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Policy Issues in Primary Industries

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POLICY ISSUES IN PRIMARY INDUSTRIES

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Business and government have espoused a variety of policies to exploit market forces to their advantage. This article explores the policies involved with important issues affecting relationships among protagonists in primary industries and offers some suggestions. The first section deals with "freeing" the supply of key information not normally accessible to less developed countries (LDC's). Sections two and three relate to two aspects of international trade: easing hardships resulting from interruptions in resource flows; and redistributing gain from resource industries among trading countries. The final two sections of the article deal with development financing, and with the accommodation of foreign investments with a country's perception of its sovereignty.

I. A Mechanism to Promote the Exchange of Information

An article in *The Economist* states, "knowledge is now the most important economic resource."[1] The availability of relevant up-to-date information, its transfer and adaptation to local conditions, and its effective and efficient use are crucial to progress.[2] To improve the flow of key information not normally accessible to LDC's, the creation of a Resource Advisory Service (RAS) agency seems warranted.

RAS's function could consist of centralizing the collection, storage and dissemination of information to member countries and to their agencies. The scope of the information should, in principle, be worldwide and involve trade and freight figures; costs of various

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1. The Economist, Dec. 27, 1969, at 10.

2. *See, e.g.*, O. Herfindahl, Natural Resource Information for Economic Development (1969); *Information as a Key to Progress*, The OECD Observer, April 1972, at 6-8.

inputs; market and credit opportunities; fiscal charges, trade barriers or incentives in countries concerned; and a roster of firms, institutions and experts dealing with various aspects of the resource in question.

RAS is likely to offer many interrelated advantages. It could prevent exploitation of ignorance; bring competitive forces to work; reduce uncertainty and facilitate decision making; permit more efficient and effective use of opportunities; reduce losses from miscalculations or premature commitments; possibly reduce the scope for bigotry, venality, misunderstanding or even conflict; publicize the relevant experiences of other nations; and permit a wider and quicker access to technical knowledge, managerial know-how, credit opportunities and tax information. Impartiality and speed in responding to requests from member countries and their enterprises are obviously essential to the successful operation of RAS.

It may prove too ambitious for the proposed RAS to act outright as a central repository and disseminator of comprehensive information in the natural resources field. Accordingly, it is more realistic in an early stage of operation to have RAS act as an intermediary, advising on the various sources for such information. Should individual countries, most likely LDC's, be unable to secure out-of-the-way information through their own means, RAS could then undertake to provide it and to advise on its authenticity and accuracy. Moreover, it will be more manageable for RAS to begin its activities with one commodity (probably one about which information is comparatively inaccessible to LDC's) or one subject matter of developmental significance, say, taxation.[3] Once proven workable and successful, its activities could be enlarged to encompass progressively the whole field of natural resources. Such a scheme already has been discussed favorably by the United Nations Committee on Natural Resources.[4] It would involve the cooperation of interested national, regional and international organizations.

3. Dudley Seers recommended the creation of a similar international agency that would advise governments on tax and conservation matters. Seers, *Big Companies and Small Countries: A Practical Proposal*, 16 KYKLOS 605-06 (Basel 1963). *See also Report on the United Nations Conference on the Application of Science and Technology for the Benefit of the Less Developed Areas*, 2 NATURAL RESOURCES 195-96, 200 (1963).

4. Committee on Natural Resources, *Report on the First Session*, 1 U.N. ECOSOC, 22-23, U.N. Doc. E/4969, E/C.7/13 (1971).

Availability of information in itself, however, is not sufficient. It must be adapted to the particular needs of the individual countries concerned. In addition, feedbacks must be arranged on a permanent and regular basis in order to control, evaluate and improve the relevance of the information made available. There is a need for effective links between the RAS and the beneficiary countries if the agency is to advise on the efficient use of the information that it provides. These links could be established through experts who are prepared to assist in drafting legislation, in setting up natural resources departments, in helping to formulate plans and forecasts of demand and supply, and in identifying up-to-date competitive terms for contracts and new market opportunities. Resource advisors should not be expected to assume decision-making prerogatives in their dealings with member states. Their function should be limited to elucidating alternatives and to analyzing elements of costs and benefits for various courses of action.

II. Security of Resource Flows

Basic minerals and several other commodities are vital to modern economies. This has led to a wide international concern for "security of supply" and for "security of demand." Insecurity of resource flows may result from war, from natural hazards, from domestic problems, from governmental actions (*e.g.*, embargoes, blockades, trade barriers or expropriations), or from company actions (*e.g.*, lockouts of labor or boycott of supplies).

The term "security" may convey different meanings to different parties: it may mean the continued and regular physical availability of commodities regardless of the attached economic or noneconomic terms; or it may mean physical availability at terms economically and politically acceptable to the parties concerned. For the United States, national security of oil flow has been defined as requiring four major objectives:

> (1) Maintain a satisfactory level of domestic reserves of crude oil, supplemented from secure sources of foreign supply;
> (2) Maintain spare capacity to produce and deliver crude oil when international factors disrupt supplies from other sources;
> (3) Maintain refinery capacity in the United States adequate to meet both defense and essential civilian needs in periods of disruption of normal world oil trade; and

(4) Provide a petroleum industry in the United States with the capacity to meet the nation's defense and essential civilian needs at all times.[5]

In the United States, restrictions on oil imports were in force from 1958 to 1973, admittedly at a cost to consumers, to protect the domestic petroleum industry and to preclude undue dependence on the vicissitudes of foreign sources. Estimates of the cost of the United States import program vary considerably. Evidence submitted to a Congressional Joint Economic Subcommittee suggests, however, that the net cost for the American public increased by "a rock-bottom minimum of $7.4 billion more in the six-year period ended in 1970 than in the previous half-dozen years."[6]

Observers are generally familiar with aspects of supply security.[7] The concept of demand security has not received, until recently, equal attention, at least from academicians and analysts.[8] "Demand interruption" refers to the decision of one or more of the industrially developed countries and of their international enterprises to interrupt, curtail or boycott directly or indirectly the regular exports of one country or a group of countries. As on the supply side, such interruptions may be prompted by mixed politico-economic motives, such as the nationalization by LDC's of assets belonging to developed countries' enterprises. The LDC's faced by demand interruption may not have the resource flexibility or the administrative ability to change their pattern of exports in the short or intermediate run. In addition, the absence of a diversified economic base may preclude them from making up for a loss of exports in one commodity by increased exports in other commodities. These countries, faced with demand interruption, could have their socio-economic programs and their internal stability impaired.

One historic example of demand interruption was that con-

5. *Hearings Pursuant to S. Res. 45 on National Goals Symposium Before the Senate Comm. on Interior and Insular Affairs*, 92d Cong., 1st Sess., pt. 2, at 489-90 (1971) (statement by George A. Lincoln, Director, Office of Emergency Preparedness).

6. Washington Post, Jan. 9, 1972, § A, at 5, col. 1.

7. *See, e.g.*, NATIONAL SCIENCE FOUNDATION STAFF REPORT, RESOURCES FOR THE FUTURE: ENERGY RESEARCH NEEDS (1971); S. SCHURR & P. HOMAN, MIDDLE EASTERN OIL AND THE WESTERN WORLD 14-16 (1971).

8. *See* M. TANZER, THE POLITICAL ECONOMY OF INTERNATIONAL OIL AND THE UNDERDEVELOPED COUNTRIES 319-48 (1969).

nected with the nationalization of the Iranian oil industry in 1951. For over three years, Iran was faced with a total boycott of oil exports instituted by major international companies that supported the Anglo-Iranian Oil Company (later British Petroleum Company) in questioning the legitimacy of Iran's nationalization. Moreover, Anglo-Iranian and the British Government threatened companies that might break the boycott with confiscation of Iranian oil on the high seas and with legal action. The World Bank and the IMF boycotted Iran for a while. The legitimacy of the nationalization, one should add, was upheld in 1952 by the International Court of Justice, but the industry boycott was maintained until late 1954 on the grounds that compensation offered by the Iranian Government was inadequate. The impact of the suspension of oil flows on the Iranian economy, dependent on oil for some 80 per cent of export earnings, was shattering.[9]

To lighten the burden of interruptions, permanent multilateral mechanisms may be necessary to establish rules and standards of compensation. Another approach could be to resort to ad hoc solutions for the mobilization of aid on a voluntary basis, as and when interruptions occur. A third approach could consist of having a standing committee that would convene on short notice to consider the problem at hand. The first approach has the merit of permanency; it also provides participants a prior knowledge of what to expect in the event of interruptions and accordingly reduces uncertainty. The third approach is a compromise; it provides for the firm opportunity to discuss matters, with no commitment on the

9. A recent example of demand interruption was the French decision in mid-1971 to boycott Algerian oil, for which France was the major consumer. The French action was prompted by their opposition to Algeria's partial nationalization (up to 51%) of hitherto French-controlled companies in Algeria, and by their disapproval of compensation terms offered by Algeria. The French Government was reported to have made representations (1) to the United States Government to cause a ban on prospective Algerian gas imports into the United States; (2) to the World Bank and other financial institutions to block any loans to Algeria until France received for its nationalized interests terms it deemed satisfactory; and (3) to other trading partners of Algeria, notably West European countries, Japan and the Soviet Union. The dispute between Algeria and France was resolved by the end of 1971. *See Boumediene Analyzes Franco-Algerian Oil Crisis*, MIDDLE EAST ECONOMIC SURVEY, June 18, 1971, at 5. *See also* OIL & GAS J., June 21, 1971, at 80; Petroleum Press Service, June 1971, at 204-05; Sonatrach, *Algeria-Petroleum*, PETROLEUM TIMES, June 4, 1971, at 1; Washington Post, July 28, 1971, § A, at 11, col. 1.

nature or amount of compensation to the suffering country. In the absence of such mechanisms, several countries have adopted individual measures such as building stockpiles of strategic and critical materials. Others, as shown below, have attempted to achieve inter-country cooperation and assistance.

A. *Developed Market Economies*

In the past two decades, the Western developed countries have taken steps individually and collectively to meet possible emergencies in oil supply interruptions. For example, after the nationalization of the Suez Canal but two months prior to its closing, planning measures for an interruption in oil supplies were undertaken by American companies through a Middle East Emergency Committee, set up by the United States Foreign Petroleum Supply Committee. A similar organization was established by the Organization for European Economic Cooperation (OEEC). Essentially the same mechanism was reactivated in 1967 by the Organization for Economic Cooperation and Development (OECD) grouping the developed countries of North America, Western Europe, and Japan.[10]

More specifically, the intergovernmental OECD Oil Committee collects and analyzes data on current and prospective conditions of demand and supply for petroleum and gas. It advises, plans and administers the scheduling, apportioning and storage of oil supplies for the benefit of member countries in periods of emergencies. In addition, it monitors a stockpiling program for West European countries that was begun at the time of the Suez crisis in 1956.[11] The OECD governments have authorized company representatives to organize themselves into an international Industry Advisory Body, and to meet on an ad hoc basis in the event that oil supplies are threatened.[12] Periodic meetings are held between the Oil Committee and leading executives of oil companies in member countries to discuss the problems of the industry. Besides the OECD Oil Committee, Western countries coordinate domestic and international emergency preparedness planning within their defense organizations. The leading example is that of the North Atlantic

10. S. SCHURR & P. HOMAN, *supra* note 7, at 14 n.12.
11. *Oil Supplies—1970*, THE OECD OBSERVER, Oct. 1971, at 29.
12. *Id.*; *see Energy Policy in the European Community*, THE OECD OBSERVER, June 1972, at 36-39.

Treaty Organization (NATO). This focuses on both military and civilian emergency planning. NATO's Petroleum Planning Committee meets periodically, usually in Brussels.[13]

It has been suggested that the most realistic way to keep supply interruptions from being employed as an instrument of policy is to render such interruptions useless. Thus, the threat to use oil as a weapon would be an empty one, and its actual use, if attempted, futile.[14] The objective of assuring supplies, according to Western analysts, can best be achieved, assuming no military intervention or political coercion, by building inventories or by keeping some domestic reserves unproduced to buy time for developing alternatives or for countering emergencies. The OECD countries' minimum stockpile of crude oil and products in early 1973 was equivalent to 45 days of current consumption. The minimum would be raised to 60 days by 1975.[15]

B. *Developed Centrally Planned Economies*

East European countries and Mongolia are linked economically through the Council for Mutual Economic Assistance (CMEA). These countries constitute a reasonably self-sufficient economic area for several basic commodities. Since the mid-1960's, supply-demand imbalances, coupled with freer international trade, have led to significant exchanges with countries outside the CMEA area. For example, Soviet oil and gas exports from Siberian fields to Western Europe are counterbalanced by gas imports from Afghanistan and Iran to the southern industrial centers of the Soviet Union, and by Eastern Europe's oil imports from the Middle East and North Africa.

CMEA countries agreed at their 25th session in Bucharest in August 1971 to pool efforts to insure adequate supplies of fuel and other raw materials. Their ultimate goals are integration, specialization and balanced growth at the regional level. The leadership

13. CONGRESS OF THE UNITED STATES, 21ST ANNUAL REPORT OF THE ACTIVITIES OF THE JOINT COMMITTEE ON DEFENSE PRODUCTION, H.R. REP. No. 92-843, 92d Cong., 2d Sess. 271 (1972).

14. S. SCHURR & P. HOMAN, *supra* note 7, at 15. *See also* Gordon, *Without Rudder, Compass, or Chart—The Problem of Energy Policy Guidelines*, 64 QUARTERLY OF THE COLORADO SCHOOL OF MINES 29, 41 (No. 4, 1969).

15. *See Energy Policy in the European Community*, THE OECD OBSERVER, June 1972, at 37.

of the Soviet Union and its capacity to carry out cooperative schemes in the CMEA are crucial factors of success. East European cooperation in fuel and raw material industries includes research and production of advanced equipment, long-term credits, intraregional trade, an oil and gas pipeline network, a CMEA-wide search for minerals, and joint ventures to pool resources and achieve specialization and economies of size.[16] Soviet sources claim that CMEA cooperation in the oil trade between the Soviet Union and Czechoslovakia resulted in lower cost imports to the latter than would have been the case with imports from outside CMEA.[17]

C. *Developing Importing Countries*

The LDC's, unlike developed countries, do not have multinational mechanisms designed to protect them against unforeseen interruptions in the trade or supply of basic commodities. It is suggested that a Commodity Insurance Fund (CIF) be set up for the purpose of assisting these countries during interruptions, financially or in kind through compensatory supplies from alternative (and admittedly more costly) resources. The Fund could be financed by voluntary contributions from the United Nations member states, and by assessments levied on participating member countries, probably based on their per capita income and population. The CIF could also conceivably be used as an international stockpile agency and carry out functions similar to national stockpile agencies.

For several countries, sudden interruption of trade flows, especially in certain commodities, is similar in its effects to a natural disaster. The world community already has recognized that hardships arising from the latter must be alleviated. In fact, as of early 1972, the Secretary-General of the United Nations has a Disaster Relief Co-ordinator reporting to him. One of his functions is to "mobilize, direct and co-ordinate the relief activities of the various organizations of the United Nations system in response to a re-

16. *See New Comecon Drive Banking on Oil, Gas,* OIL & GAS J., Aug. 30, 1971, at 26-27; Ratnieks, *Development of Fuel and Raw Material Resources in the COMECON Countries,* PETROLEUM TIMES (London), June 30/July 14, 1972, at 18; Zubkov, *CMEA Countries' Cooperation in the Fuel, Power and Raw-Material Industries,* INT'L AFFAIRS (Moscow), Dec. 1971, at 107-09.

17. Zubkov, *supra* note 16, at 107; *see* Bogomolov & Barkovsky, *Economic Cooperation among the CMEA Countries,* 21 ECON. BULL. FOR ASIA & FAR EAST 11 (No. 3, 1970) (U.N. Doc. E/CN.11/1000).

quest for disaster assistance from a stricken State." Additionally, he coordinates UN assistance with assistance given by intergovernmental organizations. He also promotes the study, prevention and control of disasters, and provides advice to governments on predisaster planning.[18] The assistance offered in natural catastrophes conceivably could be extended to economic catastrophes, if a majority of UN members agree to it. To get such an agreement is, admittedly, far from easy.

D. *Developing Exporting Countries*

Primary exporting countries have taken public cognizance of the impact of demand interruptions on their economies. The Organization of Petroleum Exporting Countries (OPEC) Conference instructed OPEC's Secretary General "to convene a Working Party of experts from Member Countries at Headquarters in order to prepare a study on the establishment of a fund to assist any Member Country affected by actions taken against it by oil companies."[19] The matter was still under study in 1973. There are, nevertheless, examples of one or more OPEC member countries coming at their own initiative to the rescue of another member country. For example, Libya assisted Algeria with a 100 million dollar advance after Algeria was faced in mid-1971 with a boycott from the oil companies following its partial nationalization of French concessionaires. The Algerians managed to overcome their financial difficulties, and to settle with the French companies, without having to make use of Libyan credit.[20] Iraq received credits from Kuwait and Libya following the boycott it faced in 1972 after instituting nationalization measures. Primary exporting countries are concerned about the most realistic way to keep demand interruptions from being employed, and to render such interruptions useless. The most practical approach in the short run is to have these countries increase their international financial reserves, as some have done. In the longer run, they should aim at a balanced diversification of their economic resources, at a reduced dependence on

18. 51 U.N. ECOSOC, Supp. 1, at 25, U.N. Doc. E/5073 (1971), *reproduced in* U.N. INFORMATION SERVICE, ROUND-UP OF THE 51ST SESSION OF THE ECONOMIC AND SOCIAL COUNCIL 31-32 (Geneva, July 30, 1971).

19. For the text of the OPEC Communique *see* MIDDLE EAST ECONOMIC SURVEY, March 10, 1972, at 5.

20. *Boumediene Acknowledges Libyan Support During Franco-Algerian Crisis,* MIDDLE EAST ECONOMIC SURVEY, March 3, 1972, at 4.

primary exports and at a joint insurance mechanism. As to the latter suggestion, Algeria, Iraq and Libya agreed on May 23, 1970, to create a joint cooperative fund to aid any of the contracting states that "may suffer harm as a result of a confrontation with the exploiting oil companies."[21] The fund, as of 1973, has not been set up.

CIPEC countries also have attempted to face up to the boycott of their exports, and more generally to "economic aggression." The latter term was defined as "any act which impedes or hinders the exercise of the sovereign right of countries to dispose freely of their national resources in order to further their development." CIPEC countries agreed not to take advantage of the situation created by such aggression against a member state. They also agreed to study methods of raising funds to assist that country, and to cooperate in this matter with other organizations of LDC's exporting raw materials, notably OPEC.[22]

All developing countries, whether importers or exporters, share a concern for the security of trade and economic relations vis-à-vis their important trading partners, the advanced industrial nations. This concern has prompted a group of 21 Latin American countries to place a resolution before the UN General Assembly's Political Committee urging the Assembly to "take appropriate measures for the creation of a system of collective security to encourage sustained development and the expansion of national economies." This group of countries along with other LDC's are fearful of the economic blackmail to which industrial countries can successfully resort with the same effect as military blackmail. As explained by a Latin American diplomat, "We have tried to build safeguards against nuclear terror through a whole variety of disarmament measures in recent years. But our countries can be destroyed by economic terror as practiced by the industrialized countries, whether it is the United States or the Soviet Union or the Common Market, almost as severely as by nuclear terror."[23]

21. For the text of the Algerian-Libyan-Iraqi Joint Communique *see* MIDDLE EAST ECONOMIC SURVEY, May 29, 1970, at 2-3.

22. *Measures of Defense and Solidarity*, in THE COPPER MARKET app. 1 (1972).

23. SOCIETY FOR INT'L DEVELOPMENT, SURVEY OF INTERNATIONAL DEVELOPMENT 3 (1971).

III. NATURAL RESOURCES AND GAIN FROM TRADE

The economies of several developing countries are narrowly based. Their foreign exchange and budgetary receipts and their national income are vulnerable to adverse changes in market and other conditions affecting one or two major export commodities. Ironing out price fluctuations of primary export commodities, however, would in itself be insufficient protection for developing economies. It must be coupled with growth of export earnings and with price stabilization of goods these countries import, notably manufactures. A leading United States lawmaker, Senator Frank Church, has advocated that "as an alternative to the palliative of aid, . . . we lend positive support to developing countries by entering into commercial arrangements that redress the terms of trade which are now rigged against them."[24]

To tackle the problem of protecting the export earnings of developing countries, UNCTAD[25] and other international forums have suggested the stabilization of terms of trade. This principle was applied, although admittedly in a crude fashion, for the first time in 1971 by OPEC in agreement with the international oil companies.[26] The stabilization of terms of trade purports to protect the purchasing power of a unit of export in terms of imports. Assuming this is administratively feasible, there is the risk that an automatic matching of the export price of a primary commodity with increases in the import price index of these countries may render that commodity less competitive, and eventually reduce the demand for it in favor of substitutes.

Demand for primary commodities is usually derived from demand for their finished products. Prices of these finished products are influenced by a number of factors including the price of raw materials. It is significant that the value of raw materials is generally a small portion of the price of end products. By comparison, the shares of labor (wages) and of the state (taxes) are more substantial and generally on the increase in the developed industrial

24. 117 CONG. REC. 38258 (1971); Washington Post, Nov. 7, 1971, § B, at 4.

25. *See, e.g., Report of the Trade and Development Board*, 26 U.N. GAOR, Supp. 15, at 236, U.N. Doc. A/8415/Rev. 1 (1972).

26. *See* Z. MIKDASHI, THE COMMUNITY OF OIL EXPORTING COUNTRIES ch.7 (1972); Mikdashi, *A la recherche d'un accroissement des benéfices économiques: les negotiations par les termes de.l'echange*, 2 ETUDES INTERNATIONALES 529-61 (1971).

countries. This applies to petroleum and metal products. Accordingly, it is unrealistic to impute to primary exporters attempting to stablize or improve the purchasing power of their export earnings the sole responsibility for pricing their commodities out of the market.[27]

It is possible that substitution of one commodity for another will not have a net adverse effect on the developing world if both the beneficiary countries and the losing countries are developing. It is, however, possible that the losers will be the least developed, leading consequently to a decline in world welfare (abstracting considerations of income distribution within these countries). Should the substitution favor commodities produced in the developed countries, say, synthetic packaging materials, at the expense of the developing countries, (in this case producing tin, iron ore or aluminum) world welfare will be worse off. Alternatively, should substitution favor commodities produced in the developing countries, say, petroleum, at the expense of a more costly protected commodity produced in the developed countries (for example, coal), world welfare will be better off. In Western Europe for example, gas oil excise taxes for the major consumer countries (France, Germany, Italy and the United Kingdom) accounted for more than 60 per cent of the price early in 1972 while its domestic competitors, notably coal and nuclear power, were heavily subsidized. Imports on gasoline serve partly to pay for the social infrastructure required in the consumption of these products, such as roads, and partly to offer a convenient and effective means of taxing the national economy.[28]

There are, however, instances of agreements between the governments of both exporting and importing countries to control consumer prices. For example, the United Kingdom obtained from Norway in 1933 a pledge regarding the maximum prices at which the Norwegian state liquor monopoly would sell British whiskey.[29] If a spirit of closer international economic cooperation is to guide transactions among nations, it may be proper to investigate means

27. *See, e.g.*, U.S. STEEL ANN. REP. (recent reports); *'Real' Oil Costs are Still Below 1957 Levels*, PETROLEUM INTELLIGENCE WEEKLY, Mar. 27, 1972, at 5-6.

28. *See, e.g., Pétrole Brut, Essence, Impôt,* BULLETIN MENSUEL D' INFORMATIONS, ENTERPRISE DE RECHERCHES ET D'ACTIVITIES PÉTROLIERES, Sept. 25, 1972, at 1-3.

29. LEAGUE OF NATIONS, TRADE RELATIONS BETWEEN FREE-MARKET AND CONTROLLED ECONOMIES 74 (1943).

of reducing the fiscal and other burdens and trade restrictions imposed by advanced countries on finished products derived from raw materials largely exported by developing countries to the extent that these burdens and restrictions adversely affect their consumption in favor of substitutes.

LDC's are not only concerned about a deterioration in their terms of trade, they are equally concerned about the related problem of devaluation in the currency of major trading countries, notably that of the United States. One Western trade source argued that the American devaluation of 1971 hurt LDC's thus:

> From the standpoint of raw material producers and especially the developing nations, this is a major fraud. Seen in its simplest terms, the industrialized nations have revalued and the developing nations, dependent upon raw materials have devalued and, with the United States as the dominant factor in major commodities, most metals and minerals will tend to follow the American currency. The result is that raw materials will be cheaper for Europe and Japan; for the developing nations, their mineral wealth, in the future, will buy fewer tractors, fewer hospitals, less food.[30]

Alone among LDC's, the OPEC countries, through concerted action, managed to shield themselves against the adverse effect of the dollar devaluations.

The argument often advocated by LDC's of protecting the purchasing power of their export proceeds is essentially an argument in equity. One should guard against its indiscriminate use in reshaping economic relations between primary exporter and importer countries. If the argument were to be applied to commodities with elastic demand, it might hurt exporters. Conversely, if applied to commodities with inelastic demand, it can permit partial exploitation of consumer surplus by the producing countries. In addition, economic development does not hinge solely on the stabilization of terms of trade; other important factors may well prove more crucial.[31]

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30. MINING J., Dec. 24, 1971, at 573.

31. Several scholars have called for the taxing of minerals (including fossil fuels) and metals—the tax to be collected by an international administration—as a means of redistributing wealth in favor of the poor countries. Professor Ian Little, for example, favors arranging commodities in noncompeting groups, and offers three criteria for tax levels: (1) competing commodities within each group should be taxed at relative rates designed to minimize substitution; (2) levels of taxes between groups should vary with their pollution impact and the risk of

IV. Funds for Development and Insurance

As put by a former senior United States official, "The World Bank and the regional banks are important, but they are the chosen instruments of the rich nations, not of the poor."[32] The logic of development would therefore seem to call for new financial institutions. One such institution might be an interregional Third World Bank (TWB), largely owned and financed by nationals and governments of LDC's that happen to be in a surplus capital position. Its function would be to service eligible LDC's worldwide.

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impending exhaustion; and (3) tax levels should maximize the chances of political acceptance. Given the difficulty of accurate determination of the first two criteria, expediency would give the third criterion greater weight.

Ian Little argues that "the demand for each such group of commodities would undoubtedly be very inelastic, implying that the taxes would be mostly passed on to consumers." Little, *International Tax on the Rich to Help the Poor*, The Times (London), May 9, 1972, at 21. This is likely to be the case if private enterprise and government in consuming countries do not react to higher tax-paid costs by developing substitutes to the minerals and metals in question. Little opts for a tax on exports rather than on consumption of products to avoid "considerable distortion" and to reduce "expense in collection." He assumes that additional taxes on producer countries will not hurt them given the inelasticity of demand (or absence of substitutability) for their products. These contentions must be demonstrated over the longer run for various minerals and metals traded internationally before producer countries submit to taxes without assurance that their interests will not be adversely affected.

Estimated tax proceeds from this proposal vary between five and ten billion dollars. Little suggests that the proceeds be disbursed directly to LDC's in inverse relation to their per capita income, with a dividing line for those eligible, possibly countries with per capita incomes of less than $700. He is opposed to giving these resources to existing international institutions and programs for fear that it would result in a corresponding decrease in current levels of contributions by donor nations.

The success of Little's scheme hinges on all major developed consuming countries submitting, since the consumption of minerals and materials varies directly with per capita income, and the richer countries therefore will be paying the bulk of the international tax. Four questions remain: (1) if the rich are invited to pay, will they accept; (2) why should the tax be limited to minerals and metals, and not tax other major commodities, primary and nonprimary; (3) is this scheme an initial step toward a worldwide central fiscal authority, and could this entail a generalized progressive consumption or income tax imposed in all countries for development purposes; and (4) would the long-term interests of exporters of taxed minerals be protected. These are significant problems that ultimately will require a political will for solution.

32. Yost, *Growing Sentiment for Isolationism*, Washington Post, Nov. 7, 1971, § B, at 6.

There are a few developing countries (*e.g.*, a number of mineral exporting countries) that have surplus financial resources. Private citizens, enterprises and government agencies of these countries deliberately have been channeling substantial amounts of their surplus resources to the developed nations. It is difficult to estimate the amount of financial resources held by LDC nationals and agents in the developed money and capital markets, but estimates for oil exporting countries alone reach several billion dollars. However, some surplus capital LDC's are beginning to invest their resources in other LDC's. The leading example of long-term credit offered by a developing country to other developing countries is that of the state-owned Kuwait Fund for Arab Economic Development (KFAED). KFAED loans from 1961 to 1970 amounted to about 350 million dollars.[33] Another developing country, Abu Dhabi, created a similar fund for Arab economic development in 1971 with a capital of 105 million dollars.[34] Kuwait had, by 1972, also offered the World Bank over 243 million dollars in direct financing—by underwriting the Bank's bonds in Kuwait through the Kuwait Investment Company.[35]

The loans provided by Kuwait and Abu Dhabi to countries in the region are not prompted by pure altruism. In fact, most loans earn rates comparable to those granted by the World Bank. Moreover, Abu Dhabi and especially Kuwait have used loans to neighboring Arab countries as a means of winning friends, and of averting possible territorial ambitions. For example, Iraq claimed total sovereignty over all of Kuwait territory in 1961, but in 1964 accepted reluctantly the independence of Kuwait, although boundaries remained disputed until 1973. Iraq has been a large beneficiary of Kuwaiti credits.

To encourage the flow of financial resources and venture capital among developing nations, institutional frameworks aimed at resolving disputes or at insuring risks not normally covered by commercial underwriters must be devised. To insure the investments of expatriate firms, bilateral or multilateral arrangements could be

33. *See* AL-HAMAD, FINANCING ARAB ECONOMIC DEVELOPMENT, THE EXPERIENCE OF THE KUWAIT FUND (KUWAIT FUND FOR ARAB ECON. DEVELOPMENT, May 1972).

34. MIDDLE EAST ECONOMIC SURVEY, July 23, 1971, at 5-7; MIDDLE EAST ECONOMIC SURVEY, July 9, 1971, at 6.

35. International Bank for Regional Development, Press Release, *World Bank Bond Issue in Kuwait* (Aug. 15, 1972).

set up. In fact, most developed market economy countries have bilateral insurance arrangements against so-called political risk losses sustained by their firms on investments in certain developing countries. Such losses may arise from currency inconvertibility, expropriation, or damages from war, revolution or insurrection. Multinational investment insurance is currently under revived active consideration.[36]

The United States Government has been a leader in insuring private American investments in LDC's. It created a government corporation called Overseas Private Investment Corporation (OPIC),[37] which was formally organized on January 19, 1971. According to its legislative charter, OPIC's insurance is available to new investments by American private enterprises in friendly LDC's. The investment project must (a) be commercially sound, (b) be beneficial to the host country, and (c) earn the approval of the United States Government and host country authorities.[38]

To broaden its insurance basis, OPIC successfully negotiated late in 1971 with Lloyd's of London the reinsurance of 250 million dollars of OPIC's outstanding 2.2 billion dollar expropriation insurance covering United States investments in some 70 developing nations and areas.[39] OPIC also placed another large part of its expropriation insurance liability with a group of international underwriters including the Soviet Union's majority-owned Black Sea and Baltic Insurance Company, registered in the United Kingdom as a subsidiary of Ingosstrakh, the Soviet state insurance agency. OPIC's president noted, "It is the first time that an arm of the USSR government has supported the United States government in insuring U.S. private investment overseas. We hope this is the beginning of similar mutually satisfactory arrangements between our two countries."[40] This is an important shift in the policy of Moscow and a departure from its Marxist economic philosophy. In the words of an Indian trade journal, "[t]he meaning of the Rus-

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36. INTERNATIONAL BANK FOR REGIONAL DEVELOPMENT, MULTINATIONAL INVESTMENT INSURANCE, A STAFF REPORT (March 1962).

37. Foreign Assistance Act of 1969, 22 U.S.C. §§ 2191-99 (1970).

38. 22 U.S.C. § 2191 (1970).

39. OPIC, 1 TOPICS 8 (No. 1, 1972). Substantial additional reinsurance was made with Lloyds, European and American firms in 1973.

40. OPIC, *More Reinsurance, Russians Included,* 1 TOPICS 7 (No. 2, 1972); *USSR Company Participates in United States Government Venture,* SURVEY OF INTERNATIONAL DEVELOPMENT 3 (Soc'y for Int'l Development, May 1972).

sian decision to underwrite American investment is this: Whenever a developing country nationalizes a firm without paying adequate compensation it is not only the western [United States] firm but the Soviet Union, as an insurer, who would also be a loser."[41]

United States and European international companies, which are eligible for their own national insurance program, favor multinational insurance schemes. The latter system, argued the President of Anaconda, would help stimulate needed investments in less stable areas "by offering more protection and certainty than could a single-nation agency . . . ."[42] It should make "unfair nationalization" against one investing country "an offense" against all investing countries, according to Sir Ronald Prain.[43] Multinational insurance has also been supported by a United States presidential commission. It recommended "the creation of a multilateral insurance agency which would include the less developed countries among its membership, and in which the costs would be equitably shared among the members."[44] It further recommended "that the United States encourage developing countries to adhere to the Convention on the Settlement of Investment Disputes, and to use the facilities provided by the Convention."[45] Latin American governments, however, view United States-inspired guarantee and insurance schemes for direct foreign investment with skepticism and suspicion, and have flatly rejected the World Bank's convention on the settlement of investment disputes as an infringement of national sovereignty and contrary to national constitutions. Guarantees and arbitration procedures offered and administered jointly by Latin American nations, perhaps with the help of regional or subregional institutions, may prove to be workable and acceptable alternatives.[46] This is similar to the suggestions of most Middle East countries. The latter fear that a worldwide multilat-

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41. *Soviet Union Underwrites U.S. Investments*, COMMERCE, May 6, 1972, at 1158 (Bombay).

42. Keynote address by Jay Parkinson, American Metal Market's Second Annual London Forum, Oct. 26, 1970, at 16.

43. Interview with Sir Ronald Prain, Chairman of RST International Metals, Ltd., in METAL BULL., Oct. 22, 1970, at 29.

44. COMM'N ON INT'L TRADE & INVESTMENT POLICY, 2 UNITED STATES INTERNATIONAL ECONOMIC POLICY IN AN INTERDEPENDENT WORLD 250 (July 1971).

45. *Id.* at 252-53.

46. *Cf.* Alejandro, *Direct Foreign Investment in Latin America*, THE INTERNATIONAL CORPORATION, A SYMPOSIUM 338-39 (C.P. Kindleberger ed. 1970).

eral scheme of insurance and dispute settlement would be dominated by the rich and powerful developed countries.

The first known example of insurance against investment risks on a regional basis among LDC's is that of the Central African countries of Dahomey, Ivory Coast, Niger, Togo and Upper Volta. By a treaty signed on June 9, 1966, these countries established a joint loan guarantee fund known as "Fonds d'entraide et de guarantie des emprunts due Conseil de l'Entente." The initial resources pool of the Fund amounted to 5.3 million dollars subscribed by members.[47] Other developing countries recently have recognized the advantages of a regional scheme for reducing noneconomic uncertainties faced by current and potential investors from developing countries venturing into other developing countries. One notable merit of such a scheme is to make financial and investment resources of capital-surplus developing countries more readily available to capital-deficit countries instead of these resources being siphoned to the developed market economy countries, as has been usually the case. Egypt, Jordan, Kuwait, Sudan and Syria agreed in May 1971 to set up an Arab Establishment for Investment Insurance to be based in Kuwait with a capital of 10 million Kuwaiti dinars.[48] Its main function would be to issue guarantees against losses sustained by Arab investors in Arab member countries. The insurance would provide protection against losses from noncommercial risks such as expropriation, nationalization or confiscation of property; inability to transfer income or principal out of the host country as a result of unforeseen restrictions; and losses due to acts of war, military operations or civil disturbances.[49]

Among the capital-importing LDC's, Egypt's experience is worth noting, bearing in mind that this country is ostensibly "socialist." To attract large potential investors from neighboring countries, especially from Kuwait, Libya, Saudi Arabia and the Arab-emirates, Egypt created a new financial institution, the Arab International Bank for Foreign Trade and Development (AIB) with an original capital of ten million pound sterling fully subscribed

47. Dep't Economic & Social Affairs, *Foreign Investment in Developing Countries*, U.N. Doc. E/4466 (1968), at 26.

48. [1971] MIDDLE EAST J. 507.

49. *See Eighth Annual Report, 1969-1970*, KUWAIT FUND FOR ARAB ECONOMIC DEVELOPMENT 10-11; Nasr, *The Kuwait Fund Scheme for the Guarantee of Inter-Arab Investments*, [1972] KUWAIT FUND FOR ARAB ECON. DEVELOPMENT (May).

by the Central Bank of Egypt. Any increase in capital may be subscribed by Arab non-Egyptian nationals, *i.e.* governments, corporate bodies or individuals. AIB's function is to finance Egypt's foreign trade and to act as agent for foreign investors in identifying, appraising and financing projects. The bank is exempt from all taxes and regulations, and deals entirely in convertible currencies.[50] Shortly after the law was enacted, Arab capital began flowing in. One leading investor (with two million pounds) was Sheikh Abdullah Al Moborak Al Sabbah of Kuwait who became a member of the Board;[51] another was the Federation of Arab Gulf Emirates (six million pounds); a third was the Libyan Government (ten million pounds).[52]

Along with the creation of the Bank, Egypt promulgated a foreign investment law providing for a five-year tax and customs holiday, freedom to repatriate principal and profits and guarantees against nationalization or expropriation. Such investments can be made in industries within delineated "free zones," areas not subject to several of the restrictions normally applying to domestic enterprises.[53] As to noncommercial risks, an official Egyptian spokesman stated:

> Foreign investment will not be subject to sequestration, nationalization, nor expropriation except in cases involving the national interest, and then fair compensation must be paid. The amount of the compensation shall be estimated within six months. The amount of the compensation shall be transferred in the same currency as that in which the investment was originally made, and in annual instalments not exceeding five years. Disagreements about the amount of the compensation shall be resolved by arbitration.[54]

The amount of compensation for expropriated property is still a critical problem. The principles for determining compensation dif-

50. Law No. 77, Oct. 10, 1971, Concerning the Establishment of the Egyptian International Bank for Foreign Trade and Development, S.A.E.; Statutes of the Egyptian International Bank for Foreign Trade and Development.

51. THE ECONOMIST, Nov. 13, 1971, at 93; The Washington Post, June 9, 1971, at M4.

52. MIDDLE EAST ECONOMIC SURVEY, June 2, 1972, at 5.

53. Decree Law No. 65 for 1971 Concerning the Investment of the Arab Funds and Free Zones (English text in I. SHIHATA, TREATMENT OF FOREIGN INVESTMENTS IN EGYPT 237-52 (1972)); Washington Post, Sept. 26, 1971, at A22.

54. Address by A.M. Kaissouni, American-Arab Association for Industry and Commerce Meeting in New York, Nov. 3, 1971.

fer dramatically between buyer and seller. Each can be internally logical. Accordingly, it may prove more beneficial to agree on the approach for assessing compensation, in order to avoid future disputes on this question.

Not only have LDC's favored multinational insurance schemes for foreign investments falling under their control, one LDC country has gone to the limit of allowing a foreign operator to deduct reserves for self-insurance if commercial insurance is not purchased. This is the case of Indonesia's agreement with a consortium of foreign firms called Indonesian Nickel. The host government has even accepted the unprecedented practice of leaving the determination and size of such deduction to the discretion of the foreign concessionaire.[55]

V. "NATURALIZING" FOREIGN INVESTMENTS

Students of international economic relations agree that conflicts between host governments and international firms center on the issue of extraterritoriality.[56] Other sources of conflict between host countries and international firms may arise from the latter patronizing suppliers and contractors outside the host country, dominating the domestic credit market to the detriment of the smaller, less resourceful local firms, refraining from plowing back earnings into nationally desirable new activities, and refusing to allow participation of national capital and management. Various resolutions of

55. To several scholars and practitioners of development, an assured flow of financial resources is not the major bottleneck to development; rather, it is primarily the absence of managerial skills. The manager of a development organization concluded "finance can normally be obtained from outside a developing country, given a certain minimum level of stability, to supplement local resources provided the right kind of projects are there. In fact, it is in most cases the scarcity of the right sort of people in the right organization mobilized to identify, investigate, promote, and finally to manage commercial projects that constitutes the effective limiting factor on development." Rendell, *Commonwealth Development Corporation Experience with Joint Ventures*, in PRIVATE FOREIGN INVESTMENT AND THE DEVELOPING WORLD 248 (P. Ady ed. 1971).

56. *E.g.*, Johnson, *The Multinational Corporation as a Development Agent*, 1970 COLUM. J. WORLD BUS. 25; I. LITVAK & C. MAULE, FOREIGN INVESTMENT: THE EXPERIENCE OF HOST COUNTRIES 23-27 (1970); Rosenstein-Rodan, *Multinational Investment in the Framework of Latin American Integration*, in MULTINATIONAL INVESTMENT, PUBLIC AND PRIVATE, IN THE ECONOMIC DEVELOPMENT AND INTEGRATION OF LATIN AMERICA 33 (1968). [April 1968] ROUND TABLE, INTER-AMERICAN DEVELOPMENT BANK, BOGOTA, COLOMBIA, 80-87.

the United Nations (in response to LDC wishes) have upheld solemnly the inalienable right of permanent national sovereignty over natural resources. The Council of Ministers of the Organization of African Unity, in a resolution passed at its Seventh Ordinary Session in Addis Ababa on June 15, 1971, went further. Besides reaffirming national sovereignty in the exploitation of natural resources, the OAU resolution "denounces the economic and political pressures which certain developed countries are attempting to bear on African countries with a view to threatening their development and to obstructing them in the exercize of their sovereignty over their natural resources, [and] recommends the formation of an African Union of Mineral Exporting Countries."[57]

To ease tension and reduce the chances of confrontation between expatriate firms and their parent countries on one hand, and host LDC's sensitive about their "sovereignty" on the other hand, changes are needed in contractual relations between the parties concerned. One could advance a variety of approaches, starting with the renegotiation of economic terms of foreign concessions, and reaching the gradual divestment of foreign enterprise. The merits or demerits of each approach should be analyzed in light of each host country's social, political and economic circumstances.[58]

A. *Renegotiation*

A number of countries have enacted legislation to permit the renegotiation of certain economic terms of contracts entered into by government and private business. Indeed, Professor Kindleberger has written, "Renegotiations of contracts with long life when the underlying conditions change is familiar in the Anglo-Saxon tradition. We have renegotiation of U.S. Government procurement

57. CM/Res. 245 (XVII). Host countries, whether developed or developing, have attempted to counter the intrusion of foreign laws and regulations. Most prominent in this respect have been the Canadian, Japanese and West European countries that have limited the extension of foreign laws while still providing opportunities for foreign investments to play a positive role in selected sectors of their economies. LDC's, by comparison, have generally been less judicious and effective. Their response to foreign firms and to parent countries' laws may vary from inaction to drastic measures such as nationalization—sometimes with secondary regard to social costs.

58. *See* Kindleberger, *U.S. Policy Toward Direct Investment with Special Reference to the Less Developed Countries*, in 2 UNITED STATES INTERNATIONAL ECONOMIC POLICY IN AN INTERDEPENDENT WORLD 338.

when subsequent information reveals that profits would be exorbitant at the costs the contractor is able to achieve."[59] The United States Renegotiation Act of 1951, for example, aims at profit limitation on defense and space contracts and related subcontracts by authorizing the recoupment of excessive profits. By June 30, 1971, Board determinations of excessive profits aggregated 1.095 billion dollars and voluntary refunds and price reductions amounted to more than 1.36 billion dollars.[60] The Government's decisions on normal return and excessive profits are not confined to procurement contracts; they also pertain to the public utilities field. Moreover, United States authorities have stretched their regulation of normal return to companies operating beyond their national boundaries. Thus the Federal Power Commission recommended that return on equity investments by El Paso Natural Gas from the export of Algerian natural gas to the United States be limited to sixteen per cent.[61]

The renegotiation of certain economic terms of long-term contracts provides a measure of flexibility for adapting to changing circumstances. It could help the firm by lightening its fiscal burden if mineral discoveries prove disappointing, and could help the host country by providing it with the opportunity of benefiting from windfall gains, or from tax credits in the firm's home country.

Some LDC's have attempted to emulate the United States experience. They have, on several occasions, asked for the renegotiation of contracts affecting the exploitation of their natural resources. Several host governments, as owners and lessors of these resources, have claimed the right of recouping excess profits. Others have asked for equity and management participation in mineral ventures, but countries at an early stage of development, like Abu Dhabi in the Arabian peninsula, have been careful not to seek immediate control over their foreign owned and operated enterprises. Commenting on the subject of national control, that country's Minister of Petroleum and Industry said: "We are a small country of limited means. . . . Other countries can afford to go faster by taking big leaps ahead. For us, it would be more prudent

59. C. KINDLEBERGER, AMERICAN BUSINESS ABROAD 151 (1969).

60. 16 RENEGOTIATION BD. ANN. REP. 1-2 (1971).

61. Initial Brief of the Federal Power Commission on Algeria Gas Imports by El Paso, Aug. 16, 1971, at 25 (1971); 47 F.P.C. ___ (Opinion No. 622, June 28, 1972).

to move slowly but safely. First of all, we have to constitute the cadres necessary for the exploitation of our resources and the development of our country."[62]

B. *Joint Ventures*

Through joint ventures, host governments hope to influence their foreign partners more effectively than they would be able to influence wholly foreign-owned concessions, possibly to induce the joint venture to carry out other business activities ranking high in national priorities. According to Kenneth Kaunda, the President of Zambia, joint ventures between foreign companies and ZIMCO, the national development group, are more conducive to growth than total national ownership.[63]

A number of foreign concessionaires have offered host governments participation in their ventures at a distant future date from the start of operation, after reaping the attractive profits they had hoped for. One example from the mining industry is the iron ore concession granted by Peru to Marcona Mining Company in 1952. The Peruvian state-owned steel company, Corporacion Peruana del Santa, holds an option to acquire 50 per cent ownership in 1982 (30 years after the original award date) without cash investment.[64]

International firms recently have accelerated the process of host country participation, albeit reluctantly. Some host governments

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62. *See* ARAB OIL AND GAS, Dec. 16, 1971, at 10.

63. "In order that this growth may continue unfettered ZIMCO is going to need money and technical expertise and this is where our philosophy of permanent partnership as against transient partnership is in our opinion particularly suitable to our situation. We need to augment our domestic sources of investment with foreign sources of investment. We need to augment our domestic skills with the sophisticated technical know-how of other countries. We need partners in progress." President Kenneth Kaunda of Zambia, CHAIRMAN'S STATEMENT, 1971 (Zambia Industrial and Mining Corp., Ltd. 1972).

64. Robinson, *Competition in the Sale of Iron Ore in World Markets*, XI CONVENCION DE INGENIEROS DE MINAS DEL PERU 2 (1969). The concessionaire Marcona exploited to advantage the fact that it had among its shareholders the politically influential Prado family. (In 1960, the President of Peru was Manuel Prado, while the president of Marcona was Max Pena Prado.) These associations have apparently helped the company to obtain more attractive terms, to the detriment of Peru's better interests. *See* W. PURSER, METAL-MINING IN PERU, PAST AND PRESENT 156-59 (1971). The Prado family, in a joint 50/50 venture with Standard Oil of California, won also a refinery concession in 1960. *See* A. QUIJANO, NATIONALISM AND CAPITALISM IN PERU: A STUDY IN NEO-IMPERIALISM (1971).

even have obtained majority ownership but foreign partners have demanded assurances that they will share effectively in decision making in the major business areas of budgeting and planning, production and control, pricing and marketing, and organizing and staffing. Host governments have been able to achieve this form of partnership when they could offer comparatively attractive terms for domestic inputs, such as fiscal incentives, and assured domestic or export markets, or when they could play on the rivalry of several firms. According to one student of international business, "the resistance of the enterprise to any threat to its centralized control has been broken only when technology or marketing [or production, this author adds] control has slipped out of the hands of the oligopolists."[65] In support of majority ownership in joint ventures, one empirical investigation dealing with Canada concludes that "the alleged redistribution of oligopoly profits from foreigners to Canadians may be an illusion"[66] if minority ownership of foreign enterprises is promoted. That author argues that "the ultimate impact of promoting minority ownership may be to erode the political basis of other, more effective policies seeking to control foreign investment behavior."[67]

To increase national ownership of key industries, several developed countries have offered financial aid to nationals. The Australian Government, for example, established on June 10, 1970, an Australian Industry Development Corporation to assist financially Australians who are interested in acquiring ownership of, and eventually control over, industries and resources hitherto dominated by foreign interests. LDC's, as compared with Canada or Australia, are far less equipped to protect their interests with minority ownership. There are many examples of "straw man" domestic partners, private or state owned, that do not play an active role in enterprises labelled as "joint."

C. *Service Contracts*

Several host countries, in their search for economic independ-

65. Wells, *The Multinational Business Enterprise: What Kind of International Organization?*, 25 INT'L ORGANIZATION 458 (1971). *See also* Franko, *Do Joint Ventures Still Make Sense in Europe?*, [Jan.-Feb. 1972] WORLDWIDE P & I PLANNING 22, 25-30.

66. HORST, ON THE BENEFITS OF DOMESTIC MINORITY OWNERSHIP OF FOREIGN-CONTROLLED FIRMS 2-3 (Harvard Inst. of Econ. Research No. 176, 1971).

67. *Id.* at 3.

ence, prefer to have the principal say in managing their resources, while depending on expatriates for technical advice for a limited period of time. These countries have favored the service contract approach. Under one type of service contract arrangement the foreign firm assumes the managerial and technical responsibility and the financial and operational risks of exploring, developing and processing natural resources on its own, over a prearranged period. In return, the venturing firm is rewarded, short of a share of ownership, with a "fee." This can be a payment in kind or in money, and can be graduated according to size of discoveries, profits, foreign exchange savings, ventured resources or other variables. Service contracts are extremely flexible devices that meet the needs of host countries for filling gaps in managerial know-how, technology and other inputs. They can be adapted to widely diverse circumstances, and may satisfy a host country's objective of greater control over its natural resources consistent with maximum national economic gain.[68]

Although international mineral enterprises have generally favored achieving vertical integration, mostly in the form of wholly owned subsidiaries, in the absence of such options, they have agreed to joint ventures or service contracts. Faced with reasons for exclusive domestic ownership, the international companies also have settled for long-term supply contracts. These contracts can "tie" the domestic operation to the international enterprise, providing for specified shipments, defined quantities, set prices, financing and even supervised production. Supply contracts constitute, in effect, an informal system of vertical integration with no formal relations of ownership. This interdependence builds economic security of flows for the buying and selling parties.

D. *Divestment*

In the petroleum and mining industries, it is common for concessionaires to relinquish their properties to host governments at the end of the lease period, which may extend over several decades.[69] To insure that mineral properties are kept in good working condition until the expiration of concessions, many host countries have

68. *See* G. MEIER, LEADING ISSUES IN ECONOMIC DEVELOPMENT 306-08 (2d ed. 1970).

69. *See* Z. MIKDASHI, A FINANCIAL ANALYSIS OF MIDDLE EASTERN OIL CONCESSIONS: 1901-1965, at 293-314 (1966).

passed special rules and regulations. The Venezuelan Act requires concessionaires to contribute to a Guarantee Fund at the rate of ten per cent of their depreciation charge used for income tax purposes. The contributions to the Fund will be returned intact if concessionaires revert their assets in good condition. According to President Caldera of Venezuela: "The country has taken an alert position to guard and ensure the abidance by these rules, so that when reversion takes place [in 1983], in accordance with the preexistent legal regulation, Venezuela would not only receive some waste lands, abandoned wells and a few pieces of scrap iron."[70]

Few concessions, however, provide in the original agreements for purchase options or for the phasing out of foreign ownership and control during the life of the contract. Purchase options have the obvious advantage from the host country standpoint of providing national interests with the opportunity for profitable investment and for learning the mineral business during a period of partnership with the international firm.

With the growth of economic nationalism, some profitable foreign-owned ventures may have to accept a gradual divestment of their properties in LDC's, starting within a few years from the beginning of commercial operations. The expatriate companies would then turn from producers and processors of raw materials in these countries into buyers of these materials from the host countries' national companies. Optimal divestment calls for devising a framework for the orderly, gradual and appropriate timing, in accordance with the socio-economic circumstances of the country concerned, of transfer of ownership and management from expatriate firms to host country interests. Payment for the transfer of ownership can be made regularly by the host government paying in kind with the commodities produced, or in money with royalty or income tax due to it. Alternatively, nationals can be offered the opportunity of buying out the foreign-owned ventures, assuming they have the resources.

Some scholars, however, have questioned the wisdom of divestment applied across the board. In a number of cases, international firms continue to contribute to national economies through a

70. *Reprinted in* an Address by Hugo Pérez La Salvia, Minister of Mines and Hydrocarbons, before the Pan American Society of New England in Boston, April 25, 1972.

broadening and deepening of their involvement. Accordingly, "a program of divestiture that cuts off this process could be hurtful to the governments that were demanding it."[71] A United States presidential commission came out bluntly against programs aimed at facilitating the sale and transfer of ownership of foreign affiliates to host countries. It said:

> In some countries, an important new deterrent to investment from abroad is developing—the "fade-out" arrangement, which requires that established as well as new foreign investors sell their ownership interests to local owners, either government or private, over a period of years. We believe the United States should actively discourage host countries from instituting fade-out requirements and from prescribing the form and extent of local equity participation.[72]

On the other hand, a number of other scholars and policy makers have advocated the transfer of ownership and control of foreign ventures to local interests as a means of speeding up economic development.[73] It is possible that local ownership to the exclusion of foreign interests can reduce the availability of foreign capital and know-how, and retard development. There is an optimal mix for each country of what is politically desirable in terms of foreign ownership and what is economically achievable in national development with various levels of foreign participation. The divestment-investment approach was discussed in 1968 by a Round Table on Multinational Investment, sponsored by the Inter-American Development Bank. It viewed foreign investment "as a rotating fund that temporarily, over periods of varying lengths, depending on the kind of investment, offsets the shortage of technical and financial resources on the part of local enterprise." According to this view, "the foreign investor should be prepared at all times to transfer majority interest in the firm to local investors

71. *See, e.g.*, R. VERNON, *Problems and Policies Regarding Multinational Enterprises*, UNITED STATES INTERNATIONAL POLICY IN AN INTERDEPENDENT WORLD 999 (1971). *See also* R. VERNON, SOVEREIGNTY AT BAY: THE MULTINATIONAL SPREAD OF U.S. ENTERPRISES 269 (1971).

72. UNITED STATES INTERNATIONAL ECONOMIC POLICY IN AN INTERDEPENDENT WORLD 251 (Report to the President, submitted by the Comm'n on Int'l Trade and Investment Policy 1971).

73. *See, e.g.*, Hirschman, *How to Divest in Latin America, and Why*, in ESSAYS IN INTERNATIONAL FINANCE (1969); Streeten, *Obstacles to Private Foreign Investment in the LDC's*, [1970] COLUM. J. WORLD BUS. 37-39.

and be ready to seek other investment opportunities in those activities where technological contributions continue to be of fundamental importance."[74] To carry out the divestment process it may be advisable to be selective. The host country may be offered the initiative in pointing to those activities or "firms where foreign ownership is felt to be irksome,"[75]—probably those firms considered too dominant in key sectors of the country's economy.

To smooth the transfer of foreign interests in developing countries, while not constricting availability of foreign capital and know-how to developing countries, there may therefore be a need for a novel financial institution. This could be called the International Divestment-Investment Corporation (IDIC), and could be entrusted with the functions of supervising the progressive liquidation of foreign investments and the transfer of their ownership and management to national interests. It should also act as a financier or trustee, or both, for a period of transition when the expatriate firms are ready and willing to make the transfer of assets, but when national interests may not have adequate financial resources to pay for the transfer at that time, or may not have the managerial capacity and technical know-how to administer these assets. IDIC could furthermore be entrusted with the function of guarantor of debtor obligations, and could be called on to act as a neutral arbiter in settling disputes or disagreements about the valuation of assets to be transferred.

The function of financial intermediary requires that IDIC have resources of its own. Whether these resources should be raised from the international money and capital markets, or whether they should be raised from existing international financial institutions deserves special investigation. Such an investigation will also have to assess the basis of contributions to be made by divesting-investing firms, host countries and parent countries. On this point, Raul Prebisch commented,

> [I]t may perhaps be difficult to understand how an advanced country could contribute financial resources in order to enable Latin American [and other LDC's, one may add] private initiative to obtain control of undertakings which would otherwise remain in the

74. Inter-American Development Bank, *Introduction*, in MULTINATIONAL INVESTMENT, PUBLIC AND PRIVATE, IN THE ECONOMIC DEVELOPMENT AND INTEGRATION OF LATIN AMERICA 15 (1968).

75. *See* Hirschman, *supra* note 73, at 13.

> hands of the developed country's private enterprise. But this would be too short-sighted a view. . . . The continuing process of technological improvement will leave foreign enterprise ample scope for action, since as soon as domestic initiative has acquired a controlling interest in certain enterprises, new opportunities for association on a basis of reciprocal benefits will supervene.[76]

Already, the Commonwealth Development Corporation (CDC), specifically set up in 1948 by the British Treasury to contribute to the development of LDC's (until 1969 confined to the Commonwealth) through equity capital, soft-term loans and managerial know-how, has agreed to arrange for a gradual transfer to local ownership and management of the productive enterprises it has helped set up. This transfer is done selectively. The General Manager of CDC, Sir William Rendell, commented:

> We tend to be inveterate "ad-hocers" on this, formulas that give options for purchasing X per cent of the shares of such-and-such a company at such-and-such a price over a given period of years. But the answer is that it is our policy to dispose of our projects when we can get a reasonable price for them and when we can afford to do so, and particularly—I have stressed this—to local investors, not just to sell them to somebody in London who may wish to make an African investment—if there are such people. That is part of our policy.[77]

A broadly similar function is performed by the International Finance Corporation (IFC), a member of the World Bank group. One major difference in the nature of the functions of the two institutions is that IFC is committed to assisting solely private enterprises, to the explicit exclusion of government-owned or controlled institutions, while no such limitation is found with CDC.

The timing of divestment should normally come after a period when the foreign investor has been able to recoup both capital and adequate profits given the risks attendant to its investment. This period would be longer for a company exploring for a mineral in a virgin territory, than for one exploring in an already proven territory. Flexibility should obtain in the sale of investments, and the host government and its nationals should be eligible to exercise the

76. R. PREBISCH, CHANGE AND DEVELOPMENT—LATIN AMERICA'S GREAT TASK: REPORT SUBMITTED TO THE INTER-AMERICAN DEVELOPMENT BANK 171 (1971).

77. PRIVATE FOREIGN INVESTMENT AND THE DEVELOPING WORLD (P. Ady ed. 1971).

purchase option over reasonably long periods, to allow for their ability to pay for and manage the domestic venture. Equally, the expatriate company should be given the opportunity of running the venture for a longer period alone, or in partnership with local interests, if the two parties find it in their mutual interest to do so.[78]

It is possible that leading creditor-investor developed countries and their international firms would be reluctant to support an institution such as IDIC.[79] In view of the presence of likely political difficulties, it is more practical to have each country establish explicitly its legal framework for foreign enterprises with divestment, reinvestment or other guidelines agreed on in advance in individual contracts, and translated to meet the particular needs of a country and the international enterprise concerned. There are a number of historical cases of international companies accepting voluntarily the conversion of their investments into joint ventures with domestic enterprises, both state-owned and privately-owned. There are also cases in which the international enterprise has voluntarily divested or sold one affiliate to develop other activities.

A notable example is that of Mexico. Mineral deposits in that country are owned by the state, and mining concessions were given, until 1961, in perpetuity, assuming normal conditions. The Mexican Government introduced in 1961 tax laws reducing to 25 years the life of mining concessions with renewals subject to majority equity interest by Mexican nationals. To induce such "Mexicanization," the government granted a 50 per cent reduction in production and export taxes. Several international enterprises have found the Mexican offer enticing. Anaconda, historically the largest producer of Mexican copper, took advantage of the Mexicanization law in 1971. The principal obstacle in the process of its divestment was "a shortage of liquid investment capital in Mexico available to purchase a majority interest."[80] The largest group of Mexican investors with available resources turned out to be government agencies.

For another example, the International Telephone and Telegraph Company (U.S.) sold, in 1969, its telephone system in Peru

78. *See also* R. VERNON, *supra* note 71, at 1000.

79. *See* INTER-AMERICAN DEVELOPMENT BANK, THE IBD'S FIRST DECADE AND PERSPECTIVES FOR THE FUTURE 38, 157, 233, 235 (Round Table at Punta del Este, Uruguay, April 1970).

80. THE ANACONDA COMPANY, ANNUAL REPORT 9 (1971).

to the government for 17.9 million dollars and agreed to use 8.2 million dollars from the proceeds to expand locally in the hotel business and to set up a joint venture with the government for the construction of a telephone equipment factory.[81] Probably the most elaborate agreement for divestment-investment has been that between a Canadian holding company, Brazilian Light and Power Company, Ltd., and the federal government of Brazil. The company, which is controlled by North American and West European capital, agreed to sell in 1966 its telephone assets for 96.3 million dollars. It concurrently agreed to reinvest 65 million dollars in Brazilian ventures, and to observe important guidelines, mainly: (a) the enterprises invested in should contribute to Brazil's development; (b) investment should be used to augment productive capacity, not to buy out existing owners; and (c) investment should be as a minority shareholder only. The Brazilian precedent could well offer a pattern worthy of emulation by other developing countries.[82]

With adequate incentives, a divestment-investment mechanism applying to foreign enterprises could yield the host country valuable benefits in the transfer of technology and know-how, in the development of managerial ability, in the acquisition of innovating methods and processes of production and in the creation of successive and successful ventures, hopefully leading to a self-sustained momentum of progressive development. The orderly transfer of management and ownership to national interests need not, furthermore, lead to a divorce between the international firm and its erstwhile affiliate. The new domestic venture can and may well be advised to maintain business relations with its former parent, especially to arrange for managerial and technical cooperation, and for the use of trademarks to take advantage of the international company's continually evolving technology.[83] This author adds that it is also in the interest of the divested domestic venture to maintain normal trading relations with the former international parent and its clients. This is especially beneficial when the domestic venture is producing specialized items that fit specifically

81. W. FRIEDMANN & J-P. BEGUIN, JOINT INTERNATIONAL BUSINESS VENTURES IN DEVELOPING COUNTRIES: CASE STUDIES AND ANALYSIS OF RECENT TRENDS 397-99 (1971).

82. *Id.* at 294-95.

83. *See* R. PREBISCH, *supra* note 76, at 169-70.

the production system of the international enterprise. It is also useful when the domestic venture does not have ready access to international markets.

The policy of requiring foreign private enterprises, old and new, to divest gradually major portions of their ownership and control in favor of local interests including employees has been incorporated in the Andean Pact,[84] which includes Colombia, Ecuador, Bolivia, Peru and Chile. The Pact requires an obligatory divestment on the part of all wholly foreign-owned enterprises of a minimum of fifteen per cent of the capital within a period not exceeding three years from the date of enforcement of the Cartagena agreement, or the date of production of the enterprise. Divestment is graduated to 51 per cent in favor of nationals, with slower schedules (over twenty years) for Bolivia and Ecuador than for Chile, Colombia and Peru (over fifteen years). In *quid pro quo* for gradual divestment, the divesting firms benefit from the incentive of duty-free movement of goods within the five countries.

The challenge from the host country standpoint is to attract the foreign firm to invest its resources (capital, managerial know-how and technology) in the development and production of a host country's resources. To do so, the firm normally requires adequate control over a certain period of the life of the project as a guarantee of return on its investments. On the other hand, the host country should be assured of the expectation of national control through buy-out options. Raymond Vernon believes that the foreign investor in raw materials can rationally require control for a period of "15 years and maybe much shorter," expect to recoup its investment plus its opportunity cost, and accept surrender of its concession at the end of that period.[85]

Empirical case studies have shown that leading American companies have had significant influence on the legislature and on the administration to prevent divestiture overseas even at times when American public interest was not necessarily being adversely affected.[86] Divestment must be accomplished with at least the tacit

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84. *See* The Commission of the Acuerdo de Cartagena, *Common Treatment of Foreign Capital, Trademarks, Patents, Licensing Agreements and Royalties in the Andean Common Market*, 10 J. COMM. MKT. STUD. 339-59 (1972).

85. R. VERNON, SOME NOTES ON CONCESSIONS POLICY (Harvard Univ. Center for Int'l Affairs, Development Advisory Service Rep. No. 117, Sept. 1968).

86. For an excellent study by a United States diplomat and economist see R. BLOOMFIELD, WHO MAKES AMERICAN FOREIGN POLICY? SOME LATIN AMERICAN CASE

approval or neutrality of major industrial countries, lest these countries use their potent trade, aid and other instruments against LDC's. For example, if "prompt, adequate, and effective" compensation has not been paid to nationalized United States interests, the President can cut bilateral aid (the so-called "Hickenlooper Amendment" to the Foreign Assistance Act), and instruct United States executive directors in the World Bank Group, the Asian Bank and the Inter-American Development Bank to vote against any loan for the benefit of the country concerned.[87] President Nixon has come out sharply against LDC's nationalization of United States property. As he put it, his new approach to the developing nations "includes strong penalties designed to discourage the expropriation of American property abroad."[88]

Spokesmen for developing countries have appealed to international agencies including the IBRD to become more attentive to the needs of the Third World countries. They have pleaded in favor of the unimpeded restitution of property to its lawful original owners, and have argued that "it is inconceivable that a country recuperating wealth of which it was dispossessed at one time in its history should be asked to own property from others by indemnification, in the form, for example, of rent for the subsoil."[89]

It is generally accepted by policy makers and scholars that there is need for improvements in the framework of world economic relations within which the development process can be accelerated. But the restructuring of the world economic order in a global strategy for development depends largely on the goodwill and cooperation of the rich countries, and their international enterprises. In summing up his position at congressional hearings on United States foreign economic policy, Raymond Vernon pointedly urged the United States to share with other countries its growing economic power. He realistically noted, however, that this would call

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STUDIES (Harvard Univ. Center for Int'l Affairs, March 1972). *See also* Address by Mason Gaffney, *Benefits of Military Spending*, to the 10th Annual Conference of the Committee on Taxation, Resources, and Economic Development, in Madison, Wisconsin, Oct. 25, 1971.

87. Act of March 10, 1972, Pub. L. No. 92-245; Act of March 10, 1972, Pub. L. No. 92-246; Act of March 10, 1972, Pub. L. No. 92-247.

88. Nixon, *The Real Road to Peace*, U.S. NEWS & WORLD REPORT, June 26, 1972, at 39.

89. International Monetary Fund, Summary Proceedings, Annual Meeting, 1971, at 94 (1972). *See also* Sonatrach, *supra* note 9.

for a wisdom that has been a rare quality in the life of nations.[90]

The opportunity for greater world harmony lies in promoting greater global interdependence in a variety of fields with fair sharing of benefits by all parties concerned. There are already several examples of successful international cooperative ventures, and this article has attempted to suggest additional possibilities. The suggestions presented above vary in nature. Some are oriented toward competitiveness (*e.g.*, RAS), while others aim at exploiting market forces through group action. They can, however, be reconciled on the basis that they aim generally at serving the dual objectives of promoting global harmony while improving, in favor of LDC's, the distribution of gain from primary trade. All types of group action assume the presence of some measure of political goodwill for cooperation among nations.

Of the suggestions presented above, it appears that the centralized exchange of information (RAS) is likely to encounter the least resistance, and accordingly appears more readily enforceable. RAS can also promote communication, leading probably to improved mutual trust and cooperation. The development of new financial and guarantee institutions among or for LDC's could be another move in the realm of the practical. Of course, this article has in no way exhausted the list of promising fields for possible cooperation in extractive industries between business and government at the national, regional and international level. Conservation of nonrenewable natural resources, and the protection of the environment are two of the areas for possible cooperation worthy of immediate consideration.

90. "We are at a point of history in which increased economic interdependence looks close to inevitable. But it is a lopsided interdependence, one in which the United States is seen as gaining most from the continuation of the trend, and losing least from its interruption. From a political and psychological point of view, that is a dangerous situation. If we are to mitigate the tension that the situation generates, it will be by action that comes hard to the nation state: by curbing the full exercise of our overwhelming economic power and by pooling that power with others. That kind of action will take a kind of wisdom and restraint which is rare in the history of nations." Testimony of Raymond Vernon, *Hearings Before the Subcomm. on Foreign Economic Policy of the Joint Economic Comm.*, 91st Cong., 1st Sess. 152 (1970).