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# THE QUESTION OF COMPENSATION: A THIRD WORLD PERSPECTIVE

*Norman Girvan**

## I. INTRODUCTION

The question of compensation for expropriated[1] property takes us, in many respects, to the heart of the relationship between the developed capitalist countries and the Third World. On no other subject is the gulf between the two—in interests, perspectives and position—potentially so great, nor so pregnant with passionate and violent conflict. The rules of international law, the principles of international economics and the science of international politics can help clarify the issues involved and provide arguments for the claims of contending parties. But they cannot yield solutions which are "neutral" or are free of value judgments and philosophical assumptions which reflect and affect the interests of contending parties in different degrees.

The question is one in which *realpolitik* has always been a dominant—if not decisive—factor. Current standards of compensation which are "internationally accepted" derive from concepts of private property that are peculiar to the capitalist countries of the North Atlantic. In the light of notions of property characteristic of the pre-colonial cultures of Asia, Africa and Indo-America, the philosophical tenets of capitalist attitudes toward private property appear to be a special case in human society and a relatively recent phenomenon in human history. That these standards should have "internationally accepted" status only attests to Euro-American

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1. No distinction is drawn in this article among "confiscation," "expropriation" and "nationalization" as distinct methods of divesting foreign interests in property. "Expropriation" is used throughout the article in its generic sense, *i.e.* state acquisition of a private foreign property interest for public use. The state action may either totally or partially deprive the alien owners of title or control. This usage of "expropriation" is intended to avoid the ambiguous normative differences that these terms have been used to represent. For an excellent discussion of these normative distinctions, see S. FRIEDMAN, EXPROPRIATION IN INTERNATIONAL LAW (1953).

hegemony over the rest of the world. A unilateral expropriation, compensation for which is determined according to the Third World country's own internal standards rather than those made internationally, runs a high risk of being termed "theft"; and, how far it can be successfully accomplished depends on the balance of economic, political and military forces in the situation.

## II. THE THIRD WORLD'S CLAIM FOR COMPENSATION

The question of compensation in international economic relations usually contemplates the case of the expropriation of a foreign company's assets in a Third World country. The case for the compensation of the peoples of the Third World is rarely argued. This is another illustration of the way in which current attitudes reflect the interests of the nations of the North Atlantic. A cursory examination of the evidence illustrates my point more lucidly. After World War I Germany made reparations to the victorious Allies for the destruction of life and property for which she was held responsible; after World War II she paid the state of Israel for the Jews who died in Hitler's concentration camps. Yet Europe has never made reparations to Africa for the nine million who died on the Middle Passage, nor for the millions of others who died on the plantations of the New World.[2] Moreover, the population of Mexico is said to have fallen from 13 million at the time of the Spanish Conquest to 2 million by the end of the sixteenth century.[3] Although human lives cannot be valued in monetary terms, money can be and has been used as partial compensation for human deaths.

What bolsters the Third World's case for compensation is the consideration that the destruction of life, transfers of booty and returns on investments in production and trade guaranteed by military force, which characterized the European impact on other peoples, can in large measure be held responsible for the present affluence of the developed world. West Indian slavery contributed markedly to the development of European industrial capitalism,[4] as the slave

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2. The Rastafarians of Jamaica have for years pointed out that the money paid as compensation to the Jamaican planters by the British Government when emancipation of the slaves resulted in the loss of their "property," should really have been paid to the slaves. Only recently have I come to recognize the revolutionary significance of this proposition.

3. K. GRIFFIN, UNDERDEVELOPMENT IN SPANISH AMERICA 46 (1969).

4. E. WILLIAMS, CAPITALISM AND SLAVERY (1944).

plantation in the South of the United States contributed to the economic development in the North and West.[5] On this issue, however, we can do no better than to quote the British economist, John Maynard Keynes:

> Indeed, the booty brought back by Drake in the *Golden Hind* may fairly be considered the fountain and origin of British Foreign Investment. Elizabeth paid off out of her proceeds the whole of her foreign debt and invested a large part of the balance (about £42,000) in the Levant Company; largely out of the profits of the Levant Company there was formed the East India Company, the profits of which during the seventeenth and eighteenth centuries were the main foundation of England's foreign connections; and so on. In view of this, the following calculation may amuse the curious. At the present time (in round figures) our foreign investments probably yield us about 6½ percent net after allowing for losses, of which we reinvest abroad about a half—say 3¼ percent. If this is, on average, a fair sample of what has been going on since 1580, the £42,000 invested by Elizabeth out of Drake's booty in 1580 would have accumulated by 1930 to approximately the actual aggregate of our present foreign investments, namely £4,200,000,000—or, say, 100,000 times greater than the original investment.[6]

The clear import of Keynes's observations is that the historical contribution of Third World peoples to the economic development of the North Atlantic countries has to be compounded over time to be calculated fully. Certainly a claim like that of James Forman for $500 million to U.S. blacks[7] appears to be extremely magnanimous to white America. The example of Germany's reparations is instructive on another point. The African, Asian or American Indian may naively ask why Europeans and Jews who suffered at Germany's hands received reparations, and he has not. One answer may be that what is unacceptable when done to whites is permissable when visited upon non-white races; but an even more relevant consideration may be simply that those who wanted Germany to pay were in a position to force her to do so.

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5. *See, e.g.,* W. NORTH, THE ECONOMIC GROWTH OF THE UNITED STATES (1961).

6. 2 J. KEYNES, THE APPLIED THEORY OF MONEY 156-57 (1930). *See also* K. GRIFFIN, *supra,* note 3, at 36.

7. Forman, *The Black Manifesto,* 1 REVIEW OF BLACK POLITICAL ECONOMY 36-44 (1970). It is pointed out that "[t]his total comes to $15 per nigger" which "is not a large sum of money." *Id.* at 40.

## III. The Country-Company Conflict

As long as the international balance of power remains unfavorable to the poor countries, the question of compensation will continue to be considered in its narrower context. It is, therefore, more immediately relevant to consider standards of compensation that are fair and reasonable from the point of view of the expropriating country. If our consideration is not to be arbitrary, we need to formulate a set of criteria which will maintain equitable principles of compensation when applied to particular cases. A criterion which says, for instance, that the payment terms should not constitute a net burden on the foreign exchange position of the country will yield one result when applied to an export industry and a different result when applied to an industry catering to the domestic market. Therefore, we need to consider a typology of cases in which the expropriating situation may arise and to which the criteria of "fairness" should be applied. To facilitate the development of such a typology, paradigmatic abstractions representing the two parties in the dispute—the multinational or parent corporation and the Third World country—will be used.

### A. *The Multinational Corporation*

The abstraction of the multinational corporation embraces the model structure of the multi-divisional, vertically integrated corporation developed by Chandler (see APPENDIX).[8] What is important for us is the integrated structure of the firm and the multinational scope of its operations. The vertical and horizontal integration of the firm's activities involve segments of the economies of a large number of different countries within the frontiers of a single decision-making machinery. The subsidiary or branch in the Third World country is, therefore, more properly considered an institutional part of the multinational corporation to which it belongs than a part of the Third World country itself. This has certain implications for its managerial, production and financial operations. On the managerial side, the subsidiary of the multinational corporation is responsible for its routine operations. But these routine managerial operations take place within the framework of strategies determined by the central office of the firm and instructions consistent with these strategies established by the departmental office to which the subsidiary is responsible. For

8. A. Chandler, Strategy and Structure 10-13 (1966). The appendix is adapted from Chandler's chart at p. 12.

example, decisions regarding the multinational corporation's overall rate of production and expansion of capacity are made centrally and therefore externally to the subsidiary, which means externally to the Third World country as well. On the production side, operations by the subsidiary are related to activity in some other sector of the multinational corporation's operations, on either the input side, the output side, or both. Thus, a manufacturing plant will buy its raw materials from a raw materials plant and supply manufactured components for assembly to another plant, and so on. Much of the "foreign trade" of the subsidiary in a Third World country, therefore, will be internal trade for the multinational corporation. Hence, this trade is totally unresponsive to market forces within the Third World country. The financial transactions of a subsidiary similarly bear little resemblance to those of an independent firm. When it "buys" its inputs from a sister plant and "sells" its output to another sister plant, bookkeeping entries in the multinational corporation's internal accounts replace actual cash movements. When cash profits are actually generated, they are at the disposal of the multinational corporation's central office. Since dividend, reinvestment and expansion strategies are determined centrally, in the light of the global multi-product operations of the multinational corporation, the use of the surplus generated by the subsidiary's segment of the Third World country's economy is subject to external control.[9]

### B. *The Third World Country*

The basis of the abstraction of the Third World country is the isolation of a number of sectors of economic activity in which subsidiaries of multinational corporations are likely to be operating. These sectors may be categorized as (1) a plantation-agriculture sector, (2) a mineral-export sector, (3) a public utilities sector and (4) a domestic manufacturing sector. There is also, of course, a government sector responsible for sustaining the level of national income and generating economic development, full employment and equitable income distribution, as the national interest demands.

Each sector has certain typical, technical characteristics of production and occupies a particular place in relation to the national economy. This relationship conditions the way in which the Third World government perceives the need to adapt the sector to the needs of national economic development, *i.e.* the expropriation motive. At

9. *See generally* N. Girvan, Multinational Corporations and Dependent Underdevelopment in Mineral-Export Economies, 19 SOCIAL AND ECONOMIC STUDIES 490-504 (1970).

the same time, however, the subsidiaries in each sector will also exhibit certain characteristic forms of integration with their parent corporations. And, in turn, this relationship conditions the perception by the multinational corporation of its interests in the conflict with the Third World government.

1. *The Plantation-Agriculture Sector.*—In this sector large areas of land are controlled by plantation enterprises, which employ large masses of relatively unskilled, low-paid labor in the production of a single crop, such as sugar or coffee, for export to metropolitan markets. Under these conditions the agricultural sector tends to exhibit a rigid "export-bias." Adjustments to changes in external marketing conditions take the form of changes in production levels rather than changes in the allocation of land and labor to different export crops or to domestic foodstuffs. The growth of domestic non-agricultural incomes and the induced growth of domestic food demand result in rising imports of food rather than growing domestic production. At the same time, the terms of trade for the plantation export tend to decline over time, eroding its purchasing power with respect to imports including imported food. Some of the export revenue from the crop also leaks abroad both to pay foreign shareholders' dividends and to pay for imported capital goods and materials. Because of their desire to be in a position to adjust production levels at will, the plantations keep substantial excess supplies of land in reserve; through their monopoly control over land they also control labor supplies and arrange to keep reserve supplies of labor as well. Hence underutilization of land and labor is endemic to the system. As monopsonistic buyers of labor, the plantations are in a position to keep wages low. Consequently, the mass of rural incomes are maintained at a subsistence level, choking the growth of the domestic market for products of manufacturing industry.[10]

The objective of the Third World government in this case is likely to be one, or both, of the following two broad alternatives. The first is to increase production of the plantation crop to secure the additional foreign exchange required for the development effort; the second is to adopt a more flexible system of resource use to service domestic demands for food and agricultural materials for industrial processing, thereby cutting back production of the plantation crop and perhaps initiating the production of new exports. In both cases there will be the desire to increase employment and incomes, especially in the rural areas, by bringing idle land and labor into production, and to nationalize the profits from agricultural production to secure them

10. *See generally* G. BECKFORD, PERSISTENT POVERTY chs. 6 & 7 (1971).

for use by the national economy in general and the government in particular. Cuban policy after the Revolution exhibited both objectives at different times: the first in 1959 and after 1963; the second from 1960 to 1963.

For the multinational corporation, the plantation represents a part of its raw material base for a worldwide system which includes transport and facilities ancillary to transport (such as storage), refining, manufacturing of the end product, manufacturing of inputs (such as machinery and transport equipment), and marketing. An expropriation that seeks to maintain or increase the level of plantation production, and to retain the transport, refining and marketing links with the multinational corporation will obviously be less adverse to the firm than one that seeks either to shift exports to different markets and generate new external connections or to shift entirely to different export crops and domestic food.

2. *The Mineral-Export Sector.*—This sector produces strategic mineral resources (petroleum, bauxite, iron ore) for transport, refining, etc., in metropolitan countries by other branches of the multinational corporation, as in the plantation case. Here, however, production is typically capital-intensive. Thus large amounts of profits and depreciation funds are generated by the industry while little labor is employed. To the government, therefore, this sector represents a crucial source of finance for the development effort—a source that is even more valuable because it is being realized in the form of foreign exchange. Additionally, mineral resources are frequently strategic inputs for industrialization. Accordingly, the government may naturally wish to use whatever natural resources the nation has as the basis for an industrial development effort. At this juncture the conflict with the interests of the multinational corporation is likely to be the sharpest because the firm itself has a global production system based on the use of the mineral resource. In other words, the national economy and the corporate economy represent directly competing interests for the use of the resource as an industrial input.[11]

3. *The Public Utilities Sector.*—Activities such as electric power, railways and communications have a different significance for both the Third World country and the multinational corporation. In this case, the output of the industry already forms a strategic input into the national economy. Thus the industry's price structure, growth rate

11. The Caribbean bauxite industry illustrates this point. *See* N. GIRVAN, THE CARIBBEAN BAUXITE INDUSTRY (1967). An application of the expropriative motive in this situation can be found in Girvan, *Why We Need to Nationalize Bauxites and How*, READINGS IN THE POLITICAL ECONOMY OF THE CARIBBEAN (N. Girvan & O. Jefferson eds. 1971).

and direction of expansion are of vital importance to both the rate and the direction of the development of the national economy. Moreover, the nature of this sector's activities are frequently such that the public utility companies have de jure or de facto monopoly status. This situation has two immediate implications. First, the particular company concerned has overt or latent powers of monopoly pricing; and secondly, the company concerned represents to the government the only means of securing the desired commodity or service at the price level and expansion rate deemed necessary for national development.

To the multinational corporation, the operation of a subsidiary in the public utilities sector of a Third World country's economy represents a source of cash profits since the output is sold on the local market to outside customers. Furthermore, the subsidiary is a captive customer for the sale of manufactured equipment and "technical services" of one kind or another from plants in other countries. Such "sales" by the multinational corporation to its own subsidiary can give rise to as much profit as the profit actually generated by the subsidiary itself. Thus, the attitude of the multinational corporation toward the expropriation will depend on the way in which the expropriation affects these two interests.

4. *The Domestic Manufacturing Sector.*—Manufacturing activities that produce a commodity such as steel, refined petroleum products, chemicals or other strategic inputs for industry can be classified as "public utility" activities for the purposes of this discussion. Similar considerations apply to these manufacturing activities as to the public utility case. However, those industries engaged in the production of items that may be classified as nonessential in the production structure, such as consumer durables, are subject to slightly different considerations. The production of such items is likely to use components and technology imported from the parent corporations, and is geared to satisfy demands from the more privileged groups in the society. Historically, such industries have not been important as targets of expropriatory action by Third World governments, nor have they been a major source of company-country conflicts. The potential interest of Third World governments in such industries would arise from more general, comprehensive policies of national planning for resource allocation, including the allocation of foreign exchange. Hence, expropriation in these cases is normally associated only with full-fledged socialist regimes, in which social ownership and comprehensive central planning is a matter of ideological principle.[12]

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12. An example of the kind of problem that can arise in this situation is provided in the following statement by Ernesto "Che" Guevara, made while he

The potential interest of Third World governments in these industries might arise from a desire to utilize their surpluses, and their foreign exchange payments to parent corporations for inputs and technology, for purposes deemed to have higher benefits in terms of national economic priorities.

The interest of the parent corporation in its subsidiary, in this case, is in maintaining the subsidiary (1) as a source of cash profits, (2) as a captive customer for the components, technology and "services" provided by other plants, and (3) as a means of controlling and enlarging its share of the global market for the end product. The exact nature of the expropriation, of course, will affect each of these interests in some particular way.

There is a tendency on the part of academic and other commentators from the North Atlantic to regard acts of expropriation by Third World governments as unfortunate and uninformed aberrations of government conduct. The words "rash," "irrational," "xenophobid," and "senseless" are often used to conjure up an image of a lunatic who runs amok and destroys the very source of his livelihood. The frequent implication is that therapy, in the form of sound economic advice from foreign experts, is necessary. Moreover, economic development textbooks are written to include discussions demonstrating the value of foreign capital to the development process of Third World countries, and expensive projects are mounted to show the ways in which the interests of multinational corporations and those of Third World governments may be harmonized.

Hopefully, the brief discussion in this section has helped to show that conflict between the multinational corporation and the Third World government is to a large extent structurally inherent in the relationship,[13] arising from the divergence of the structure and

was Minister of Industry in Cuba: "Coca-Cola was one of the most popular drinks in Cuba, but today it tastes like cough syrup. It has seven, eight, or nine—I don't remember how many—ingredients, some of which are secret. This was one of those secrets held by American factories: ingredients arrive with the label 'xz-29' and all the Cuban technician has to know is that he must put a certain amount into the mechanism in which the components are mixed, and out comes the ordinary Coca-Cola with the taste we all know. It was necessary to do much investigation and a substitute has been found, but sometimes we have to eliminate an ingredient that we can't get and can't make." E. BOORSTEIN, THE ECONOMIC TRANSFORMATION OF CUBA 104 (1968).

13. Extended discussions of such structural conflict can be found in G. BECKFORD, *supra* note 10; R. MIKESELL, FOREIGN INVESTOR-HOST COUNTRY RELATIONS (1971); Girvan, *supra* note 9. Mikesell's book contains a mine of information on petroleum and other resource industries and is characterized by its emphasis on the harmonization of country-company conflicts.

perspectives of the multinational corporation from those of the national economy. Hymer suggests:

> Multinational corporations are private institutions which organize one or a few industries across many countries. Its polar opposite is a public institution which organizes many industries across one region.[14]

Consequently, acts of expropriation must be seen as attempts to resolve structural conflicts by transferring ownership of natural resources and other assets from one party to the other through the assertion of the principle of national sovereignty. Such acts usually have an economic rationale which derives from the needs of economic development and the material improvement of people in Third World countries. The motives are not only to capture surpluses generated through the use of the nation's natural resources and through monopoly market situations, but also to secure *control* so that the industry in question can be organized effectively to support policies of full employment, income growth and industrialization. Except for cases in which expropriations take place because of attachment to socialist or communist principles, such acts usually occur after periods of dispute and attempts at negotiated settlement. This period can last for decades and go through many phases.[15] Moreover, expropriation occurs only after the government in question has taken the psychological step of assuming responsibility for production and marketing, with confidence in its capabilities and in those of the nation. In this sense, expropriation must be viewed as an act of maturity rather than one of childishness.

## IV. The Compensation Question

The "fair" amount and method of compensation from the point of view of the Third World government should be evaluated in the context of the industry concerned and the specific motive for the government take-over. In addition, the elements of compensation arrangements are many and varied, and their total effect must be accounted for in assessing their financial significance. Finally, compensation arrangements can contain features other than those associated with financial payments. These features must also be taken into account in evaluating the significance of various alternative arrangements.

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14. Hymer, *Multi-National Corporations and Uneven Development,* ECONOMICS AND WORLD ORDER (J. Bhagwati ed. 1970).

15. *See* the many articles in B. MIKESELL, *supra* note 13; N. GIRVAN, COPPER IN CHILE: A STUDY IN CONFLICT BETWEEN CORPORATE AND NATIONAL ECONOMY (1972).

### A. *Financial Aspects*

The financial aspect of compensation traditionally has been discussed in terms of the method of valuing the assets and the promptness of payment. While these elements are undoubtedly key aspects of the question, they are not exclusive, and other factors can have an equally important influence on the total effect. A more complete listing would include the following elements:

(a) the method of valuing the assets;
(b) the speed, currency and interest-rate adopted for deferred payments;
(c) the fiscal regulation applying on any remaining equity interest of the parent corporation and the corporation's net earnings therefrom; and,
(d) other earnings by the parent corporation from the new enterprise resulting from the "sale" of services such as marketing and management.

1. *Valuation.*—A fairly large number of alternative valuation methods exist, but the ones most likely to be used as the basis for contending positions are the capitalized market value, the replacement value, the depreciated book value, and the sales value of real assets. The capitalized market value is based on the expected profitability of the operation as a going concern, with an appropriate time discount factor. The formula used will be a price-earnings ratio or some variant of it. Usually, some figure agreed upon as the normal or expected annual net profits of the operation will be multiplied by an agreed factor in computing the market value. In this method there is an implicit view of the government as an investor making a take-over bid for the business on a mythical stock exchange.[16] This method was used in the "Chileanization" agreements between the Frei Administration in Chile and the United States copper companies.[17]

The principal problem with this method lies not with the practical difficulties of making reality conform to the myth, but rather with the

16. An *actual* take-over bid is usually prohibited by the fact that subsidiaries in Third World countries are usually wholly-owned by their parent multinational corporations and their stock is not traded.

17. *See* R. SAEZ, CHILE Y EL COBRE: PERSPECTIVAS DE UNA NUEVA POLITICA (1965) for the method used to value the 51% of Kennecott's subsidiary acquired in 1964. CORPORACIÓN DEL COBRE, AGREED NATIONALIZATION (1969) discusses the formula which was to have been used for the acquisition of the remaining 49% of Anaconda's subsidiary (the first 51% was acquired at book value).

validity of using the profits of the enterprise as a basis for valuation. In natural resource industries, a portion of the profits can be ascribed to the use of and control over the natural resource itself, and not merely returns on invested capital. In other words, they contain an element of what economists call "economic rent" or "quasi-rent." In most Third World countries, especially former colonies, the argument can be made that because formal ownership of the minerals is vested in the state, the economic rent should be excluded from the valuation. Similar valuation problems can arise both in the plantation-agriculture case, in which part of the profit is due to monopoly control of land, and in the public utilities case, in which part of the profit is due to monopoly status in the market.

A much more intractable problem in using profits as a valuation basis is that the amount of net profits of the business itself is subject to government influence to a large degree. Merely by raising its tax rate by a certain amount, the government can, for example, halve the annual net profits of the operation and thereby halve the "market" value. Government power to regulate prices can also be used to the same end in the public utilities case. Therefore, the capitalized market value method has a frail foundation when the buying party can unilaterially, and arbitrarily, change the factors which determine the value itself.

The basis of the replacement value method is the amount that it would or will cost the firm to replace the fixed assets it has lost as a result of the expropriation. This method, therefore, may be relied upon to produce a result which is generally favorable to the parent corporation. Like the capitalized market value method, it involves the implicit principle that the firm should suffer as little as possible financially—and, if possible, not at all—as a result of expropriation.

Third World governments are more likely to favor a method such as the depreciated book value used for income tax purposes. This method was proposed by the Guyana Government for its participation in the bauxite producing subsidiary of the Alcan aluminum company.[18] The calculation of the amount of due compensation by this method is based on the actual historical cost of the assets involved less the amounts historically deducted and written off against income tax for depreciation. This amount will be much lower than the replace-

18. *See* Address by Hon. L.F.S. Burnham, S.C., Prime Minister of Guyana, Control of Our Natural Resources: Address to the Nation, February, 1971. This method was also used by the Zambian Government for the acquisition of its 51% share in its copper mines. It seems likely that a number of oil-producing countries may propose similar schemes to begin participation in the petroleum companies. *See* 3 OPEC WEEKLY BULL. NO. 5, REVIEW OF THE PESO 11 (1972).

ment cost since the current cost of capital goods is higher than in the past, and since the capital is purchased at market prices before deduction of depreciation. Moreover, the equity of this method is supported by the fact that it utilizes the value officially and formally recorded by the multinational corporation in its books for purposes of its prior dealings with government authorities. The government can reasonably argue that the firm cannot legitimately use one valuation for the purposes of tax payments, and then seek to use another (much higher) valuation for purposes of compensation. The practical advantage of this method over the capitalized market value method or the replacement cost method is that it allows for little dispute over the exact figure that should be used.

A fourth method of valuation is based on an estimate of what the parent corporation would actually realize if it were to sell the physical assets concerned. The use of this method is almost certain to result in the lowest possible valuation. Machinery and equipment will have, at best, second-hand value on the market, and, at worst, scrap value. Lands owned by plantations are usually very large in relation to local land supplies; therefore, placing this land on the market will steeply depress the price. Land containing mineral deposits cannot be mined without government permission, and mining leases cannot be sold by one lessee to another. Thus, ownership of the surface area becomes worthless once government permission to use the resources of the subsoil has been withdrawn. An equivalent situation holds for public utility companies operating as legal monopolies. Essentially, this "sale" value of the real assets amounts in large part to a forced-sale value in which the party who is acquiring the assets—the government—is not only identical with the party who is forcing the sale but also the party who can virtually dictate its own terms.

Obviously this method will arouse the bitterest opposition from the companies because it gives rise to the lowest possible valuation and involves the most drastic violation of the norms associated with the sanctity of private property. Yet it must be pointed out that this method is the logical result of the application of the principle of national sovereignty and the right of the sovereign nation to nationalize. A decision to nationalize is, in effect, a decision to impose a forced sale. Once the validity of the sovereign right to nationalize is recognized, the properties of a forced sale may be attached realistically to the act of nationalization itself. To put it another way, a forced-sale value is no more unfair to the company than the capitalized market value is unfair to the government. Both methods involve the application of norms which attach to either one of the parties: the one, the sovereignty of the nation; the other, the sanctity of private property. If we speak of *the* standard of compensation for

Third World governments, then, we speak of the forced-sale value; anything more amounts to a concession involving the relaxation of the sovereignty principle.

2. *Speed, Time-Distribution and Currency of Payment.*—Multinational corporations and the governments of capital-exporting countries tend to emphasize the "promptness" of payment as basic to fair compensation arrangements. The ideal against which all other arrangements are measured is immediate payment in the form of convertible currency. Such a standard strikes at the very heart of the motive for which expropriation is undertaken by the Third World government. Because the expropriation motive reflects the need to nationalize the surplus and foreign exchange generated by the subsidiary for national use, immediate payment in cash will be either financially impossible or, if financially possible, inconsistent with the purpose of the expropriation. The payment would deplete not only the cash resources of the government but also, and more importantly, the nation's foreign exchange reserves. Third World governments normally suffer from a chronic shortage of foreign exchange; it is, in fact, one of the characteristics of underdevelopment itself. It is difficult enough to make cash payments in the form of domestic currency. Possible means include government borrowing from the central bank, borrowing on the local capital market from private investors, and increases in taxation. When the cash is in the form of foreign exchange, the method adopted would have to provide means for facilitating the availability of the resources in the latter form. This will necessitate recourse to such measures as cutting imports, trying to expand exports, borrowing internationally, and running down existing exchange reserves, all of which impose severe additional burdens on an underdeveloped economy. Indeed, as our previous discussion has shown, it is precisely because of such strains that a Third World government resorts to expropriation in the first case.

The standards adopted for Third World governments, therefore, will be based broadly on the principle of ability to pay. In practice this means that some form of deferred payment must be used and that the arrangement will relate both the amount and the form of payment to the position of the enterprise after nationalization. In other words, the annual payment of principal and interest must be low enough to permit the expected net after-tax profit of the enterprise to cover it and leave something for the enterprise or the government to use.[19] Moreover, whether payments are made in convertible currency will

19. This was also used in the case of Guyanese bauxite. *See* Girvan, *The Guyana-Alcan Conflict and the Nationalization of Demba,* 5 NEW WORLD Q., No. 4 (1971).

depend on the expected ability of the new enterprise to generate foreign exchange.

The dimensions of the problem can be appreciated more fully by the following example. Suppose that the net profits of an expropriated company normally amount to approximately fifteen per cent of the agreed value of assets. Paying a theoretical commercial interest rate of seven per cent would leave an annual flow amounting to eight per cent of assets. Thus, if all of the profits are used for amortization and interest payments, it will take roughly eight years to pay off the debt with nothing left behind for the government to use for other purposes. More realistically, a Third World government works with the following arithmetic. Using two-thirds of the net profit of the nationalized enterprise for developmental purposes would leave behind a flow amounting to five per cent of the value of assets for debt servicing. If this residual amount is used entirely for amortization it will take twenty years to pay for the assets on an interest-free basis; if interest is paid, it will take even longer. If the agreed value of the assets is lower, then it will take a shorter time to pay, but only because the principal involved is smaller.

Such calculations assume that the enterprise—after nationalization—will continue to earn the level of profits it earned prior to nationalization. There are, however, many possible circumstances that render any model founded upon such an assumption of little more than academic value. Suppose, for example, in the case of an export industry, that the multinational corporation and its home government boycott sales of the nationalized enterprise. Or suppose that whatever the industry, the flow of components and spare parts is cut off. Profit levels may then decline during a period of dislocation while markets, production and supply sources are reorganized. Such a period may endure for years. Would it then be reasonable for the Third World government to agree on compensation terms that assume profit levels that are themselves disrupted by the aggressive actions of the multinational corporation and its home government? The answer can only be no. The Third World government is put in an impossible position: the multinational corporation and its home government concede the right to expropriate in principle, but insist on "prompt and adequate" compensation, which is impossible in practice. To put pressure on the Third World government, the multinational corporation and its home government impose economic sanctions, which make it difficult for the Third World government to provide for any compensation at all. This is then used as further evidence of the Third World government's "unreasonableness."

The result is that deferred payment arrangements by the Third World government must be based not only on "ability to pay" but

also—to be realistic—must be made contingent on the maintenance of "good behavior" on the part of the multinational corporation and its government in those areas which affect the enterprise's ability to pay. For all industries this means doing nothing to interfere with the normal flow of materials, components and spares to the nationalized enterprise. For export industries it means, in addition, doing nothing to disrupt the maintenance of the normal export markets of the enterprise. In the context of the vertically integrated multinational corporation this means the maintenance, for a transitional period, at the minimum, of at least some of the transport, processing, supplying and marketing links between the new enterprise and its former parent.

A further complication arises in applying the "ability to pay" principle to industries catering to the domestic market when part of the expropriation motive is to reduce the price of output in order to service the rest of the economy. This could be the case for public utilities, industries producing basic industrial inputs, and consumer goods industries producing items for mass consumption. Expropriation may take place here in order to reduce the profit rate. In such a case the validity of this motive must be recognized in evaluating the enterprise's ability to pay.

We can now apply these considerations broadly to the main types of industries found in the Third World country. In plantation-agriculture, the main form of capital is land. Since this asset is non-transportable, its price is subject to internal factors and the government is in the strongest position to impose a forced-sale value. Since this industry is also labor-intensive, the share of profits in output is likely to be relatively low. This requires an extended period of deferred payment, which may be shortened to the extent that the agreed value of assets is lowered, and to the extent that the new enterprise is able to improve profits by raising production and prices. Both the amount of payment and the payment's international convertibility will be partly contingent on the maintenance of normalcy in the external relationships of the enterprise. This would permit arrangements which might include delivery of the output of the nationalized enterprise to the multinational corporation as part of the payment flow, a device which both permits payment to be made in kind and resolves part of the marketing problem for the Third World government, as well as part of the raw material supply problem for the multinational corporation.

In mineral-export industries, production is usually capital-intensive. Since machinery and equipment is more amenable to international pricing, there is a higher floor to the forced-sale value, but since profits form a high share of the value of output, ability to pay is generally favorable. Furthermore, since the distribution of mineral

resources between countries is skewed, and because time is needed to discover new deposits and bring them into production, mineral-exports are more amenable to oligopolistic pricing by producer nations, as witness the case of petroleum and copper. Hence, payment periods can be relatively short, and convertibility relatively easy to guarantee. Chile paid for the 51 per cent of Kennecott it acquired under the 1964 agreement in two years in U.S. dollars largely as a result of bonanza prices for copper. Zambia is compensating expropriated interests over a period of eight years by six per cent bonds which are guaranteed convertible into U.S. dollars. In slight contrast, Guyana proposed to acquire its share of the bauxite industry by paying out of the future profits of the new company, and in the final negotiated nationalization agreement, payment is to be made over a period of twenty years at an effective interest-rate of four and one-half per cent. This reflects a lower ability to pay, due to the lack of a "free" market in bauxite and alumina, the currently depressed state of the aluminum industry, and the lack of oligopolistic pricing by bauxite producing countries.

In both domestic manufacturing and public utilities, production is likely to be more capital-intensive than in plantation-agriculture and less so than in mineral exports. The general level of the forced-sale value will occupy a corresponding position. However, since a favorable ability to pay in this case implies a price structure that is considered too high in the context of the national economy, it may well have to be revised downward. This implies a fairly long period of deferred payment. Since the industries cater to the home market, they do not directly generate foreign exchange and, hence, the convertibility of payments cannot normally be guaranteed. The multinational corporation, in other words, experiences a degree of exchange risk that is no greater and no smaller than the risk it experienced as the full owner of the subsidiary when it realized surplus in the form of domestic currency.

3. *Fiscal Regulations Applying to any Remaining Equity Interest of the Multinational Corporation and Its Earnings from such Equity Interest.*—When the government acquires only a controlling interest—*e.g.*, 51 per cent—of the multinational corporation's subsidiary, the parent retains ownership of an equity interest in the operation. In such cases the parent may seek to negotiate the sale of various services to the new mixed company, such as management, marketing, technical services and purchasing. In such cases, therefore, the net financial effect of nationalization—in reality, partial nationalization—is a result not only of the compensation arrangements for the majority share acquired by the Third World government, but also of the financial characteristics of the arrangements governing the multinational cor-

poration's minority interests and its sales of services to the new company.

In some outstanding recent cases—Chile in 1964, Zambia in 1969, and Guyana in 1971—multinational corporations sought fiscal concessions on their minority interest as the price of their agreement to the government's acquisition of a majority interest. Among the concessions sought were drastic tax cuts—or exemptions from taxes altogether—and freedom from exchange control and other restrictions. Such concessions may be given by the Third World government to secure an agreement by the multinational corporation to undertake expansion of the enterprise using government money or funds provided by third parties. The objective of such an agreement is to insure that the total of compensation payments and earnings from the multinational corporation's minority equity are not only maintained but also *increased* relative to its previous earnings as full owner of its former subsidiary.[20] When tax rates are reduced, the Third World government, in effect, is induced to accept dividends on its equity interest (for which it is obliged to pay) partly in lieu of tax receipts, for which of course it does not pay and to which it is entitled as of right. When expansion is to be undertaken, the Third World government must either put up money itself, or secure the funds from international financial institutions under government guarantee. Such arrangements, therefore, while having the appearance of harmonizing the interests of the Third World governments and the multinational corporations, will probably be approached with growing caution by Third World governments in the future.[21]

The provision of a variety of services to the new company also represents an important form of earnings to the multinational corporation, since payment for these is usually put on a percentage-of-gross-revenue basis. Under such conditions the receipts of the multinational corporation for such service do not bear a direct relationship to the actual value of the services provided. On the other hand, as managing and marketing agent on a commission basis, the multinational corporation does have an incentive to maximize production, sales and prices. Yet the multinational corporation's incentive to maximize profits through minimizing costs may be weaker, as its only interest in so doing would be to maximize the return on its equity interest.

20. *See* Semonin, *Nationalization and Management in Zambia,* 5 NEW WORLD Q., No. 3, at 1 (1971); K. GRIFFIN, *supra* note 3, at ch. 6; N. GIRVAN, *supra* note 15.

21. It was as a result of such caution that the Guyana-Alcan negotiations broke down.

The value of such arrangements to the multinational corporations, however, goes beyond its financial implications. These arrangements offer means by which the parent corporation may retain various kinds of control over an enterprise that is nominally controlled by the Third World government. Such arrangements thus have the advantage for the multinational corporation of conceding the form of government control without the substance. The arrangements are also made to appear advantageous to the Third World government by securing the parent corporation's provision of a variety of skills without which, theoretically, the goals of the expropriatory action cannot be attained. Ideally, these governments should be in a position to retain only those links that are absolutely essential for the maintenance of production and profits, and only for as long as they are necessary. Multinational corporations tend to argue that if they are to provide the external links that minimize the risks inherent in deferred payment arrangements, the links must be provided in forms that are sufficiently comprehensive and long-term to retain control for the multinational corporation.

The overall result is that multinational corporations are often willing to concede majority holdings to the government, and to provide external links to the new enterprise, only on terms that are at variance with both the financial and the control motives of the Third World government. As with the standards of compensation for full expropriation, the inherent structural differences between the perspectives of the two parties tend to be very wide.

## V. CONCLUSION

The considerations we have been discussing are summarized in schematic form in TABLE 1. As shown in the tabular presentation, the various aspects of compensation arrangements are outlined in the rows of the table, with the alternatives ranked in the order of their degree of advantage to the Third World government. The four main types of industry selected for this analysis are placed in the columns. The table is filled in by a general assessment of the extent to which any compensation feature corresponds to the interests of the Third World government as the expropriating party. The most advantageous arrangement for the Third World government is labelled "preferable." Beyond this, however, some slight differences in the positions of different industries emerge. Of the industries distinguished, mineral-exports are likely to be the most financially capable for the purposes of compensation. Public utilities and domestic manufacturing may be

TABLE 1

| | Plantation-Agriculture | Mineral-Export | Public Utility | Domestic Manufacturing |
|---|---|---|---|---|
| *Valuation* | | | | |
| (i) Forced-sale value | Preferable | Preferable | Preferable | Preferable |
| (ii) Depreciated book value | Possible | Possible | Possible | Possible |
| (iii) Replacement cost | ——— | ——— | ——— | ——— |
| (iv) Capitalized market value | ——— | ——— | ——— | ——— |
| *Timing of Payment* | | | | |
| (i) Long-term | Preferable | Preferable | Preferable | Preferable |
| (ii) Short-term | Improbable | Possible | Improbable | Improbable |
| (iii) Immediate | ——— | ——— | ——— | ——— |
| *Interest-Rate* | | | | |
| (i) Zero | Preferable | Preferable | Preferable | Preferable |
| (ii) Nominal | Possible | Probable | Possible | Improbable |
| (iii) Commercial | Improbable | Possible | Improbable | Improbable |
| *Currency of Payment* | | | | |
| (i) National | Preferable | Preferable | Preferable | Preferable |
| (ii) Convertible | Possible | Possible | Improbable | Improbable |
| *Fiscal and Exchange Burden* | | | | |
| (i) Greater | Preferable | Preferable | Preferable | Preferable |
| (ii) Same as before | Probable | Probable | Probable | Probable |
| (iii) Lower | Improbable | Improbable | Improbable | Improbable |
| *Provision of Services* | | | | |
| (i) Selective, at Third World gov't discretion, at "market" value | Preferable | Preferable | Preferable | Preferable |
| (ii) Total, long-term, on percentage basis | Improbable | Improbable | Improbable | Improbable |

the least capable because of the sensitivity of the remainder of the economy to their price structure. Moreover, they are less capable of paying in convertible currency than are plantation-agriculture and mineral-exports. In all cases, the concessions sought by the multinational corporations, concerning fiscal and exchange burden and provision of services, are not likely to be consistent with the motives for which Third World governments seek full or part nationalization.

This analysis has endeavored to reveal a number of points to bear in mind in evaluating compensation arrangements from the viewpoint of Third World governments that carry out expropriations. First,

countries whose peoples have been the victims of centuries of decimation, plunder and exploitation are bound to approach the question of compensating foreign interests with a great deal of cynicism. That they contemplate compensation at all may be only in deference to international *realpolitik*. Secondly, the economic motives for expropriation imply certain specific financial and control aspects of the compensation arrangements that are consistent with such motives. These will vary from industry to industry, but as a general rule they will differ profoundly from what is considered "fair" by the multinational corporations. Thirdly, this profound difference stems from the wide divergencies in structure, perspectives, objectives and, ultimately, philosophy between the Third World countries and the multinational corporations in the developed countries. Finally, those whose stated ideal is the promotion of the development of Third World economies and the material betterment of their people may find even they have to choose between their stated ideals and their financial interests, which most probably coincide with those of the multinational corporations.

## Appendix

### Administrative and Commodity Flows for the Vertically Integrated, Uni-Divisional Firms