it could produce much more than estimated, it designed a program called the "Codegua Project" which would increase copper production by huge amounts. However, the political risk involved was too high for the company to undertake this project. Kennecott expressed that even if he twenty years guarantee of inviolability was accorded, the project would be cancelled.\textsuperscript{11} It felt that long-term operations were too risky. So when Frei was elected, Kennecott announced its wish to sell 51 percent majority ownership to the Chilean government. Kennecott made this decision because it knew that the moderate Frei government's life expectancy was no more than six years, and the company's top management was concerned about developing left wing political events.

Kennecott wanted to finance a high percentage of the new investments to increase the capacity by the amount
paid. Kennecott kept control of the management and also of the sales operations of the new joint venture.\textsuperscript{12} On the other hand, Kennecott took all measures to secure itself against the harms of nationalization, expropriation and compensation. Kennecott insured the equity sold through Agency for International Development (later undertaken by OPIC). At the same time, it required the host government to guarantee the loans provided by the Ex-IM Bank for the sale amount, both would be subject "to the laws of the State of New York."\textsuperscript{13} As a matter of fact, Kennecott transferred its political risk to insurance under OPIC (a U.S. government agency) and the loans it received from the Ex-IM Bank to the Chilean government in case of failure to fulfill the contract. Kennecott's policy was aimed to put the home and host country governments "face-to-face confrontation," in case of nationalization of the remaining equity. The corporation could be backed by the Hickenlooper Amendment and OPIC would face huge amounts of claims. On the other hand, Kennecott made \textit{ex ante} contracts with its customers for new production and "sold collection rights to Japanese and European banks."\textsuperscript{14}

Anaconda, however, preferred a policy based on 100 per cent ownership, despite the Chileanization. Anaconda financed its expansion by the Ex-IM Bank (under Anaconda's guarantee) and the Import Bank of Washington ("guaranteed
by Corporation de Fomento and Corporation del Cobre" sub-agencies to the Chilean government), with symbolic participation of Chile. Anaconda also followed adverse personnel policies. For instance, there was only Exotica which has negligible importance, represented by a local citizen on the Board of Directors.

When the copper world price jumped to ninety cents per pound from twenty-nine cents per pound, in spite of the twenty-year guarantee "inviolability" accordance, given by the Chilean government to the companies, the Frei government decided to impose a surtax. This was followed by the formation of a strong front for the nationalization of copper companies which was supported by "the Conservative Party, Liberal Party, Socialists, Radicals and some members of the Christian Democrats." The Frei government proposed that Anaconda sell its 50 per cent ownership to the state. Anaconda asked for nationalization with compensation. Accordingly, the nationalization of part of Kennecott and the entire Anaconda Corporation was realized during the Frei government. However, the compensations had not been paid and the elections were about to take place.

The candidates were Mr. Allessandri, conservative candidate who is pro-foreign investments; Mr. Tomic, Christian Democrat, former ambassador to the U.S. and
Dr. Allende, the Socialist leader of the United Popular Party, who was running for the presidency for the fourth time.18 Tomic was moderate on nationalization issues; however, Allende declared that he would take radical measures once he was elected president. The elections were September 4, 1970.

Unilateral Measures to Protect the MNCs
Involvement in Clandestine Activities

Although the report of the U.S. ambassador favored Allessandri's candidacy, many others did not agree. Mr. McCone, a former director of the CIA and an advisor at the time, was also a director of the ITT board. He asked his successor in the CIA to "support one of the candidates who stood for the principles that are basic in this country."19 The "Forty Committee" of the CIA (committee to lead clandestine activities of the CIA), chaired by Dr. Kissinger, answered on July 10, 1970 that the CIA was not supporting any candidate.20

Elections were held on September 4, which provided a plurality for Allende but not the majority required for presidency. According to the Chilean constitution, elections had to be repeated (on October 24) in Congress to decide between the two important runoff candidates.21 To prevent the election of Allende as president, the U.S. government engaged itself in a course of activities. CIA Director Helms wrote in his note that the CIA was to
"make the economy scream." The CIA also had orders to support a coup d'état if necessary. According to Hendrix, an ex-journalist who was at one time a reporter for ITT's Corporate Relations Department on Chilean political developments, "late Tuesday night September 15, Ambassador Edward Korry finally received a message from the State Department giving him the green light to move in the name of President Nixon, giving him maximum authority to do all possible to keep Allende from taking power. . . ." 

A scare campaign "to equate Allende's victory with violence and Stalinist repression" was supported by the CIA. There was even an attempt to provoke army intervention. The Commander in Chief of the Chilean Army was reportedly assassinated for this purpose on "October 22 by a military group in contact with the CIA." 

During these processes, ITT offered one million dollars for any government plan to prevent Allende's election. ITT furthermore proposed to have the U.S. cut aid to Chile. ITT's attempt before the major private banks, according to the bank representative's reports, was unsuccessful to push them into such an involvement. 

In his Church testimony, "Mc Cone agreed that he would be 'very disturbed' if the expenditure of one million dollars by a foreign corporation were to influence a
close American election." He was answered by Church, "Don't you think the Chileans feel the same way?" All these activities ITT undertook were to prevent the nationalization of the company's 150 million holdings.

After Allende's election, the Chilean case offers an example of contradictions between international law and national jurisdiction over investment disputes (see Calvo Doctrine, Chapter IV). A dramatic nationalization program and multinational protection forms will be discussed in this part of the case study.

**Nationalization of Anaconda and Kennecott under Allende**

In July 1971 the Chilean Congress unanimously accorded the nationalization of remaining American ownership in Chilean copper industry. President Allende announced that the nationalization would be with compensation. However, all excess profits recognized by the companies since 1955 would be deducted from the compensation which was to be equal to the book value of the firms. Accordingly, the Comptroller General evaluated the value of excess profits. He computed profits derived by the companies, from 1955 to the date of nationalization. To determine excess profits done by the companies, he used three criteria: 1) average profits derived from the copper company's operation, on a worldwide scale, 2) the higher taxation principle adopted in 1969 for the
taxation of profits derived because of unusually high world copper prices, 3) the decision 24 of Andean Pact countries, which allows only a 14 per cent ceiling on profit remittance for foreign companies.\textsuperscript{31} As a result, no compensation was provided any longer for the nationalization. The companies appealed before the Special Tribunal in Chile. The court decided that it had no jurisdiction right over a presidential decision based on a constitutional amendment. Kennecott sued the Chilean government in the State of New York in order to receive the loan granted to Chile. The Federal Court attached Chilean properties and lendings. For instance, jets of the Chilean Airlines, and accounts of Chilean Central Bank were attached.\textsuperscript{32}

The Allende government pledged to cover its obligation on this matter and in the following twenty days, promissory notes were honored. Then Kennecott wanted to receive compensation for 49 per cent of its ownership through the sales of copper on the \textit{ex ante} agreement that it had made before its nationalization.\textsuperscript{33} In 1972, Kennecott wanted to block the payments of shipped copper for European harbors and brought its case before the Court of Extended Jurisdiction of Paris.\textsuperscript{34} Despite success in the court, the dockers' union refused to unload the ship. At Rotterdam, Kennecott remitted another demand for the attachment. Instead of petitioning in France, Kennecott referred to international law in Holland this time.\textsuperscript{35}
Issues on the promissory of the Copper Corporation in Chile, which were guaranteed by the Chilean government, were taken by the Anaconda to the Special Tribunal. At the first step, the Tribunal decided to hold temporarily all payments, until the compensation was ended with agreement. At the same time, the court required remittances of a deposit to the Tribunal the equivalent to the promissory notes. At the second step, the Special Tribunal ruled in favor of Anaconda. Accordingly, Anaconda received the right for compensation of its 51 per cent property sold to Frei administration.

Anaconda and Kennecott tried to influence Chile by applying measures in addition to the legal ones. Kennecott wanted to cut the links between buyers and Chile. Anaconda wanted to apply a ban on the spare parts for Chile and the mines. Kennecott's actions were more "nuisance than serious threat," for the Chilean government. It helped the Chilean government even to gain support at the Inter-governmental Council of Copper Exporting countries (CIPEC) and at the U.N.

Negotiations started in 1971 to bring to solve the issue of debts owed to the U.S. The United States wanted a satisfactory resolution for "compensation of nationalization properties as a pre-request to an agreement." After some confusion, Western Europe promoted an agreement hard upon both Chilean law and international law.
An agreement was feasible despite the conflicts between the laws as interpreted in the Chilean constitution and the U.S.'s stance from the viewpoint of international law. Both parties referred to a treaty (signed bilaterally in 1914) for the settlement of controversies. While negotiation started and was about to find a solution, the coup d'etat of September 11, 1973 took place. The successful junta agreed to pay $159 million of compensation to ITT, part of which was to be reinvested in other ventures in Chile.

**OPIC and the Chilean Case**

In 1971 OPIC (Overseas Private Investment Corporation) was a newly formed agency with limited sources. In that year, OPIC reserves were around $100 million, with the additional funds allowed by Congress. Against these available resources, claims received by OPIC from the Chilean operations were around $400 million. One hundred and sixty million dollars coverage was for ITT's holdings, $159 for Anaconda, and the rest for Kennecott and Cerro.

These huge claims threatened financial troubles for OPIC. Therefore, the existence of OPIC guarantees in this case provided an agreement for the necessity of intervening in Chile "to protect the U.S. taxpayers." OPIC denied its obligations toward Anaconda. It contended that the company had been pushed to expropriation
at the time of the Frei government in Chile in 1979, "when it had no current coverage at time of the forced sale, and that the insurance contracts did not apply to the new and fundamentally different interests, namely Chilean agency notes and a minority stock interest subject to a contract of sale."  

However, on July 17, 1975, the American Arbitration Association ruled in favor of Anaconda, with reserves to go to another arbitration for the amount of liability. The final settlement between OPIC and Anaconda provided a partial payment to Anaconda by OPIC, and OPICs guarantees to "Chilean promissory notes pledged as compensation."  

Peru: Nationalization of Marcona and Negotiations for Compensation

Marcona in Peru

Peru's rich iron deposits were authorized to be explored in 1932, and development was started during the last year of World War II. In 1952 Utah Construction Company started its iron ore extraction operations in Peru. The company renegotiated and extended its lease five more times and invested over fifty million dollars in Peru. This sum includes amounts for manufacturing, Marcona investments on port facilities, and contributions to the urbanization. Marcona also had marketing and shipping operations registered in Liberia and Panama.
Development during Pre-Nationalization of Marcona

In 1968 General Juan Velasco Alvarado led the Revolution in Peru. A junta with a leftist tendency took over the country.\textsuperscript{47} In the 1970's there were two proposals for joint ventures with Marcona. One of the proposals came from the Peruvian government, the other from the company itself. The government's proposal was vetoed by General Velasco. Marcona's proposal in 1974 for a state takeover of the mine "with compensation paid out in future production providing that the company would receive a management contract," was returned also by General Velasco.\textsuperscript{48} This proposal included an investment of sixty-five million dollars and assurance of foreign markets provided by Marcona.\textsuperscript{49} The same year, on independence day, General Velasco announced the "Inca Plan" which emphasized state leadership and dominance in economic matters, ownership of industry, and economic independence from the United States.\textsuperscript{50} Meanwhile, Peru's economy was in crisis. The deficit of balance of payments was increasing.

On July 25, 1975 General Velasco announced the nationalization of Marcona. He accused the company of draining Peru's economy through intercompany transactions. By this he meant the company's figures show profits on its sales and marketing operations and show losses in mining operations for tax avoidance purposes.\textsuperscript{51} The U.S.
government acted by referring to international law and later requested the prompt, adequate and effective compensation of the expropriated assets. The relations between the home and host countries became extremely tense because of the compensation issue.  

Economic Conditions in Peru after the 70's: Their Effect on Negotiations

It is largely agreed that the timing of the expropriation was wrong. In addition to the economic difficulties and foreign currency shortages in Peru, world iron prices were dropping. "The timing of the nationalization could not have been worse. In 1975, Peru was running up a balance-of-payments deficit that would eventually total over one billion dollars." The social instabilities and the President's unhealthy physical condition were further problems in the country. Based on these issues at the end of August, General Francisco Morales overthrew his president. After he took office on August 30, 1975, negotiations with Marcona started.

President Velasco nationalized Marcona not for economic but for political reasons, in fact, for personal aggrandizement and also to arouse the nationalistic emotions of the Peruvian people and thus "legitimize" himself as President. This case shows that the problem is not only the multinational corporations' conduct but also the unstable politics, frustration, naiveté, and
need for trust in truth, documentation and law on the part of the LDCS.

Negotiations

Negotiations took four stages. In the first place, the Peruvian government suggested nine million dollars for compensation while Marcona declared the value of its expropriated assets was 166,691,000 dollars. The Peruvian government expressed its desire to deal with the U.S. government rather than a private company. As a result of the first negotiations in December 1975, both parties agreed to continue to negotiate for a just compensation settlement. Meanwhile they agreed on Marcona's starting to transport iron ore. This also provided a reserve of one dollar a ton for the compensation. The amount would be included in the final compensation.

At the second stage of the negotiations both parties acted to evaluate the value of expropriated assets. A French consulting firm for Peru and the Stanford Research Institute for the United States worked to estimate Marcona's holdings. At the same time, in 1976, Peru's economic problems reached a point that the government was not able to pay back its debts. This required much multinational financial assistance.

At the third stage, "Undersecretary of State Carlyle E. Maw with substantial negotiation experience," took
over the negotiations as the Special Representative of the State Department.\textsuperscript{58} Peru tried to assure its balance of payments through loans, and bring it in a position to be enabled to pay compensation.\textsuperscript{59}

Finally, at the fourth stage, the Undersecretary of State took into consideration the serious difficulties of cash payments by the Peruvian government and offered a package of compensation which involved:

- 37 million promissory note to be financed by loans from a United States banking group;
- 22.4 million from discounts to Marcona by Peru to be paid from the sale of 3.74 million tons of iron ore pellets over the next four years at a fixed price at six dollars a ton, below the estimated future world market prices; and
- two million dollars from the one dollar a ton payments under the December shipping contract.\textsuperscript{60}

The compensation amount of 61.4 million was less than the Peruvian consultant's evaluation which was $70 million dollars. On the other hand, Marcona was happy too, for receiving an amount much higher than Peru's first offer.\textsuperscript{61}

\textbf{Angola: Political Risk, Collaborating with "Illegal" Governments}

The Angolan case offers yet another example of political risks taken by MNCs. Several MNCs have become involved in complicated conflicts because of their operations in connection with "illegally or colonially occupied and repressively administered territories." ["Illegal" regimes here refers to those in Ziparabwe-Rhodesia and Namibia (South-West Africa).]
The colonial regimes in recent times were those controlled by the Portuguese government in Angola, Mozambique, and Guinea (Bissau). The United Nations has interpreted collaboration with these "illegal" governments as any observance of laws and regulations passed by the illegal regimes; the violations of United Nations sanctions; the payment of taxes or royalties; the supply of arms to the illegal regimes or conducting public relations activities on their behalf; establishing joint ventures with the illegal authorities and supplying them with technology; or undertaking any activities that facilitate the survival of the illegal regimes and their maintenance in power. This also applies to MNCs "aiding or abetting" colonial regimes.

Charges of "collaboration" lead to serious problems for MNCs, who have even sometimes been operating in direct contradiction to their home country's policies and even to international organization resolutions. Because they are sometimes forced to choose between cooperating with the colonial government and the liberating forces which might be actually controlling the host country, the MNCs find themselves going beyond their legal rights and unavoidably negotiating with the various parties involved in the conflict. In view of the varied and serious risks involved, most MNCs have tried to withdraw from these high-risk situations involving colonial occupation.

However, sometimes a MNC has too much at stake and decides to continue its operations in the host country,
in spite of widespread criticism, much of which comes even from the MNC's home country. Gulf Oil is a prime example.

Gulf first became involved in Angola in 1954 when it began exploration. In 1957 it received its first drilling concession from Portugal, but had to suspend operations in 1961 when insurgents captured the enclave of Cabinda, where Gulf's operations were based. However, Portugal retook the area and Gulf returned. In 1968, Gulf began production and by 1971 it was producing 850,000 barrels of oil a day, after having invested $150 million. By 1973, this investment had increased to $210 million, and "Angolan oil accounted for 6 per cent of Gulf's profits and from 8 per cent to 10 per cent of the company's sales, world production, and proven reserves."

Gulf's involvement in Angola became the target of sharp criticism by the late 1960's and early 1970's. Groups from the U.S. as well as from England, Canada, the United Nations and other international organizations condemned Gulf for aiding colonialism by providing Portugal with:

(1) tax and royalty payments since 1954, (2) foreign exchange contributing to financial stability and war-related purchases, (3) a strategic resource helping to make Portugal safe from economic sanctions and oil embargoes, (4) a contractual relationship that indirectly influenced United States policy toward support for Portugal's African wars, and (5) a positive image of Portuguese colonialism in America.63
Gulf responded by saying that it was neutral in the conflict between insurgents and Portugal. Further, Gulf claimed that it was contributing positively to Angola by hiring and upgrading black nationals, providing more medical services, and generally improving the social and economic conditions of the people of Angola. When various groups, beginning with the Southern Africa Task Force of the United Presbyterian Church in 1971, pressured Gulf "to cease operations in colonially held territories," Gulf responded by arguing that if they withdrew, it would not harm the Portuguese government but would instead leave it in possession of a well-established, lucrative oil field which it could easily operate. Furthermore, Gulf said the government's revenue would increase dramatically.

Nevertheless, protest continued. Various groups pushed for a general boycott of Gulf, and anti-Gulf actions in the American black community became intense. The situation was so bad that Gulf hired a black public relations firm and made some large grants to black religious organizations. Of course, this prompted charges of "trying to buy off" its opponents.

The situation became even more complicated in April, 1974 when the Caetano government in Portugal was overthrown and the new junta guaranteed independence to Portugal's colonies. Control of Angola was the goal of various factions, including the Soviet-Cuban backed MPLA
(Popular Movement for the Liberation of Angola) and the FNLA (National Front for the Liberation of Angola) and UNITA (National Union for the Total Independence of Angola), both supported by the U.S., China, and South Africa. During the heavy fighting, Gulf tried to remain neutral but had to finally decide to make its ten dollars per barrel payment to the MPLA, which controlled Cabinda and the capital city of Luanda. Gulf's funds actually financed a regime that the U.S. government was opposing. In fact, the CIA had provided more than thirty million dollars to the socialist and moderate factions.

Gulf conferred with the U.S. State Department about what to do concerning continuing tax and royalty payments to the MPLA and was advised to shut down its operations and withhold payments, which it did in December, 1975. The MPLA then charged that Gulf was "waging economic war on Angola" and threatened to get help from other countries in operating the fields. Gulf, having an enormous investment to consider, opened indirect talks with the MPLA. Gulf's president subsequently announced that the company "would have no trouble working with any government in Angola."

By February of 1976, the MPLA government had been recognized by Western European nations, Canada, and the Organization of African Unity. Gulf received permission from Secretary of State Kissinger to release payment of
$125 million. Angolan civil strife, nevertheless, continues, and Gulf still faces a certain amount of political risk.

Guyana: Aluminum Industry Nationalization of Dembo

Canadian-based Alcan Aluminum Ltd's subsidiary, Demerara Bauxite Corporation, was established at Mackenzie in British Guiana in 1916. The subsidiary showed many of the characteristics of an enclave, isolated from the country "to such an extent that it was not even accessible by road until 1966." It had a substantial place in the Guyanese economy.

Reactions to Alcan before Independence

Guyana's desire to have state control over Demba's operations grew during its colonized years. In 1964, the leader of the leftist People's Progressive Party, was in favor of nationalization. Its leader, Jagan, who had been prime minister of several governments, declared that this was necessary for economic independence.

Developments after Independence

In 1964 the People's National progress and the United Force constituted the first government of independent Guyana. Both parties were pro-free enterprise. However, Burnham, the new prime minister, urged Alcan that bauxite exports to Canada would be interrupted unless it
established a smelter in Guyana. This would increase Guyana's export revenues since "semi-fabricated aluminum yields a gross income which is seventeen times higher than that created by mining;"  

67 "at each stage of production the benefits increase at the ratio of 1:2.5:8:17."  

68 As a result of Burnham's visit to Alcan in Canada, both parties agreed that aluminum smelting would be advantageous to both Alcan and Guyana. A U.N. report confirmed the feasibility of building a hydraulic power development necessary for smelting. However, each party thought the other should be responsible for construction of such a facility.  

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The 1968 Elections

Burnham defeated his opponents in the elections and became Guyana's prime minister. Pressure from the opposition increased. Although the government was mainly seeking an augmentation of processing, and a participation of control over Demba's operations, later it adopted a policy of increased control over Demba. On November 16, 1970 talks between the company and the government opened. After three months of negotiations, talks ended with Guyana's desire to nationalize the assets. In fact, the Guyanaese government designated February 23, 1971 as Republic day commemorating the nationalization of Demba. On July 14, a compensation settlement was reached by both parties involved in the dispute.
Reasons for Alcan's Rejection of a Smelter in Guyana

Alcan, through vertical integration, had diversified its operations. It was using Canada's and Norway's less costly hydroelectric power to smelt large natural resources of Caribbean bauxite. The company wanted to limit its risk in Guyana through diversification. Evidently, Alcan intended to "maintain the integrity of its international network." Guyana's participation would be an obstacle to holding this integrity. Alcan also was worried that Guyana's action would instigate a "domino effect" in case of its realization and would affect the other Caribbean countries. "Alcan had of course no interest to commit any further resources to what had become a poor investment risk country."

Why Guyana Wanted to Nationalize Demba

Guyanese leaders realized that Alcan was becoming increasingly independent of the bauxite in the country. Guyana was worried that Alcan wouldn't mine as much bauxite since they were able to find alternative sources. That is why the confidential letter of November 28, 1970 written by Guyanese Prime Minister Burnham to Alcan's headquarters set their terms of participation as "not negotiable," indicating that if Alcan did not agree to the terms, Guyana would nationalize Demba. Guyana's
main proposals were a majority government ownership and control; application of the book value criteria for asset evaluations; the payments out of after tax profits of the new joint venture; and these terms would be in effect by January 1, 1971, if Alcan agreed on them. Alcan turned the confidential note into a public discussion through the press in an effort to use the radical image of the Guyanese government against them.

Guyana preferred a joint venture agreement to benefit from Alcan's technology and marketing abilities. In fact, when negotiations started Guyana did not stop the production of Demba because it needed Alcan's know-how of operations. Furthermore, Guyana recognized the difficulties of foreign investment flows after a nationalization act. Alcan could only accept a 49 per cent government participation, and it would not include calcined bauxite and aluminum operations. 73

Negotiations after Nationalization

The Guyanese government preferred a compensation formula for Alcan's assets. 74 Alcan opposed this solution, holding that it was not fulfilling the "prompt, adequate and effective compensation" criteria. Alcan tried to call international attention to the case in order to put pressure on Guyana, and it was successful in doing so. "Ironically, however, the U.S. rather
than the Canadian government exerted pressure on Guyana to accept the principle of prompt, adequate and effective compensation."75 This act was mostly designed to support the prompt, adequate and effective compensation principle, which was at the time a concern for the U.S. in Chile.

During Alcan's nationalization, the U.S. government intervened in negotiations between Alcan and the Guyanese government because almost 50 per cent of Alcan's equity was in the hands of U.S. nationals in the United States. When Alcan's home country did not take an active role, the company called the U.S. State Department for help. In contrast to the U.S., Canada continued to send its foreign aid to Guyana and supported "multilateral loans to that country."76

On July 14, 1971, the day before the deadline, a settlement on compensation was agreed to by both parties, favoring mostly Alcan. In fact, Guyana had elevated the values of nationalized assets at forty-six million dollars, while Alcan was asking for the undepreciated value of Demba, 114 million dollars. Compensation provided eighty million dollars, which is a compromise figure.

After the settlement, Alcan lost its calcined Bauxite operations and its sources of bauxite and
aluminum. Nevertheless, because of the previous diversification of resources, Alcan overcame this problem. In its further attitudes Alcan denied the new Guyanese corporation, Guybau, "the use of its transshipment facilities located at Trinidad.

On the Guyanese side, the company first suffered from the immediate effects of nationalization (marketing, financing and maintenance problems) but it knew how to overcome them. In fact, a company based at New York and Switzerland was in charge of marketing operations and another New York based company was contracted as the purchasing agent. Guyana's success impressed other natural resource-abundant countries of the area, in contrast to the expectations of Alcana. For instance, Jamaica started to take an active role in its own bauxite and aluminum operations.
CHAPTER ENDNOTES

1 Sigmund, p. 137. The Nuevo Trato (New Deal) is the legislation which provided a single 50 per cent tax and 25 per cent surtax on copper production. The latter 25 per cent surtax was "to be reduced in proportion to increases in production, disappearing altogether when output reached a level which was two times average production between 1949 and 1953."


5 Paul Sigmund, The Multinationals in Latin America (Wisconsin, 1980), p. 323. ITT owned 70 per cent of the CTC.


8 Ibid., p. 122.

9 Moran, p. 132.

10 Moran, p. 127; Sigmund, p. 325.

11 Moran, p. 131.

12 Ibid., p. 133.

13 Moran, p. 185.
According to Moran, the goal of Kennecott previous to nationalization "was to make any threat of nationalization result unavoidably in a face-to-face confrontation between the U.S. and the Chilean governments," Moran, p. 135. "For instance, Kennecott demanded that the sale amount and Ex-IM bank loans be unconditionally
guaranteed by the Chilean state and made subject to the laws of the State of New York," Moran, p. 135.

32 Moran, p. 148.
33 Fortin, p. 133.
34 Fortin, p. 134.
35 Fortin, p. 135.
36 Fortin, pp. 136, 137.
37 Ibid., p. 137.
38 This settlement requires governments to solve their conflicts directly before going to international arbitration. Chile refused to include ITT in a general settlement, when John Anderson, New York Times syndicate, published the relationship between ITT and the CIA to prevent the election of Allende.

39 Modelski, p. 242.
40 Modelski, p. 243.
41 Topics, 4 (September, 1975), 7.
42 Sigmund, p. 156.
43 The company is now Utah International and is the parent of Marcona Company, Sigmund, p. 210; Gantz, p. 474.

45 Gantz, p. 475.
46 Gantz, p. 475.
48 Sigmund, p. 211.
49 Sigmund, p. 211.
50 Goodsel, p. 21.
51 Sigmund, p. 212.
52 Sigmund, p. 45; Gantz, p. 478.
53 Sigmund, p. 212.
54 Sigmund, p. 214; Gantz, p. 479.
55 Sigmund, p. 214.
56 Gantz, p. 481.
57 Sigmund, p. 214; Gantz, p. 478.
58 Gantz, p. 482; Sigmund, p. 215.
59 Gantz, p. 484.
60 Sigmund, p. 215.
61 Sigmund, p. 215.
62 Gladwin and Walter, pp. 192-196.
63 Gladwin and Walter, p. 196.
64 Akinsanya, p. 141.
66 In 1968, for instance, Demba accounted for approximately 14 per cent of Guyana's GDP, 10 per cent of total government revenues, 9 per cent of annual fixed investment, and between 40 and 50 per cent of Guyana's exports.
67 Morris, Lavipour, Sauvant, p. 121.
68 Morris, Lavipour, Sauvant, p. 121.
69 Akinsanya, pp. 142-143.
70 Morris, Lavipour, Sauvant, p. 123.
71 Morris, Lavipour, Sauvant, p. 126.
72 Morris, Lavipour, Sauvant, p. 126.
Burnham did not make a great deal of the nationalization to use it for the reasons of popularity, because as a new independent country he did not want to create a poor risk country image.

Morris, Lavipour, Sauvant, p. 129.

This formula was based on evaluation of Alcan's assets on the book value basis, and payments through future after-tax profits for compensation of nationalization.

Morris, Lavipour, Sauvant, p. 131.

Morris, Lavipour, Sauvant, p. 132.

Morris, Lavipour, Sauvant, p. 134.

Thomas N. Gladwin and Walter Ingo, Multinationals under Fire (New York, 1980).
CHAPTER VII

HOW TO MINIMIZE POLITICAL RISK

It was assumed in Chapter IV that political risk affects the optimum level of FDI. In accordance with this supposition, one may approach the minimization of political risk. In fact, host countries, home countries and firms have to cooperate in order to reduce risk.

Measures Taken by the Host Country

To Minimize Political Risk

Foreign investment policies in the host country should enforce the regulations of international organizations resolutions. (See U. N. resolutions, OECD guidelines).

It is suggested that host country regulations of foreign investments should be clearly defined in domestic law. Sudden changes of these laws should be kept to a minimum and, if possible, made only after prior consultation with concerned parties. An uncertain business environment could be created with each change of government and the application or context of FDI law might take on a new aspect. On the other hand, new governments should respect the contracts of previous governments with foreign investors. Most governments should avoid discriminatory attitudes toward aliens.
Nationalist reactions should not be raised against foreign investors. Governments tend to make scapegoats out of foreign investors because of their own particular economic or political problems. The case of Velasco in Peru is a prime example. A world-wide crisis on a particular product may create an economic crisis for the host country. For instance, during the early 1970's, world copper prices were low and oil prices were high. Peru relied on copper and iron ore exports. On the other hand, it was an oil importing country. Accordingly, it started to suffer from imbalanced export-import trends. However, General Velasco accused the MNCs for Peru's problems and nationalized them. (See Case Study: Peru-Marcona).

In case of conflict with foreign investors, host governments should refer to the norms of ongoing international law. In fact, enforcement of law and tradition in legitimacy is an important factor in decreasing political risk. (See Chapter V, and Case Studies). A stable social contract within a country would also lessen political risk. Avoidance of extreme income inequality, and stabilization of differences between economic sectors would also contribute to a better climate for FDI. For instance, improved income distribution would help avoid social conflict. Protection of already developed local investments and benefiting different sectors of the economy (agriculture
and industry) would help to prevent negative reactions of various interest groups.

As much attention as possible must be paid to recognizing that host country officials may have objectives which differ from their nation's welfare; e.g., self-preservation in office, self-aggrandizement, etc. LDCs must develop guards against this, and not let the MNC be used politically. Home countries should also follow the codes of international law. The home country should encourage its firms to participate in host governments' development projects. The host country at the same time should enforce international law. (See Chilean case, Guyana case).

OPIC and Insurance of Private Investments

Insurance of the FDI helps the investors to reduce, if not transfer, the risk. Accordingly, it can encourage investors in a LDC which has a riskier political climate. For that reason, the existence of a risk absorber and development oriented corporation such as OPIC may be helpful for the improvement of U.S. investments in LDCs.② Created by the Foreign Assistance Act of 1969, it provides insurance, loans, and all loan guarantees, and pre-investment assistance to U.S. investors mobilizing their capital into overseas markets.③ OPIC insurance covers the political risk of expropriation, inconvertibility of local currencies, capital, and capital repatriation restrictions, and
war damages, as well as loss due to the revolution or insurrection and civil riots. Investment guarantee programs are backed by the United States of America (See Appendix on OPIC).

OPIC has advantages for the investor as well as for the host country. OPIC organizes investment missions to several areas of the world to analyze the business climate.

Another advantage of OPIC is the reduction of the possibility of occurrence of events that threaten foreign investments. OPIC offers its programs only to new appropriate technology transfers, which is a contribution to the development of the host country. By influencing the form and nature of investments (joint-venture, non-equity investments in raw materials, and introducing new technologies), OPIC can reduce the risk of restrictions by supporting investments which are advantageous to the host countries.

In summary, OPIC provides at least an additional area of investment for multinational corporations by absorbing the political risk. In addition, OPIC makes the FDI entry possible for some risky capital demanding LDCs.

On the other hand, critics have pointed out potential disadvantages of OPIC programs. According to the report of the General Accounting Office (GAO) on OPIC in February, 1981, OPIC projects are not as development oriented as proponents claim them to be. According to this report,
only 3 per cent of the proposed investment insurance was refused. This is interpreted as OPIC's dependence on information given by the investing companies to decide whether a project is development oriented or not. The report also says that "the primary responsibility" of OPIC's clients "is to their shareholders to maximize sales and profits." Another possible disadvantage of OPIC has to do with "moral hazard," the tendency of insurance to encourage the sources of risk. When MNCs transfer their risk to insurance agencies like OPIC, they may fail to take appropriate measures to protect themselves. As a consequence, sources of risk may have an easier environment within which to manifest themselves.

On the other hand, the existence of a worldwide insurance project may also contribute to the creation of universal norms of conduct toward foreign investors through indirect pressure. For example, OPIC is a prestigious insurance company, and if it refuses to insure investment in a particular LDC, this will be bad for the LDC because the LDC will be unable to attract needed FDI.

Responsibilities of Corporations

The measures that corporations can take to minimize political risk are manifested in diverse areas. First, receiving information about the country is necessary. The information should consist of the aims of the governments,
opposition, and interest groups. In addition, the company
should investigate the historical and cultural background
of the host country. These can be analyzed together with
the quantitative measurements of risk.

Information about the aims of the host government
can be acquired by contacts with top officials and key
persons in the host government. This can give the company
at least an idea about the aims of the governments, their
aspirations, their public purposes or their considerations
about the foreign investors.

Information about the opposition is necessary to know
about the probable alterations of policy which may occur
in case of a change in power. This information is available
and possible to obtain in parliamentary democracies. How-
ever, it is difficult to ascertain, especially the aims of
the opposition, in a totalitarian regime. Here it would be
necessary to get in touch with the underground forces or
the exiles. It is even possible to deal with the under-
ground or exile forces to assure a corporation's activities
in the future. For instance, in Angola, Gulf Oil Corpora-
tions indirectly supported the MPLA against the reigning
totalitarian regime and other unpopular groups. (See Case
Study: Angola and Gulf.) In the Chilean case, the U. S.
government supported a regime which favored its corpora-
tions). The power of the forces in exile and their prestige
in the international arena versus that of the regime in power in
their country, is also a criteria to be taken in consideration. Not for intervening in the internal affairs of a country, but for the acknowledgment of the probable changes or their probable effects on the host country's policies. This information is necessary for a long-term project in a market. It may also provide the possibility for the MNC's to prepare a shadow policy for probable increases or decreases in the level of political risk.

For instance, very popular opposition supported by the majority of the people or a powerful interest group is a sign of an eminent change in the future. It is useful for the corporation to know about the policy of such groups and to be ready for changes in it. Knowledge, then, is one of the major factors in minimizing political risks. It is as different as walking in the darkness and the daytime.

A corporation should, as Gulf did, state publicly that it can cooperate with any government the people choose. Information about the interest groups is useful because they influence the rotation of policies. Thus, knowledge about the theories of interest groups could be a factor to take in to consideration. An interest group may be active against foreign investment. It may be marginal or major, but it can have the potential to be a major influence on policies. For instance, the opposition may gain wide popularity throughout the country.
Another way to minimize risk is diversification. In fact, it may decrease bargaining power of the corporations if the host country realizes the dependency of the corporation and applies leverage on the company to gain a larger share than granted on the previously agreed terms. Diversification can protect the corporation from such attempts. Financial diversification can be done through broad international sources, rather than only one. For example, when their properties were nationalized, Kennecott in Chile and Marcona in Peru were both supported by a wide international banking and finance organization because of their diversified sources of debts. (See Case Studies: Peru and Chile.) Equity diversification also diminishes political risk.

Joint ventures with the host nationals is another way of diversification. This may increase the cost of nationalization for the host government. Equity interest of host country nationals gives MNCs political support.

Lastly, diversification can be accomplished by holding operations in different steps of the industry. For instance, when Occidental Petroleum foresaw the nationalization of Libyan oil, where it had huge investments, the corporation tripled its tankers, thus diversifying by increasing their involvement in oil transportation. Accordingly, Occidental Petroleum could gain benefits from an act which is most of the time a difficult issue for the others.11
Third, corporations in general should be cooperative with their host governments. MNC's can create an image of contribution to world development rather than contributing to their home country alone. Although a low profile for MNC's is suggested in the literature, the corporation can be very visible if correctly so, and still may face minimum risk. In fact, MNC's can be very effective in solving the problems that LDC's are suffering.

Fourth, evaluation of risk through diversified techniques based on quantitative data can give firms the opportunity to foresee the risks. These quantitative results, however, are not sufficient. They should be enhanced by experience and talent.

Fifth, a corporation should prepare a guideline of behavior to standardize its policies on some issues such as facilities, relations with employees, technology, finance, observance of local laws, business ethics and public responsibilities. (See Appendix for Caterpillar's Code of Conduct.)

The Attitudes of Subsidiary

The subsidiary manages the risk. The subsidiary furnishes information to its parent company and applies the information received. In addition, the affiliate contributes to the improvement of established economic relations in a given market. Affiliates in the host countries should thus manage the following policies:
1) Relations with the host administration.
2) Relations with local interest groups.
3) Relations with local businesses and unions.
4) Relations with the environment.
5) Handling conflicts.
6) Accumulating information and directing it to form new policies.
7) Applying the creation of the needed image.

The overall strategy of the corporation should be to answer whether its project or operations entail risks of serious attack on the company for its present or future practices. This strategy should start from the beginning of a project by setting the terms of the contract, by taking the measures explained above, and by preparing training and staff policies in accordance with the local legal requirements and government aims. Local nationals should be informed and trained about the host country's various features: culture, social status, political regime, political, social and economic powers, and local businesses. The behavior of the MNCs should also reflect decisions of the U. N. resolutions on MNC duties in the host countries as well as the guidelines of OECD.

Finally, transfer of risk is a way to minimize political risk, (though it has the side effect of moral hazard referred to above). Transferring risk is possible through insurance (eg. OPIC), or may be done through a legal system. (See Case Study: Chile-Kennecott, attaching Chile's
properties at New York). Transferring risk may also be achieved during the contracting period by guarantees obtained by the home country with the sponsorship of some multilateral finance organizations. Accordingly, in the case of a loss of property due to the host government's measures, the home government may be obligated to lose its credibility with international organizations.

In fact, all the above mentioned form the basis of the overall investment strategy of MNC's. Working together, the LDCs, MNCs, and world organizations can legitimate necessary foreign direct investment and relieve the tensions which affect it,
CHAPTER ENDNOTES

1 Legitimacy refers to a government's and the company's actions being in accordance with the laws of the host country. Of course, the problem is that in countries where the political situation is volatile, legitimacy is subject to sudden change.


3 "Hearing before the Committee on Foreign Relations, United States Senate, Ninety-Sixth Congress, First Session on S.2186," (December 20, 1979), p. 2.

4 As of February 1981, OPIC and AID had experienced the settlement of "119 insurance claims for a total of $377.4 million (74 for inconvertibility, 32 for expropriation and 13 for war, revolution or insurrection)." OPIC by itself settled by the corporation. Ibid., p. 84.

5 Since 1975 these missions covered more than thirty LDCs on different continents. "Investment Missions," TOPICS, 6 (November, 1977), 7-9.

6 "Hearings and Markup before the Committee on Foreign Affairs and its Subcommittee on International Economic Policy and Trade, House of Representatives, Ninety-Seventh Congress, First Session on H. R. 3136" (May 18; June 3, 23; and July 14, 1981), p. 84.


8 Ibid.

9 "Hearings" (May 18; June 3, 23; and July 14, 1981), p. 6.


CONCLUSION

Foreign direct investment is increasingly spread throughout the world, especially since World War II. It could be one of the greatest contributions of the developed world to the less developed countries. It is important to notice that two-thirds of the world is suffering from underdevelopment. To overcome this condition, FDI is one of the best solutions. Even socialist countries, including the U.S.S.R., want it. In fact, it provides the capital needed in LDCs, the technology and the know-how for production and marketing. On the other hand, LDCs provide the developed world with a large potential market. A home country market may be saturated for a given product, but there is always a place to introduce it in the world. However, custom barriers and import restrictions limit free trade. In addition, because of economies of scale, a MNC may be better off to produce elsewhere than in a home country. Cheap labor, a large market, and capability of dominating the market are the basic reasons to invest overseas. Despite the mutual benefits, because of political risk, foreign direct investment cannot reach a level to provide optimum benefits for both capital exporting and importing countries.
Uncertainties, uneven legitimacy, social conflicts, differences in social, economic and historical backgrounds of the host countries cause an increase in political risk which functions as a transaction cost. Firms accordingly avoid even very profitable projects, from which host countries are able to benefit financially, and from development and employment opportunities.

As a result of conflicts, many corporations are expropriated or nationalized and their activities are restricted. The conflicts may rise to the point of hostility. Examples of conflicts between Chile and the foreign mining industry and the telecommunication industry, as well as the case of Marcona in Peru and Alcan in Guyana show us how great the conflicts may be.

International and in many countries, domestic, law is not yet strong enough to provide a legal tradition. In fact, the development of MNCs has outpaced the formation of a private international law which could embody their problems of definition and bring solutions to present conflicts, have been developed through the best past experiences and guidelines issued by international organizations such as the U. N. and OECD, OPIC, the insurance provided by the U. S. Government for foreign investors contributes to diminish political risk for MNCs, but does not solve the problem of "moral hazards."
To minimize political risk, all parties concerned should take measures on their own, but with the purpose of mutual cooperation. The multinational corporations should also realize their duties to the host countries and they to multinational corporations, providing them with their means of economic growth. Both have an interest in developing a system of procedures for conflict resolution. The need for a viable framework transcends the interests and emotions of any particular time and event.
APPENDIX A

European Communities: Articles on Prohibited Practices and Abuse of Dominant Market Position

In the treaty of April 18, 1967, which established the European Community in its present form, the two articles setting forth the Community's policy on competition are Article 85 (Prohibited Practices) and Article 86 (Abuse of Dominant Market Position). They read:

1. Article 85 (Prohibited Practices)

The following shall be prohibited as incompatible with the Common Market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction, or distortion of competition within the Common Market, and in particular those which:

a. directly or indirectly fix purchase or selling prices or any other trading condition;
b. limit or control production, markets, technical development, or investment;
c. share markets or sources of supply;
d. apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
e. make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Article 86 (Abuse of Dominant Market Position)

Any abuse by one or more undertakings of a dominant position within the Common Market or in a substantial part of it shall be prohibited as incompatible with the Common Market insofar as it may affect trade between Member States. Such abuse may in particular, consist in:

a. directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
b. limiting production, markets or technical development to the prejudice of consumers;
c. applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
d. making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

3. Key issues for MNEs: What direct impact might the application of National Treatment have on operations
of foreign-controlled enterprises within the OECD countries? The following is a list of the general kinds of discriminatory treatment now covered by the OECD Declaration:

a. Tax Obligations: Higher tax rates, "branch taxes," denial of exemptions, or other special provisions for liabilities of foreign-controlled enterprises;

b. Right to Official Aid and Subsidies: Denial of subsidies for MNE operations in sectors not related to the host country's need to maintain public order and to protect essential security interests;

c. Access to Local Bank Credit and Capital Markets: Restrictions on access to local credit for companies whose foreign capital exceeds a specified percentage of total capital, special conditions attached to domestic loans granted against a non-resident guarantee, or controls on bank loans in local currency to foreign-controlled enterprises;

d. Government Purchasing and Public Contracts: Buy-national requirements for other discriminatory procurement policies not justified by the need to protect essential security interests and to fulfill commitments relating to international peace and security.

e. Investment at Second Remove: Contingent authorization for acquisition of real property, restrictions
on the purchase of a controlling interest in existing domestic companies, or other barriers to local direct investment by foreign-controlled enterprises already established within Member countries.

f. International Regulations and Practices: Nationality requirements for ownership or management of industries or businesses in specified sectors of the country's economy, such as agriculture, telecommunications, the computer industry, transportation, insurance, mining, banking or military supplies.
APPENDIX B

List of Areas of Concern Regarding the Operations and Activities of Transnational Corporations

1. Preferential treatment demanded by transnational corporations (TNCs) in relation to national enterprises.

2. Lack of adjustments by TNCs to the legislation of the host countries in the matters inter alia of foreign investment and policies concerning credits exchange, fiscal matters, prices and commercial matters, industrial property, and labor policies.

3. The negative attitudes by TNCs toward the renegotiations of original concessions if such exist and if this should be considered necessary by the Government of the host country.

4. The refusal of TNCs to accept exclusive jurisdiction of domestic law in cases of litigation.

5. Direct or indirect interference in the internal affairs of host countries by TNCs.

6. Requests by TNCs to governments of the country of origin to intercede with the host government, with actions of a political or economic nature in support of their private interests.

7. The refusal of TNCs to accept the exclusive jurisdiction of domestic law in the question of compensation.
on nationalization.

8. Extension by TNCs of laws and regulations of the country of origin to the host country.

9. The activities of TNCs as instruments of foreign policy, including for intelligence purposes, contrary to the interests of the host country.

10. The contribution of TNCs in the maintenance of racist and colonial regime and support of policies of apartheid and foreign occupation.

11. The role of TNCs in the illegal traffic of arms.

12. Obstruction by TNCs of the efforts of the host country to assume its rightful responsibility and exercise effective control over the development and management of its resources in contravention of the accepted principle of permanent sovereignty of countries over their natural resources.

13. Tendency of TNCs not to conform to the national policies, objectives and priorities for the development set forth by the governments of host countries.

14. Withholding of information of their activities by TNCs making host countries unable to carry out effective supervision and regulation of those activities.

15. Excessive outflow of financial resources from host countries due to practices of TNCs and failure to generate expected foreign exchange earnings in the host country.
16. Acquisition and control by TNCs of national, locally capitalized enterprises through controlled provision of technology among other means.

17. Superimposition of imported technology without any adaptation to local conditions, creating various types of distortions.

18. Failure by TNCs to promote research and development in host countries.

19. Obstruction or limitation by TNCs to access by host countries to world technology.

20. Imposition of restrictive commercial practices, inter alia, on affiliates in developing countries as a price for technical know-how.

21. Lack of respect of the sociocultural identify of host country.

Note: Submitted by the Group of 77.
APPENDIX C

Areas of Concern Which Relate to Relations between Transnational Corporations and Governments

Preamble

1. The following is a selection of areas of concern which, in the opinion of the delegations having prepared this document, deserve particular consideration, although not all of these delegations necessarily share all the concerns mentioned herein. These cover broadly effects on economic and social development of the activities and operations of transnational corporations (TNCs) within the framework set by governments, including positive and negative impacts.

List of Areas of Concern

2. Areas of concern of particular importance are set out below. The list is nonexhaustive and may be added to or modified in the light of experience.

a. The extent to which host country legislation and regulations may discriminate (either in favor of TNCs or against TNCs as compared to domestic enterprises) in the treatment of enterprises on the basis of whether or not such enterprises are under foreign control; the extent to which any such discriminatory treatment affects the activities of
TNCs as well as the contributions of TNCs to the development objectives of host countries.

b. The extent to which expropriation of properties undertaken for public purposes related to internal requirements of the countries concerned are non-discriminatory in application and are accompanied by prompt, adequate and effective compensation.

c. The extent to which recourse to international arbitration (including that provided by the International Center for Settlement of Investment Disputes) or other dispute settlement organizations or procedures play a role in the settlement of disputes arising out of the activities of TNCs.

d. The effect of the presence or absence of a stable investment climate as a factor affecting the ability of TNCs to contribute effectively to development.

e. The observance and nonobservance of contracts and agreements between TNCs and governments, the consequential issues which arise in the case of non-observance by either party, and the role which contracts may play in the creation of a stable investment climate.

f. The role which freedom or restriction of establishment by TNCs in countries can have in assisting or hampering economic and industrial development.
g. The extent to which domestic laws, regulations and practices on social policies help or hinder development of labor relations activities in TNCs.

h. The extent to which the social policies practiced by TNCs help or hinder development of labor relations activities in countries in which they operate.

i. The effects of TNC operations and activities on employment possibilities and whether these give rise to benefits (e.g. job creation) or nonbenefits (e.g. strain on indigenous resources of host countries).

j. The extent to which the presence or absence of declared points of contact within both TNCs and host governments have assisted or hindered development of an effective and continuing dialogue between the parties concerned.

k. The effect of TNC operations and activities on the social and cultural identities of host countries, the positive or negative impacts which these can have on such countries and the extent to which host countries make their expectations known in these respects.

l. The extent to which existing codes of conduct and guidelines concerned with any aspect of the range of issues relating to the activities of TNCs may already exist, including the study of materials underlying such codes and guidelines, commentaries
thereon and the implementation and/or effects of such codes and guidelines upon TNCs and governments.

m. Issues relating to cooperation between host government and TNCs to ensure the fullest possible attainment of their respective objectives when TNCs invest in host countries, including the extent to which TNCs and host countries state their needs and objectives in a sufficiently clear manner and how such cooperation may be improved for their mutual benefit.

n. The need to define more clearly the areas of acceptable and unacceptable political activities on the part of TNCs.

o. The role played by TNCs and governments in the transfer of technology to host countries, including the types of technology involved, conditions imposed by the TNCs and governments in connection with such transfers, and the positive and negative effects of technology transfers and the framework within which they are made on host country development objectives and the viability of the investment concerned.

p. The role played by TNCs in fostering development and growth of related industries in host countries and the positive and negative effects of the activities
of TNCS on the existing patterns of indigenous supply and production.

q. The extent to which TNCs endeavor to participate in or ignore local business and regional organizations of host countries, host country regulation of such participation where these exist, and the consequences of TNC and host country actions in this area.

r. The extent to which TNCs seek to promote indigenization of their operations and activities in host countries, including appointment of staff at all levels, and the extent to which policies adopted by host governments help or hinder this process.

s. The extent to which TNCs may help to improve or make worse the working conditions of employees, including workers' health and safety, and the extent to which host governments make clear their requirements and/or expectations in these respects.

t. Identification of those countries having declared policies on conservation and protection of the environment, and the extent to which these may or may not be observed by TNCs operating therein.

u. The appropriateness or otherwise of the forms in which TNCs allow for participation in the equity of their operations in host countries, and relevant
host country policies and the extent to which these are made known.

v. The extent to which TNCs take host countries' interests into account in the repatriation of capital, remittance of profits, payments of dividends, royalties, and management fees, the extent to which the levels at which these are made are constrained by Governments and the effect this may have on the development process.

w. The extent to which domestic commercial policies (e.g., in relation to restrictive business practices) have been developed by host governments, whether appropriate machinery has been set up by them within which TNCs and governments may discuss problems of mutual interest and, if so, the extent to which TNCs and/or governments use these facilities when it would be appropriate for them to do so.

Note: Submitted by the delegations of France, the Federal Republican of Germany, Italy, the United Kingdom of Great Britain, and Northern Ireland, and the United States of America.
Ownership and Investment

In the case of business investment in any country, the principle of mutual benefit to the investor and the country should prevail.

We affirm that Caterpillar investment must be compatible with social and economic priorities of host countries and with local customs, tradition and sovereignty. We intend to conduct our business in a way that will earn acceptance and respect for Caterpillar, and allay concerns—by host country governments—about "foreign" ownership.

In turn, we are entitled to ask that such countries give careful consideration to our need for stability, business success and growth; that they avoid discrimination against "foreign" ownership; and that they honor their agreement, including those relating to rights and properties of citizens of other nations.

We recognize the existence of arguments favoring joint ventures and other forms of local sharing in the ownership of a business enterprise.

Good arguments also exist for full ownership of operations by the parent company: the high degree of control necessary to maintain product uniformity and protect patents
and trademarks, and the fact that a single facility's profitability may not be as important (or as attractive to local investors) as its long-term significance to the integrated, corporate whole.

Caterpillar's experience inclines toward the latter view--full ownership--but with the goal of worldwide ownership of the total enterprise being encouraged through listing of parent company stock on many of the world's major stock exchanges.

Since defensible arguments exist on both sides of the issue, we believe there should be freedom and flexibility--for negotiating whatever investment arrangements and corporate forms best suite the long-term interests of the host country and the investing business, in each case.

**Corporate Facilities**

Caterpillar plants, parts warehouses, proving grounds, product demonstration areas and offices are to be located wherever in the world it is most economically advantageous to do so, from a long-term standpoint.

Decisions as to location of facilities will, of course, consider such conventional factors as nearness to sources of supply and markets, possibilities for volume production and resulting economies of scale, and availability of a trained or trainable work force. Also considered will be political and fiscal stability, demonstrated governmental
attitudes, and other factors normally included in defining the local investment or business "climate."

We do not seek special treatment in the sense of extraordinary investment incentives, assurances that competition from new manufacturers in the same market will be limited, or protection against import-competition. However, where incentives have been offered to make local investment viable, they should be applied as offered in a timely, equitable manner.

We desire to build functional, safe, attractive factories to the same high standard worldwide, but with whatever modifications are appropriate to make them harmonious with national modes. Facilities are to be located so as to complement public planning and be compatible with local environmental considerations.

Facility operations should be planned with the long-term view in mind, in order to minimize impact of sudden change on the local work force and economy. Other things being equal, facilities will give preference to local sources of supply, and to local candidates for employment and promotion.

Relationships with Employees

We aspire to a single, worldwide standard of fair treatment of employees. Specifically, we intend:
1. To select and place employees on the basis of their qualifications for the work to be performed—without discrimination in terms of race, religion, national origin, color or sex.

2. To protect the health and lives of employees by creating a clean, safe work environment.

3. To maintain uniform, reasonable work standards, worldwide, and strive to provide work that challenges the individual—so that he or she may feel a sense of satisfaction resulting from it.

4. To attempt to provide continuous employment and avoid capricious hiring practices. Employment stabilization is a major factor in corporate decisions.

5. To compensate people fairly, according to their contribution to the Company, within the framework of prevailing practices.

6. To promote self-development, and assist employees in improving and broadening job skills.

7. To encourage expression by individuals about their work, including ideas for improving the work result.

8. To inform employees about Company matters affecting them.

9. To accept without prejudice the decision of employees on matters pertaining to union membership and union representation; and where a group of
employees is lawfully represented by a union, to build a Company-Union relationship based upon mutual respect and trust.

10. To refrain from employing persons closely related to members of the board of directors, administrative officers and department heads—in the belief that nepotism is neither fair to present employees, nor in the long-term interests of the business.

**Product Quality**

Wherever in the world Caterpillar products are manufactured, they will be of uniform design and quality. Wherever possible, parts and components are to be identical. When such isn't practicable, they will be manufactured to the same high quality standard, with maximum interchangeability.

We strive to assure worldwide users of after-sale parts and service availability at fair prices. Wherever possible, such product support is to be offered by locally based, financially strong, independently owned dealers. We back the availability of parts from dealers with a worldwide network of corporate parts facilities.

We acknowledge that the pursuit of product quality is only a matter of providing the best value in terms of cost, but also of providing products responsive to the public's desire for lower equipment noise levels, compliance with
reasonable emission standards, and safe operating characteristics. We shall continually monitor the impact of Caterpillar products on the environment--striving to minimize any potentially harmful aspects, and maximizing their substantial capability for beneficial contributions.

Technology

We intend to take a worldwide view of technology. We locate engineering facilities in accordance with need, and without reference to countries or nationalities involved. We exchange design and specification data from facility to facility, on a worldwide basis, while recognizing local restrictions that may exist.

We desire to raise the technical capacity of employees and suppliers in all countries in which Company facilities are located. And we provide access, as appropriate, to technical competence which we have elsewhere in the organization.

Finance

The principal purpose of money is to facilitate trade. Any company involved in international trade is, therefore, unavoidably involved in dealing in several of the world's currencies, and in exchanges of currencies on the basis of their relative values.

Our policy is to conduct such currency dealings only to the extent they may be necessary to operate the business
and protect our interests.

We buy and sell currencies only in amounts large enough to cover requirements for the business, and to protect our financial positions in those currencies whose relative values may change in foreign exchange markets. We manage currencies the way we manage materials inventories--attempting to have on hand the right amounts of the various kinds and specifications used in the business. We don't buy unneeded materials or currencies for the purpose of holding them for speculative resale.

**Intercompany Pricing**

With respect to pricing of goods and services transferred within the Caterpillar organization, typically from one country to another: such pricing is to be based on ethical business principles consistently applied throughout the enterprise. It is to reflect cost and a reasonable assessment of the value of the good or service transferred. Prices are not to be influenced by problem differences in taxation between countries.

**Differing Business Practices**

While there are business differences from country to country that merit preservation, there are others which are sources of continuing dispute and which tend to distort and inhibit--rather than promote--competition. Such differences deserve more discussion and resolution. Among
these are varying views regarding anti-competitive practices, international mergers, accounting procedures, tax systems, transfer pricing, product labeling, labor standards, repatriation of profit and securities transactions. We favor multilateral action aimed at harmonizing or resolving differences of this nature.

Competitive Conduct

Fair competition is fundamental to continuation of the free enterprise system. We support laws of all countries which prohibit restraints of trade, unfair practices or abuse of economic power. And we avoid such practices in areas of the world where laws do not prohibit them.

We recognize that in large companies like Caterpillar, particular care must be exercised to avoid practices which seek to increase sales by any other basis than quality, price and product support.

In relationships with competitors, dealers, suppliers and users, Caterpillar employees are directed to avoid arrangements which restrict our ability to compete with others—or the ability of any other business organization to compete freely with us, and with others.

Relationships with dealers are established in the Caterpillar dealership agreements. These embody our commitment to fair competitive practices, and reflect the customs and laws of the various countries in which Caterpillar
products are sold. The dealership agreements are to be scrupulously observed.

In relations with competitors, Caterpillar personnel shall avoid any arrangements or understandings which affect our pricing policies, terms upon which we sell our products, and the number and type of products manufactured or sold—or which might be construed as dividing customers or sales territories with a competitor.

Suppliers are not required to forego trade with our competitors in order to merit Caterpillar's purchases. Suppliers are free to sell products in competition with Caterpillar, except in a situation where the product involved is one in which we have a substantial proprietary interest—because of an important contribution to the concept, design, or manufacturing process.

No supplier shall be asked to buy Caterpillar products in order to continue as a supplier. The purchase of supplies shall not be influenced because the supplier is a user of Caterpillar products—unless evaluations of quality, price and service provide no substantial basis for choosing a different supplier.

Observance of Local Laws

A basic requirement levied against any business enterprise is that it know and obey the law. This is demanded by
those who govern; and it is widely acknowledged by business managers.

However, a corporation operating on a global scale will inevitably encounter laws from country to country that are incompatible, and which may even conflict with each other.

For example, laws in some countries may encourage or require business practices which—based on experience elsewhere in the world—we believe to be wasteful or unfair. Under such conditions it scarcely seems sufficient for a business manager to merely say: we obey the law, whatever it may be!

We are guided by the belief that the law is not an end but a means to an end—the end presumably being order, justice, and, not infrequently, strengthening of the governmental unit involved. If it is to achieve these ends in changing times and circumstances, law itself cannot be insusceptible to change or free of criticism. The law can benefit from both.

Therefore, in a world increasingly characterized by a multiplicity of divergent laws at national, state and local levels, Caterpillar's intentions fall in three parts: (1) to obey the law; (2) to neither obstruct nor defy the law; and (3) to offer, where appropriate, constructive ideas for change in the law—based on our worldwide experience with the advancement of the wisest, fairest usage of human and natural resources.
Business Ethics

The law is a floor. Ethical business conduct should normally exist at a level well above the minimum required by law.

One of a company's most valuable assets is a reputation for integrity. If that be tarnished, customers, investors and desirable employees will seek affiliation with other, more attractive companies. We intend to hold to a single standard of integrity everywhere. We will keep our word. We will not promise more than we can reasonably hope to deliver; nor will we make commitments we do not intend to keep.

In our advertising and other public communications, we will avoid not only untruths, but also exaggeration, overstatement and boastfulness.

Caterpillar employees shall not accept costly entertainment or gifts (excepting momentos and novelties of nominal value) from dealers, suppliers, and others with whom we do business. And we will not tolerate circumstances that produce, or reasonably appear to produce, conflict between the personal interests of an employee and the interests of the Company.

We seek long lasting relationships--based on integrity--with employees, dealers, suppliers and all whose activities touch upon our own.
Public Responsibility

We believe there are three basic categories of possible social impact by business:

1. First is the straightforward pursuit of daily business affairs. This involves the conventional, but often misunderstood, dynamics of private enterprise, developing desired goods and services, providing jobs and training, investing in manufacturing and technical facilities, dealing with suppliers, paying taxes, attracting and holding customers, earning a profit.

2. The second category has to do with conducting business affairs in a way that is socially responsible. It isn't enough to design, manufacture and sell useful products. A business enterprise should, for example, employ people without discrimination, see to their job safety and the safety of its products, help protect the quality of the environment, and conserve energy and other valuable resources.

3. The third category relates to initiatives beyond our operations, such as helping solve community problems. To the extent our resources permit—and if a host country or community wishes—we will participate selectively in such matters, especially where our facilities are located. Each corporate
facility is an integral part of the community in which it operates. Like individuals, it benefits from character building, health, welfare, educational and cultural activities. And like individuals, it also has citizen responsibilities to support and develop such activities.

All Caterpillar employees are encouraged to participate in public matters of their individual choice. Further it is recognized that employee participation in political processes or in organizations that may be termed "controversial" can be public service of a high order.

But clearly, partisan political activity is a matter for individual effort. The Company will not attempt to influence such activity in any city, state or union. Caterpillar will not contribute money, goods or services to political parties and candidates, or support them in any way.

Where its worldwide experience can be helpful, the Company will offer recommendations to governments concerning legislation and regulation being considered. Further, it will selectively analyze and take public positions on issues that have a relationship to operations, when Caterpillar's experience can add to the understanding of such issues.

Finally, we affirm that the basic reason for the existence of any company is to serve the needs of people.
The public is, therefore, entitled to a reasonable explanation of operations of a business, especially as those operations bear on the public interest. Larger economic size begets an increased responsibility for such public communication.

**International Business**

We believe the pursuit of business excellence and profit—in a climate of fair, free competition—is the best means yet found for efficient development and distribution of goods and services. And we believe the international exchange of goods and ideas promote human understanding, and thus harmony and peace.

These are not unproven theories. The enormous rise in post-World War II gross national product and living standards in countries participating significantly in international commerce has demonstrated the benefits to such countries. And it has also shown their ability to mutually develop and live by common rules, among them the gradual dismantling of trade barriers.

As a company that manufactures and distributes on a global scale, Caterpillar recognizes the world is an admixture of differing races, religions, cultures, customs, languages, economic resources and geography. We respect these differences. Human pluralism can be a strength, not a weakness; no nation has a monopoly on wisdom.
It is not our aim to attempt to remake the world in the image of any one country. Rather, we would hope to help improve the quality of life, wherever we do business, by serving as a means of transmission and application of knowledge that has been found useful elsewhere. We intend to learn and benefit from human diversity.

We ask all governments to permit us to compete on equal terms with our competitors. This applies not just to the government of a particular country; it also applies to the substantial way such a government can control or impact on the business of a company in other lands.

We aim to compete successfully in terms of design, manufacture and sale of our products, not in terms of artificial barriers and incentives.
Title II
Overseas Private Investment Corporation

Sec. 321. CREATION, PURPOSE, AND POLICY.—To mobilize and facilitate the participation of United States private capital and skills in the economic and social progress of less developed friendly countries and areas, thereby complementing the development assistance objectives of the United States, there is hereby created the Overseas Private Investment Corporation (hereinafter called the Corporation), which shall be an agency of the United States under the policy guidance of the Secretary of State.

In carrying out its purpose, the Corporation, utilizing broad criteria, shall undertake:

(a) to conduct its financing operations on a self-sustaining basis, taking into account the economic and financial soundness of projects and the availability of financing from other sources on appropriate terms;

(b) to utilize private credit and investment institutions and the Corporation's guaranty authority as the principal means of mobilizing capital investment funds;

(c) to broaden private participation and revolve its funds through selling its direct investments to
private investors whenever it can appropriately do so on satisfactory terms;

(d) to conduct its insurance operations with due regard to principles of risk management including, when appropriate, efforts to share its insurance risks;

(e) to utilize, to the maximum practicable extent consistent with the accomplishment of its objectives, the resources and skills of small business and to provide facilities to encourage its full participation in the programs of the Corporation;

(f) to encourage and facilitate efforts by private investors to conduct their operations in less developed friendly countries and areas in a manner that is sensitive and responsive to the special needs of those economies and societies;

(g) to consider in the conduct of its operations the extent to which less developed country governments are receptive to private enterprise, domestic and foreign, and their willingness and ability to maintain conditions which enable private enterprise to make its full contribution to the development process;

(h) to foster private initiative and competition and discourage monopolistic practices;
(i) to further to the greatest degree possible, in a manner consistent with its goals, the balance of payments objectives of the United States;

(j) to conduct its activities in consonance with the activities of the agency primarily responsible for administering part I and the international trade, investment and financial policies of the United States Government; and

(k) to advise and assist, within its field of competence, interested agencies of the United States and other organizations, both public and private, national and international, with respect to projects and programs relating to the development of private enterprise in less developed countries and areas.

Sec. 322. CAPITAL OF THE CORPORATION.--The capital of the Corporation shall be $100,000,000 which shall be paid in to the Corporation by the President of the United States, who is authorized to use for this purpose funds made available pursuant to section 203(f). Of such total, there shall be paid in $20,000,000 upon the creation of the Corporation and $20,000,000 during each of the fiscal years 1971 through 1974, upon the call, in whole or in part, of the board of directors of the Corporation. Upon each payment of capital by the President, the Corporation shall
issue an equivalent amount of capital stock to the Secretary of the Treasury.

Sec. 324. INVESTMENT INCENTIVE PROGRAMS.--The Corporation is hereby authorized to do the following:

(a) INVESTMENT INSURANCE.--(1) To issue insurance, upon such terms and conditions as the Corporation may determine, to eligible investors assuring protection in whole or in part against any or all of the following risks with respect to projects which the Corporation has approved:

(A) inability to convert into United States dollars other currencies, or credits in such currencies, received as earnings or profits from the approved project, as repayment or return of the investment therein, in whole or in part, or as compensation for the sale or disposition of all or any part thereof;

(B) loss of investment, in whole or in part, in the approved project due to expropriation or confiscation by action of a foreign government; and

(C) loss due to war, revolution or insurrection.
(2) Recognizing that major private investments in less developed friendly countries or areas are often made by enterprises in which there is multinational participation, including significant United States private participation, the Corporation may make arrangements with foreign governments (including agencies, instrumentalities or political subdivisions thereof) or with multilateral organizations for sharing liabilities assumed under investment insurance for such investments and may in connection therewith issue insurance to investors not otherwise eligible hereunder: Provided, however, That liabilities assumed by the Corporation under the authority of this subsection shall be consistent with the purposes of this title and that the maximum share of liabilities so assumed shall not exceed the proportionate participation by eligible investors in the total project financing.

(c) All guaranties issued prior to July 1, 1956, all guaranties issued under sections 202(b) and 413(b) of the Mutual Security Act of 1954, as amended, all guaranties heretofore issued pursuant to prior guaranty authorities repealed
by the Foreign Assistance Act of 1969, and all insurance and guaranties issued pursuant to this title shall constitute obligations, in accordance with the terms of such insurance or guaranties, of the United States of America and the full faith and credit of the United States of America is hereby pledged for the full payment and performance of such obligations.
Non-Discriminatory and Discriminatory Interference

The sovereign state has the right to expropriate foreign properties. However, interventions should be non-discriminatory; they should not be directed toward foreigners simply because they are foreigners.

Non-Discriminatory Interference

This type of interference is not implemented to give an advantageous position to the local nationals over foreigners. Indeed, it has public purposes such as improving the economic and social status of the country. David Eitman and Arthur Stonehill suggest the following examples of non-discriminatory interferences:

1. Requiring the use of local national management positions;
2. Negotiating transfer prices designed to favor the host country's tax base.
3. Requiring that social and economic overhead facilities be constructed by the investing firm.
4. Requiring export industries to sell in the home market at a breakeven price in order to subsidize local consumption or investment of the particular product.
5. Requiring the use of a given percent of local content in assembly of knocked-down imported components.
6. Temporarily making the best in current convertible, such as dollars.
Discriminatory Interferences

Eitman and Stonehill include the following as discriminatory interferences:

1. Allowing only joint ventures, with nationals at the majority. For instance, Malaysia allows 30 per cent ownership to the foreigners by 1990.
2. Applying a tax policy or fees, or utility charges only to foreign owned companies.
3. Legal harassment such as requiring special permits, over-documentation of all transactions, etc.
4. Encouraging national boycott of a firm's goods, or a strike of its workers.
5. Mandating the terms or conditions under which the corporation's patents or expertise may be used.
6. Levying taxes, royalties or other charges against foreign firms to the point at which profits are no longer possible.

U.S. Policy on Foreign Expropriation of Private Investment

U.S. policy on expropriation of FDI is based on the recognition of non-discriminatory interferences.

The U.S. recognizes the rights of sovereign states to nationalize or expropriate foreign owned property . . . ; conform with international law standards which require that takeovers be for a public purpose; and do not discriminate against U.S. citizens and are accompanied by prompt, adequate, and effective compensation.

The amount of expropriated or confiscated U.S. property ranges between two (2) or three (3) billion dollars. In percentages, it is 2 per cent to 6.4 per cent of the total U.S. based FDI.
APPENDIX D ENDNOTES


2 Ibid., pp. 185-186.


APPENDIX G

The FDI in Turkey, and Some Sources of Political Risk

Historical Outlook

During the Ottoman Empire (1201-1923) some cultural groups were dominant over others. They were mostly occupied with military actions and administration. There was no class of capitalist bourgeois.¹ For instance, when the empire conquered a territory, it controlled the army, administration, customs, and postal services, while the dominated people were deliberately left to continue normal economic activities.

After World War I, Turkey was occupied by the Allies. Between 1918 and 1922 Turkey made an independence war against them and in 1923 constituted the Turkish republic. The new economic system encouraged investments to increase the capital accumulation. This policy was followed until the late 1940's.

Since World War II, political and economic norms have changed. The 1950 election changed the twenty-seven years dominance of the republican party, which had supported state control of the economy. The new Democratic government tried to create "a little America" and aimed their economic policies to develop the private sector and entrepreneurs. Turkey participated in NATO (North Atlantic
Treaty Organization) and benefited from the Marshall Plan. In addition, Turkey became a member of the Organization for Economic Cooperation and Development and associated with the European Economic Community. This was the beginning of opening the Turkish economy to the corporate experience.

Law 5583, 1950 and Law 5521, 1950

These laws would guarantee capital and profit remittances of foreign investors. Law 5821 was more explicit. It favored joint ventures and discouraged monopolization by foreign companies. FDI was permitted only in industry, energy, extraction of natural resources, construction, transport and tourism sectors. A special committee had to approve the project. The transfer of interests and profits was limited to 10 per cent per year of the initial capital.

In its body, Law 5821 was too restrictive to attract FDI. Ironically, the government which introduced this law was pro-private and supposedly pro-foreign investment policies.

Law 6624: Incentive for Foreign Investments

The Turkish government invited Mr. Clarence Randall, president of the Committee of Planning for Economic Matters in Foreign Policy at the U.S. Treasury Department,
the presiding committee of experts in Turkey. In accordance with the suggestions of this committee in January, 1954, the National Assembly adopted Law 6224, which provided incentives for foreign capital. Law 6224 is liberal in its terms for FDI. Although the committee on FDI still had to review the proposal of any foreign product, there are several incentives compared to previous regulations. In fact, profit remittances are permitted without limit and 100 per cent ownership is allowed. It also provides that alien investors be treated equally with the natives with regard to their position in the market.

In spite of the liberal nature of Law 6224, there were difficulties in its application. Bureaucratic obstacles were the major difficulties. To prevent this, on January 24, 1980, the government took measures to increase foreign capital inflow. Accordingly, except for big projects and banking, there is no need for a governmental decision on the acceptance of foreign products. Instead of the necessity of acceptance of FDI projects by various powers, there is only a central organization charged with dealing with formalities. In addition, the government also passed Mining Law 6309 in order to minimize the restrictions of Law 2172, which had brought about the nationalization of mines.

By doing this, Turkey hoped to increase FDI flow in the future. It was also considered to be a solution to
eliminate balance of payment deficits, develop the tourism sector and bring about a more prosperous society.

Political Risks in Turkey

Although Turkey has not been very stable politically, it has not been against foreign investments during the last three decades. There are some leftist and nationalist groups which are against the FDI; however, they do not constitute a decisive power. There is a slight possibility that increase of the number of local entrepreneurs may be a source of political risk. These could, in fact, demand protection of developing infant industry. There is not much danger that the peasants will react against FDI, since new developments of foreign projects intending to invest in the agricultural sector eliminate possible reaction. In general, Turkey's policies favor foreign investments.
APPENDIX G ENDNOTES

1 For details of the Ottoman organization, see Geoffrey Lewis, *La Turquie* (Paris, 1968), pp. 27-28/
APPENDIX H

Interview

1. Is political risk a factor which modifies the level of optimum investment in the world? How important is it?

I think political risks play a role in the decision making processes of many companies. I don't think it is the most important point. I think that questions of market size as measured by GNP, competitors or presence of competitors are equally or more important than political risk. But certainly it plays a role.

Do you believe that political risk can be an important factor in certain areas of the world?

The argument I made cuts across everything, in other words, all geographical areas. Economic factors are the main determinants for decision making and investment decision making. But I am not denying that in particular large scale natural resource projects, regardless of what they have, political factor plays a bigger role than as in manufacturing projects.

2. Does foreign direct investment stabilize host economies?

There is a huge literature on the impact of FDI on host economies. FDI can clearly make a contribution to economic development, but efforts have to be
undertaken to make sure that any negative effects [of FDI] are being controlled. In fact, that is one of the main functions.

3. Is it unfair to identify the multinational corporations with the ex-colonialists who "often adapted policies to slow down rates of growth and arrest the development of either a native capitalist class or native proletariat which could overthrow them"? (Hymer, 1970, p. 69).

Most of the trans-national corporations are headquartered in developed countries, most of which are ex-colonial powers and I think it is also fair to say a lot of the natural resource investments started or were done under the umbrella of a colonial or quasi-colonial relation. But I think things are changing now. The issue is much broader than whether or not one can identify trans-national corporations with ex-colonialists. There are new dynamics involved, which includes the relations between foreign investors and host countries.

4. In the book of Galbraith, The Nature of Mass Poverty, there is a concept of "equilibrium poverty." Nigeria, who was heavily exploited, experienced also a growth rate, much larger than the neighborhood countries. Do you believe in "equilibrium poverty," or do you think that Nigeria might be a misleading example, because of the petroleum problem?

I think the main issue here is one of distribution. In other words, the economic wealth which is being created, be it through petroleum or others, has
to be used and distributed in a certain way for everybody to benefit, which does not happen. What you have is gaps between the rich and the poor increased, and it was a consequence of economic development of the country as a whole.

5. Between the company and the host country, which one really benefits from the foreign direct investment?

Both benefit. The question again is one of distribution. The host country tries to maximize its benefits locally, i.e. within its national territory. The trans-national corporation tries to maximize its benefits internationally, and there is a conflict between the two. It can only be resolved through bargaining, which means that the host country has to see what it can get and has to get it through a bargaining relation.

Can we say that the game is zero-sum?

No, because both benefit. It is only a question of how much both benefit. If a relation is worked out which works, I think the benefits can be maximized for both, but it is not necessarily a zero-sum game.

6. What kind of foreign direct investment would you promote if you were a host country?

I think it depends entirely on the priorities of
the host country. The host country has to identify its priority plans and then tries to channel FDI into these priority areas, be it through incentives or dis-incentives or other regulatory mechanisms, etc.

7. What kind of changes would you like to see in the future: international law, restrictions of the host countries, what could happen in twenty years?

I think you will see a growing body of international law but also a growing body of national law but more sophisticated. You will also see a growing body of international laws, codes of conducts of all sorts of trade, which address problems, specific or general, of transactions.

There are conflicts between international and national laws as always in all areas and here too. That is one of the issues being worked out in the different codes of conducts to see how one can address to them.

8. Do you think that the legal tradition and efficiency and law enforcement are important for investors? What do you think about the legitimacy problem?

It is quite obvious that investors have made it clear that they want to have stability in policies and most important is stability in legal framework. I think that is a very important element in the investment climate and this is what companies emphasize.
From that point of view, it does contribute to the industrial climate and stability in investment policy.

9. Do you believe that the role of the socio-cultural background of a country is a determining factor for the project life cycle (i.e. Iran)?

NO, I don't think so at all. The industrial development for most countries is determined by factors other than social and cultural background of the country involved but something which is associated with industrial relations. As such, you might have different varieties of industrialization, but they are essentially themes and variations of the same thing.

10. What do you think about the policies adopted by the Group of the Seventy-Seven toward the multinational corporations?

The Group of Seventy-Seven tries to represent the collective views of developing countries vis-a-vis transnational corporations and from that point, they try to, in this case, negotiate a code of conduct which, in fact, represents its views and through which it can obtain a maximum of benefits for the host country.

Note: Karl Sauvant, United Nations Committee on Transnational Corporations, New York, NY, January 5, 1983.
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