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THE UNITED STATES GOVERNMENT PERSPECTIVE ON EXPROPRIATION AND INVESTMENT IN DEVELOPING COUNTRIES

*Richard J. Smith**

The title for my presentation given in your program clearly covers two major subjects, either of which would make an ambitious topic for the relatively brief presentation I intend to make today. Therefore, for the half-hour or so that I will talk before we get into the more important and valuable exchange of ideas and discussion to follow, I have made the decision, which I hope you will agree is sensible, to deal mostly with the subject I know more about—the protection of United States private interests abroad.

But just so no one asks for his money back, let me first say a few words about the United States perspective on exploitation and supply of energy resources. Our perspective can in fact be dealt with quickly because it is straightforward and obvious. Having suffered, along with most of the rest of the world, the adverse economic effects of the huge price increases imposed by the OPEC oil cartel, as well as the embargo actions of the Arab oil producers, we are most anxious to see new sources of oil and other energy supplies developed, which will reduce the relatively unrestrained monopoly power currently exercised by OPEC.

It is in this context that we are deeply concerned about the current expropriations of oil company assets that are occurring in a number of countries. These companies are being placed in a position where they have little choice but to relinquish their assets for far less than their true market value. This is not only unfair to the individual investors, but also has broader and profoundly disturbing ramifications. This wave of poorly-compensated expropriations can only have a chilling effect on the investor in high risk energy exploitation projects. Thus, at a time when substantial new investment in energy exploration is most needed it is being discouraged. Further, to the extent new investment occurs, an incentive has been created to shift to higher cost and less promising

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potential energy sources in the developed countries in order to avoid the risk of expropriation in the developing countries.

The United States is concerned about the threat of decreased investment in the developing countries in energy sources, and in raw materials in general. Secretary Kissinger has suggested that the World Bank "increase its financing of resource investments and explore new ways of combining its financial aid with private management, skills, technology and capital." In particular, we are encouraging the International Finance Corporation (IFC), the World Bank Group member which lends to the private sector, to undertake more projects in the area of minerals development, and to this end we are supporting an increase in the capitalization of the IFC.

Let me turn now to a consideration of the United States Government's perspective on the protection of United States private property, which I will discuss under the heading of expropriation policy. I want to explain not only what it is, but why it is. Our policy can be simply stated: we recognize the right of any country to expropriate the property of a United States investor, in the absence of specific governmental undertakings to the contrary, so long as the taking is non-discriminatory, for a public purpose, and accompanied by prompt, adequate, and effective compensation. In our view, these are the minimum standards under international law.

While policies can be stated simply, the realities to which they are applied are invariably more involved and ambiguous. Whether a "taking" has in fact occurred is often not obvious. Further, the determinations of how much compensation is "adequate," and how prompt is "prompt" are far from trivial matters. These are among the questions that the Inter-Agency Expropriation Group, under the auspices of CIEP (Council on International Economic Policy) must wrestle with in its monthly meetings, which typically deal with an agenda that includes a review of a dozen or more complex investment disputes. This inter-agency group is charged with reaching determinations regarding appropriate United States Government actions in particular disputes, including, where appropriate, the cessation of AID, withdrawal of support for loans from international development banks, and withdrawal of trade preferences under the Hickenlooper and Gonzalez Amendments and the Trade Act, respectively.

In many cases, investment disputes arise from actions short of formal nationalization, but which nevertheless may be expropriatory in effect. Such actions include intervention, cancellation or forced renegotiation of contracts or concession agreements, coerced

sales or "participation" arrangements, and the raising of taxes to confiscatory levels. Whether a particular action is expropriatory must be evaluated in light of all the relevant circumstances of the particular case, and this makes it more necessary than ever to carefully review investment disputes on a case-by-case basis to fully develop all the relevant facts.

Once it appears that a "taking" of American-owned property has occurred or is about to occur, it is the longstanding and continuing position of the United States Government that international law requires payment of fair market value, calculated as if the expropriatory act had not occurred or was not threatened. Since market value is often not directly ascertainable, and since there usually are not recent sales of comparable properties to refer to, market value generally must be approximated by indirect methods of valuation. There are at least three methods.

The going-concern approach attempts to measure earning power (and so encompasses elements such as loss of future profits which may be based on projections of past earnings or estimates of future earnings), and in the view of the United States Government generally best approximates market value. We recognize that there may be circumstances in which application of this method is impracticable, or where it might operate unfairly—for example, where an investment has a limited history of operating results, or where expropriation occurs after significant costs are incurred but before a revenue-generating stage is reached. This method of valuation is also vulnerable to governmental actions which adversely affect profitability, such as increased taxes, threat of cancellation of contractual or concessionary rights, or withdrawals of privileges. We believe that such actions taken for the purpose of, or which have the effect of, unfairly influencing compensation may not properly be allowed.

The replacement cost of the property at the time of expropriation less actual depreciation, a standard which is likely to yield an amount substantially greater than book value but which does not take into account earning capacity, is of limited use in valuing intangibles, and, in our view, is generally less acceptable in most circumstances than the going-concern approach.

Book Value, or some variation of it, which (unlike the replacement-cost approach) values assets at acquisition cost less depreciation—is a figure which in most cases bears little relationship to their actual value. We believe this to be the least acceptable method for valuation of expropriated property.

We recognize that no single method of valuation is valid under

all circumstances. The method or combination of methods most likely to provide just compensation for expropriated property varies, and depends upon the attendant circumstances of the particular case. We also recognize that non-monetary aspects of settlements—for example, assured access to sources of supply, preferential pricing, or new arrangements for the provision of technical or other services on a contractual basis—may in certain instances constitute elements of compensation.

We believe that issues concerning valuation of expropriated property are best resolved by the parties themselves through negotiation, and we stand ready to facilitate discussions between the parties aimed at achieving a mutually acceptable outcome. Since questions of valuation often present complex and sensitive issues in cases of expropriation, we also support independent appraisal as a procedural method for resolving them. More broadly, we favor agreement in advance on dispute settlement mechanisms applicable to the full range of contentious issues capable of arising between host governments and foreign investors, and subsequent resort to them as required by the parties legal obligations. In such cases, failure to meet these arbitral or other obligations in itself may constitute a denial of justice in violation of international law. We particularly encourage use of the facilities on the International Center for the Settlement of Investment Disputes (ICSID), a member of the World Bank Group and the major existing international institution intended specifically to help resolve investment disputes.

Our policy concerning valuation of expropriated property was most recently elaborated in a public statement on "Foreign Investment and Nationalization" issued by the Department of State on December 30, 1975. The text of that statement is as follows:

There have been significant developments during the past year concerning foreign investments by U.S. private firms. The Secretary, at the 7th Special Session on September 1 and at CIEC December 16, emphasized the U.S. belief that foreign private investment can make a very substantial contribution to economic development. There have also been a number of actual or contemplated nationalizations involving U.S. firms, and ensuing settlement negotiations. In these circumstances, the Department wishes to reiterate pertinent U.S. policy. The President of the United States, in January 1972, drew attention to the importance which the United States attaches to respect for the property rights of its nationals. He stated that the policy of the United States concerning expropriatory acts includes the position that:

“Under international law, the United States has a right to expect:

- that any taking of American private property will be non-discriminatory;
- that it will be for a public purpose; and
- that its citizens will receive prompt, adequate, and effective compensation from the expropriating country.”

With regard to current or future expropriations of property or contractual interests of U.S. nationals, or arrangements for “participation” in those interests by foreign governments, the Department of State wishes to place on record its view that foreign investors are entitled to the fair market value of their interests. Acceptance by U.S. nationals of less than fair market value does not constitute acceptance of any other standard by the United States Government. As a consequence, the United States Government reserves its rights to maintain international claims for what it regards as adequate compensation under international law for the interests nationalized or transferred.

Now to the “why” of United States expropriation policy. In the first instance the answer seems obvious. Clearly, it is one of the most basic responsibilities of a government to seek to protect the lives and the property of its citizens whether at home or abroad. But this narrow answer based on our consular protection function does not tell the whole story. There is a broader reason based on our view of the world, and our aspirations for it, that more fully explains the depth of our feelings regarding this issue.

It has been a fundamental United States policy throughout the post World War II period to assist the developing countries in successfully meeting their development goals. There is an element of altruism in this policy, but there is also a large dose of enlightened self-interest, which recognizes that a world in which the legitimate aspirations of the developing countries are frustrated is not likely to be the kind of world we are comfortable living in. Further, we are convinced that substantial flows of private capital, with the technology, know-how, and management skills that accompany it, are essential to this development process. Government-to-government and multilateral aid also have a role, but it cannot substitute for those private resource transfers.

Inadequately compensated expropriations constitute a major threat to these critical private investment flows. Private investors come from environments in which private property rights are recognized and assured and will not continue to put their assets at risk in countries in which these rights are not respected. Indeed, nearly 80 per cent of all private direct foreign investment takes place

among the developed countries and the indications are that this percentage is increasing. Unless the trend towards inadequately compensated expropriations is arrested, the prospects for the developing countries to receive the levels of investment, in energy resources or elsewhere, which they require in the era of capital shortage we are now entering, are not good. This is a major reason why the United States Government views the expropriation issue as such a serious one.