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The wave of nationalizations and expropriations of private foreign investments since World War II by the established, as well as the recently created, countries of the developing world has generated serious concern in the capital-exporting countries. Findings/Conclusions: Expropriations and nationalizations of U.S. direct private foreign investments have increased dramatically since World War II because of the adoption of communism or socialism as the basis of some national governments, especially in Eastern Europe, and the desires of developing nations to acquire a firmer grip on their own economic destinies. It has been virtually impossible to obtain meaningful, complete figures on the value of expropriated or nationalized U.S. private investments. Prospects for the success of efforts by several governments and organizations to protect private foreign investments against expropriation and nationalizations by developing countries are inconclusive, mainly because of the objections of those countries. Some capital-exporting countries are not willing to join in any unified effort that would appear to confront the developing worlds, on which they depend for raw materials and as markets for their exports. Recommendations: The Secretary of State should initiate a broad-based effort to negotiate friendship, commerce, and navigation treaties, emphasizing protection of private foreign investments, with

developing countries where the potential for U.S. private investment exists. (Author/SC)

REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Nationalizations And Expropriations Of U.S. Direct Private Foreign Investment: Problems And Issues

Department of State and
Other Federal Agencies

Prospects for the success of efforts by several governments and organizations to protect private foreign investments against expropriation and nationalization by developing countries are inconclusive, mainly because of developing countries' objections. Also, some capital-exporting countries are not willing to join in any unified effort that would appear to confront the developing world, on which they depend for raw materials and as markets for their exports.

Adequately protective treaties of friendship, commerce, and navigation are one method that the United States could employ more extensively to better protect its private foreign investments in developing countries. The report recommends that the Secretary of State take appropriate action along those lines.

MAY 20, 1977

ID-77-9

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-172255

To the President of the Senate and the
Speaker of the House of Representatives

The wave of nationalizations and expropriations of private foreign investments since World War II by the established, as well as the recently created, countries of the developing world has generated serious concern in the capital-exporting countries.

This report discusses some efforts that have been and could be made to establish a climate in which U.S. investors could risk capital in developing countries with reasonable assurances that their investments could continue operating without the fear of expropriation or nationalization.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget; Secretaries of State, Treasury, and Commerce; President of the Overseas Private Investment Corporation; Executive Director of the Council on International Economic Policy; and U.S. Executive Director at the World Bank.

Elmer B. Staats
Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

NATIONALIZATIONS AND EXPROPRIATIONS OF U.S. DIRECT PRIVATE FOREIGN INVESTMENT: PROBLEMS AND ISSUES
Department of State and Other Federal Agencies

D I G E S T

Since the end of World War II, expropriations and nationalizations of U.S. direct private foreign investments have increased dramatically because of the (1) adoption of communism or socialism as the basis of some national governments, especially in Eastern Europe and (2) desires of developing nations to acquire a firmer grip on their own economic destinies.

No formal procedure exists for compiling a complete list of expropriations and nationalizations of U.S. direct private foreign investments. However, from a series of reports prepared by the State Department, GAO was able to tabulate 260 known major disputes involving such investments that occurred between January 1961 and the end of January 1975. Of these, 118 occurred in Latin America, 75 in Africa, 37 in the Middle East, and 30 in Asia.

The industrial sectors involved were petroleum and related industries, 84; mining and related processing, 44; banking and insurance, 38; public utilities, 14; manufacturing, 35; and other industries, 45. (See p. 2.)

It has been virtually impossible to obtain meaningful, complete figures on the value of expropriated or nationalized U.S. private investments.

U.S. GOVERNMENT POLICY ON FOREIGN EXPROPRIATIONS OF PRIVATE INVESTMENTS

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

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When an investment dispute develops, the Government tries to maintain a low profile by keeping the involved firm out in front during negotiation with the host government. In many cas firms have successfully resolved investment disputes without significant direct U.S. Government involvment.

The Congress has enacted numerous laws to impose sanctions against countries which nationalize, expropriate, or seize property owned by U.S. citizens without taking reasonable steps to compensate the former owners. The sanctions could be waived if the President determines that it is in the U.S. national interest to do so.

Sanctions have been imposed in only a few instances. (See pp. 5 to 13.)

EFFORTS TO COPE WITH EXPROPRIATION

Various multilateral and U.S. unilateral efforts have been and are being made to provide prospective investors with incentives--in the form of protection against expropriation and nationalization--to risk their capital in developing countries.

The creation of an International Investment Insurance Agency has been considered for some time, but the idea has been shelved, at least temporarily, because differences, mainly between developed and the developing countries, could not be resolved concerning:

--Whether the agency should be linked organizationally with the World Bank.

--How voting rights were to be distributed.

--Participation in the agency's expenses and financial obligations.

--Provisions for subrogation and international arbitration.

GAO believes that, because of its international character, the proposed agency could deter some expropriations and precipitate prompt, adequate, and effective compensation and that the United States should not abandon its efforts to achieve its creation. However, the United States should also strive to devise other measures to protect the interests of its private foreign investors.

Im May 1976 the Secretary of State proposed the creation of an International Resources Bank to facilitate private investment in resource development in developing countries. The World Bank has agreed to study the idea and prepare a report.

The International Finance Corporation's Board of Directors has recommended that the Corporation's authorized capital be increased from $110 million to $650 million to enable it to provide more assistance toward financing of development-oriented projects.

The Treasury Department has proposed the establishment of a special representative for overseas investment and a commission on investment disputes. The special representative's principal mission would be to try to prevent expropriations and to obtain better settlements after expropriations have occurred.

Among other alternatives the Government has considered is the establishment of a judicial remedies convention, through which former owners of expropriated or nationalized investments would be permitted to sue in the courts of third-party countries to obtain control of such properties or products derived therefrom that nad been shipped from the expropriating or nationalizing country.

Numerous attempts have been made over the years to develop international codes of conduct. In June 1976 the Council of the Organization for Economic Cooperation and Development adopted a Declaration on International Investments and Multinational Enterprises which included guidelines setting forth the general conditions under which multinational corporations should be able to operate. However, the guidelines are voluntary and apply only to foreign investments made within the territories of the Organization's member countries, not to investments in non-member countries where most of the recent nationalizations and expropriations have occured.

The World Bank and its affiliates maintain a continuing interest in disputes between member countries or agencies and nationals and firms of another member country when such disputes stem from certain international financial transactions, including disputes over compensation to aliens for expropriated property.

The Bank will not lend to a country which has expropriated alien-owned property if the Bank determines that the country's stance on compensation to the former owners is adversely affecting the country's international credit standing. (See pp. 14 to 20.)

FRIENDSHIP, COMMERCE, AND NAVIGATION TREATIES

The United States has treaties of friendship, commerce, and navigation, and similar treaties, with 43 countries. A principal purpose of such treaties is to establish a climate in which investments could be made by nationals and companies of either country within the territory of the other without fear of harassment, threats, or other discriminatory actions by host-country governments. Other provisions are included to ensure prompt, adequate, and effective compensation in the event an investment is nationalized or expropriated by the host government.

Many treaties are outdated and do not provide adequate protection to U.S. private foreign investments. Also, there are substantial U.S. private investments in many developing countries with which the United States does not have friendship, commerce, and navigation treaties. (See pp. 29 to 38.)

A series of adequately protective treaties could encourage private investment to develop supply sources for materials which are critical to the national security and economy but which are either unavailable or cannot easily be developed domestically.

The Departments of Commerce, State, and Treasury; the Overseas Private Investment Corporation; and the Council on International Economic Policy agreed with GAO's recommendation that the Secretary of State initiate a broad-based effort to negotiate friendship, commerce, and navigation treaties, emphasizing protection of private foreign investments, with developing countries where the potential for U.S. private investment exists.

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ABBREVIATIONS

CIEP	Council on International Economic Policy
FCN	friendship, commerce, and navigation
GAO	General Accounting Office
IIIA	International Investment Insurance Agency
OECD	Organization for Economic Cooperation and Development
OPIC	Overseas Private Investment Corporation

CHAPTER 1

INTRODUCTION

Since the end of World War II, expropriations and nationalizations of U.S. private foreign investments have increased dramatically because of the (1) adoption of communism or socialism as the basis of some national governments, especially in Eastern Europe, and (2) desires of developing nations to acquire a firmer grip on their own economic destinies.

In those countries which adopted communism or socialism, government takeover of all foreign and domestic private investment was virtually certain since, under such systems, the state owns all industry. In non-Communist developing nations, nationalizations and expropriations were usually prompted by one or more of the following factors.

1. The emergence of a nationalistic spirit, especially in nations which had attained their independence from developed countries since the end of World War II.

2. The increased awareness that certain natural resources within their borders have become scarce and more critical to the needs of the world, particularly to the major industrialized powers.

3. Their strong resentment toward the economic exploitation and political as well as economic domination of their countries, as they perceive it, by powerful multinational foreign investors.

4. Their determination to obtain a larger share of the benefits derived from the development of their resources, which, they contend, they were not receiving when the multinationals operated without restriction.

There is no formal procedure for compiling a complete list of expropriations and nationalizations of properties formerly owned by U.S. nationals. However, from a series of reports prepared by the State Department, we were able to make the following tabulation of the known major disputes involving U.S. direct private investment by industry and geographic area that occurred between January 1961 and the end of January 1975.

Industry	Geographic Area: Latin America	Africa	Middle East	Asia	Total	Percent
Petroleum-related	26	23	28	7	84	32
Mining and processing	35	9	0	0	44	17
Banking and insurance	6	17	5	10	38	15
Public utilities	13	0	1	0	14	5
Manufacturing	20	5	0	10	35	14
Other	18	21	3	3	45	17
Total	118	75	37	30	260	
Percent	45	29	14	12		100

As the tabulation shows, the highest proportion of investment disputes have occurred in Latin America, and the investments most susceptible to takeover by host governments are in resource extraction and related industries. This could be explained in part by the popular belief in many countries that their valuable natural resources have been exploited more for the benefit of foreign investors than for their own people.

It has been virtually impossible to obtain meaningful, complete figures on the value of expropriated U.S. private foreign investments. Information on such values is readily available only for the most controversial cases, those insured by the Overseas Private Investment Corporation, and those about which Embassy officials have personal knowledge. Also, most expropriation cases in non-Communist countries are settled without direct extensive U.S. Government involvement.

Takeovers of private foreign investments by host-country governments can occur through:

--Formal expropriation or nationalization, seizure of property with or without compensation.

--Intervention, government assumption of managerial control, without ultimate determination of legal ownership, which may or may not lead to expropriation.

--Requisition, similar to intervention, but implying temporary government control for a specific public purpose.

--Coerced sale, government effort to induce owners to sell all or part of their properties to a government entity or to private citizens of the host country, sometimes at lower than market value.

--Contract/concession renegotiation, government effort to induce owners to accede to substantial changes in contracts or concession agreements, with or without compensation.

These classifications are not legal definitions in the strict sense, since such concepts as intervention and requisition vary considerably from country to country and have no generally accepted meaning under international law.

As shown below, in Asia, Africa, and the Middle East, 78 percent of the takeovers were accomplished through formal nationalization and expropriation and only 22 percent through the other methods. In Latin America, however, only 29 percent of the takeovers were accomplished through formal expropriation and nationalization and 71 percent through the other methods.

	Nationalization and expropriation	Intervention or requisition	Contract renegotiation or coerced sale	Other	Total
Africa					
Number	58	1	13	3	75
Percent	77	1	17	4	100
Asia					
Number	29	0	1	0	30
Percent	97	-	3	-	100
Middle East					
Number	24	2	11	0	37
Percent	65	5	30	-	100
Subtotals					
Number	111	3	25	3	142
Percent	78	2	18	2	100
Latin America					
Number	34	30	40	14	118
Percent	29	25	34	12	100
Totals					
Number	145	33	65	17	260
Percent	56	13	25	6	100

The disproportionate number of takeovers by other methods in Latin America is attributed mainly to the Chilean Government's frequent use of these methods as a means of implementing its socialization program.

PURPOSE OF STUDY

This study was made to find out the magnitude of the foreign investment expropriation/nationalization problem, determine possible solutions, and identify obstacles that might be impeding solutions. Once the magnitude of the problem had been determined, we wanted to find out what efforts the Government had been making, both unilaterally and in concert with other nations, to curb the incidence of expropriations and nationalizations and to ensure that investors would be adequately compensated.

SCOPE OF STUDY

We examined State Department records of investment disputes that occurred over a 14-year period and prepared appropriate analyses of the data in those records. We reviewed other State Department records concerning Government policies on and efforts to cope with the expropriation problem.

U.S. representatives to the Organization for Economic Cooperation and Development and the World Bank were contacted to ascertain the policies of those international organizations toward expropriation and efforts they make to cope with it.

Various laws enacted to impose sanctions against countries which expropriate U.S. private investments but make no effort to compensate former owners were reviewed, together with administering agencies' records, to ascertain the extent to which the sanctions were either imposed or waived.

We examined (1) U.S. friendship, commerce, and navigation treaties with 43 countries and dependencies, (2) more than 100 bilateral agreements for instituting the U.S. investment insurance program and the legislative history of the statute pertaining to such agreements, and (3) the German Federal Republic's investment protection treaties with 10 African countries.

CHAPTER 2

GOVERNMENT POLICY ON EXPROPRIATIONS OF PRIVATE FOREIGN INVESTMENTS

The United States traditionally has recognized the rights of sovereign states to nationalize or expropriate foreign-owned property, provided such takeovers do not violate specific host country international commitments and conform to standards of international law which require that the takeovers be for a public purpose, are not discriminatory, and are accompanied by just compensation.

Since World War II, many newly independent states, aspiring to achieve economic as well as political independence, have looked upon nationalization and/or expropriation as an attractive device for realizing those aims. The United States has held the position that, regardless of the motivation, inadequately compensated expropriations are not legal and tend to impede the attainment of those aims.

The problem of inadequately compensated nationalizations and expropriations received top-level attention when the President of the United States, in a policy statement dated January 19, 1972, expressed the administration's general approach to the role of private investment in developing countries, particularly to the problem of expropriations without adequate compensation.

It was announced that, to carry out U.S. expropriation policy effectively, each potential case of expropriation would be followed closely and that a special interagency group would be established under the Council on International Economic Policy (CIEP) to do so and to recommend appropriate courses of action.

The group was established in March 1972, comprising representation from State, Treasury, Defense, and Commerce. Participation by personnel of the National Security Council, CIEP, and other agencies, as appropriate, was also provided for. The group's functions are to:

--Continually review all potential and active expropriation cases and compile relevant facts and analyses, including information concerning economic benefits subject to potential U.S. action.

--Ascertain in each case, for purpose of policy implementation, whether an expropriation has occurred and, if so, whether reasonable provision has been made for prompt, adequate, and effective compensation.

--Recommend courses of action for the U.S. Government, consistent with the President's policy statement of January 19, 1972.

--Coordinate policy implementation.

The group meets about every 6 weeks at the chairman's initiative or at the request of any member. Meetings are also held more frequently as necessary, as they were in late 1975 during the intensive review of country eligibility for generalized preferences under the expropriation and arbitration provisions of the Trade Act of 1974.

Before each meeting an annotated agenda from the chairman is distributed to the participants and to the Executive Director of CIEP. The agenda normally reports on developments concerning expropriatory cases in about 15 to 25 countries. Although only about half of these are reported in writing, all cases are intended to be discussed at the meeting. Representatives from the State Department, usually including officials of the concerned regional bureau and the Legal Adviser's Office, provide an oral briefing on the particular case or issue, which is followed by questions and discussion.

The group's findings and recommendations--for example, whether (1) an expropriation has occurred, (2) more information about an expropriatory situation should be sought, (3) a demarche to a foreign government should be prepared, or (4) withholding of economic benefits should be recommended--are arrived at by consensus. Interagency disagreements tend to be resolved within the group by direct discussions among those with competing viewpoints. Occasionally the full group is reconvened at a higher level to resolve differences, as on the recent issue of Argentina's eligibility for generalized preferences under the Trade Act.

After each meeting, the chairman circulates a summary report to the membership, noting actions to be taken during the coming weeks and differences, if any, that arose among the representatives of the member agencies.

When an investment dispute develops, the U.S. Government tries to maintain a low profile by keeping the involved firm out in front during negotiations with the host government.

Many companies have successfully resolved investment disputes through direct negotiations with host governments and through local administrative and judicial channels without U.S. Government involvement. Some disputes have been referred to arbitral bodies such as the International Center for Settlement of Investment Disputes, a World Bank affiliate. None of the five disputes referred to the Center during its 10-year operating history has been resolved through Center arbitration.

Overall, State believes that routine, significant, and direct U.S. Government involvement in the merits of an investment dispute would have the following disadvantages.

--The interests of foreign investors could be disproportionately emphasized, but not necessarily furthered, at the expense of overall national interests.

--Flexibility in dealing with such disputes could be nullified by direct involvement.

--Involvement could dilute what leverage the United States might have toward deterring expropriation or encouraging compensation and thus adversely affect the investor's interests.

--Involvement could result in governmental confrontation, especially in Latin America where the Calvo Doctrine 1/ is adhered to, thus resulting in undesirable politicization of the dispute.

Nevertheless, the U.S. Government does become actively involved and seeks to keep fully and currently informed in order to exercise its "good offices" role in the settlement of disputes. (See app. V.) These activities range from encouraging the parties to negotiate a mutually satisfactory settlement to extensive involvement on the merits of a dispute when an active mediating effort appears warranted.

1/In the context of expropriations and investment disputes, the Calvo Doctrine asserts that aliens are entitled only to national treatment; i.e., that there is no international standard applicable to the conduct of the host country, and that therefore aliens are not entitled to the protection of their home governments under any such claimed standard. Their only legitimate procedural recourse is through host-country administrative and judicial processes.

Examples of this latter approach include the Greene mission in the early 1970s to help settle investment disputes after the Peruvian Government expropriated some major U.S. private investments. Also, in 1975 and 1976, U.S. Government representatives were intensively involved in a dispute concerning the expropriation of the Marcona Mining Company by Peru. Both disputes were settled, apparently satisfactorily, under terms which included an intergovernmental agreement.

State also considers that direct U.S. Government involvement would be appropriate under certain circumstances, such as:

1. When one or more investment disputes have so impaired relations with a country that direct government-to-government negotiations are needed to "clean the slate" and provide a basis for establishing a new constructive relationship. The State Department has formally espoused some claims of U.S. nationals whose property was seized. Espousal is a government's formal adoption of the international legal claim of a national, whereupon the dispute becomes the concern of the governments involved. A claim would not be espoused, however, unless all available legal and administrative remedies had been exhausted and resulted in a clear denial of justice.

2. When U.S. Government and investor interests may not fully coincide. For example, when the U.S. investor in an oligopolistic industry is in a dispute with the government of a developing country which itself is trying to exercise economic power.

EXPROPRIATION LEGISLATION

Since the end of World War II, the Congress has enacted numerous laws to impose sanctions against countries which take over properties in which U.S. citizens hold 50 percent or more interest but which do not take reasonable steps to compensate the former owners.

Foreign Assistance Act of 1961

Section 620 (e) (1) (Hickenlooper amendment) of the Foreign Assistance Act of 1961, as amended (22 U.S.C. 2370 (e)), requires the President to suspend assistance to the government of any country which has (1) nationalized, expropriated, or seized ownership or control of property owned by any U.S. citizen or by any corporation, partnership, or association at least 50 percent beneficially owned by U.S. citizens, (2) repudiated or nullified existing contracts or agreements with any citizen or business at least 50 percent beneficially owned by U.S. citizens, or (3) imposed or enforced discriminatory taxes or other exactions or restrictive maintenance or operational conditions or take other actions which are in effect nationalizations, expropriations, or seizures and which does not, within a reasonable period, take appropriate steps to make prompt, adequate, and effective compensation.

Since its enactment in 1962, the Hickenlooper amendment has been formally invoked only once, against Ceylon (now Sri Lanka) in February 1963. Bilateral aid was suspended until July 1965, when it was determined that Ceylon had fulfilled its obligation to compensate nationalized U.S. oil companies.

According to one Assistant Secretary of State, aid to other countries had been held in abeyance on several other occasions after expropriations had occurred, pending clarification of the positions and intentions of those involved in the disputes. For example, the amendment was not invoked following Peru's expropriation in October 1968 of the International Petroleum Company, a subsidiary of Standard Oil Company of New Jersey. The executive branch justified not invoking the amendment on the basis that efforts toward a settlement were progressing satisfactorily. During that period, aid to Peru was "carefully considered" and only emergency relief loans were approved to relieve the effects of the devastating earthquake of May 31, 1970. The case was settled in February 1974.

<u>Multilateral development bank legislation</u>

The United States may withhold its support of loans being considered by the three multilateral development banks of which it is a member. On March 10, 1972, Public Laws 92-245 (for the Asian Development Bank), 92-246 (for the Inter-American Development Bank), and 92-247 (for the International Bank for Reconstruction and Development (World Bank) and the International Development Association) were approved. The pertinent section (Gonzales amendment) of each of the three acts directs the President to instruct the U.S. Executive Director of each institution to vote against any loan or other use of funds of the Bank and the Association for the benefit of any country which has:

> "(1) 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 percentum of which is beneficially owned by United States citizens;

"(2) taken steps to repudiate or nullify existing contracts or agreements with any United States citizen or any corporation, partnership, or association not less than 50 percentum of which is beneficially owned by United States 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 or control 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."

Because of unsatisfactory progress in settling U.S. expropriation disputes, U.S. representatives to the financial institutions have six times abstained from voting and twice voted against loans to expropriating countries. Also, U.S. representatives abstained twice when non-U.S. private investments were involved. Four of the abstentions took place before the Gonzales amendment became law on March 10, 1972.

In each case the loan was approved despite the abstention or negative vote of the United States. The table below shows the abstentions and the negative votes.

Institution	Date	Borrower	Amount (millions)	Project	Vote	Percent of U.S. vote power
World Bank	June 1971	a/Guyana	$ 5.4	Sea defense	Abstain	24.0
	June 1971	a/Bolivia	23.25	Gas pipeline	Abstain	24.0
	June 1972	Iraq	12.9	Education	No	23.0
	Jan. 1973	Iraq	40.0	Irrigation	Abstain	23.0
	Nov. 1973	Peru	24.0	Education	Abstain	23.0
	Dec. 1976	Congo	8.0	Education	No	23.5
International Development Association	May 1973	Syria	15.0	Water supply	Abstain	26.0
Inter-American Development Bank	Nov. 1969	Peru	9.0	Electric power	Abstain	41.9
	June 1971	Bolivia	19.0	Gas pipeline	Abstain	44.3
	Apr. 1973	Peru	6.0	Mining	Abstain	37.9

a/Non-U.S. investments.

Fishermen's protective acts

Public Law 83-680, August 27, 1954 (68 Stat. 883), provided for reimbursing owners of U.S. vessels for fines paid to foreign governments to secure the prompt release of seized vessels and crews.

The Fishermen's Protective Act of 1967, as amended (22 U.S.C. 1975), requires the Secretary of State to transfer from the foreign assistance funds programed for any country--which seizes a U.S. vessel on the basis of rights or claims in territorial waters or the high seas which are not recognized by the United States--to the Fishermen's Protective Fund an amount equal to any unpaid U.S. claims against such country for amounts reimbursed by the United States to the owners of seized vessels who have paid fines, license fees, registration fees and/or other direct charges to the seizing country. The requirement is waived if the President certifies to the Congress that it is in the national interest not to withhold such foreign assistance funds from the seizing country.

The State Department has information concerning the seizures of 287 vessels by foreign governments in territorial waters not recognized by the United States since passage of the Fishermen's Protective Act in 1954.

Country	Number of vessels seized
Colombia	2
El Salvador	4
Ecuador	113
Honduras	11
Mexico	68
Nicaragua	25
Panama	4
Peru	60

Other vessel seizures may not have been reported to the Department.

State has certified, and Treasury has paid, 204 vessel owner claims for more than $6.3 million.

No claims are pending against countries that seized U.S. fishing vessels, and no amounts have been received from those countries.

The governments of Peru and Ecuador were notified, pursuant to the Fishermen's Protective Act, on three separate occasions that the U.S. Treasury had reimbursed owners of vessels seized by them. In each instance it was determined that a transfer of foreign assistance funds was not in the national interest.

Foreign Military Sales Act

Section 3(b) of the Foreign Military Sales Act, as amended (22 U.S.C. 2753 (b) (Supp. III 1973)), prohibits sales, grants or extensions of credits, or guarantees to any country for 1 year after such country seizes, takes custody of, or fines an American fishing vessel for engaging in fishing more than 12 miles from its coast.

Military sales to Peru and Ecuador were stopped in the spring of 1969 but resumed in August of the same year pursuant to assurances obtained during the four-power fisheries conference convened that month.

In January 1971, sales to Ecuador were suspended again for 3 years, after which the President determined that it was important to U.S. security to lift the suspension. Ecuador has not seized any U.S. tuna vessels since February 1975.

Sales to Peru were suspended for a year beginning on March 30, 1971. The suspension was not formally announced, but military sales were kept "under review." Sales were again suspended in December 1972 but lifted in May 1973 when the President determined that the national security required it. Peru has not seized any U.S. tuna vessels since January 1973.

Trade Act of 1974

Section 502(b)(4) of the Trade Act of 1974 (Public Law 93-618) excludes from the definition of a beneficiary developing country, for the purpose of determining eligibility for trade preferences, any country which has taken nationalization or expropriatory measures, such as those enumerated in the Foreign Assistance Act of 1961, and has not taken reasonable steps to compensate the former owners.

When countries eligible for trade preferences were designated in Executive Order 11844 published on March 26, 1975, Somalia, Uganda, and the People's Democratic Republic of Yemen were not listed because they had not made good faith efforts to negotiate settlements with former owners of expropriated or nationalized investments. Subsequently, Somalia and Uganda did make sincere efforts to resolve investment disputes; Somalia then was listed among the eligibles, but Uganda has not yet been listed. The People's Democratic Republic of Yemen is the only other country presently denied eligibility for trade preferences.

Sugar Act of 1948

Amendments to the Sugar Act of 1948 (Public Law 80-338) required the President to suspend the quota of any sugar-exporting country which nationalizes, expropriates, or seizes private property owned or controlled by U.S. citizens, corporations, partnerships, or associations and does not take appropriate steps to compensate the former owners. The act of October 14, 1971 (Public Law 92-138), further amended the Sugar Act by (1) making the Presidential action discretionary instead of mandatory, (2) permitting suspension of part, as well as all, of an expropriating country's quota, and (3) authorizing the President, either in addition to any suspension or as an alternative thereto, to levy a duty of not more than $20 a ton against any such country.

No sanctions were ever imposed under either the earlier mandatory provisions or under the discretionary amendment of 1971, and the Sugar Act expired on December 31, 1974.

CHAPTER 3

OTHER EFFORTS TO PROTECT INVESTMENTS AND COPE WITH EXPROPRIATIONS

Various multilateral and U.S. unilateral efforts to protect against expropriation and nationalization have been and are being made to encourage prospective investors to risk their capital in developing countries. A number of these efforts are discussed in the following sections.

INTERNATIONAL INVESTMENT INSURANCE AGENCY

Proposals for the establishment of a multilateral investment insurance scheme have been considered for some time. The World Bank made an initial survey in 1961 at the request of the Organization for Economic Cooperation and Development (OECD). 1/ In June 1965, OECD prepared a report which served as the basis for a draft set of "Articles of Agreement of the International Investment Insurance Agency" (IIIA) which were prepared by the World Bank in 1966. A second draft of the articles was prepared by the Bank staff in 1968.

Discussions of the second draft left a number of major issues unresolved, and in 1972 a new draft was distributed to the Bank's executive directors. The directors concluded that unless enough developed and undeveloped countries expressed positive interest, the Bank would do no further work on the proposal.

The issues which led to failure of the negotiations for establishment of the IIIA are described briefly below.

Link with World Bank

The World Bank's executive directors could not agree on whether the IIIA articles should link the Bank and the IIIA through common membership, representation on the IIIA's plenary body, chairmanship of the IIIA's board of directors,

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1/Members are Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

or through staff. Some regarded the link as essential for reasons of convenience and efficiency and to lend the Bank's prestige to the new agency. Others thought that a link was not essential, at least initially but that, since such a link might become desirable, the articles should be neutral on this score.

Voting rights

It was agreed that the agency's capital-exporting and capital-importing countries, as separate groups, should be represented on the agency's board. However, in the election of directors, views were divided as to whether each country within each group should have one vote or whether votes should be weighted and on what basis and whether voting arrangements for both groups should be the same.

The distribution of voting rights in the board of directors involved the issues of how voting power was to be distributed between capital-exporting and capital-importing countries and whether and how to weight the votes of directors.

Financial participation by developing countries

The issue was whether and to what extent developing-country members should participate in the expenses and obligations of the IIIA. Representatives of some developing countries were opposed to any financial participation by developing countries.

Subrogation

Some representatives objected to any provision for subrogation on the grounds that it would lead to a confrontation between the agency and a member country.

Arbitration

The representatives of some less developed countries objected to the provision for binding international arbitration on the grounds that it was inconsistent with the concept of sovereignty as understood in their countries and that it increased the possibility of a confrontation between a host country and the international community in the person of the agency.

The principal objectors to subrogation and arbitration under the proposed multilateral insurance scheme were certain Latin American countries. (See ch. 6.)

U.S. support

The United States has generally favored establishment of the IIIA. In its July 1971 report to the President, the Commission on International Trade and Investment Policy favored U.S. membership in an international insurance agency such as the proposed IIIA. The Commission thought that payments under the OPIC investment insurance program were virtually guaranteed; therefore investors and expropriating host countries would have little incentive to negotiate and, as a result, the U.S. Government, rather than the investors, would more likely become a principal participant in investment disputes.

The view would not necessarily hold, however, if the expropriated investment's replacement value had increased as a result of inflation over the years and if the enterprise had been and was likely to continue to be profitable. The investor, in such case, would have a strong incentive to negotiate with the host government for more compensation than he would receive under his OPIC insurance contract.

OPIC actively encourages its insured investors and foreign governments to resolve disputes to avoid expropriations, but if they occur, it helps the investor obtain acceptable compensation from the host government.

Also, under OPIC's insurance contract, the expropriatory action must continue for at least a year as a condition of recovery, thereby affording the investor ample opportunity to try to negotiate a settlement.

In the policy statement on economic assistance to and investment security in developing nations, the President on January 19, 1972, called for early establishment of the IIIA.

In a speech delivered on behalf of the Secretary of State on September 1, 1975, to the seventh special session of the U.N. General Assembly, the U.S. Permanent Representative stated that insurance for foreign private investors should be multilateralized and should include financial participation by developing countries to reflect the mutual stake in encouraging foreign investment in the service of development.

The State Department requested comments on the President's January 19 statement from the governments of other industrialized countries. Our review of the comments received from some of these countries indicates that, although they generally favored establishment of an IIIA, their own national interests precluded them from joining in any unified effort that would appear to confront the developing world, on which they depend for raw materials and as markets for their exports.

Conclusions

We believe that the proposed IIIA, in large part because of its international character, could effectively deter some expropriations and could precipitate prompt, adequate, and effective compensation when expropriations do occur. Although numerous obstacles presently prevent its establishment, we believe the United States should continue to work toward its creation. However, the United States should also strive to devise other measures to protect the interests of its private foreign investors.

INTERNATIONAL RESOURCES BANK

In an address before the fourth ministerial meeting of the U.N. Conference on Trade and Development at Nairobi, Kenya, on May 6, 1976, the Secretary of State proposed the establishment of an international resources bank. The bank's objective would be to facilitate private investment in resource development in developing countries where such ventures are more economically justified but where the unfavorable investment climate discourages private investment.

The bank's principal function would be to guarantee investments against non-commercial risks specified in individual trilateral contracts (between the investor, the host country, and the bank) within general guidelines which would be established.

In response to a request from the Secretary of the Treasury, the World Bank has agreed to study and report on the idea of such a bank.

EXPANDING CAPITAL BASE OF INTERNATIONAL FINANCE CORPORATION

In May 1976, the International Finance Corporation's board of directors recommended that the board of governors propose an increase in the Corporation's authorized capital from $110 million to $650 million. This is intended to overcome a continuing shortage of investment capital which is inhibiting the Corporation's ability to participate with private investment in sound, development-oriented projects.

In February 1976 the Administration submitted legislation which would have authorized the U.S. Governor in the Corporation to vote for increasing the capital base and authorized the proposed U.S. subscription to the increase in the Corporation's capital stock.

SPECIAL U.S. REPRESENTATIVE FOR OVERSEAS INVESTMENT

In February 1975 the Treasury Department transmitted to the State Department a proposal that the Government play a more active role in investment disputes by establishing a special representative whose principal mission, as a representative of the Secretary of the Treasury, would be to prevent expropriations and expropriatory actions by:

--Creating an office to provide more centralized and high-level leadership and coordination to improve the existing early warning system.

--Encouraging a framework for the negotiated settlement of investment disputes which would minimize confrontation and mediate competing interests in an orderly fashion.

--Establishing an independent body to provide the Government with relevant facts.

--Creating a framework in which the Government could express its views on the merits of competing claims.

--Supporting U.S. companies in negotiations, where appropriate.

The proposal included also the establishment of an independent fact-finding commission on investment disputes which, on request of either the expropriated company or the special representative, would try to make an independent judgment based on the facts underlying competing claims in an investment dispute. The commission would have statutory subpoena powers and access to the records of a parent company and, where local law allowed, to those of the foreign subsidiary.

The proposal was evaluated by the interagency staff coordinating group on expropriations and was opposed by the representatives of the other departments and agencies in the group on the grounds that insufficient support had been presented to warrant a recommendation for approval. Concern was expressed that it would result in a less flexible and balanced expropriation policy without increasing its effectiveness.

In August 1975, meetings were held with 35 executives of major U.S. multinational firms to obtain their views on the role the Government should play in investment disputes involving foreign subsidiaries of U.S.-based parent companies. A draft report on that study, prepared for CIEP, stated that

--most of the responding executives opposed the creation of an office such as the proposed special representative; 66 percent believed the Government should play an indirect rather than a directly interventionist role;

--60 percent believed the State Department should take the initiative and the responsibility for representing the Government in private business interests in foreign countries;

--only 10 percent felt that an agency other than State should do so.

Conclusions

We believe that a need for the proposed permanent special representative for overseas investment and the commission on investment disputes remains to be demonstrated. It appears that the functions of the existing interagency staff coordinating group largely parallel some of the functions of the proposed new offices with substantially less visible U.S. Government involvement, a condition preferred by the business community, which has the most direct and principal interest in investment disputes.

We believe that designation of a special representative might be desirable on an ad hoc basis, when the implications of an actual or impending nationalization or expropriation could significantly affect the overall interests of the United States. The resolution of the disputes with Peru, discussed on pages 7 and 8, illustrates the successful employment of special representatives on an ad hoc basis.

JUDICIAL REMEDIES CONVENTION

The United States has revived its efforts to establish a judicial remedies convention, under which former owners of expropriated or nationalized investments would be permitted to sue in the courts of third-party countries to obtain control of expropriated or nationalized properties or products derived therefrom that had been shipped from the expropriating or nationalizing country. A previous effort made in 1972 failed due to British and German objections.

CHAPTER 4

CODES OF CONDUCT FOR MULTINATIONAL CORPORATIONS

Various private and intergovernmental attempts have been made over the years to develop international codes of business conduct. In June 1976, the council of the Organization for Economic Cooperation and Development adopted a Declaration on International Investment and Multinational Enterprise which included guidelines encouraging multinational enterprises to:

--Consider host-country general policy objectives, aims, and priorities for economic and social progress, industrial and regional development, environmental protection, employment, and technological advancement and technology transfer.

--Provide host-country authorities, on request, with information relevant to their activities, subject to legitimate requirements of business confidentiality.

--Cooperate closely with local community and business interests.

--Free their foreign subsidiaries to develop their activities and to exploit their competitive advantages in foreign and domestic markets, consistent with the needs of specialization and sound commercial practice.

--Avoid discrimination in filling responsible positions in the foreign enterprise.

--Refrain from paying bribes or other improper benefits to public officials or employees and, unless legally permissible, from contributing to political candidates or parties or other political organizations.

--Abstain from any improper involvement in local political activities.

Other detailed guidelines pertain to (1) the disclosure of operating, financial, and related information, (2) competition, (3) financing, (4) taxation, (5) employment and industrial relations, and (6) science and technology.

The guidelines are voluntary and are not legally enforceable. They apply only to foreign investments made within the territories of the OECD member countries and are not for implementation in developing countries.

OECD member countries are generally the world's most advanced and industrialized societies and are both capital-exporting and capital-importing. Thus they are acquainted with the problems on both sides of the foreign investment picture. About 70 percent of total U.S. direct private foreign investment at yearend 1975 was in OECD member countries. The OECD guidelines probably will help to resolve some of the present problems between investors and OECD host countries.

The most contentious private foreign investment problems exist in the developing countries where private foreign investment is welcomed as necessary for economic development but is often also looked upon with suspicion and resentment and frequently nationalized and/or expropriated as these countries demonstrate their economic nationalism.

Generally, developing host countries want foreign companies to ensure that their investment plans will (1) harmonize with host-government economic and development plans, (2) permit advancement of local nationals to policymaking managerial and technological positions, (3) arrange for more local ownership of the enterprises, (4) help balance-of-payments positions through increased production for export by the foreign enterprises, and (5) use locally produced materials and supplies to the extent practicable.

Multinational corporations, on the other hand, would like (1) freedom from harassment, discriminatory taxation, and other forms of "creeping" expropriation, (2) assurances that concessions and other operating rights would not be arbitrarily revoked, (3) unrestricted rights to transfer profits, (4) full or majority ownership and control of the enterprises, and (5) a stable investment climate and reasonable assurance that investment disputes will be resolved fairly.

CONCLUSIONS

The OECD's recently adopted code of conduct might provide the broad principles under which foreign investments are to be conducted. However, we believe that it will not of itself generate the healthy climate over the long run that reasonably prudent prospective investors would require as a precondition to risking substantial resources in foreign ventures. Other elements essential to attract foreign investment, especially to developing countries include:

--Reasonable assurances of political stability in the potential host country over the long run.

--An adequately protective bilateral treaty between the host country and the prospective investor's home government. (See ch. 7.)

--Complete understanding between the host country and the prospective investor on a myriad of issues; the more that issues are identified and agreed upon, the better the chances will be of establishing a climate in which an investment could be made and continued without harassment or disputes. For example, agreement on possible adverse effects of the investment on the environment and responsibility for correction, employment of host-country nationals in higher level technical and managerial positions, use of host-country products, and host-country requirements for partial divestiture of ownership to local nationals.

CHAPTER 5

WORLD BANK POLICIES ON EXPROPRIATIONS

According to its stated policy on expropriations the World Bank and its affiliates maintain a continuing interest in disputes between a member country or one of its agencies and nationals and firms of another member country when such disputes stem from certain kinds of international financial transactions, including compensation to aliens for expropriated property. Because the Bank's resources are limited, developing countries also must look to public institutions, the private capital market, and direct private investment to finance their development.

The Bank also relies on the world's capital sources for its own lending funds, and its status could be severely damaged if it made new loans to countries which do not make reasonable efforts to resolve investment disputes. Consequently, a developing country with disputes outstanding because of uncompensated expropriations would have difficulty obtaining capital for its planned development projects.

The Bank will not lend to a country which has expropriated alien-owned property if it determines that the country's stance on compensation to the former owners is adversely affecting the country's international credit standing.

Even though an expropriated alien investor may have been adequately compensated through an investment guarantee or insurance plan, the Bank's position toward the expropriating country might be determined as though compensation had not been paid, unless extenuating conditions dictate otherwise.

We did not review the Bank's implementation of its stated policy.

CHAPTER 6

BILATERAL AGREEMENTS FOR ESTABLISHING PRIVATE INVESTMENT INSURANCE PROGRAM ABROAD

When the investment guarantee program was initiated under the Economic Cooperation Act of 1948, the Government's interests were protected by a statutory requirement that when a claim was paid under a guarantee against inconvertibility of a host-country's currency the insured investor's holdings of and credits in that currency became the property of the U.S. Government. (The Act of 1948 insured against inconvertibility only.)

The 1949 amendments amplified that requirement by adding "and the United States Government shall be subrogated to any right, title, claim, or cause of action existing in connection therewith." The provision was retained by the 1950 amendments, which broadened coverage under the program to include expropriation of qualified investments, and by the Mutual Security Act of 1954, which revamped foreign aid legislation.

The administering Federal agencies (Economic Cooperation Administration and its successor agencies) interpreted the provision as requiring bilateral agreements, which instituted the investment insurance program in host countries, to specifically (1) recognize U.S. ownership and nondiscriminatory use of local currency transferred to the U.S. Government upon payment of convertibility claims, (2) recognize U.S. Government ownership of property turned over to it and claims to which it would be subrogated as a result of expropriation claims paid, (3) agree to direct negotiation and arbitration of such claims, and (4) agree to most-favored-nation treatment for the United States and its nationals in the distribution of war damage payments, reparations, etc., concerning property turned over in connection with a war risk guarantee. (Coverage of investment losses sustained by reason of war was authorized by the Mutual Security Act amendments of 1956.) Practically all bilateral agreements currently in force contain these or similar provisions.

However, constitutional and statutory provisions prevented some Latin American countries from accepting these provisions. For example, some Latin American countries preclude foreign governmental ownership of real property; consequently, they could not recognize transfers of properties to the U.S. Government. Also, because of their adherence to the Calvo Doctrine some Latin American countries will not agree to subrogation, negotiation, or international arbitration of claims.

These obstacles have made it almost impossible for the U.S. Government to execute satisfactory bilateral agreements with some Latin American countries. For example, the agreement with Chile, entered into force definitively in February 1961, provides that the U.S. Government has subrogation rights concerning only the transfer and use of Chilean currency and credits therein which shall be available for meeting U.S. administrative expenses; subrogation to physical or real property comprising a U.S. Government-insured investment is specifically excluded.

In December 1963 the U.S. Secretary of State and the Chilean ambassador exchanged notes which constituted an agreement incorporating subrogation and international arbitration provisions, subject to approval under Chilean constitutional procedures. To date, however, that agreement has not been entered into force either provisionally or definitively.

The agreement with Argentina is essentially the same as the one with Chile. The definitively in-force agreement of May 5, 1961, provides for currency transfer and use only; a supplemental agreement which provides for subrogation and international arbitration is not in force either provisionally or definitively.

The agreement with Colombia merely provides that the United States and Colombia will consult on any investment the United States may guarantee and that it will not guarantee an investment unless Colombia approves. The agreement contains no specifics on subrogation, international arbitration, or convertibility of Colombian currency.

The agreement with Venezuela is identical in its substantive provisions to the one with Colombia.

The agreement with Peru covers only guarantees against inconvertibility of investment receipts and provides for the transfer to and use by the U.S. Government of Peruvian currencies acquired by the U.S. Government pursuant to such guarantees. Investments made in Peru are not insured against losses from expropriation or from war, insurrection, or revolution under the U.S. investment insurance program.

To facilitate insuring of investments in Latin America, the Foreign Assistance Act of 1961 eliminated the firm requirements for (1) transferring to the U.S. Government the rights in expropriated investment properties and host-country currencies and (2) subrogation of the U.S. Government to such rights. Substituted therefor was the more flexible provision which directed the President to

> "make suitable arrangements for protecting the interests of the United States Government in connection with any guaranty issued * * * [under the act] including arrangements with respect to the ownership, use, and disposition of the currency, credits, assets, or investment on account of which payment under such guaranty is to be made, and any right, title, claim, or cause of action existing in connection therewith."

This relaxation of the statute permitted the insuring of private investments in advance of final agreement with host countries on subrogation and property transfer rights if the administering agency and the Secretary of State determined that satisfactory final agreement could be expected within a reasonable period following issuance of such insurance.

From the passage of the Foreign Assistance Act of 1961 through about the end of calendar year 1970, a number of private investments in Argentina, Chile, Colombia, Peru, and Venezuela were insured under the relaxed statute. The following table shows the maximum coverage in force in those countries as of December 31, 1976, issued during that period.

Country	Number of contracts	Inconvertibility	Expropriation	War, insurrection, revolution
Argentina	45	$151,930,081	$73,012,880	$57,573,734
Chile	18	55,522,125	37,009,740	34,442,834
Colombia	40	57,417,413	58,237,738	46,809,793
Peru	13	17,289,653	-0-	-0-
Venezuela	41	34,689,588	34,788,588	30,576,688
Total	157	$316,848,860	$203,048,946	$169,403,049

The Foreign Assistance Act of 1969 created the Overseas Private Investment Corporation (OPIC) and transferred the investment insurance program to it. OPIC was directed to conduct its financing operations on a self-sustaining basis and its insurance operations with due regard to the principles of risk management. These two provisions apparently generated a more cautious approach to the insuring of investments in the five Latin American countries. Since it commenced operations in January 1971, OPIC has issued no insurance in Chile, Colombia, or Peru through December 31, 1975, and has insured only one investment in Argentina. However, 12 ventures were insured in Venezuela during the same period.

To minimize the objections of host governments which refuse to recognize subrogation of other national governments to claims concerning expropriated properties, OPIC has negotiated some agreements under which it, as a separate entity, not the U.S. Government, would be subrogated to the rights of former owners.

CHAPTER 7

FRIENDSHIP, COMMERCE, AND NAVIGATION TREATIES

The United States has treaties of friendship, commerce, and navigation (FCN) and similar treaties with 43 countries. The general objective of these treaties is to establish bilateral reciprocal bases for protecting the personal security, rights, and property of nationals of each country who are residents in the territory of the other. A specific purpose of such treaties, especially those entered into after World War II, is to establish a climate in which nationals and companies of either country can make direct investments within the territory of the other without fear of harassment, threats, or other discriminatory actions by host-country governments. Other provisions are designed to ensure prompt, adequate, and effective compensation in the event an investment is nationalized or expropriated by the host-country government.

We found, however, that many FCN treaties are outdated and do not provide adequate protection to the extensive U.S.-owned private investments that are not insured against expropriation by OPIC. Also, there are substantial U.S. private foreign investments in many developing countries with whom the U.S. Government does not have FCN treaties.

TREATIES ENTERED INTO FORCE DURING 19th CENTURY

Treaties with 12 of the 43 countries 1/ were entered into force during the 1800s when U.S. private foreign investments were negligible compared with current investments. Probably as a result of that earlier condition, 8 of the 12 treaties do not address the question of reciprocal protection of foreign investments.

1/Argentina — Morocco
Bolivia — Paraguay
Brunei — Switzerland
Colombia — United Kingdom
Costa Rica — Yugoslavia
Malagasy Republic (originally with France)
Malta (originally with the United Kingdom)

The treaties with Argentina, Bolivia, and Columbia provide for reciprocal rights of establishment and host-government protection of trading businesses but not of manufacturing or resource-related industries. Only the treaty with Switzerland provides specifically for the reciprocal establishment of manufacturing and other industries as well as trading businesses. It is also the only one that provides for compensation in the event of an expropriation. However, compensation is not ensured as the treaty merely places foreign investors on an equal footing with citizens of the host country; if host-country citizens would not be compensated after being expropriated, neither would foreign investors.

PRE-WORLD WAR II TREATIES

Treaties with 10 of the 43 countries 1/ were entered into force during the early part of the 20th century; 8 of the treaties provide for reciprocity of investment freedom and host-country assurances of protection equal to that accorded national investors. The treaty with Iraq contains no provisions for private foreign investments, and the treaty with Turkey provides for most-favored-nation treatment of investors. Compensation in the event of expropriation is provided for in seven of the treaties; those with Spain, Turkey, and Iraq contain no such provisions.

POST-WORLD WAR II TREATIES

Treaties with the remaining 21 countries 2/ were entered into force after World War II, the earliest with Nationalist China in 1948, and the latest with Thailand in 1968.

1/ Spain, Esthonia, Latvia, Honduras, Austria, Norway, Turkey, Finland, Liberia, Iraq

2/ Belgium, China, Denmark, Ethiopia, France, Germany, Greece, Iran, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Muscat and Oman, The Netherlands, Nicaragua, Pakistan, Thailand, Togolese Republic, Vietnam

Each of these treaties provides for national treatment (see p. 32) and/or most-favored-nation treatment of nationals and companies of both contracting parties in matters pertaining to:

--Recognition of their juridical status and right of free access to courts of justice and administrative agencies.

--Protection and security of direct and indirect property interests.

--Establishment and acquisition of interests in commercial and industrial enterprises.

--Protection in exclusive use of inventions, trademarks, and trade names, consistent with local law.

--Assessment of taxes, fees, and other charges.

The treaties also prohibit takeovers of properties of nationals, corporations, and associations of either contracting party, except in accordance with due process of law or for a public purpose, and provide that such takeovers be accompanied by just, prompt, and effective compensation.

Each treaty also provides for the free transfer, in the currency of the country of which the recipient is a national, corporation, or association, of returns from investments, including profits and dividends, as well as of compensation paid for expropriation or nationalization.

Most of the treaties provide for settling disputes between the contracting parties as to the interpretation or application of the treaty via diplomatic efforts, and if necessary, by submittal to the International Court of Justice. The treaty with Thailand provides for such submittal to a panel of arbitrators. The treaty with Muscat and Oman does not provide for arbitration of disputes.

ESSENTIALS OF FCN TREATIES

One essential of any FCN treaty is a provision for national treatment of foreign investments. Such a provision should be included to ensure that foreign firms of either country operating within the territory of the other are granted treatment not less favorable under comparable circumstances than that accorded firms of the host country.

State Department officials said that some developing countries would grant most-favored-nation treatment but not national treatment to foreign firms because of (1) expressed desires to favor domestic firms, (2) fears of the power of foreign multinational firms, and (3) beliefs that reciprocal national treatment by developed countries would be of only academic value because their own firms don't have the capital to invest abroad.

State officials told us that they would not accept less than national treatment because (1) a national treatment provision sets the climate for a secure operating environment and affords better protection against host-country discriminatory actions than would most-favored-nation treatment and (2) acceptance of less than national treatment would set a bad precedent by undermining future negotiations with countries that otherwise might be willing to grant national treatment.

FCN treaties should also provide for adequately compensating the foreign owners in case the investment environment deteriorates and the venture is nationalized or expropriated by the host government. These other provisions should specify that:

--Expropriation or nationalization shall not be discriminatory and shall be only for a public purpose, accompanied by prompt, adequate, and effective compensation.

--Compensation shall amount to the investment's market value immediately before the expropriation or before the host government's official announcement that expropriation would occur, whichever is earlier.

--Disputes between a foreign investor and the host country shall be submitted to international arbitration for settlement.

--Disputes between the treaty countries concerning interpretation or application of the treaty shall be submitted to international arbitration if diplomatic settlement efforts fail.

--Investors shall be granted national treatment and most-favored-nation treatment in the transfer of funds between the territories of the treaty countries and neither country shall impose exchange restrictions.

The Congress, by implication, recognized the need for treaties that would adequately protect the interests of U.S. private foreign investors in developing countries and, thereby, provide U.S. firms with the needed incentive to invest in the development of third-world countries.

In section 402 (c) of the Economic Cooperation Act of 1950 (64 Stat. 204), the Congress expressed the view that:

> "Technical assistance and capital investment can make maximum contribution to economic development only where there is understanding of the mutual advantages of such assistance and investment and where there is confidence of fair and reasonable treatment and due respect for the legitimate interests of the peoples of the countries to which the assistance is given and in which the investment is made and of the countries from which the assistance and investments are derived. In the case of investment this involves confidence on the part of the people of the underdeveloped areas that investors will conserve as well as develop local resources, will bear a fair share of local taxes and observe local laws, and will provide adequate wages and working conditions for local labor. It involves confidence on the part of investors, through intergovernmental agreements or otherwise, that they will not be deprived of their property without prompt, adequate, and effective compensation; that they will be given reasonable opportunity to remit their earnings and withdraw their capital; that they will have reasonable freedom to manage, operate, and control their enterprises; that they will enjoy security in the protection of their persons and property, including industrial and intellectual property, and nondiscriminatory treatment in taxation and in the conduct of their business affairs." (Underscoring supplied.)

The above language, which contains several of the essential elements of an adequately protective FCN treaty, is not in the current Foreign Assistance Act of 1961, as amended, which superseded the Economic Cooperation Act of 1948 and the Mutual Security Act of 1954. We believe, however, that the congressional view is still valid.

GERMAN FEDERAL REPUBLIC'S TREATIES IN AFRICA

The situation on the African continent exemplifies the need for an effort to negotiate adequately protective FCN treaties. Statistics compiled by Commerce's Bureau of Economic Analysis show that at yearend 1975, U.S. firms had investments in at least 790 affiliates and branches in 47 developing African countries. These investments had reported values of about $2.4 billion, excluding investments of less than $2 million each. However, the United States has FCN treaties only with Ethiopia, Liberia, the Malagasy Republic, Morocco, and the Togolese Republic. Only the treaties with Ethiopia (1953) and the Togolese Republic (1966) provide for adequate protection of foreign investments.

On the other hand, the Federal Republic of Germany has enjoyed considerable success in negotiating treaties with African countries for the protection of its private foreign investments and as of June 30, 1974, had such treaties with 26 African countries. 1/ Egypt, Ethiopia, Ghana, and Kenya had not ratified their treaties as of that date. English translations were readily available for 10 of the treaties (identified by the letter E in the footnote), and we used them to review and analyze certain essential provisions.

1/Cameroon(E)
Central African Republic
Chad
Congo
Egypt
Ethiopia
Gabon
Ghana (E)
Guinea
Ivory Coast
Kenya(E)
Liberia (E)
Malagasy Republic
Mauritius (E)
Morocco
Niger
Rwanda
Senegal
Sierra Leone (E)
Sudan (E)
Tanzania (E)
Togolese Republic
Tunisia
Uganda (E)
Zaire
Zambia (E)

National treatment of foreign investments

Eight of the 10 treaties we analyzed provide essentially that neither country shall subject investments owned or controlled by nationals or companies of the other country to conditions less favorable than those it imposes on its own or third-country nationals or companies.

The treaties with Kenya and Tanzania, however, provide that neither country shall subject nationals or companies of the other country--concerning ownership, management, use, or enjoyment of their investments--to conditions less favorable than it imposes on other similar investments in its territory. In effect, these provisions reserve to the host countries the right to discriminate among industrial sectors and to impose restrictions and/or requirements that might not be imposed on other industries. Examples would include payment of royalties to the host government based on production, such as barrels of oil extracted, tons of ore mined, etc. But so long as such requirements are applied uniformly and without discrimination as to nationality of ownership, the provision could be construed as granting, in principle, national treatment to all investments. On the other hand, the provision could be used to discriminate against industries that are totally owned by foreigners.

Expropriation and compensation

Each of the 10 treaties provides that investments by nationals and companies of either country shall not be expropriated, except for a public purpose. An expropriation must be accompanied by compensation representing the fair value of the investment expropriated. The compensation shall be actually realizable, made without delay, and transferable.

Transfer of returns on investment and capital

Treaties with 8 of the 10 countries impose no limits on the transferability of returns on investments and capital. The treaty with Sudan does not allow free transfers of inconvertible foreign currency imported by foreign investors into the host country. The treaty with Ghana permits either country to restrict the free transfer of investment returns and liquidation proceeds to the extent required by its balance-of-payments position. However, minimum transfers are guaranteed--20 percent annually on liquidation proceeds and 12 percent annually of value of investment on returns. The treaty also provides that if the allowed transfers are not made within 1 year, transfer of the balances is guaranteed in the following year.

Arbitration of disputes

Each treaty provides for international arbitration of disputes concerning its application or interpretation.

TRADE ACT OF 1974

The United States depends almost totally on foreign sources for various materials, some of them critical to the national security and economy. A principal objective of section 102 of the Trade Act of 1974 is to assure the United States fair and equitable access to those essential products which either are unavailable or cannot be easily developed domestically. A series of adequately protective FCN treaties could encourage investment to develop supply sources for such commodities.

CONCLUSIONS

We believe that the United States will have to make its own arrangements for protecting U.S. private investments in developing countries because:

--Efforts to organize an international investment insurance agency appear to be stalled.

--Other capital-exporting countries are not enthusiastic about joining the United States in any common effort against expropriation and nationalization of private foreign investments by developing countries.

--The OECD's code of conduct, if adopted, would apply only to investments made among the capital-exporting countries, not the developing world.

FCN treaties are one type of device that could help to establish the kind of investment climate needed to induce private investors to risk their capital in developing countries.

FCN treaties that provide for adequate protection of private foreign investment could result in substantial benefits to industry, the U.S. Government, and host countries.

1. The economic and industrial development of a developing country could be hastened by the increased foreign investment that such a treaty could generate by improving the investment climate.

2. The improved investment climate could persuade some firms to make investments without OPIC expropriation insurance that otherwise would not have been made unless expropriation insurance was available. Also, some companies might terminate OPIC expropriation insurance carried before such a treaty was entered into.

3. The possible reductions in OPIC's exposure for expropriation coverage would reduce the U.S. Government's contingent liability for expropriation losses.

We are aware that an adequately protective FCN treaty does not of itself ensure a healthy investment climate either permanently or for even a relatively long term. The instability and insecurity of the governments of some more recently formed developing countries might discourage foreign investment because of the threat posed by possible overthrows of constitutional governments and the abrogation of international agreements by radical successor governments.

We believe, however, that such possibilities should not deter the U.S. Government from making the effort to enter into adequately protective FCN treaties with developing countries where investment potential exists. Also, the Government should keep current on events in a host country which might affect investment climate. Thus, it would be in a better position to relay such information to prospective investors who request it.

Such activity would be consistent with the Government's current practice of maintaining a low profile and minimal involvement in private investment matters. Prospective investors should make the ultimate judgments about the desirability of the investment climate and whether to make investments.

AGENCY COMMENTS

This report was submitted for comment to the Departments of Commerce, State, and Treasury and to CIEP and OPIC. Each agency offered criticisms intended to lend completeness and precision to the report, and practically all of the suggestions have been incorporated into the final report. (See apps. I to V.) All five agencies agreed with our recommendation.

RECOMMENDATION

The Secretary of State should initiate a broad-based effort to negotiate treaties of friendship, commerce, and naviagation, emphasizing protection of private foreign investments with developing countries where significant potential for U.S. private investment exists.

OVERSEAS
PRIVATE
INVESTMENT
CORPORATION

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Washington, D.C. 20527
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Office of the President

JAN 2 5 1977

Mr. J. K. Fasick
Director
International Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Fasick:

Thank you for affording OPIC an opportunity to comment on the GAO's draft report entitled "Nationalizations and Expropriations of U. S. Direct Private Foreign Investment: Problems and Issues."

We would like to preface our specific remarks with several general observations on the Report. First, we believe that the Report unfortunately follows a somewhat outdated approach in its examination of this subject. Its emphasis on the negotiation of treaties with developing countries to provide for the protection of private U. S. investment does not allow for much attention to the political and economic factors that have made U. S. efforts to negotiate such treaties so unsuccessful in recent years and which promise even greater difficulty for future negotiations. The Report does not display adequate appreciation of the newer and more flexible investment protection techniques, such as those that OPIC has developed as well as various investor "self-help" practices. We therefore feel that the Report should acknowledge that it concentrates on one approach to the problem (i.e., international agreements and organizations) and that other approaches, such as OPIC programs, are not examined in similar detail.

Second, we note that the Report does not address the substantial role that OPIC has played in seeking prompt, adequate and effective compensation in a large number of the non-petroleum expropriation cases since 1961. We would be happy to furnish information on our claims settlement record. In any event, there now seems to be wide recognition that OPIC is one of the U.S. Government's more effective dispute settlement mechanisms and some mention of our activities in this field should be made in Chapter 3. You may want to refer readers to the Comptroller General's July 1973 report on "Management of Investment Insurance, Loan Guaranties, and Claim Payments by the Overseas Private Investment Corporation."

Third, the Report is not sufficiently critical of shortcomings in the rather inadequate fabric that now exists for the protection of U.S. investments. It does not, for example, impart to a reader the World Bank's general reluctance to use its considerable influence to urge moderation in LDC treatment of foreign investors. There appears to be more optimism than circumstances warrant in the Report's portrayal of prospects for the IIIA and a code of conduct going beyond the OECD to the LDCs.

GAO note: Page number references may not correspond to the pages of this report.

Mr. J. K. Fasick

Our more specific comments are as follows:

1. The paper fails to identify the Congressional Directive under which it was prepared and which defines the scope and purpose of the inquiry.

2. The word "international" should be inserted prior to "commitments" in the first sentence on page 6 in order to make this an accurate statement.

3. At the top of page 8, the Report implies that most investment disputes have been resolved by companies through administrative or judicial channels. Although we have not kept a tally on this question, it is our impression that most disputes have been resolved through negotiation rather than formal channels. The first paragraph also suggests a more significant ICSID role than has been the case so far. Only five investment disputes have been referred to ICSID in the Centre's ten-year operating history, and none of these disputes has been resolved through ICSID arbitration. We suggest that it be pointed out on page 8 that the requirement under international law for prior exhaustion of local remedies bars official home government involvement of official standing at the early stages of such disputes, but that investment insurance provides the basis for early and effective OPIC involvement (even if behind the scenes) at the stage of early negotiations when these matters can be most effectively resolved.

4. The discussion of U. S. statutory sanctions in Chapter 2 lacks critical analysis of the standards applied in the administration of these statutes, i.e., just what kind of host government conduct has been found directly or impliedly to be "reasonable" or "adequate." Doesn't the desire to avoid imposing sanctions risk debasing the principles enunciated in the statutes?

5. The discussion of the IIIA concept ignores the basic point that national investment insurance schemes have proliferated and grown since the IIIA proposal was proposed in 1962, presumably based upon the perceived self-interest of the investing nations involved. This makes it possible that there may be even less incentive now to accommodate to the requirements of other countries (LDC or otherwise) with respect to the organization and operation of a multilateral insurance scheme. Also, the sentence at the end of the paragraph in the middle of page 19 refers to a 1971 study indicating that OPIC insurance removes an investor's incentive to negotiate. This has been disproved by experience. On this issue, your researchers may want to refer to conclusions expressed in the House Subcommittee on Foreign Economic Policy's November 1973 report on OPIC, specifically

Mr. J. K. Fasick

Section VII thereof ("OPIC, Investment Disputes, and the Claims Settlement Process"). It should also be pointed out in the discussion on page 19 that the official USG position has been to favor IIIA as a supplement, not as a replacement for national programs such as OPIC's.

6. The GAO should try to verify its assumption (middle of page 21 and elsewhere) that involvement of multilateral financial institutions tends to deter nationalization. OPIC's limited claims experience with projects involving IFC investments does not support this conclusion. We have processed only two claims on projects in which IFC had invested, and in neither case did IFC's presence appear to make a difference. It would be helpful to have a statistical picture of the incidence of nationalization, forced governmental participation, and fundamental revisions of the rules of the game affecting projects in IFC's portfolio.

7. The Report refers briefly to the IRB on page 20 but does not indicate some of the principal objections to it from industry as well as foreign governments. These might be helpful to the Congressional reader who should see and understand the IRB both in terms of concept and feasibility.

8. Chapter 4 should be expanded to include the expectations for a code of conduct governing investments in LDCs. The conclusion of a code among OECD countries may mislead the reader into believing that a similar code is feasible with developing countries.

9. The Report seems to attribute a more activist role to the World Bank in investment disputes than is actually the case. It is our impression that the Bank seldom exerts its efforts in the direction of urging LDCs to deal fairly with expropriated investors. The Report thus appears to miss the reality of Bank policy.

10. Note 1 at page 32 cites adherence to the Calvo Doctrine for positions taken by Latin American countries which were in fact based on a variety of policy and legal considerations.

11. Mention should be made at the top of page 33 of the fact that OPIC negotiated a new full agreement with Chile in early 1976 which awaits a USG decision for execution.

12. Line 22 on page 33 implies that the Expropriation Coverage is available in Peru under the OPIC bilateral. The Peruvian bilateral provides only for Inconvertibility Coverage.

Mr. J. K. Fasick

13. Chapter 6's review of OPIC bilaterals is useful but incomplete and somewhat misleading. It appears to highlight the deficiencies rather than the benefits of the bilaterals. U.S. rights under the bilaterals should be seen in conjunction with, not separate from, the total body of U.S. rights.

14. On page 34, the last line should be changed to read "...most of which was issued during the 1961-70 period." Some of the Peruvian insurance was issued prior to 1961 and, as noted elsewhere in the Report, coverage was issued in Venezuela as late as 1974.

15. The figures on current level of coverage in the table on page 35 are not pertinent and, since they convey "privileged business information" when broken down by country, should be deleted. Also, the word "rebellion" should be changed to "revolution."

16. The International Court of Justice is incorrectly referred to at the middle of page 40 as an "arbitral tribunal."

17. The discussion of FCN treaties in Chapter 7 ignores (1) the post World War II effort to negotiate FCN treaties with developing countries, the lack of success, and the reasons therefor; and (2) the more recent evidence from UNCTAD meetings and other multilateral forums that even national treatment for foreign investment will be increasingly difficult to obtain in light of the present third world attitude toward the rights and responsibilities of multinationals, to say nothing of the higher standards contemplated by the Report for FCN treaties. Despite these difficulties, OPIC supports the Report's recommendation that an effort be made to obtain FCN treaties in more LDCs.

18. The Report should note on page 44 that the West German investment insurance program is able to insure even in the absence of an investment guaranty bilateral. The Germans do, however, require a determination that the rights of foreign investors are adequately protected in the prospective recipient country.

19. Perhaps the Report should point out in Chapter 1 that domestic as well as foreign investors have fared badly when populist governments came to power. When a government seeks to establish state control of the "commanding heights" of an economy, domestic investors holding sensitive or large-scale enterprises are frequently expropriated. This has been the case in Chile, Cuba, India, Iraq, Pakistan, Peru and Zambia.

Mr. J. K. Fasick

We would very much appreciate an opportunity to discuss this Report with your researchers if they feel that such discussions might be useful. Mr. John Gurr of OPIC's Development staff (telephone 632-1796) would be happy to make appropriate arrangements.

Sincerely yours,

David Gregg III
Executive Vice President

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL ON INTERNATIONAL ECONOMIC POLICY
WASHINGTON, D.C. 20500

January 27, 1977

Dear Mr. Lowe:

I have been asked to respond to your December 28 letters to CIEP's Chairman and Executive Director on your proposed report to Congress entitled "Nationalizations and Expropriations of U.S. Direct Private Foreign Investment: Problems and Issues."

I wish to commend GAO's efforts to review the important subject of expropriations and other investment disputes. Having reviewed your draft, my staff and I find it, by and large, a useful factual presentation of the problems facing the U.S. Government and American private investors abroad. I believe your recommendations for broader utilization of FCN treaties bear looking into as a further means to protect U.S. private foreign investment, and I understand that the State Department also is sympathetic to this approach.

There are a few areas where you may want to consider amending or amplifying your report. First, we believe it would be useful to describe in somewhat more detail how the U.S. Government assists in helping investors resolve disputes with foreign governments. Your Chapter 2 description of U.S. Government activities briefly describes the framework of USG efforts in this area but might appropriately delve more into the actual workings of CIEP's Interagency Group on Expropriations.

Second, we have some difficulty with the wording in the middle of page 47 of your Conclusions Section. Here, the Report implies that the U.S. Government's responsibilities in helping to resolve private investor disputes with foreign governments are or should be limited to negotiating FCN treaties and keeping abreast of events in a host country which might affect the investment climate. While we wholeheartedly agree with the U.S. Government's current "low-profile" approach to investment disputes, we believe that your conclusions should indicate -- as does the body of your proposed report -- that the Executive Branch has a legislative mandate to deny aid and trade benefits to foreign governments who do not make prompt and adequate compensation to investors whose properties have been expropriated.

I trust you will be able to make these corrections for the purpose of rounding out your useful report. Please feel free to call upon me or my staff if you have any questions regarding our comments.

Sincerely,

Douglas W. Metz
Associate Director and
General Counsel

Mr. Victor L. Lowe
Director
General Government Division
United States General Accounting
Office
Washington, D.C. 20548

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Policy
Washington, D.C. 20230

2 8 ... ...

Mr. Henry Eschwege
Director
Community and Economic
Development Division
U.S. Genera' 'ccounting Office
Washington, ..C. 20548

Dear Mr. Eschwege:

We wish to thank you for the opportunity to comment on the GAO draft report to the Congress on problems and issues in nationalizations and expropriations of U.S. direct private foreign investment. It is a comprehensive presentation of U.S. and bilateral efforts to protect private foreign investment abroad and to deal with the problem of expropriation and nationalization. Of course, all of these takeovers are part of a larger scheme characterized, in short, by the less-developed countries' calling for a revamping of the world economic orde.. In fact, even expropriations and nationalizations are taking more sophisticated forms such as forced sell-downs to minority ownership, rapidly rising production and export taxes, and cartelization. Indeed, the whole issue of foreign investment abroad has taken on heated, political overtones in addition to the long-standing economic arguments.

In line with this stance by the LDCs is the undertaking within the United Nations organization of the drafting of a code of conduct for multinational corporations. While the process and goal are quite similar to the code exercise undertaken by the OECD, the UN effort differs in that LDCs and developed countries are both involved. It may be interesting to note in your draft the difficulty developed countries have in trying to convince the developing countries of the importance of foreign investment to their development and, hence, the necessity of their maintaining a healthy, stable environment for that investment.

While we believe it is unlikely in the current political environment that LDCs will be willing to sign FCN treaties with the United States, such an effort may, indeed, be successful with some countries. Furthermore, if the projected shortage of investment monies materializes, more LDCs may be willing to reduce their demands and temper their

APPENDIX III

intractability in order to improve their investment climate relative to others. In such a case, it may be helpful to have the mechanism for FCN negotiation at the ready.

In summary, your study generally appears to be a concise and fair statement of the expropriation/nationalization issue.

Sincerely,

S. Stanley Katz

S. Stanley Katz
Deputy Assistant Secretary for
Economic Policy and Research

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

JAN 31 1977

Dear Mr. Lowe:

This letter is in response to your request for Treasury comments on the GAO draft report entitled "Nationalizations and Expropriations of U.S. Direct Private Foreign Investment: Problems and Issues". The report shows a considerable amount of effort and adds a great deal to our understanding of the issue.

My main comment concerns the description in the report of the past operation of U.S. expropriation policy in specific investment disputes (Chapter 2). While it is true that, as stated in the report, the USG has sought to maintain a low profile and minimal involvement in investment disputes, at times it has become actively engaged in the settlement process. For example, on occasion, the U.S. has taken an independent position on the merits of a dispute and, in one recent case, went so far as to negotiate directly with an involved U.S. firm and the host government in order to reach a settlement. The USG has also had recourse to various intermediate measures, including making suggestions about suitable negotiating guidelines, expressing dissatisfaction on occasion with the pace of negotiations, conveying our view of the general requirements of U.S. and international law in order to reach acceptable results, etc. We believe that Chapter 2 should accurately reflect the full range of approaches taken within the Executive Branch to promote settlements.

The report's chief recommendation--that the Secretary of State initiate a broad-based effort to obtain treaties of Friendship, Commerce, and Navigation (FCN) with developing countries emphasizing protection of private foreign investments--is an interesting proposal. I might note that my staff is now in the process of reviewing options in the area of expropriations policy, including the option of intensifying our efforts to obtain updated and strengthened FCN treaties. In this connection, it would be helpful to our analysis if the GAO could expand Chapter 7 of its report to include a discussion of how effective FCN treaties have been in providing protection for West German investors or investors of other developed countries against expropriation or other unilateral action by host governments.

The report shows a considerable amount of effort and should prove helpful to Treasury in the course of our review of expropriation and investment policy.

Sincerely yours,

W M Blumenthal

W. Michael Blumenthal

Mr. Victor L. Lowe
Director
General Government Division
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

DEPARTMENT OF STATE

Washington, D.C. 20520

February 2, 1977

Mr. J. K. Fasick
Director
International Division
U.S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Fasick:

I am replying to your letter of December 28, 1976, which forwarded copies of the draft report: "Nationalizations and Expropriations of U.S. Direct Private Foreign Investment: Problems and Issues."

The enclosed comments were prepared by the Assistant Secretary for Economic and Business Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Daniel L. Williamson
Deputy Assistant Secretary
for Budget and Finance

Enclosure: As stated

GAO DRAFT REPORT: "NATIONALIZATIONS AND EXPROPRIATIONS OF U.S. DIRECT PRIVATE FOREIGN INVESTMENT: PROBLEMS AND ISSUES".

We generally find the draft report to be a good review of the problems posed by expropriation of U.S. direct private investment abroad, and of current efforts -- as well as others which might profitably be pursued -- seeking to deal with them. In particular, our preliminary reaction is favorable on its major recommendation, viz., the initiation of a broad-based effort in developing countries to negotiate treaties of friendship, commerce, and navigation (FCN) emphasizing investment protection (p.48). Over the coming weeks we intend to intensify considerations already underway as to whether and how such an initiative might be undertaken.

There are, however, certain portions of the draft report which we believe should be modified, and these are discussed below.

1. <u>INR Statistics (Digest pp. i-ii, pp. 1-4)</u>

Instead of the unqualified use of the terms "expropriation" and "nationalization" to refer to the various totals compiled by the Department's Bureau of Intelligence and Research, it should be made clear that the statistics refer generally to disputes with host governments involving U.S.-owned property abroad, but that these are not necessarily expropriations or nationalizations in any technical or legal sense. This point is made in the second full paragraph on page 3, but we believe it warrants greater prominence, particularly since the way the numbers are characterized may from the outset affect how they are viewed. For example, the phrase "expropriations and nationalizations" at the top of page 2 could be replaced by "investment disputes," and this change should also be reflected in other appropriate places.

2. <u>Current Implementation of U.S. Expropriation Policy (pp. 7-9)</u>

In our view, the description of the CIEP Interagency Staff Coordinating Group on Expropriation (Expropriation Group) at page 7 inadequately conveys the scope and manner of the Expropriation Group's operations. A memorandum on this subject is attached, and portions of it (pp. 2-4) might usefully be drawn upon to give a more complete picture of the Group's work.

We also believe that the discussion of the current implementation of U.S. expropriation policy (pp. 8-9) to some extent mis-characterizes the process by implying that it is essentially passive save in cases of formal espousal or in instances where U.S. and investor interests diverge in some unspecified way.

It is true that the State Department generally believes that the most effective policy is one which avoids routine significant involvement by the USG in the merits of particular cases. In addition to enhancing our abilities to play an ongoing and constructive role in such cases, and to respond flexibly to the full range of U.S. interests involved, this approach avoids the risks of politicizing disputes which in themselves may not have major political overtones, and of intruding unduly (and unwelcomely) into the affairs of private parties.

At the same time, it should be noted that the Department, both individually and in its roles as chairman and staff support of the Expropriation Group, is actively involved in numerous cases worldwide (certainly more than 100 at any given time) about which we seek to keep fully and currently informed to enable us to exercise our "good offices." This encompasses a range of functions from, for example, gently encouraging the parties to negotiate a mutually-satisfactory settlement, to considerable involvement on the merits when an active mediating effort appears warranted. Examples of this latter approach include the Greene Mission to Peru in the early 1970's, and the Marcona case in 1975-76, both of which were resolved satisfactorily in a manner which included the negotiation of an intergovernmental agreement. Actions along this continuum -- all of which fall short of formal espousal -- are far from passive, and comprise the great preponderance of work done by the USG in this area.

3. Special Representative for Overseas Investment (pp. 21-23)

In addition to pointing out that there was no support for this proposal among the other member agencies of the Expropriation Group, it is noteworthy that the opposition to it was on the merits. As reported in a memorandum of May 10, 1976 from the Chairman of the Expropriation Group to the Executive Director of CIEP, the other agencies were concerned that the proposal "would result in a less flexible and balanced expropriation policy, without increasing its effectiveness," and we believe that language to this effect should be added to the second full paragraph on page 22.

With respect to the conclusion concerning the desirability of employing a Special Representative on an ad hoc basis only (final paragraph on page 23), we believe that cases such as the Greene Mission and Marcona, noted above, demonstrate that we currently have the ability to do this, and that we have done so on appropriate occasions.

4. Bilateral Agreements on Investment Insurance (p. 34)

The reference at line 12 to a determination by "the administering agency" is not accurate since an important part of the Secretary of State's "policy guidance" under the Foreign Assistance Act involves participation in the determination of when the requirement for "suitable arrangements" is being met.

5. Miscellaneous

Finally, there are a number of additional points which we believe warrant clarification along the lines indicated.

-- Digest p. i, line 3 and Page 1, lines 1, 3, 6, 8: the various references to "communism" might modified to "communism or socialism" or to "the adoption of state ownership or control as the basic economic model of some countries, especially in Eastern Europe."

-- Digest p. ii, text line 10: after "property," insert "(in the absence of specific governmental undertakings to the contrary)."

-- Digest p. ii, text lines 18-19: delete last sentence and substitute "Companies have in many cases successfully resolved investment disputes without significant direct U.S. Governemnt involvement."

-- Digest p. iii, text lines 3-5: Subsection (1) is an example of a finding that a country is in compliance with the requirements of the law, not of a waiver of its provisions.

-- Digest p. v, text lines 6-11: we suggest substituting "Among a number of alternatives the Government has considered, is an initiative to establish a judicial remedies convention under which former owners of expropriated or nationalized investments would be permitted to sue in the courts of third-party countries to obtain control of such properties or products derived therefrom that had been shipped from the expropriating or nationalizing country."

-- Digest p. v, text line 18: after "guidelines," insert "are voluntary and."

-- Page 6, line 5: substitute "are non-discriminatory, and are accompanied by just compensation."

-- Page 8, line 7: after "referred to," insert "arbitral bodies such as."

-- Page 9, line 3: substitute "routine significant and direct" for "deep."

-- Page 10, lines 11-12: insert "formally" before "invoked."

-- Page 10, line 21: the "abeyance" of aid or of the invocation of Hickenlooper?

-- Page 12: the numbers in the first paragraph and the accompanying table should be modified to reflect that in December 1976 the U.S. voted against an IBRD education loan to the People's Republic of the Congo, citing expropriation as the reason for doing so. The loan was nevertheless approved.

-- Page 15, lines 10-13: although Uganda subsequently resolved the outstanding expropriation, it has not yet been designated an eligible beneficiary.

-- Page 21, text line 13: at the end of that sentence, add "in which the IFC participates."

-- Page 24, line 4: substitute "expropriated or nationalized properties or products derived therefrom" for "properties (mainly inventory products."

-- Page 25, footnote 1: Turkey, although an OECD member, did not join in the Declaration.

-- Page 27, line 12: after "enterprise," insert "a stable investment climate and reasonable assurance that disputes arising with respect to their investments will be resolved fairly."

-- Page 32, footnote 1: this appears to be an incorrect statement of the Calvo Doctrine in the context of expropriation and investment disputes. In such cases, this doctrine asserts that aliens are entitled only to national treatment, i.e., so that there is no international standard applicable to the conduct of the host country, aliens are not entitled to the protection of their home governments under any such claimed standard, and their only legitimate procedural recourse is through host country administrative and judicial processes.

Julius L. Katz
Assistant Secretary for
Economic and Business Affairs

Attachment:

Purposes and Procedures of the
Council on International
Economic Policy's (CIEP)
Group on Expropriation

PURPOSES AND PROCEDURES OF THE COUNCIL ON INTERNATIONAL ECONOMIC POLICY'S (CIEP) INTERAGENCY STAFF COORDINATING GROUP ON EXPROPRIATION

The Council on International Economic Policy's (CIEP) Interagency Staff Coordinating Group on Expropriation (Expropriation Group) is the primary mechanism within the USG for coordinating implementation of U.S. expropriation policy. The Expropriation Group's origins, purposes, and current procedures are described below.

Formation and Role of the Expropriation Group

In a January 1972 Presidential policy statement on "Economic Assistance and Investment Security in Developing Nations", it was announced that in order to carry out U.S. expropriation policy effectively, each potential case of expropriation of U.S.-owned property abroad would be followed closely, and that a special interagency group would be established under CIEP to do so and to recommend appropriate courses of action for the USG. It was noted in the statement that the Department of State had set up a special office to follow expropriation cases in support of CIEP (State's Office of Investment Affairs, which provides the Expropriation Group with staff support, and whose Director serves as the Group's Staff Director).

Subsequently, in a memorandum of March 8, 1972, from the Assistant to the President for International Economic Affairs to the Secretaries of State, Treasury, Defense, and Commerce, the Expropriation Group was established to include representatives of those agencies, with provision to be made for NSC and CIEP staff participation, as well as for that of other agencies on appropriate occasions. The Group's functions were described as:

-- Keeping under continuing review all potential and active expropriation cases; compiling relevant facts and analyses, to include information concerning economic benefits subject to potential U.S. action;

-- Making a finding in each case for purposes of policy implementation that an expropriation affecting a significant U.S. interest has, or has not, occurred; and, if so, whether reasonable provision has been made for prompt, adequate, and effective compensation;

-- Recommending courses of action for the USG, consistent with the President's January 1972 expropriation policy statement; and

-- Coordinating policy implementation.

The Secretary of State was directed to designate a senior officer, who would also be responsible to the Executive Director of CIEP, to chair the Expropriation Group. The officer so designated was the Assistant Secretary of State for Economic Affairs (currently "Economic and Business Affairs"), the office whose incumbent continues to serve as Chairman.

The Expropriation Group was instructed to deal expeditiously with any alleged expropriation problems, upon the request of any member and within its terms of reference. In cases of interagency disagreement - following the failure of urgent efforts to resolve the issue - the Chairman was required to submit a report promptly to the CIEP Executive Director setting forth the issue or issues, the conflicting views, the options proposed, and a reasoned statement of the advantages and disadvantages of each proposed course of action. Each Department represented was authorized to request the CIEP Executive Director to review a case to attempt to resolve the issue or, if necessary, to submit it for Presidential decision.

Since the Expropriation Group's inception, it has been extremely active, both in coordinating implementation of U.S. expropriation policy in particular cases, and as a forum for continuing interagency consideration and review of broader issues of expropriation policy. It also plays a significant role in the application of U.S. legislation calling for withholding of economic benefits (trade preferences, bilateral assistance, and support for loans under consideration in international development banks) from countries which expropriate American-owned property without taking the required steps toward payment of fair compensation. For example, by a July 6, 1972 Presidential "Memorandum for the Secretary of the Treasury," the Secretary of the Treasury is to "(take) into account any advice received as a result of CIEP expropriation policy coordination and review procedures" before instructing the U.S. representatives to the Inter-American Development Bank, the Asian Development Bank, and the International Development Association. More recently, in an exchange of letters in February-March 1976, the Expropriation Group and STR agreed to an ongoing process by which the Group will provide findings and recommendations to STR with respect to outstanding nationalization cases or failures to honor arbitral awards which might affect country eligibility for generalized preferences under Sections 502 (b) (4) or 502 (b) (6) of the Trade Act of 1974. The Group has also undertaken to conduct periodic Congressional briefings on expropriation issues arising in the context of the Trade Act, and has done so on several occasions over the past few months.

How the Expropriation Group Operates

The 1972 Presidential statement and the implementing memorandum of March 8, 1972 continue to provide the basic framework for the Group's operation.

Meetings are convened at the Chairman's initiative, or at the request of any member. These are normally held every six weeks or so, but are also convened as necessary so that (as in the case of the Group's intensive review in late 1975 of country eligibility for generalized preferences under the expropriation and arbitration provisions of the Trade Act of 1974) they sometimes occur much mor frequently. Participants generally include representatives from State, Treasury, Commerce, Defense, CIEP, NSC, CIA, STR, OPIC, AID and OMB. Other agencies, e.g., Exim and Agriculture, participate as appropriate.

The Expropriation Group's meetings are generally held at the working-level (i.e., Office Director, although there is occasionally higher-level representation), and are chaired by the Staff Director. Before each meeting, an annotated agenda from the Group's Chairman is prepared and distributed to the participants and to the Executive Director of CIEP. The agenda normally reports on developments in expropriatory situations in some fifteen to twenty-five countries. About half of these are reported on in writing only, while the remainder are also intended to be discussed at the meeting. During the Group's meetings, which regularly last for several hours, and may take up most of the working day), representatives from the Department of State (normally including representives of the concerned regional bureau and the Office of the Legal Adviser) provide an oral briefing on the particular case or issue, which is followed by questions directed to the speaker and by discussion. The Group's findings and recommendations--for example, whether an expropriation has occurred, or to seek more information about an expropriatory situation, or to prepare a demarche to a foreign government, or to recommend withholding of economic benefits--are arrived at by consensus, with the formal machinery for resolving interagency disagreement rarely, if ever, brought into play. Instead, any such disagreement has tended to be resolved within the Group itself by direct discussions among the agencies with competing points of view. Often this is accomplished through informal contacts following the meetings between higher level policy officials of the concerned agencies. Occasionally the full Expropriation Group is reconvened at a higher level to seek resolution of interagency differences, as was the case, for example, on the issue of GSP eligibility for Argentina during the past year.

Following each meeting, a report is circulated by the Chairman to the membership summarizing its results, and reflecting what actions are intended to be taken over the coming days and weeks as a result of the Group's deliberations. This report contains a clear and concise statement of any differences of view which may have arisen among the representatives of the member agencies.