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POLITICAL RISK ANALYSIS: A STUDY OF THE OVERSEAS PRIVATE INVESTMENT CORPORATION AND PRIVATE FIRMS ENGAGED IN POLITICAL RISK INSURANCE AND MANAGEMENT ANALYSIS

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Political Risk Analysis: A Study of the Overseas Private Investment Corporation and Private Firms Engaged in Political Risk Insurance and Management Analysis

A dissertation in the Department of Politics submitted to the faculty of the Graduate School of Arts and Science in partial fulfillment of the requirements for the degree of Doctor of Philosophy at New York University.

Submitted by Alan C. Brennglass

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Faculty Adviser Louis Koenig

DISSERTATION ABSTRACT

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A dissertation in the Department of Politics with assistance from professors at the New York University Graduate Business School submitted to the faculty of the Graduate School of Arts and Science in partial fulfillment of the requirements for the degree of Doctor of Philosophy at New York University.

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The subject of my dissertation centers around the Overseas Private Investment Corporation (OPIC), an independent U.S. Government agency established under the Foreign Assistance Act of 1969 and which since 1971 has been conducting the national investment guarantee program. Prior to OPIC's functioning, the program was administered by several successive foreign aid agencies. Investment guarantees are basically insurance contracts under which the United States agrees to insure private investors against losses arising from certain political and economic risks.

The dissertation consists of eight chapters together with an introduction and conclusion. My eight chapters are entitled as follows: Chapter I: The Investment Guarantee Program of the United States from its Inception until the Creation of OPIC; Chapter II: The Creation of OPIC; Chapter III: OPIC: Its Formative Years; Its Problems in Chile; and the 1973-1974 OPIC Hearings and Amendments Legislation; Chapter IV: OPIC and Privatization; Chapter V: The Multilateral Investment Guarantee Plans, Their Relation to OPIC, and How OPIC Compares with Other National and Private Investment Guarantee Programs; Chapter VI: OPIC: Its Relationship to Anti-Bribery Legislation; the Foreign Corrupt Practices Act of 1977; and the Problem of Questionable Payments; Chapter VII: The 1977-1978 OPIC Hearings and Amendatory Legislation with Reflections on Development; Chapter VIII: OPIC and Political Risk Investment Analysis: Identification, Conceptualization, Approaches, Methodologies, and their Relationship to OPIC.

In addition to setting forth the relevant investment guarantee legislation since 1948 and the history of the precursors of OPIC, my study considers and analyzes such cognate subjects involved in the functioning of OPIC as the nature and theory of political risk and the anti-bribery legislation outlawing questionable payments abroad enacted in 1977-1978. Consideration is also given to proposals for having private insurance companies take over all or part of OPIC's insurance operations; of international and multilateral investment guarantee programs and to those programs similar to OPIC conducted in other countries. Private political risk insurance programs are also discussed.

At the time of its creation, OPIC received a directive to conduct its operations in accordance with sound business management principles on a self-sustaining financial basis "with due regard to principles of risk management" in its insurance operations. Since political risk has been OPIC's life blood, in the final chapter of my work an in-depth analysis is made, *inter alia*, of the various factors involved in risk management and its relation to insurance; risk classification under insurance theory; definitions and classification of political risks; risk management techniques in relation to political risks; factors to be considered by a potential investor before investing in a host country; methods or formulas ascertaining the relation between risk and return; sources and evaluation of political data by multinational corporations; and the various risk management techniques and evaluation utilized by OPIC in its operations.

Consideration is given to various studies on political stability and its components as well as the utility of these studies in forecasting political instability in particular and international relations in general. The possible effect of political instability on foreign direct investment and sovereign country risk investment is also discussed.

In my conclusion, I evaluate OPIC's programs, political risk analysis in general, and set forth certain suggestions for reform and improvement.

CONTENTS

INTRODUCTION

As a result of World War II, much of free Europe suffered great economic hardship. In order to assist European economic recovery, both for rehabilitative and developmental purposes, it became part of the foreign policy of the United States to devise means and establish agencies whereby both public and private funds could be canalized for such beneficent purposes. It was hoped that initial direct government-to-government loans and grants would in due course stimulate the flow of private capital and, accordingly, private funds would permit an earlier cessation of direct government assistance.

After the need for assistance among European countries receded, the necessities of other less developed countries throughout the world became the object of U.S. foreign aid. The agencies which had been created to assist European recovery were utilized to promote the economic development of these non-European countries. The dissolution of the European empires in Africa and elsewhere since World War II; the emergence of scores of new nations from former colonial possessions; the rise of nationalism in older underdeveloped countries; and the increasing reliance of the industrial nations upon the raw materials, natural resources and sources of energy in the underdeveloped countries have all contributed to emphasize the paramount necessity of the continued flow of private funds to these countries.

The initial post-war Congressional legislation to assist the European economic recovery was the Foreign Assistance Act of 1948 which had as its formidable purpose, "to promote world peace and the general welfare, national interest, and foreign policy of the United States through economic, financial, and other measures necessary to the maintenance of conditions abroad in which free institutions may survive and consistent with the maintenance of the strength and stability of the United States." Its title I, frequently cited as the Economic Cooperation Act of 1948, emphasized capital investment for economic development through private funds, and provided that the Administrator might facilitate and maximize the use of private channels of trade in several ways including the making of "guaranties to any person of investments in connection with projects approved by the Administrator and the participating country concerned as furthering the purposes of this title." This emphasis on private financing stemmed from the desire to reduce as much as possible the tax burden of the people of the United States and also from the traditional preference for private enterprise in achieving policy objectives.

The subject of the present study is the Overseas Private Investment Corporation (OPIC), the independent U.S. Government agency established under the Foreign Assistance Act of 1969 and which since 1971 has been conducting the national investment guarantee program. Prior to OPIC's functioning, the program was administered by several successive foreign aid agencies. Investment guarantees are basically insurance contracts under which the United States agrees to insure private investors against losses arising from certain political and economic risks.

In addition to setting forth the relevant investment guarantee legislation since 1948 and the history of the precursors of OPIC, this study will consider and analyze such cognate subjects involved in the functioning of OPIC as the nature and theory of political risk and the anti-bribery legislation outlawing the questionable payments abroad enacted in 1977 and 1978. Consideration is also given to proposals of international and multilateral investment guarantee programs and to those programs similar to OPIC conducted in other countries.

According to its 1969 enabling legislation, OPIC is a U.S. Government agency "under the policy guidance of the Secretary of State," created to "mobilize and facilitate the participation of United States private capital and skills in the economic and social programs of less developed countries and areas, thereby complementing the development assistance objectives of the United States." The statute delegated to OPIC the specific risk guarantee program of its immediate predecessor, the Agency for International Development (AID), renamed investment insurance and affording protection against loss due to three specific types of political risk, inconvertibility, expropriation and war (defined immediately below); the former AID extended risk investment guarantee program, renamed investment guarantees, permitting guarantees against business risks on loans and equity investments; the former Public Law 480 (Cooley) loan program, renamed direct investment, providing loans in U.S. dollars or local currencies on a reimbursable basis to "firms privately owned or of mixed private and public ownership"; and small pre-investment and technical assistance programs together with a pilot agricultural credit and self-help community development institution program in not more than five Latin American countries.

The program of insurance against political risk is the <u>sine</u> <u>qua</u> <u>non</u> of OPIC's existence. Inconvertibility is defined as the inability to convert to dollars local currencies received as income, repayment, or return of investment up to the amount of the investment. Expropriation includes confiscation and nationalization. War embraces both revolution and insurrection. Unlike its predecessors and the national programs of other countries, OPIC operates under a statutory mandate which declares that OPIC, "utilizing broad criteria, shall undertake to conduct its financing operations on a self-sustaining basis," and "to conduct its insurance operations with due regard to principles of risk management." Apart from these two basic limitations which were to cause Congressional opposition to its continued existence, OPIC was confronted with an initial provision that not later than March 1, 1974, it was to submit to Congress "an analysis of the possibilities of transferring all or part of its activities to private United States citizens, corporations, or other associations." The spectre of privatization was present even at its birth.

The history of the operations of OPIC and its predecessors during the past three decades has been a reflection of the political and economic events of this period. When first established, the investment guarantee program was initially limited to guarantees against the risk of inconvertibility of currency. In 1950, guarantee coverage was extended to loss through expropriation; in 1956, to loss "by reason of war." It is interesting to note that when Lloyd's of London entered the field of political risk insurance in the 1970's, it not only limited coverage to expropriatory action but limited policies to a one-year period.

The Korean War caused a shift in emphasis of the U.S. foreign aid program by 1951, with military assistance, rather than economic recovery, a basic consideration. Additionally, the focus of the investment guarantees shifted from the European area to other areas embracing certain developing countries. By 1959, the program had served its purpose in the developed areas of Western Europe and Japan which had attained a measure of economic and political stability since World War II. In that year, the takeover of Cuba by Fidel Castro and the concomitant expropriations were to have a marked impact upon the program. The election in November 1970 of Salvador Allende as President of Chile was to result both in a cataclysmic change in Chile and in a new critical look at the program and its soon-to-function administrative agency, OPIC. The exposure in Chile caused Congressional discontent with OPIC to multiply and increased the pressure for privatization.

The investment guarantee program has had criticism and opposition since its inception. Leading senators and representatives opposed extending OPIC's authorization. It was urged that OPIC's encouragement of investment only in poor countries had proved unrealistic. It was directly harmful to the U.S. economy. It gave foreign investment a preferred status which sapped the domestic economy of needed capital and deprived U.S. workers of jobs. However, notwithstanding such opposition, Congress in April 1978 passed the Overseas Private Investment Corporation Amendments Act of 1978 which emphasized the developmental objectives of OPIC and ended the dream of complete privatization for direct political risk insurance. The legislation did take note of the protectionist sentiment prevalent in the declining U.S. economy by prohibiting OPIC support for projects involving foreign copper, palm oil, sugar, or citrus crops for export to the United States.

This 1978 legislation also contained anti-bribery provisions which required OPIC to refuse payment of any claim for losses on any OPIC-assisted project with respect to which the insured investor had been found guilty under the Foreign Corrupt Practices Act of 1977.

As noted, at the time of its creation, OPIC received a directive to conduct its financing and insurance operations in accordance with sound business management principles on a self-sustaining financial basis and "with due regard to principles of risk management" in its insurance operations. Accordingly, in Chapter VIII of this work an in-depth analysis is made, inter alia, of the various factors involved in risk management and its relation to insurance; risk classification under insurance theory; definitions and classification of political risks; risk management techniques in relation to political risks; factors to be considered by a potential investor before investing in a host country; methods or formulas ascertaining the relation between risk and return; sources and evaluation of political data by multinational corporations; and the various risk management techniques and evaluation utilized by OPIC in its operations. Consideration is given to various studies on political instability and its components as well as the utility of these studies in forecasting political instability in particular and international relations in general. The inevitable conclusion is that unlike other forms of insurance, political risk insurance has as yet no actuarial basis; but progress is being made.

In the concluding chapter, the writer's evaluation of the OPIC programs and suggestions for reform are set forth.

CHAPTER I

THE INVESTMENT GUARANTEE PROGRAM OF THE UNITED STATES FROM ITS INCEPTION UNTIL THE CREATION OF OPIC

INVESTMENT GUARANTEE LEGISLATION 1948-1952

As an outgrowth of its foreign policy following World War II, the United States became the first nation to have an investment guarantee[1] program. The initial legislation was proposed as a foreign aid tool to assist European economic recovery. Its sponsors urged that stimulation of the flow of private capital would be less expensive for the U.S. Government than direct government-to-government loans and that the encouraged employment of private funds would permit an earlier ending to direct government assistance.[2]

The "Investment Guaranty Program" (hereinafter sometimes "program") was established in 1948 as part

1. Throughout this work the form "guarantee" has been preferred over that of "guaranty," unless the latter is required in the particular title, legislation, or quotation. "As a noun, -y is correct in some senses, but -ee is established in all." H.W. Fowler, A Dictionary of Modern English Usage (London: Oxford University Press, 1959), p. 222.

2. See U.S. Congress, House, Committee on Foreign Affairs, United States Foreign Policy for a Post-War Recovery Program, Hearings, 80th Cong., 1st and 2d Sess., 1948, Pt. I, pp. 835-871; U.S. Congress, Senate, Committee on Foreign Relations, United States Assistance to European Economic Recovery, Hearings, 80th Cong., 2d Sess., 1948, Pt. III, pp. 1080-1106.

of the Economic Cooperation Act of 1948 (ECA) and was initially limited to guarantees against the risk of inconvertibility of currency.[3] It represented the first of a long series of compromises between an enthusiastic House of Representatives and a reluctant, if not oppositional Senate.[4]

Investment guarantees are basically insurance contracts under which the United States agrees to insure private investors against losses arising from certain political and economic risks.

The program guaranteed new investments against inconvertibility only in those European countries that entered into Economic Cooperation Act treaties with the United States. In order to reduce the risks to the U.S.

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3. 62 Stat. 137, 143-146 (1948). The overall statute is known as the Foreign Assistance Act of 1948, of which title I is the ECA. Inconvertibility is the inability to convert to dollars local currencies received as income, repayment, or return of investment up to the amount of the investment. § 111(b)(3)(i), 62 Stat. 145. See Chapter VIII, pp. 588-595, _infra_.

4. For a comprehensive analysis of the first decade of the program see Marina Von Neumann Whitman, _The United States Investment Guaranty Program and Private Foreign Investment_, Princeton Studies in International Finance, No. 9 (Princeton, 1959) _passim_ [hereinafter cited as Whitman].

An early critical comment concerning the guarantee incentive is found in Comment, "Point Four: A Reexamination of Ends and Means," _Yale Law Journal_, 59 (June 1950), pp. 1277, 1312-1315.

Government, those treaties contained a clause which established procedures for payment of claims.[5] Guarantee issuing authority was limited to $300 million during the 14-year lifetime of the program with a maximum of $15 million during the first year.[6] The program was to be administered by the ECA administrator.[7] During the first year very few convertibility guarantees were issued.[8]

During 1949 hearings on foreign aid legislation

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5. The guarantee clause provided that:

"(1) The Governments of the United States of America and [European Recovery Program signatory] will, upon the request of either Government, consult respecting projects in [that country] proposed by nationals of the United States of America and with regard to which the Government of the United States of America may appropriately make guaranties of currency transfer under Section 111(b)(3) of the Economic Cooperation Act of 1948.

"(2) The Government of [European Recovery Program signatory] agrees that if the Government of the United States of America makes payment in United States dollars to any person under such a guaranty, any [units of that country's currency] or credits in [units of that country's currency], assigned or transferred to the Government of the United States of America pursuant to that Section shall be recognized as property of the Government of the United States of America."

Economic Cooperation Administration, First Report to Congress 83 (1948).

6. § 111(b)(3), 62 Stat. 145.

7. § 104(a), 62 Stat. 138.

8. Convertibility guarantees for four industrial undertakings totalled $2.625 million, with applications for $4.5 million -- "figures fall[ing] far short of the expectations of the Congress in originally legislating the convertibility guaranty provisions." U.S. Congress, House, Committee on Foreign Affairs, <u>Extension of the European Recovery Program</u>, Report on H.R. 3748, 81st Cong., 1st Sess., 1949, p. 20.

numerous suggestions were made to broaden the program.[9] Amendatory legislation enacted that year expanded the definition of "eligible" investment to include investments to expand, modernize, or improve existing enterprises. However, the guarantee authorization was reduced to $150 million.[10] In 1950, guarantee coverage was extended to loss through expropriation or confiscation, issuing authority was increased to $200 million, and "investment" was broadened to include loans, shares, royalties, patents, processes, and techniques. At the insistence of the House Foreign Affairs Committee the

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9. The House Committee recommended broadening the scope of the convertibility guarantee to include actual earnings and extending coverage to "losses on the investment resulting from seizure, confiscation, or expropriation; destruction by riot, revolution, or war; any law, ordinance, regulation, decree, or administrative action (other than measures affecting the conversion of currency), which in the opinion of the Administrator prevents the further transaction of the business for which the guaranty was issued. Ibid., p. 21.

The Senate Committee on Foreign Relations rejected broadening the terms of the guarantees, stating: "The committee felt that ... broadening the terms of the guaranties would not result in substantial amounts of increased investments unless the guaranty was made so broad that, in fact, this Government would assume most of the risks which private capital should be expected to carry." U.S. Congress, Senate, Committee on Foreign Relations, Extension of the European Recovery Program, Report on S. 1209, 81st Cong., 1st Sess., 1949, p. 9.

10. 63 Stat. 50, 51, 52 (1949).

following language was inserted in the statute: "It being the intent of the Congress that the guaranty herein authorized should be used to the maximum practicable extent and so administered as to increase the participation of private enterprise in achieving the purposes of this Act, ..." [11]

The Korean War caused a shift in emphasis of the foreign aid program by 1951, with military assistance, rather than economic recovery, a basic consideration. Additionally, the focus of the investment guarantees shifted from the European area to other areas embracing certain developing countries. The investment insurance program was viewed as a means to encourage private investment, lead to economic development and stability in the host countries, and help them thwart Communist aggression.[12]

The Mutual Security Act of 1951 widened the geographic coverage of the guarantees from Europe to any

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11. 64 Stat. 198, 199 (1950). See John T. Miller, Jr., "The ECA Guaranties and the Protection and Stimulation of Foreign Private Investment," Georgetown Law Journal, 39 (November 1950), pp. 1,14-17.
The subject of expropriation is considered at length in Chapter VIII, pp. 488-491, 595-597, *infra*.

12. See U.S. Congress, House, Committee on Foreign Affairs, The Mutual Security Program Hearings, 82d Cong., 1st Sess., 1951, and especially the testimony of ECA Administrator William C. Foster, pp. 153-232.

area in which assistance was authorized by the act, i.e., Europe, Near East and Africa, Asia, the Pacific and American Republics, and transferred administration of the program to the Mutual Security Agency.[13] At the transfer of the program on December 31, 1951, there were 37 contracts covering investments and earnings totalling $33.7 million -- $32.4 million for convertibility and $1.3 million for expropriation.[14]

The supporters of the program, especially in the House Foreign Affairs Committee, expressed continued disappointment over its performance. "The committee is not satisfied that the Director for Mutual Security has exerted all the reasonable effort possible to implement those provisions ... The point is that private capital has a definite place in the program which should be recognized by the executive branch and our partners

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13. 65 Stat. 373, 384 (1951). The purpose of the Act was to "maintain the security and to promote the foreign policy of the United States by authorizing military, economic, and technical assistance to friendly countries to strengthen the mutual security and individual and collective defenses of the free world, to develop their resources in the interest of the security and independence and the national interest of the United States and to facilitate the effective participation of those countries in the United Nations system for collective security." Ibid., p. 373.

14. First Report to Congress on the Mutual Security Program, December 31, 1951 (Washington, 1951), p. 64. See also U.S. Congress, House, Committee on Foreign Affairs, A Bill to Amend the Mutual Security Act of 1951, Report on H.R. 7005, 82d Cong., 2d Sess., 1952, p. 64.

in mutual security."[15] Attempts to add coverage for losses by reason of war, revolution, or insurrection were unsuccessful.[16]

LEGISLATION 1953-1956

In 1953, amendatory legislation expanded the program to any country with which the United States agreed to institute it; extended the permissible duration of the guarantee to 20 years from the date of insurance; and transferred the program to a new agency, the Foreign Operations Administration (FOA).[17] At the time of the transfer on August 1, 1953, the number of contracts had risen to 53 totalling \$41.2 million -- \$39.6 million for convertibility and \$1.6 million for expropriation -- with pending applications totalling \$69.2 million.

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15. House Committee on Foreign Affairs, <u>supra</u> note 14, p. 62.

16. The 1952 amendment to the Mutual Security Act of 1951 made no substantive changes but directed the Mutual Security Agency to cooperate more fully with private business groups to "encourage greater participation by private capital to the guaranty program and ... develop broad criteria to facilitate such participation." 66 Stat. 141, 146 (1952).

17. 67 Stat. 152, 158, 161 (1953). See Note, "Government Guaranties of Foreign Investments," <u>Harvard Law Review</u>, 66 (January 1953), pp. 514-524.

Seventeen countries had signed agreements for convertibility guarantees, all but two of which also signed with respect to expropriation guarantees. Four non-European countries (China, Israel, Haiti, and the Philippines) were among the signers.[18]

The Mutual Security Act of 1954 codified in section 413 the guarantee provisions of all previous acts relating to private investment.[19] During that year, the FOA made some administrative changes to increase the program's productivity: (1) reduction in fees to one-half of 1 percent for each from a high of 1 percent for convertibility and 4 percent for expropriation; (2) increase of convertibility insurance to a maximum of 200 percent of the original investment from the previous 175 percent; (3) reduction of the required percentage of stock ownership by American citizens in an investor company from 85 percent to 51 percent; (4) no reduction of conversion rights by the amount of earnings withdrawn without resort to the guarantee.[20]

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18. Report to Congress on the Mutual Security Program, for the six months ended June 30, 1953 (Washington, 1953), pp. 60-61.

19. 68 Stat. 832, 846 (1954).

20. Report to Congress on the Mutual Security Program, for the six months ended December 31, 1954 (Washington, 1955), pp. 62-63; Whitman, p. 30.

During the 23 months of FOA's operations before its expiry on June 30, 1955, the number of investment guarantees had risen to 91 totalling $91.4 million -- $77.6 million for convertibility and $13.8 million for expropriation.[21] The last six months thereof showed a substantial increase attributable both to a reduction of fees and to changes in policy.[22]

Criticism of the program

In June 1955, the Commission on Organization of the Executive Branch of the Government issued a critical report on overseas economic operations, including a section on the investment guarantee program.[23] The report noted the absence of guarantees in undeveloped countries; expressed the belief that a significant number of companies which carried insurance would have made the investments without the guarantees; and indicated that since no breaches of the agreements had yet occurred, the efficiency of the program's honoring its

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21. Report to Congress on the Mutual Security Program, for the six months ended June 30, 1955 (Washington, 1955), p. 58.

22. Ibid.

23. U.S. Commission On Organization of the Executive Branch of the Government, Task Force Report on Overseas Economic Operations (Washington, 1955), pp. 383-390.

guarantees remained untested. It urged the extension of risk coverage of guarantees to include losses by reason of war and observed that many potential investors were likewise perturbed by possible sovereign repudiation of commitments not amounting to expropriation, especially in the extractive industries in undeveloped countries. "Guaranties will never be a major influence on the flow of investment; they will be decisive only in the still scarce instances when the investment motive -- unusual earnings prospects, development of maintenance of a name and market in countries to which exports are difficult, assuring sources of materials, low cost production of components -- outweighs the many uninsurable foreign risk."[24]

Criticism of the FOA's administration of the program, sometimes at odds with other foreign policy considerations, led to the proposal that the Export-Import Bank administer the program.[25]

Reiterating earlier criticism[26] of the administration of the program, the House Foreign Affairs Committee

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24. Ibid., p. 388.

25. Ibid., p. 389.

26. Supra note 15 and accompanying text.

in 1954 observed that "the fact remains that practically nothing has been accomplished in 2 years. Accordingly, the committee feels it necessary to again emphasize that it is the intention of Congress, expressed in that provision of the guaranty legislation carried over in the present bill ... that the guaranty program -- 'shall be used to the maximum practicable extent and shall be administered under broad criteria so as to facilitate and increase the participation of private enterprise in achieving any of the purposes of this Act.'"[27] The House Committee recognized the opposition of its Senate counterpart, the Senate Foreign Relations Committee, and the Senate in general to any expansion of coverage. In House Committee hearings on Mutual Security Act legislation of 1957, the position of Senator Walter F. George of Georgia, a consistent and persistent opponent of broadening the scope and terms of the guarantees, was phrased by Congressman Walter H. Judd of Minnesota, a leading proponent, as follows: "If you have a big American company over there that has a big investment and is losing money on it, some companies are ruthless enough that they will organize an insurrection so they

27. U.S. Congress, House, Committee on Foreign Affairs, The Mutual Security Act of 1954 on H.R. 9678, 83d Cong., 2d Sess., 1954, p. 88. The Committee wanted the program extended to underdeveloped areas, especially in Latin America. Ibid., p. 87.

can get their money back through the guaranty."[28]

With the passage of the Mutual Security Act of 1956,[29] House proponents were able to obtain some of their objectives. The issuing authority was extended for 10 years to June 30, 1967, and the limitation on the total face value of guarantees was increased to $500 million. All guarantees issued after June 30, 1956 were put on a fractional reserve basis, in accordance with customary insurance and banking practice. Coverage was broadened to include losses "by reason of war." Administration of the guarantee program was moved from the FOA to the International Cooperation Administration (ICA) of the Department of State.

The 10-year extension of the authority to issue guarantees was designed to facilitate the negotiation of guarantee agreements with non-participant countries which previously had demurred because of the imminent expiration of the program.[30] Placement of new guarantees on a fractional basis meant that instead of the

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28. U.S. Congress, House, Committee on Foreign Affairs, <u>The Mutual Security Act of 1957 Hearings</u>, 85th Cong., 1st Sess., Pt. VI, 1957, p. 1271. Similar sentiments were expressed some 17 years later in hearings dealing with the program being conducted by the Overseas Private Investment Corporation (OPIC).

29. 70 Stat. 555, 558-559 (1956).

30. U.S. Code Congressional and Administrative News, 84th Cong., 2d Sess., Vol. II, 1956 (West Publishing: St. Paul, Minnesota), p. 3235.

face amount of the guarantees being fully backed by notes purchased by the Treasury Department, a 25 percent reserve would be sufficient.[31]

LEGISLATION 1957-1959

The Mutual Security Act of 1957[32] created a new agency, the Development Loan Fund (DLF), with authority to issue guarantees against any type of loss, except that it could not insure equity investments against normal business risks. While the DLF was given the broadest authority and was designed to complement the ICA, it only issued three guarantees totalling $57.9 million, only one of which covered an equity investment.[33]

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31. Ibid., pp. 3235-3236.

32. 71 Stat. 355, 357-358 (1957).

33. See Bruce E. Clubb and Verne W. Vance, Jr., "Incentives to Private U.S. Investment Abroad under the Foreign Assistance Program," Yale Law Journal, 72 (January 1963), pp. 475, 489-490, notes 60-61. "While the ICA and DLF authorities were designed to be complementary, they were in fact competitive because they both operated in the same area, but one was broader than the other. Not only was DLF's coverage authority broader, but also DLF was not required to obtain a bilateral agreement with the host country before issuing guaranties, as was ICA. DLF did not feel that it could issue guaranties in a country with which ICA was negotiating a bilateral agreement because to do so would have undercut the ICA negotiations. Similarly, DLF could not issue a broader guaranty than ICA was authorized to issue without encouraging all investors to seek DLF, rather than ICA, guaranties. One might expect that in such a competitive situation the agency with the broader authority would issue all the guaranties. It is characteristic of the administration of the guaranty program, however, that this was not the case."

Legislation in 1958 gave the President the authority to transfer the program from the ICA to another agency if deemed desirable.[34]

<u>Initial reactions of the business community to the program</u>

While one of the basic principles which legislation governing the Mutual Security Program had emphasized was the importance of private-capital investment as a potent force in raising the economic and social standards of the assisted areas, the initial reactions of the business community were not encouraging.[35] A 1953 study of 366 respondents (247 being foreign investors) by the Department of Commerce revealed that approximately one-half were familiar with the guarantee program. Of the foreign investors, 52 percent thought that guarantee insurance had a generally encouraging effect on foreign investment with only 5 percent taking a contrary view. Nevertheless, 65 percent stated that the insurance factor was irrelevant to their decision and in no single decision had the existence of guarantees tipped the scales. The existence of the program had encouraged the decisions of 8 percent; 9 percent felt they might

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34. Mutual Security Act of 1958, § 413(b)(4), 72 Stat. 261, 267 (1958).

35. Whitman, pp. 59-61; Clubb and Vance, <u>supra</u> note 33, pp. 476-477.

utilize the insurance.[36] However, a 1958-1959 Commerce Department survey of 41 participants in the program indicated that fully one-half had rested their decision upon the availability of a guarantee.[37]

With the passage of time the program began to show limited success in encouraging overseas investment of private funds. However, even though by mid-1959, nearly $450 million in guarantees had been issued, this represented less than .25 percent of the total U.S. direct investment abroad from 1948 through 1958.[38] From the inception of the program in 1948 through June 30, 1959, investment guarantees had been issued totalling $431.6 million -- $235.1 million for convertibility and $196.5 million for expropriation. They were concentrated in four European countries (Italy, France, Germany, and

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36. U.S. Department of Commerce, Bureau of Foreign Commerce, Factors Limiting U.S. Investment Abroad, II (Washington, 1954), pp. 26-30, as cited in Whitman, pp. 62-63.

37. U.S. Department of Commerce, Responses to Business Questionnaire regarding Private Investment Abroad (Washington, 1959), p. 9, as cited in Whitman, p. 63.

38. Whitman, pp. 5, 34. The book value of U.S. direct investment abroad between 1948 and 1958 totalled $187.6 billion -- Latin America, $67.6 billion; Canada, $60.5 billion; Western Europe, $35.2 billion; other areas, $23.3 billion. Whitman, p. 5, Table 1, from U.S. Department of Commerce, Office of Business Economics.

the United Kingdom), with large U.S. multinational corporations as the client-beneficiaries.[39]

The overconcentration of guarantees in Western Europe was disturbing to many members of Congress. A 1959 Senate Foreign Relations Committee report on proposed legislation to amend the Mutual Security Act stated that "[t]he program was originally established to encourage private investment in Western Europe, but that was at a time when Europe was prostrate from the war and was receiving massive Government economic assistance. This condition no longer exists. The focus of efforts to encourage private investment is now on underdeveloped countries. These efforts should certainly be pursued, but there is no reason to give this further encouragement to private investment in Europe."[40]

Reports of Presidential Committee

In November 1958, President Dwight D. Eisenhower appointed a special committee, consisting of prominent

39. International Cooperation Administration, Investment Guaranties Division: Investment Guaranties Issued, 1948-1959 (June 30), as cited in Whitman Appendix B, pp. 83-88.

40. U.S. Congress, Senate, Committee on Foreign Relations, The Mutual Security Act of 1959, Report on S. 1451, 86th Cong., 1st Sess., 1959, p. 31.

attorneys, bankers, business executives, and former high ranking military officers, to study all aspects of the U.S. Military Assistance Program, of which the investment guarantee program was a part. In its first interim report, submitted in March 1959 and publicly released the following month, the committee concluded that the Mutual Security Program "is and will continue to be an effective and essential tool in carrying out our national security interests and in promoting free world defense" against expanding Communist economic and political threats and capabilities.[41]

In its third interim report, dealing with economic assistance programs and administration and released in July 1959, the committee expressed the belief "that the substantial expenditures made by our Government in recent years for economic assistance are justified on grounds both of enlightened self-interest and of our moral responsibility to ourselves to do what we can to help other peoples realize their legitimate aspirations."[42] It urged closer cooperation between the Government and U.S. business organizations in fostering

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41. U.S., The President's Committee to Study the United States Military Assistance Program, Vol. I (Washington, 1959), pp. VII, 3, 14.

42. _Ibid._, p. 60.

private loans and investments overseas and recommended increased use of Government guarantees. "The Committee supports use of such guaranties in preference to direct government-to-government loans wherever feasible, with broadened coverage to include additional types of risks, and with the reserve to back the guaranties limited to maximum foreseeable net cost rather than to set aside 100 percent of the amount of the guaranties issued. We also believe that the various incentives and programs should be so geared as to channel as much United States private investment as possible into the less developed countries, where the need for economic development is the greatest."

The Presidential committee was critical of the "lip service" manner in which Government agencies and officials encouraged private investment abroad, and emphasized that what was needed "is not only new techniques and procedures, but also a more affirmative attitude" by Government officials.[43]

Acting upon the recommendation of the Senate Foreign Relations Committee,[44] Congress in 1959 amended the investment guarantee legislation to provide that

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43. Ibid., pp. 90-91.

44. Supra note 40.

projects must further "the development of the economic resources and productive capacities of economically underdeveloped areas."[45]

The results of the first decade of the program

The enactment of the 1959 legislation some ten years after the inception of the investment guarantee program marked the end of one stage and the beginning of another. The program had served its purpose in the developed areas of Western Europe and Japan which had attained a measure of economic and political stability since World War II. While the Communist threat still remained, the focus of legislators and administrators was turned to the underdeveloped nations. New problems would arise with the substantial statutory limitations upon the geographic application of the program. Changes could be expected in the acceptance, structure, and policy guidelines of the program.

In terms of both new guarantee contracts completed and of applications received, 1958 was a banner year in that more business was done than in the previous 9

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45. Mutual Security Act of 1959, § 413, 73 Stat. 246, 251 (1959). Subsequent legislation referred to "less developed friendly countries and areas." Foreign Assistance Act of 1961, § 221(a), 75 Stat. 424, 429 (1961). See Note, "The Investment Guaranty Program: Problems of Administration," Columbia Law Review, 64 (February 1964), pp. 315-317.

years of the program.[46] However, a sharp decline followed in the next three years, due in large measure to the ineligibility of economically developed countries and the complexities involved in guarantees affecting underdeveloped areas.[47] In 1959, 103 guarantees totalled \$97.5 million, of which \$29.8 million were for less developed areas; in 1960, exclusively for underdeveloped areas, the total for 46 guarantees was \$63.8 million; in 1961, \$71.1 million.[48]

Commencing in 1959 events of transcendent importance occurred which were to have a major impact on the future course of the investment guarantee program and which resulted in the near doubling in applications for guarantees pending from \$1.1 billion in 1959 to \$2 billion at the end of 1961.[49] This was the takeover of Cuba by Fidel Castro and the concomitant expropriations, which merit more detailed exposition.

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46. Marina Von Neumann Whitman, Government Risk-Sharing in Foreign Investment (Princeton, N.J.: Princeton University Press, 1965), p. 96.

47. Ibid., p. 84.

48. Ibid., p. 97.

49. Ibid., pp. 97-98.

CUBAN EXPROPRIATION AND THE PROGRAM

In June 1959, Cuba promulgated an Agrarian Reform Law which permitted the seizure both of farms and cattle land of U.S. citizens and of non-agricultural enterprises on the pretext of preventing social abuses.[50] On July 6, 1960, the Law of Nationalization was decreed expropriating an overwhelming number of U.S. holdings with dubious provisions for payment.[51] The seized properties were valued at $1.8 billion, of which nearly $1.6 billion represented certified corporate claims and approximately $221 million, claims of individuals.[52] Ten U.S. companies suffered more than 65 percent of the corporate

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50. Cole Blasier, "The Elimination of United States Influence," in _Revolutionary Change in Cuba_, ed. by Carmelo Mesa-Lago (Pittsburgh: University of Pittsburgh Press, 1968), pp. 60-63.

51. Eric N. Baklanoff, _Expropriation of U.S. Investments in Cuba, Mexico and Chile_ (New York: Praeger Publishers, 1975), pp. 113, 134, 161. A provision for compensation in 30-year bonds at two percent interest was contained in the Nationalization Law. However, compensation would not become effective unless the then prevailing American sugar quota of 3.2 million tons and the U.S. price of sugar were both raised. The practical effect of this provision was the effective non-payment of all nationalized properties. _Ibid._, p. 134.

52. U.S. _1972 Foreign Claims Settlement Commission Annual Report_ (Washington, D.C.: Government Printing Office, 1973), p. 412.

losses; two public utilities sustained extremely high capital losses. Five of the companies were predominantly in sugar growing and milling, two in petroleum refining for the domestic market, and one in nickel mining and refining.[53]

By 1959 Cuba, enjoying a very favorable foreign investment climate, ranked second behind Venezuela in U.S. direct investments in Latin America. One-eighth of the total U.S. investments in that region were in Cuba when expropriations were there carried out.[54]

The investment guarantee program became available

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53. Ibid., p. 414. The claimants and their awards were:

Cuban Electric Co.	$ 267,568,414
ITT	130,679,758
West India Co.	108,975,068
Moa Bay Mining Co.	88,349,000
United Fruit Sugar Co.	85,110,147
West Indies Sugar Co.	84,880,958
American Sugar Co.	81,011,240
Standard Oil Co.	71,611,003
Bangor Punta Corp.	53,081,110
Texaco, Inc.	50,081,110
Total	$1,021,645,816

54. Eric N. Baklanoff, "International Economic Relations," in Revolutionary Change in Cuba, supra note 50, p. 254.

in Cuba on November 29, 1957, some 13 months before Castro's accession to power. Under the existing legislation, guarantees were available against currency inconvertibility and expropriation relating to new investments or expansion of existing enterprises.[55]

In 1959, Castro's first year in power, U.S. firms invested in Cuba more than $75 million, nearly one-fifth of total U.S. investment there since 1946, for expansion of mining and utility enterprises and extension of credit to oil company subsidiaries.[56]

The International Telephone and Telegraph Company (ITT), through its Cuban Telephone Company subsidiary, suffered the second largest expropriation loss. On March 14, 1957, ITT executed a new concession agreement with the Cuban Government to expand its telephone facilities at a cost of nearly $66 million. Two years later more than $17 million of new construction was in progress.[57] Notwithstanding eligibility for and availability of guarantees in a well publicized program, neither

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55. Baklanoff, _supra_ note 51, p. 111.

56. _Ibid._, p. 21.

57. Foreign Claims Settlement Commission Annual Report, _supra_ note 52, pp. 193, 414.

ITT nor other companies sought guarantee contracts in Cuba from 1958 until May 1960 when they were no longer being issued. While U.S. companies initially believed that Castro's Cuba was safe from political risks, the expropriations of 1960 changed their attitudes and made them receptive to the advantages of the program, especially in Latin America.[58]

THE KENNEDY TASK FORCE AND THE ESTABLISHMENT OF AID

Shortly after he assumed office, President John F. Kennedy in March 1961 created a task force to make recommendations concerning a reorganization of U.S. foreign assistance programs. Three months later the

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58. U.S. Report to Congress on the Mutual Security Program for the Fiscal Year 1960 (Washington, 1961), pp. 109-110. See also Note, _supra_ note 45, p. 325.

Very generally, except for countries which embarked on programs of full-scale socialization of their economies, completely repudiating the concept of private property, expropriation of foreign-owned property had been relatively infrequent until the 1960's. The pattern of expropriation -- with the exception of the completely socialized countries such as Cuba -- had been the taking over of long-operating companies holding key positions in the country's economy and which frequently had become politically vulnerable. Letter from Department of State to Senator J.W. Fulbright, dated May 7, 1962, reprinted in U.S. Congress, Senate, Committee on Foreign Relations, _Foreign Assistance Act of 1962, Report on S. 2996, 87th Cong., 2d Sess., 1962_, pp. 91-95.

task force presented its report containing numerous significant recommendations, among which were the following: the establishment of a new, all-encompassing foreign aid agency, the Agency for International Development (AID), in the Department of State, which would administer the Investment Guaranty Program as well as other grants, loan and technical assistance programs previously administered by the ICA; the expansion of risk coverage to include insurrection, civil strife, and revolution under war risk insurance, certain forms of "creeping expropriation" under expropriation insurance, and acts of municipal and provincial governments -- in addition to those of the central governments -- for all types of coverage; the extension of eligibility to wholly-owned foreign subsidiaries; greater flexibility concerning the requirement that bilateral agreements be executed with host countries before the guarantee program could be applied, especially with respect to provisions dealing with the subrogation rights of the U.S. Government; the exclusive use of arbitration in all future disputes with investors; and the establishment of an all-risk guarantee program on an experimental basis for high priority projects which would incorporate the DLF program[59] with guarantees of both loan and equity

59. _Supra_ notes 32 and 33 and accompanying text.

investments.[60]

The recommendations of the Presidential task force became the subject of hearings before the appropriate Congressional committees. The chief administration spokesman was Frank M. Coffin, managing director of the DLF and chairman of the task force's group on program development. The comprehensiveness of the hearings warrants extensive consideration.

Testimony of Frank M. Coffin

In his statement before the House Committee on Foreign Affairs, Coffin observed that the new approach to economic assistance envisaged a range of measures as necessary to the effective mobilization of U.S. private enterprise. The proposed legislation was based on experience gained since 1948, and on essential response to the needs of the 1960's, especially those of the less-developed countries (LDC). Lack of close familiarity with conditions in LDC's often led prospective investors to rate their risk even higher than may be

60. U.S., Department of State, An Act for International Development, Fiscal Year 1962, A Summary Presentation (Washington, D.C., 1961), pp. 105-108.

merited -- a situation frequently resulting in lower productivity with a concomitant greater requirement for public assistance. Illustrative was the drastic decline in 1960 of fresh U.S. direct investment in Latin America, caused both by Cuban expropriations and the fear of political turmoil elsewhere.

Coffin submitted that by expanding the investment guarantee program through reducing the risks of loss, Congress could help to raise the levels of private investment in the LDC's. Congress should raise the authorization to $1 billion against specified non-business risks, and permit foreign chartered corporations majority-owned by U.S. citizens to obtain investment guarantees. War guarantees should include coverage for risks caused by revolution, insurrections, and civil strife, and by sanctions decreed by other governments against the project country. Expropriation insurance should include acts of municipal and provincial governments and governmental breaches of agreement producing substantially expropriatory results. The requirement that the project government recognize the U.S. Government's right to subrogation to any claims of private investors paid by this Government, and to succession to ownership rights to the property concerned, should be made more flexible in special cases where political or other practical difficulties were present in the foreign government. Thus, in some cases, mainly in Latin America, a turnover of land following payment of a guarantee by the U.S. Government would present constitutional problems. It was anticipated that the present operative fees of one-half percent annually for the three specific risk guarantees would be retained, but a more flexible policy based upon experience should be considered.[61]

Coffin announced the Kennedy administration's support -- the first administration to do so -- of a proposal for the establishment of an international guarantee institution, associated in some manner with the International Bank, provided it could be proved feasible and was attractive to a significant number of LDC's. Such an institution would be aimed at superseding existing unilateral or bilateral guarantee systems; would provide equal protection to investment from all member industrialized countries, thus eliminating differences and competition between guarantee systems; and would

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61. U.S. Congress, House, Committee on Foreign Affairs, The International Development and Security Act Hearings on H.R. 7372, 87th Cong., 1st Sess., Pt. III (1961), pp. 903-911.

directly associate the LDC's desiring private investment in the substance and obligations of the guarantee program.[62]

The House hearings devoted considerable discussion concerning both Latin America's relation to the investment guarantee program and the newly proposed "all-risk" guarantees. Coffin observed that unless checked, the forces of change in Latin America could lead to Communist revolution. Recognition necessarily must be given to the widely varying economic and political conditions in the various Latin American countries. The Presidential proposal of an alliance for progress program, in conjunction with broadening the authority to make guarantees against specific risks and providing limited authority to make "all-risk" guarantees, would contribute significantly toward increased private investment in Latin America and simultaneously lessen the need for public financing.[63]

In response to a question as to how the guarantee

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62. Ibid., p. 910.

63. Ibid., pp. 982-991.

program could create the political stability essential for private investment, Coffin replied that the program, "a foot-wetting process," would afford sufficient assurance to private industry to go to Latin America and Africa and hence allay initial fears concerning political risks. Once present in those countries, private investors would realize the potential for profiting both themselves and the host country.[64]

Inquiries of Congressmen

Congressman Walter H. Judd of Minnesota, a long time supporter of the guarantee program, inquired why in the absence of any losses, the premium rate or fee was maintained at one-half percent instead of being reduced to one-quarter percent. The existing fee was a deterrent to investment; the reduction would make the program more attractive. Coffin's response was that a reduction in fee would be in the discretion of the program's administrator; additionally, authority would be sought of setting a reduced package fee if a business bought coverage for several risks simultaneously.[65]

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64. Ibid., pp. 936-937.

65. Ibid., pp. 933-935.

Congressman Barrett O'Hara of Illinois expressed concern over the proposal to broaden war coverage to include "civil strife accompanying war, revolution, or insurrection," as it might expose the United States to an unreasonably great risk of loss. He cited the disastrous experience of a private insurer during World War I. In reply, Coffin pointed out that the primary purpose of the program was not to convey benefits on private business. "We are doing this because we think that the interest of the United States in the development program benefits by a much greater participation by private business and that the risk of some loss is well worth achieving the goal of far better participation ... We think the geographical coverage is so much that although there might be losses in a particular country there would be relative stability in most countries and that this would not be a major problem." Moreover, the Government, to lessen civil strife losses, might not insure the entire loss but only some percentage and additionally use deductible costs.[66]

The Government requested authority for the submission to arbitration of disputes concerning claims under

66. _Ibid._, pp. 958-959.

the program. The arbitration panel would be tripartite, a nominee of the host country, a nominee of the program agency, and a third selected by the others. Arbitration would facilitate the settlement of claims, and if the U.S. Government refused to pay, the Court of Claims was available.[67]

The hearings before the Committee on Foreign Relations of the Senate, which from the inception of the investment guarantee program had afforded little legislative impetus, centered about the proposed "all-risk" guarantees. Frank M. Coffin, again the principal administration spokesman, noted that an expansion of the program in the LDC's would have little, if any, adverse effect on the balance of payments of the United States, and that there was little likelihood that the program would stimulate competition to U.S. industry abroad. _Per contra_, the program would pave the way to creating new future markets; absent U.S. private investment in the LDC's, other countries, some unfriendly to ours, might take over. As to the fear of private companies insured under the program making large windfall profits at Government expense, two approaches were available:

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67. _Ibid._, pp. 910, 960.

(1) means to make the investor share the profits with the host country for purposes well received therein; (2) contractual provisions whereby such profits could be paid to the U.S. Government in terms of variable fees or otherwise.[68]

Inquiries and doubts of Senators

Several members of the committee voiced doubts about extending specific risk coverage and issuing all-risk guarantees. Chairman J.W. Fulbright of Arkansas observed that it would be difficult to ascertain the boundaries of "creeping expropriation" -- defined as substantial breaches of agreement by the host country or its provincial and local divisions. "Does that cover an increase in taxes?" he asked. Moreover, extension of guarantees on loss for any reason whatever seemed unacceptable. Coffin's response concerning creeping expropriation was that notwithstanding apparent difficulties, extreme versions, such as doubling of taxes overnight, would be recognizable and ultimately subject to arbitrable or judicial cognizance.[69]

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68. U.S. Congress, Senate, Committee on Foreign Relations, The International Development and Security Act, Hearings on S. 1983, 87th Cong., 1st Sess., Pt. I (1961), pp. 271-272.

69. Ibid., pp. 273-275, 296.

Senator Albert Gore of Tennessee expressed deep concern about the all-risk guarantees. He thought that "the existing law was overly generous with respect to guarantees," and that the proposal, coupled with the tax laws relating to income earned abroad, "would attract companies with a virtual guarantee of profits and an exemption of taxes." Coffin shared his concern but said that as an experimental proposal, it was worth trying in order to induce equity or lending capital in the LDC's.[70]

Senator Stuart Symington of Missouri raised some serious questions about the all-risk proposal which were to be repeated in hearings a decade later. With 99 of the nation's 100 largest companies operating abroad, what criteria would the Government use to select a firm in a competitive industry so as to give it in effect a risk-free investment? Would not competitive management fee contracts serve a more useful purpose and reduce the resentment of the U.S. firms unsuccessful in the biddings? Coffin pointed out that the all-risk proposal was limited to a ceiling of $100 million for both equity and loan repayment and repeated that the essential consideration was to get the resources of private

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70. Ibid., p. 276.

enterprise involved in the less developed areas. Having gained experience, the U.S. investor would seek less reliance on any kind of guarantees. Moreover, competitive management fee bidding does not produce the best talent.[71]

Bilateral international agreements as of June 1961

At the time of the hearings in June 1961, 37 bilateral international agreements had been executed: of these, 23 covered convertibility, expropriation, and war risks; 33 covered convertibility and expropriation; and 14 were limited to war risk. Significantly, Argentina, Chile, Columbia, and Peru then limited their coverage to convertibility risk. Thirty-eight underdeveloped free world countries, including Brazil, Dominican Republic, Venezuela, Nigeria, and Indonesia, were not then participating in the investment guarantee program.[72]

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71. Ibid., pp. 289-294.

72. Ibid., pp. 286-288; cf. Clubb and Vance, supra note 33, p. 498, as to June 1, 1962 figures.

LEGISLATION 1961-1963

On September 4, 1961, the Foreign Assistance Act of 1961 (FAA of 1961) became law.[73] Except for periodic minor changes vis-a-vis the investment guarantee program, this legislation governed the operation of the program until the creation of the Overseas Private Investment Corporation (OPIC) some eight years later.[74]

The 1961 legislation provided for the issuance of guarantees not to exceed $1 billion outstanding at any one time to U.S. citizens or U.S. corporations, partnerships, or associations "substantially beneficially owned by United States citizens, as well as any wholly-owned foreign subsidiary of any such corporation" against inconvertibility of currency, loss of investment resulting from "expropriation or confiscation by action of a for-

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73. 75 Stat. 424, 429-432 (1961).

74. Foreign Assistance Act of 1969, 83 Stat. 805, 809-818 (1969). Although chartered on December 30, 1969, OPIC did not officially take over AID's investment guarantee program until January 19, 1971, when President Richard M. Nixon issued an executive order transferring the program to OPIC pursuant to § 239(b), 83 Stat. 816. Executive Order No. 11579, 36 Federal Register 969 (1971).

eign government," and "war, revolution or insurrection."[75] An all-risk provision was added, with a face amount of guarantees in this category not to exceed $90 million and no individual guarantee to exceed $10 million. The eligibility criteria for such risks were intentionally left unclear -- "where the President determines such action to be important to the furtherance of the purposes of this title, assuring against loss of not to exceed 75 percentum of any investment due to such risks as the President may determine, upon such terms and conditions as the President may determine: Provided, that guaranties issued ... shall emphasize economic development projects furthering social progress and the development of small independent business enterprises ..."[76]

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75. FAA of 1961, § 221(a) and (b), 75 Stat. 429-430. Section 223(b) defined "expropriation" as "includ[ing] but is not limited to any abrogation, repudiation, or impairment by a foreign government of its own contract with an investor, where such abrogation, repudiation, or impairment is not caused by the investor's own fault or misconduct, and materially adversely affects the continued operation of the project." 75 Stat. 432 (1961).

76. FAA of 1961, § 221(b)(2), 75 Stat. 430 (1961).

In place of the previous requirements that foreign governments recognize the U.S. Government's right to subrogation after payment of claims, the FAA of 1961 merely provided, "The President shall make suitable arrangements for protecting the interests of the United States Government."[77] Great latitude was likewise given concerning the types of projects eligible for coverage. The proposed guarantee should "facilitate and increase the participation of private enterprise in furthering the development of the economic resources and productive capacities of less developed friendly countries and areas ... The guaranty program ... shall be administered under broad criteria."[78]

The FAA of 1961 also authorized the issuance of all-risk guarantees not to exceed $10 million for investments in "self-liquidating pilot housing projects" in Latin America, but unlike the general all-risk authority, there was no 75 percent ceiling.[79]

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77. Ibid., § 221(d), 75 Stat. 430 (1961).

78. Ibid., § 221(a), 75 Stat. 429 (1961). See Note, supra note 45, pp. 316-317, note 12.

79. Ibid., § 224(a) and (b), 75 Stat. 432 (1961). See Clubb and Vance, supra note 33, pp. 500-502; Note, supra note 45, p. 320.

Consonant with the recommendation of the Presidential task force,[80] the statute created AID to administer the various foreign aid programs, including the investment guarantee program.

In enacting the FAA of 1961, Congress reiterated its strong preference for programs of assistance developed through private channels.[81] It continued to urge that the investment guarantee program be expanded and that it stress economic development.[82]

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80. Supra note 60 and accompanying text.

81. FAA of 1961, § 601(b)(4), 75 Stat. 439 (1961).

82. U.S. Congress, House, Committee on Foreign Affairs, Foreign Assistance Act of 1962, Report on H.R. 11921, 87th Cong., 2d Sess., June 7, 1962, pp. 8-9; U.S. Congress, Senate, Committee on Foreign Relations, Foreign Assistance Act of 1962, Report on S. 2996, 87th Cong., 2d Sess., May 28, 1962, p. 18.

Government guaranteed private funds would appear to offer a cheaper means for foreign economic development than public funds. In the case of direct foreign aid, the Government must make an immediate outlay of public funds, charging the borrower a rate of interest much lower than what it has to pay on its own securities. In the case of the guarantee not only does the Government make no immediate outlay of funds and charge a premium but its liability does not accrue until the guaranteed-against loss occurs. See Clubb and Vance, supra note 33, p. 490.

The changes to the FAA of 1961 in the following two years were primarily in the financial authorization. The 1962 legislation raised the maximum on the face amount of outstanding guarantees from $1 billion to $1.3 billion; of all-risk guarantees, from $90 million to $180 million; of housing project guarantees in Latin America, from $10 million to $60 million.[83] The 1963 legislation increased the ceiling of the specific guarantees to $2.5 billion and that of the housing projects to $150 million. It also provided that in the issuance of a guarantee, "the President shall consider the possible adverse effect of the dollar investment under such guaranty upon the balance of payments of the United States."[84]

Countries participating in program 1964-1968

Following the enactment of the FAA of 1961, many additional countries signed agreements making them eligible under the investment guarantee program. By March 31, 1964, the number of countries participating reached

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83. FAA of 1962, § 104(a)(1) and (3), 76 Stat. 255, 256-257 (1962). See Richard B. Lillich, "The Protection of Foreign Investment and the Foreign Assistance Act of 1962," Rutgers Law Review, 17 (Winter 1963), pp. 405-427.

84. FAA of 1963, § 104(a)(1) and (f), 77 Stat. 379, 381-382 (1963).

58, an increase of 18 in approximately two years.[85] The additions included a number of newly independent states in Africa as well as several Latin American countries. Moreover, 13 agreements were amended to allow expanded risk coverage. The liberalizing provisions concerning bilateral agreements in the 1961 legislation[86] were valuable vis-a-vis negotiations of agreements or amendments, especially with certain Latin American countries. On the basis of interim agreements, signed but not yet ratified by the host countries' appropriate governmental bodies, the United States was able unilaterally to issue guarantees provisionally.[87]

By September 1966, the number of countries participating in the program reached 75.[88] The last major Latin American country to do so was Brazil in February

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85. Whitman, op. cit., supra note 46, pp. 87-90. See Note, "Intergovernmental Agreements under the United States Investment Guaranty Program," Indiana Law Journal, 43 (Winter 1968), pp. 429-461.

86. Supra note 77 and accompanying text.

87. Whitman, supra note 85; F. Bradford Morse and Timothy B. Atkeson, "United States Private Investment under the Alliance for Progress," Boston University Law Review, 46 (1966), pp. 143, 151.

88. U.S. Department of State, Agency for International Development, Specific Risk Investment Guaranties Division, Office of Development, Finance and Private Enterprise, Specific Risk Guaranty Handbook (Washington, October 1966), pp. 50-51 [hereinafter cited as 1966 Handbook].

1965, some four months after a military takeover.[89]

In 1968, AID was issuing guarantee contracts in over 40 countries.[90] When the investment guarantee program was officially transferred to OPIC in January 1971, bilateral agreements had been signed with over 90 LDC's.[91]

AID'S MODUS OPERANDI AND ELIGIBILITY REQUIREMENTS

In directing that the program "be administered under broad criteria,"[92] Congress indicated that it should not be constricted by administrative decision. Accordingly, AID sought to retain as much discretion as possible, passing on each application on an individual basis. Its operative definitions and *modus operandi* were set forth in a handbook and specimen contracts rather than in regulations. While, as noted, legislation required that some sort of agreement exist between the

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89. See Morse and Atkeson, *supra* note 87, pp. 151-154.

90. U.S. Congress, House, Committee on Foreign Affairs, *Overseas Private Investment Corporation Hearings*, 93d Cong., 1st Sess., 1973, pp. 200-201.

91. U.S. Overseas Private Investment Corporation, Political Risk Investment Insurance Handbook, Draft Copy (Washington: January 1971), pp. 5, 62-63.

92. FAA of 1961, § 221(a), 75 Stat. 429 (1961), *supra* note 78.

United States and the host country, the primary purpose of which was to determine the settlement of disputes between the host country and the United States as subrogee, the investor was not affected in any way by the inter-governmental agreement. The contract between the U.S. Government and the investor set forth the conditions under which AID would pay the investor irrespective of any agreement with the host country, except that in each instance such agreement would provide that the latter must first give its approval of the investment for guarantee purposes. The obligation of obtaining approval was imposed upon the investor -- a requirement which Congress insisted upon but which AID officials preferred to eliminate since on occasion it was difficult to ascertain which host country agency was needed to approve.[93]

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93. Leigh M. Miller, "United States Guaranty Program," University of Missouri at Kansas City Law Review, 35 (1966), pp. 46-49.

The requirement of foreign approval lengthened the processing time for applications and many applicants urged its elimination. However, elimination would have created numerous problems including the necessity to renegotiate all the bilateral agreements affecting the program.

Charles Warden, Chief of the Investment Guaranties Division of AID, stated in 1962 that the basic standard for issuance of an investment guarantee was the extent the project would further U.S. foreign policy objectives. His division was willing to guarantee an investment wherever the applicant was prepared to invest. The requirement that a project contribute to the economic development of the host country usually coincided with the paramount objective of furthering U.S. foreign policy. Most guarantees have been for basic industries. Applications on behalf of utilities or mortgages of housing projects, which might entail too great a risk of involvement with local regulatory agencies or foreclosure proceedings were rejected or discouraged. Similarly, projects likely to encounter Congressional or public disapproval would be rejected in order not to jeopardize the program. In the absence of sufficient claims to provide guidelines, each claim would be treated on an ad hoc basis.[94]

In an informal working paper published some four years later, Leigh M. Miller, a successor of Warden, expressed similar sentiments. The U.S. Government re-

94. Interview of November 30, 1962, as reported in Note, supra note 45, pp. 323-325.

garded overseas investment as an integral part of the foreign aid program with the Investment Guaranties Division of AID deemed a foreign policy arm of the Government. "We would not be offering this insurance program if it were not for the fact that we are in the foreign aid effort. We would not be asking the taxpayer to be responsible for over two and one-half billion dollars worth of possible liability unless we thought this was a really important part of the foreign aid program."[95]

According to Miller, the program was most flexible, with AID responsive to the needs of investors in the LDC's. Very few kinds of investments were ineligible -- only those not beneficial to the host country. Very few applications were rejected; rejections occurred because either the program was not available in the prospective host country or the investment contained a basic infirmity. While the program was designed as an incentive to bring new investments, expansion of an existing investment was sufficient; and in proper case the guarantee would cover not only the new investment for expansion but also the old investment. With respect to the eligibility requirements of applicants, AID considered a foreign corporation American-controlled if

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95. Supra note 93, p. 50.

it were over 50 percent owned by U.S. citizens. If so controlled, the corporation could still borrow from foreign sources up to 400 percent of its net worth and be deemed eligible.[96]

Miller's division had developed a standardized contract, of necessity complicated, but where circumstances required, some changes in the contractual provisions were made. With 1,400 applications currently on file, seeking $10 billion of insurance coverage, all requests for modification of the standardized provisions could not be granted.[97]

Miller noted that recently several changes had been made in the guarantee program. The guarantee contract against inconvertibility had assured the investor that in exchange for local currency acquired as return of capital or investment earnings from the guaranteed project, the investor would obtain 95 percent[98] of the

96. Ibid., pp. 47, 50-51.

97. Ibid., p. 51.

98. The 5 percent was to allow for minor fluctuations and such ordinary expenses as transfer commissions, mail or cable transfer charges, transactions, stamp taxes, etc., usually borne by foreign investors transferring local currency into dollars. This was an administrative decision not required by legislation. See Note, supra note 45, p. 318, note 26.

equivalent in dollars according to the "Reference Rate of Exchange," the rate used for official government transactions. That figure was changed to 99 percent. Premium rates or fees were being reduced: for convertibility insurance, .25 percent per annum; for expropriation and for war, each .5 percent or .875 percent in combination. The standby fee, the amount between the maximum amount selected and the amount the investor had to risk at any one time, was reduced from .25 percent to .1 percent for all three specific political risk coverages. Coverage against expropriation had been expanded by broadening the definition to include some forms of indirect or creeping expropriation. While the statutory mandate[99] permitted all-risk guarantees to cover only up to 75 percent of the commercial and political risks involved in an appropriate loan investment, AID permitted specific risk guarantee coverage for the remaining 25 percent. Accordingly, the only uncovered risk was for the commercial portion of 25 percent of

99. Supra note 76 and accompanying text.

the loan.[100]

GROWTH OF THE PROGRAM IN THE 1960'S

During the 1960's the investment guarantee program grew rapidly. From its inception in 1948 to 1960, some $500 million in guarantees were issued, primarily in the countries of Western Europe. From 1961 to 1965,

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100. Supra note 93, pp. 54-55; 1966 Handbook, pp. 14-27; see Note, supra note 45, pp. 318-320.

The establishment of premium rates had no useful historical precedent as a guide. It had been suggested that rates vary according to the riskiness of the investment location -- a practice employed for expropriation insurance until 1954. However, in October 1954, expropriation (and inconvertibility) rates were made uniform irrespective of location risks.

Even though the FAA of 1961 was silent on the matter, AID rejected varying rates based on risk-location. This was based on the advice of actuaries as well as the feeling that a varied fee structure would produce a negative reaction among host countries in high risk areas and might jeopardize U.S. relations with the LDC's involved in the program. Whitman, op. cit., supra note 46, p. 117.

The AID contracts gave the investor the option of selecting annually whether he wished to continue paying the premium for coverage or paying the lower premium for standby. The lower charge caused many investors to seek the standby which was discontinued when OPIC took over. U.S. Congress, Senate, Committee on Foreign Relations, Multinational Corporations and United States Foreign Policy Hearings before the subcommittee on Multinational Corporations, 93d Cong., 1st Sess., 1973, Pt. III, pp. 476-478 [hereinafter cited as 1973 SOH].

the amount reached $2.6 billion, almost all in LDC's.[101] In fiscal year 1963, $214 million in investment guarantees were issued for 20 countries, with Pakistan, Argentina, and India accounting for 80 percent thereof;[102] in 1964, $545 million for 24 countries, with Argentina accounting for 45 percent thereof;[103] in 1965, $858 million for 47 countries, with Columbia and Argentina accounting for more than one-half of Latin America's 64 percent, and Africa for nearly 17 percent;[104] in 1966, $1,110 million for 41 countries, with Chile and Argentina accounting for 61 percent of Latin America's fifty percent.[105]

The average annual amount of insurance issued by AID from 1966 through 1970, when OPIC took over the program, was $1,672 million. Its guarantee program was

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101. *Ibid.*, p. 47.

102. U.S., State Department, Agency for International Development, Operations Report (Washington, June 30, 1963), pp. 16-17, 114 [hereinafter cited as AIDOR].

103. AIDOR, June 30, 1964, pp. 16-17, 100.

104. *Ibid.*, June 30, 1965, pp. 12-13, 81-82.

105. *Ibid.*, June 30, 1966, pp. 14-15, 116-117.

concentrated in a few countries and industries, and when it turned over its insurance portfolio to OPIC its active contracts -- generally for 20 years -- concentrated coverage largely in 7 countries, all of which, except for Korea and India, were in South America or the Caribbean area.[106]

The geographic application of the guarantee program between 1965 and 1970 is informative. During this period, AID issued 1,725 specific risk contracts in Latin America totalling over $5.8 billion of "collapsed"[107] insurance.[108] Comparable figures for other regions were:

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106. U.S. Congress, House, Committee on Foreign Affairs, The Overseas Private Investment Corporation: A Critical Analysis, prepared by Foreign Affairs Division Cong. Research Service-Library of Congress, 93d Cong., 1st Sess., 1973, pp. 42, 62-63 [hereinafter cited as CRS Study]; U.S. Comptroller General of the United States Management of Investment Insurance, Loan Guarantees, and Claim Payments by the Overseas Private Investment Corporation, Report to the Subcommittee on Multinational Corporations, Senate Committee on Foreign Relations (Washington: July 16, 1973), p. 12 [hereinafter cited as CGR]. The CRS Study refers to concentration in 8 countries, including the Philippines as the eighth country after India.

107. When insurance issued under "combined coverage" is counted twice -- once for expropriation and once for war -- it is considered "collapsed." CRS Study, p. 63, note 24.

108. CRS Study, p. 55.

Africa -- 947 contracts, \$2.7 billion of insurance;[109] Near East and South Africa -- 699 contracts, \$1,225 billion of insurance;[110] East Asia (Far East) -- 510 contracts, \$850 million of insurance.[111]

In 1968, its peak year, AID issued contracts to 19 Latin American, 14 African, 6 Near East and South African, 8 East Asian, and one European country -- a total of 48 countries.[112]

Heavy concentration in Latin America and the Alliance for Progress

The reasons for the heavy concentrations of guarantee contracts in Latin America were twofold: (1) the previously described expropriatory actions of the Cuban Government under Castro; (2) the emergence of the Alliance for Progress program. The latter was initiated

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109. *Ibid.*, p. 57.

110. *Ibid.*, p. 56.

111. *Ibid.*

112. U.S. Congress, House, Committee on Foreign Affairs, Hearings before the Committee on Foreign Economic Policy, *Overseas Private Investment Corporation*, 93d Cong., 1st Sess., 1973, p. 220.

when President John F. Kennedy on March 31, 1961, brought together the Latin American ambassadors to announce that the United States desired to join their countries in a new alliance dedicated to the economic and social improvement of their countries and the strengthening of democratic institutions. In addition to substantial measures of self-help, their countries could count on U.S. large-scale financial assistance over a period of years. Five months later, on August 17, the chief delegates of 19 Latin American countries (all except Cuba) and the United States formally inaugurated the Alliance for Progress by approving its basic documents: a "Declaration to the Peoples of America" and "The Charter of Punta del Este Establishing an Alliance for Progress within the Framework of Operation Pan America." The Declaration expressly stated as a goal the "stimula[tion] of private investment."[113]

Congress was generally sympathetic to the goals of the Alliance for Progress and to the encouragement of private investment through the investment guarantee

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113. Herbert K. May, _Problems and Prospects of the Alliance for Progress_ (New York: Praeger Publishers, 1968), pp. 30-32.

program. In connection with the proposed Foreign Assistance Act of 1962,[114] the House Committee on Foreign Affairs urged the execution of more bilateral agreements with Latin American countries and observed: "There is need, now more than ever, for a more imaginative use of these guaranties if private enterprise participation in programs such as the Alliance for Progress is to take place. In Latin America, for example, the specific risk guaranties and housing guaranties can be used to encourage reinvestment of earnings or capital that would otherwise leave the area ..."[115]

The initiation or expansion of the guarantee program in Latin America in the 1960's[116] is reflected in the greatly increased collapsed volume of political risk insurance issued by AID, particularly in the following five countries: Chile, with $1.826 billion; Jamaica, $1.099 billion; Brazil, $764 million; Argentina, $754 million, and the Dominican Republic, $698 million --

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114. Supra note 83 and accompanying text.

115. Report, supra note 82, p. 9.

116. Morse and Atkeson, supra note 87, p. 151.

a total of over $5 billion before the transfer of operations from AID to OPIC.[117] Somewhat detailed examination of the coverage in Chile and Jamaica, with lesser exposition concerning the other three countries, will prove instructive.

The program in Chile and the "Chileanization" program

Percentagewise, AID's exposure in Chile in terms of its overall insurance portfolio exposure was as follows: inconvertibility, 10.1; expropriation, 8.4; war, 3.1. Only Jamaica had a greater percentage of expropriation exposures, namely 17.8.[118] The guarantee contracts covering Chile had been issued perforce the Alliance for Progress program on the basis of the political judgment that acceleration of Chile's development was consonant with the long-range interests and security of the United States. As stated in a 1968 Congressional hearing by U.S. Ambassador Edward M. Korry: "With the election of President Eduardo Frei in 1964 Chile assumed an importance for us because of the significant role it seemed ready to play in the Alliance for Progress' policy of seeking accelerated reform, development and

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117. CRS Study, p. 63.

118. CGR, p. 12.

growth in Latin America within a democratic framework ... In no little measure the preservation of Chile's democratic values rests on the ability of the Frei administration to redeem its electoral promise of a fundamental reform of Chilean society within the context of personal liberty ... We have collaborated with the Chilean Government in the pursuit of these goals ..."[119]

In line with its policy of giving priority to developmental benefits, AID insured very large investments in the expansion of Chilean copper mines to support the "Chileanization" program of the Frei Government. Similar coverage was given to Chilean utilities.[120]

An outstanding feature of Chile's economy for the past half century has been its considerable dependence on the export of one commodity, copper, which accounted for almost 70 percent of the nation's export earnings.

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119. U.S. Congress, House, Committee on Government Operations, AID Operations in Latin America under the Alliance for Progress, Hearings before a Subcommittee on Government Operations, 90th Cong., 2d Sess., 1968, p. 832 [hereinafter cited as 1968 HAP].

120. 1973 SOH, p. 146.

In December 1964, but two months after Frei became president, an agreement was reached on a formula for the Chilean Government's purchase of a 51 percent interest in the Kennecott Copper operation, and 25 percent government participation in new Anaconda Company ventures and in a new venture in the Cerro Corporation. For five years prior to Frei's election, the large copper companies, known locally as the "Gran Mineria," had slowed down their investment in new plants and equipment due to uncertainty over increases in taxes and the investment climate.[121]

Frei's "Chileanization" program included the following objectives: (1) doubling the copper output; (2) increasing the value added in Chile by refining the bulk of the copper; (3) providing for Chilean Government participation in the production and marketing of copper as a partner of the foreign copper companies. The $600 million required for the expansion program was provided by foreign banks and suppliers ($309 million, including $197 million from U.S. Export-Import Bank), the U.S. copper companies ($222 million), and most of the balance

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121. Baklanoff, _op. cit._, _supra_ note 55, p. 64; Morse and Atkeson, _supra_ note 87, p. 154.

from the state-owned Chilean Copper Corporation (CODELCO).[122]

Both the Chilean Government and the U.S. copper companies gained from their agreements. The former achieved a stronger voice in the mining operations, including marketing and pricing, and shared directly in the profits. The latter obtained government guarantees against expropriation for all new investments in the industry, lower tax rates, provisions for tax stability for 20 years, and sharing of labor negotiations with the government.

In 1965, Chile amended its investment guarantee agreement with the United States to include expropriation, with the result that AID insured nearly all of the new financing provided by U.S. companies.[123] Kennecott Copper, among others, indicated the importance of

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122. Baklanoff, pp. 75-77. It is interesting to note that in 1964 Senator Salvador Allende, who subsequently became president in 1970 and in whose regime massive expropriations occurred, had a bill in the Chilean Congress to nationalize the U.S. companies. Under its provisions, they would have received a token $123 million in the form of bonds paying 3 percent. Coming events frequently cast their shadows beforehand. Ibid., p. 77, note.

123. Ibid., p. 78.

the guarantee insurance when it wrote its stockholders: "The overall agreement is contingent upon enabling legislation by the Chilean Congress, investment guarantees by the U.S. Agency for International Development, certain tax rulings, and favorable action by international lending agencies."[124]

The International Telephone and Telegraph Company (ITT), which had expended millions of dollars for modernization and expansion of its facilities in Cuba without insuring its investment, only to have its fingers burned, expanded its investment in Chile through its affiliate, International Telephone and Telegraph Company, Sud America, which had made investments in Compania de Telefonas de Chile, which was operating a successful telephone system. The issuance of AID's four expropriation guarantee contracts in 1965 and 1967 was the sine qua non of ITT's expanding its Chilean facilities -- "In our discussions with the Chilean Government, we have made it clear that the obtaining of AID specific risk guaranties on these retentions is an underlying premise of our ability to contribute this in-

124. 1973 SOH, p. 442.

vestment to any new expansion."[125]

The program in Jamaica

The extensive insurance coverage by AID in Jamaica followed a path somewhat different from that in Chile. Of its total insurance portfolio, AID's exposure in Jamaica percentagewise was as follows: inconvertibility, 1.4; expropriation, 17.8; war, 21.5.[126] Most of the coverage was in metal mining. Jamaica is one of the most abundant sources of bauxite, the most economical source of aluminum. By 1957, Jamaica became the largest single source of the bauxite used by the U.S. aluminum industry.[127]

In 1966, Kaiser Aluminum Company, Reynolds Metal Company, and Anaconda Company formed a Delaware partnership, Alpart, consisting of individual subsidiary Delaware corporations, all 100 percent owned by the affiliated parent companies. The partnership was established

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125. *Ibid.*; "International Telephone and Telegraph Corporation, Sud America -- Overseas Private Investment Corporation: Arbitration of Dispute Involving U.S. Investment Guaranty Program," *International Legal Materials*, 13 (November 1974), pp. 1307-1308.

126. CGR, p. 12.

127. 1973 SOH, p. 49.

to build, operate, and manage an aluminum smelter at an initial investment of $200 million. In June 1968, AID issued guarantees against expropriation to these companies totalling $234.9 million, with Kaiser obtaining $61.6, Reynolds $86.2, and Anaconda $87.1 million. Without such insurance the decision would not have been made to proceed with the project or with a project of that magnitude.[128]

AID initially issued the insurance without any difficulties. Subsequently, in the fall of 1969, Kaiser and Reynolds sought additional guarantees totalling $85.8 million for an expansion of the smelter. Simultaneously, the Aluminum Company of America and the Revere Brass Company had applied for guarantees, respectively, of $98.6 million and $77.2 million, also for the purpose of converting investments in aluminum smelters. Thus, in addition to the guarantees of $234.9 million issued by it in 1968, AID had under consideration

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128. Ibid., pp. 50-53. See also U.S. Congress, Senate, Committee on Foreign Relations, The Overseas Private Investment Corporation Amendments Act, Report on S. 2957, 93d Cong., 2d Sess., 1974, pp. 20-21 [hereinafter cited as 1974 SOR].

in the fall of 1969 additional guarantee applications for $261.6 of insurance -- a total risk exposure if the applications were favorably received of approximately one-half billion dollars.[129]

During this latter period legislation was pending and subsequently enacted which created OPIC.[130] OPIC received, together with its developmental mandate, a directive to conduct its financing and insurance operations in accordance with sound business management principles on a self-sustaining financial basis and "with due regard to principles of risk management" in its insurance operations. Although AID officially administered the guarantee program until January 1971, the OPIC legislation mandated that in the interim AID was likewise required to consider principles of risk management in its operations.

The 1969 applications by the aluminum companies for additional insurance did not have as smooth sailing as the initial applications. In the fall of 1969, Vincent de Roulet, an advertising executive, was appointed

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129. 1974 SOR, p. 21.

130. Foreign Assistance Act of 1969, 83 Stat. 805, 809-818 (1969). See supra note 74 and accompanying text.

U.S. Ambassador to Jamaica. His initial reaction was opposition to the issuance of the additional insurance on the ground that the proposed $500 million level of guarantees in a single industry in a small country was unsound. However, he withdrew his objection in the face of considerable pressure from the companies, AID officials, and the government of Jamaica, as well as the knowledge that his State Department superiors favored the applications.[131]

In September 1970, the applications were approved with substantial modifications. In order to reduce its financial exposure, AID issued its guarantee contracts for shorter periods than the 1968 original guarantees -- from the previous normal 20-year term to 13½ years after completion of construction, and with declining exposure with the passage of time. Moreover, unlike its 1968 action, in 1970 AID insured only 75 percent of the investment, leaving the balance uninsured to afford the companies strong economic motives to resolve by negotiation any disputes with the Jamaican Government.[132]

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131. 1974 SOR, pp. 22-23; 1973 SOH, pp. 109-133, 148-161, 504-508.

132. 1973 SOH, pp. 505-507; 1974 SOR, p. 23.

Subsequent Congressional hearings concerning OPIC's operations revealed some interesting commentaries with respect to AID's 1970 Jamaican guarantees. Herbert Salzman, in 1968-1970 the assistant administrator for Private Resources in AID and in charge of the investment guarantee program, later acting president and executive vice president of OPIC, testified that the negotiations were lengthy and very difficult. AID's prime objective was to provide the minimum incentive adequate to assure a positive investment decision conditioned on the companies' agreement to reduced and shorter term coverage -- radical departures from previous practice which the companies fought -- and on the U.S. Embassy in Jamaica and the State Department's favorable opinion of the long-range risks. In addition, AID received public assurances from the Jamaican prime minister and the leader of the opposition concerning their desire for the investment. Frequent consultations were held with the State Department, the U.S. Embassy, and Jamaican officials. It was only after all conditions were met that "we were reluctantly willing to go forward with the insurance" -- a total of one-half billion dollars.[133]

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133. 1973 SOH, pp. 505-507.

Robert Hurwitch, deputy assistant secretary for Inter-American Affairs, Department of State, told a Senate subcommittee that AID had issued the insurance at the request of the aluminum companies and the Government of Jamaica. The latter had as its objective, endorsed by both major political parties, achieving optimum local transformation of bauxite to alumina with the purpose of maximizing benefits to the local economy. The investment helped to assure for the United States a reliable nearby source of this vital material. The decision to issue AID insurance was based on the assessment that Jamaica offered the prospect of political stability and was a signatory to an international agreement to settle investment disputes. There was a favorable working relationship between the aluminum industry and Jamaica.

Hurwitch noted that from 1967 through 1970 investment insurance covered an average of approximately $430 million annually in Latin America and the Caribbean.[134] Since 1969, the United States had "moved, finally from a posture of paternalism and patronizing attitude to the other countries of the hemisphere" to one of partnership.[135]

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134. Ibid., pp. 147-149.

135. Ibid., p. 129.

The program in Brazil

As noted, besides Chile and Jamaica, AID had a heavy concentration of insurance coverage in Brazil, the Dominican Republic, and Argentina. Foreign policy considerations were likewise important factors in such coverage. In February 1965, Brazil became the last major Latin American country to participate in the investment guarantee program. For a few years prior to a military coup in November 1964, there had been several major disputes between the Brazilian Government and U.S. companies. The former pro-left, anti-U.S. attitude changed with the military takeover; the new government became a major recipient of U.S. foreign aid, a purchaser of U.S. military supplies, and a supplier of troops in 1965 for an Organization of American States (OAS) peace-keeping mission in the Dominican Republic, which the United States backed. The enactment of legislation favorable to business and industry in the years following the coup led to extensive AID insurance coverage.[136]

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136. 1968 HAP, pp. 442, 853; CRS Study, p. 63; Morse and Atkeson, supra note 87, pp. 151, 153-154.

The program in the Dominican Republic

AID's insurance in the Dominican Republic increased from $46 million in June 1965 to $698 million by 1971. As a result of civil unrest with Communist overtones in 1965, an Organization of American States peace-keeping mission, including U.S. troops, was for a time stationed there. Elections in 1966 resulted in the establishment of a pro-American administration, followed by heavy U.S. private investment, especially in mining operations.[137]

The program in Argentina

The bulk of AID insurance in Argentina was issued before 1966, having risen from $114 million in 1962 to $670 million by the latter year. As a supporter of the Alliance for Progress program and a major recipient of its assistance, Argentina as early as 1962 began receiving low interest rate loans from AID and the International Bank for Reconstruction and Finance.[138]

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137. CRS Study, p. 63; AIDOR, June 30, 1965, p. 81, and December 31, 1970, p. 78.

138. AIDOR, March 31, 1963, p. 84, and June 30, 1966, p. 116; 1968 HAP, p. 843.

In 1965, Argentina had the largest per capita gross national product of any Latin American country. There had been a considerable flow to it of private U.S. direct investment. Thus, in 1962-1963, AID insured a $72 million PASA petrochemical project, funded in part by the International Finance Corporation and the International Development Bank. AID issued to 29 U.S. investors in PASA convertibility, expropriation, and all-risk insurance.[139]

Beginning in 1965, U.S. assistance to Argentina through AID was primarily in the form of a modest technical assistance program.[140] During the next five years Argentina encountered several political and economic problems, especially those of political instability and inflation, with the resultant loss of private foreign investment.

The program in Korea and Southeast Asia

Korea had the second largest amounts of AID-insured investment insurance after Chile -- $1,294 million.

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139. Whitman, op. cit., supra note 46, p. 98.

140. 1968 HAP, p. 843.

Virtually all of the U.S. investment there occurred after the 1960 signing of the bilateral agreement establishing the investment guarantee program. Practically all major U.S. investments were AID-insured. Although other factors helped to create an excellent foreign investment climate, particularly the 1966 Foreign Investor Act, the presence of political risk insurance was an important contributing factor to most investments.[141]

Illustrative of an insured Korean project is the Korea Pacific Chemical Corporation. In 1968, the Dow Chemical Company was asked to enter into a joint venture with a corporation owned by the Korean Government to establish a facility to produce petrochemical products. Mindful of the uneasy truce and the unsettled condition of the border between North and South Korea but impressed with the economic soundness of the project provided certain conditions -- e.g., maintenance of a Korean protective tariff against foreign imports -- were met, Dow made its participation dependent upon AID's fully insuring its investment. AID agreed and in August 1970 issued policies providing coverage for inconvertibility, expropriation, and war risks and $3 million future royalties. Additionally, considerable financing

141. CRS Study, p. 63; 1973 SOH, pp. 443-444.

of the project came from English sources. The plant began operation in January 1973 and appears to have been a successful venture.[142]

Following the Korean War, the United States, with Congressional authorization, extended substantial military and economic assistance to Taiwan and the Philippines, as well as Korea -- countries of heavy concentration of AID insurance.[143]

Taiwan and Korea reciprocated with assistance to the United States in the Vietnam War and all three countries permitted U.S. troops and military bases on their territory. They also enacted legislation favorable to U.S. private investment.

A 1973 report of the Comptroller General of the United States concerning the operations of the former AID and of OPIC noted that over half of AID's insurance covered high risk projects. AID's average project coverage was approximately $2.58 million; but 57.5 percent of its coverage applied to large projects of $10 million and over, while 34.7 percent related to medium-size projects of $1 to $10 million. AID's portfolio had

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142. 1973 SOH, pp. 326-328.

143. CRS Study, p. 59.

large concentrations in two industries -- metal mining, 23.9 percent, and manufacturing of chemicals and allied products, 18.2 percent; primary metals processing accounted for 8.3 percent and petroleum refining, 7 percent. Since these industries require large amounts of capital and since many of the projects were located in LDC's with prior political and economic problems or previous anti-American sentiment, it was natural that AID insurance was concentrated in large multinational corporations. These corporations clearly indicated that the presence of AID insurance was a determining factor in their investment decision.[144]

The experience of Dow Chemical Company

The importance of U.S. Government insurance covering projects overseas was graphically presented by Paul F. Oreffice, financial vice president of the Dow Chemical Company, to a Senate subcommittee in July 1973. As noted, his company had invested in the Korea Pacific Chemical Corporation. Dow's policy in making a capital investment was to investigate thoroughly every circumstance -- *e.g.*, the products to be manufactured and the location of the plantsite -- to make certain that the project was economically sound. Political and economic

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144. CGR, pp. 18-19; CRS Study, p. 89; 1973 SOH, pp. 470-471.

risk factors, as well as sociological conditions in the host country, were considered.

In the mid-1950's, Dow decided that instead of exporting its products from the United States, it would be feasible and desirable to build plants where the foreign markets were located. Having learned of the investment guarantee program, as early as 1955 Dow took out investment insurance. Its ideas of the needs for insurance coincided with AID's policy concerning both the geographic application of, and the specific risks covered by the guarantee program. While the availability of insurance was an important factor in the decision-making process, "we did not decide to make investments because AID insurance was available, but if AID insurance had not been available, we probably would not have made the investments."[145]

Whether the availability of AID insurance was as crucial a factor to other insured companies as it was to Dow cannot be known with certainty. AID made it comparatively easy for many applicants to obtain its insurance which was relatively cheap, available for a 20-year period, and purchasable on a standby basis. Until 1968 applicants were asked simply to describe briefly

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145. 1973 SOH, pp. 323-326.

the manner in which the investment would further the development of the economic resources and productive capacities of the project country. A short paragraph, usually narrative rather than quantitative, was provided. AID did not require -- as OPIC did -- significant data on each investment: host country revenue, related local private investment, prices, foreign exchange, earnings, and employment.[146]

Criticism of AID's administration of program

Critics have pointed out the inadequacies of the investment guarantee program administered by AID. It failed to maintain adequate records on insurance exposure; it failed to initiate any serious analysis of exposure by country and sector. Its personnel were preoccupied with the politics and psychology dominating investment actions and relied upon ambassadors and other important officials to support new investment proposals.[147]

As noted, the FAA of 1961 expressly granted AID

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146. Supra note 112.

147. Keith Wheelock, "What is the Direction of U.S. Political Risk Insurance?" Columbia Journal of World Business, 8 (Summer 1973), pp. 59-60.

great latitude concerning the types of projects eligible for coverage and mandated that the guarantee program "be administered under broad criteria."[148] As a branch of the Department of State, AID was considerably influenced by the Department's foreign policy aims.[149]

AID heavily concentrated its insurance program in a few countries which had stable governments and friendly relations when the guarantees were approved. Moreover, once a compatible relationship was established with a particular host country, it was easier to guarantee new projects there than to attempt geographical diversification.

AID, unlike OPIC,[150] was under no legislative mandate to operate its insurance program through utilization of prudent risk management principles. Subjective,

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148. Supra notes 77 and 78 and accompanying text.

149. Interview with Mr. David Stebbing, a State Department Foreign Service officer in the Office of Investment Affairs and the Department's representative on OPIC's board of directors, Washington, D.C., August 2, 1976.

Mr. Lawrence Potter, an OPIC insurance consultant, stated that during the latter part of 1967, AID was being pushed "to issue as much insurance in Chile as we could." CRS Study, p. 95. See also ibid., p. 64.

150. See note 130 and accompanying text.

instinctive factors were the bases for issuing guarantees. In the words of a former official, what was good for U.S. foreign policy was acceptable for AID insurance.[151]

In a 1976 interview, Harry L. Freeman, a quondam high official of AID and later vice president for finance of OPIC, stated that the guarantee division cooperated with other divisions of AID and the State Department to utilize its guarantee program to facilitate comprehensive social and economic developmental programs. If a host country were receiving foreign assistance in some manner, AID was not overly concerned about the risks surrounding the issuance of insurance on private projects. Indeed, top Government officials in policy-making roles took the position that AID's insurance stimulated economic support through private investment and, accordingly, necessitated less direct support by the U.S. Government.[152]

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151. Interview with Mr. Gil Carter, former counsel of AID's Investment Guaranties Division and later of OPIC, Washington, D.C., January 7, 1976.

152. Interview with Mr. Freeman, Washington, D.C., January 7, 1976.

AID and political risk analysis

According to Freeman, some AID officials in 1966-1968 informally undertook political forecasting and political risk analysis of some of the countries with which AID was involved. Unofficial studies which indicate improvement in Chile but major concern over Guinea, showed the results to be generally inaccurate; because of the sensitiveness of the subject the results were not published. However, the studies indicated that some projects, located in high risk host countries, had been insured for political reasons. When on several occasions AID sought the assistance of actuaries to determine whether it should modify its fee schedules and the duration of its contracts, it was told that the guarantee program, both intrinsically and as administered, could not be regarded as a normal insurance operation subject to actuarial tables.[153]

The ultimate responsibility for the investment guarantee program resided with Congress which periodically (often annually) determined the extent of the guarantee authorization and the expiry date of the agency responsible for administering the program. It was not

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153. *Ibid.* See Chapter VIII, note 38 and accompanying text.

until the 1969 AID-OPIC hearings that Congress paid much attention to the program; with the 1973 OPIC hearings, in-depth, critical examination took place. This lack of Congressional interest is partially attributable to the fact that AID and its predecessors had been presented with few claims. Had there been a number of substantial claims, the history of the program would undoubtedly have been different.

Claims against AID

Only 21 formal claims were filed with AID, of which 11 were acted on favorably, one proceeded to arbitration, and none was litigated. Of the 10 convertibility claims, 5 were granted, 4 were denied, and one not yet decided when AID's operations were taken over by OPIC in 1971. Of the 6 expropriation claims, 2 were granted and 4 denied. Of the 5 war, revolution, or insurrection claims, 4 were granted.[154] Some \$3.5 million was paid to the 11 successful claimants; some \$5.2 million was denied to the unsuccessful claimants.[155] Insurance fees

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154. William T. Adams, "The Emerging Law of Dispute Settlement under the United States Investment Insurance Program," Law and Policy in International Business, 3 (1971), pp. 101, 106. See also David G. Armstrong, "The United States Government's Investment Guaranty Program," Business Lawyer, 20 (November 1964), pp. 27, 35-36.

155. Adams, ibid., p. 151.

collected during fiscal years 1961 through 1970 totalled \$94.48 million.[156] Thus, AID paid out in claims less than four percent of what it received as fees. Moreover, as subrogee the U.S. Government was able to recoup a substantial portion of what it awarded to the successful claimants.

For several years before 1969, many members of Congress and interested groups were recommending that the investment guarantee program should be administered by a semi-private governmental agency operated under sound business management procedures and subject to risk management principles. It was not until December 30, 1969 that these recommendations received Congressional approbation in the enactment of the legislation creating OPIC.[157]

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156. CRS Study, p. 45.

157. Foreign Assistance Act of 1969, 83 Stat. 805, 809-818 (1969). See <u>supra</u> notes 74 and 130 and accompanying text.

CHAPTER II

THE CREATION OF OPIC

THE GENESIS OF OPIC

The Benjamin A. Javits Peace by Investment Corporation

The concept of a federally chartered corporation to promote private investment in less developed countries (LDC's) was probably first developed by the late Benjamin A. Javits, lawyer-brother of Senator Jacob K. Javits of New York. Commencing with his 1950 work, *Peace by Investment*,[1] and a subsequent collaborative tract with Leon H. Keyserling, chairman of the President's Council of Economic Advisers in the administration of Harry S. Truman, Javits advocated the establishment of a "Peace by Investment Corporation" (PBIC) that would expand by billions of dollars the flow of private U.S. investment for economic development projects in LDC's.[2]

Javits's PBIC would be a U.S. corporation serving as an equity investment agency and making available

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1. Benjamin A. Javits, *Peace by Investment* (New York: Funk and Wagnalls, 1950), *passim.*

2. Benjamin A. Javits and Leon H. Keyserling, *The Peace by Investment Corporation* (Washington, D.C., by the authors and distributed by International Committee for Peace by Investment, June 1961), p. 4.

funds of a private capital nature in LDC's. It would finance directly, make loans, and engage in the purchase of securities. Assistance from it would have to meet sound economic criteria, meet the approval of the host country, not take the place of funds which otherwise would be available for the same purpose, and be consistent with U.S. foreign and domestic policy.

PBIC would be funded initially by the sale of $100 million class A stock to the U.S. Treasury and basically by the sale of several billion dollars worth of class B stock to the public. Additionally, it would also be authorized to obtain initial and temporary capital funds by issuing obligations to the Treasury. Part of the proceeds of the sale of class B stock would be earmarked for the retirement of class A stock within a period of six years. Until such retirement, PBIC would be an independent agency of the Government with voting power resting in class A stock. During this period, its management would consist of a board of directors of fifteen members, consisting of a president and executive vice president appointed by the President and five members appointed from private life by the President, all with the advice and consent of the Senate; four members appointed by the President from various agencies concerned with international economic development; and the Secretaries of State, Treasury, Commerce, and Labor, serving *ex officio*. This would facilitate coordination of effort. So long as it remained an agency of the United States, its basic obtaining of funds would be subject to careful supervision by the Secretary of the Treasury. Upon retirement of the class A stock, voting power would lodge in the class B stock. At that time, further legislation would be sought so that PBIC could function as a private corporation.

PBIC would be empowered to establish two insurance systems: (1) on an actuarially sound basis, to protect all or part of its outstanding overseas investments against loss arising from any cause, including but not limited to political or military events; (2) to protect against loss for specific causes, not including mismanagement, all or part of the outstanding investments of private investors other than the corporation in any overseas undertaking eligible for financial assistance by the corporation.[3]

As will be seen, several of the ideas found in the PBIC proposal became the bases for subsequent legislation.

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3. *Ibid.*, pp. 4-7.

Senator Javits's proposals and the report of a House subcommittee

Jacob K. Javits, who became a Senator in 1957, early espoused his brother's proposal, and during the decade commencing in 1958 introduced numerous Peace by Investment bills.[4] While none became law, the concept behind them later had an effect on the creation of the Overseas Private Investment Corporation in 1969.

Senator Javits maintained a long-standing policy of promoting private enterprise involvement in overseas development efforts. In the early 1960's he was a major sponsor of legislation to establish private investment banks in Latin America and elsewhere to marshall foreign private developmental investment.[5] He urged the creation

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4. S. 4267, 85th Cong., 2d Sess., 1958; S. 1743, 86th Cong., 1st Sess., 1959; S. 1965, 87th Cong., 1st Sess., 1961; S. 2785, 88th Cong., 2d Sess., 1964; S. 1992, 89th Cong., 1st Sess., 1965; S. 2697, 89th Cong., 1st Sess., 1965; S. 3415, 90th Cong., 2d Sess., 1968.

5. Senator Javits was one of the primary sponsors of the Atlantic Community Development Group for Latin America (ADELA). See Congressional Record, Vol. 110, January 7, 1964, pp. 653-654. ADELA came into being on September 24, 1964, as a private multinational investment corporation designed to make capital investments in Latin America as well as to engage in debt financing and underwritings, alone or with others. According to Javits, ADELA's objectives included making and developing capital investments, obtaining a reasonable return for its subscribers, and encouraging and supporting participation of local and foreign private

of commissions to study the most effective means for utilizing private enterprise in the foreign assistance program. In 1963 he introduced an amendment to the subsequently enacted Foreign Assistance Act (FAA) of 1963 [6] which created an Advisory Committee on Private Enterprise in Foreign Aid of nine members to submit a final report by December 31, 1964. The members of the committee, chosen by the head of the Agency for International Development (AID), consisted of representatives from the business, labor, professional, and academic world. Arthur K. Watson, chairman of the IBM World Trade Corporation, was designated as committee chairman.[7]

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capital. Jacob K. Javits, "The Fortunes of ADELA," Columbia Journal of World Business, 1 (Spring 1966), pp. 123-127.

Senator Javits was also in the forefront in establishing the Private Investment Company for Asia (PICA), incorporated in November 1968 to make capital investments in the LDC's of Asia. The New York Times, January 13, 1969, pp. 37-38.

6. FAA of 1963, § 301(b), 77 Stat. 379, 385 (1963).

7. U.S. Foreign Aid through Private Initiative, a Report of the Advisory Committee on Private Enterprise in Foreign Aid (Washington, D.C., distributed by the Agency for International Development, July 1965), p. 1.

The committee's report, consisting of 33 recommendations, commented favorably on many aspects of the Javits Peace by Investment proposal. Concerning the investment guarantee program it recommended that both the selected and extended risk programs be expanded and that both types of insurance be available to portfolio investors as well as direct investors. It urged expansion of AID's private enterprise professionals.[8]

In 1966, Senator Javits sponsored an amendment to the subsequently enacted Foreign Assistance Act of 1966[9] which created the International Private Investment Advisory Council on Foreign Aid (IPIAC) as an advisory body to the AID administrator. IPIAC was "to be composed of such number of leading American business specialists as may be selected, from time to time,"[10] by the AID administrator who thereafter selected senior officials of six national business organizations.[11]

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8. Ibid., pp. 30-33.

9. FAA of 1966, § 301(4), 80 Stat. 795, 804 (1966).

10. Ibid.

11. U.S. Congress, Joint Economic Committee, Foreign Economic Policy for the 1970's, Hearings before a subcommittee of the Joint Economic Committee, 91st Cong., 2d Sess., Pt. III, 1970, p. 743. The six national business organizations were: The Chamber of Commerce of the U.S.; The Committee for Economic Development; The National Association of Manufacturers; The National Industrial Conference Board; The National Foreign Trade Council; and the U.S. Council of the International Chamber of Commerce. Ibid., note 2.

In February 1967, President Lyndon B. Johnson reorganized AID and created within it a new Office of Private Resources (OPR) for the purpose of concentrating on the marshalling of private investment and expanding private sectors in the LDC's. The investment guarantee program became a part of OPR.[12]

During July through October 1967, a Subcommittee on Foreign Economic Policy of the House Committee on Foreign Affairs, chaired by Leonard Farbstein of New York, held extensive hearings on the involvement of U.S. private enterprise in developing countries, and rendered an exhaustive report in April 1968.[13]

The subcommittee sought to determine whether Congress could do more to assist private business to increase its investment in the LDC's. It found that existing Government programs were inadequate; "the present flow of U.S. private investment is on a plateau and has been stagnant for some years."[14] Several witnesses ex-

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12. U.S. Congress, House, Committee on Foreign Affairs, The Involvement of U.S. Private Enterprise in Developing Countries, H. Rept. No. 1271, by Subcommittee on Foreign Economic Policy, 90th Cong., 2d Sess., 1968, p. 30. The report is also known as the Farbstein report.

13. Ibid.

14. Ibid., pp. 1, 3.

pressed the view that private investment in the LDC's could better be served by a separate quasi-public corporation which would not be subject to political and bureaucratic control and to annual Congressional review.[15]

The report contained a number of significant observations and recommendations. Operating as part of AID which in turn functioned in conjunction with the Department of State, OPR -- while making a positive contribution -- of necessity competed with other divisions of AID for time, staff, and money and must justify its existence annually before Congress. The proposed Javits PBIC legislation received favorable comment with the added caveat that such corporation's activities would have to be reviewed "in terms of general U.S. foreign policy commitments and with development programs."[16]

Among the subcommittee's recommendations were the following: (1) initiation of studies concerning the feasibility of establishing a quasi-public corporation dedicated solely to private industrial development work

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15. Ibid., pp. 29-30.

16. Ibid., pp. 30-31.

in the LDC's. Such corporation offering greater organizational flexibility initially should be supported by public funds, but such assistance should be tapered off and, if possible, means should be adapted for making the corporation self-supporting through funding from private sources. (2) As regards the investment guarantee program, the specific risks guarantee should be broadened to include not only war, revolution, and insurrection coverage, but also losses from civil strife, viz.: riots, which might not amount to insurrection. Moreover, careful consideration should be given to expanding the extended risk guarantees on commercial risks. (3) The United States should endeavor to reach agreement with other developed countries regarding the establishment of a multilateral investment guarantee program, under the auspice of some international organization such as the World Bank.[17]

In a 1976 interview, John C.L. Donaldson, a former OPR official and later assistant U.S. Special Representative for Trade Negotiations, Executive Office of the President, stated that prior to the Farbstein subcommittee hearings, AID officials had not seriously considered

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17. Ibid., pp. 3-6.

establishing a quasi-public corporation to administer a private investment program in the LDC's. Having reached a decision concerning the desirability and feasibility of such corporation, AID officials sought the advice and counsel of IPIAC.[18]

In 1968, Senator Javits proposed an amendment to the Foreign Assistance Act of 1968, calling for a reappraisal of foreign assistance program by a review committee. This committee, _inter alia_, was to make recommendations concerning the establishment of a Government corporation facilitating the U.S. private capital and skills in the LDC's.[19] The legislation as enacted in October 1968 requested the President to make a comprehensive review of foreign aid programs and to consider proposals regarding the establishment of a Government corporation or a federally chartered private corporation to stimulate the flow of U.S. private capital to LDC's.

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18. Interview with Mr. John C.L. Donaldson, Washington, D.C., August 4, 1976.

19. U.S. Congress, House, Committee on Foreign Affairs, _The Overseas Private Investment Corporation: A Critical Analysis_, prepared by Foreign Affairs Division Cong. Research Service-Library of Congress, 93d Cong., 1st Sess., 1973, p. 6 [hereinafter cited as CRS Study].

The review should also consider whether the corporation should utilize Government guarantees and funds as well as private funds; develop, promote, and underwrite new investment projects; assist in transferring skills and technology to LDC's; and invest in the securities of development institutions and assist in the development of local capital markets.[20]

Report of a Presidential committee

Later in October 1968, the President's General Advisory Committee on Foreign Assistance Program, headed by Dr. James A. Perkins of Cornell University, recommended formation of a Government corporation to take over AID's private investment programs and with authority to raise capital funds at Government guaranteed rates and to lend directly to high risk private ventures in LDC's. Since these programs are "predominantly of a business nature, are revenue producing and call for a considerable flexibility of administration and funding," a Government corporation was the appropriate vehicle for operations.[21]

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20. FAA of 1968, §§ 501-502, 82 Stat. 960, 966-967. See also George D. Aiken, Senate Diary: January 1972 - January 1975 (Brattleboro, Vt.: Stephen Green Press, 1976), p. 114.

21. U.S., The President's General Advisory Committee on Foreign Assistance Programs, Development Assistance in the New Administration (Washington, D.C., dis-

IPIAC, established by the 1966 legislation,[22] issued its report in December 1968 under the title, "The Case for a U.S. Overseas Private Enterprise Development Corporation." The thrust of the report is contained in its introduction: "While recognizing that the following proposal is a draft to be further developed and refined, the Council recommends the organization of an overseas private enterprise development corporation of and funded by the United States, as responsive to the Javits Amendment to the 1968 Foreign Assistance Act, and a sound basis for legislative consideration. Implementation of its recommendations would further the economic and foreign policy interests of the U.S. and would foster private sector growth in developing countries."[23]

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tributed by the Agency for International Development, October 1968), pp. 2, 26.

22. Supra note 9.

23. U.S., The International Private Investment Advisory Council (IPIAC), The Case for a U.S. Overseas Private Enterprise Development Corporation (Washington, D.C., distributed by the Agency for International Development, December 1968), p. 1.

President Nixon's recommendations

In his 1969 foreign aid message to Congress, President Richard M. Nixon recommended the establishment of the Overseas Private Investment Corporation for the purpose of enlisting greater private enterprise participation in the foreign aid effort. In the statement of purpose and policy OPIC was to conduct investment financing on a financially self-sustaining basis; utilize private sources of financing as the principal means of encouraging investment; increase private participation by selling its direct investments to private investors; apply risk management principles in issuance of insurance; utilize and encourage participation of small business in OPIC programs; support investments in less developed "friendly" countries which contribute to their economic and social development; take into account the receptivity of LDC governments to private enterprise; encourage private initiative and competition and discourage monopolies; consider the balance of payments effects of OPIC activites.[24]

These goals were similar to those of AID's guarantee program except for the new emphasis on self-sufficiency and risk management.

24. CRS Study, pp. 6-7.

According to Donaldson, Herbert Salzman, the assistant administrator for OPR in AID and in charge of the investment guarantee program, later acting president of OPIC, excerpted the desirable proposals in the Farbstein hearings and the IPIAC report, added suggestions from his colleagues and others, and presented them to the Nixon administration for consideration. From the Salzman recommendations came the OPIC plan submitted to Congress by the Nixon administration.[25] It is somewhat ironic that while the idea of creating a Government corporation to promote private investment in LDC's was first strenuously advocated in the Democratic Johnson administration, it was a Republican administration which supported the creation of OPIC. Perhaps the legislative directive that OPIC conduct its financing and insurance operations in accordance with sound business management principles made a strong appeal to an administration generally geared to a philosophy of free enterprise.[26]

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25. Interview, _supra_ note 18.

26. Interview with Mr. Gil Carter, former counsel in OPR, Washington, D.C., January 7, 1976.

House of Representatives's deliberations concerning creation of OPIC

The Nixon administration's OPIC proposal was introduced in the House of Representatives in the proposed Foreign Assistance Act of 1969 (FAA of 1969). Intensive committee hearings were held by the House of Representatives which noted the importance of U.S. private investment in the economic progress of LDC's.[27]

Concerning the specific proposal for establishing OPIC as a Government corporation, the House Foreign Affairs Committee, while expressing approval of a partnership between U.S. private management and official policy makers which could conduct operations in a businesslike manner, suggested several changes in the corporate

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27. See U.S. Congress, House, Committee on Foreign Affairs, Foreign Assistance Act of 1969, Hearings on H.R. 11792, 91st Cong., 1st Sess., 1969 [hereinafter cited as 1969 HOH]; U.S. Congress, House, Committee on Foreign Affairs, Overseas Private Investment Corporation, Hearings before Subcommittee on Foreign Economic Policy on Title II of H.R. 11792, 91st Cong., 1st Sess., 1969; U.S. Congress, House, Committee on Foreign Affairs, Foreign Assistance Act of 1969, H. Rept. 91-611 on H.R. 14580, 91st Cong., 1st Sess., 1969 [hereinafter cited as 1969 HOR].

The House bill was originally numbered 11792 when introduced on June 9, 1969. Following a markup of the bill, on October 30, 1969, a clean bill, numbered 14580, was laid before the House.

structure of OPIC. In addition, the committee suggested two very important limitations on OPIC's business activities: (1) not more than 10 percent of the total face amount of the investment insurance or guarantees could be issued to a single investor, and (2) a prohibition against use of loans "to finance operations for mining or other extraction of any deposit of ore, oil, gas, or other mineral."[28] The latter policy decision was made to prevent involvement in an area of activity which often produced "political repercussions."[29]

Several influential members of the House Committee expressed concern over certain aspects of the OPIC proposal.[30] Representatives John C. Culver of Iowa, Jonathan B. Bingham and Benjamin S. Rosenthal of New York, and Edward R. Roybal of California were critical about

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28. 1969 HOR, pp. 32-33; CRS Study, pp. 7-8. Both of these limitations are found in the FAA of 1969, § 234(a)(3), (b), and (c), 83 Stat. 812 (1969).

29. 1969 HOR, p. 33.

30. U.S. Congress, House, debate on H.R. 11792, 91st Cong., 1st Sess., Congressional Record, Vol. 115, November 19, 1969, pp. 34904-34939; November 20, 1969, pp. 35183-35231 [hereinafter cited as 1969 HCR Debate].

taking away from AID an important tool of foreign aid and giving it to an organization governed by business concerns. Increased Government identification with U.S. corporations might lead to charges of economic colonialism.[31] Representative Clement J. Zablocki of Wisconsin noted the following reservations concerning OPIC: (1) OPIC would not do much more than was already being done by OPR; (2) OPIC would operate at higher cost with less efficiency; (3) Since OPIC would not need yearly appropriations, Congressional control would be severely diminished.[32] Other representatives specifically criticized the costliness and highly paid management of OPIC.[33]

In the floor debate, Representative H.R. Gross of Iowa questioned the need to create a corporation to run a program which had been running well for 20 years. He asserted that OPIC would add another costly layer to the federal bureaucracy. He offered an amendment

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31. 1969 HOR, pp. 179-183.
32. Ibid., p. 173.
33. Ibid., pp. 192-194.

which would have deleted the language of the bill creating OPIC and maintained the status quo.[34]

Proponents of OPIC declared that while AID had served an important function in the past, OPIC was proposed as a mechanism that could render quicker and better decisions than AID and would be better equipped to monitor the projects it promotes.[35] Representative Farbstein, whose subcommittee on foreign economic policy had rendered a report the previous year,[36] pointed to the advantage of having a "small specialized organization designed to meet both public and private business needs." Bettering monitoring of project performance would result from OPIC's reliance on businesslike methods.[37]

Representative Thomas E. Morgan of Pennsylvania, chairman of the Foreign Affairs Committee, noting that the committee had written the original authorization

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34. 1969 HCR Debate, pp. 35196-35198.

35. Ibid., pp. 34917-34919.

36. Supra notes 13-17 and accompanying text.

37. 1969 HCR Debate, p. 34917.

for AID investment guarantees and that private enterprise had been contributing to the foreign aid program since the program's inception in 1948, regretted the emphasis on a new agency. The purpose of the program remained to stimulate more private funds into LDC's in order to relieve the U.S. taxpayers of some of the foreign aid burden.[38]

After defeating both the Gross amendment deleting the provision creating OPIC and an amendment which would have placed a limit of 10 percent of the total capital authorized to be paid into OPIC as to the maximum amount which it could lend to a single firm, the House passed the bill 176 to 163, on November 20, 1969.[39]

Senate deliberations concerning creation of OPIC

In the Senate, the foreign aid bill reported by the Foreign Relations Committee did not contain a provision for the establishment of OPIC.[40] During floor de-

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38. Ibid., p. 35200.

39. Ibid., pp. 35201, 35229-35231.

40. CRS Study, pp. 9-10. The OPIC proposal drafted by the Nixon administration was introduced in the Senate as S. 2347 before the Senate Committee on Foreign Relations. U.S. Congress, Senate, Foreign Assistance Act, 1969, Hearings on S. 2347, 91st Cong., 1st Sess., 1969. The committee felt that in order to expedite Senate passage of the foreign aid measure, the bill should not contain the OPIC proposal and other innovations of the House version. CRS Study, p. 10.

bate,[41] Senator Javits with 17 cosponsors introduced an amendment to provide for the creation of OPIC identical to the provisions of the House bill which had already passed. Senator Javits cited the following benefits by establishing OPIC: (1) OPIC would stimulate more private companies to invest abroad. As of 1969, 95% of U.S. business were not active in foreign investment or export. (2) OPIC's main assets were its corporate structure, its right to sue and be sued, its right to have income and to have a corporate budget. (3) As a private corporation OPIC would be able to show greater initiative than a Government agency. (4) Other countries had successfully used private corporations to promote private investment in development. (5) After the corporation began to make money on its own, there would be no more need for Government appropriations. (6) OPIC would do for the field of overseas private investment what the Export-Import Bank had done for the U.S. exporter.[42]

Senator J.W. Fulbright of Arkansas, chairman of the Foreign Relations Committee, was the major opponent of the Javits amendment. He thought the proposal should

41. U.S. Congress, Senate, debate on S. 2347, 91st Cong., 1st Sess., Congressional Record, Vol. 115, December 11, 1969, pp. 38461-38475; December 12, 1969, pp. 38684-38731 [hereinafter cited as 1969 SCR Debate].

42. <u>Ibid.</u>, pp. 38693-38700.

first have been fully considered in committee. He also raised some policy considerations concerning OPIC: (1) What are the political consequences of introducing large amounts of capital into the weaker economies of LDC's? (2) Should the United States give 100% no-risk insurance guarantees to American investors abroad when there was no similar program for encouraging investments in the ghetto or poverty areas? (3) With the OPIC program designed to help big American business abroad, it should be in a separate bill. Was such a program consistent with giving aid to a foreign country? (4) The free enterprise system would be subverted when the Government, in effect, underwrote foreign investment risks. (5) Because of changes in the U.S. international economic position in the last 20 years -- in terms of balance of payments and diminished gold reserves -- past policies should no longer be determinative.[43]

The Javits amendment to establish OPIC and authorize $20 million to be appropriated in fiscal years 1970 and 1971 was passed in the Senate 53 to 34, on December 12, 1969.[44] The same day the Senate passed the bill

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43. Ibid., pp. 38701-38705.

44. Ibid., p. 38709.

with the OPIC provision 52 to 31.[45]

The statute creating OPIC

The conference report which accepted the establishment of OPIC was agreed to by the House and Senate on December 19, 1969.[46] The Foreign Assistance Act of 1969 became law on December 30, 1969.[47]

Views of organizations concerning the creation of OPIC

While Congress was debating the proposal for the establishment of OPIC, other organizations, private, governmental and international, were likewise considering the merits of the proposal. In March 1969, the National Planning Association issued a report recommending the creation of an OPIC-type agency chartered by Congress and wholly owned by private investors. However, a minority of its directors would be appointed by the

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45. Ibid., p. 38731.

46. U.S. Congress, House, Conference Report, Foreign Assistance Act of 1969, H. Rept. 91-767, Conference Report on H.R. 14580, 91st Cong., 1st Sess., 1969, pp. 6-15.

47. FAA of 1969, 83 Stat. 805, 826 (1969).

President and would include AID's administrator and other government officials.[48] Later the organization recommended that such agency should possess the authority to make equity investments of a limited percentage in projects in LDC's in which U.S. investors held at least as large an equity position.[49]

In September 1969, the Committee for Economic Development, a private organization concerned with the problems of economic development in LDC's, issued a report recommending the establishment of a Government corporation that would absorb the guarantee functions of AID and otherwise promote private investment abroad.[50]

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48. National Planning Association (NPA), Joint Statement by NPA Joint Subcommittee on U.S. Foreign Aid and the NPA Board of Trustees and Standing Committees, A New Conception of U.S. Foreign Aid, Special Report No. 64, March 1969, reprinted in U.S. Congress, House, Joint Economic Committee, A Foreign Economic Policy for the 1970's, Hearings before Subcommittee on Foreign Economic Policy, 91st Cong., 2d Sess., 1970, pp. 566-569.

49. Hearings, supra note 48, p. 546.

50. Committee for Economic Development, Statement by the Research and Policy Committee, "Assisting Development in Low-Income Countries: Priorities for U.S. Government Policy" (New York: Committee for Economic Development, September 1969), pp. 70-73. See also Hearings, supra note 48, p. 519.

The following month, the Commission on International Development, initiated by World Bank President Robert McNamara and chaired by Canadian Prime Minister Lester B. Pearson working with seven colleagues from different countries, issued a book-length report examining a number of aspects in international development and supporting expansion of bilateral investment guarantee programs of the type administered by OPIC.[51]

Nelson A. Rockefeller, then Governor of New York and later Vice President of the United States, in 1969 undertook a special mission to the Latin American countries on behalf of President Richard M. Nixon. The product of his mission was set forth in an exhaustive report released on November 10, 1969 containing almost 100 specific recommendations.[52] In testimony given two days later to the House Subcommittee on Inter-American

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51. Partners in Development, Report of the Commission on International Development, Lester B. Pearson, Chairman (New York: Praeger Publishers), *passim.* See also 1969 SCR Debate, p. 38700.

52. U.S. Congress, House, Committee on Foreign Affairs, Governor Rockefeller's Report on Latin America, Hearing before Subcommittee on Inter-American Affairs, 91st Cong., 1st Sess., 1969.

Affairs, Rockefeller supported the creation of OPIC; urged greater use of the contract mechanism, particularly in overtures important to economic growth but with high risks; and urged OPIC to support medium-size and smaller companies rather than the large multinational corporations. In so doing OPIC would help improve the U.S. image abroad.[53]

On September 24, 1969, President Nixon appointed a task force on international development to make recommendations concerning the role of U.S. assistance to LDC's. The task force, headed by Rudolph A. Petersen, former president and board chairman of the Bank of America, had, as noted, been authorized by the Foreign Assistance Act of 1968.[54] It submitted a report in March 1970 strongly supporting OPIC and recommending "that OPIC make greater use of U.S. guaranty program in combination with those of other countries to encourage international joint ventures."[55]

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53. *Ibid.*, pp. 34-35.

54. *Supra* note 20 and accompanying text.

55. U.S. Presidential Task Force on International Development, *U.S. Foreign Assistance in the 1970's: A New Approach*, *reprinted in* U.S. Congress, Joint Economic Committee, *A Foreign Economic Policy for the 1970's*, Hearings before Subcommittee on Foreign Economic Policy, 91st Cong., 2d Sess., 1970, pp. 460-502, especially pp. 484-485.

ANALYSIS OF STATUTE CREATING OPIC

At this point, analysis of the pertinent OPIC provisions added by the Foreign Assistance Act of 1969 (FAA of 1969)[56] appears appropriate. OPIC is a U.S. Government agency "under the policy guidance of the Secretary of State," created to "mobilize and facilitate the participation of United States private capital and skills in the economic and social programs of less developed countries and areas, thereby complementing the development assistance objectives of the United States ..." [57] All of its capital stock, totalling $40 million by fiscal year 1971, is held by the Secretary of the Treasury.[58] It is governed by an 11-member board of directors, a majority of whom are required not to be Government officials. Of the six non-Government members, who are appointed by the President with the advice and consent of the Senate for terms of no more than three

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56. FAA of 1969, 83 Stat. 805, 807, § 105, adding a new Title IV, §§231-240A. See William P. Macht, "Financing Developing Country Enterprise through the Overseas Private Investment Corporation (OPIC)," Law and Policy in International Business, 3 (1971), pp. 469-509.

57. Ibid., § 231, 83 Stat. 809.

58. Ibid., § 232, 83 Stat. 810.

years, at least one must be experienced in small business, one in organized labor, and one in cooperatives. Among the minority of five governmental directors are AID's administrator, who is *ex officio* board chairman, OPIC's president, appointed with the advice and consent of the Senate, and three other governmental officials, all of whom serve at the President's pleasure. The executive vice president is likewise appointed by the President and requires Senate confirmation. However, up to 20 staff members may be appointed outside the civil service system.[59]

The statute delegated to OPIC the former AID specific risk guarantee program, renamed investment insurance and affording protection against loss due to inconvertibility, expropriation, confiscation, or war, revolution, or insurrection;[60] the former AID extended risk investment guarantee program, renamed investment guarantees, permitting guarantees against business risk for up to 100 percent of loans made by eligible investors and up to 75 percent of equity investments made by such investors;[61] and the former Public Law 480 (Cooley) loan

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59. *Ibid.*, § 233(a), (b), (c), and (d), 83 Stat. 810-811.

60. *Ibid.*, § 234(a), 83 Stat. 811-812.

61. *Ibid.*, § 234(b), 83 Stat. 812.

program, renamed direct investment, providing loans in U.S. dollars or local currencies on a reimbursable basis to "firms privately owned or of mixed private and public ownership."[62] In addition to these programs, OPIC was given small pre-investment and technical assistance programs and a pilot $15 million agricultural credit and self-help community development institution program in not more than five Latin American countries.[63]

The FAA of 1969 authorized a maximum contingent liability for the specific risk guarantee program of $7.5 billion,[64] a reduction from the former $8.5 billion;[65] for the extended risk program, $750 million,[66] an increase from the former $550 million.[67] Under the

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62. Ibid., § 234(c), 83 Stat. 812.

63. Ibid., §§234(d), (e), and 240, 83 Stat. 813, 817-818.

64. Ibid., § 235(a)(1), 83 Stat. 813.

65. FAA of 1968, § 103(a), 82 Stat. 960.

66. FAA of 1969, § 235(a)(3), 83 Stat. 813.

67. FAA of 1968, § 103(a), 82 Stat. 960.

latter program, 25 percent of the amount of outstanding guarantees must be maintained in a reserve fund to meet claims.[68] No more than 10 percent of the total investment insurance or investment guarantees could be issued to a single investor.[69] No loans could be made to finance operations for mining or other extraction of any deposit of ore, oil, gas, or other mineral.[70] Support should be given only to those private investments "which are sensitive and responsive to the special needs and requirements" of the LDC's economies and "which contribute to the social and economic development of their people."[71] OPIC was to submit to Congress annually a detailed report of its operations; and not later than March 1, 1974, it was to submit to Congress "an analysis of the possibilities of transferring all or part of its activities to private United States citizens, corporations, or other associations."[72]

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68. FAA of 1969, § 235(a)(2), 83 Stat. 813.
69. Ibid., § 234(a)(3) and (b), 83 Stat. 812.
70. Ibid., § 234(c), 83 Stat. 812.
71. Ibid., § 231(f), 83 Stat. 810.
72. Ibid., § 240A, 83 Stat. 818.

OPIC inherited all the outstanding contingent liabilities of its predecessors' insurance and guarantee programs which carried the full faith and credit of the United States.[73] This amounted to over $10 billion in outstanding insurance liability as of September 30, 1970, of which over $3 billion covered each of the specific risk categories, convertibility, expropriation, and war.[74] Contingent guarantee liabilities at the end of 1970 amounted to approximately $170 million.[75] Against this multibillion contingent liability, Congress made available only $54.49 million to OPIC's Insurance Reserve and $40.87 million to its Guaranty Reserve. Also available for the insurance reserve was AID's current reserves for the program of approximately $27 million.[76]

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73. Ibid., §§ 235(d) and 237(c), 83 Stat. 814-815.

74. CRS Study, p. 45. These figures include combined coverage for both expropriation and war. Ibid., note 2.

75. Ibid., p. 68.

76. FAA of 1969, § 235(c) and (d), 83 Stat. 813-814; Foreign Assistance and Related Programs Assistance Act of 1970, 84 Stat. 5, 6 (1970); U.S. Congress, Senate, Committee on Foreign Relations, Nominations to the Overseas Private Investment Corporation Board of Directors, Hearings, 91st Cong., 2d Sess., 1970, p. 25 [hereinafter cited as 1970 Hearings].

These combined funds patently constituted a minuscule percentage of reserve available for potential insurance and guarantee claims.

Although its statutory mandate declared that OPIC, "utilizing broad criteria, shall undertake to conduct its financing operations on a self-sustaining basis,"[77] and "to conduct its insurance operations with due regard to principles of risk management,"[78] it was even then readily apparent and later acknowledged by OPIC officials[79] and others that it was undercapitalized and that the reserves were inadequate compared to the total amount of contingent liability.

VIEWS OF CONCERNED PERSONS RE LEGISLATION

At the December 1970 hearing on his confirmation as OPIC's first executive vice president, Herbert Salzman, assistant administrator for OPR in AID, commenting on the inadequacy of the reserves, stated that following OPIC's creation, Congress had transferred $50 million

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77. FAA of 1969, § 231(a), 83 Stat. 809.

78. Ibid., § 231(d), 83 Stat. 810.

79. 1970 Hearings, p. 25.

available for OPIC program to the Latin American housing program, and that three years earlier Congress had deleted some $200 million in reserves then available to pay contingent liabilities. He thought the statutory reserve of 25 percent for new loan guarantees a conservative allocation. As regards insurance reserves, OPIC should have available sufficient funds to pay a major claim of $300 million and smaller claims aggregating $50-$100 million. While the present reserves were much less than his objective, it was his expectation and the Congressional committees' intention that each year $25 million in earned reserves might be accumulated.[80] Congressional aides and others who participated in drafting the FAA of 1969, not envisaging such future catastrophic events as the subsequent Chilean expropriations, felt that the modest insurance reserves would be sufficient and, in any event, were the most that could then be obtained from Congress. Requests for greater financial

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80. Ibid. Mr. Erlan H. Higgenbotham, OPIC's vice president for development, stated that at the time of its creation, OPIC's main liability was its undercapitalization and lack of sufficient insurance reserves. OPIC has constantly sought to build up its reserves to meet any contingency. Interview in Washington, D.C., July 26, 1976.

assistance might have been counterproductive.[81]

According to John Donaldson, it was difficult to get new appropriations from Congress. The question of OPIC's reserves was being considered at a time when Salvador Allende, the Marxist candidate, was thought to have a good chance of becoming Chile's president. Since AID had insured many large investments to support the Frei Government's copper and utilities program,[82] many members of Congress might have been hesitant about giving OPIC greater reserves.[83]

In a 1976 interview,[84] Herbert Salzman stated that the provision concerning an analysis of the possibility of transferring OPIC's functions, primarily insurance responsibilities, to private companies,[85] was inserted to allay the fears of those legislators who were apprehensive for OPIC's future, especially since its issuing

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81. Interview with Mr. Don Szabo, legislative assistant to Senator Javits in 1969, Washington, D.C., July 27, 1976; interview with Mr. Ken Gunther, legislative assistant to Senator Javits in 1969, Washington, D.C., July 27, 1976.

82. See Chapter I, pp. 62-67, _supra_.

83. Interview, _supra_ note 18.

84. Interview with Mr. Herbert Salzman, New York, N.Y., October 18, 1976.

85. FAA of 1969, § 240A (b), 83 Stat. 818.

authority was to continue until June 30, 1974.[86] As a further safeguard, the requirement of an annual report was also inserted.[87]

As noted, the purpose of creating OPIC and the principal Congressional mandate are to facilitate U.S. private direct investment in LDC's and to complement the development assistance objectives of the United States.[88] While the Congressional guidelines for OPIC operations were necessarily broad and general,[89] and while every individual OPIC project might not have met all of these criteria, an overview of OPIC's numerous projects demonstrates OPIC's ability to function well with such guidelines.[90]

Herbert Salzman, then acting president of OPIC, in a prepared statement submitted to the Senate Foreign

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86. Ibid., § 235(a)(4), 83 Stat. 813.

87. Ibid., § 240(a), 83 Stat. 818.

88. Ibid., § 231, 83 Stat. 809.

89. Ibid., § 231(a)-(k), 83 Stat. 809-810.

90. Interview with Mr. James Offut, former legislative counsel and counsel to OPIC's board of directors, Washington, D.C., July 20, 1976.

Relations Committee in August 1973 on OPIC's first two years of operations, declared that OPIC's programs were a series of projects and its objectives must be pursued case by case. All of the legislative policy guidelines are preceded by the clause, "the Corporation [OPIC], utilizing broad criteria, shall undertake"[91] -- suggesting a common-sense, case by case judgment. OPIC's program required the making of compromises with the ideal, but OPIC had not found the legislative mandates to be contradictory or unduly restrictive of its basic purpose in most instances. The most limiting of the mandates has been operating the finance program on a self-supporting basis.[92]

As noted, the FAA of 1969 creating OPIC became law on December 30, 1969. However, it was not until January 19, 1971, when President Nixon issued an executive order transferring the private investment programs being administered by AID to OPIC, that OPIC began functioning formally. [93] Most of AID's staff administering the program went to OPIC. A dispute between Congress and the

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91. FAA of 1969, § 231, 83 Stat. 809.

92. U.S. Congress, Senate, Committee on Foreign Relations, Multinational Corporations and United States Foreign Policy, Hearings before Subcommittee on Multinational Corporations, 93d Cong., 1st Sess., 1973, Pt. III, pp. 413-414 [hereinafter cited as 1973 SOH].

93. Executive Order No. 11579, 36 Federal Register 969 (1971).

administration concerning a chief executive officer for OPIC had delayed its formal opening for several months.[94]

According to Herbert Salzman, with confirmation from outside sources,[95] he had the strong backing of Senator Javits and others to become OPIC's first president; but since he was a Democrat, he failed to obtain Nixon administration support.[96] The administration's candidate was John Shad, an investment banker and officer of the brokerage firm of E.F. Hutton & Co. Shad supporters asserted their candidate would view potential projects for OPIC with an eye toward promising opportunities for U.S. business; Salzman supporters feared that Shad's orientation would lead to OPIC's giving greater weight to the needs of U.S. business and less to the needs of the LDC's.[97]

John Donaldson stated that many members of Congress

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94. "Birth Pains," _Forbes_, September 15, 1970, p. 44.

95. _Ibid._

96. Interview, _supra_ note 84.

97. _Forbes_, _supra_ note 94.

thought that the administration's nominees for the board of directors and for top executive positions were too close politically to the administration and that political considerations were prime determinants in the ultimate selection. The administration was not giving OPIC a high priority to enable it to function formally at an early date.[98]

The stalemate was broken with an agreement that Bradford Mills, a New Jersey investment banker, would become OPIC's president and Salzman its executive vice president.

98. Interview, *supra* note 18.

CHAPTER III

OPIC: ITS FORMATIVE YEARS; ITS PROBLEMS IN CHILE; AND THE 1973-1974 OPIC HEARINGS AND AMENDMENTS LEGISLATION

In Chapter I, the impact on the future course of the investment guarantee program resulting from the takeover of Cuba in 1959 by Fidel Castro and of the concomitant expropriations was briefly delineated.[1] Also cursorily described was the economic development of Chile in the 1960's during the administration of Eduardo Frei; the expansion of American investments in the copper industry and in telephonic communications; and the large volume of political risk insurance issued to the U.S. companies in Chile by the Agency for International Development (AID). This insurance had been issued perforce the Alliance for Progress program on the basis of the political judgment that acceleration of Chile's development was consonant with the long-range interests and security of the United States.[2] The election in November 1970 of Salvador Allende as President of Chile resulted both in a cataclysmic change in Chile and in a new critical look at the investment guarantee program and its soon-to-function administrative agency, the Overseas Private Investment Corporation.

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1. See Chapter I, pp. 29-32, *supra*.

2. *Ibid.*, pp. 62-67.

THE CHILEAN EXPROPRIATIONS

Allende was a Marxist who as a Senator in 1964 had submitted a bill in the Chilean Congress to nationalize U.S. companies.[3] A principal program of his administration was the socialization of key areas of the economy. Within seven weeks after he took office, Allende on December 22, 1970 submitted to the Chilean Congress a constitutional amendment to nationalize -- in effect to expropriate -- the mineral resources and related facilities of the large copper companies.[4] A short while later and about the time when OPIC formally commenced to function,[5] the Chilean Government initiated the purchase of most of the foreign and private banks and broadened its efforts to gain control over other areas

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3. Ibid., p. 65, note 122.

4. Eric N. Baklanoff, Expropriation of U.S. Investments in Cuba, Mexico and Chile (New York: Praeger Publishers, 1975), p. 89.

5. OPIC began functioning formally on January 19, 1971, when President Richard M. Nixon issued an executive order transferring the private investment programs being administered by AID to OPIC. Executive Order No. 11579, 36 Federal Register 969 (1971). See Chapter II, p. 120, note 93.

of the economy.[6]

On July 16, 1970, the constitutional amendment nationalizing and expropriating the major U.S.-controlled copper mining companies became effective.[7] Known as the nationalization law, the amendment departed from traditionally accepted methods of compensation in several respects: (1) compensation was to equal book value as of December 31, 1970, less certain deductions, as determined by the Comptroller General; (2) payment was to be made within a 30-year period at an interest rate no less than 3 percent annually; (3) authority was given Allende to deduct from the value of compensation "excess profits" earned by the U.S. companies since May 5, 1955; (4) appeal from the Comptroller General's determination within 15 days lay only to a special five-

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6. U.S. Department of State, Bureau of Intelligence and Research, "Disputes Involving United States Foreign Direct Investment: July 1, 1971 through July 31, 1973" (Washington: February 28, 1974), p. 22 [hereinafter cited as 1974 SDS].

7. Chilean Law 17450 amending Article 10, Section 10 of the Political Constitution of the State and Nationalizing the Major Mining Industry. Reprinted in Wolfgang G. Friedmann, Oliver J. Lissitzyn, and Richard C. Pugh, 1972 Supplement to Cases and Materials on International Law (St. Paul, Minnesota, West Publishing, 1972), pp. 143-146 [hereinafter cited as Friedmann].

man tribunal, consisting of two appellate justices, a member of the constitutional tribunal, the president of the Central Bank, and the national director of internal revenue; and (5) debts of the seized enterprises were not to be assumed when, in Allende's opinion, "the amounts involved have not been usefully invested."[8]

On October 11, 1971, the Comptroller General submitted an assessment of the five large copper mines partially owned by U.S. companies at $664 million as of December 31, 1970. Approximately one-half of this amount -- *i.e.*, $333 million -- represented the remaining equity of the U.S. companies. Two weeks earlier, Allende had set the excess profits (item "3" of the preceding paragraph) at $774 million -- $410 million for Kennecott and $364 for Anaconda. Since excess profits could not be charged against two large new mines that were becoming operational in 1970, approximately $28 milion were awarded for these.[9] Both the companies and the Chilean Government appealed to the special tribunal which held it was not competent to review Allende's ex-

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8. *Ibid.*; Baklanoff, *supra* note 4, pp. 89-90.

9. Baklanoff, pp. 90-91; Friedmann, pp. 150-151; 1974 SDS, pp. 23-24.

cess profits deductions. No other Chilean judicial appeals procedures remained.[10]

In addition to its expropriatory actions against the copper companies, Chile was employing similar tactics against the International Telephone and Telegraph Company's (ITT) affiliate, International Telephone and Telegraph Corporation, Sud America, which had a 70 percent interest in the Chile Telephone Company, Compania de Telefonos de Chile (CHILTELCO). Following many months of unsuccessful negotiations between ITT and the Chilean Government -- which did not hesitate to employ harassing tactics -- concerning the purchase, _inter alia_, of ITT's interest in CHILTELCO, the Government on September 29, 1971, "intervened" and took over CHILTELCO's property by force. The following month the Government asked for a resumption of negotiations, and after some delay talks were resumed in February 1972. However, on March 21, 1972, Jack Anderson, the syndicated columnist, commenced publishing certain of the ITT internal communications indicating that ITT had tried to prevent Allende's election in November 1970 and had later sought U.S. Government assistance to use economic pressure in Chile. In light of these disclosures Chile refused to deal with

10. 1974 SDS, p. 24.

ITT.[11]

On May 12, 1972, legislation was introduced to annul CHILTELCO's telephone concession and nationalize its assets. This legislation was enacted in February 1973, but a proposed constitutional amendment permitting an arbitrary determination of compensation similar to the copper companies amendment[12] failed to gain approval before the fall of the Allende Government in September 1973.[13]

As noted,[14] AID's largest outstanding insurance exposure was in Chile where it had written $1.826 billion of political risk insurance. Its expropriation coverage there constituted 8.4 percent of its total expropriation exposure. As AID's successor, OPIC assumed

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11. *Ibid.*, pp. 24-25; "International Telephone and Telegraph Corporation, Sud America -- Overseas Private Investment Corporation: Arbitration of Dispute Involving U.S. Investment Guaranty Program," *International Legal Materials* 13 (November 1974), pp. 1327-1330 [hereinafter cited as ITT-OPIC Arb].

12. *Supra* note 7.

13. 1974 SDS, p. 25; ITT-OPIC Arb, p. 1332.

14. See Chapter I, pp. 62-67, notes 117-125 and accompanying text.

AID's liabilities as insurer with "the full faith and credit of the United States ... hereby pledged for the full payment and performance of such obligations."[15]

During the Congressional hearings which resulted in the creation of OPIC, claims against AID approximated $4 million. As a result of the Chilean expropriatory actions, in February 1972 OPIC faced claims of about $250 million. This potential liability was a matter of concern to some members of Congress like Senator William Proxmire of Wisconsin; but OPIC supporters, like Senators Jacob K. Javits of New York and Hiram Fong of Hawaii, were confident that OPIC could successfully negotiate any Chilean claims and administer the guarantee program.[16]

On February 3, 1972, Senator Javits made public a letter written the previous day by OPIC's president, Bradford Mills, stating, "While the situation in Chile

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15. Foreign Assistance Act of 1969, § 237(c), 83 Stat. 815 [hereinafter cited as FAA of 1969].

16. U.S. Congress, Senate, debate on H.R. 12067, 92d Cong., 2d Sess., Congressional Record, Vol. 118, February 2, 1972, pp. 2430-2431; February 3, 1972, p. 2512.

faces OPIC with the prospect of sizeable insurance claims, OPIC has approximately $100 million in reserves and retained earnings currently available to cover insurance claims without Congressional appropriation action." Mills also stated that AID had advised the Anaconda Company in 1969, when it had over $150 million of AID insurance, that since Anaconda had elected "standby" coverage -- i.e., no insurance protection while in effect -- instead of the more expensive "current" coverage, Anaconda had no coverage. Moreover, Anaconda had contravened the terms of insurance coverage by voluntarily selling substantial interests to Chile without AID's consent. The contracts provided for arbitration of disputes in accordance with the rules of the American Arbitration Society.[17]

Senator Fong had printed in the Congressional Record OPIC background fact sheets concerning earnings, reserves, appropriation requests, claims, fee structure, and risk management. The thrust of the OPIC position was that with modest appropriations to supplement its earnings, OPIC would in the next few years be able to build up reserves adequate to meet reasonably anticipated claims short of a catastrophic loss caused by wide-

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17. Ibid., p. 2512.

spread war or uncompensated expropriations. OPIC was raising its premium rates, exploring risk management techniques, and reinsuring some of its risks with Lloyd's of London.[18]

Congressional criticism of OPIC arising out of Chilean expropriations

With the problems affecting OPIC-insured investments in Chile multiplying and with claims against OPIC increasing, Congressional discontent with OPIC grew.

In connection with the proposed Foreign Assistance Appropriations legislation for fiscal year 1973, OPIC sought an additional $85 million to increase its insurance reserves threatened by the Chilean expropriations. During House debate several members expressed views which would have curtailed, if not eliminated, OPIC's operations.[19]

Representative Sam M. Gibbons of Florida offered

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18. Ibid., p. 2513.

19. U.S. Congress, House, debate on H.R. 16705, 92d Cong., 2d Sess., Congressional Record, Vol. 118, September 21, 1972, pp. 31803-31833; U.S. Congress, House, Committee on Foreign Affairs, The Overseas Private Investment Corporation: A Critical Analysis, prepared by Foreign Affairs Division Cong. Research Service -Library of Congress, 93d Cong., 1st Sess., 1973, pp. 12-13 [hereinafter cited as CRS Study].

an amendment which would have prohibited the use of funds appropriated under the act for the discharge of future liabilities under insurance or guarantees issued by OPIC. While in favor of private investment abroad, taxpayers' money should not be used to subsidize U.S. private investment abroad.[20] Representative Otto E. Passman of Louisiana, chairman of the Subcommittee on Appropriations, stated that if Congress did not want to have an agency to guarantee overseas investments, then the appropriate action should be taken by the proper legislative committee. Moreover, in less than 18 months, OPIC was required[21] to submit an analysis of the possibilities of transferring its activities to the private sector.[22] Representative Clarence Long of Maryland offered an amendment to decrease the appropriations

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20. Congressional Record, p. 31829; CRS Study, p. 12.

21. March 1, 1974 was the date set in the FAA of 1969, § 240(b), 83 Stat. 818.

22. Congressional Record, p. 31831; CRS Study, p. 12. Representative John C. Culver of Iowa, chairman of the important House Subcommittee on Foreign Economic Policy, whose deliberations are discussed <u>infra</u>, pp. 156-160, said he opposed the Gibbons amendment, although he shared some of the misgivings expressed about OPIC. Congressional Record, p. 31832.

to $12.5 million, the amount allotted the previous year. He and others raised the spectre of domestic unemployment, of export of jobs overseas, and of private investment going to the developed countries rather than to the LDC's. In language ever expressive of the sentiments of OPIC opponents, Long stated, "What started out to be a contributory insurance system under which firms would pay for their own insurance has become a Treasury raid by big United States and foreign conglomerates -- like the ITT -- and this is only the beginning. Now is the time to stop them. That is a subsidy -- an export of the Nation's capital, to say nothing of a campaign contributions subsidy."[23]

The Gibbons amendment was defeated 141 to 167 on September 21, 1972.[24]

By 1973 claims against OPIC arising from Chilean expropriations had reached $389 million.[25] As noted, AID in 1969 had advised Anaconda that "standby" coverage afforded no protection and furthermore that the sale of 51 percent of its interests to the Chilean Government

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23. Congressional Record, pp. 31826-31830.

24. <u>Ibid.</u>, pp. 31832-31833.

25. CRS Study, p. 74.

without AID's consent also vitiated protection.[26] During its negotiations in 1969 with Chile, Anaconda had requested AID either to permit it to shift from standby to current coverage or to assure it that Anaconda's investment would be covered by AID despite the new arrangements with Chile. AID denied these requests. Anaconda tendered premiums for full expropriation coverage for periods beginning December 29, 1969 and 1970. AID refused the tender but agreed that Anaconda's tender would preserve its position. On February 10, 1972, Anaconda submitted applications to OPIC for $154 million in compensation under the contracts of guarantee. OPIC denied them on September 19, 1972. Pursuant to the provisions of the contracts of guarantee with AID dated December 29, 1967, Anaconda sought arbitration conducted under the auspices of the American Arbitration Society. Hearings were held in January 1975 and decision in favor of Anaconda as to OPIC's liability was rendered on July 17, 1975.[27]

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26. Supra note 17 and accompanying text.

27. "Anaconda Company and Chile Copper Company -- Overseas Private Investment Corporation: Arbitration of Dispute Involving U.S. Investment Guaranty Program," International Legal Materials, 14 (July 1975), pp. 1210, 1212, 1230, 1246.

Following columnist Jack Anderson's disclosures concerning ITT's alleged meddling in the 1970 Chilean Presidential elections,[28] the Senate Foreign Relations Committee in May 1972 voted to conduct a full-scale inquiry concerning the ITT charges and the role of multinational corporations (MNC) in general in influencing U.S. foreign policy. A special Subcommittee on Multinational Corporations, consisting of five members and with Senator Frank Church of Idaho as chairman, was created. In order to insure a fair and balanced investigation, hearings, envisioned to take several years to complete, were postponed until after the November 1972 U.S. Presidential election.[29]

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28. Supra note 11 and accompanying text.

29. U.S. Congress, Senate, Committee on Foreign Relations, Multinational Corporations and United States Foreign Policy, Hearings before the Subcommittee on Multinational Corporations on The International Telephone and Telegraph Company and Chile, 1970-1971, 93d Cong., 1st Sess., 1973, Pt. I, p. 1 [hereinafter cited as 1973 SOH]. In addition to Senator Church, the Subcommittee consisted of Senators Clifford P. Case of New Jersey, Edmund S. Muskie of Maine, Charles H. Percy of Illinois, and Stuart Symington of Missouri.

The Subcommittee's hearings on ITT's role in the 1970 Chilean elections and ITT's subsequent proposals to U.S. Government officials designed to bring about President Allende's downfall, were held between March 20 and April 2, 1973. ITT's October 1971 claims against OPIC for $92.5 million under the expropriation coverage of its contracts of guarantee were a focal point of inquiry. The OPIC contracts provided that an action provoked or instigated by the insured investor was not an expropriatory action. The only way this provision would be rendered nugatory was to prove that the provocative action was taken at the specific request of the U.S. Government. Harold S. Geneen, ITT's chairman and chief executive officer, acknowledged that he had offered $1 million to the Central Intelligence Agency (CIA) to prevent Allende's election; but the testimony is unclear as to whether a Government request was involved in ITT's activities.[30]

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30. Ibid., pp. 208, 239-240, 471; see also John Revett, "OPIC Caught in Difficult Squeeze while Denying ITT's Chilean Claim," Business Insurance, April 23, 1973, p. 4.

OPIC's rejection of ITT's claims

On April 9, 1973, OPIC denied ITT's expropriation claims for $92.5 million on the ground of ITT's noncompliance with contractual obligations.[31] OPIC's officials denied that its rejection, coming so soon after the ITT hearings, resulted from pressure stemming from the inquiry.[32] Its staff had recommended denial of the claim prior to the March 1973 meeting of the OPIC directors. It was discussed then and at the April directors' meeting, when a State Department representative's statement was discussed that "postponement of action on the ITT claim by the Board has been helpful to" the department's "negotiations with representatives of the Chilean Government on debt rescheduling." OPIC's directors had also considered the "effect of the ... claim denial on U.S. Government foreign policy" in rejecting the claim. On April 30, 1973, ITT filed its demand for arbitration.[33] Decision in favor of ITT as to OPIC's liability was rendered on November 4, 1974.[34]

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31. Overseas Private Investment Corporation, Annual Report Fiscal Year 1973, p. 58; Revett, supra note 30.

32. Revett, ibid.

33. ITT-OPIC Arb, p. 1334.

34. Ibid., p. 1375.

Press reports indicated that there was general agreement among OPIC spokesmen and Senate staff attorneys that OPIC's rejection of ITT's claims had effectively removed an element of immediate danger to OPIC's program; granting ITT's claim might have jeopardized OPIC's continued existence, especially in view of its request for additional funds from Congress to build up its reserves and place its operations on an independent financial footing.[35]

Absent Congressional assent, OPIC's legislative authority was set to expire on June 30, 1974.[36] The question of its continued existence was considered in comprehensive hearings conducted by both Houses following the termination of the ITT hearings by the Senate Subcommittee on Multinational Corporations.[37]

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35. Revett, supra note 30.

36. FAA of 1969, § 235(a)(4), 83 Stat. 813.

37. U.S. Congress, House, Committee on Foreign Affairs, Hearings before the Subcommittee on Foreign Economic Policy, Overseas Private Investment Corporation, 93d Cong., 1st Sess., 1973 [hereinafter cited as 1973 HOH]; 1973 SOH. The Subcommittee's hearings on OPIC are found in Part 3 and are entitled "Overseas Private Investment Corporation (OPIC)." Unless otherwise noted 1973 SOH will refer to Part 3.

Congressional oversight hearings on OPIC

The first series of oversight hearings on the policy and operations of OPIC was held on 9 days between May 22 and June 20, 1973, by the Subcommittee on Foreign Economic Policy of the House Committee on Foreign Affairs. It was chaired by Representative John C. Culver of Iowa.[38] On 6 days between July 22 and August 1, 1973, the Senate Subcommittee on Multinational Corporations, which had concluded its ITT hearings less than 4 months before,[39] conducted the Senate's most comprehensive oversight hearings on the investment guarantee program, especially since the program was so frequently utilized by MNC's.[40] Both subcommittees had previously directed staff members to take survey trips. The House Committee on Foreign Affairs had requested the Foreign Affairs Division, Congressional Research Service (CRS) of the Library of Congress, to undertake an in-depth study and critical analysis of OPIC in order to assist the Subcommittee's inquiry. The exhaustive analysis was made public on September 4, 1973,[41] and even though

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38. HOH, p. ii. The Subcommittee consisted of 12 members; the full Committee had 40 members.

39. See supra note 30 and accompanying text.

40. 1973 SOH, supra note 37.

41. CRS Study, p. iii.

prepared for a more favorably disposed House of Representatives, was more critical of OPIC than a similar report prepared by the U.S. Comptroller General (CG) at the request of the Senate Subcommittee and released on July 16, 1973.[42]

Detailed review of these two studies will prove instructive.

The Congressional Research Study on OPIC

The CRS Study noted that OPIC had not attracted as much private capital as its predecessor program under AID and that it had not been guided to the same extent by social and economic development considerations. During its short history, OPIC had been confronted with several built-in problems. The Congressional mandate that its financing operations be conducted on a self-sustaining basis and its insurance operations be consonant with principles of risk management,[43] coupled with

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42. U.S. Comptroller General of the United States, Management of Investment Insurance, Loan Guarantees, and Claim Payments by the Overseas Private Investment Corporation, Report to the Subcommittee on Multinational Corporations, Senate Committee on Foreign Relations (Washington: July 16, 1973) [hereinafter cited as CGR].

43. FAA of 1969, § 231(a) and (d), 83 Stat. 809, 810.

threats of appropriation cuts, made OPIC officials extremely risk-conscious. The U.S. balance of payments deficit made more difficult the requirement of supporting only those projects consistent with U.S. balance of payments objectives.[44] Moreover, economic nationalism in the LDC's was creating a relatively unfavorable investment climate with increased risk of expropriation and adverse Government involvement.

These problems had made OPIC perhaps necessarily selective.[45] However, while AID's insurance program had been charged with overconcentration in a few countries, statistics show that OPIC's program was concentrated in fewer countries than the AID program.[46] Almost one-half of all OPIC clients indicated that political risk insurance would be necessary for any of their future investments.[47]

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44. Ibid., § 231(i), 83 Stat. 810.
45. CRS Study, pp. 39-41.
46. Ibid., pp. 63-64.
47. Ibid., pp. 45-46.

The study further noted that OPIC sought to balance its guarantee portfolio with lower risk projects and by undertaking a smaller share of the financing of higher risk or larger projects. The guarantee program's $75 million in reserves could finance a portfolio of up to $300 million under the 25 percent reserve requirement, but the current loan guarantee portfolio was only $193.9 million. OPIC was reducing these operations in large, sensitive projects such as natural resource projects.[48]

OPIC was criticized for concentrating its political risk insurance on the largest U.S. MNC's and commercial banks. "Large multinational corporations can pose political problems for the host countries in which they invest ... Their size and direct involvement in the commercial life of the developing country can make these large corporations relatively vulnerable to expropriation. OPIC experience, however, indicates that it is not the size of the company which is important, but rather the industry field of the project, and the project's size relative to the local economy as a whole."[49] OPIC had issued 45 percent of its contracts to small business, an increase of 4 percent over AID.[50]

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48. Ibid., pp. 46-47.

49. Ibid., pp. 88-89.

50. Ibid., p. 89.

The study noted that while U.S. businessmen were cognizant of the risk-reducing effects of joint ventures with host country investors, OPIC had not stressed types of investments involving joint ventures "fade-out" or divestiture provisions in LDC investments -- the sale of U.S. private interests to host country business or government after a certain period of time. As indicative of the low priority it placed on joint ventures, OPIC kept no records of the number of joint ventures insured. Moreover, joint ventures as a percentage of new ventures supported by the finance program had declined from AID's 72 percent to OPIC's 53 percent. A caveat to OPIC's hesitancy over joint ventures was observed: "Perhaps the commercial risks taken by involving local investors in projects outweigh the political dangers of existing as a wholly owned U.S. project.[51]

Concerning OPIC investment disputes and the negotiation process, the CRS Study gave OPIC a creditable rating. It had successfully settled over 60 percent of its disputes. Its specialized staff and financial resources offered expropriated businesses a low profile channel through which to gain prompt and adequate compensation. It helped corporations to cut through red

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51. Ibid., pp. 91-93.

tape in the host country bureaucracy and to reestablish lines of communication with the host government. Its contractual ties to expropriated MNC's afforded the U.S. Government a means to influence their actions. It frequently was able to assist the contending parties to settle their differences by entering into a new mutually acceptable business arrangement. However, the major detrimental effect of OPIC involvement in investment disputes was the threat -- not yet realized -- of direct government-to-government conflict over subrogated assets. To avoid such conflict, concerning which OPIC insurance would play a very minor role, Congress would have to reverse traditional U.S. policy and amend several laws.[52]

OPIC legislation required it to "further to the greatest degree possible, in a manner consistent with its goals, the balance of payments objectives of the United States."[53] The CRS Study referred to two outside surveys commissioned by OPIC which indicated that OPIC-insured investments had overall positive effects on the U.S. balance of payments and had no detrimental effect

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52. <u>Ibid.</u>, pp. 96-103.

53. <u>Supra</u> note 44.

on domestic employment.[54] Compared to OPIC-type programs in Germany, France, Japan, Sweden, and the United Kingdom, OPIC, whose rates were the highest, was much more developmentally oriented toward its projects in the LDC's than the others.[55]

The CRS Study indicated that OPIC's financial guarantees and investment risk insurance programs had a fair chance of becoming self-sustaining under certain conditions but at a probable price of a reduction in the scope of its operations and less emphasis on developmental objectives. Neither program, however, could operate without the full faith and credit of the U.S. Government. OPIC had inherited AID's guarantee program with somewhat risky investments with a high developmental potential. Its insurance operations were conducted in accordance with principles of risk management. In reducing its susceptibility to risk, OPIC had reinsured with Lloyd's of London, on favorable terms, 50 percent of its expropriation insurance covering 50 percent of the countries where expropriation insurance was written. Except for the Chilean expropriatory claims, the overall financial situation of the insurance program was favor-

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54. CRS Study, pp. 77-81.

55. Ibid., pp. 114-129.

able but the insurance reserve had to be substantially increased if self-sufficiency were to be attained. In fine, "prospects do not appear favorable that OPIC can have most of its insurance functions transferred to the private sector within the foreseeable future."[56]

THE COMPTROLLER GENERAL'S REPORT ON OPIC

The Comptroller General's (CG) report stated that OPIC had made progress during the more than two years of its operations. It had taken a number of steps to share its risks and to set limits on the degree of concentration of its insurance coverage in individual countries. Its monitoring system appeared to be adequate to provide current information to assess political risks. OPIC's revision of the standard contract for loan investments, completed in December 1972, incorporated several risk management changes, which significantly altered the nature and degree of coverage in OPIC's favor. However, due to the long-term, non-cancelable nature of the insurance contracts, OPIC's risk assessment system could only prevent acquisition of incremental liability in a high risk situation but existing contracts remained vulnerable to future political actions.[57]

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56. Ibid., pp. 67-76.

57. CGR, pp. 1, 27, 34.

In view of the limited number of claim settlements -- OPIC had paid $19.4 million on 14 claims -- the Comptroller General was unable to make any overall conclusions on the general adequacy of procedures, guidelines, and criteria used by OPIC in evaluating claims. A questionnaire sent to 21 OPIC investors with claims involving OPIC resulted in 14 replies to the effect that the claimants were generally satisfied with OPIC's handling of their claims.[58]

The Senate subcommittee's report

As will be shown, the Senate subcommittee investigating OPIC was much more critical than its House counterpart. It made extensive inquiry into the operations of a few MNC's with OPIC guarantees, especially in Jamaica, Taiwan, and Korea. It sought to ascertain why the investments were made abroad and whether the investment guarantee program led to greater U.S. Government involvement in the internal affairs of the host LDC's. Having but recently completed its inquiry into ITT's operations in Chile,[59] the subcommittee was familiar with OPIC's exposure in that country and sought to

58. Ibid., pp. 40, 45-47.

59. See supra note 30 and accompanying text.

assess the impact of OPIC exposure, actual and potential, on U.S. foreign policy.

THE HEARINGS AND REPORTS ON AID COVERAGE IN JAMAICA

In Chapter I[60] a brief description of the extensive insurance coverage by AID in Jamaica -- over $1 billion and second only to that in Chile -- was noted together with its political implications and effects. Jamaica is one of the most abundant sources of bauxite, the most economical source of aluminum. In 1966, Kaiser Aluminum Company, Reynolds Metal Company, and Anaconda Company formed a Delaware partnership, Alpart, to build, operate, and manage an aluminum smelter. In June 1968, AID issued guarantees against expropriation to these companies totalling $234.9 million. In the fall of 1969, Kaiser and Reynolds sought additional guarantees totalling $85.8 million for an expansion of the smelter. Simultaneously, two other aluminum companies had applied for guarantees of $175.8 million, also for the purpose of covering investments in aluminum smelters. Thus, if the applications were favorably received, the total risk exposure would approximate one-half billion dollars.

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60. See Chapter I, pp. 67-72, *supra*.

The then newly appointed U.S. Ambassador to Jamaica, Vincent de Roulet, later testified before the Senate subcommittee.[61] He stated that his initial reaction was opposition to the issuance of the additional insurance on the ground that the proposed $500 million level of guarantees in a single industry in a small country was unsound. However, in July 1970, he withdrew his objection in the face of considerable pressure from the companies, AID officials, and the Government of Jamaica, as well as the knowledge that his State Department superiors favored the applications. Continued opposition by him might have been construed as indicative of a lack of confidence by the U.S. Government in the Jamaican Government and economy. Following approval of the applications with substantial modifications in September 1970, he undertook to play an active role in manifesting U.S. concern over Jamaican policy toward the aluminum companies to its two largest political parties.

In 1972, just prior to the Jamaican elections, de Roulet undertook to convince the leadership of the two major parties to eliminate as an election issue full U.S. ownership of the alumina-bauxite industry. In

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61. 1973 SOH, pp. 109-124, 134-136, 142, 144. See also pp. 148-170, 504-508.

return for such assurances, there would be no U.S. interference in the election.[62]

On the basis of the de Roulet testimony, a majority of the Senate Committee on Foreign Relations issued a report (SOR) in February 1974, stating: "The story of the investment guarantee program in Jamaica, whether administered by AID or OPIC, is thus, one of the involvement on the part of the United States in the internal policies of Jamaica. The companies attempted to use the program to promote an identity of interest between the U.S. Government and the corporations. The United States Embassy was propelled into a volatile issue in Jamaican politics -- the American ownership and control of the bauxite/alumina industry."[63]

Testimony at variance with that of de Roulet was given by Robert Hurwitch, deputy assistant secretary for Inter-American Affairs, Department of State; Herbert Salzman, in 1968-1970 the assistant administrator for Private Resources in AID and in charge of the investment

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62. Ibid., pp. 114-121.

63. U.S. Congress, Senate, Committee on Foreign Relations, The Overseas Private Investment Corporation Amendments Act, Report on S. 2957, 93d Cong., 2d Sess., 1974, p. 24 [hereinafter cited as 1974 SOR].

guarantee program, later acting president and executive vice president of OPIC;[64] and representatives of the aluminum companies.[65] They disputed the de Roulet contention of undue involvement by the United States in Jamaica internal political affairs because of the existence of the program. While the majority SOR failed to mention the contrary testimony,[66] the minority SOR used such testimony, inter alia, to declare that the majority had drawn several incorrect conclusions regarding the operation of the program in Jamaica.[67]

The minority SOR thought it incorrect to imply that OPIC's insurance or activities were the source of strain or disputes in U.S.-Jamaican relations. It was not OPIC insurance which led de Roulet into "the internal politics of Jamaica." As noted by Hurwitch, "it is entirely unrealistic to believe that were there not insurance in Jamaica and $500 million worth of United States company bauxite were nationalized, that the United States

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64. See Chapter I, pp. 69-72, supra.

65. 1973 SOH, pp. 45-85, 150-170.

66. 1974 SOR, pp. 20-24.

67. Ibid., pp. 58-60.

would not get involved." Even without insurance, the United States has both a financial stake -- through the 48 percent tax deduction for uninsured losses due to war or expropriations -- and a political interest in investments abroad. Why, noted the minority, should OPIC be held responsible for what de Roulet, a non-professional diplomat, did solely on his own initiative? A professional diplomat would have avoided de Roulet's alleged intervention actions in Jamaican affairs -- actions contrary to U.S. policy.[68]

OPERATIONS IN TAIWAN

The majority SOR did not deem Jamaica an isolated case. It pointed to Taiwan where the investment guarantee program was being interpreted as a symbol of U.S. support for the local regime. It cited the testimony of Acting Assistant Secretary of State Herman Barger, who stated that if OPIC insurance were to be cut off for business reasons "in the next number of months," Taiwan would regard such action as indicative of a lack of U.S. confidence in it and a withdrawal of long-term U.S. support for Taiwanese independence.[69] The United

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68. Ibid., p. 59.

69. Ibid., p. 25.

States, which had been issuing investment guarantees through OPIC and AID to Taiwan for several years, also had continuing military relationships with it.[70]

John Sagan, a Ford Motor Company vice president and treasurer, testified before the Senate subcommittee concerning his company's operations in Taiwan. Ford had utilized the investment guarantee program since its inception in 1948. It had two OPIC-insured plants in Taiwan, a 100 percent owned Philco-Ford factory established in 1965 to manufacture radios, televisions, and stereo/TV components, all exported to the United States; and a 70 percent owned Ford Lio Ho Motor acquired in late 1972 to assemble cars and trucks for sale locally, and with the remaining equity held by the Chinese investors who owned the predecessor company. The consumer electronics manufacturing plant was established because of Japanese competition and an unsatisfactory supply source, primarily also Japan. Taiwan was selected over other countries because it offered an attractive plant site, ample labor supply, competitive wage rates, good component supplies, and a stable local government friendly to investors. In view of the external military

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70. 1973 SOH, pp. 272-290.

pressure on Taiwan in the mid-1960's, Ford's investment in this plant was conditioned upon securing adequate Government-backed investment insurance. However, because the 1972 political situation in Taiwan was substantially more stable than it was in 1965, the general availability of OPIC insurance was not then as important a consideration in the 1972 investment decision to acquire an automobile assembly plant.[71]

The testimony of William P. Meehan, assistant treasurer of Motorola, Inc., concerning his company's opening of a television manufacturing plant in Taiwan in late 1969, was similar. His company thought there was some risk of hostilities breaking out in the area, with the possibility of currency exchange restrictions, and deemed it advisable to utilize the insurance program. In 1967, Motorola established a plant in Korea to assemble semiconductor devices, almost all of which are distributed in the United States and other world markets. Because of its plant location close to the northernmost border of Korea, it felt it prudent to obtain maximum war risk, expropriation, and convertibility insurance, just as many U.S. companies had done. It endorsed the insurance program as administered by OPIC.[72]

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71. Ibid., pp. 171-202.

72. Ibid., pp. 227-242.

While the majority SOR cited Jamaican and Taiwanese insured investments, but not Korean, as establishing that an AID or OPIC investment guarantee program leads to a deepening involvement on the part of the United States in the internal affairs of host LDC's,[73] the minority report referred to testimony that "one of OPIC's principal benefits is that it provides a practical mechanism for resolving investment disputes without involving the U.S. government."[74] The majority report countered with its subcommittee's earlier hearings on ITT's role in the 1970 Chilean elections. Testimony was there adduced indicative of implied U.S. Government approval so as to prevent the accrual of claims based on possible expropriation of properties covered by AID guarantees. Since any Government-sponsored and administered investment guarantee program involved the full faith and credit of the U.S. Treasury, political complications affecting the United States and host countries were inherent in the nature of any such program. According to the majority, government insurance may at

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73. 1974 SOR, pp. 20-25.

74. Ibid., pp. 58, 60, quoting CRS Study, p. 99.

times increase the likelihood of expropriation; government assumption of political risks may lull the insured investor into a false sense of security and induce it not to make the necessary adjustments to changing local conditions.[75]

The House subcommittee's report

The OPIC report of the Subcommittee on Foreign Economic Policy of the House Committee on Foreign Affairs, issued on November 29, 1973 (HOR), was in general consonant with the views expressed in the minority SOR.[76] Its hearings did not delve into the role of specific MNC's with certain LDC's and the overall relationship with OPIC, its predecessor AID, and the U.S. Government. The Subcommittee found OPIC's present management team highly competent but because of the inherent

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75. Ibid., pp. 25-26.

76. U.S. Congress, House, Committee on Foreign Affairs, The Overseas Private Investment Corporation, Report of Subcommittee on Foreign Economic Policy, 93d Cong., 1st Sess., 1973 [hereinafter cited as 1973 HOR]. In the letter of transmittal by Chairman Thomas E. Morgan of the House Foreign Affairs Committee to House Speaker Carl Albert, it was noted that "the findings of this report do not necessarily reflect the views of the membership of the full Committee on Foreign Affairs." Ibid., p. iii.

conflicts in its statutory mandates OPIC might be shifting its main developmental purpose.[77]

In connection with OPIC's role in investment disputes, the report stated that OPIC exercised a positive effect in their settlement. OPIC kept a low, non-official profile during the negotiation of investment disputes by keeping the investor out in front. While it had been involved in 22 disputes, OPIC had never negotiated directly with a foreign government over subrogated assets owned by the U.S. Government. Nevertheless, "[t]he subcommittee is not convinced that the existence of OPIC's expropriation insurance is a deterrent to nationalization since ... expropriation actions are in many instances based on political rather than economic motivations." [78]

Among the findings and recommendations set forth in this report were: OPIC should concentrate on encouraging "new modes" of investments, such as joint ventures and non-equity investments -- e.g., management and production-sharing arrangements. It should expand its operations to more countries. It should administer its finance program to complement rather than compete with

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77. Ibid., p. 13.

78. Ibid., pp. 18-20.

private U.S. lenders. It should cooperate more fully with privately owned multilateral regional development companies such as ADELA and PICA.[79] Its authority should be extended an additional two years to June 30, 1976. Its institutional framework, together with its contractual arrangements, expertise, and financial resources, could better insure that U.S. private corporate activities in the LDC's did not unnecessarily precipitate conflicts directly involving the U.S. Government. It should consider extending the 12-month waiting period of an investor claimant. The restrictive amendments dealing with expropriation situations -- Hickenlooper,[80] Gonzalez,[81] and Pelly [82] -- should be modified to make

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79. See Chapter II, p. 89, note 5.

80. Foreign Assistance Act of 1963, 77 Stat. 379, 386, 387; Foreign Assistance Act of 1964, 78 Stat. 1009, 1013, 22 U.S.C. § 2370(e) (1976). The Hickenlooper amendment authorizes the President to suspend aid to countries expropriating property owned primarily by U.S. citizens without taking steps within 6 months to adequately compensate the U.S. citizen.

81. 86 Stat. 58, 59-61, 22 U.S.C. § 283(r), 284 (j), 285(o) (1976). The Gonzalez amendment requires the U.S. representatives to the multilateral lending institutions to vote against loans to any country which has expropriated U.S. interests without prompt, adequate, and effective compensation.

82. Foreign Aid and Related Agencies Appropriations Act of 1963, 76 Stat. 1163, 1165, § 107. The amendment prohibited assistance to any country which aided the Castro regime in Cuba unless the President determined that such assistance was in the U.S. national

it easier for the Executive Branch of the Government to respond to expropriatory actions on a case by case basis. Uninsured investors had sought to involve the Executive in their disputes by seeking application of these amendments. OPIC should be made an obligatory participant in governmental responses to any requests by a U.S.-based investor, whether insured or guaranteed

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interest.

1974 legislation authorized the President to waive provisions which prohibited assistance to countries trading with designated countries. Foreign Assistance Act of 1974, 88 Stat. 1795, 1805, § 33. This was repealed in 1977. International Development and Food Assistance Act of 1977, Public Law 95-88, § 123. Section 132 of this Act provided that none of the funds authorized to be appropriated thereunder could be used to assist Cuba and other designated countries.

The Foreign Relations Authorization Act, Fiscal Year 1978, Public Law 95-105, § 511, provided concerning negotiations with Cuba: (a) It is the sense of the Congress that any negotiations toward the normalization of relations with Cuba be conducted in a deliberate manner and on a reciprocal basis, and that the vital concerns of the United States with respect to the basic rights and interests of United States citizens whose persons or property are the subject of such negotiations be protected. (b) Furthermore, it is the sense of Congress that the Cuban policies and actions regarding the use of its military and paramilitary personnel beyond its borders and its disrespect for the human rights of individuals are among the elements which must be taken into account in any such negotiations.

The International Development and Food Assistance Act of 1978, Public Law 95-424, § 62, reiterated the prohibition of assistance, "either by monetary payment or by the sale or transfer of any goods of any nature" to Cuba and other designated countries. Thus, one recognizes the effects of the Castro revolution almost 20 years later.

or not. OPIC should be allowed to forego formal bilateral subrogation agreements as an invariable precondition to insuring projects in a particular country, and afforded the flexibility of developing alternative arrangements for protecting its potential interests in a claimant's property. OPIC should pursue its efforts to form with the private insurance industry a joint investment insurance association, with the aim of eventually being phased down to a minority participant therein, but continuing as a reinsurer of the association's portfolio. The United States should continue to support the World Bank's proposal to create an International Investment Insurance Agency.[83]

The majority and minority Senate reports

The majority SOR questioned whether the investment guarantee program constituted a significant incentive to corporate investment abroad and whether such investment was beneficial to the economic development of the LDC's. OPIC's insurance programs were probably not a decisive consideration in corporate decisions to invest overseas. Such decisions were made in the first instance irrespective of the availability of investment

83. 1973 HOR, pp. 34-38.

insurance guarantees. According to the CRS Study, excluding oil investments, 77 percent of U.S. direct investment in LDC's in 1971 was not covered by OPIC, as compared with only 7 percent uninsured in 1968. OPIC's insured investment was concentrated in only a few LDC's and had only a marginal effect on fostering new investment when compared to total U.S. investment in the LDC's. However, once the basic decision to invest in LDC's had been made, the availability and cost of OPIC insurance made it an attractive proposition for a significant number of corporate investors.

As to the developmental role of OPIC's programs, the majority SOR stated categorically: "The world's poorest countries have received little OPIC-insured investment. OPIC has not been successful in persuading U.S. firms to invest in the vast majority of poor nations." It concluded: "In light of the conflicting views about the real contributions, or lack thereof, of foreign private investment to the development of the poorer countries, and the evidence that the bulk of the 17 OPIC-guaranteed projects studied by the GAO [CG report] have had little development or growth impact, we cannot conclude that the OPIC investment insurance program is justified on the grounds that it is an aid to development of the poorer countries. Rather, the program is used by American corporations as an insurance program which lowers their risk against adverse political events in less developed countries. If the program is to be continued it should conform to the rationale for which it is used, an insurance program and not a development aid program."[84]

The minority SOR drew opposite conclusions from the voluminous testimony. OPIC insurance was an important factor -- sometimes a crucial factor -- in many investment-making cases. Investment insurance had a ground-breaking role in encouraging investors to go into Korea and Indonesia. A 1971 OPIC-sponsored survey found that 93 percent of the responding companies said investment insurance was either necessary or desirable, including 46 percent who believed that such insurance was essential for their investment in the LDC's.

The minority report stated that the considerable testimony that private investment was an important contributor to economic development in the LDC's had been ignored by the majority. While private foreign investment was not a substitute for foreign aid and could not accomplish miracles in the face of maladministration and subsistence agriculture, it was a highly useful com-

84. 1974 SOR, pp. 17-20.

plement to other forms of aid.[85] The CG report concerning developmental impact, cited by the majority,[86] involved 17 pre-OPIC-guaranteed projects; on the basis of OPIC's development analysis criteria, this report, nevertheless, gave these projects a comparatively overall favorable rating. The CRS Study found that OPIC's insurance and finance programs "still do have substantial developmental impact."

Referring to the finding of the House Subcommittee that "the bulk of private foreign investment can and does comprise a useful development tool," the minority concluded that private investment contributes to the development of LDC's.[87]

The HOR noted that interviews with representatives of both large and small OPIC-insured investors established that the latter felt that the availability of

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85. Ibid., pp. 56-57. The minority report quoted Dean Peter Gabriel of Boston University as follows: "To the extent therefore, that industrialization in the less developed countries depends on private resources and capabilities from abroad, private investment has a vital function to perform and should be encouraged." p. 57.

86. Ibid., p. 20.

87. Ibid., pp. 57-58.

OPIC insurance was critical to their decision-making process; the former felt less need for such insurance, purchasing it because it was available and relatively inexpensive. While difficult to determine the actual incentive effectiveness of the OPIC insurance program, the availability of the insurance appeared to have only a marginal effect on fostering new investment in the LDC's.[88]

The Congressional hearings produced a wide range of opinions from academicians, businessmen, and government officials concerning the economic effects of foreign direct investment and its contribution to the economic welfare of LDC's. Since the criteria used in basing one's opinion may well determine one's attitude toward the OPIC programs, some discussion of relevant testimony would appear appropriate.

<u>The opinions of academicians at the hearings</u>

Professor Robert Stobaugh of the Harvard Business School, a member of OPIC's Advisory Board, noted that there was substantial uncertainty about the economic effects of direct investment overseas because estimates

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88. 1973 HOR, p. 10.

of such effects depended upon the personal judgmental decision of what would have happened if the investments had not been made. He thought such investment beneficial to the U.S. economy; it increased domestic income by creating jobs in this country with higher skill levels and better pay. It was likewise beneficial to the host country's economy, increasing the amount of technology and management skills with the resultant improvement in output and efficiency. Overall, OPIC had substantial potential for helping the U.S. and foreign economies.[89]

Professor Dale R. Weigel of the College of Business Administration, University of Iowa, noting that risk was still an ambiguous concept and how risk affected investment decisions was still problematical, "guessed" that the OPIC insurance program made a difference in the development of projects in some high risk countries. The effectiveness of the OPIC programs depended upon the answers to three questions: (1) do they increase the flow of private capital to the LDC's? (2) do such flows contribute to the economic well-being of those countries? (3) do the OPIC programs encourage investments contributing to the LDC's economic development?

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89. 1973 HOH, pp. 2-4.

The answer to the first question was uncertain. OPIC insurance policies were based on the assumption that investors demand a higher return to compensate for higher risk. If OPIC absorbs some of the risk for a fee, the returns demanded would be reduced, more investments would meet the lower requirements, and capital flows would increase. As to the second question, the direct effects of a foreign investment depend on the circumstances under which the investment is made. Investments in extractive industries are made to produce for export with benefits to the host country in the form of taxes; those in manufacturing, for host country consumption, and usually receive protection from imports to compensate for the higher risks and higher costs. Generally, on the basis of crude data, it may be said that investment for local market consumption is not desirable in the chemical and paper industries which use relatively large amounts of scarce resources; contrariwise, for primary and fabricated metals and non-electric machinery. Since OPIC had begun to discriminate among applicants in terms of the development effect of the investment, Professor Weigel's conclusion was that "OPIC probably has had a small, but significant effect" on the amount of private capital that has flowed to the

LDC's. Additional effort was needed, however, to insure that the development goal should not be sacrificed to the other competing goals pursued by OPIC.[90]

An entirely different approach was taken by Professor Thomas Weisskopf of the Economics Department of the University of Michigan. The basic issue in evaluating OPIC's role was whether public resources should be utilized to subsidize U.S. private business in LDC's. Phrased differently, does private investment there serve national objectives that could not be better served in other ways? In giving a negative answer, Weisskopf stated that U.S. private investment did not promote the social and economic progress of the LDC's, defined as not merely stimulating economic growth but also promoting a more egalitarian distribution of wealth and power. The obstacles to progress were as much political as economic. The political and economic leadership of the LDC's was in the hands of a relatively small dominant elite whom the U.S. investor, in the interests of the profitability of his investment, wanted to keep in power. Accordingly, the indiscriminate subsidization of investment in the LDC's was at least as likely to

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90. Ibid., pp. 4-9.

retard social and economic progress as to promote it. Whether such investment contributed to the growth of the U.S. economy was an irrelevant circumstance. Moreover, whether it currently contributed to the U.S. balance of payments was a proposition of doubtful validity; whether it increased job opportunities in the United States or for Americans was difficult to determine. What was irrefutable was that the OPIC and cognate programs benefited the foreign investor.[91]

The HOR noted that through its contractual arrangements OPIC could play an important role in influencing the quality, form, and behavior of private investments in the LDC's in order to maximize the acceptability of such investments and minimize the risk of expropriation. OPIC had already instituted such program and had recently introduced several risk management procedures providing leverage to influence an insured investor's form of investment.[92]

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91. Ibid., pp. 9-14.

92. 1973 HOR, pp. 2, 14.

The status of OPIC's financial condition

The status of OPIC's financial condition was much disputed in the SOR. While both the inconvertibility and war risk programs had admittedly been major money-makers, the majority declared the outstanding unsettled expropriation claims and guarantees,[93] amounting to $369 million, of which those of ITT and Anaconda as regards Chilean expropriation totalled $246.5 million, placed OPIC by ordinary financial standards on the brink of insolvency. OPIC then had $3.3 billion of expropriation insurance outstanding, had collected $84.6 million in premiums therefrom, and had paid out a net of $28.1 million in claims. If OPIC were a private insurance company, under generally accepted accounting principles it would have to set aside a reserve against the outstanding claims which would have the effect of reducing available reserves to a negative factor. OPIC's claim that it is a self-sufficient agency was and is not completely true. Its growth of reserves had to a significant extent resulted from annual Congressional appropriations. In sum, in order to demonstrate its ability

93. Guarantees are amounts which expropriating governments have agreed to pay and which OPIC will pay if the expropriating government defaults. 1974 SOR, p. 27, note 8.

as a self-sufficient agency, OPIC should be given new appropriations only when its own reserves were depleted.[94]

The minority SOR maintained that a realistic look at the facts belied the majority's pessimistic view. As of December 31, 1973, OPIC had approximately $190 million available for claims and annual net income of $30 million. Apart from the ITT and Anaconda claims which OPIC had rejected and were the subject of arbitration, present claims were but $20 million. Even though OPIC also had guaranteed settlements of approximately $120 million, there was no reason to assume that these foreign government obligations would not be met.[95]

The HOR noted that the overall financial stability of OPIC's expropriation insurance program was not clear. If OPIC were successful in the arbitration proceedings with ITT and Anaconda, it would have a viable reserve; if unsuccessful, it could possibly find itself relying on Congressional appropriations or Treasury payments based on the full faith and credit clause of its enabling legislation.[96] Furthermore, OPIC had sustained

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94. Ibid., pp. 26-30.

95. Ibid., pp. 60-61.

96. FAA of 1969, § 237(c), 83 Stat. 815, supra note 15.

losses of $12.7 million on its direct loan program, having inherited from its AID predecessor a portfolio of high commercial risk investments. To compensate for AID's portfolio OPIC was constrained to emphasize low risk investments.[97]

OPIC and the balance of payments

As noted, OPIC has a legislative mandate to consider the balance of payment effect of its insured investments.[98] The majority SOR concluded that at least in the short run, OPIC tended to worsen the balance of payments problem; the impact on the long-term balance of payments -- *i.e.*, whether investments in the LDC's would eventually return as much, or more capital to the United States than sent out -- remained unclear. According to the testimony of Ford's John Sagan[99] and Motorola's William Meehan,[100] OPIC did not require its insured companies to purchase U.S. products; moreover, its encouragement of investment abroad marginally stimulated an outward flow of U.S. capital. Other testimony

97. 1973 HOR, pp. 28-29.

98. FAA of 1969, § 231(i), 83 Stat. 810, *supra* note 44.

99. See *supra* note 71 and accompanying text.

100. See *supra* note 72 and accompanying text.

indicated that by OPIC's insuring MNC's off-shore subsidiaries, a means was available for the latter indefinitely to withhold the return of profits to the United States -- again to the detriment of the U.S. balance of payments position. Even though OPIC introduced a new insurance application form in March 1972 formulating criteria concerning the impact of the proposed investment on the U.S. balance of payments, insured projects often had an adverse impact thereon. In fine, "[w]hat is clear is that OPIC management cannot avoid encouraging capital outflows and still write insurance."[101]

The minority SOR found that the record of the hearing and independent studies, such as the CRS and that of the Harvard Business School, showed that OPIC programs significantly contributed to U.S. economic progress and improved competitiveness overseas. The March 1972 application screening process set forth a rigorous set of guidelines for analyzing the economic benefits of a proposed project both on U.S. employment and on the U.S. balance of payments. In the long run OPIC-insured projects would produce a strongly positive net benefit to the U.S. economy. Moreover, OPIC could save

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101. 1974 SOR, pp. 32-33.

the U.S. taxpayer money in the event of an uncompensated expropriation suffered by an American company. This was so because the tax code allowed losses only to the extent there was no insurance recovery and OPIC losses were less expensive to the U.S. taxpayers than tax write-offs.[102]

The HOR regarded the policy guidelines instituted by OPIC as helpful in meeting the statutory balance of payments objectives.[103] OPIC analyzed the trade and capital effects of a proposed project following submission by the applicant for insurance or investment of detailed information on trade effects and financial flows. The three balance of payments criteria established by OPIC were: (1) the likelihood of a non-U.S. investor making a similar investment to serve the same foreign market, the possibility that present U.S. exports might be displaced by the output of the investment, and the essentiality of the investment for the entry or retention of U.S. participation in local or

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102. Ibid., pp. 62-65. See further testimony of Stanford G. Ross, former assistant tax legislative counsel, Treasury Department, 1973 SOH, pp. 1-32 and 1974 SOR, p. 65.

103. FAA of 1969, § 231(i), 83 Stat. 810, supra note 44.

other foreign markets; (2) analysis of the export and import effects to assess the short-term impact; and (3) estimate of cumulative financial flows resulting from the investment-capital investment weighted against financial returns. Every accepted project must meet all three criteria. According to both the CRS and CG studies, adherence by OPIC to these criteria would provide reasonable assurance that U.S. economic interests were protected.[104]

OPIC and geographic concentration

The majority SOR decried the AID-OPIC principle of concentration under their investment guarantee programs with respect to both the geographic coverage -- eight countries -- and the major beneficiaries -- the largest MNC's and banks. Such dual concentration appeared to have a momentum of its own which OPIC was unable to change.[105] The minority SOR did not comment on these criticisms, although OPIC officials had testified that the large proportion of MNC's as investors was a reflection of the fact that new projects in LDC's demanded manpower reserves not always available to smaller investors; further, that only with the passage

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104. 1973 HOR, p. 26.

105. 1974 SOR, pp. 30-31.

of time could extreme geographic concentration be lessened.[106]

The HOR also expressed concern over OPIC's concentration in a few countries and in the size of its clients -- i.e., the MNC's. It noted that when OPIC began to administer the investment guarantee program, it limited coverage growth in countries where concentration in any one category of insurance exceeded 10 percent of worldwide coverage for the category. It had, however, increased the growth limit for new coverage in one country from one to two percent -- a policy which the report disapproved. Moreover, to broaden the geographic area of its coverage, OPIC must relax its self-imposed requirement for bilateral agreements with host governments assuring OPIC subrogation rights, and must overcome investors' reluctance to invest in other than a few LDC's. Invariable insistence on subrogation agreements was not in the national interest. As to the investors' reluctance, OPIC should rely on the resources of the Executive Branch of the Government and use its programs to encourage investments in countries with good potential but at present with little investor interest.[107]

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106. 1973 SOH, pp. 411-525.

107. 1973 HOR, pp. 13-14.

The HOR recognized that start-up costs and absence of managerial depth made it much more difficult for small business to invest in LDC's. Several years were required before the average new investment became profitable and most small businesses could not afford to wait so long. Failure abroad might have ill effects both in the host country and with the U.S. parent company. The report further noted that while OPIC's insurance program in relation to small business had shown a small improvement over that of AID, OPIC's finance program had performed better for the small investors. While consideration had been given to limiting OPIC's program to small and medium-size companies, nevertheless, OPIC "should not be isolated from the major MNC's, which account for the majority of U.S. overseas investments."[108]

The majority SOR stated that OPIC, unlike AID, had issued very little insurance to metal mining corporations -- three percent of the former's insurance portfolio compared to the latter's 25 percent. The report denied OPIC's assertion that the availability of its insurance helped assure the United States a source of

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108. Ibid., pp. 16-17.

supply of vital raw materials. OPIC's few new investments in the extractive industries resulted from a recognition of the high risk nature of the general area. Since OPIC was writing less insurance for the mining industry, it was fallacious to maintain that its insurance program affected security of investment in raw materials.[109]

The minority SOR ignored the subject of foreign metal mining. However, Marshall Mays, OPIC's then general counsel and later president, had testified that OPIC's more selective policy was not intended to eliminate coverage in metal mining. It permitted sufficient coverage to assure that particular vital projects could be undertaken. Moreover, while other projects might require almost full OPIC coverage to get under way, extractive industry projects were not so demanding and did not seek coverage for the full 20-year period.[110] Herbert Salzman, then OPIC's acting president, observed that mining was a cyclical industry; that from 1966 to 1970, there was an enormous expansion of U.S. mining

109. 1974 SOR, p. 32.

110. 1973 SOH, pp. 460-467.

investment in certain countries which AID had covered; that with a tapering off of mining investment, the new applicants for OPIC coverage were meeting its stricter risk management criteria.[111]

In discussing what should be OPIC's role in securing supplies of essential raw materials, the HOR recognized that a definitive answer depended on a national resource policy which had not yet been articulated. OPIC had recognized the trend in expropriations of large and sensitive industries, especially in the natural resources areas. Its statutory mandate requiring risk management[112] had prompted it to set special guidelines for insuring investments in these areas. OPIC had initiated and encouraged new modes of non-equity investments which were more acceptable to the national interests of LDC's and thus less prone to expropriation. Projects in the natural resources area were consistent with OPIC's developmental mission because many LDC's need foreign technology to develop their natural resources whose sale would produce much needed capital.

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111. Ibid., pp. 466-467.

112. FAA of 1969, § 231(d), 83 Stat. 810.

Investments in the form of technical service and management contracts with production-sharing arrangements -- as negotiated with Peru -- appeared worthy of emulation.[113]

OPIC and U.S. employment

A major area of contention was the impact of OPIC's programs on U.S. employment. Organized labor was a vociferous opponent of OPIC at the hearings. Benjamin A. Sharman, Grand Lodge representative of the International Association of Machinists & Aerospace Workers, testified about labor's concern that OPIC was depriving U.S. workers of jobs by assisting "runaway industries" -- *i.e.*, those industries which leave the United States in complete or partial replacement of going concerns here, and then export the finished products back to the United States in direct competition with U.S. production. The electrical-electronic industry had been especially hit hard by the transfer of manufacturing operations to the LDC's.[114]

The majority SOR observed that OPIC had guidelines

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113. 1973 HOR, pp. 24-25.

114. 1973 SOH, pp. 265-272; 1974 SOR, p. 33.

prohibiting the issuance of insurance to runaway industries. However, in practice, as the CG study found, OPIC was unable rationally to determine whether the move overseas was actually necessary to protect U.S. industry from foreign competition because almost all information -- always incomplete -- concerning the move came from the applicant company. While OPIC planned to introduce new measures more closely to monitor the project's impact on the U.S. economy, attainment of the desired goal would require a major change in OPIC's organizational structure and additional personnel.[115]

The minority SOR stated that its findings "suggest that the great bulk of investments insured by OPIC are unquestionably benefitial to the U.S. economy and employment." This was clearly true of investments in local service operations and manufacturing to serve local or regional markets which could not otherwise be reached competitively by U.S. industry. The new, more stringent procedures initiated by OPIC in March 1972 were, according to both the CRS and CG studies, sufficient to protect the special interests of U.S. labor. Additionally, proposed amendments to the enabling stat-

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115. 1974 SOR, p. 33.

ute would give further protection to labor's interests.[116]

In March 1974 testimony before the House subcommittee, Andrew J. Biemiller, director of the Department of Legislation, American Federation of Labor and Congress of Industrial Organizations, urged the complete termination of OPIC because it cost U.S. workers jobs and encouraged the export of jobs in industries already suffering from unemployment.[117] The response of OPIC's president, Marshall T. Mays, to these charges was that they were based on data before OPIC's extensive March 1972 revision of past policies and practices and ignored the presence of an organized labor representative on OPIC's board of directors.[118]

The HOR noted that in its screening process OPIC had recently been particularly anxious not to grant

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116. Ibid., pp. 63-64.

117. U.S. Congress, House, Committee on Foreign Affairs, Hearings before the Subcommittee on Foreign Economic Policy, Overseas Private Investment Corporation, 93d Cong., 2d Sess., 1974, p. 2 [hereinafter cited as 1974 HOH].

118. Ibid., pp. 26-27.

program support to "runaway industries." The remedy for the loss of jobs in trade impacted industries to competition abroad was adjustment assistance and programs to assist workers, industries, and communities adversely affected by imports and the movement abroad of MNC's. OPIC should not "forget that its primary mission is to support U.S. private investment in developing countries which will make a major contribution to the economic progress of those countries."[119]

The Senate Committee majority's four options concerning OPIC

The majority SOR listed four options concerning OPIC's insurance programs: (1) the maintenance of the status quo; (2) allowance of insurance only as to those projects which significantly benefit the development of the host country; (3) termination of the program; (4) transfer of the insurance function to private insurance companies.[120] The first option was unacceptable since it linked the United States too directly with private investment abroad and unnecessarily involved the Government in the internal political affairs of the host country without yielding sufficient development gains

119. 1973 HOR, pp. 26-27.

120. 1974 SOR, p. 37.

for the LDC's. Moreover, the current claims and guarantee greatly outweighed OPIC's reserves, with the resultant likelihood that the U.S. Treasury might have to absorb substantial losses.[121]

The majority report ruled out the second possibility, citing the experience of Sweden -- the only country with strict development criteria in its contracts -- which had been unsuccessful in convincing any companies to accept its criteria even with low premium rates. Moreover, since there was basic disagreement among economists as to what type of private investment was most helpful to the development of the LDC's, formulation of the appropriate development criteria presented a difficult task.[122]

The third option of terminating OPIC's insurance program had a certain appeal. Existing insurance contracts would be honored, but after its expiry date on December 31, 1974,[123] OPIC could no longer issue new insurance. However, a complete termination of the U.S.

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121. Ibid.

122. Ibid., p. 38.

123. The Foreign Assistance Act of 1973, § 6(1), 87 Stat. 714, 717, substituted "December 31, 1974" for "June 30, 1974."

investment guarantee program, after 25 years of existence, would constitute an abrupt change in direction and not in the best interests of the United States. Other industrialized countries operated similar programs; any abrupt termination of the program would remove for U.S. investors a facility available to competitors in such other countries. The obvious disadvantage to U.S. investors could only be eliminated by maintaining an insurance program -- one administered by the private insurance companies.[124]

In opting for the fourth option, the majority report recommended that OPIC phase out writing direct insurance by December 31, 1980, and transfer this function to the private sector. This was the most desirable alternative because it created a minimal amount of disruption to U.S. corporate investment plans while extricating the U.S. Government from the political and financial risks created by a Government-sponsored investment guarantee program. The private insurance sector had indicated a willingness and ability to enter the political risk insurance field; Lloyd's of London already had a substantial reinsurance contract with OPIC. In the cir-

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124. 1974 SOR, pp. 38-39.

cumstances there should be a phased transition in which an increasingly large proportion of new direct insurance contracts would be written by private companies. These insurers would also be encouraged to take as large a proportion of OPIC's present portfolio as they might desire. If OPIC and the private insurance sector could not reach a satisfactory arrangement for the complete transfer of the former's program by December 31, 1980, OPIC should discontinue issuing political risk insurance until such time as agreement was reached. OPIC should be phased into a reinsurance role as quickly as possible and required to issue periodic reports on its progress toward transferring its various functions. Finally, OPIC's finance programs should be transferred to AID by December 31, 1979.[125]

The Senate Committee minority's views

The minority SOR concurred with the majority's objective to increase the private sector's participation in OPIC's insurance program. It asserted, however, that the majority's legislative proposals would discourage private insurance companies from participating in the

125. *Ibid.*, pp. 39-42.

program on the required scale and terms. The result might well be the demise of the program rather than transforming it into an effective private enterprise. Implicit in the majority's proposals were the rejection of cautious experimentation toward private participation; the untested assurances that private insurers would make the needed long-term commitments and accept more than a small fraction of the risks taken by OPIC. According to the minority, the majority's proposals were based on negative views of overseas private investment in general and of OPIC in particular.[126]

The minority report opposed a mandatory target date when OPIC's insurance functions would be taken over by private insurance companies. The private sector itself indicated support only of additional study and experimentation but not of complete transfer to it of OPIC's program. Mandating OPIC's transfer but with voluntariness the standard of the private insurers' participation, would compromise OPIC's negotiating position with the private companies who would be encouraged to raise their demands for shares of OPIC's fee income. Moreover, the private insurers would wish to insure projects

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126. Ibid., pp. 55-56.

in developed countries or limit insurance to a select list of LDC's. In short, absent a trial period to determine the feasibility of transferring the program to the private sector, mandatory interim goals, and unrealistic limits would discourage private participation in the program.[127]

Many of the findings and recommendations of the HOR -- much more detailed and comprehensive than those of the SOR -- have already been noted.[128] Recognizing the conflict between the growing need of the United States for imported raw materials and the sensitivity of foreign investment in resource extractive activities in LDC's, the report directed OPIC to follow its sensitive project guidelines by concentrating on encouraging non-equity investments such as management, development, production sharing, and purchasing contracts which allow the host country to own all or most of the equity on the project. As a prime mover in the formation of a joint investment insurance association,[129] OPIC, as a member and reinsurer, should use its leverage to influence the private insurance companies in the orientation

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127. Ibid., pp. 66-67.

128. See supra notes 77-83 and accompanying text.

129. See supra note 83 and accompanying text.

and form of investments insured so that the investments would be structured to maximize acceptability to the host country and minimize the risk of expropriation.[130]

Unlike the majority SOR, the HOR placed neither deadline nor condition upon OPIC's transfer of its insurance program to the private sector.

Following their respective reports, a Joint Senate-House Committee ironed out their differences concerning legislation extending OPIC's operating authority. The conference bill more closely resembled the views of the HOR than of the majority SOR.[131]

ANALYSIS OF THE 1974 LEGISLATION

The Overseas Private Investment Corporation Amendments Act of 1974 became law on August 27, 1974.[132] Its purpose clause provided that OPIC should "conduct financing, insurance and reinsurance operations on a self-sustaining basis."[133] In its most important provision

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130. 1973 HOR, pp. 36-37.

131. U.S. Congress, House, Conference Report to accompany S. 2957, Report No. 93-1233, Overseas Private Investment Corporation, 93d Cong., 2d Sess., July 30, 1974.

132. 88 Stat. 763. The statute is hereinafter cited as OPICAA of 1974.

133. OPICAA of 1974, § 2(1)(B)(a), 88 Stat. 764.

the statute reflected the Congressional desire that OPIC gradually transfer its insurance functions, other than those of reinsurer, to the private insurance industry.[134] It extended OPIC's operating authority through December 31, 1977.[135] It expressed the Congressional intention that OPIC should achieve private participation in insurance contracts for inconvertibility and expropriation risks of at least 25 percent under contracts issued after January 1, 1975, and of at least 50 percent under those issued after January 1, 1978. The corresponding quotas for policies for war, revolution, or insurrection risks were 12.5 percent for contracts after January 1, 1976 and 40 percent for those after January 1, 1979.[136] These quotas were not mandatory; if unable to meet them, OPIC would be required to submit a detailed report to Congress setting forth the reasons for its inability to achieve such percentages of participation and the date by which the quotas would be met.[137]

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134. _Ibid._, § 2(2), 88 Stat. 764-766.

135. _Ibid._, § 2(3)(A), 88 Stat. 766.

136. _Ibid._, § 2(2)(C), 88 Stat. 767-768.

137. _Ibid._

Moreover, not later than January 1, 1976, OPIC was to submit an analysis of the possibilities of transferring all of its activities to the private sector, multilateral organizations, or other entities.[138]

The legislation prohibited OPIC from participating as insurer in policies for incovertibility and expropriation risks after December 31, 1979; for war risks, after December 31, 1980. However, the significant proviso was added, "unless Congress by law modifies" these prohibitions.[139] December 31, 1979 was also the target date for OPIC to cease operating various finance and special programs. Thereafter, the President was authorized to transfer such programs, together with related obligations and assets, to other U.S. agencies, with the provision that the programs be limited to countries with per capita income of $450 or less in 1973 dollars.[140]

Unlike the prior legislation which permitted OPIC to insure a project for 100 percent of its value,[141] the

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138. Ibid., § 2(7), 88 Stat. 768.

139. Ibid., § 2(2)(c), 88 Stat. 765.

140. Ibid., § 2(5), 88 Stat. 768.

141. Foreign Assistance Act of 1969, § 237(f), 83 Stat. 815.

1974 statute provided that the insured or its affiliates bear at least 10 percent of the risk of loss of the total investment.[142] Preferential consideration in its activities, to the maximum extent practicable consistent with its purpose, was to be given by OPIC to small businesses -- i.e., "of not more than $2,500,000 net worth or with not more than $7,500,000 of total assets."[143] OPIC's existing policy guidelines that sought to protect the special interests of U.S. labor from "runaway plant" projects were codified.[144] OPIC was required to decline any assistance in projects which would significantly reduce the investor's U.S. employees and to monitor investors assisted by it for their compliance with this new provision.[145] Finally, OPIC was required to assess the impact of its activities on the environment; within six months it should "develop and implement specific

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142. OPICAA of 1974, § 2(4)(g), 88 Stat. 767.

143. Ibid., § 2(1)(D), 88 Stat. 764.

144. Ibid., § 2(1)(E), 88 Stat. 764.

145. Ibid., § 2(1)(H), 88 Stat. 764.

criteria intended to minimize the potential environmental implications of projects undertaken by [its] investors abroad."[146]

This 1974 legislation did not still the debate over OPIC's role. Congress was adopting a wait-and-see approach before final decision on OPIC's future.

VIEWS OF CONCERNED PERSONS RE 1974 LEGISLATION AND THE INTERESTED LEGISLATORS

At this point, one may well ask why such a polarization of views existed concerning OPIC among the members of the Senate Committee on Foreign Relations and its Subcommittee on Multinational Corporations. Also, why the comparative unanimity of pro-OPIC views in the House Committee on Foreign Affairs and its Subcommittee on Foreign Economic Policy. Some explanation is afforded from interviews with key staff members and others.

Jerome Levinson, chief counsel to the Senate Subcommittee on MNC's, stated that his group made a much more in-depth examination of OPIC than its House counterpart.[147] Researchers visited such countries as Jamaica and Taiwan to investigate OPIC's relations with

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146. Ibid., § 2(5), 88 Stat. 768.

147. Interview with Mr. Jerome Levinson, Washington, D.C., January 14, 1976.

large MNC's and their foreign subsidiaries. Not only were the traditional aspects of economic development examined but also the specific issue of what part of society benefited when an MNC operated in an LDC. ITT's relationship with OPIC was thoroughly explored. To ascertain how OPIC aided economic development in the LDC's, the subcommittee examined witnesses with differing viewpoints.

The subcommittee, supported by a majority of the Foreign Relations Committee, concluded that OPIC was in a sense providing a subsidy to MNC's in LDC's by having the U.S. Treasury ultimately responsible for the payment of losses from political risk insurance. The MNC's should themselves assume political risks or seek insurance from the private sector. ITT was a good example of an MNC which wanted the U.S. Government to bail it out via OPIC insurance. While one subcommittee member, Senator Clifford P. Case of New Jersey, wanted to terminate the OPIC program at the end of its present term,[148] Chairman Church felt a phasing out period would be more acceptable to the House and at the same time give the private insurance companies time to take over the program. On the other hand, Senator Jacob K. Javits

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148. See 1974 SOR, p. 69.

of New York, a fervent supporter of the investment guarantee program since he became a Senator,[149] felt that with the general decline of U.S. foreign assistance programs, OPIC must continue as a worthwhile agency encouraging U.S. private investment and promoting the development of the LDC's. Levinson personally rejected Javits's opinion concerning OPIC; moreover, were OPIC unable to achieve the mandatory goal of private participation within a definite time limit, Levinson favored automatic termination of OPIC's insurance program.[150]

Jeffrey Shields, a member of the Senate Subcommittee's staff and later a staff assistant to Chairman Church, said that the proposal to have private insurance participate in the OPIC program was first advanced in connection with the OPIC enabling legislation in 1969.[151] The subcommittee felt that while in 1969 OPIC had been urged upon Congress as a developmental agency, this characterization was only marginally accurate. The overwhelming majority of MNC's would have invested in the LDC's without OPIC insurance. OPIC was considered

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149. See Chapter II, pp. 89-91 and accompanying text.

150. Supra note 147.

151. FAA of 1969, 83 Stat. 805, supra note 15.

a special interest group favoring the large MNC's. The insured projects did not benefit the very poor in the LDC's. Because the full faith and credit of the U.S. Treasury was involved in OPIC's insurance activities, substantial liabilities might be incurred. Accordingly, the subcommittee decided that the Government should withdraw from the investment guarantee field but that there should be a definite transition period during which the program would be transferred to the private insurance sector. One group in the subcommittee wanted the immediate termination of OPIC when its authority expired in 1974; the majority, however, favored a longer period during which the private companies would participate in the program.[152]

According to Shields, the most vexing questions before the subcommittee were, what were the long-term social, economic, and foreign policy considerations underlying an investment guarantee program like OPIC? Was OPIC needed? Could the private insurance sector administer the program as effectively as a Government or quasi-Government agency? Was OPIC encouraging U.S.

152. Interview with Mr. Jeffrey Shields, Washington, D.C., July 13, 1976.

companies to invest in more LDC's? Did OPIC improve risk management principles under which its clients operated; or did the presence of OPIC insurance make its clients more lax?

Shields thought that the national interest would be better served without OPIC insurance since the MNC's would invest in more LDC's. While OPIC's termination might cause a temporary slight downward trend in aggregate foreign investments, the long-term forecast of increased investments was favorable. Whether OPIC should be terminated if unable to fulfill Congressional mandates was a political decision to be rendered by Congress.

Shields denied the charge that events in Chile and ITT's involvement with OPIC influenced the subcommittee's attitude toward OPIC. In light of the universal principle of self-preservation, OPIC during the extensive hearings and pending the amendatory legislation, used extensive public relations and lobbying efforts in its behalf. While favorable reports were received from OPIC-insured MNC's, the subcommittee preferred to base its conclusions, *inter alia*, on unbiased scholarly studies such as those of the CRS and CG.

As regards Senators Javits's strong support of

OPIC, Shields pointed out that many MNC's who were OPIC clients had principal offices in New York -- a factor that could not be ignored. Although not on the subcommittee, Javits was an influential member of the Foreign Relations Committee and a signatory to the minority SOR who had testified before both the Senate and House subcommittees.[153]

Frank Ballance, a staff assistance to Senator Javits during the 1973-1974 hearings, stated that the Senator believed that OPIC served a very important role in the LDC's.[154] If the private insurance companies assumed the entire OPIC insurance program, OPIC would have no incentive for further development, especially in high risk countries. The private companies as a practical matter would want to limit insurance to a select list of LDC's without great risks. However, association with the private sector would permit OPIC to insure projects for developmental purposes in some high risk LDC's.

According to Ballance, it was Javits's position that OPIC had not been given sufficient time to prove

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153. Ibid.

154. Interview with Mr. Frank Ballance, Washington, D.C., July 27, 1976.

its worth. The recommendations in the majority SOR, with deadlines and conditions for transferring the insurance program to the private companies, were much too rigid and unworkable. Moreover, OPIC remained burdened from projects inherited from AID.

Ballance's own opinion was that some Senate Subcommittee members were basically biased against OPIC. He favored OPIC's continuance without any restrictions or fixed schedules concerning the participation in the investment guarantee program by the private insurance industry. Since the termination of the Congressional hearings, OPIC was seeking to solve some of the problems raised by critics at the hearings.[155]

Charles Stephen Levy, a staff consultant to the House Subcommittee on Foreign Economic Policy, mentioned that prior to the hearings, its Chairman, John C. Culver of Iowa, conferred with OPIC's president, Bradford Mills.[156] The latter asked Culver to conduct the hearings with an open mind and this was done. In

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155. Ibid.

156. Interview with Mr. Charles Stephen Levy, Washington, D.C., July 31, 1976.

1969, when OPIC's enabling legislation was first proposed, Culver was not an OPIC proponent. Indeed, even before the hearings, he apparently had several reservations as regards OPIC's operations during the two years of its existence.

Before the commencement of the hearings, Levy had undertaken a field trip to Latin America to study some of OPIC's operations. Following the taking of testimony at the hearings, the subcommittee drafted its report (HOR) containing 26 findings and general policy recommendations.[157] The final phase consisted of drafting legislation with the amendments agreed upon by the Committee of Conference.[158]

Levy initially thought that the testimony adduced at the subcommittee hearings indicated that OPIC had not completedly followed the Congressional mandates. However, he recognized that the mandates were somewhat incompatible with each other -- namely, a developmental role for the LDC's alongside a profit-making one. Nevertheless, both principles were required in order to obtain Congressional approval.

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157. 1973 HOR, pp. 34-38.

158. Supra note 131.

It was Levy's assessment that Representative Culver, after hearing the testimony, felt that despite the problems present in the OPIC program, it did provide some limited benefits to the United States. With proper management and some program restructuring, additional benefits could be expected. If OPIC were given sufficient time to implement the subcommittee's recommendations, improvement in OPIC's operations could be anticipated.

According to Levy, his subcommittee never considered the complete transfer of OPIC's insurance program to the private insurance industry after a designated date. The feasibility of partial transfer was, however, contemplated. The unworkable recommendations of the majority SOR that the private sector take over OPIC's insurance operations according to a predetermined formula and timetable, were an indirect means of the majority to terminate OPIC's operations -- the goal of OPIC's antagonists.[159]

George M. Ingram, a fellow subcommittee staff consultant with Levy, stated that Chairman Culver, a liberal Democrat in favor of the free enterprise system, had

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159. <u>Supra</u> note 156.

undertaken the inquiry free from prejudice.[160] The 1974 OPIC legislation had been considered primarily in the context of one of OPIC's two objectives -- namely, the developmental goal. The witnesses before the subcommittee expressed conflicting views as to whether the investment guarantee program assisted economic development in the LDC's.

Ingram's discussions with Senator Church's subcommittee staff members led him to believe that they commenced the inquiry on the assumption that private foreign investment did not promote the development of LDC's. The Senate Subcommittee's investigation of ITT's activities in Chile in particular and of MNC's in general undoubtedly influenced its negative attitude toward OPIC.

According to Ingram, a major subject of inquiry, not involving one of OPIC's expressed public purposes, was whether OPIC protected U.S. private investment abroad. OPIC supporters maintained that OPIC generally had a successful record in preventing disputes from reaching the level of government-to-government confrontation, and in reducing losses to both the insured investor and to OPIC. If OPIC's program were transferred

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160. Interview with Mr. George M. Ingram, Washington, D.C., July 23, 1976.

to the private sector, it was extremely doubtful whether the insurance companies could achieve similar results.

It is evident that the two subcommittees entered their respective investigations of OPIC with different assumptions. As Ingram noted, the majority of the House Subcommittee assumed from the outset that foreign private investment could comprise a useful development tool and that a move towards the complete privatization of the OPIC program might imperil, if not terminate, the development goal of the program. The private sector, motivated solely by profits engendered from low risk projects, would relegate any developmental objective. Moreover, his subcommittee placed more credence on the job creation statistics presented by OPIC supporters than on organized labor's concern over the loss of jobs from runaway industries. Organized labor could more easily have influenced the Senate group.

Ingram observed that in the House Subcommittee's deliberations the question was raised whether OPIC should charge different insurance fee rates for different countries -- a practice employed by the Foreign Credit Insurance Association of the Export-Import Bank in insuring commercial risks for export credit sales.

The suggestion of varied rates was quickly dismissed for political reasons. As the experience of the Foreign Credit Insurance Association demonstrated, the employment of different rates caused representatives of the various countries to seek periodic downward adjustment of the rates affecting their principals. Political and other pressures often accompanied applications for review. In the subcommittee's view, neither OPIC's structure nor the experience of the Export-Import Bank's Association lent support to a varied insurance fee rate schedule.[161]

As might be expected, OPIC officials were more outspoken in their reactions to the Senate Subcommittee than to its House counterpart. Bradford Mills, OPIC's first president, believed the former was not serious in its inquiry and sought headlines for political purposes. Its chief counsel, Jerome Levinson, was extremely prejudiced against OPIC. Cognizant that it could not directly terminate OPIC, the Senate Subcommittee purposely advanced as a political ploy an inflexible and unworkable formula for transferring the OPIC insurance program to the private insurance industry. If the

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161. Ibid.

private sector failed or refused to take over the program -- as might have been anticipated -- OPIC's demise would have been the natural and intended consequence.[162]

Herbert Salzman, OPIC's executive vice president, said he did not doubt Levinson's sincerity but thought Levinson's extreme anti-OPIC views had been shaped by his previous experiences with foreign aid programs. The difference in attitude of the two subcommittees toward OPIC could be gleaned by the type of witnesses appearing before the subcommittees. Many more hostile witnesses were called by the Senate group, many of whose members appeared to have prejudged OPIC before all the testimony was introduced.[163]

Rutherford Poats, OPIC's vice president for development and later acting president, thought both Senator Church and Levinson were biased against OPIC. The latter's position had been influenced by his disagreement with AID policies in Brazil where he had served as an AID loan officer. The Church subcommittee's mandate was to investigate the MNC's. Since OPIC had insured

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162. Interview with Mr. Bradford Mills, New York, N.Y., June 16, 1976.

163. Interview with Mr. Herbert Salzman, New York, N.Y., October 18, 1976.

many MNC's, including ITT, this afforded the subcommittee an opportunity -- in reality a pretext -- to investigate OPIC. Significantly, other foreign aid programs were untouched. Unlike this subcommittee, the House Subcommittee never desired to destroy OPIC, only to reform it.[164]

James Offut, OPIC's legislative counsel responsible for Congressional liaison and later counsel to its board of directors, thought that the Church subcommittee's earlier investigation of ITT and other MNC's greatly influenced its unreasonable and unjust negative attitude toward OPIC. Senator Church's opposition was not particularly directed to OPIC or its development role; he regarded any government incentives for overseas private investment as having an adverse effect on U.S. employment. Moreover, Church was not favorably disposed to the foreign policy guidelines under which OPIC had insured heavily in such countries as Korea and Taiwan. OPIC projects would inevitably lead to closer relations with and additional support for the host countries. Finally, Offut believed that when the anti-OPIC subcommittee realized it could not terminate OPIC upon the

164. Interview with Mr. Rutherford Poats, Washington, D.C., January 14, 1976.

expiry of its original mandate, it proposed the unreasonable timetable for transferring OPIC's insurance program to the private sector with the proviso that if the schedule were not met, OPIC's authority would terminate.[165]

Gerald Morgan, OPIC's deputy vice president for insurance and later its general counsel, expressed the opinion that Senator Church's opposition to OPIC was largely based on the belief that OPIC's operations brought the U.S. Government directly into the disputes with the host countries. According to Morgan, no credible evidence substantiated such belief.[166] Jonathan Dill, OPIC's acting vice president for development, stated that organized labor's opposition to OPIC greatly influenced the Senate Subcommittee's attitude.[167]

That the situation in Chile in 1973, the ITT hearings which preceded the OPIC hearings, and the climate

165. Interview with Mr. James Offut, Washington, D.C., July 21, 1976.

166. Interview with Mr. Gerald Morgan, Washington, D.C., July 15, 1976.

167. Interview with Mr. Jonathan Dill, Washington, D.C., January 6, 1976.

engendered by the Watergate disclosure all contributed to the subcommittee's negative attitude toward OPIC, were suggested by David Stebbing, a foreign service officer in the Office of Investment Affairs at the State Department. This office had a close relationship with OPIC.[168] Fred Bergsten, in 1974 a senior fellor at the Brookings Institution and later an Assistant Secretary of the Treasury for International Affairs, thought that the manner in which the hearings were conducted indicated a preexisting bias against OPIC.[169]

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168. Interview with Mr. David Stebbing, Washington, D.C., July 28, 1976.

169. Interview with Mr. Fred Bergsten, Washington, D.C., July 20, 1976.

CHAPTER IV

OPIC AND PRIVATIZATION

As noted in the preceding chapter,[1] the most important provisions of the Overseas Private Investment Corporation Amendments Act of 1974[2] authorized and encouraged OPIC to involve the private insurance industry in its programs with the objective that by 1981 OPIC would function solely as reinsurer. Although the statute set forth specific and increasing percentage goals of private participation in insuring overseas investments against the political risks of expropriation, inconvertibility, and war,[3] the quotas were not mandatory; if unable to meet them, OPIC would be required to explain to Congress why the private participation percentages were not achieved.[4]

OPIC's enabling legislation[5] had provided that no

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1. See Chapter III, pp. 188-191, _supra_.

2. 88 Stat. 763. The statute is hereinafter cited as OPICAA of 1974.

3. OPICAA of 1974, § 2(2)(C), 88 Stat. 767-768.

4. _Ibid._

5. Foreign Assistance Act of 1969, 83 Stat. 805, 807 (1969).

later than March 1, 1974, it should submit an analysis of the possibilities of transferring its programs to the private sector.[6] According to Herbert Salzman, OPIC's executive vice president, this provision concerning future private participation in ("privatization" of) OPIC's insurance programs had been inserted in such legislation to allay the fears of some Congressmen who had reservations concerning the creation and future of the agency. With only a five-year mandate, it appeared a good risk management tool for OPIC to share some risks with private parties. Moreover, an initial requirement that by a specified date OPIC present plans for seeking private participation in its insurance operations seemed to have a beneficial public relations aspect.[7]

OPIC's initial efforts of participation with Lloyd's

Within six months after OPIC's formal establishment in January 1971, OPIC sought private reinsurance of part of its investment guarantee portfolio. According to

6. *Ibid.*, § 240 A, 83 Stat. 818.

7. Interview with Mr. Herbert Salzman, New York, N.Y., October 18, 1976.

Bradford Mills, OPIC's first president, the agency initially communicated with U.S. insurance and reinsurance companies. They refused to participate on the ground they knew nothing about political risk insurance. Turning to Lloyd's of London, OPIC found one underwriter willing to consider forming a pool, on a one-year experimental basis, to reinsure a portion of OPIC's expropriation liabilities.[8]

The Lloyd's agreement, executed in December 1971, initiated participation by the private sector. That agreement jointly committed the participating syndicates and companies to pay a fractional ("quota share") reimbursement up to $7 million of OPIC's losses on expropriation coverage in any country except Chile during 1972. In effect, the Lloyd's share of losses was one-half in countries where OPIC's expropriation liabilities

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8. Interview with Mr. Bradford Mills, New York, N.Y., June 16, 1976; Overseas Private Investment Corporation, Report to the Congress on the Possibilities of Transferring OPIC Programs to the Private Sector (1974), p. 6 [hereinafter cited as OFRTC], reprinted as Appendix in U.S. Congress, House, Committee on Foreign Affairs before the Subcommittee on Foreign Economic Policy, 93d Cong., 2d Sess., 1974, pp. 63-64 [hereinafter cited as 1974 HOH].

totalled $14 million or less, and smaller fractions in countries of higher exposure. OPIC officials who participated in the contract negotiations with Lloyd's thought Lloyd's had received very favorable terms. These had been given so as to attract future participation by U.S. insurers.[9]

Proposals toward approach to private participation in the program

In the same month of December 1971, the OPIC Advisory Council[10] held its first meeting to discuss various aspects inherent in a reduction or phasing out of the Government's role in investment insurance. The Council encouraged OPIC to pursue increased private participation in both the insurance and finance programs.

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9. OFRTC, p. 6; 1974 HOH, p. 64; interview with Mr. Gerald Morgan, OPIC's insurance counsel, Washington, D.C., August 15, 1976; interview with Mr. Edward Wright, OPIC assistant vice president for insurance, Washington, D.C., January 12, 1976.

10. The Advisory Council was established by the Chairman of the OPIC board of directors, as required by section 239(f) of the Foreign Assistance Act, to provide views of the private business community on OPIC's objectives and operations. It consisted of senior officers of representative industrial companies, business associations, banks, insurance companies, and professional specialists concerned with foreign investment.

It noted the difficulty of formally abandoning access to the ultimate financial backing of the U.S. Treasury so long as OPIC was exposed to the risk of catastrophic loss. Some Council members voiced concern that a private underwriting affiliate or private dominated OPIC might stress risk avoidance and profitability to the detriment of OPIC's responsibility as a risk taker in the less developed countries (LDC's) especially in the field of mining investment.[11]

In the summer of 1972, an Insurance Advisory Committee of the Council was established to recommend approaches to industry participation in the OPIC insurance program.[12] At the Council's meeting in October 1972, the Committee's report was considered by a panel which concluded: (a) The OPIC insurance program cannot and should not be completely transferred to the private sector, in view of the need for long-term coverage commitments, excess loss reinsurance, and assurance that the program's public purposes will be maintained. (b) The application of the private insurance industry's underwriting expertise to OPIC's operations would be useful.

11. OFRTC, p. 9; 1974 HOH, p. 65.

12. Ibid.

(c) OPIC should seek private insurance industry participation through creation of an association which would directly write investment insurance, with private members bearing first loss liability up to a stated amount and OPIC bearing excess of loss, or catastrophic liability. (d) If such an association could be arranged in financial terms satisfactory to both OPIC and the private companies, broad participation by the U.S. insurance industry probably could be achieved in a significant band of expropriation and inconvertibility liabilities but not for war risks. (e) Initially, OPIC should handle the association's underwriting and other administrative functions through a management contract.[13]

At the same meeting a second panel considered means of increasing private participation in OPIC's finance program. It concluded that since this program had only limited experience, it was too early to contemplate a new private OPIC affiliate's taking over part or all of the finance activities. On the basis of these Council recommendations, OPIC concentrated on planning an

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13. Ibid.

experimental association of its insurance program with the private sector.[14]

Renewal agreements with Lloyd's

During its one-year experimental agreement with OPIC,[15] Lloyd's syndicated insurance among a reinsurance pool which included among its British and European members the Russian majority owned Black Sea and Baltic Insurance Company.[16] Lloyd's renewed its agreement for a second year on the same conditions, but doubling the original per-country reinsurance liability to $14 million per country. During this renewal period, seven U.S. insurance companies joined the reinsurance pool.[17]

Absent any expropriation losses in the first two years of its Lloyd's agreement, OPIC was able at the end of 1973 to negotiate more favorable terms. The renewal was for a three-year period through 1976, with Lloyd's per-country reinsurance liability increased to $18.25 million. The form of reinsurance was altered

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14. OFRTC, p. 10; 1974 HOH, p. 65.

15. Supra notes 8 and 9 and accompanying text.

16. OPIC Press Release, April 23, 1972.

17. OFRTC, pp. 6-7; 1974 HOH, p. 64.

from the initial contract by contract quota share liability for first losses to an aggregate first-loss pool in which Lloyd's would bear slightly more than 45 percent of any OPIC expropriation settlement of up to $40 million in any country, including Chile, annually or up to $120 million worldwide annually.[18]

Because of their traditional policy against insuring land war risks, both Lloyd's and the U.S. private sector refused participation in reinsuring OPIC's war and insurrection liabilities. However, success with their expropriation reinsurance led to negotiation of a separate reinsurance pool for inconvertibility risks.[19]

Additional proposals for private participation in the program

During the 1973 Senate OPIC hearings,[20] Marshall T. Mays, OPIC's then general counsel, stated that because of the new reinsurance with Lloyd's, there seemed to be more immediate possibilities of initiating an

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18. OFRTC, p. 7; 1974 HOH, p. 64.
19. *Ibid.*
20. See Chapter III, p. 147, *supra*.

early experiment in joint underwriting and risk taking with U.S. private insurance companies.[21] James Meenaghan, vice president and assistant to the chairman of the board of the Fireman's Fund American Insurance Companies, representing a Special Insurance Industry Group (SIIG),[22] appointed by OPIC management in August 1972, testified that a feasible combined private industry-OPIC insurance program covering expropriation and inconvertibility risks would have to include these features: (1) creation of an association consisting of all interested private companies and OPIC; (2) initially, the private sector should have a minimum interest of 25 percent in the association; (3) OPIC -- in effect the U.S. Government -- should provide catastrophic reinsurance backup protection; (4) initially, a management contract with OPIC would provide for its staff administering the program; and (5) underwriting policy and procedures of the association should be directed by a board

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21. U.S. Congress, Senate, Committee on Foreign Relations, Multinational Corporations and United States Foreign Policy, Hearings before Subcommittee on Multinational Corporations, 93d Cong., 1st Sess., 1973, Pt. III, p. 458 [hereinafter cited as 1973 SOH].

22. Ibid., pp. 371-372. Only four of the 2,700 U.S. property-liability insurers had representatives on the SIIG. Ibid., p. 372.

of governors which would negotiate with OPIC such matters as the proper reinsurance premium and management contract fee. Many areas of concern, involving extensive research and negotiation, remained before the SIIG could solicit broadscale industry support. In Meenaghan's view, "the OPIC insurance program cannot and should not be completely transferred to the private sector."[23]

In a subsequent Congressional hearing in March 1974, some nine months later, Meenaghan in a prepared statement noted that in July 1973 the SIIG was confident it had reached an agreement on the basic economics of a combined OPIC-private sector program, but an impasse resulted over the division of premiums and the maximum exposure to loss.[24] As a consequence, his company was constrained to resign from the SIIG but still recommended the formation of an association (item [1] of the

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23. Ibid., pp. 372-374.

24. 1974 HOH, pp. 34-36. At the same hearing, Marshall T. Mays, then OPIC's president, observed that in July 1973, the Senate Subcommittee on Multinational Corporations, not favorably disposed towards OPIC, was holding its hearings. The Senate proposal made it difficult to negotiate an acceptable division of premiums but he was optimistic concerning the outcome. Ibid., p. 37.

preceding paragraph) for an initial three-year trial period.[25] This support of additional study and experimentation constituted criticism of the proposal advanced by a majority of the Senate Committee on Foreign Relations that OPIC transfer its direct insurance business to the private sector according to specific schedules and terminate such function by December 31, 1980. The House version, with amendment, could permit the kind of experimentation necessary to develop a sound program with the private sector.[26]

OPIC's first report to Congress re privatization

In its first report to Congress concerning the possibilities of transferring its programs to the private sector, OPIC pointed out that "the nature of OPIC's investment insurance 'business' -- its policy mandates and restrictions, the difficulty of projecting its long-term income: loss ratios, and the potential for catastrophic losses -- set real limits on the extent of its

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25. Ibid., pp. 34-37.

26. See Chapter III, p. 160, and notes 125-131 and accompanying text. See U.S. Congress, Senate, Committee on Foreign Relations, The Overseas Private Investment Corporation Amendments Act, Report on S. 2957, 93d Cong., 2d Sess., 1974, Report of Minority, p. 66 [hereinafter cited as 1974 SOR].

transfer to the private sector." Insurance actuaries were in agreement that mathematical projection of loss rates could not be generated on the basis of the limited experience of OPIC and its predecessor agency, Agency for International Development (AID) during their 15 years of operation in LDC's.[27]

Four conclusions concerning the investment insurance program were reached: (1) There are realistic possibilities of inducing significant participation by private insurers, reinsurers, or mutually insuring investors in the investment insurance program. A set of experimental public-private collaborations should be undertaken before deciding what should be the U.S. Government's long-term role in overseas investment insurance operations. (2) OPIC needs additional statutory authority and time to test various combinations of joint insurance underwriting and reinsurance arrangements with private insurance companies, international agencies, and others. (3) Private participation in the form of OPIC's purchase of reinsurance from syndicates of Lloyd's of London, initiated in January 1972, has proved capable of expansion to relieve OPIC of a substantial portion of its liabilities on expropriation insurance.

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27. OFRTC, pp. 5-6; 1974 HOH, p. 63.

Private reinsurance of OPIC does not, however, provide a full test of the feasibility of transferring direct underwriting responsibilities and claims management in overseas investment insurance to the private sector or sharing these responsibilities and related financial liabilities between the Government and private insurers. (4) The private insurance industry operates under regulations which limit its capacity to cover U.S. overseas investment against political risks. Consequently, the industry will not accept large exposure in the unfamiliar field of political risk insurance unless the U.S. Government provides reinsurance against large losses disproportionate to annual premium income. Alternative forms of private underwriting, such as a mutual association of investors, also will require substantial U.S. Government reinsurance. Private insurance companies also will not commit themselves to exposure over an extended term of years in this unfamiliar field.[28]

As noted in the preceding chapter,[29] a number of present or former officials affiliated with OPIC felt

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28. OFRTC, pp. 2-3; 1974 HOH, pp. 61-62.

29. See Chapter III, pp. 204-206, notes 162-167 and accompanying text.

that the Church Subcommittee on Multinational Corporations and OPIC had a preexisting bias against the agency. While the privatization issue had been a minor factor in the enactment of the enabling legislation in 1969,[30] it had been blown all out of proportion by the Senate opponents of OPIC. Cognizant that they could not directly terminate OPIC, these opponents sought to accomplish by unreasonable mandatory deadlines for private participation what overt efforts towards OPIC's demise could not attain.[31] The non-mandatory quotas for private participation set forth in the 1974 legislation were in effect a defeat for the anti-OPIC Senators. The statutory extension of OPIC's operating authority through December 31, 1977[32] permitted OPIC to conclude

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30. Interview with Mr. John C.L. Donaldson, a former Office of Private Resources official and later assistant U.S. Special Representative for Trade Negotiations, Executive Office of the President, Washington, D.C., August 4, 1976.

31. Interview with Mr. James Offut, OPIC's legislative counsel responsible for Congressional liaison, Washington, D.C., July 21, 1976; interview, _supra_ note 8; _cf._ interview with Mr. Jeffrey Shields, a member of the Senate Subcommittee staff, Washington, D.C., July 13, 1976.

32. OPICAA of 1974, § 2(3)(A), 88 Stat. 766.

negotiations with the private sector.[33]

<u>Creation of the Overseas Investment Insurance Association</u>

A few days before the 1974 legislation became law,[34] OPIC officials met with over 200 executives of leading private insurance companies to discuss means of involving their industry in underwriting political risk insurance in partnership with OPIC.[35] The conference adopted OPIC's proposal for the formation for an initial three-year period of the Overseas Investment Insurance Association (OIIA, more frequently known as "the Group"), an unincorporated association, which would assume underwriting responsibility for OPIC's expropriation and inconvertibility coverages under future insurance policies. The Group, in which OPIC held member-

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33. Overseas Private Investment Corporation, <u>Report to Congress on the Possibilities of Transferring OPIC Activities to the Private Sector</u> (1976), p. 6, [hereinafter cited as 1976 ORTC].

34. OPICAA of 1974, <u>supra</u> note 3, was approved August 27, 1974.

35. OPIC Press Release, August 15, 1974; Overseas Private Investment Corporation, <u>Insurance Industry Meeting, Conference Materials</u> (August 21, 1974).

ship, became a functioning reality with the signing of its constitution by 12 U.S. private insurers and Lloyd's on February 19, 1975.[36]

The Group, acting as agent for its members, was empowered to issue new policies covering expropriation and inconvertibility risks; the private sector shunned war, revolution, or insurrection insurance. Each member's liability was limited to a stated percentage and there was no joint liability. OPIC reinsured the members for losses in excess of certain stop-loss limits. In addition to issuing new policies, the Group also reinsured a large portion of OPIC's existing expropriation and inconvertibility portfolio and continued OPIC's practice of writing policies of up to 20 years' duration.[37]

Pursuant to a management agreement, OPIC was to manage the Group on a fee basis for the initial period of three years. Members could withdraw from the associ-

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36. 1976 ORTC, pp. 3, 6.

37. Ibid., pp. 6-7. See Joseph P. Griffin, "Transfer of OPIC's Investment Insurance Programs to Private Insurers: Prospects and Proposals," Law and Policy in International Business, 8 (1976), pp. 631, 647-648.

ation at the end of any fiscal year on 90 days' prior notice. Policies were issued in the names of the members of the Group and provided that OPIC would assume the direct interest of any retiring member for whom there was no private insurer replacement.[38]

The Group's activities were supervised by a joint public-private board of governors of 12 members, of whom six were representatives of the private insurers. The board's responsibility entailed establishing underwriting policies and procedures within basic policy guidelines which could not be changed without OPIC's consent.

The group had a first loss pool liability with annual loss limits of $40 million per country and $80 million worldwide. In its first year of operations, private participation amounted to only $6.55 million of the $40 million per country first loss pool. Nevertheless, this private participation in such pool, together with OPIC's additional reinsurance agreement with Lloyd's, sufficed to satisfy the Congressional intent for at least a 25 percent private participation in the liabilities incurred in underwriting expropriation and inconvertibility coverages under contracts issued after

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38. Ibid.

January 1, 1975.[39]

Toward the end of 1975, the Group was able to add five private insurers, including one European company, to its membership, and increased private participation in the first loss pool by $1.25 million to $7.8 million. OPIC's participation accordingly was reduced in the same amount. Notwithstanding this increase in membership, OPIC was disappointed. It had hoped to increase private participation to $10 million. Moreover, one participating company, the Fireman's Fund American Insurance Companies, an early proponent of an OPIC-private sector association, withdrew.[40]

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39. 1976 ORTC, p. 6; Griffin, _supra_ note 37, p. 648; Panel Discussion, "New Developments in Insuring Overseas Investments against Political Risks," sponsored by the Subcommittee on Insuring Overseas Investments of the International Law Section of the American Bar Association, held at Georgetown University Law Center, Washington, D.C., April 21, 1976, and substantially reprinted in _Law and Policy in International Business_, 8 (1976), pp. 661-662 (remarks of Marshall Mays and Gerald Morgan, respectively) [hereinafter cited as Panel Discussion].

40. 1976 ORTC, p. 6.

VIEWS OF CONCERNED PERSONS RE PRIVATIZATION

The privatization of OPIC evoked different opinions among those who have been associated with OPIC. In general, former officials were more critical of OPIC's privatization efforts than incumbents who tended to support the program but expressed reservations concerning the ability to meet the Congressional goals.

Thus, Harry Freeman, a former AID official and later OPIC's vice president for finance, who left the agency in April 1975 to become a vice president of the American Express Company, the Fireman's Fund parent company, stated that privatization of OPIC was contrary to the best interests of the U.S. Government.[41] OPIC's main purpose was development of the LDC's by raising their economic and social standards. As a Government agency, OPIC could afford to issue insurance for politically unstable countries at relatively low rates. Contrariwise, the profit-motivated private insurance industry, conservatively operated, would function in fewer LDC's and be more guarded in its risk taking. OPIC was not an insurance company in the classical sense: while

41. Interview with Mr. Harry Freeman, Washington, D.C., January 7, 1976.

the private sector necessarily relied upon actuarial tables based upon past experience, actuaries who examined OPIC's insurance program uniformly concluded it was not yet susceptible to mathematical projections of loss rates based upon past experience.

According to Freeman, the objective of AID's Office of Private Resources (OPR), OPIC's immediate predecessor in administering the investment guarantee program, was to work jointly with other AID bureaus to develop comprehensive economic and social programs for the LDC's. Since AID had a very heavy concentration of public sector projects in specific LDC's, it was not overly concerned with insuring private projects in those countries. Many U.S. officials then welcomed private investment in those LDC's, even with Government-guaranteed insurance, because it would mean less direct U.S. foreign aid as well as the receipt of the insurance premiums.

Because of outside pressures upon OPIC in the early 1970's, the developmental aspects of OPIC were subordinated to the conservatively oriented insurance aspects of prudent risk management. This change was not consonant with OPIC's original purpose as a developmental agency.

The reason for the Fireman's Fund American Insurance Companies' withdrawal from the Group after one year was its belief that the Group was not strictly in the insurance business and his company did not find it profitable to continue therein. The few private insurers which had joined the Group had done so more to project a good public relations image than to profit under customary insurance business practices. The private insurance industry preferred the present state regulation to any Federal regulation.[42] By jointly participating with an agency like OPIC, the industry demonstrated its concern for the public interest both to the Congress and to the public. As a practical matter, those insurers who became members of the Group risked relatively little exposure on a country by country basis. In sum, according to Freeman, the benefits to the insurance industry far outweighed the token risks taken by those accepting membership in the Group.[43]

Freeman's views generally accorded with those of

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42. See United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944).

43. Interview, *supra* note 41.

Gil Carter, a former counsel with OPR and OPIC.[44] OPIC was established as a developmental agency and was never intended to operate as a private insurer. The private insurance industry basically was not interested in OPIC's program, as evidenced by the few private insurers which had joined the Group. Those which had become members of the Group might have joined because some of their clients were multinational corporations (MNC's) already insured by OPIC. Such membership represented good customer relations with minimal exposure on a country to country basis.[45]

Edward Wright, a former OPIC assistant vice president for insurance, stated that Freeman and Carter always opposed the privatization of OPIC's insurance program since they regarded OPIC first and foremost as a developmental agency.[46] The few U.S. private insurers which had become members of the Group had been influenced to participate because of the OPIC-Lloyd's agreements initiated in December 1971.[47] The private participation in the first year of the Group's operations

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44. Interview with Mr. Gil Carter, Washington, D.C., January 7, 1976.

45. Ibid.

46. Interview with Mr. Edward Wright, Washington, D.C., January 12, 1976.

47. See supra note 9 and accompanying text.

represented but a small portion of OPIC's insurance. Wright was doubtful whether the legislative schedules for privatization could be met.[48]

Both a present and a former insurance official with OPIC took the position that privatization had detracted from OPIC's developmental objective. The more profitable OPIC might become, the more private participation in OPIC's insurance program could be anticipated. Both had reservations concerning the private sector's willingness and ability to take over OPIC's insurance functions in accordance with the Congressional timetable.[49] William T. Adams, the former official, additionally noted the foreign policy role involved in OPIC's operations which the private sector would have difficulty in fulfilling.[50]

George M. Ingram, staff consultant to the Subcommittee on Foreign Policy of the House Committee on Foreign Affairs, who played a significant behind-the-scenes

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48. Interview, _supra_ note 46.

49. Interview with Mr. Charles Clark, OPIC insurance official, Washington, D.C., January 12, 1976; interview with Mr. William T. Adams, Washington, D.C., April 21, 1976.

50. Interview, _supra_ note 49.

role in the passage of the 1974 legislation,[51] stated his belief that OPIC's functions included creation of the marginal difference of investment in an LDC vis-a-vis a new investment.[52] Only because of OPIC insurance with its Government-subsidized rate structure would most companies be willing to invest especially in the lowest income LDC's. OPIC should be regarded as a developmental agency. So long as OPIC remained in charge of the program, with the U.S. Government's backing up the Group as a reinsurer through OPIC, the private sector would continue to function, giving more weight to profit and risk management considerations than to the developmental goals of the LDC's.

According to Ingram, the prospects of the private sector's taking over completely all of OPIC's operations were unlikely. However, there was a good possibility that the private sector would take over the bulk of the expropriation coverage. Whether Congress would extend the deadlines for privatization remained problematical.[53]

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51. OPICAA of 1974, 88 Stat. 763, supra note 2.

52. Interview with Mr. George M. Ingram, Washington, D.C., July 23, 1976.

53. Ibid. See further remarks of Mr. Ingram in Panel Discussion, pp. 678-679, 682, 688.

According to John C.L. Donaldson, a former OPR official and later assistant U.S. Special Representative for Trade Negotiations, Executive Office of the President, the profit-motivated private sector could not properly administer the OPIC program.[54] OPIC provided the "opportunity for a critical margin of difference" in permitting private direct investment in the development of LDC's. The U.S. Government's backing of OPIC represented the difference between a possible profit/loss situation and a risk management situation. While OPIC's primary considerations were developmental and U.S. foreign policy, the private insurer's were profit-making. Some of OPIC's projects were neither highly developmental nor overly risky, and permitted an accumulation of reserves for the riskier, more developmental projects. On the whole both AID and OPIC had been developmentally oriented. Bradford Mills, an investment banker who became OPIC's first president, was very much interested in OPIC's financial condition and in its ability to make a profit from its operations.[55]

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54. Interview, _supra_ note 30. See Chapter II, pp. 95, 118, 122, notes 18, 82, 83, 98 and accompanying text.

55. Interview, _supra_ note 30.

Mills felt the private sector had a significant participatory role in the OPIC insurance program.[56] Privatization was essential for OPIC's survival. Lloyd's, much more innovative than the U.S. private sector, merited commendation for participating with OPIC. While the initial one-year arrangement with Lloyd's gave Lloyd's very favorable terms, it resulted in Lloyd's extension for a three-year term and greatly influenced U.S. private insurers' participation in the Group. Additional insurance companies were slowly joining the Group.

Even though only 14 U.S. private insurers were members of the Group by 1976 -- one participating company having withdrawn[57] -- and even though the liability of each member averaged only $400,000 per country, Mills expressed optimism about the private sector's increased willingness in time to underwrite the political risk

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56. Interview, supra note 8.

57. See notes 36 and 40 and accompanying text. Regretting the withdrawal of the Fireman's Fund American Insurance Companies, Mr. Mills noted that Fireman's chairman, Lou Niggeman, had been enthusiastic over private participation in the OPIC program. Unfortunately, Niggeman died and his successors had a different outlook toward privatization.

insurance of the OPIC program. Eventually, the program would be highly profitable inasmuch as OPIC had both a good claims record and the backing of the U.S. Government and would remain as reinsurer. Host countries would hesitate before rejecting a fair settlement of an OPIC claim since such action would jeopardize any future U.S. assistance. OPIC's earlier major claims problems had their origin in AID-insured projects; settlements were being negotiated. As its first president, he had instituted risk management procedures to eliminate insuring risky and unworthy projects. He ventured no prediction as to the Group's taking over OPIC's primary insurance role according to the Congressional timetable. Nevertheless, privatization would ultimately be an actuality.[58]

Herbert Salzman, OPIC's executive vice president who had been the assistant administrator for OPR in charge of the investment guarantee program, observed that OPIC had four constituencies: (1) the U.S. Government; (2) the investor-client involved in the OPIC project; (3) the host country; and (4) outside financial partners assisting the investor, such as host country

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58. Interview, supra note 8.

nationals in a joint venture or even an international financial consortium. It was OPIC's task to maintain amicable relations with all four classes.[59]

Under AID, with emphasis on the developmental role, the interests of the host country and local investors were given special consideration. Budgetary problems and conservative risk management principles were of secondary importance in the Democratic administrations of Presidents Kennedy and Johnson.

OPIC's creation occurred during the administration of Republican Richard M. Nixon. The Chilean expropriations had tremendous impact on the program and increased the pressure for privatization. Accordingly, OPIC's management viewed more sympathetically the interests and concerns of the U.S. investor and the private insurance industry. Emphasis on OPIC's becoming a self-sustaining agency and on its generation of profits supplanted the earlier primary developmental objective.

According to Salzman, the antagonistic attitude toward OPIC of the Church Senate Subcommittee on Multinational Corporations reflected a disillusionment with the foreign policy of the Nixon administration which

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59. Interview, supra note 7. Mr. Salzman is a Democrat.

supported U.S. business interests and a continuation of United States involvement in Vietnam. The subcommittee's proposal, accepted by the Senate, requiring OPIC completely to withdraw from directly writing political risk insurance within a seven-year period, was one drastic method of eliminating the Government as an insurer of MNC's in the LDC's.

Salzman concurred with those who viewed Lloyd's agreements with OPIC as significant in influencing private insurers to join the Group. Possible losses of the Group members on a country by country basis would be minimal; similarly, profits would be minimal. The few private insurers which participated in the Group might have become members out of curiosity or out of a feeling that membership created a favorable public relations image. He remained optimistic concerning OPIC's future but expressed doubts as to the willingness and ability of the private sector to meet the Congressional schedules for privatization.[60]

Marshall T. Mays, former OPIC general counsel and its president 1973-1977, stated that OPIC's management fully supported the objective of privatization. Private management of the insurance program as a profitable

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60. <u>Ibid.</u>

business was fully consonant with the idea of economic development by private investment. Private participation was an experiment that required a fair test. He felt that, barring catastrophic losses, the Group's activities should prove successful. Initial assessment of progress in privatization must await Congressional review in 1977.[61]

In Mays's opinion, even when OPIC would function solely as a reinsurer for the Group, its existing policies would probably continue to control the initial underwriting. As of mid-1976, OPIC was insuring approximately 300 projects annually -- a volume which would permit OPIC to examine each future project considered by the Group for the purpose of OPIC reinsurance.[62]

Mays took cognizance of the four apparent but overstated conflicts of interest in the privatization program which many maintained were irreconcilable: (1) OPIC clients desired a maximum of protection at a minimum price, with minimum foreign policy considerations; (2) the State Department desired a foreign policy tool unhampered by the private sector's profit-making orientation; (3) the private sector desired minimum risk with

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61. Panel Discussion, pp. 665-666.

62. Ibid., p. 682.

maximum profit and no foreign policy considerations; and (4) OPIC officials desired no elimination of their positions. His item by item refutation pointed out that (1) OPIC clients were willing to pay a fair price for insurance without U.S. taxpayer subsidy; (2) the State Department could accept a privately managed program which would relieve a Government agency of the responsibilities for underwriting and claims decisions; (3) the private sector desired to offer a broader service at reasonable rates commensurate with the risks; and (4) OPIC was an atypical agency, with officials rotating from and to the private sector.[63]

Gerald Morgan, OPIC's general counsel from 1973 to mid-1976, stated that the Congressional mandate requiring OPIC to utilize prudent risk management principles and to become self-sufficient necessarily differentiated OPIC's operations from those of its predecessor AID.[64] After two years of negotiations, the Group was created as a joint underwriting association issuing expropriation and inconvertibility insurance.

63. Ibid., pp. 665-666.

64. Interview with Mr. Gerald Morgan, Washington, D.C., July 23, 1976; Panel Discussion, pp. 661-663.

The names of each private insurer and of OPIC appeared on every insurance policy which stated the several liability of each insurer as a specific percentage of the full liability. While the Group's overall management responsibility was lodged generally in its board of governors, some of the responsibility had been delegated to an Underwriting and Claims Committee equally represented by the public and private sector. Under the terms of its management contract, OPIC generally handled such everyday matters as processing applications and handling claims. The Group formed a first loss pool of its own direct coverages and, through reinsurance, of most of OPIC's portfolio of expropriation and inconvertibility risks. By mid-1976, the private insurers held approximately 20 percent of the participation in the Group; OPIC, the balance. OPIC was seeking to transfer portions of its participation to the private sector when new private members became available or existing members desired increased participation. Even though Group members committed themselves for only one-year periods, subject to renewal, OPIC, as the Group's agent, continued to issue long-term coverage and assumed the coverage of any withdrawing Group member. The Group had achieved by mid-1976 the statutory schedule of expropriation coverage set for 1978, generally through Lloyd's participation, and had also achieved the 25 percent in inconvertibility coverage in 1975. The most widely held view was that OPIC would be unable to reach its goal of functioning solely as a reinsurer by 1980.[65]

Erlan Higgenbotham, OPIC's vice president for development for several months in 1976, stated that Group members wanted a substantial increase in premiums.[66] However, OPIC could not do this as it would have adversely affected its developmental objectives. In some instances a reduction in rates would stimulate more developmental projects. Because of such problems as those which had arisen in Chile, OPIC was obliged to become more selective in its choice of insured projects. While OPIC's loss reserves had been inadequate, substantial efforts were being made to increase them.

According to Higgenbotham, a Democratic administration would be less inclined than a Republican to have the private sector completely undertake OPIC's underwriting functions and to phase OPIC into a reinsurance

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65. Ibid.

66. Interview with Mr. Erlan Higgenbotham, Washington, D.C., July 26, 1976.

role after 1980. A Democratic administration would also be more developmentally oriented and place less emphasis on OPIC's becoming a self-sufficient, profit-making agency.

It was Higgenbotham's view that the private sector would not substantially increase its participation beyond that already attained. Absent a complete transfer of OPIC's insurance functions other than that of reinsurer, the private sector would continue subservient to the public policy role established for OPIC by the Government. Notwithstanding a lack of both funds and personnel, OPIC's future as a resourceful and innovative agency appeared bright.[67]

Peter Gilbert, OPIC's counsel for claims from 1972 until early 1976, noted that during its negotiations with the private sector, OPIC opposed its attempt to raise OPIC's premium structure on the ground an increase would be detrimental to OPIC's program. OPIC expressed willingness to have an outside agency examine its rate structure.[68]

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67. Ibid.

68. Interview with Mr. Peter Gilbert, Washington, D.C., July 21, 1976.

Robert Svensk, assistant to George Cooper, until August 1976 OPIC's vice president for insurance, expressed optimism concerning the Group's taking over most of OPIC's direct underwriting functions. While the full Congressional goals might not be attained, OPIC had proved to be a great experiment unprecedented in foreign assistance programs. Reference was made to a then confidential study of OPIC's rate structure and related factors by a private consulting firm.[69]

Jonathan Dill, OPIC's acting vice president for development, was optimistic that the private insurance companies could and would meet the goals intended by Congress for private participation in OPIC's insurance program.[70] He felt that the Fireman's Fund American Insurance Companies had withdrawn from the Group after

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69. Interviews with Mr. Robert Svensk, Washington, D.C., January 7, 1976 and August 4, 1976.
The confidential study by the Tillinghast Company of Atlanta, Georgia, was later made public and is considered in both Chapters VII, pp. 457-458 , and VIII, p. 540 , *infra*.

70. Interviews with Mr. Jonathan Dill, Washington, D.C., July 12, 1976 and July 21, 1976.

its first year because of policy differences over how the Group should be administered. The views of Harry Freeman, OPIC's vice president for finance before becoming an American Express Company official,[71] were not shared by many of his OPIC colleagues.[72]

Dill's optimism concerning the private sector's ability and willingness to attain the Congressional goals for privatization by 1980 was not shared by Deidre Maloney, the Treasury Department's liaison with OPIC. Her Department's major concern was OPIC's role as an instrument of U.S. foreign policy and how the Group might detrimentally influence such role.[73]

David Stebbing, a foreign service officer in the Office of Investment Affairs at the State Department and liaison with OPIC, also felt that the privatization goals of Congress were unattainable. He noted that OPIC was mandated to function in a foreign policy role under guidelines set by his Department. AID's operations had been directly influenced by foreign policy considerations which had led to overconcentration of its programs

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71. See supra notes 41 and 43 and accompanying text.

72. Interview, supra note 70.

73. Interview with Ms. Deidre Maloney, Washington, D.C., July 20,1976.

in certain countries. In similar manner, operations of the private insurance industry in the OPIC program should be subject to Government control in light of these foreign policy considerations.[74]

The views expressed and the problems raised by James White, a reinsurance officer with the St. Paul Insurance Company and chairman of the board of governors of the Group, merit extensive consideration.[75] His company, engaged in a wide spectrum of risks and with a reputation for innovation, had, like others in the private sector, no particular expertise in the field of political risk insurance. The Group's immediate goal was to establish the commercial viability of political risk insurance affecting expropriation and inconvertibility; there was no present receptivity to war risk proposals. The Group was faced with the problems of generating a worldwide premium base that would support the per-country loss exposure and of responding to changing political conditions in the affected countries.

74. Interview with Mr. David Stebbing, Washington, D.C., August 3, 1976.

75. Panel Discussion, pp. 667-670.

According to White, complete privatization of the OPIC program by 1980, with OPIC's functioning solely as reinsurer, could not be met. Instead, a more realistic objective would be that the private sector could respond to the needs of most investors most of the time. By 1978 it should be known whether private participation will have succeeded. Certain types of political risk should retain OPIC as the primary insurer. These included certain exceptionally large or sensitive risks; risks, regardless of size, which could not meet the Group's underwriting criteria but merited consideration under foreign policy standards; and new types of political risk exposure which a U.S. Government agency, backed by the full faith and credit of the Government, could insure but were too innovative for the private sector. Furthermore, there would always be a need for OPIC to co-insure to some extent every risk the Group insured so as to attract the resources of the U.S. Government in handling its claims. OPIC's record of settling claims was based on the resources available to it.[76]

White envisaged certain important policy problems requiring solution in the event the private sector per-

76. Ibid., pp. 667-668.

manently took over OPIC's investment guarantee program. Would OPIC's authority as a reinsurer prohibit it from reinsuring Group business inconsistent with OPIC's present manner for doing business -- *e.g.*, coverage of a runaway plant or coverage into already developed countries? Group members already were insuring prospective political risk customers with the traditional forms of property liability risks. These customers would expect expanded coverage in the newer fields. When the employees of the private sector would in fact administer the underwriting and claims functions, would the sources of information available to OPIC be available to the Group as might be expected? Finally, if privatization were accomplished, Congress should provide that OPIC would continue to provide reinsurance on a long-term basis to insure a stable market for political risk insurance.[77]

Troublesome problems facing private insurance companies interested in issuing political risk insurance were noted by LeRoy Simon, a senior vice president of Prudential Reinsurance Company.[78] Such insurance did

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77. *Ibid.*, p. 669.

78. *Ibid.*, pp. 672-675.

not fall in the classical mold; rather it should be regarded as an opportunity for a client to prepay a loss fund, out of which, when losses occur, money was available. The omnipresent fear, accentuated by the lack of experience, was that of a catastrophic occurrence. This fear could be overcome only by the production of profits and the accumulation of adequate surplus. It was not fair for the private sector to say its desire was for profits and the risk-taking should be the responsibility of OPIC. OPIC, the best loss prevention and loss reduction organization, would be needed as a reinsurer by the private sector for a long time. Only OPIC could provide the essential long-term coverage.[79]

Policy questions raised by privatization

Don Wallace, professor of law at Georgetown Law School and director of the Georgetown Institute for International and Foreign Trade Law, raised several policy questions concerning the transfer of OPIC's activities to the private sector.[80] Political risk insurance was probably not technically insurance in the normal

79. Ibid., pp. 673-674, 681.

80. Ibid., pp. 679-681, 688-689.

actuarial sense. OPIC's insurance program was intertwined with U.S. Government bilateral agreements covering such important factors as the settlement of claims. These agreements necessarily left some residual governmental functions even if privatization were to succeed. The policy question arises: Would OPIC be left with the reinsurance risk while the insurance companies were left with the premiums?[81]

According to Wallace, Congress had to decide the future of OPIC's developmental objectives. He thought OPIC could play a role with respect to high risk countries, high risk projects, small business, and unexplored areas of activity which the Government had been pushing U.S. industry into for the last 20 to 25 years. Moreover, since the period was replete with the aspirations of the new international economic order, it was problematical whether the private sector should take over the OPIC insurance program without at least some measure of Governmental guidance. Perhaps the times called for the enlargement rather than the abridgement of OPIC's role: OPIC could represent the public interest of the United States with respect to setting standards

81. Ibid., pp. 679-680.

for U.S. private investment in LDC's and in working with international bodies to develop codes of conduct and guidelines for MNC's. In sum, OPIC, as a technical and financial agency as well as insurer, or an agency like OPIC, might become the focal point for the formulation of U.S. policy with respect to MNC's as they invest in LDC's, supplanting in part operations of the State and Treasury Departments. "[I]t is very irresponsible to talk about dismantling an intelligent, rational, coherent public, if not government, presence in this field." [82] If OPIC went completely out of business, it was unlikely that the private sector would take up all the political risks.[83]

Cecil Hunt, OPIC's deputy general counsel, noted that the bilateral agreements relating to the investment guarantee program had been negotiated between the U.S. Government and other governments and contemplated programs operated and claims asserted by the U.S. Government.[84] When OPIC, a juridically distinct entity, and the Group were established, the other signatories to

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82. Ibid., pp. 680-681.

83. Ibid., p. 689.

84. Ibid., pp. 685-686.

the bilateral agreements were informed of the new structure of the operation of the programs. However, the existing agreements had not yet been modified so as to recognize the new operating agencies. Nevertheless, no objections to the *modus operandi* of claim controversies had been made by host governments because of the fact that the party being subrogated might be OPIC or the Group rather than the U.S. Government. Were such objection to be filed that an improper party was seeking subrogation under a bilateral agreement, it should be possible to transfer the claim to the U.S. Government. In the past technicalities had not hampered claims-settlement procedures.[85]

OPIC's second report to Congress re privatization

As noted, the 1974 OPIC legislation provided that not later than January 1, 1976, OPIC was to submit an analysis of the possibilities of transferring all of its activities to the private sector, multilateral organizations, or other entities.[86] A preliminary report

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85. *Ibid.*

86. See Chapter III, p. 190, note 138 and accompanying text.

was issued on December 31, 1975, followed by a more detailed report two months later.[87] The latter report stated: "Experience with the Group's operations to date is too brief to permit prediction of its future attractiveness to the private sector. Early indications are mixed but encouraging."[88] At another point the report observed that "the results of the membership campaign effort were somewhat disappointing."[89] Two factors predominated in preventing realization of the membership goal: (1) many private insurance companies, having suffered serious financial losses in recent years, hesitated to enter the unfamiliar political risk field; (2) the sudden collapse of the South Vietnamese Government in the spring of 1975. While it was anticipated that only non-Group-insured war damage claims might arise in South Vietnam, insured investors had submitted claims for expropriation damage. As a consequence, Group members faced the possibility of underwriting losses in their first year of participation.[90]

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87. See <u>supra</u> notes 27-28 and accompanying text.

88. 1976 ORTC, p. 9.

89. <u>Ibid.</u>, p. 6.

90. <u>Ibid.</u>, pp. 6-7. For other factors apparently responsible for the lack of greater participation by the private sector, see Griffin, <u>supra</u> note 37, pp. 649-650.

The hesitancy of the private sector to join the Group was confirmed by the addition to the Group by mid-1977 of only four private insurers, to a total membership of but 21. The Group's private participation in the first loss pool increased from $7.8 million in 1976 to $10.2 million in 1977. Percentagewise, the increase was from slightly under 20 percent to slightly over 25 percent. However, of the $10.2 million of private participation, significantly only $3.45 million represented U.S. private insurance, with the balance represented by Lloyd's reinsurance arrangements.[91]

OPIC's war risk record

As noted, the 1974 legislation expressed the Congressional intention that OPIC should achieve private participation in insurance contracts for war, insurrection, and revolution of at least 12.5 percent under contracts issued after January 1, 1976, and 40 percent for those after January 1, 1979.[92] From 1957, when insurance coverage was broadened to include losses "by reason

91. U.S. Congress, Senate, Committee on Foreign Relations, OPIC Authorization, Hearings before Subcommittee on Foreign Assistance, 95th Cong., 1st Sess., 1977, pp. 28-29 [hereinafter cited as 1977 SOH].

92. See Chapter III, p. 189, note 136 and accompanying text.

of war,"[93] until June 30, 1975, OPIC and its predecessors had a war risk exposure of $2.22 billion in 60 countries. During this period the agencies had collected almost $75 million in premiums but paid but $661,000 on eight claims. In fiscal year 1975 war coverage premiums amounted to $11.4 million.[94]

Notwithstanding OPIC's impressive record with war risk insurance, neither Lloyd's nor U.S. private insurers were interested in underwriting such insurance. Stephen Merrett, an underwriter for a syndicate at Lloyd's who was also involved in Lloyd's reinsurance arrangements with OPIC, expressed the belief that fundamentally there was no viable future in substantial private participation in OPIC's war risk portfolio. This risk inherently involved the likelihood of very substantial liabilities in one country at a time. The possibility of minimizing losses was minimal. Moreover, the presence of a cancellation clause made coverage of doubtful utility to an insured since the private insurer

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93. See Chapter I, p. 20, note 29 and accompanying text.

94. U.S. OPIC, A Proposal to Form a War Risk Reciprocal Insurance Association (September 9, 1975), p. 3 (Mimeographed).

would seek termination when some kind of conflict became apparent.[95]

Proposal for the creation of a war risk reciprocal

Because of the reluctance of the private sector to cover land-based war risks, OPIC in 1974 commenced seeking alternative sources of private participation in that coverage.[96] In its 1974 report to Congress, OPIC mentioned as an alternative approach the formation of a mutual type of insurance association among OPIC and its investor-insured clients which could make long-term commitments.[97] On September 9, 1975, OPIC released a proposal for the formation of such mutual association to be known as the War Risk Insurance Reciprocal (Reciprocal). The insureds would exchange the insurance liability for each other's risks. Initially, the Reciprocal would be co-insuring with OPIC, gradually taking larger portions of the liabilities as its reserves grew. In its March 1976 report to Congress, OPIC observed: "While the Reciprocal could provide an important vehicle

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95. Panel Discussion, pp. 670-672.

96. 1976 ORTC, p. 7.

97. OFRTC, p. 14.

for the transfer of the war risk insurance program to the private sector, investor willingness and ability to participate in the Reciprocal have not yet been tested adequately to support any conclusions."[98]

In February 1976, OPIC applied to the District of Columbia Superintendent of Insurance for a certificate to operate the mutual Reciprocal.[99] By the end of 1977, the Reciprocal had not yet been formed and it was doubtful whether permission would ever be obtained. OPIC also received two preliminary proposals from private insurers for limited sharing of war risks, but the terms of these proposals were not acceptable to OPIC management. In short, although there were indications that it might be possible to attract some private participation in war risk insurance on acceptable terms, the amount of any such participation, as well as its rate of growth, would be initially small. If this type of insurance were to retain a developmental purpose, the specific statutory timetable for OPIC withdrawal by 1980 would not be met.[100]

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98. 1976 ORTC, p. 3; Panel Discussion, pp. 663-664 (remarks of Caryl Cole).

99. 1977 SOH, pp. 17, 28.

100. Ibid., pp. 28-29.

In testimony given to the Subcommittee on Foreign Assistance of the Senate Committee on Foreign Relations (SOH) on July 27, 1977,[101] Rutherford M. Poats, OPIC's acting president, stated that OPIC's financial condition had improved steadily since its inception in 1971 and was then sound. The Anaconda Company claims for the expropriation of two mining properties in Chile -- the last substantial claims from Chilean nationalization -- had recently been settled. When organized, OPIC faced claims of more than $400 million, with insurance reserves of only $85 million; in mid-1977, claims were $93 million, reserves $205 million. Its last three years of operation indicated that OPIC could continue to fulfill its public purposes on a self-sustaining basis.[102]

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101. The members of the Subcommittee consisted of Senator Hubert H. Humphrey, chairman, and Senators Frank Church of Idaho, Dick Clark of Iowa, Joseph R. Biden, Jr., of Delaware, Clifford B. Case of New Jersey, Jacob K. Javits of New York, and Charles H. Percy of Illinois.

102. 1977 SOH, p. 27.

Outlook for privatization in 1977

As to OPIC's privatization program, Poats noted that the more significant participation was OPIC's separate reinsurance arrangements with Lloyd's. U.S. private insurers' participation had been disappointing. If present rates of growth of such participation were maintained for expropriation and inconvertibility risks, by 1981 private U.S. loss limits in the Group would be only about $10 million per country and $20 million maximum per year. Moreover, many private insurers indicated an intention to condition their future participation on OPIC's retaining a significant -- 20 to 25 percent -- percentage of first loss liabilities and a role in both direct underwriting and claims management. The unwillingness of the private sector in the Group to commit participation for more than one year at a time or of Lloyd's for three years as regards reinsurance, sharply limited the usefulness of insurance as an investment incentive. It was unlikely that the private insurers would ever write non-cancellable political risk insurance for terms beyond three or at most five years. Assured protection for much longer periods was essential. OPIC's complete withdrawal from underwriting and management by 1980 would run counter to any foreign aid developmental objectives. Furthermore, there might be a variety of other national interests and policy restrictions which the investment insurance program could serve only as a U.S. Government operation. The Congressional timetable for OPIC's transfer of its insurance program to the private sector had preoccupied OPIC management and diverted staff energies from the primary mission of encouraging private investment in LDC's.[103]

According to Poats, OPIC's goal of privatization was producing an educative function important to both OPIC and the private sector. Cooperative efforts with insurance companies had educated OPIC personnel in commercial risk management techniques and inculcated a commitment for operation on a self-sustaining basis. Similarly, the private sector was learning about operating in the field of political risk insurance. However, it was essential that OPIC should not execute risk-sharing agreements unless the financial interests of the U.S. Government were adequately protected and unless OPIC were permitted to retain a sufficient share of premiums to compensate for its assumption of the long-term risk and for its exposure as an excess of loan reinsurer. Poats could not envisage complete privatization in the

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103. Ibid., pp. 28-29.

immediately foreseeable future; the definitive answer of the future might still be "Never."[104]

The Carter administration's policy review

With the advent of a new Democratic administration under President Jimmy Carter in January 1977 and with Congressional oversight hearings scheduled for the summer of 1977, a cabinet-level Economic Policy Group of the new administration conferred with OPIC directors and officials for a policy review of the agency's operations and functions.[105] From this review the Carter administration concluded that OPIC was advancing several important U.S. foreign policy objectives and its programs warranted an extension until September 30, 1981. It further concluded that the privatization guidelines of the 1974 legislation could not be met by 1980 and that the privatization objective ran counter to OPIC's developmental objectives.[106]

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104. Ibid., pp. 29-30.

105. U.S. Congress, House, Committee on International Relations, Extension and Revision of Overseas Private Investment Corporation Programs, Hearings and Markup before the Subcommittee on International Economic Policy and Trade, 95th Cong., 1st Sess., 1977, pp. 8-9 [hereinafter cited as 1977 HOH].

106. Ibid.; 1977 SOH, pp. 4, 7.

With OPIC management support, the Carter administration submitted a draft bill containing the following significant provisions to effectuate the preceding conclusions: (1) extension of OPIC's authority to issue insurance and guarantees through September 30, 1981; (2) alteration of the private participation requirements set forth in the 1974 legislation, substituting therefor authority for OPIC to share risks with private insurers or multilateral organizations as a means of risk management and to further the development of private markets for investment insurance under equitable arrangements compatible with OPIC's basic developmental objectives; (3) authority to alter war risk insurance terms so as to permit adjustment of the insured value of assets to account for inflation in replacement costs; and (4) submission of a report to Congress by December 31, 1980, on the development of private and multilateral programs and of any participation arrangements with private insurers and multilateral organizations.[107]

The Carter administration's proposal in subordinating the objective of privatization to that of development was a boost for OPIC proponents. However, victory

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107. 1977 HOH, pp. 323-326 (H.R. 7854, 95th Cong., 1st Sess., 1977); 1977 SOH, pp. 1-2 (S. 1771, 95th Cong., 1st Sess., 1977).

for these proponents who advocated long-term political risk insurance in the LDC's was still far away. Developments are set forth in Chapter VII.

CHAPTER V

THE MULTILATERAL INVESTMENT GUARANTEE PLANS, THEIR RELATION TO OPIC, AND HOW OPIC COMPARES WITH OTHER NATIONAL AND PRIVATE INVESTMENT GUARANTEE PROGRAMS

As noted in Chapter III,[1] the Overseas Private Investment Corporation Amendments Act of 1974[2] expressed the intention of Congress that OPIC achieve participation in its political risk insurance programs by "private insurance companies, multilateral organizations, or others."[3] Moreover, not later than January 1, 1976, OPIC was to submit an analysis of the possibilities of transferring all of its activities to the private sector, multilateral organizations, or other entities.[4]

In the preceding chapter, consideration was given to OPIC's efforts of transferring its programs to the private sector. In the present chapter, similar attention is devoted to multilateral organizations and institutions. In addition, a brief comparative study of

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1. See Chapter III, p. 188, note 132 *et seq.* and accompanying text.

2. 88 Stat. 763. The statute is hereinafter cited as OPICAA of 1974.

3. OPICAA of 1974, § 2(2), 88 Stat. 765.

4. *Ibid.*, § 2(7), 88 Stat. 768.

OPIC-like agencies in other countries is made together with the activities of private insurance companies in the field of political risk.

EARLY PROPOSALS FOR THE CREATION OF MULTILATERAL GUARANTEE INSTITUTIONS

The proposal for the establishment of a multilateral organization, an international guarantee institution, was first advanced by the administration of President John F. Kennedy in mid-1961.[5] Frank M. Coffin, managing director of the Development Loan Fund, an agency created in 1957 with authority to issue guarantees against various types of loss,[6] advocated before Congressional committees the creation of such international agency, associated in some manner with the International Bank for Reconstruction and Development (World Bank) (IBRD), provided it could be proved feasible and was attractive to a significant number of less developed countries (LDC's).[7] For the next six years the proposal lay

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5. U.S. Congress, House, Committee on Foreign Affairs, The International Development and Security Act, Hearings on H.R. 7372, 87th Cong., 1st Sess., Pt. III, 1961, p. 910. See Chapter I, p. 37, note 62 and accompanying text.

6. See Chapter I, p. 21, notes 32 and 33 and accompanying text.

7. *Supra* note 5.

sterile in the halls of Congress.

During July through October 1967, the Subcommittee on Foreign Economic Policy of the House Committee on Foreign Affairs held extensive hearings on the involvement of U.S. private enterprise in developing countries, and rendered an exhaustive report in April 1968.[8] Among its several recommendations,[9] including the creation of OPIC, was that the United States should endeavor to reach agreement with other developed countries regarding the establishment of a multilateral investment guarantee program, under the auspices of some international organization such as the IBRD.[10] Following the establishment of OPIC,[11] President Richard M. Nixon on May 21, 1970 appointed the Commission on International trade and Investment Policy, under the chairmanship of Albert I.

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8. U.S. Congress, House, Committee on Foreign Affairs, The Involvement of U.S. Private Enterprise in Developing Countries, H. Rept. No. 1271, by Subcommittee on Foreign Economic Policy, 90th Cong., 2d Sess., 1968, pp. 1-6, 29-31. The report is also known as the Farbstein report. See Chapter II, pp. 92-94, notes 13-17 and accompanying text.

9. Ibid., pp. 3-6 and Chapter II, p. 94, note 17 and accompanying text.

10. Ibid.

11. Foreign Assistance Act of 1969, 83 Stat. 805, 826. See Chapter II, p. 107, note 42 and accompanying text.

Williams of the International Business Machines Corporation, to study the problems of foreign private investment in developing countries.[12] In July 1971, this commission issued a report recommending that the United States continue efforts to establish a multilateral insurance agency which would include LDC's among its membership and in which the costs would be equitably shared among its members.[13]

The Robinson plan

During the oversight hearings on OPIC in May 1973 by the House Subcommittee on Foreign Economic Policy,[14] Charles W. Robinson, then president of the Marcona Corporation, a multinational corporation (MNC) engaged in mining and shipping ventures especially in Latin America, and later Under Secretary of State for Economic

12. U.S., Commission on International Trade and Investment Policy, Report to the President on United States International Economic Policy in an Interdependent World (Washington, D.C., July 1971), letter of transmittal to President Richard M. Nixon.

13. Ibid., p. 250.

14. U.S. Congress, House, Committee on Foreign Affairs, Hearings before the Subcommittee on Foreign Economic Policy, Overseas Private Investment Corporation, 93d Cong., 1st Sess., 1973 [hereinafter cited as 1973 HOH].

Affairs in the administration of President Gerald R. Ford, strongly advocated that the IBRD, "the one multilateral organization with non-political muscle," should assume the risk of political exposure and administer the global insurance program. OPIC's role should become that of "a broker, to screen applications, to assure that the application ... is in harmony with the criteria of national interest."[15]

According to Robinson, OPIC's bilateral insurance program was unrealistic. The relative strength of the industrial nations vis-a-vis the LDC's as regards natural resources and energies was bound to change: "Ten years from now the developing world will be calling the shots as far as industrial growth is concerned in the developed world ..."[16] The dominance of U.S. economic power following World War II was being challenged by Western Europe, Japan, and even the Communist bloc countries. In the LDC's U.S. investors have borne the brunt

15. Ibid., p. 78.

16. Ibid., p. 74.

of politically inspired attacks.

To meet these inevitable changing and changed conditions, Robinson urged the development and encouragement of international guidelines to substitute for the proliferation of political unilateral action. Resource development should be multilateralized. More equitable sharing of benefits was essential. In his view, "OPIC suffers not only from lack of clearly defined U.S. national objectives which are in harmony with long-range host nation interests, but there is also an inherent weakness in the bilateral approach."[17]

Under the Robinson plan OPIC could serve on the board of directors of the World Bank insurance corporation and could collect fees for it under contractual arrangement. As regards risk, the World Bank could fully assume it or share some of it with OPIC. The basic ingredient would be the involvement of the World Bank as administrator of the program -- the most effective international organization to reduce the possibility of unilateral action and to minimize loss.[18]

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17. Ibid., pp. 75-76, 79.

18. Ibid., p. 78.

The Gabriel proposal

In the 1973 Senate MNC's hearing, Professor Peter P. Gabriel, Dean of the College of Business Administration of Boston University, also advocated a multilateral investment guarantee program under the aegis of an international agency such as the IBRD. He noted that contrary to the initial expectations, the climate for private foreign investment in the LDC's had not improved as a result of economic development. In fact, there appeared to be a negative correlation between the degree of economic development achieved and the acceptability of foreign investment. The terms and conditions which host countries found increasingly difficult to accept were the ones OPIC insured -- i.e., the ownership rights associated with conventional direct investment. OPIC's program contained a serious contradiction, entailing the seeds of its own destruction: while OPIC guarantee was initially conditioned on host country acceptability of the project, the insurance was against later non-acceptability by the host country. Since OPIC's insurance coverage extended over a period up to 20 years, if there were any doubt about the project's long-term acceptability, the host country's later rejection of the project indicated it then perceived its national interests in a different light. The relationship between the foreign equity investor and the host country was relatively unstable because the relative power of the parties changed continuously over the life of the parties.

Gabriel envisaged future arrangements as tripartite -- a local project owner, a multinational contractor, and an international finance agency like the IBRD which could effect risk diversification through its very size. The debtor under these arrangements would be governments and private enterprises in the host countries which would be willing to pay the special premium rates that would have to be associated with these loans, especially where the main creditor would be the not-for-profit IBRD.[19]

Senator Frank Church, chairman of the special Subcommittee on Multinational Corporations[20] and an OPIC

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19. U.S. Congress, Senate, Committee on Foreign Relations, Multinational Corporations and United States Foreign Policy, Hearings before Subcommittee on Multinational Corporations, 93d Cong., 1st Sess., 1973, Pt. III, pp. 87-90 [hereinafter cited as 1973 SOH].

20. Ibid., Pt. I, p. 1. See Chapter III, p. 135, note 29 and accompanying text.

opponent, deemed Gabriel's proposal for the involvement of the IBRD and other multilateral institutions operating on a non-profit basis as an "interesting possibility." [21] The report in February 1974 of the majority of the Senate Committee on Foreign Relations recommended a swift transfer of OPIC's insurance function to the private insurance sector or to a multinational body such as the IBRD.[22]

In similar manner, the November 1973 report of the House Subcommittee on Foreign Economic Policy recommended U.S. support of the World Bank's proposal to create an International Investment Insurance Agency (IIIA), [23] operating under arrangements acceptable to both the developed and developing countries. In addition, OPIC should work with the private investment community, host countries, and international agencies such as the World

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21. 1973 SOH, p. 90.

22. U.S. Congress, Senate, Committee on Foreign Relations, The Overseas Private Investment Corporation Amendments Act, Report on S. 2957, 93d Cong., 2d Sess., 1974, p. 39 [hereinafter cited as 1974 SOR].

23. The IIIA was also referred to as the "International Investment Insurance Association."

Bank and the United Nations, to develop workable codes of investor behavior for incorporation in the investment guarantee program both as a precondition to insurance and as a continuing obligation of the insured investor.[24]

The plan advanced by Robinson and Gabriel in the 1973 hearings for the establishment of a multilateral organization or institution to administer political risk insurance on a global scale, was not new. It is interesting and instructive to trace its origins and history.

The Narasimhan program

Beginning in the late 1950's, individuals and organizations advanced proposals for multilateral investment insurance. In July 1958, C.V. Narasimhan, Under Secretary for Special Political Affairs of the United Nations, privately circulated a confidential draft concerning international insurance of private foreign investment. His suggestion envisaged a program undertaken by the IBRD. The program would not differ from the guarantee which a member government offered as repayment

24. U.S. Congress, House, Committee on Foreign Affairs, The Overseas Private Investment Corporation, Report of Subcommittee on Foreign Economic Policy, 93d Cong., 1st Sess., 1973, pp. 37-38 [hereinafter cited as 1973 HOR].

by a non-government borrower from the Bank. Government membership in the program would consist of those countries indicating acceptance thereof. The Bank would charge an insurance fee and could reinsure with private underwriters.[25]

The Straus proposals

In November 1960, Ralph I. Straus, an economist, member of the United States Council (USC) of the International Chamber of Commerce (ICC) and of the United States Management Advisory Committee to the Organization for Economic Co-Operation and Development (OECD),[26] to-

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25. This and numerous other papers, documents, and letters pertaining to proposals for the establishment of a multilateral organization to administer political risk insurance on a global scale were shown the writer by Mr. Ralph I. Straus, a leading advocate of such agency. See *infra* note 26 and accompanying text. The writer acknowledges his indebtedness to Mr. Straus for making his files available.

Since some of the materials in the Straus files bear the notation "restricted," "confidential," etc., the general reference "Straus file" may in some private instance be the method of citation *infra*.

26. *Supra* note 25. The OECD was established in 1961 to promote the economic growth of its member countries, assist LDC's, and promote trade expansion throughout the world. It grew out of the Organization for European Economic Co-Operation founded in 1948. It became global after December 14, 1960, when the United States and Canada became members. In 1978, it consisted of 24 countries, almost all industrialized. See OECD, *Investing in Developing Countries* (4th rev. ed., Paris 1978), p. 2 [hereinafter cited as 1978 OECD].

gether with August Maffrey of the Irving Trust Company of New York, circulated a memorandum to USC members concerning the creation of an international investment guarantee corporation as an affiliate of the IBRD.[27] The following month, the Straus-Maffrey proposal as well as other plans for a multilateral approach to investment insurance was discussed at the ICC's International Businessmen's Conference in Karachi, Pakistan. Most of the private papers suggested IBRD administration. The Conference agreed to make a study of the subject.[28]

Commencing in February 1961 and for the next decade, Straus circulated numerous drafts for "an International Investment Guaranty Corporation: A Proposal for the Establishment as an Affiliate of the International Bank for Reconstruction and Development." The

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27. USC of ICC, An International Investment Guaranty Corporation, November 4, 1960. This and other proposals are summarized in International Bank for Reconstruction and Development, Multilateral Investment Insurance -- A Staff Report (Washington, D.C.: IBRD, March 1962) [hereinafter cited as IBRD 1962].

28. Straus file: USC of ICC, Promotion of International Investment -- Discussion Group I, Annex 2 -- Multilateral Investment Insurance [undated, but probably 1963], p. 1 [hereinafter cited as USCICC].

following principles were advanced as bases for the proposal:

"1. Government capital must be supplemented by private capital in order to achieve the volume of investment in the less developed countries that the times require.

2. Unsettled political conditions in Asia, Africa, and South America have resulted in a diminishing, not increasing, volume of private foreign investment.

3. Bilateral investment guaranty insurance schemes have not generated a sufficient atmosphere of confidence to cause private capital to flow to the less developed countries in sufficient volume.

4. Therefore, a multilateral guaranty insurance scheme should be devised and should be administered by an organization that would command worldwide acceptability, authority, and responsibility. The IBRD (International Bank for Reconstruction and Development) is the only institution that fulfills these qualifications.

5. Both capital-exporting and capital-importing nations must share the financial risks of such an investment guaranty insurance scheme in order to generate the atmosphere of mutual confidence necessary to attract private foreign capital." 29

Straus's proposal was studied by and received the general support of some international personages and

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29. Ralph I. Straus, "An International Investment Guaranty Corporation: A Proposal for Its Establishment as an Affiliate of the International Bank for Reconstruction and Development," p. 1a (New York, July 20, 1961).

organizations. Among these was Julius K. Nyerere, in 1961 chief minister of the then Territory of Tanganyika and later president of Tanzania, who suggested convening an international conference in Dar es Salaam.[30] In April 1961, the Directing Committee of the Association Internationale d'Etudes pour la Promotion et la Protection des Investissements Prives en Territoires Etrangers (APPI), a Paris-based organization similar to the ICC, agreed to study the various proposals, including Straus's, and present its analyses to the ICC.[31] In June 1961, the U.S. Treasury Department wrote Straus that the Staff Committee of the National Advisory Committee was undertaking a serious study of the general type of institution proposed by him.[32]

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30. Straus file: correspondence of March 8, 1961.

31. Association Internationale d'Etudes pour la Promotion et la Protection des Investissements Prives en Territoires Etrangers, Report of the Working Committee of the APPI on the Establishment of an International Guarantee Fund, p. 2 (Paris, September 13, 1961).

32. Straus file: correspondence of June 6, 1961.

The first IBRD report

The following month, the Development Assistance Committee (DAC)[33] of OECD, meeting in Tokyo, requested the IBRD to undertake its own study concerning a multilateral investment insurance program.[34] In cooperation with the ICC, the IBRD circulated a questionnaire and in March 1962, it issued a staff report entitled "Multilateral Investment Insurance." The report was not designed to "seek to establish a position for or against the creation of an international investment insurance program," nor did it "attempt to devise, in outline or in detail, a specific proposal for a multilateral program." It did examine the principal issues inherent in the concept of a multilateral investment program; the broad policy question of whether such program was likely to be more effective than national programs, and the working issues of the nature and extent of coverage; the criteria of eligibility for insurance; scope of membership; and the basis for fixing capital subscriptions

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33. The Development Assistance Committee (DAC) of the OECD is a sixteen-member committee which convenes to find means of improving the contributions of their governments to the economic and social development of LDC's. Organization for Economic Co-Operation and Development, OECD at Work for Development, pp. 7, 19 (Paris: OECD, February 1973 [2d ed.]).

34. USCICC, p. 1.

and determining members' liability for losses.[35]

Following the IBRD report, in 1963 two meetings of experts were convened by the OECD to assist in preparing a report on the technical and legal aspects of different multilateral proposals. In 1964, OECD's DAC considered a report based on those minutes and requested the organization's Secretary General to consult with interested member governments and to prepare draft Articles of Agreement for a multilateral program, reflecting governmental views and the conclusions of the report.[36]

At a meeting of the OECD Council on April 30, 1964, the United States and most of the other OECD members endorsed the principle of multilateral investment guarantees. France, Germany, and the United Kingdom withheld their endorsement.[37]

In the spring of 1964, the first United Nations Conference on Trade and Development (UNCTAD) requested IBRD to expedite its studies on investment insurance

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35. IBRD 1962, pp. 2-3.

36. Straus file: correspondence of September 22, 1965.

37. _Ibid._: correspondence of June 22, 1964.

and submit a detailed report by September 1965.[38] During this period, an OECD group of experts prepared a "Report on the Establishment of a Multilateral Investment Guarantee Corporation" which was transmitted to the IBRD in June 1965 with the approval of the OECD Council.[39] The IBRD had delayed action on UNCTAD's request pending submission of the OECD's report since the membership of the OECD included almost all the countries which could be expected to contribute to a guarantee fund or make other provisions for meeting losses sustained by a multilateral program.[40]

The OECD report and the IIGC

The OECD report recommended a multilateral investment guarantee program administered by a new entity,

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38. International Bank for Reconstruction and Development, Report on the Status of the International Bank Studies on Multilateral Investment Guarantees -- A Staff Report (Washington: IBRD, September 1965), p. 2.

39. Ibid.; OECD, Investing in Developing Countries (3d rev. ed., Paris 1975), p. 103 [hereinafter cited as 1975 OECD].

40. Supra note 38.

International Investment Guarantee Corporation (IIGC), set up within the IBRD group. Its membership would be the same as the Bank's and any additional governments accepting the Bank's invitation to participate. Member governments would be classified as contributing members, developing (host) countries, or consulting members -- i.e., capital-exporting countries unwilling to accept losses. The issuance of a guarantee would be subject to approval both by the government of the investor and that of the host country. New investments would be guaranteed, when approved, against expropriation or impairment of the investor's control, inconvertibility and inability to repatriate either principal or earnings, and other risks of a non-commercial nature.[41]

THE SEVERAL IBRD DRAFTS

The first draft

The IBRD made the OECD report available to its members, set forth a number of questions for consideration,

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41. United States Council of the International Chamber of Commerce, Report to Members (New York, October 1965), p. 3; Straus file: IBRD, Principal Points for Consideration in Connection with Multilateral Investment Guarantees, December 1965.

and solicited responses to such questions. Based upon the responses to such questions, the IBRD on November 30, 1966 issued the first draft of its proposed multilateral investment guarantee program entitled "Articles of Agreement for an International Investment Insurance Agency." The draft was circulated among the Bank's members and various business organizations such as the ICC, APPI, and OECD's Business and Industry Advisory Committee (BIAC).[42] Statements and comments, generally favorable, were submitted by the latter organizations,[43] but key European governments were cool to the Bank's proposal. While the United States, Sweden, and The Netherlands (which had no foreign investment guarantee program of its own) favored the proposal, West Germany and France felt their own programs were adequate, and the

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42. The Business and Industry Advisory Committee (BIAC) of the OECD is the representative body for the business federation of the OECD countries which acts as a channel of communication between the OECD and private industry on all matters of common interest. U.S.A., Business and Industry Advisory Committee to the OECD, memorandum (New York, November 1967), p. 1.

43. See Comments by ICC, dated March 31, 1967; by APPI, dated February 10, 1967, March 2, 1967, and April 21, 1967; of BIAC, dated August 4, 1967; and U.S.A.-BIAC, dated February 27, 1967.

United Kingdom believed implementation of the proposal might bring an additional drain on its currency reserves. The United States's approval was assisted by the psychological uplift that its program would have the backup of an internationally accepted system. The LDC's as prospective host countries, were understandably favorable to the proposal.[44]

ICSID and the IBRD

As noted in the last footnote, the Convention on the Settlement of Investment Disputes between States and Nationals of Other States was a formulation of the IBRD to establish a mechanism for settling disputes involving a government on the one side and a foreign private investor on the other. The large number of bilateral treaties dealing with investments to be made by

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44. "Europeans Cool -- Investment Cover Plan Falters," Journal of Commerce, November 2, 1967, p. 1.

Commenting on the above article shortly after its appearance, the president of IBRD indicated that the article was too pessimistic; that the reluctance of West Germany, France, and the United Kingdom was understandable; and that he was not yet ready to abandon the proposal for a multilateral investment insurance program which could be connected with the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. The purpose and objectives of this Convention are discussed in the text. Straus file: correspondence of November 1967.

the nationals of one party within the territory of another mandated the creation of an instrument in which government-foreign private investor disputes could be settled without direct involvement of the investor's government. The Convention was submitted to governments by IBRD's executive directors on March 18, 1965, and became effective on October 14, 1966.[45] Under the Convention the International Center for Settlement of Investment Disputes (ICSID) was established under IBRD auspices. It represented an impartial international forum in which a consenting foreign private investor and a consenting host country could settle their disputes by conciliation or arbitration. The Convention set forth both the circumstances and methods of submission and the form and effects of the resulting proceedings. As of late 1977, the Convention had been signed by 73 countries, 69 of which had completed ratification, and only six disputes had been submitted to ICSID.[46]

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45. International Bank for Reconstruction and Development, Convention on the Settlement of Investment Disputes between States and Nationals of Other Countries, ICSID/2 -- English, and Accompanying Report of the Executive Directors (1966).

46. Ibid., International Centre for Settlement of Investment Disputes, ICSID Regulations and Rules (reprint 1975), passim; 1978 OECD, pp. 95-97.

The second draft

On April 1, 1968, Robert S. McNamara succeeded George D. Woods as IBRD's president. On August 19, 1968, McNamara sent its executive directors a second draft of Articles of Agreement for IIIA which had been prepared in a series of meetings by the executive directors between May 1967 and July 1968.[47]

Significant provisions of the second draft included:

1. Organisation and Management - The Agency would be integrated into the World Bank "family" to insure fullest investor confidence in the Agency and its management. The Bank's President would be the Head of the Agency.

2. Insurance Operations - Risks eligible for insurance are broadly defined to include political and commercial coverage.

3. Definition of Investment - Authority to determine from time to time the maturity of loans which qualify for insurance rests with the Agency and is not established in the draft Articles of Agreement. Securities are referred to as a form of investment.

4. Eligible Investments - Investments of developmental character approved by the host country and investor country are insurable. Establishing the economic value of a particular investment falls on the investor.

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47. International Bank for Reconstruction and Development, Draft Articles of Agreement for International Investment Insurance Agency, R 68-156, August 19, 1968.

5. <u>Insurance for Multinational Investments</u> - Insurance would be available for the promotion of multinational investments which cannot be provided to any similar degree by national guarantee schemes. This insurance would also provide a mechanism for citizens of countries without national insurance schemes to participate in international development.

6. <u>Premiums</u> - No specific level of premiums is proposed in the draft Articles of Agreement. It is understood that rates would be competitive with national guarantee schemes in order to encourage more private investment.

7. <u>Loss-sharing Arrangements</u> - Losses should be shared by Agency members and the host country. Emphasis has been placed on participants' obligations as well as benefits that can be derived. Mutual liability is set forth as a means for improving the investment climate. The draft articles <u>do not</u> provide for LDC loss-sharing or in meeting initial administrative expenses.

8. <u>Settlement of Disputes</u> - Independent arbitration machinery would be established for the settlement of disputes between the Agency and insured investors. 48

The comments on the second draft by the U.S. alternate executive director to the Bank preferred an affiliation with the Bank's International Finance Corporation (IFC) to the proposed IIIA. However, the insurance program should be operated on a financial basis separate from the assets and present functions of the IFC. Voting power should bear some reasonable relationship to financial participation. All members, including the

48. <u>Ibid.</u>

LDC's, should participate in the obligations, such as meeting administrative expenses, as well as the benefits of the program. Nothing in the loss-sharing provisions should lessen obligations for payment under international law.[49] In contrast to the U.S. comments, the representatives of the LDC's indicated that the LDC's were unwilling to participate in the IIIA if they had to share losses or contribute even to administrative expenses.[50]

The United Kingdom and West Germany continued their opposition to the IIIA proposal set forth in the second draft and were joined by Japan. France, previously oppositional, changed to interestedness, a position also taken by Canada and Italy, provided others concurred. Although the U.S. Government had not formally announced its position, the State Department had apparently endorsed the proposal in principle and the Treasury Department and other agencies were engaged in analyzing various aspects of the program.[51]

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49. International Bank for Reconstruction and Development, R 68-157, August 19, 1968.

50. Report of the Committee of the Whole, supra note 47, unnumbered page.

51. Straus file: correspondence of July 10, 1969.

IBRD's president, McNamara, personally favored its operation of a political risk insurance entity, but absent sufficient support from its members, especially that of the United States, the Bank would permanently drop the proposal. Other countries were waiting to see what definitive position the United States would take.[52]

For a few years following the issuance of the second draft of Articles of Agreement for IIIA in 1968, discussion and controversy centered about two points. First, various countries were unwilling to accept the concept of loss-sharing or sharing of administrative expenses by all participating members, including the LDC's. The principle of sharing rather than its quantum remained the stumbling block. Second, there was controversy over the mechanism to be adopted for settling disputes -- *i.e.*, ICSID or some alternative such as an arbitrational forum handling only IIIA matters.[53]

As of September 1971, McNamara did not deem the time propitious for adopting a multilateral investment insurance plan (MIIP). Some of the LDC's indicated a

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52. *Ibid.*: correspondence of August 15, 1969.

53. Chamber of Commerce of the U.S.A., *Multilateral Insurance Against Expropriation*, Staff Paper, July 15, 1971, p. 10.

willingness to share administrative expenses -- a position regarded favorably by the United States. Recent occurrence of expropriatory actions in such countries as Algeria mandated renewed consideration of an MIIP.[54]

The third draft

In February 1972, the third draft of Articles of Agreement for IIIA was circulated by the IBRD.[55] It suggested that LDC's make nominal contributions for administrative expenses. There would be no constitutional links between IIIA and ICSID since only private investors could utilize the latter's jurisdiction.

Provisions of the third draft included the following: Membership in the IIIA would be available to IBRD member states and others invited to membership.[56] The Agency would have a Council as its plenary assembly and

54. Straus file: memorandum of Mr. Straus dated September 15, 1971.

55. International Bank for Reconstruction and Development, Revised Draft, February 1972, of Articles of Agreement of the International Investment Insurance Agency [hereinafter cited as IIIAAG-3].

56. Ibid., Article I, § 2.

a Board of Directors. The Council would consist of one representative of each member who would have one vote. There would be ten members of the Board of Directors, half elected by representatives of developing countries and half by the other members. The first half would possess 35 percent of the voting power; the second, 65 percent. The voting power of each director would reflect the vote he received in his particular half -- i.e., developing or otherwise. Moreover, in the election of directors, each member country would exercise a vote weighted in proportion to the size of the nation's contribution to the Common Fund and the investment insurance sponsored by the member or covering investments made within its territory. The Board would appoint a managing director as chief of the Agency's operating staff.[57]

The criteria for eligibility of investments for risk insurance included the following: The investment must be (1) a foreign one made by an investor of a nongovernmental character; (2) sponsored for insurance by a member; (3) made in the territory of a developing,

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57. Ibid., Article II, § 1(a)-(c), § 2(a) and (h), § 3(a)-(d) and (j), § 4(a)-(b).

non-sponsoring country; (4) approved for insurance by the developing country; and (5) a new investment, including investment for expansion, modernization, or development of an existing enterprise, and contributing to the economic development of the host country; or a refinancing or acquisition of an already insured investment.[58]

The IIIA's financing would come from several sources. In the common working capital fund each member would pay a membership fee "equivalent to three-fourths of one mil of its subscription to the capital of the Bank." As regards a member not a Bank member, its contribution would be determined by the Council, upon the recommendation of the Board of Directors, by a vote of two-thirds of the total voting power of each.

The assets of the common working capital fund were to be used to meet any excess of administrative expenses over premium income. In the common account premium income and administrative expenses would be entered. Each member sponsoring insurance would have a separate sponsor's account. As to losses incurred under insurance

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58. Ibid., Article III, § 2.

issued by the IIIA, the sponsoring country would pay one-quarter and the balance shared by all sponsoring countries.[59]

In evaluating proposals for the issuance of insurance, the IIIA could cooperate with existing investment insurance or investment guarantee agencies of sponsoring countries. It could issue reinsurance provided certain requirements were met and could also reinsure with commercial insurance risks insured by it.[60]

Negative response to the third draft

The third draft was sent to governments in 1973, accompanied by a staff memorandum identifying the principal outstanding issues. Governments were asked to indicate whether they were interested in proceeding with the proposal. The responses were negative, with the result that consideration of the proposal was suspended.[61]

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59. *Ibid.*, Article IV, § 2(a) and (c), § 3(a)-(c), § 4(a), § 6(a).

60. *Ibid.*, Article III, § 5, § 7.

61. 1975 OECD, pp. 103-104.

OPIC and U.S. Treasury Department officials generally favored the concept underlying IIIA, since "multilateralizing OPIC" was viewed as an effective means of spreading political risk, especially of expropriation, among several countries. In addition, the weight of multicountry judgment on expropriatory actions carried a significance beyond that of a single insuring government.

VIEWS OF CONCERNED PERSONS RE MULTILATERALIZATION PLANS

The views of various interested officials concerning the establishment of a multilateral guarantee scheme are interesting and illuminating. Edward Wright, OPIC's assistant vice president for insurance from 1972 through 1974, noted the difficulty of having some LDC's bear judgment on another LDC in a dispute between the latter and a foreign private investor. Especially if the dispute involved natural resources would one LDC be hesitant to criticize another LDC.[62]

62. Interview with Mr. Edward Wright, Washington, D.C., January 12, 1976.

Michael Bradfield, a former assistant general counsel of the Treasury Department involved in the IIIA proposal, stated that while the Department favorably regarded such proposal as set forth in the third draft, acceptance depended upon insertion of provisions for weighted voting and shared costs. The United States wanted greater voting power for the major industrial countries, compulsory arbitration, and subrogation rights for the IIIA. Many LDC's opposed compulsory arbitration on principle; Latin American countries opposed subrogation rights. According to Bradfield, President McNamara failed to push the proposal as strongly as he might have in face of lukewarm support, if not opposition, of the LDC's and some major developed nations.[63]

Andrew Monroe, whose position with the Treasury Department prior to the release of the third draft was like Bradfield's, stated that the United States wanted the LDC's to share some liability in the IIIA's risk pool. Many LDC's were unalterably opposed to any risk sharing: some regarded it as a threat to their sovereignty; others, as an imperialist, capitalist ploy.

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63. Interview with Mr. Michael Bradfield, Washington, D.C., January 14, 1976.

Reluctance by such important countries as West Germany and Japan was premised on the belief an international agency could not serve their nationals as effectively and as cheaply as their own national systems.[64]

One of those closest to the IIIA proposal was Aaron Brachus of The Netherlands, counsel to the IBRD and secretary general of ICSID. In his opinion, the United States assumed an extremist position in demanding that LDC's share in the risk pool losses and submit to compulsory arbitration and that the IIIA obtain subrogation rights -- provisions deemed by LDC's as inimical to their interests. When the IIIA scheme was first proposed, only three countries (the United States, West Germany, and Japan) had investment guarantee insurance programs. The number had risen to over twelve, and with such increase the countries with their own national programs gave a low priority to the creation of an international agency. Since the LDC's interest in an international agency was never as great as that of some developed countries, demands deemed excessive by the former caused them to oppose the proposal. Accordingly,

64. Interview with Mr. Andrew Monroe, Washington, D.C., July 7, 1976.

the IBRD ceased promoting the proposal.[65]

The ECMC proposals

While the third draft proposal of the IBRD was floundering, the European Common Market countries (ECMC)[66] contemplated establishing their own multilateral guarantee scheme. On February 12, 1973, the President of the Council of the European Communities consulted the European Parliament on a late 1972 proposal from the Commission of the European Communities to establish a "guarantee system for private investments in third countries."[67] The proposed scheme was designed to complement existing national schemes and, in particular, cover transnational investment.

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65. Interview with Mr. Aaron Brachus, Washington, D.C., July 19, 1976.

66. In 1973, the members of the ECMC were France, Italy, West Germany, Belgium, The Netherlands, and Luxembourg which were joined after January 1, 1973 by the United Kingdom, Ireland, and Denmark.

67. European Communities, European Parliament Working Documents 1973-1974, Report on the Proposal from the Commission on the European Communities to the Council (Doc. 290/72) for a Regulation Establishing a Community Guarantee System for Private Investments in Third Countries, Doc. 208/73, November 27, 1973, p. 3.

The explanatory statement noted that the proposal provided an incentive for the joint financing of investment projects by Europeans of different nationalities, which would be beneficial both to them and to host countries.[68] The guarantee was available only if a bilateral investment protection agreement existed between the Community and the host country providing sufficient legislative guarantees to foreign investment. The guarantee covered war, expropriations, non-payment, non-transfer and inconvertibility, and foreign exchange losses.[69] The administering agency, known as the European Guarantee Office, would be subrogated to the rights of the investor if indemnity were paid. It pointedly observed that "the work of the IBRD has petered out in 20 years of discussion," the proposal "gives the Europe of the Nine equal chances with the United States."[70]

The proposal was favorably received by the European

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68. Ibid., explanatory statement, p. 9.
69. Ibid., p. 10.
70. Ibid., pp. 10-11.

Parliament and its Economic and Social Committee. However, no implementation occurred at the hands of the Council of Ministers.[71]

In 1978, the 1972 proposal was superseded by a new European Community proposal. Members of the Community felt that they had been less successful than investors from the United States and Japan in insuring investments in LDC's against political risks. With their economies suffering from high import costs and falling raw materials export prices, the LDC's appeared more amenable to foreign private investment. Political risks were one of the reasons for the continuing decline of European private investment in the LDC's.[72]

With both the members of the European Community and the LDC's in a mood for increased foreign private investment, the 1978 proposal envisaged two kinds of

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71. 1975 OECD, p. 104. See also U.S. Congress, House, Committee on International Relations, Extension of the Overseas Private Investment Corporation, Hearings and Markup on H.R. 9179, 95th Cong., 1st and 2d Sess., 1977-1978, p. 50 [hereinafter cited as 1978 Markup].

72. "Guarantees to Spur Investment in LDC's," Business Week, August 21, 1978, pp. 46-48.

action: (1) the negotiation of agreements, or clauses for inclusion in global agreements, between the Community and LDC's on basic rules for the treatment of foreign investments. These rules would include non-discriminatory treatment, arrangements for the transfer of income and capital, fair treatment of property, and dispute-settling procedures; (2) selection of projects of specific economic interest for the Community and the LDC's concerned, especially in the mining sector.[73]

The mining sector and multilateralization plans

The reference to the mining sector -- *i.e.*, such basic raw materials as minerals, metals, ores, and fuels -- has assumed greater significance with the passage of time. In May 1974, Milton F. Rosenthal, president of the Engelhard Minerals and Chemicals Corporation, observed that expropriations, confiscations, and unilateral modifications of existing agreements by host countries had seriously modified the flow to the United States of natural resources produced by U.S. MNC's, and

73. 1978 OECD, pp. 94-95.

had made other materials more costly. An indispensable ingredient of any program for the continued U.S. development of foreign resources must be the perpetuation of an insurance system like OPIC.[74] He reiterated his views before a Congressional subcommittee in July 1977, prophetically pointing out that "we must not forget that our dependence on foreign sources of raw materials will grow inexorably, and access to them could be one of the most troublesome problems we will have to face in the decades to come."[75]

As noted in preceding chapters,[76] almost a quarter of AID's insurance portfolio covered extractive mineral

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74. Milton F. Rosenthal, "Access to Raw Materials," an excerpt from a speech delivered at an OPIC seminar on May 7, 1974.

75. U.S. Congress, House, Committee on International Relations, Extension and Revision of Overseas Private Investment Corporation Programs, Hearings and Markup before the Subcommittee on International Economic Policy and Trade on H.R. 7854, 95th Cong., 1st Sess., 1977, p. 176 [hereinafter cited as 1977 HOH].

76. See Chapter I, p. 78, note 144 and accompanying text; Chapter III, p. 177, note 109 and accompanying text.

industries. Under OPIC, only three percent of its portfolio covered metal mining corporations. The precipitous decline resulted from a backload of Chilean expropriatory action, OPIC's utilization of prudent risk management principles, and a general cutback of exploration by U.S. companies in the LDC's.

OPIC and the Berne Union

In mid-June 1974, some few weeks before passage of the OPIC legislation,[77] OPIC joined the Berne Union, an international association of export credit and investment insurance agencies. Established in the 1930's, the Berne Union, whose membership included operating agencies, both public and private, had until recently been concerned only with export credit.[78] Pursuing the statutory mandate of participating with multilateral organizations,[79] OPIC was able to join the Union only after the latter created a committee for investment insurance.

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77. *Supra* note 2.

78. OPIC Press Release, June 12, 1974, TS 282; Overseas Private Investment Corporation, Annual Report Fiscal 1974, p. 4.

79. *Supra* note 3.

Negotiations for a formal arrangement between the Berne Union and OPIC had begun as early as 1971. It was not, however, until OPIC had completed examination of the possibilities of transferring its insurance activities wholly or partially to other multilateral organizations that agreement was reached in 1974 for the establishment of the Union's investment insurance committee. This committee meets semi-annually to discuss coverage problems, joint risk sharing, and mutual pool arrangements.[80]

OPIC's president, Marshall T. Mays, and its chairman, Daniel Parker, also administrator of the Agency for International Development (AID), welcomed OPIC's entering into the Berne Union as opening many possibilities for the exchange of technical information on practices and policies, and for cooperation among insurers on individual projects or problems. They expressed the

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80. Supra note 78; Overseas Private Investment Corporation, Report to Congress on the Possibilities of Transferring OPIC Activities to the Private Sector (1976), pp. 8-9.

hope that in time such association might facilitate direct risk pooling among investment insurers.[81] However, this was not to be. OPIC's official report in March 1976 noted that efforts to transfer some of OPIC's activities to multilateral organizations, including the Berne Union, had been discouraging. "Most of the members of the Berne Union are either not involved in investment insurance activities or are specifically prevented by their legislative charters from participation in a multilateral investment insurance program. The few members of the Berne Union that do have the authority to participate in such a program currently have little interest in such a proposal for a variety of economic and political reasons."[82] A similar pessimistic view concerning participation in a multilateral reinsurance association affiliated with Berne Union was reiterated in July 1977 by OPIC's acting president,

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81. Overseas Private Investment Corporation, Annual Report Fiscal 1974, _supra_ note 78.

82. _Supra_ note 80.

Rutherford M. Poats.[83]

Charles W. Robinson[84] had been an early proponent of the concept underlying the IIIA. When he became Under Secretary of State for Economic Affairs in late 1974, the possibility of a viable IIIA was most remote. Economic officials in the State Department and in other interested agencies sponsored a plan to spur private investment for the production of more raw materials. An ingredient of the proposal was insurance against expropriation in behalf of investors in natural resource production.

THE KISSINGER IRB PROPOSAL

On May 6, 1976, at the fourth meeting of UNCTAD in Nairobi, Kenya, Secretary of State Henry Kissinger presented the U.S. plan for improving economic relations between the developed countries and the LDC's.[85] The

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83. U.S. Congress, Senate, Committee on Foreign Relations, OPIC Authorization, Hearings before Subcommittee on Foreign Assistance, 95th Cong., 1st Sess., 1977, p. 24 [hereinafter cited as 1977 SOH].

84. *Supra* note 15 and accompanying text.

85. U.S. Department of State, Bureau of Public Affairs, Office of Media Services, Speech of Secretary Henry A. Kissinger before the Fourth Meeting of UNCTAD, May 6, 1976; excerpts are found in The New York Times, May 7, 1976, p. A 12.

plan laid heavy stress on free enterprise and private initiative.

The central provision of the proposal was the establishment of an International Resource Bank (IRB) designed to stimulate private investment in the development of mineral resources, including oil and gas, in the LDC's. IRB could also be utilized to develop agricultural productivity; if other means of financing, such as export taxes or commercial loans, were unavailable, the Bank could finance commodity buffer stocks, thus indirectly assisting stabilization of a given commodity.

The IRB would mobilize capital for sound resources development projects by assisting individual resources projects to secure direct financing and issuing bonds which could be secured by a specific commodity. Alternatively, these bonds could be retired through delivery of a specific commodity. To enhance confidence in both investors and host governments, IRB's initial capital would be $1 billion. It would participate in project agreements specifying the conditions of the investment, such as production sharing and procedures to develop the managerial, technological, and marketing capabilities of the host government. It would support guarantees of performance by both investor and host, thereby reducing non-commercial risks. These guarantees would promote greater flows of investment capital for resource projects on reasonable terms.[86]

In a memorandum submitted by the United States to the OECD on June 14, 1976, it was stated that IRB would not operate as a traditional bank in the sense of making loans from general funds. Rather, it would facilitate financing on a project by project basis. It would act both as underwriter or issuer of project bonds to finance a project and also as guarantor against defaults on the investment resulting from non-commercial factors. The provisions of a contract executed by the investor, host country government, and the IRB might deal with preproduction activities to complete technical and commercial evaluation of projects; the means for financing the project -- conventional loans or IRB bonds; production sharing; technology transfer; performance and payment guarantees; and dispute settlement procedures.

The $1 billion initial capital to cover the investment guarantee program would be subscribed by the developed and oil-exporting countries. The contributions

86. Ibid.

would serve primarily as a loss reserve fund and it was assumed that the amounts of defaults in relation to total coverage would be small. For a number of reasons the IRB should be associated with the World Bank group.[87]

When the IRB proposal was circulated at the UNCTAD meeting, foreign reaction was generally negative. Some of the oil-exporting countries which were expected to make capital contributions, appeared less than enthusiastic about contributing to another international development bank. France doubted the need for the IRB; the IBRD could accomplish the program without creating another bureaucracy. West Germany was equivocal concerning the financing of commodity buffer stocks as a possible disruptive influence on market prices.[88]

When a resolution to back a study of the IRB proposal came before the final session of the UNCTAD meeting at the end of May 1976, it was defeated by a vote

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87. U.S., Department of State, Outline of U.S. Proposal for the Establishment of an International Resources Bank (IRB), June 14, 1976.

88. Michael T. Kaufman, "Kissinger Offers Program to Help Poor Lands Grow," The New York Times, May 7, 1976, pp. A 1, 13.

of 33 to 31. A substantial number of the negative votes were cast by Communist countries; almost all the LDC's either abstained or absented themselves.[89]

Following this vote Kissinger and Treasury Secretary William E. Simon issued a statement deploring the rejection which "does not augur well for the future of the dialogue of the worldwide development effort." The LDC's "must not lend themselves to parliamentary manipulation by those states who contribute nothing to the development of the poorer nations of the world." The United States would continue to advance the IRB proposal.[90]

U.S. comments on the Kissinger IRB proposal

OPIC officials and officials of other interested agencies favored the IRB proposal as complementary to OPIC. Rutherford M. Poats, who had become an OPIC vice president in 1971, a senior adviser for Economic Affairs in the State Department in 1975, and OPIC's acting

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89. Edwin L. Dale, Jr., "Kissinger and Simon Irked by Rebuff at Trade Parley," The New York Times, June 2, 1976, pp. 1, 8.

90. Ibid.

president in 1977, in July 1976 viewed the proposal as lessening the commercial but not the political risks inherent in natural resource and raw material projects. The IRB could act as a conduit for the flow of essential debt capital required for these projects in the LDC's. Moreover, the existence of the IRB could in some measure deter defaults by the host countries.[91]

C. Fred Bergsten, in July 1976 a senior fellow at the Brookings Institution and currently an assistant secretary of the Treasury for International Affairs, observed that OPIC was not insuring as many natural resource and raw material projects as it could. The IRB proposal envisaged stimulation of such projects by promoting non-equity means on the part of MNC's -- e.g., management, marketing, and servicing contracts, rather than the traditional equity capital input. As a multilateral agency, the IRB could complement OPIC's activities. Unfortunately, the LDC's want the industrialized countries fully to assume the investment insurance risks, while the latter want some participation therein

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91. Interview with Mr. Rutherford M. Poats, Washington, D.C., July 20, 1976.

by the former. Moreover, while the industrialized countries want to extract as much raw materials as they might require, the LDC's desire to limit production so as to prevent price deterioration. These considerations underlay the hesitancy of the LDC's to support the IRB proposal.[92]

Theodore H. Moran of the School of International Studies of Johns Hopkins University and an associate of Bergsten,[93] regarded the IRB proposal as greatly lessening the political risks of U.S. natural resources companies in the LDC's. Since the traditional manner of MNC equity investment in the extractive industries was more easily subject to expropriatory action by the host country, non-equity involvement through management, service, and marketing contracts would minimize political risks. Contractual arrangements could be expected

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92. Interview with Mr. C. Fred Bergsten, Washington, D.C., July 20, 1976.

93. Messrs. Bergsten and Moran, together with Thomas Horst, are the authors of American Multinationals and American Interests (Washington, D.C.: Brookings Institution, 1978). See especially Chapter V, "Access to Raw Materials."

to generate less tension that equity investments since they eliminate the cession to foreign ownership of the producing earth facility for an indefinite period of time. In this period of nationalistic fervor, foreign ownership of the source of such materials would remain a source of conflict between the host country and the natural resource company.[94]

As noted, opposition to the creation of a multilateral investment guarantee corporation was voiced by those industrialized nations which had their own national programs.[95] In the circumstances, they felt an international agency could not serve their nationals as satisfactorily as their own programs. Moreover, they were wary of a possible conflict between their national agencies and an international organization.

94. Interview with Mr. Theodore H. Moran, Washington, D.C., July 19, 1976.

95. See supra notes 44 and 51 and accompanying text.

COMPARISON OF OPIC WITH OTHER NATIONAL INVESTMENT PROGRAMS

At this point, a brief comparative study of OPIC-like agencies in other countries will be made. While the U.S. investment guarantee program was initiated in 1948,[96] it was not until 1956 that a second country, Japan, undertook a similar program.[97] West Germany followed in 1960.[98]

Accordingly, when the proposal for a multilateral investment guarantee agency was first advanced in the early 1960's, only the above-mentioned three countries had operating programs. With the plan for an international institution unable to get off the ground, more countries instituted their own national programs. As of 1978, 15 industrialized countries besides the United States had investment guarantee programs.[99] In order

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96. See Chapter I, pp. 9-10, notes 1-3 and accompanying text.

97. 1978 OECD, p. 11; 1975 OECD, p. 12.

98. <u>Ibid.</u>

99. 1978 OECD, p. 12; 1978 Markup, p. 46, note 1.

of the commencement of the programs, the countries are (year of commencement follows the country): Japan-1956; West Germany-1960; Norway-1964; Austria-1964; Denmark-1966; Australia-1966; France-1967 with limited scope and general in 1971; Sweden-1968; Canada-1968; The Netherlands-1969; Switzerland-1970; Belgium-1971; Italy-1971; United Kingdom-1972; and New Zealand-1974. Some of these programs have been of limited scope. Some, like the Japanese and British, initially received U.S. assistance in the commencement of their operations.[100]

As noted, the Berne Union, which OPIC joined in June 1974, constitutes a medium in which the various national investment guarantee agencies discuss coverage problems, joint risk sharing, and mutual pool arrangements.[101] While the various programs differ materially from one another, each pursues its own national interests and joint action has been the exception.

OPIC remains the largest national investment guarantee program. As of December 31, 1977, OPIC's maximum

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100. Supra notes 97 and 99. The charts are contained in Appendices 1 and 2 infra.

101. Supra notes 77-80 and accompanying text.

potential liability was $4.173 billion, consisting of inconvertibility coverage of $2.87 billion; expropriation, $3.341 billion; and war risk, $2.81 billion. While a breakdown for other countries as to coverage of the particular risks is generally unavailable, the total amounts of covered investment in those countries are: Japan, $3.376 billion; West Germany, $754.9 million; France, $178.8 million; Canada, $171.8 million; and United Kingdom, $100 million. The remaining countries range from Austria's $61.7 million to New Zealand's under $1 million.[102]

While the various national programs are basically similar in the types of protection extended -- *i.e.*, coverage against loss from expropriation, war, and transfer risks -- they differ in basic policy objectives, premium rates, eligibility requirements, length and amounts of project coverage, and selectivity factors such as domestic and host country effects. Except for the United States and West Germany, where programs of investment guarantees and export credit insurance are

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102. 1978 OECD, p. 14. The chart is contained in Appendix 3 *infra*.

administratively separated, other countries combine the two programs in one agency.[103]

Concerning the purpose and objective of their programs, almost all the investing countries recognize a positive correlation between exports and selectively encouraged foreign investment. The U.S. and Swedish programs emphasize the developmental factor as a complement to governmental development assistance programs. The British and Dutch programs express a similar purpose to a lesser degree. The Japanese program makes acquisition of raw materials a major objective.[104]

OPIC's program is among the most restrictive as regards investor eligibility, requiring that the insured be a company legally and beneficially owned by U.S. citizens, and that preference be given to small business investors. In most other countries which do not apply the beneficial ownership test, the domicile of the investor -- e.g., a foreign-owned subsidiary of an MNC -- in the country would permit insurance coverage. France covers only French-controlled resident companies.[105]

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103. 1978 Markup, p. 46; Appendices 1 and 2.

104. Ibid.

105. Ibid.

Most programs deny insurance coverage to existing investment unless accompanied by substantial new investment. Coverage is extended to equity loans, advances, licenses, and royalties. OPIC denies or restricts insurance offered to projects wholly in the public sector or likely to compete with sensitive domestic industries such as textiles.[106]

Classification of geographical coverage of insured investments includes developing countries only, countries having signed bilateral agreements, and worldwide. Australia, Austria, Belgium, Japan, Norway, and the United Kingdom have worldwide applicability. OPIC is the only agency that applies a rigorous per income test in determining the eligibility of the LDC and requires a bilateral agreement with the host government protecting its rights of recovery in the event of losses as well as a separate approval letter for each insured investment. Since OPIC insists on subrogation rights, those host countries refusing to grant them -- *e.g.*, Andean Pact countries -- have been receptive to the programs of other countries not insisting on such condition. Nevertheless, OPIC's geographical coverage in

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106. *Ibid.*

almost 80 countries far surpasses the distribution of other programs.[107]

OPIC's program is alone mandated to be self-sustaining. Accordingly, this is reflected in its higher and more complex premium rates. Many of the other programs provide "package" insurance -- i.e., all coverages at one percent or less annually of the insured amount. West Germany's premium for the combined coverage on non-sensitive investments is 0.5 percent; Japan's, 0.55 percent; United States, 1.5 percent. On mineral investment, U.S. premiums may be four or more times as high as in other programs which apply a uniform lower fee regardless of the type of investment.[108]

The various programs vary as to the duration of coverage. Most provide coverage up to 15 years. OPIC provides up to 20 years in non-sensitive areas and 12 years for large and sensitive projects. The loss payable under the programs ranges from 80 to 100 percent, with most, including OPIC, having a maximum of 90 per-

107. 1978 Markup, p. 47; Appendices 1 and 2; Overseas Private Investment Corporation Annual Report 1978, pp. 15-16.

108. 1978 Markup, pp. 46-47; Appendices 1 and 2.

cent. On large and sensitive projects, OPIC pays 50 percent.[109]

As noted, only OPIC is committed to be self-sustaining. As of May 31, 1977, it had paid or guaranteed claims of over $325 million, over 95 percent involving expropriatory action.[110] To the same period Japan had paid claims of but some $5.9 million.[111] While by 1978 the volume of OPIC insurance, measured in terms of new insurance written each year and aggregate outstanding coverage, was declining, the growth in other countries, especially Japan, was dramatic. Statutory restrictions on OPIC may well have been the reason for the contrast in growth.[112]

The rapid growth of the national programs of Japan and West Germany, both vanquished in World War II,

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109. 1978 OECD, p. 15; Appendices 1 and 2.

110. 1977 HOH, pp. 66-72.

111. 1978 OECD, p. 62.

112. 1978 Markup, pp. 47-48.

merits further consideration. Although this expansion may in part have been motivated by an increased commitment to assist the development of the LDC's, it was not a mere coincidence that especially in Japan the program is administered by the Ministry of International Trade and Industry (MITI) rather than by government aid agencies. In both countries, the expanding domestic economies made the search for foreign markets imperative.[113]

The Japanese program

For the first 14 years of its existence, the Japanese programs were limited in scope and activity. Until mid-1970, MITI operated two investment insurance programs, the first concerned with capital investment; the second, with profits. The programs remained of a moderate size, mainly because of a traditional reluctance of Japanese investors to invest abroad, and also because of the relatively limited coverage provided by the programs. In May 1970, the two programs were combined into one, the Overseas Investment Insurance Scheme, with further improvements being made in 1972 and 1974.[114] From

113. 1973 SOH, p. 638; 1978 OECD, pp. 61-62.

114. 1978 OECD, pp. 61-62.

1956 to April 1970, investments covered totalled $68.6 million; from May 1970 to the end of 1973, the total was $407 million.[115] By the end of 1977, the total was $3.376 billion.[116] At the end of June 1977, the geographical distribution was Asia, 60 percent; Middle East, 6.1 percent; Africa, 2.5 percent; Latin America, 15 percent; and others, 16.4 percent.[117]

To be eligible under the Japanese program, investments must involve a new project or an expansion program and must contribute to the development of Japan's international relations. Consideration is afforded to the investment climate of the host country and to the development effects of the project thereon. Approval of the host country is requested in principle.[118]

Japan-domiciled companies may apply for insurance covering the three classes of political risks -- i.e., expropriation, war, and transfer. Usually, the three

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115. 1975 OECD, pp. 66-67.

116. 1978 OECD, p. 14; cf. p. 62.

117. Ibid., p. 62.

118. Ibid.

risks are combined in one package. Eligible investments include shares and dividends in subsidiaries or joint ventures; long-term loans to foreign partners in joint ventures; debentures and other long-term loans to foreign-controlled firms; real estate, mining rights, and industrial property rights of Japanese-controlled firms; and loans for long-term contracts to develop and import minerals. Coverage is worldwide. The maximum period of coverage is usually 15 years but in exceptional cases the interval between the investment and the start of operations may be added to this period. The percentage of loss payable is 90 percent of the original investment amount, or the estimated worth at the time of the loss, whichever is the smaller. For loans for long-term contracts to import mineral ores, the percentage of loss payable is 80.[119]

As an island nation of over 115 million inhabitants and an area of 143,000 square miles[120] -- less than that of California -- Japan has been more dependent than most of the other developed nations on outside sources for

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119. Ibid.; Appendices 1 and 2.

120. 1980 Colliers Year Book (New York: Macmillan Education Corporation, 1979), p. 325.

its raw materials. It supports new mineral developments by flexible guarantees, direct lending, and direct participation in mineral ventures. Its incentives are greater than those offered by the United States through OPIC or the Export-Import Bank. Through its Overseas Economic Cooperation Fund, it provides loans for prospecting and exploration in the LDC's. In production-sharing arrangements, which have increasingly become the form of new mineral projects, commercial as well as political risk protection is afforded, with both premiums and loan repayments geared to cash flow.[121]

The West-German Program

The West German system of guarantees against political risk for private direct investments reflects both the importance which the government attributes to the private development effort and the serious obstacles which had to be overcome to encourage private investment to the LDC's. It applies generally only to LDC's with which the German Government has concluded bilateral agreements.[122]

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121. 1978 Markup, pp. 47-48.

122. 1978 OECD, p. 51.

The program is administered by the Trewarbeit AG (TAG), a private body acting as an agency of the Government. Final approval of all applications rests with an Interministerial Committee under the chairmanship of the Ministry of Economics. Projects are selected on the basis of their "worthiness of promotion," involving the development impact on the host country and the effects upon the German economy.[123]

Eligible investors are German resident companies including foreign-owned subsidiaries. A single policy covers the three classes of political risks. Eligible investments include equity, loans provided in connection with a participation, and capital supplied to a foreign branch of the German investor. Coverage is also available under certain conditions to service contracts in the oil sector. The duration of the coverage is normally 15 years but in exceptional cases may run to 20 years. The percentage of loss payable is 95 percent of the value of the capital investment. Coverage of profits including interest is offered to the extent of 8 percent of capital investment per annum to a maximum

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123. Ibid., p. 52.

loss of 24 percent of such investment.[124]

Analysis of the guarantee programs of other countries establishes that the foreign programs have eligibility requirements more liberal than OPIC's. Unlike OPIC, none requires preference to small business investors or to poorer LDC's; or has been confronted with demands for privatization; or has been enjoined to be self-sustaining.[125]

These other programs are much more commercially oriented than OPIC. Many were originally instituted because their businessmen felt at a disadvantage in competing with U.S. investors who could obtain low cost political risk insurance for their new or expanded investments in the developing countries. With the foreign programs offering premium rates substantially lower than OPIC's, some U.S. businessmen have desired a strengthened OPIC to eliminate any competitive disadvantages.

THE PROGRAMS OF THE PRIVATE SECTOR

As noted, the various programs at present only insure new investments and, in some instances, expansion

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124. Ibid., pp. 53-54; Appendices 1 and 2.

125. Appendices 1 and 2.

of existing investments. None covered existing investments in foreign countries *per se*. However, following its participation in its reinsurance program with OPIC,[126] Lloyd's of London embarked on its own private political risk insurance program for investments worldwide not eligible under national programs.[127]

The Lloyd's background and program

Lloyd's of London, or simply Lloyd's, describes a society of underwriters willing to accept almost all categories of insurance on the basis of individual unlimited liability. It also refers in a secondary sense to a corporation administering and servicing the international insurance market of Lloyd's. The general conduct of market of Lloyd's is governed by a Committee of 16, who may include both underwriters and brokers, and who are the Corporation's board of directors.[128]

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126. See Chapter IV, pp. 214-215, notes 15-19 and accompanying text.

127. Julian Radcliffe, "Political Risk Insurance Market Expands," *Risk Management*, April 1974, pp. 8-12 [hereinafter cited as *Radcliffe*].

128. Lloyd's Nautical Year Book and Calendar (London: Lloyd's of London Press Limited, 1978), pp. 6-10 [hereinafter cited as 1978 NYB].

Lloyd's insurance exchange, founded in London almost three centuries ago and always located there, has over 18,000 members, of whom a majority are British. The key to its character is the group of men who are the underwriting agents for its approximate 300 syndicates. These agents each have their area of expertise. The syndicates may number from three or four to several hundred members. Each syndicate member accepts unlimited personal liability, bearing a share of risks and earning a share of the premiums.[129]

Insurance may only be placed in the market through one of the 250 firms accredited as Lloyd's brokers who bring in risks worldwide. The broker, representing the prospective insured, goes to a lead underwriter who works out the terms, conditions, and premium rates. Other underwriters and their syndicates may be asked to participate so as to cover the entire risk.[130]

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129. "The Character of Lloyd's," Excess and Surplus Lines Manual (Indianapolis, Ind.: Insurors Press, February 1970), pp. 5-6; 1978 NYB, pp. 7-9.

130. 1978 NYB, p. 9; "The Character of Lloyd's," *supra* note 129, pp. 11-14.

Before Lloyd's undertook to insure political risks, brokers representing a leading syndicate spent two years in studying and analyzing the market. About 2,500 overseas investors were canvassed. It was ascertained that many private direct investments abroad were sound for political risk insurance coverage, but could not qualify under the restrictions and limitations of national programs. Moreover, there was an enormous volume of old investments predating the national programs which were not insured at all.[131]

The Lloyd's study analyzed all expropriation losses since the 1920's. The confiscations fell into three classes: (1) blanket, affecting every type of industry and nationality of ownership -- e.g., nationalization in Communist countries; (2) sectoral, affecting a particular sector, such as banking; (3) one aimed at a particular nationality of ownership -- e.g., American in certain Latin American countries.[132]

Decision was made to enter the private market only

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131. Radcliffe, pp. 9-10.

132. Ibid., p. 10.

with respect to expropriation losses and to regard the new service as complementary to the national programs, not competitive with them. Coverage for war damage and inconvertibility was excluded because of technical problems.[133]

In 1972, a Lloyd's insurance brokerage firm, Investment Insurance International (III), a subsidiary of the Hogg Robinson Group of brokers, was established to place insurance against expropriatory actions. Coverage was obtainable directly from III or through overseas agents working on a non-exclusive basis. One such U.S. agent is the Pittsburgh-based American Investment Guaranty Corporation (AIGC), a subsidiary of Babb Inc. which furnishes a variety of management and insurance services. AIGC is the only U.S. broker specializing exclusively in the market against losses by expropriation. Other large U.S. brokers, however, have also placed such insurance through III.[134]

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133. Ibid., p. 12.

134. Ibid., p. 10; Mary Ann Callahan, "Broker Specializing in Foreign Political Risks," Business Insurance, April 1, 1974, p. 6; Donald C. Casciato, "Political Risk Cover Expands," Journal of Commerce, March 18, 1974, p. 2.

Besides III, only one large U.S. firm has undertaken to write expropriation insurance. This is the New York-based American International Group (AIG) whose operations are much smaller than those of the III and which is heavily reinsured at Lloyd's and elsewhere. Other major insurance companies refrain from covering political risks, although a few have reinsured a small portion of Lloyd's exposure.[135]

When III first began operations in 1972, it limited its coverage to $6 million first loss limit for any one insured in any one country. On this basis the underwriters would pay up to this amount of loss and if the total asset value was $20 million, the underwriters would not receive any payable compensation until the reinsured had been reimbursed in full. This was a way of maximizing the value to clients of Lloyd's restricted capacity available. It had the added advantage that partial losses would be paid in full, while the national programs usually only paid total losses.[136]

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135. "Thanks to You, General Amin," Forbes, March 15, 1976, pp. 41-42.

136. Radcliffe, p. 10.

Within a year of commencement of operations, III raised its coverage to $9 million first loss limit for a single investor in one country, and by 1976 increased this to $10 million.[137]

Lloyd's rates vary according to the spread of risks offered for insurance but can average between 0.2 percent and 10 percent per annum of the value of the asset insured. The rates are based on individual corporate management style including its corporate image, the type of industry, its geographical location, the nationality of the investor, the political climate of the host country, and other factors.[138]

III's basic premise is the spreading of risks to as many countries as possible. It often requires as a condition for political risk coverage that the investor insure all its overseas assets irrespective of location. If the investor seeks insurance only in high risk areas, the premium requested may exceed that needed to insure all the overseas assets wherever situate.[139]

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137. Ibid.; Forbes, supra note 135, p. 41.

138. Radcliffe, p. 13; Callahan, supra note 134; Casciato, supra note 134.

139. Radcliffe, p. 10. Interview with Mr. Julian Radcliffe, New York, N.Y., April 24, 1976.

Loss experience in the field of political risk is unsettled. There are no long-term actuarial tables as tools; decisions concerning the degree of exposure are constantly under intensive review but generally remain subjective. Accordingly, III insists on global coverage. Because of the risk spread requirement, the "capacity" or amount of insurance available in each country is limited and sold until the country is saturated. Lloyd's allocates a certain amount of insurance for each country to be issued to foreign investors with assets therein. The overall amount depends on such factors as the investment climate and the stability of the country. Such amount is then divided on the basis of the investors' nationality. The particular national allocation is further apportioned according to industry classification. Since the investors' nationality is deemed an important determinant in premium fixing, on the premise that investment by one national group may be more prone to expropriation than that of another, two competitive foreign companies of different nationalities may be charged different premiums.[140]

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140. Ibid.; "Private Insurance Group Offers Companies Flexible Asset Protection Against Political Risks," Business International Weekly Report, April 19, 1974, pp. 121-122.

Comments concerning the private sector's involvement

Julian Radcliffe, a director of III who has travelled to over 40 countries to develop a market for its political risk insurance, has written and lectured extensively on the subject. Even though the normal duration of Lloyd's political risk policy is for only one year and non-cancellable by either party, renewal has been effected in almost every instance, even for some troubled areas like Portugal and Lebanon. With greater experience, the period might be increased to three years, but beyond that was doubtful. As of 1976, Lloyd's political risk business was moderately sized, perhaps 20 percent of OPIC's coverage.[141] The business was profitable with no major losses being suffered.

III was not using any sophisticated or computerized means of analyzing political risks. It relied principally upon Lloyd's worldwide intelligence-gathering network. Its association with OPIC and with its British counterpart, Export Credits Guarantee Department (ECGD), which it helped establish, was giving it much needed experience. It not only acted as reinsurer for both

141. _Forbes_, _supra_ note 135, p. 41.

programs but also as agents for ECGD.[142]

Chandler G. Ketchum, president of AIGC, III's principal U.S. agent, voiced optimism concerning the future of expropriation insurance coverage by the private sector. Because OPIC as a Government agency is subsidized by the Government, the private sector cannot compete with OPIC's rate structure. However, limitation by national programs on new investments and exclusive of old investments afforded a fertile field for coverage by the private sector.[143] An example of the cost to an unidentified U.S. company with worldwide assets having a book value of $245 million and insurance of $53 million is set forth in an appendix.[144]

A less optimistic view concerning the future of privately placed expropriation insurance was expressed by Stephen Merrett, an underwriter whose Lloyd's syndicate places both III's insurance and OPIC's reinsurance. The private sector does not presently possess a sufficient capital base to underwrite political insurance

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142. Interview with Mr. Julian Radcliffe, _supra_ note 139.

143. Interview with Mr. Chandler G. Ketchum, Pittsburgh, Pa., January 15, 1976.

144. See Appendix 4.

risks of the magnitude undertaken by OPIC and some other national programs.[145]

Russel Tandy, an executive with the brokerage firm of Marsh and McLennan, who in 1973 declined a top position with OPIC, stated that the high premium rates charged by the private sector for political risk insurance was a major factor in inhibiting its growth. The newness of this form of insurance meant the lack of experience and actuarial tables, with the result that only Lloyd's and AIG had ventured into the field as underwriters. However, there was room for considerable growth, especially because of the restrictions and limitations inherent in the various national programs. Thus, a moderate size U.S. manufacturer with several older plants in Western Europe and other non-LDC's -- accordingly, ineligible for OPIC coverage -- might not want to undergo the expense of worldwide coverage but would be willing to purchase selected insurance for only one-quarter or one-third of the value of a plant. The

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145. Panel Discussion, "New Developments in Insuring Overseas Investments against Political Risks," sponsored by the Subcommittee on Insuring Overseas Investments of the International Law Section of the American Bar Association, held at Georgetown University Law Center, Washington, D.C., April 21, 1976, and substantially reprinted in Law and Policy in International Business, 8 (1976), pp. 670-672.

rationale for such course is that in the event of expropriation, the probabilities are that the host country would eventually pay between 20 and 40 percent of the value. In the meantime, the U.S. tax laws would permit the investor to take a considerable tax write-off. Accordingly, the aggregate of the insurance proceeds from the reduced valuation base, the expropriating country's payment, and the tax write-off might produce a reasonably adequate result in an otherwise unpleasant, if not disastrous, situation.[146]

The observations of Radcliffe, Ketchum, Merrett, and Tandy were made in 1976. A survey conducted in 1979 showed that, surprisingly, recent world turmoil has done little to increase demand for political risk insurance.[147] While nearly 90 percent of the respondents have permanent investments outside the United States, less than 30 percent carried expropriation insurance and less than 20 percent carried government-sponsored inconvertibility and war insurance. Only a handful of

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146. Interview with Mr. Russel Tandy, New York, N.Y., April 26, 1976. See also Appendix 5.

147. Risk Management Forum, "Shying Away from Political Risk Insurance," Institutional Investor, November 1979, pp. 115-116, 119, 122.

respondents have insurance on special types of foreign contracts -- e.g., repudiation or deterioration of contract or unfair calling of on-demand bank guarantees. The reasons for not carrying political risk insurance, with the percentage of replies, are: unnecessary-55 percent; too expensive-40 percent; too restrictive coverage-27 percent; too low limits on coverage-12 percent; unavailable coverage-6 percent. Ninety-two percent of those with some kind of existing coverage had not significantly expanded their geographical distribution. Eighty-eight percent of those purchasing such insurance in the preceding 12 months were not influenced by recent political upheavals, such as that in Iran.[148] Some risk managers indicated that the private sector was having difficulty pricing competitively against OPIC; others still regarded such insurance "an esoteric or even exotic coverage of uncertain value."[149]

We have seen the unsuccessful attempts to create an international agency with an investment guarantee

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148. Ibid.

149. Ibid., p. 116.

program. We have seen the limited success of III and AIG in the private sector. However, notwithstanding opposition and travail, OPIC has continued to perform a creditable job.

APPENDIX # 1

TABLE 1

RUNDOWN OF NON-U.S. INVESTMENT GUARANTEE PROGRAMS

RUNDOWN OF NON-U.S. INVESTMENT GUARANTEE PROGRAMS

	Australia	Canada	Denmark
Agency	Export Finance and Insurance Corp. (EFIC) Changed Feb. 1 1975 from EPIC	Export Development Corp (EDC)	Danish International Development Agency (DANIDA).
Risk covered—(A) Political (B) Commercial	(A) [illegible] (B) Not covered	(A) Coverage is available for [illegible] war or insurrection [illegible] funds (B) [illegible] covered	(A) A comprehensive policy [illegible] convertibility [illegible] nationalization [illegible]
Eligible countries	In principle, all countries, however each application is treated on its individual merits	All developing countries receptive to foreign investment	All developing countries [illegible]
Eligible investments	All [illegible] investment (equity and loans)	Almost any right that an investor [illegible] in a foreign [illegible] equity, loans, [illegible] [illegible] guarantee [illegible]	All new direct (not portfolio) investments [illegible]
Eligible investors	Australian companies or residents. Foreign-owned subsidiaries [illegible] given [illegible] Government's [illegible] to Efic	Canadian resident companies.	Danish resident companies (including foreign-owned subsidiaries).
Indemnification—(A) Amount (percent of loss) (B) Term	(A) 9[illegible] percent of actual loss (B) 15 yrs (minimum 5)	(A) 85 percent of the actual loss to a maximum of C$5[illegible] (B) [illegible]	(A) 85 percent (B) 15 yrs.
Rates, fees	As a benchmark figure under 1 percent [illegible] 0.12 [illegible] [illegible] allocated to investment	1 percent p.a. The investor, however [illegible] of coverage [illegible] reduction [illegible] costs to the investor	0.5 percent p.a. of the insured amount
Other stipulated requirements	To qualify the investment must make a [illegible] contribution to the host country's development. Joint ventures are specifically encouraged	The investment should help to maintain [illegible] Canada's trade [illegible] It should [illegible] Canadian private sector involvement in the industrial growth of developing countries	Investor must control management [illegible] it must aid the [illegible] economic development and have host-government approval

	France	Germany	Japan
[illegible]	[illegible]	[illegible]	[illegible]
Risk covered—(A) Political (B) Commercial	(1) [illegible]	(A) [illegible] (B) [illegible]	(A) [illegible]
Eligible countries	(1) Former French colonies [illegible]	Developing countries that pro- [illegible] foreign investment.	All countries.
Eligible investments	(1) [illegible]	Investments in shares of for- [illegible]	Shares and dividends in sub- [illegible] joint venture [illegible] long term [illegible] to foreign [illegible]
Eligible investors	[illegible]	[illegible] companies [illegible]	[illegible]
Indemnification—(A) Amount (percent of loss) (B) Term	(1) [illegible]	[illegible]	(A) [illegible] percent of loss—90 percent [illegible]
Rates, fees	(1) [illegible]	0.5 percent p.a. of the insured [illegible]	0.55 percent p.a. of insured amount
Other stipulated requirements	(1) [illegible]	The investment must be in [illegible]	The investment must be con- [illegible]

APPENDIX # 1

TABLE 2

	NETHERLANDS	SWEDEN	[illegible]
Agency	Netherlands [illegible]	[illegible] Credit Guarantee [illegible]	[illegible] Guarantee [illegible]
Risk covered—(A) Political (B) Commercial	(A) [illegible]	(A) [illegible]	(A) [illegible]
Eligible countries	All [illegible]	[illegible]	All developing countries that [illegible]
Eligible investments	[illegible]	All new projects and expansion [illegible]	[illegible]
Eligible investors	[illegible]	[illegible] Sweden.	[illegible]
Indemnification—(A) Amount (percent of loss) (B) Term	(A) [illegible]	(A) [illegible]	(A) 90 percent [illegible]
Rates, fees	0.8 percent p.a. There is also [illegible]	0.7 percent p.a. for full cover [illegible]	1.5 percent p.a. [illegible]
Other stipulated requirements	The investment must further [illegible]	The host country must recog[illegible] satisfactory [illegible] conditions	The new investment must com[illegible]

	United Kingdom	EEC (proposed)
Agency	Export Credits Guarantee Department (ECGD)	Office of Private Investment Guarantees
Risk covered—(A) Political (B) Commercial	(A) Expropriation, war and insurrection and currency inconvertibility (B) Not covered	(A) War and revolution nationalization, expropriation [illegible] transfer of profits and capital inconvertibility and foreign exchange losses (B) None
Eligible countries	All countries	Any country that has concluded a bilateral investment protection agreement with the EEC or a trade or [illegible] agreement or provides sufficient legal [illegible] guarantees to foreign capital
Eligible investments	Equity capital which may include plant or know-how and loans of 3 yrs or more. A [illegible] of existing enterprises provided new capital is [illegible] where participation is greater than £50,000 and 10 percent of the venture	Equity investments intended to create or increase a [illegible] in manufacturing [illegible] long term loans [illegible] to such establishments
Eligible investors	All UK based companies (including foreign owned subsidiaries)	EEC companies, EEC subs of non-EEC companies, or joint ventures with EEC companies
Indemnification—(A) Amount (percent of loss) (B) Term	(A) 90 percent of the claim (B) 15 years (minimum 3 yrs)	(A) 100 percent during 1st 10 yrs tapering off by [illegible] in next 5 yrs. (B) 15 to 20
Rates, fees	1 percent p.a. on the current amount (less 20 percent of premium if 1 type of risk is excluded from the policy) plus 0.5 percent on the difference between the current amount and the maximum	To be worked out
Other stipulated requirements.	The investor is responsible for obtaining all necessary approval from the host government. ECGD is granted considerable flexibility in deciding whether or not to accept a policy, to change the terms offered or to remove a country from the eligibility list if necessary	Projects must be approved by host country [illegible] benefit host country [illegible] development [illegible] and trade [illegible] local capital

Table 1. SUMMARY OF GUARANTEE SCHEMES FOR PRIVATE DIRECT INVESTMENT[1]

DAC countries Name of Executive agency or department	Types of risks insured a) Expropriation risks b) War risks c) Transfer risks I	Geographical coverage a) Worldwide b) Developing countries only c) Countries having signed bilateral agreement II	Type of investment covered[2] a) Equity b) Loans and advances c) Licences and royalties d) Other III	Legal eligibility requirements a) Development effect b) Link with national economy c) Global ceiling IV	Coverage of principal and earnings[3] a) Initial investment b) Reinvested earnings c) Remitted earnings (% of original investment) V	Coverage in case of loss: Basis for evaluation VI	Coverage in case of loss: Loss payable VII	Annual premium rates % of current amounts except if otherwise shown VIII	Duration of coverage IX
AUSTRALIA Export Finance and Insurance Corp (EFIC)	a) b) c)	a)	a) b) c)	a) b) c) $245 million	a) 200 % b) 200 % c) 200 %	Financial statements	Up to 90 %	1.0 % on current amount (0.8 % in case of joint venture) (0.3-0.4 % per risks) plus half the above on stand by amount	Normally minimum 5 years maximum 15 years
AUSTRIA Oesterreichische Kontrollbank (OKB)	a) b) c)	a)	a) b) c)	b)	a) 90-100 % b)	Financial statements	90-100 %	0.5 % for the three risks together	Up to 20 years
BELGIUM Office National du Ducroire (OND)	a) b) c) and natural disasters in some cases	a)	a) b)	a) b) c) $23.5 million	a) 90 % b) 90 % c) 90 %	Phasing out on a case to case basis	Up to 90 %	0.75 % for the three risks together 0.05 % for inclusion of profits	Up to 15 years
CANADA Export Development Corp. (EDC)	a) b) c)	b)	a) b) c) d)	a) b) c) $250 million	a) 100 % b) 50 % of initial investment	Phasing out on a case to case basis	Up to 100 %	1.0 %	Up to 15 years
DENMARK Danish International Development Agency (DANIDA)	a) b) c)	b)	a) b) c)	a) b) c) $130 million (covering both export credits and investments)	a) 100 % b) c) 8 % p.a. for up to 3 years	Financial statements	Up to 85 % or 90 %	0.5 % for the three risks together	Up to 15 years
FRANCE BFCE and COFACE	a) b) c) for capital only	a) COFACE only b) Franc area only c)	a) b) Exceptionally long-term loans	a) b)	a) b) Up to 50 % of initial investment (COFACE 100 %) c) Up to 25 % of initial investment (COFACE 50 %)	Generally no phasing out	90 % to 95 %	0.7 % (if investment protection agreement) to 1.0 % per year	Up to 15 years
GERMANY Treuarbeit	a) b) c)	b) c) 48 countries	a) b) c)	a) b)	a) 100 % b) 50 % c) 8 % p.a. for up to 3 years	"Going concern" value not exceeding capital brought in	Up to 95 %	0.5 % of current amount for the three risks together plus inscription fee	Normally up to 15 years; exceptionally up to 20 years
JAPAN Overseas Investment Insurance Scheme (MITI)	a) b) c) and credit risks in some cases	a)	a) b) c)	a) b) c) $1 350 million	a) 100 % b) 100 % c) 10 % p.a. and up to 100 % over the contract life	Financial statements	Up to 90 % Up to 80 % for credit risks	0.55 % for the three risks together and 1.00 % when credit risks are added	Normally up to 15 years
NETHERLANDS Netherlands Credit Insurance Company (NCM)	a) b) c)	b)	a) b) c)	a) b)	a) 100 % b) 50 % c) 8 % p.a.	After 10 years annual reductions of 10 %	Up to 90 %	0.8 % for the three risks together	Up to 15 years following completion of the investment
NORWAY Export Credit Guarantee Agency (GIEK)	a) b) c)	a)	a) or a) and b) together	a) c) $750 million (covering both export credits and investments)	a) 100 % b) For expansion c) 8 % p.a. up to three years	Fixed schedule of amortization - starts normally after three years	Up to 90 %	0.5 % of maximum amount for the three risks together	Up to 20 years
SWEDEN Export Credit Guarantee Board (EKN)	a) b) c)	b) Major recipients of bilateral official development assistance	a) b) c)	a) b) c) $100 million	a) 100 % b) 500 % if transferable c) 8 % p.a. of maximum coverage not exceeding 24 % of initial amount invested	Phasing out on a case by case basis	Up to 80-90 %	0.7 % for the three risks together	Normally up to 15 years; exceptionally up to 20 years
SWITZERLAND Office for Guaranteeing Export Risk (GERG)	a) b) c) In addition insolvability or refusal to pay by local public entities	b) In principle	a) b) In some cases	a) c) $220 million	a) 100 % b) c) Up to 24 % of principal	For equity, in principle regular amortization (around 5 % per year)	Up to 90 %	Normal rates Principal 1.25 %, profits 4 % of expected profits	15 years in principle
UNITED KINGDOM Export Credit Guarantee Department (ECGD)	a) b) c)	a)	a) b) c)	a) c) $650 million	a) 100 % b) 100 % c) 100 % } Total cover limit 200 %	Financial statements	Up to 90 %	1 % for the three risks together plus 0.5 % on stand by amount	Up to 15 years
UNITED STATES[4] Overseas Private Investment Corporation (OPIC)	a) b) c)	b) c) To date some 114 countries	a) b) c) d)	a) c) Authority for $7.5 billion new insurance	a) 90 % b) 90 % c) 90 % } Total cover limit 200 %	Financial statements phasing out for large and sensitive projects	Up to 100 % 50 % for large and sensitive projects	a) 0.30 % (convertibility) b) 0.60 % (expropriation) c) 0.60 % (war) plus 0.25 % on stand by amount	Maximum 20 years, 12 years for large and sensitive projects

1. Provisions of individual schemes may in some cases not correspond exactly to the common classification adopted in the table. Details of the various schemes, however, are provided in individual country chapters below. Financial amounts are expressed in US$ equivalent, at the IMF exchange rates as of the end of 1976.
2. The coverage applies to equity and loan participations, and to fees and royalties. The investment can be made in various forms: cash, machinery, goods, know-how and services, etc. (d) above covers specific situations such as production sharing agreements.
3. This column shows the coverage of principal and earnings for equity investments only. As regards loan investments, schemes usually wholly cover outstanding principal and interest.
4. The table gives a presentation of the United States Political Risk Investment Insurance Programme only. The Loan Guaranty Programme has not been inserted in the table, data on this latter programme are provided in the chapter on the United States.

TOTAL AMOUNT OF INVESTMENT IN DEVELOPING COUNTRIES UNDER COVER AS OF 31.12.1977
($ million)

DAC Member Country	Total amount of investment under cover	Coverage provided			
		Convertibility	Expropriation	War	Combined risks
Australia	47.6	21.1	50.4	44.5	—
Austria	61.7	—	—	—	61.7
Belgium	17.5	—	—	—	17.2
Canada	171.8	170.6	169.5	135.8	—
Denmark[2]	16.5	—	—	—	17.0
France	178.8	—	—	—	104.7
Germany	754.9	—	—	—	989.5
Japan	3 376.5	—	—	—	3 039.1
Netherlands	25.4	—	—	—	36.6
New Zealand	0.6	0.6	0.6	0.6	—
Norway[1]	20.3	—	—	—	13.9
Switzerland[1]	55.4	—	—	—	38.8
United Kingdom	100.0	—	—	—	126.4
United States	4 173.0	2 870.0	3 341.0	2 810.0	—

1. Data as of 31.12.1976.
2. Data as of mid-1977.

Source: Berne Union.

EXAMPLE OF COST OF PRIVATE POLITICAL RISK INSURANCE

An unidentified US company, whose worldwide overseas assets have a book value of $245 million, obtained a premium quote from AIGC of $260,000 p a , based on a $53 million indemnity. In this case the indemnity is 90% book value in each country except for those where the insurance company's capacity would have been exceeded if this rate were applied, e g Belgium and Italy. In the latter event, the insurance company proposed the specific, lower indemnity amounts The average premium rate for the total $53 million insurance works out to 0 49%, which, interestingly, is lower than OPIC's fixed standard rate of 0.6%

Country	Basis of Value Book ($)	Indemnity ($)	Country	Basis of Value Book ($)	Indemnity ($)
Argentina	2,752,000	2,476,800	Italy	38,225,000	2,500,000
Chile	885,000	796,000	Liechtenstein	2,853,000	2,567,700
Brazil	3,850,000	3,465,000	Netherlands	10,784,000	2,500,000
Venezuela	480,000	432,000	Spain	6,0[illegible],000	2,500,000
Mexico	2,285,000	2,056,500	Sweden	3,[illegible]15,000	2,500,000
Jamaica	3,580,000	3,222,000	Switzerland	913,000	821,700
Aruba	12,000,000	3,500,000	South Africa	3,385,000	2,500,000
Dominican Rep.	700,000	630,000	Gabon	846,000	762,120
Austria	614,000	552,600	Australia	25,338,000	2,500,000
Belgium	26,473,000	2,500,000	Hong Kong	555,000	499,500
Denmark	1,012,000	910,800	Japan	3,890,000	2,500,000
Finland	291,000	261,900	Philippines	569,000	512,100
France	30,696,000	2,500,000	New Zealand	1,942,000	1,747,800
Germany	22,205,000	2,500,000	Canada	38,976,000	2,500,000
Greece	323,000	290,700	Total all countries	$245,467,800	$53,005,720

APPENDIX # 5

A COMPARISON OF LLOYD'S AND OPIC'S INVESTMENT GUARANTEE PROGRAMS

FACTORS	LLOYD'S	OPIC
Eligibility	New or existing investment	Only new investment or substantial expansion, modernization or development of existing enterprise
	Any country of ownership including multinationals	Only U.S owned companies
COVERAGE		
Expropriation	Full coverage including confiscation, seizure, etc	Full coverage including expropriation, seizure, etc
Non Convertibility of Dividends, Return Capital, etc.	Non convertibility of compensation after expropriation only	Full cover for non convertibility of return capital, profits, earnings, loans and interest on loans, etc.
War	No war coverage but malicious damage, riots, strikes can be covered By separate policy	Full war, civil war, revolution and insurrection but excluding malicious damage, riots strikes, etc
	No coverage for commercial risks	No coverage for commercial risks
Flexibility	Any combination of risks above including some embargo contingencies, business interruption, strikes, cut off of raw materials, etc can be negotiated	Coverage can be given for individual categories of risk or a combination of risks as above
	Specific inclusions or exclusions attached to policy	Standard policy only
Rates	Vary according to spread of risks offered for insurance but can average between 0.2% and 10% on total capacity offered	Expropriation rate fixed at 0 6% for any eligible risk War, inconvertibility and stand by options cost extra. Aggregate in excess of 1% P A (Subject to review)
Period	Normal period – twelve month spread	Equity – maximum twenty years at fixed rate but insured has option to cancel after three years
	All spread policies normally renewable but terms subject to renegotiation. No minimum period. Many short periods for contractors' plants, stocks, etc	Loans – duration of loan
Increase in Coverage	Negotiable upon client request.	Not offered except as provided by standby option
Profits	Loss of anticipated net profits, i.e. net profit after tax but before appropriations following confiscation – covered up to 25% of asset value. In event inability to transfer profits value of assets can be increased to extent that profits plowed back	Full convertibility covered for profits, earnings, etc. Retained earnings up to 100% of initial value covered (standby amount or automatic uplift).
Interest	Any direct investment providing title to physical assets, land, buildings, fixed and movable plant, equipment, oil pipelines, ships, aircraft, livestock, stock in trade. Contractors plant used in construction contracts and remaining property of contractor.	Primarily direct investment by equity participation in cash or kind, medium term loans in plant and equipment, buildings, etc. Construction contracts with government agencies can also be insured in certain countries.
Major Exceptions	Countries where capacity is over-subscribed. Investors who have exceeded their available capacity in a given country.	Proposed investments in host countries which have not concluded an investment guarantee agreement with the U.S.A Proposed investments in Canada, Mexico, Japan, Western Europe, Australia, New Zealand, etc are ineligible. Proposed investments judged to be inappropriate by OPIC, i.e real estate, distilling, runaway industry and other factors
Capacity	Limited for individual risks and areas of accumulation	Normally unlimited
Self-Insurance	Usually 10% but negotiable – insureds participation can be increased if required, i.e 50/50 basis.	OPIC generally covers 100% of original equity, participation or 100% of principal in loan
Registration	No fee.	No fee
	No time bar.	Case must be registered before investor committed to project.
Loss-Payment	No minimum time–subject to agreement with client–may be immediate with provision to adjust.	Minimum of twelve months before payment with respect expropriation risks, six months for non-convertibility risks

CHAPTER VI

OPIC: ITS RELATIONSHIP TO ANTI-BRIBERY LEGISLATION; THE FOREIGN CORRUPT PRACTICES ACT OF 1977; AND THE PROBLEM OF QUESTIONABLE PAYMENTS

One of the most delicate, complex, and controversial problems of the 1970's, with serious legal and moral as well as international economic implications, has been that of the questionable or illegal corporate overseas payments.[1] Foreign bribes, political payoffs, and other questionable payments have probably been intertwined with foreign commerce and investment for millenia. How this problem since 1975 has related to the activities and functioning of OPIC vis-a-vis its insured clients is the interesting and ever debatable subject of this chapter.

The United Brands Company's bribes

In September 1974, the United Brands Company paid

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1. See generally Edward D. Herlihy and Theodore A. Levine, "Corporate Crisis: The Overseas Payment Problem," Law and Policy in International Business, 8 (1976), pp. 547 et seq.; Association of the Bar of the City of New York, Ad Hoc Committee on Foreign Payments, Report on Questionable Foreign Payments by Corporations: The Problem and Approaches to a Solution (1977), p. 1 et seq.; Gerald T. McLaughlin, "The Criminalization of Questionable Foreign Payments by Corporations: A Comparative Legal Systems Analysis," Fordham Law Review, 46 (1978), pp. 1071 et seq.

a $1.25 million bribe to the Economic Minister of Honduras to obtain a reduction in the Honduran export tax on bananas.[2] The suicide of United Brands's chairman, Eli M. Black, on February 3, 1975, caused the Securities and Exchange Commission (SEC) to conduct an investigation into the affairs of the company and also resulted in the overthrow of the Honduran president in April 1975. In the course of its investigation the SEC uncovered the Honduran bribe and also discovered other illicit payments made elsewhere by the company. The SEC, as well as the media, began investigation of illicit payments abroad by other multinational corporations

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2. Thomas P. McCann, An American Company: The Tragedy of United Brands (New York: Crown Publishers, 1976), pp. 214-234. See also "United Brands Paid Bribe of $1.25 Million to Honduran Official," Wall Street Journal, April 9, 1975, p. 1; "SEC Charges United Brands Company Paid $1.25 Million Bribe to Honduras Government Officials to Obtain Favorable Tax Treatments on Banana Shipment," The New York Times, April 10, 1975, p. 1; other New York Times articles on United Brands and related matters appeared on April 11, 1975, p. 45; April 12, 1975, p. 33; April 13, 1975, sec. 3, p. 18; April 14, 1975, p. 49; April 15, 1975, p. 49; April 16, 1975, p. 67; April 18, 1975, p. 36; April 22, 1975, p. 45; April 23, 1975, p. 1; April 24, 1975, p. 3; April 25, 1975, p. 2; April 28, 1975, p. 32; May 5, 1975, p. 1; May 11, 1975, sec. 3, p. 7; May 13, 1975, p. 47; May 14, 1975, p. 71; May 16, 1975, p. 1; May 18, 1975, p. 54; May 19, 1975, p. 33; May 20, 1975, p. 56; May 21, 1975, p. 61; May 22, 1975, p. 65; May 23, 1975, p. 41; July 25, 1975, p. 47; July 29, 1975, p. 31; October 23, 1975, p. 41; December 11, 1976, p. 11.

(MNC's). As of September 1976, the SEC had been generally successful in bringing enforcement actions against a score of corporations, including United Brands, alleging violations of the proxy provisions of the Securities Exchange Act of 1974, on the basis of reports misstating or omitting material information.[3]

CONGRESSIONAL INVESTIGATIONS INTO QUESTIONABLE PAYMENTS ABROAD

These investigations and disclosures prompted a series of Congressional investigations into questionable U.S. corporate activities and payments abroad. It was established therefrom that more than 350 U.S. companies had been involved in various forms of improper payments, including so-called facilitating payments, suspicious commissions, and outright bribes.[4]

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3. Herlihy and Levine, supra note 1, pp. 578-581.

4. William Proxmire, "The Foreign Payoff Law Is a Necessity," The New York Times, February 3, 1978, sec. 3, p. 4; Neil H. Jacoby, Peter Nehemkis, and Richard Eells, "Foreign Payoff Law: A Costly Error," The New York Times, February 22, 1978, sec. 3, p. 14; McLaughlin, supra note 1, p. 1072.

Significantly, it was the Senate Subcommittee on Multinational Corporations, chaired by Senator Frank Church of Idaho -- which had conducted the OPIC hearings in the summer of 1973 and issued a highly critical majority report in February 1974 [5] -- which commenced hearings on May 16, 1975, on the practice of promoting sales abroad by channeling money to foreign government officials through commission agents' fees and direct political contributions. In his opening statement, Senator Church listed among the questions to be answered by witnesses the following: "Does the United States have a foreign assistance program in the country in which the payment was made? Was the company's investment in the country guaranteed, in whole or in part, by our Government's Overseas Private Investment Corporation?"[6]

A few weeks later, on June 5, 1975, the Subcommittee on International Economic Policy of the House Committee on International Affairs began hearings to in-

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5. See Chapter III, pp. 139, 150, notes 39, 40, 63 and accompanying text.

6. U.S. Congress, Senate, Committee on Foreign Relations, Multinational Corporations and United States Foreign Policy: Political Contributions to Foreign Governments, Hearings before the Subcommittee on Multinational Corporations, 94th Cong., 1st Sess., 1975, Pt. 12, pp. 1-2.

vestigate charges that U.S. corporations had maintained secret funds for the payment of gratuities to foreign governments and political officials.[7] Among the five-man subcommittee and its most active member was Stephen J. Solarz, a freshman Congressman from New York, who introduced general legislation to monitor overseas business activities of MNC's[8] and in September 1975 proposed legislation requiring OPIC to issue regulations to provide for automatic termination of its insurance where bribery of foreign officials was found.[9]

In opening the House Subcommittee's hearings, its chairman, Representative Robert N.C. Nix of Pennsylvania, stated that while payments to foreign officials were not presently a violation of U.S. law, they were

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7. U.S. Congress, House, Committee on International Relations, The Activities of American Multinational Corporation Abroad, Hearings before the Subcommittee on International Economic Policy, 94th Cong., 1st Sess., 1975 [hereinafter cited as 1975 HMNC].

8. Ibid., pp. ii, 4.

9. U.S. Congress, House, Committee on International Relations, To Require Certain Actions by the Overseas Private Investment Corporation, Hearings before the Subcommittee on International Economic Policy, 94th Cong., 2d Sess., 1976, p. 2.

very often a violation of the foreign law and had an immediate impact on U.S. foreign policy.[10] Representative Solarz, in his multiple role of sponsor of the legislation, witness, and cross-examiner, presented a statement setting forth the philosophy and rationale underlying his legislation: questionable and illicit corporate payments abroad "have no more of a place in commercial transactions in foreign lands than they do in our own country." They seriously disrupt the conduct of international relations and needlessly exacerbate world tensions. It is a sad commentary that U.S. MNC's seek to excuse their "scandalous" activities by pointing to similar conduct by foreign competitors. The reputation of the Government is at stake to establish standards of honesty and integrity universally applicable.[11]

<u>OPIC's attitude toward and approach to questionable payments</u>

Reflecting OPIC's importance in the overseas payments problem, the subcommittee called as its first

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10. 1975 HMNC, pp. 1-2.

11. <u>Ibid.</u>, pp. 3-5.

witness Michael F. Butler, vice president and general counsel of OPIC.[12] In his prepared statement Butler noted that on the broad issue OPIC condemned all forms of illicit payments abroad, whether voluntary or coerced. While bribes were illegal everywhere, tips, commissions, consulting fees, and contributions for political campaigns or charitable endeavors may be normal and accepted practice in one situation and unlawful in another. Inasmuch as OPIC had no general powers to regulate investment abroad, OPIC concurred with the view that the best way to handle the problem was under the provisions of the laws of the host country.[13]

Butler observed that OPIC's operating procedures and provisions of its standard insurance contract related to illegal payments. Applicants for its insurance were required to disclose agreements with the host government concerning the investment and operation of the project. In scrutinizing the various facets of the proposed project, OPIC particularly reviewed the terms of any concession agreements, holidays, or other special

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12. <u>Ibid.</u>, pp. 5-22.

13. <u>Ibid.</u>, pp. 5-7.

terms, and sought the advice of the U.S. Embassy in the host country. It engaged special consultants to evaluate the project to determine the eligibility of the client and likewise urged the host country to utilize similar outside consultants to protect its interests. Terms deemed unfair to the host country were eliminated from insurance coverage or caused a failure to insure. Breach of the insured client's warranty that the project was in conformity with local law could result in termination of the contract. As regards expropriation claims, OPIC was not liable for Government action provoked by the investor. However, the latter was protected where bribery allegations were a mere pretext for expropriatory actions or other illegitimate actions. Periodic monitoring of projects until completion was maintained. In sum, the existing contractual provisions and procedures were deemed adequate to deter significant illegal payments, to safeguard OPIC's interests as insurer, and to establish Government opposition to illegal payments.[14]

In response to questions from the subcommittee,

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14. Ibid., pp. 7-8, 12.

Butler stated that no definitive assessment could be made of the impact of illicit payment disclosures on U.S. interests. Some MNC's named as having engaged in illegal activities overseas were OPIC clients for projects unrelated to such activities. While OPIC's current portfolio covered 700-800 investors, he had no knowledge of any large illegal payments; minor payments of the peccadillo variety were probably commonplace. Drawing the line between bribery and extortion was frequently difficult. It was his feeling that the improper payment resulted from a direct threat to the investor or an apprehension that absent payment, the consequences would be detrimental. There were no consultations with other Federal agencies, such as the SEC or the Internal Revenue Service (IRS), concerning ongoing contracts. Nor was investigation made of the general level of morality in a particular country.[15]

While material misrepresentations by the investor at the execution of the contract could vitiate the contract, Butler stated that the consequence of a subsequent illicit payment depended on its effect upon the

15. <u>Ibid.</u>, pp. 10-14.

investment: if there were no expropriatory or similar action by the host country, the insurance coverage would continue. However, a post-execution payment might, nevertheless, invalidate a later claim for compensation. Drafting appropriate provisions to cover misconduct subsequent to the contract signing meant encountering difficulties. Would it embrace a $10 payment to a petty bureaucrat to expedite decision? How would one differentiate a voluntary bribe from an extortionate demand? How could one resolve the issue without speaking to the foreign government official involved?[16]

Butler's personal view that demands for illegal payments should be refused irrespective of the cost of such refusal to the investor, met with Representative Solarz's comment: "It is nice to hear some responsible official of the U.S. Government standing up for some old-fashioned principles of morality even if the price of morality may be the loss of one's company."[17] However, Butler expressed doubts concerning the ability

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16. Ibid., pp. 14-15, 21.

17. Ibid., p. 16.

of the U.S. Government to police the morality of the world; serious international complications could arise from such activities.[18] Butler did not think that the threat of expropriation if an illegal demand were rejected was a significant factor in the investor's decision making. If the OPIC standard contract were expressly to provide that illegal payments constituted a basis for its termination, the host country following such payments might utilize them as ground for expropriatory actions as "a justifiable penalty in bribe situations."[19]

In Butler's view, if an OPIC-insured client were guilty of bribery by admission or conviction vis-a-vis a non-insured project in a particular country, OPIC would not terminate its insurance contracts covering other projects there or elsewhere. However, if corruption were the general method of doing business as laid down by top management decision in the United States, the result might be different. In such case OPIC would hesitate to insure that kind of investor.[20]

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18. Ibid., pp. 17-18. Representative Jonathan B. Bingham of New York observed that "we should perhaps not be too self-righteous about it." Ibid., p. 21.

19. Ibid., pp. 17-18.

20. Ibid., pp. 20-21.

Representative Edward G. Biester, Jr. of Pennsylvania raised the ever important question of what means could be used to combat the extortionate demands of many countries supplying the rest of the world with a commodity such as oil vital to national economies. Since OPIC does not insure oil investments, Butler replied that his agency did not have to face up to the Organization of Petroleum Exporting Countries's (OPEC) international cartel problem. As to other situations reflecting the general problem of illicit payments, what was needed "is self-policing by the corporation ... the problem is really a problem of the local country."[21]

Representative Solarz's initial proposed legislation

Representative Solarz found the OPIC standard contract inadequate in relation to post-execution illegal payments.[22] Accordingly, towards the conclusion of the subcommittee's hearings, on September 25, 1975, he introduced legislation that would require OPIC to issue regulations providing for automatic termination of in-

21. Ibid., pp. 19-21.

22. Ibid., pp. 14-15.

surance where bribery of foreign officials was found.[23] Several revisions of the basic proposal, influenced in part by hearings on the general problem of bribery, were subsequently submitted by him.[24]

Commencing January 14, 1976, a Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, chaired by Senator William Proxmire of Wisconsin, who was also the chairman of the Senate Committee on Banking, Housing, and Urban Affairs, held hearings through March 5, 1976, on abuses of corporate power. Its focus was the involvement of U.S. corporations in questionable payments here and abroad, including bribes, kickbacks, and illegal campaign contributions. Concentration was effected on cases where illegal payments were made as matter of corporate policy approved by and participated in by top management.[25]

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23. H.R. 9860, 94th Cong., 1st Sess., 1975.

24. H.R. 11532, 94th Cong., 2d Sess., 1976.

25. U.S. Congress, House-Senate, Joint Economic Committee, Abuses of Corporate Power, Hearings before the Subcommittee on Priorities and Economy in Government, 94th Cong., 2d Sess., 1976, p. 11. Representative Solarz was not a member of the joint committee or joint subcommittee.

On April 5, 7, and 8, 1976, the Senate Banking, Housing, and Urban Affairs Committee held hearings on a bill submitted by Senator Proxmire to remedy overseas bribery by U.S. corporations. The bill would amend the Securities and Exchange Act of 1934 (SEA of 1934)[26] to require issuers of securities covered by the statute to maintain accurate records and to furnish reports relating to certain foreign payments. The reports were to cover payments to any person or entity employed by, affiliated with, or representing directly or indirectly a foreign government or its instrumentality; to any foreign political party or candidate; to any consultant for obtaining or maintaining business with a foreign government or its instrumentality; or for influencing the legislation or regulations of a foreign government. Moreover, it was made unlawful in general to use the mails or other instrumentalities of interstate commerce to offer, pay, or agree to pay to the persons mentioned in the preceding sentence, or to pay or agree to pay "in a manner or for a purpose which is illegal under the laws of a foreign government having jurisdiction

26. 48 Stat. 881 (1934), 15 U.S.C., § 78 a-m (1970).

over the transactions." Chairman Proxmire stated that the SEC was doing an excellent job with a small staff but its enforcement program would be more effective if bribes were directly prohibited and there were systematic disclosure of all foreign consultants' fees.[27]

Other initial legislative proposals

At a hearing of the same Banking Committee on May 18, 1976, two other bills were considered. One bill sponsored by the SEC would have codified the requirement of mandatory disclosure by the maintenance of complete records.[28] The second, sponsored by some members of the Subcommittee on Multinational Corporations of the Senate Committee on Foreign Relations, would have required disclosure of both foreign government and commercial bribes; permitted private law suits; mandated establishment of independent audit committees of the

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27. U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, Foreign and Corporate Bribes, Hearings on S. 3133, 94th Cong., 2d Sess., 1976, pp. 1-3. See Note, "Foreign Corrupt Practices Act of 1977," Law and Policy in International Business, 10 (1978), pp. 1253, 1256-1257 [hereinafter cited as 1978 Note].

28. S. 3418, 94th Cong., 2d Sess., 1976. See U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, Prohibiting Bribes to Foreign Officials, Hearings on S. 3133, S. 3379, and S. 3418, 94th Cong., 2d Sess., 1976, pp. 1-2; 1978 Note, pp. 1255-1256.

corporate boards of directors and regular reports to Congress by the Secretary of State; and barred tax deductibility for bribes.[29] A recently released SEC report on questionable and illegal payments and practices revealed that nearly 100 corporations had come forward under the Commission's voluntary disclosure program to admit improper foreign and domestic payments.[30]

On May 25 and 27 and June 8, 1976, the House Subcommittee on International Economic Policy renewed hearings on Representative Solarz's revised legislation[31] requiring OPIC to issue regulations to terminate insurance

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29. S. 3379, 94th Cong., 2d Sess., 1976. See Hearings, supra note 28, p. 2; 1978 Note, p. 1254.

30. U.S. Securities and Exchange Commission, Report to the Senate Committee on Banking, Housing, and Urban Affairs, Questionable and Illegal Corporate Payments and Practices, 94th Cong., 2d Sess., passim (May 1976).

31. H.R. 11532, 94th Cong., 2d Sess., 1976. See U.S. Congress, House, Committee on International Relations, To Require Certain Actions by the Overseas Private Investment Corporation, Hearings before the Subcommittee on International Economic Policy, 94th Cong., 2d Sess., 1976 [hereinafter cited as 1976 HOH].

coverage where OPIC found its insured client to have substantially bribed foreign public officials. The bill contained a policy statement, engendered by charges that OPIC and a consortium of credit institutions had forced a client to make illegal currency transfers, that OPIC should not encourage the violation of the law of host countries by its clients.[32]

Representative Solarz's views

The hearings on the first two days were chaired by Representative Solarz who reiterated his views in opening remarks that the MNC's engaged in bribery overseas were damaging the conduct of American foreign relations. Such conduct was morally wrong and damaging to the free enterprise system. Whether bribery was necessary to win contracts -- a debatable issue with much negative evidence -- was subordinate to the damage done to U.S. foreign policy. OPIC was created as an instrument of this foreign policy -- an agency "under the policy guidance of the Secretary of State." Almost all the countries in which OPIC insured investments made

32. 1976 HOH, pp. 2-4.

bribery a substantial crime. Accordingly, his proposals merely provided additional incentives to obey such foreign laws.[33]

In Solarz's opinion, OPIC would continue to provide insurance coverage for post-execution illegal payments by the insured unless mandated by legislation to terminate such coverage automatically. OPIC should be able to act in cases investigated by such agencies as the SEC and the IRS and already had the authority under its standard contract to examine the books of its clients. While the problem of corruption in foreign countries was a multilateral one, not solvable by the United States alone, it was unlikely that an international pact combatting corporate bribery could be obtained in the foreseeable future, if ever. "At a very minimum, the U.S. Government should not be in the position of protecting a system of illicit payments by insuring tainted contracts."[34]

When asked by a colleague whether his legislation required conviction of OPIC's insured in the host country before the penalty of insurance termination became

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33. <u>Ibid.</u>, pp. 3-5.

34. <u>Ibid.</u>, pp. 7-8.

effective, Solarz replied in the negative. Other means were available to satisfy the requirement that the laws of the host country had been violated. The SEC had established the existence of illegal payments under foreign laws without a formal record of conviction.[35]

Additional views of OPIC

The first witness at the House Subcommittee's May-June 1976 hearings was Gerald D. Morgan, Jr., who had succeeded Michael F. Butler as OPIC's vice president and general counsel. Morgan reiterated much of what Butler had expressed at the 1975 hearings[36] and opposed many of Solarz's views and interpretations on the ground the legislation was both unnecessary and undesirable.[37]

According to Morgan, while OPIC had broad discretionary powers under its enabling legislation whether to insure a particular project, once insurance had been issued, numerous legal principles, including due process of law, would preclude automatic termination of substantial, vested contractual rights for which substantial

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35. Ibid., pp. 9-10.

36. See supra notes 12-21 and accompanying text.

37. 1976 HOH, pp. 15-16.

premiums had been paid, on the basis of mere allegations of illegal payments abroad. Competent evidence was essential to establish the violation of the laws of the host country; statements of such violation by the SEC or the IRS were insufficient. The best proof of illegality would be a conviction obtained in the courts of the host country. Absent a conviction, even the opinions of experts as to what the foreign courts might have determined should be inadequate to declare a penal forfeiture of rights.[38]

OPIC insurance discouraged investor bribery in two ways: (1) its contract held the investor liable for investment losses due to illegal activity; (2) the investor was protected against threats of economic retaliation if illegal payments were not made. The contract was being revised to provide expressly that in the event of a loss resulting from illegal acts by the investor, OPIC would not be liable.[39]

None of OPIC's insured projects had been involved in bribery controversies. The revelations concerning questionable and illicit payments abroad involved trans-

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38. Ibid., p. 11.

39. Ibid., pp. 14-15, 21.

actions in developed countries affecting military equipment and the petroleum sector -- areas beyond OPIC's statutory jurisdiction. Were the Solarz proposals to become law, it would convert OPIC into a regulatory agency required to examine foreign government officials with respect to their own official acts -- a highly undesirable function which would create grave diplomatic problems for the U.S. Government. Moreover, the bills were devoid of effective and practicable guidelines. What constituted significant illegal payments? Significant to whom, the briber or the recipient? A payment of $100 to expedite entry of imported equipment might be very significant to a foreign customs inspector whose monthly salary might be less than such amount. Should an admission of guilt by the OPIC-insured investor be tantamount to a conviction by a court of the host country? Assume a covert, substantial illegal payment by the vice president of a corporation's international division made against company policy. The official and all those involved in the payment were fired immediately and were punished by the courts of the host country. Should automatic termination of its OPIC insurance be the lot of the insured which acted in exemplary fashion? Assume a corporation is guilty of bribery in one country and has an unrelated OPIC-insured project in another, should OPIC cancel the latter coverage? The legislators themselves answered this question in the negative.[40]

Morgan noted that while OPIC had numerous contracts, the number of claims was small. Assuming an expropriation related to a publicized bribe of a government official, one would expect a judicial finding of illegal payments in the host country. In these circumstances OPIC's functions would be the establishment of the causal relation between the illegal payment and the expropriation -- a task consonant with the practice of the insurance industry in analogous situations. In the score of claims for expropriation settled by OPIC, none had involved any allegations of bribery. There was a marked difference between the case of a claim for expropriation with a defense of illegal behavior and a termination by OPIC because of illegal payment: in the former, there would typically be an investigation and finding by the host country; in the latter, no investigation, hearing, or finding of guilt could be expected.[41]

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40. Ibid., pp. 15-25.

41. Ibid., pp. 21-22, 26-27.

Concerning an inquiry as to OPIC's background investigation of an applicant for insurance, Morgan stated that the credit worthiness of the applicant was not investigated since OPIC did not bear the credit risk. The proposed project was carefully reviewed; the detailed application form required, inter alia, disclosure of all agreements with the host government; and a request was made to the U.S. Embassy in the host country to verify the answers in the application. In large measure the answers were treated as material representation, the falsity of which afforded basis for termination. While OPIC had broad discretion as to issuance of an insurance contract, such discretion was undoubtedly limited by constitutional and perhaps other guarantees. In the event of an illegal payment abroad by an OPIC-insured client, the procedure should initially involve prosecution of the guilty in the host country; extreme disciplinary action against the malefactors by the corporation as soon as it became aware of the wrongdoing; and the institution of internal controls to prevent recurrences. Beyond these measures, it would be inappropriate for OPIC to terminate the insurance coverage. Termination solely because of a report by an agency such as the SEC should be deemed arbitrary even if the insured investor could challenge such determination in a court of law.[42]

Morgan stated further that intertwined with a charge of bribery was the defense of extortion, recognized as valid in many jurisdictions. One of the main problems inherent in the proposed legislation was the difficulty of determining whether the challenged payment was a voluntary bribe or an extortionate demand. Not only would it be unfair to punish an OPIC client from whom payments had been extorted by termination of its insurance but it would be dangerous to attempt to establish questions of fact related to extortions. U.S. MNC's should strongly resist extortionate demands and seek assistance under the laws of the host country when threats were directed at them. Contrary to Solarz's approach, the current OPIC insurance provided the investor having a political risk insurance policy covering expropriation with a strong incentive not to yield to extortionate demands. If the investor voluntarily offered a bribe, it ran the risk of not collecting insurance if a loss ensued; per contra, if it resisted an extortion demand and expropriation resulted, its insurance would remain effective. In fine, the effective

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42. Ibid., pp. 32-35.

manner of solving the problem of questionable and illegal payments was to encourage foreign governments to prosecute their erring officials.[43]

Views of Joseph P. Griffin

Morgan's views were in large measure supported by Joseph P. Griffin, chairman of the Committee on Insuring Overseas Investments of the International Law Section of the American Bar Association, who testified in his personal capacity. He had serious doubts concerning either the necessity or the fairness of the proposed legislation. Recent Congressional hearings, SEC investigations, and public statements by companies revealed four often overlapping reasons for illegal corporate payments abroad: (1) expediting or otherwise influencing minor foreign officials to perform their routine duties in connection with carrying on daily business in a foreign country; (2) procurement or increase of business in the foreign country; (3) influencing foreign administrative or legislative actions or trends to procure, maintain, or increase business; (4) "preventive maintenance" -- *i.e.*, preventing governmental actions such

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43. *Ibid.*, pp. 36-37.

as expropriation, nationalization, expulsion, or cancellation of existing rights. The third reason is a generalized version of the second, aimed at establishing or preserving the proper climate or attitude towards the MNC doing business in the foreign country.[44]

According to Griffin, the Solarz proposals would not deter illegal payments abroad. The vast majority of companies linked to questionable payments had no OPIC insurance in the countries where payments were made. Most of the revelations involved sales of hardware or other goods rather than foreign direct investments in the developing or less developed countries (LDC's). It was doubtful whether companies with no OPIC investment insurance would be deterred by the pending legislation. Even those carrying such insurance would probably opt for paying bribes for two reasons: (1) it was more financially important to expand or protect their investment than to preserve their OPIC insurance; (2) the presence of current and proposed additional exculpatory provisions would mitigate any deterrent effect.[45]

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44. Ibid., pp. 39-40, 43.

45. Ibid., pp. 40-41.

Even assuming a deterrent effect of the Solarz proposals, Griffin found they presented several legal problems raising serious questions of fundamental fairness. Under the legislation, what would trigger an OPIC termination of investment insurance? Would it be (1) a finding of illegality by a foreign court or government? (2) a mere allegation of violation of foreign law? (3) an investigation or report by a U.S. Government agency? or (4) an admission by the company? As to item (1), U.S. courts and agencies have traditionally refused to act as enforcement organs for foreign criminal legislation, although a foreign criminal conviction might in some circumstances entail consequences in the United States. However, it could be anticipated that one whose OPIC insurance had been terminated on the basis of the foreign findings, would demand an independent hearing so as to raise a defense such as extortion and prove the foreign finding erroneous or fraudulent.

Concerning item (2), it would be even more necessary to provide a quasi-judicial administrative proceeding, possibly including expert testimony concerning the relevant foreign law standards. If the third item were deemed applicable, OPIC would still retain the obligation to comply fully with due process requirements.

Similarly, the mere admission by a company would not, absent a waiver of rights, relieve OPIC of adhering to the principles of due process. In short, even if all four factors were present without more, a full adjudicatory administrative hearing, with all the safeguards of due process, would be necessary before terminating OPIC investment insurance.[46]

Griffin observed that the basic tenet that the punishment fit the crime was not met by the proposals. Termination of OPIC insurance should be effected only where there was clear and convincing proof of a cause and effect relationship between the payment and the insurance loss. It was the smaller companies trying to get a foothold abroad who principally need OPIC insurance. Assuming one of them did something illegal abroad unrelated to its OPIC investment, OPIC should judge the particular circumstances and not automatically terminate its insurance.[47]

Representative Biester of Pennsylvania, a member of the subcommittee, while of the opinion that the

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46. Ibid., pp. 41-44.

47. Ibid., pp. 43, 51.

legislation would be a deterrent as to substantial payments, raised the question of its effect upon OPIC operations in competition with those of its foreign counterparts in Europe and elsewhere. Griffin replied that the international aspect could not be ignored while an international solution was being sought. However, when the State Department proposed an international code for bribery, the proposal received a cool reception. U.S. businessmen doing business abroad would be faced with a Hobson's choice vis-a-vis their foreign competitors who would be unfettered by legislation comparable to that under consideration.[48]

As Griffin cursorily noted, the U.S. effort to obtain an international treaty to curb corrupt payments by businessmen in one country to government officials in another received almost universal resistance.[49] The U.S. proposal, first urged late in the administration of Gerald R. Ford and espoused by its successor, would require business enterprises in the signatory countries

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48. Ibid., pp. 52-54.

49. Ibid., p. 54.

to disclose questionable payments, including fees or commissions funneled through middlemen, in reports filed regularly with a Government agency and open to public inspection. Home country officials accepting money to arrange government deals "of direct commercial interest to an enterprise" would also be publicly identified. In addition, the United States was seeking treaty provisions expanding the bribery laws of the signatory countries to cover business dealings by their nationals with other governments.[50]

Mark B. Feldman, deputy legal adviser of the Department of State and chief negotiator in the treaty negotiations held under United Nations (UN) auspices, found strong support for the principles of an anti-bribery treaty, but implementation of the principle by effective agreements was seemingly beyond attainment.[51]

Attitude of European governments

Hesitation among European governments to accept the U.S. proposals probably reflected official involve-

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50. Jerry Landauer, "Proposed Treaty against Business Bribes Gets Poor Reception Overseas, U.S. Finds," Wall Street Journal, March 28, 1977, p.1.

51. Ibid.

ment in making questionable payments. Thus, in West Germany, the taxing authorities permitted resident corporations to deduct foreign bribes, known as "sonderspesen," or special expenses, so long as the recipients were named. Moreover, even domestic bribes were permissible there if both briber and recipient reported the transaction. Similarly, in France payoffs were tax-deductible; its export-conscious defense ministry was nicknamed "Ministry of Bribes." In Great Britain, corrupt payments to its government officials were tax-deductible. Reform was opposed by a 1976 Royal Commission on the ground that the courts could levy extra fines on convicted bribers to recapture any tax benefits. British businessmen dealing with the LDC's functioned on the premise that no substantial deal involving goods with a negotiated price could be consummated without some manner of questionable payments. Both the amount of the payment and the name of the recipient were known. Indeed, the Bank of England had a complete record of virtually every bribe paid abroad. In Japan, almost all export sales of the kind that generated questionable payments were arranged with government export financing or other government support.[52]

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52. <u>Ibid.</u>; Alvin Shuster, "Post-Lockheed Picture

In a subsequent hearing on August 5, 1976, before the full House Committee on International Relations, following a favorable report by the Subcommittee on International Economic Policy, Marshall T. Mays, OPIC's president, noted that while 16 countries had investment guarantee programs similar to OPIC's, a check of the four or five largest ones revealed that none had contractual provisions offering a disincentive to bribery payments or protecting the insured from extortionate demands. Moreover, no changes or reforms in the contracts, legislative or otherwise, were contemplated.[53]

Views of Thomas A. Wood and TAW litigation

A leading proponent of the Solarz proposal who

Not at All Clear," The New York Times, March 20, 1977, sec. 4, p. 2; Herlihy and Levine, supra note 1, pp. 564-566; Thomas N. Gladwin and Ingo Walter, "Thinking about Overseas Corporate Payoffs," working paper (#77-31, May 1977), New York University, Graduate School of Business Administration, p. 22 [hereinafter cited as Gladwin and Walter]; "Canada's Flexible Bribery Standards," Business Week, June 13, 1977, p. 35.

53. U.S. Congress, House, Committee on International Relations, To Require Certain Actions by the Overseas Private Investment Corporation, Hearings and Markup Sessions on H.R. 14681, Pt. II, 94th Cong., 2d Sess., 1976, p. 16 [hereinafter cited as 1976 Markup].

offered supporting testimony at the May-June 1976 hearings of the subcommittee was Thomas A. Wood. Wood was the chief executive of TAW International Leasing, Inc. and its subsidiary, TAW International Leasing Corp. (TAW) engaged in leasing capital equipment and facilities in 10 African countries. He had been a member of OPIC's Advisory Council and of the board of directors of the Chase Manhattan Bank.[54] At the time of the hearings TAW had litigation pending in the New York courts against OPIC, some of its bank creditors, and others.[55]

Wood stated that TAW had commenced operations with financing guaranteed by OPIC's predecessor, the Agency for International Development (AID) and had obtained OPIC political risk insurance. Its creditors included the Chase Manhattan Bank, the First National Bank of Chicago, and the General Motors Corporation. In November 1974, OPIC and the two banks demanded their money

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54. 1976 HOH, pp. 54-55, 65, 94.

55. The history of the litigation is set forth in TAW International Leasing, Inc. et al. v. Overseas Private Investment Corporation et al., 66 A.D. 2d 754, 411 N.Y.S. 2d 607 (1978). See also same case in 53 A.D. 2d 811, 386 N.Y.S. 2d 633 (1976); 57 A.D. 2d 799, 394 N.Y.S. 2d 672 (1977).

back. Following negotiations, the parties entered into a composition agreement pursuant to which TAW was to liquidate its assets and lease receivables in Africa for cash and to pay 60 percent of the local currency proceeds to the creditors through deposits in special bank accounts in each country. TAW agreed to use its best efforts, consonant with local laws, to convert the local currencies into U.S. dollars transferred to this country. However, TAW's creditors' committee, consisting of OPIC and the aforementioned creditors, coercively directed TAW to pay over $440,000 in foreign currencies to U.S. Embassies without obtaining necessary foreign government approval. These transfers were effected despite TAW's warning that they violated local law and a request for documentation of their validity.[56]

Prior to Wood's testimony, Representative Solarz had sought to question Morgan as OPIC's general counsel concerning the TAW litigation. Morgan pointed out that since the matter was sub judice, his comments must of necessity be limited. The defendants-creditors had denied any allegations of wrongdoing and had counterclaimed against TAW and Wood for fraud and conversion.

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56. 1976 HOH, pp. 28, 55-56, 95-97, 133-135.

OPIC had secured in advance of the transfers to the U.S. Embassies administrative approvals of the State and Treasury Departments and a legal opinion from the former concerning the propriety of the transfers. The New York court had ordered a plenary trial.[57] Immediately following Wood's testimony, Morgan was recalled and stated that the lower New York court had denied TAW any preliminary relief and prohibited it from making certain transfers from the creditors' restricted bank accounts.[58] In fine, except for TAW, OPIC never had a case in which its client stated that local law prevented it from fulfilling its contractual obligations.[59]

Wood admitted that the challenged transactions involving the defendant creditors had not resulted in any expropriatory actions against TAW, principally because the host governments were unaware of the transactions. However, OPIC's failure to police the payments left TAW's employees, all citizens of the host countries,

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57. Ibid., pp. 28-31.

58. Ibid., pp. 84-85; see supra note 55.

59. Ibid., p. 29.

liable to possible criminal penalties. There was a real need for the adoption of the Solarz proposals which would clarify and strengthen OPIC's statutory purposes and its policy statements.[60] Representative Biester pointedly observed that Wood's own documentation[61] indicated that some of the countries involved in the TAW charges had patently unclear and ambiguous foreign exchange laws and regulations.[62]

In his rebuttal testimony, Morgan reiterated that the proposed legislation was unnecessary since OPIC's policy and practice encouraged respect for foreign law. If anti-bribery legislation were to be enacted, it should be of a general character, applicable to various governmental agencies and not limited to OPIC. Moreover, careful draftsmanship was essential to avoid conflict between foreign law and U.S. law.[63]

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60. Ibid., pp. 65-66.

61. Ibid., pp. 131-180.

62. Ibid., p. 82.

63. Ibid., pp. 85-87, 89. As illustrative of conflict, Morgan pointed to several automobile companies whose local subsidiaries in Argentina were prohibited from selling to Cuba by U.S. legislation, although required to do so under Argentinian law.

OPIC's objection to becoming a policy regulatory agency

As noted, two months after the subcommittee's hearings, the full House Committee on International Relations met in markup sessions[64] to consider Representative Solarz's revised proposals.[65] OPIC's president Mays, while noting that "[t]he reputation of U.S. business in the developing world is critical to the success of OPIC's objective, which is to help these countries to develop by stimulating U.S. private investment in those countries in businesses that conduct themselves in an ethical fashion," reiterated OPIC's position that the existing provisions of its contract functioned very well to minimize the problem of questionable and illegal payments by its clients. While sympathetic with the objectives of the proposed legislation, OPIC objected to its becoming a regulatory agency to police the activities of its clients abroad.[66]

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64. See supra note 53 and accompanying text.

65. H.R. 14681, 94th Cong., 2d Sess., 1976. This specific legislation was co-sponsored by Representative Charles W. Whalen, Jr. of Ohio and Representative Robert N.C. Nix of Pennsylvania.

66. 1976 Markup, pp. 4-7.

Mays noted specific objections to the latest version of the legislation which would still require OPIC to adopt regulations providing for the termination of OPIC insurance and reinsurance where its client made a significant payment to an official of a foreign government to influence governmental action. What constituted a "significant" payment? Significant to whom, the recipient or OPIC's client? Small payments would be very significant depending on purpose and circumstances. The legislative standard was too vague and inadequate.[67]

According to Mays, the cost and mechanics of administering regulations presented numerous problems. Proof of illicit payments would require surveillance and investigation of suspected malefactors, both domestic and foreign. No provision was made for necessary OPIC subpoena power or increased OPIC personnel.[68] Diplomatic contretemps might result from attempted interrogation of foreign officials. Applicability of the

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67. Ibid., pp. 5, 8.

68. Ibid., p. 8. Out of a total staff of 130, about one-half were professional personnel. Ibid., p. 12.

legislation to existing insurance contracts might run afoul of constitutional guarantees since the problem of questionable payments abroad was international in scope. The method and timing of unilateral action in this area by the United States remained a general foreign policy issue upon which a consensus was still lacking. What was clear was that OPIC and its limited operations in the LDC's should not be singled out in a piecemeal fashion.[69]

In response to committee questioning, Mays stated that with the possible exception of Gulf Oil Corporation's activity in Korea, no other client of OPIC had been suspected of making illegal payments. Requests for information from the SEC and IRS had not been fully met, since those agencies deemed some material confidential and available only for their own purposes. Absent any claim, if OPIC had any information concerning an illegal payment by an insured, it would nevertheless investigate the circumstances. If wrongdoing were established, OPIC would recommend disciplinary action against the offending official and advise the client

69. 1976 Markup, pp. 8-9.

to "discuss it with the Government so that it would never happen again." However, it was important to distinguish between the acts of the individual and that of the corporation. In certain circumstances, the client might be ineligible for further OPIC protection. While bribery, nearly universally illegal, which was material to the risk would be a basis for rejecting a claim, other types of payment, such as the use of commission agents and political contributions, might be considered legal in many foreign countries, although questionable in the United States. It was his understanding that the State Department, whose under secretary served on OPIC's board of directors, opposed the legislation.[70]

Following the markup hearings, the full House Committee on International Relations unanimously reported the Solarz legislation which then was adopted by the House of Representatives. However, no action was taken by the Senate during the last few weeks of the 94th Congress.[71]

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70. Ibid., pp. 13-14, 16-18, 23.

71. U.S. Congress, House, Committee on International Relations, Extension and Revision of Overseas Private Investment Corporation Programs, Hearings and Markup before the Subcommittee on International Economic Policy and Trade, 95th Cong., 1st Sess., 1977, pp. 132, 136 [hereinafter cited as 1977 HOH].

Reintroduction of OPIC anti-bribery legislation in 1977

With the advent of both a new Congress and the new Carter administration, Representative Solarz and others on February 16, 1977 reintroduced his OPIC anti-bribery legislation.[72] During June, July, and September 1977, the House Subcommittee on International Economic Policy and Trade [73] held oversight hearings on legislation to extend and revise the authority of OPIC. During these hearings the anti-bribery legislation was also considered.

OPIC's acting president, Rutherford M. Poats, and its acting general counsel, Cecil Hunt, both reiterated that the anti-bribery legislation was unnecessary. Poats listed four main objections to the legislation: [74]

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72. H.R. 3603 and 3604. Both bills were entitled "To provide for termination of investment insurance and guaranties issued by the Overseas Private Investment Corporation in any case in which the investor makes a significant payment to an official of a foreign government for the purpose of influencing the actions of such government."

73. The members of the subcommittee consisted of Jonathan B. Bingham of New York, chairman, and Andy Ireland of Florida, Wyche Fowler, Jr. of Georgia, E(kika) de la Garza of Texas, John J. Cavanaugh of Nebraska, Charles W. Whalen, Jr. of Ohio, and Paul Findley of Illinois.

74. 1977 HOH, p. 90.

(1) it was unfair to impose an additional penalty of insurance termination on an OPIC client while other investors abroad remained unaffected; (2) since the legislation would apply to reinsurance, termination by OPIC would affect the rights of the private reinsurers to their disadvantage. Automatic cancellation would jeopardize OPIC's relation with those members of the private insurance sector who had joined the Overseas Investment Insurance Group (Group)[75] and with OPIC's plan for privatization; (3) it would afford a host country, finding an OPIC insured guilty of bribery, a basis, albeit a rationalization, for expropriatory action; and (4) it would convert OPIC into an investigatory and regulatory agency, necessitating subpoena powers, and hampering OPIC's ability to obtain clients. If legislation be deemed advisable, it should be general legislation imposing a standard penalty for events and actions analyzed by a single administrative agency. Denial of insurance rights to OPIC clients would be an unequal penalty not imposed on other investors abroad.[76]

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75. See Chapter IV, pp. 223-225, notes 36-40 and accompanying text.

76. See Chapter IV, _passim_.

Cecil Hunt observed that the new Carter administration, unlike its predecessor, was supporting legislation to provide general criminal sanctions for improper payments or bribes. OPIC backed this kind of general, non-discriminatory legislation.[77]

Joseph P. Griffin, who had previously testified at a May 1976 hearing,[78] reiterated his personal opposition to the pending anti-bribery legislation. While its goals were desirable, it would neither achieve these goals nor solve the problems of questionable payments abroad. On the contrary, the legislation would seriously jeopardize existing political risk investment insurance programs. Its deterrence value was questionable, its standards vague and ambiguous under due process standards. However, what was clear was that it would undoubtedly have adverse consequences for U.S. foreign policy.[79]

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77. 1977 HOH, p. 91.

78. See <u>supra</u> notes 44-50 and accompanying text.

79. 1977 HOH, pp. 165-166.

While no longer a member of the subcommittee in 1977 as he had been in the previous year, Representative Solarz sought both by testimony and in a prepared statement to rebut the critics of his legislation. He expressed the hope that it would be considered as an amendment to the general legislation authorizing a continuation of OPIC. The U.S. national interest required discouraging the use of illegal payments by MNC's. It was inconsistent for OPIC to refuse insurance for illegal activity before contract closing but to deny cancellation for similar activity post issuance. Even if OPIC were expressly to amend its contract so as to permit termination of insurance where the illegal payments resulted in expropriation, unfortunately the same result would not obtain if no expropriation occurred. Since with minor exception all host countries in which OPIC insured projects already criminalized bribery, the legislation did not impose a unique U.S. morality on those countries. OPIC was already engaged in making a host of quasi-administrative determinations; jurisdiction to make post-contract cancellation determinations would not present insuperable difficulties for OPIC.[80]

80. Ibid., pp. 132-135.

<u>The House International Relations Committee's report</u>

On October 7, 1977, the House Committee on International Relations reported its approval of a modified version of the Solarz OPIC anti-bribery legislation as a provision of the basic OPIC extension legislation. Such provision would prohibit claims from being paid on any OPIC-assisted project with respect to which the insured investor had been found responsible for a significant bribe of a foreign official. Recognizing OPIC's inadequacy to investigate its clients for possible acts of bribery, the proposed legislation would prohibit OPIC from paying any claim of an investor found responsible by another Governmental agency, such as the SEC, for bribing a foreign official with respect to the claim-related project. The provision would apply only to future OPIC contracts and future acts of bribery. OPIC would also have the flexibility to conform the definition of bribery in this statute with definitions and findings under other statutes.[81]

81. U.S. Congress, House, Committee on International Relations, <u>Overseas Private Investment Corporation Amendments Act of 1977</u>, H. Report, 95-670, 95th Cong., 1st Sess., 1977, pp. 20-21 [hereinafter cited as HR 95-670].

The International Relations Committee rejected the arguments of OPIC and the Carter administration (1) that the likelihood of enactment of general anti-bribery legislation obviated the necessity for OPIC sanctions against bribes related to OPIC projects and (2) that special bribery penalties linked to OPIC insurance would make its policies less attractive and unmarketable. Regardless of criminal sanctions, the full faith and credit of the United States, which backed OPIC insurance and guarantees, should not be used to compensate losses by investors found to have engaged in bribery of foreign officials.[82]

The Senate Foreign Relations Committee's report

During the summer of 1977, A Senate Subcommittee on Foreign Assistance held general oversight hearings on OPIC which did not specifically consider anti-bribery legislation vis-a-vis OPIC.[83] On October 19, 1977, the

82. Ibid., p. 21.

83. U.S. Congress, Senate, Committee on Foreign Relations, OPIC Authorization, Hearings before the Subcommittee on Foreign Assistance, 95th Cong., 1st Sess., 1977, pp. 1-2 [hereinafter cited as 1977 SOH].

Senate Foreign Relations Committee issued a report dealing with an extension and revision of OPIC's operating authority.[84] The report recommended the enactment of a provision, effective prospectively only, that OPIC be prohibited from paying a claim of an insured investor found responsible by a Federal agency or court for significant acts of bribery in the host country. While similar to the Solarz-sponsored House version, the Senate provision would be applicable only until such time as pending general legislation, providing for criminal penalties for bribes given by U.S. investors to influence the actions of foreign governments, would be enacted.[85]

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84. U.S. Congress, Senate, Foreign Relations Committee, Overseas Private Investment Corporation Amendments Act of 1977, S. Report 95-505, 95th Cong., 1st Sess., 1977 [hereinafter cited as S95-505]. The bill, S. 1771, was reported out by the committee by a vote of 10 to 4 on October 11. U.S. Congress, Senate, Debate on S. 1771, 95th Cong., 1st Sess., Congressional Record, Vol. 123, October 25, 1977, p. S17688. Senator Frank Church of Idaho and Senator Clifford P. Case of New Jersey expressed a minority view that "the best course is to terminate OPIC altogether when its present authorization expires." S95-505, pp. 43-44.

85. S95-505, p. 27.

Concurring with the views of OPIC and the Carter administration, the Senate Committee opted for general anti-bribery legislation rather than general and specific OPIC legislation. The existence of two statutes, one general and one specific, might expose an OPIC investor to double penalties for the same act. Moreover, in some circumstances, refusal to pay claims because of bribery payments might constitute a penalty disproportionate to the particular delict.[86]

The OPIC Amendments Act of 1978

On October 25, 1977, the Senate passed its Foreign Relations Committee's OPIC amendments bill by a vote of 69 to 12.[87] On November 2 and 3, 1977, the House took up the counterpart proposals reported by its Committee on International Affairs. Numerous amendments were offered, but no decision on a final bill was reached[88] until February 23, 1978, when a much revised

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86. Ibid.

87. Congressional Record, Vol. 123, October 25, 1977, p. S17699.

88. Ibid., November 2, 1977, pp. H12053-12065; November 3, 1977, pp. H12109-12128.

version of a general OPIC extension of authority bill was passed.[89] On March 6, 1978, the Senate substituted its bill after the enacting clause of the House companion bill and called for a joint conference.[90] On April 5, 1978, a joint conference report was issued [91] which was adopted by the Senate the following day.[92] On April 11, 1978, the House approved the report by a vote of 216 to 185 [93] and on April 24, 1978, the Overseas Private Investment Corporation Amendments Act of 1978 became law.[94]

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89. Ibid., Vol. 124, February 23, 1978, pp. H1438-1454. The vote was 191 to 165. Ibid., p. H1454.

90. Ibid., March 6, 1978, p. S3004.

91. U.S. Congress, House, Conference Report to accompany H.R. 9179, Report No. 95-1043, Overseas Private Investment Corporation Amendments Act of 1978, 95th Cong., 2d Sess., April 5, 1978.

92. Congressional Record, Vol. 124, April 6, 1978, p. S4929.

93. Ibid., April 11, 1978, p. H2744.

94. 92 Stat. 213 (1978), amending 22 U.S.C. § 2191 et seq. (1976).

As noted, this 1978 legislation contained, in addition to the anti-bribery provisions, general provisions affecting OPIC which are considered at length in Chapter VII.

The OPIC anti-bribery provisions, set forth in section 6 of the 1978 legislation, added a new subsection (1) to section 237 of the basic Foreign Assistance Act of 1961, and read as follows:

> "(1) No payment may be made under any insurance or reinsurance which is issued under this title on or after the date of enactment of this subsection for any loss occurring with respect to a project, if the preponderant cause of such loss was an act by the investor seeking payment under this title, by a person possessing majority ownership and control of the investor at the time of the act, or by any agent of such investor or controlling person, and a court of the United States has entered a final judgment that such act constituted a violation under the Foreign Corrupt Practices Act of 1977.
>
> "(2) Not later than 120 days after the date of enactment of this subsection, the Corporation shall adopt regulations setting forth appropriate conditions under which any person convicted under the Foreign Corrupt Practices Act of 1977 for an offense related to a project insured or otherwise supported by the Corporation shall be suspended, for a period of not more than five years, from eligibility to receive any insurance, reinsurance, guaranty, loan, or other financial support authorized by this title." 95

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95. 92 Stat. 215.

The legislation does not define "preponderant cause" of the loss.[96] According to the explanatory statement of the Committee on Conference, "the act of bribery must be a very weighty, although not an exclusive part of the determination by the host country to take action which results in a loss to the U.S. investor."[97] Not only must the challenged payment be the preponderant cause of the loss but a court of the United States must have entered a final judgment that the payment was a violation of the Foreign Corrupt Practices Act of 1977 (FCPA)[98] enacted into law on December 19, 1977, the general Federal anti-bribery legislation which is considered _in extenso_ immediately below.[99] No investigatory functions, which OPIC had consistently opposed, were imposed upon it. However, OPIC was directed within four months of enactment to issue regulations under which an investor's eligibility for new OPIC support may be suspended for up to five years after conviction under the FCPA of 1977 with respect to an OPIC-

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96. _Ibid._

97. Hearings, _supra_ note 91, p. 10.

98. 91 Stat. 1494 (1977). See generally 1978 Note, _supra_ note 27.

99. _Supra_ note 95 and accompanying text.

supported project.[100] Such regulations were issued on August 15, 1978, and are summarized in the footnote.[101]

HISTORY AND ANALYSIS OF THE FOREIGN CORRUPT PRACTICES ACT OF 1977

Because of the coupling of the anti-bribery provisions in OPIC's 1978 legislation with the FCPA, it would

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100. Ibid.

101. 43 Fed. Reg. No. 158, August 15, 1978, pp. 36064-36066, 22 C.F.R., Pt. 709 (1979). The purpose of the regulations is to prescribe the procedure and conditions under which individuals and companies may be disqualified from receiving OPIC services because of conviction under the FCPA of an offense related to an OPIC-supported project. § 709.1(b). The issuance of these regulations does not limit or derogate from OPIC's discretion to determine whether to support the investment of a particular entity. § 709.1(d). Any entity convicted of an offense, defined in § 709.3(c), may be suspended from eligibility for additional OPIC services for a period up to five years. § 709.4.

If OPIC's general counsel ascertains that there has been a conviction for a proscribed offense, he reports such finding "and any known circumstances indicating that suspension would not be in the national interest of the United States," to OPIC's president. If the president finds no compelling national interest to forego the suspension, the entity is notified of the offense, that the maximum suspension period is being considered, and to present any evidence in defense. Following his review of such evidence, the general counsel reports his findings and recommendations to the president who shall make the determination with respect to suspension. § 709.5(a). The duration of any suspension may be reduced, § 709.5(b), or even increased, § 709.5 (c), by the president for "good cause." Various nonexclusive factors are set forth for consideration in setting or amending the duration of any suspension. § 709.6. A suspended entity is not eligible to receive any additional insurance or other financial support from OPIC. § 709.7. A reversal of the basic judgment of conviction voids the suspension. § 709.8.

appear informative to examine at length the latter general legislation, its assumptions, and implications.[102]

As noted at the outset of this chapter, the problem of questionable or illegal corporate overseas payments has been one of the most delicate, complex, and controversial problems of the 1970's.[103] As a result of the activities of the office of the Watergate Special Prosecutor, the SEC learned that some large corporations had been making illegal domestic political contributions. Further investigations disclosed that some MNC's had made illicit payments to foreign government officials and had concealed these activities by using secret bank accounts or other means of circumventing the system of internal accounting controls.[104]

The initial legislative hearings

During the 94th Congress (1975-1976), the Senate Committee on Banking, Housing, and Urban Affairs held extensive hearings to consider several bills designed

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102. Supra note 98.

103. Supra p. 344.

104. Arthur Andersen & Co., "An Analysis of the Foreign Corrupt Practices Act of 1977," p. 1 (1978-mimeographed).

to deal with the problem through the approaches of disclosure and criminalization.[105] On May 12, 1976, the committee received from the SEC an extensive "Report on Questionable and Illegal Payments and Practices" which summarized the SEC's enforcement activities and findings.[106] The report declared that such payments were widespread and represented a serious breach in the operation of the SEC's system of corporate disclosure and, correspondingly, in public confidence in the integrity of the system of capital formation. The report recommended, *inter alia*, the enactment of legislation to enhance the accuracy of corporate books and records.[107]

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105. See *supra* notes 26 and 27 and accompanying text. U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, S. Report, No, 95-114, to accompany S. 305, 95th Cong., 1st Sess., 1977, p. 1 [hereinafter cited as S95-114]. Note, "Disclosure of Payments to Foreign Government Officials under the Securities Acts," *Harvard Law Review*, 89 (1976), p. 1848 *et seq.*; Note, "Foreign Bribes and the Securities Acts Disclosure Requirements," *Michigan Law Review*, 74 (1976), p. 1222 *et seq.*

106. U.S. Securities and Exchange Commission, Report to the Senate Committee on Banking, Housing, and Urban Affairs, *Questionable and Illegal Corporate Payments and Practices*, 94th Cong., 2d Sess. (Committee Print, May 1976).

107. *Ibid.*, pp. 3, 13.

On June 22, 1976, the committee reported a bill [108] which incorporated the SEC's recommendations and a direct prohibition against illicit payments abroad by U.S. businesses. This legislation was passed unanimously by the Senate on September 15, 1976.[109] However, because of an early adjournment before the national elections in November 1976, the House did not take any final action that year.[110]

Shortly after the 95th Congress convened, on January 18, 1977 the measure was reintroduced in the Senate. [111] The Banking Committee held hearings in March and heard testimony from the SEC, the Treasury Department, the American Bankers Association, and the Securities Industry Association. On May 5, 1977, the bill passed the Senate[112] and became the subject of consideration by the House Committee on Interstate and Foreign

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108. S. 3664, 94th Cong., 2d Sess., 1976; S95-114, p. 2.

109. Congressional Record, Vol. 122, September 15, 1976, p. S30426.

110. S95-114, p. 2.

111. S. 305, 95th Cong., 1st Sess., 1977.

112. Congressional Record, Vol. 123, May 5, 1977 (daily ed.), pp. S7193-7195; S95-114, p. 2.

Commerce. On November 1, the House passed its version.[113] A Conference Report was filed on December 6,[114] approved by the Senate the same day,[115] by the House the following day,[116] and signed by President Carter on December 19.[117]

The salient provisions of the FCPA

The salient provisions of the legislation may be briefly summarized as follows: It consists of two titles. Title I, the Foreign Corrupt Practices Act of 1977, requires a corporation subject to the SEC's jurisdiction to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions" of its as-

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113. Congressional Record, Vol. 123, November 1, 1977 (daily ed.), pp. H11930-11936.

114. U.S. Congress, House, Conference Report to accompany S. 305, Report No. 95-831, Foreign Corrupt Practices, 95th Cong., 1st Sess., December 6, 1977.

115. Congressional Record, Vol. 123, December 6, 1977 (daily ed.), pp. S19398-19402.

116. Ibid., December 7, 1977 (daily ed.), pp. H12823-12827.

117. 91 Stat. 1494 (1977), supra note 98.

sets.[118] It also makes it unlawful for a reporting corporation[119] and an unregulated domestic concern,[120] or "for any officer, director, employee or agent ... or any stockbroker thereof acting in behalf of such" corporation or concern [121] "to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value" to the following: (1) any foreign government official; (2) any foreign political party, any official thereof, or any candidate for foreign political office; and (3) any person, "knowing or having reason to know that all or a portion of such money or

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118. FCPA, § 102, 91 Stat. 1494, amending SEA of 1934, § 13(b) by adding new subsection (2)(A).

119. FCPA, § 103(a), amending SEA of 1934 by adding new section 30 A, 91 Stat. 1495.

120. Ibid., § 104(a), 91 Stat. 1496.

121. Ibid., § 103(a) and 104(a), 91 Stat. 1495, 1496.

thing of value will be offered, given, or promised, directly or indirectly," to any foreign official, political party, or candidate in order to influence the recipient to misuse his official position so that the bribe giver can obtain, retain, or direct business to any person.[122] A reporting corporation or a domestic concern (other than an individual) guilty of violating the preceding sections is subject to a fine of up to one million dollars, the largest in U.S. criminal law.[123] An individual who is an officer, director, or stockholder acting on behalf of a reporting corporation, or is a domestic concern, can "be fined not more than $10,000, or imprisoned not more than five years or both."[124] When the reporting corporation or domestic concern has been found to have violated the statute,

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122. Ibid., §§ 103(a)(1)-(3), 104(a)(1)-(3), 91 Stat. 1495-1497.

123. Ibid., § 103(b)(2), amending SEA of 1934, § 32, by adding a new subsection (c)(1) and §104(b)(1)(A), 91 Stat. 1496-1497.

124. Ibid., § 103(b)(2), amending SEA of 1934, § 32, by adding a new subsection (c)(2) and §104(b)(1)(B)(1) and (2), 91 Stat. 1496-1497.

a lower level employee or agent, subject to U.S. jurisdiction, who willfully effected the violation, is liable to the same penalties as the individual mentioned in the preceding sentence.[125] When such individual has been fined, neither the reporting corporation nor the domestic concern may indemnify him.[126]

Title II, the Domestic and Foreign Investment Improved Disclosure Act of 1977, amends section 13 of the Securities Exchange Act of 1934 by expanding the disclosure requirements applicable to foreign and domestic investors having more than 5 percent beneficial ownership interest in the securities of U.S. corporations.[127]

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125. Ibid., § 103(b)(2), amending SEA of 1934, § 32, by adding a new subsection (c)(3) and § 104(b)(1)(B)(3), 91 Stat. 1496-1497. The Conference Report predicated an employee's or agent's liability upon a finding that the employer or principal had violated the statute. Supra note 114, p. 12.

126. Ibid., § 103(b)(2), amending SEA of 1934, § 32, by adding a new subsection (c)(4) and § 104(b)(1)(B)(4), 91 Stat. 1496-1497.

127. 91 Stat. 1498 (1977). For a critical analysis of the FCPA of 1977, see Judah Best, "The Foreign Corrupt Practices Act," Rev. Sec. Reg., 11 (February 13, 1978).

VIEWS CONCERNING THE FCPA

Debate over the necessity, desirability, and wisdom of the FCPA continues unabated in business, academic, and even governmental circles.

Shortly after the enactment of the FCPA, the authors of the then recently published "Bribery and Extortion in World Business,"[128] wrote that the legislation was a costly error and unnecessary.[129] Indeed, most U.S. MNC's had substantially reduced or eliminated foreign political payments. However, other apparently legal means were used to circumvent the legislation. For example, some MNC's were having their former agents act as principals who bought and sold on their own accounts. U.S. engineering and construction companies were abandoning their roles as prime contractors to become subcontractors of nationals or other developed countries. In effect, the practice of making political

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128. Neil H. Jacoby, Peter Nehemkis, and Richard Eells, Bribery and Extortion in World Business (New York: Macmillan Publishing, 1977); see *supra* note 4.

129. *Supra* note 4.

payments was continuing in the hands of foreigners. While the overall loss of business to U.S. corporations as a result of the anti-bribery legislation was probably less than the conjectured 10 percent, it had been material, especially in the pharmaceutical, engineering, and construction industries, and adversely affected the U.S. balance of trade and payments.

The authors maintained that the great majority of payments were made by the managers of foreign subsidiaries or affiliates of MNC's without the authorization or knowledge of top U.S. management, and were consonant with the cultures and commercial practices of the host governments. U.S. unilateral reform action, absent multinational cooperation, would continue to be ineffective. More effective means than the FCPA would include stricter internal controls by MNC's, greater protection by the State Department of MNC's to resist extortionate demands, and adherence by host countries to codes of responsible behavior to make easier the position of the foreign investor.[130]

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130. Ibid.

Views of Senator William Proxmire

Senator William Proxmire of Wisconsin, chairman of the Banking Committee and a principal proponent of FCPA, sought to refute the preceding arguments.[131] Bribery of foreign government officials by U.S. MNC's was incompatible with the American way of life and tarnished the image of American democracy abroad, especially among the LDC's. Bribery distorted competition, created significant risks, paved the way for expropriation, and usually found the ordinary stockholder unaware of its existence.

According to Proxmire, leading members of both the Carter and Ford administrations had supported the legislation which was causing no diminution of the U.S. export market. Utilization of loopholes in the legislation might be self-defeating as offering proof of violation. Compliance with the law required MNC's to keep strict accounting controls over their foreign subsidiaries. The most effective panacea was an international treaty requiring all the developed countries to incorporate within their domestic law the provisions of the FCPA.[132]

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131. Supra note 4.

132. Ibid.

Views of Professor Irving Kristol

The opponents of the United States unilaterally prohibiting questionable corporate payments to foreign government officials and politicians have marshalled numerous arguments for their opposition both before and after the enactment of the FCPA. One noted scholar, Professor Irving Kristol of New York University, writing generally in late 1976, referred to "the post-Watergate morality" with its full-swing moralistic fervor.[133] While such morality was "far, far better than the pre-Watergate morality ... it may be too good for any of us to survive."[134] Even though no one openly approved of bribery, there were many countries where government officials had always engaged in it more or less openly. Like prostitution, it was one of those transactions corrupting both parties but the effective solution of which was not a reasonable goal.[135] While there would be no

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133. Irving Kristol, "Post-Watergate Morality: Too Good for Our Good," The New York Times, November 14, 1976, magazine sec., p. 34.

134. Ibid.

135. Ibid., pp. 50-53.

harm in urging U.S. policy upon foreign governments, the U.S. Government must recognize that their leaders were "not needful of therapeutic guidance from a benign social worker named Uncle Sam."[136]

Other critics of the legislation have pointed out that the two fundamental approaches in the legislation, disclosure and criminalization, were inherently incompatible. Assuming the desirability of disclosure, prosecution of an MNC for violating a disclosure statute would be far less difficult than prosecution for violating the criminal provisions with their standard of proof beyond a reasonable doubt.[137] Moreover, if the criminal law system of the host country differed markedly from that of the United States, the alleged U.S. briber might be at a disadvantage.[138]

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136. Ibid., p. 53.

137. Bar Association Report, supra note 1, p. 19.

138. McLaughlin, supra note 1, p. 1074.

View that FCPA places U.S. businessmen at a disadvantage

A major argument against the anti-bribery legislation is that it places U.S. investors at a serious disadvantage in competing for overseas jobs and orders. While the proponents of the legislation urged at the Congressional hearings that the competitive position of U.S. investors would not adversely affected by an anti-bribery law, there was evidence that the FCPA had in fact seriously hurt overseas sales.[139] Thus, it was reported that largely because of the 1977 law, the United States, which in 1976 ranked first in its share of the overseas construction market, had dropped to fifth place in 1978, trailing Japan, Korea, West Germany, and Italy.[140] Significantly, bribery by West German corporations to obtain foreign contracts was not only not illegal in West Germany but the payments were deductible business expenses for tax purposes.[141] A White House

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139. See Jacoby, Nehemkis, and Eells, supra note 4.

140. "U.S. Firms Say '77 Ban on Foreign Payoffs Hurts Overseas Sales," Wall Street Journal, August 2, 1979, p. 1.

141. Landauer, supra note 50.

task force, officially called the Export Disincentives Task Force, estimated that the FCPA might be costing the United States one billion dollars annually in lost business -- a figure challenged by Senator Proxmire.[142] While the Commerce and Justice Departments favored providing businesses with guidelines enabling investors to obtain official interpretations of the FCPA, the SEC entered opposition thereto.[143] As yet, such guidelines have not been promulgated.

Another argument against the FCPA is that it is inherently ambiguous and that absent authoritative guidelines or clarifying regulations, it presents a maze of uncertainty, making it difficult to distinguish between a legal facilitating payment and an illegal bribe.[144] How does an investor differentiate between

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142. "Debate on Anti-Bribery Law Heats Up -- How Much Has the Act Hurt American Exports?" Commerce Clearing House, Disclosure Guide SEC Compliance, Vol. 4, No. 14, p. 1; Philip Taubman, "Bribe Law Is Defended in Congress," The New York Times, June 13, 1979, sec. D, p. 7; Wall Street Journal, supra note 140.

143. David Ignatius, "Justice Department Aide Outlines Policy of 'Review' for Firms' Payments Abroad," Wall Street Journal, November 9, 1979, p. 10.

144. John S. Estey and David W. Marston, "Pitfalls (and Loopholes) in the Foreign Bribery Law," Fortune, October 9, 1978, p. 182.

the exempt "grease, dash, squeeze, mordida, cumshaw," etc. made to clerical or ministerial employees and illegal gravy paid to a foreign government "official"? Since the identity of the recipient rather than the motive of the payer is the statutory criterion, a blatant payoff to a foreign purchasing agent or a government official with private interests to which the payment is made, may be a perfectly valid loophole. Finally, what is the practical demarcation between excluded extortion and criminal bribery? Is it too cynical to observe that "[t]he FCPA may well turn out to be as effective as Prohibition was against booze?"[145]

As noted, the revelations concerning questionable and illegal payments abroad involved transactions in developed countries affecting military equipment and the petroleum sector -- areas beyond OPIC's statutory jurisdiction.[146] Studies have shown that businesses in which large-scale bribery appears to be particularly

145. Ibid., pp. 184, 188.

146. See supra pp. 353, 366.

common include pharmaceuticals and health care, oil and gas, aerospace, chemicals, rubber, food products, construction, communication, and shipping. In some instances, U.S. MNC's engaged in the same industry -- *e.g.*, oil or aluminum -- have occasionally coordinated their questionable payment behavior. Industries closely regulated by host country agencies are more vulnerable to such payments; consumer product industries and those involving exclusive product technologies are less vulnerable. Most of the payments have been responses to extortionate demands by officials of foreign governments and have been a small and immaterial factor in the foreign business of most U.S. corporations. The poorer a country, the greater likelihood of questionable payments -- corruption is an inevitable product of economic backwardness. Similarly, authoritarian regimes appear as fertile grounds for payoffs. The larger the individual transaction, the great probability of the existence of a questionable payment, easily disguised in the price. [147]

Critics of FCPA have consistently urged that since

147. Gladwin and Walter, *supra* note 52, pp. 16, 18, 25-29.

the problem of questionable or illegal payments abroad has serious international implications and ramifications, only collective international action based on a multilateral treaty implemented by national legislation can effect a solution.[148] While recognizing that several legal bases exist for legislation prohibiting U.S. investors from making illegal payments abroad,[149] these critics point out that the prospects of an international multilateral solution are dim.[150]

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148. Ibid., p. 42.

149. At least three bases exist for assuming jurisdiction to impose criminal sanctions on U.S. citizens or corporations for engaging in proscribed conduct abroad: (1) the "territorial" principle -- attaching legal consequences to conduct occurring within the territory, irrespective of where the effect of the conduct takes place; (2) the "effects" principle -- conduct outside the territory that causes an effect within the territory; and (3) the "nationality" principle -- conduct of nationals irrespective of where the conduct occurs. See A.L.I., Restatement (Second) of Foreign Relations Law of the United States, § 17, 18, 30 (1); 1978 Note, pp. 1296-1297; Bar Association Report, supra note 1, pp. 5-8.

150. Gladwin and Walter, p. 43.

Proposals of international organizations

A few international organizations have unsuccessfully sought to solve the problem of such payments. In June 1976, the Organization for Economic Cooperation and Development (OECD), consisting of 24 industrial countries,[151] adopted voluntary guidelines for multinational enterprises.[152] The guidelines provide that MNC's should not pay, or be solicited to pay, bribes to any public servant or holder or public office or make illegal contributions to political candidates or parties. Furthermore, MNC's should abstain from any improper involvement in local political activities.[153] Because of their voluntariness, some commentators have approved the OECD solution.[154]

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151. The list of OECD members is found in OECD's Investing in Developing Countries (4th rev. ed., Paris 1978), p. 2.

152. Ibid., p. 8; Jacoby, Nehemkis, and Eells, supra note 128, p. 224; 1978 Note, pp. 1299-1300; Gladwin and Walter, p. 42.

153. Ibid.

154. Jacoby, Nehemkis, and Eells, pp. 225-226.

Code of the International Chamber of Commerce

The Paris-headquartered International Chamber of Commerce in 1977 published a code to combat bribery and extortion in business transactions which is tougher than the OECD effort and sets forth standards more stringent than those presently found in most countries. Its code calls for the enactment of legislation outlawing commercial and political corruption. MNC's should be prohibited from offering or paying a bribe to a government official or to any employee or agent of another enterprise to obtain or retain business. Facilitating payments are frowned upon but not prohibited; government inspection of books and records which accurately reflect all transactions is approved.[155]

Proposals of UN agencies and commissions

In addition to voluntary codes of conduct prohibiting foreign bribery by MNC's issued by important nongovernmental organizations, continuing efforts at solution have been undertaken by agencies and commissions of the United Nations (UN). In November 1974, the UN

155. Gladwin and Walter, pp. 43-44; 1978 Note, p. 1300.

Economic and Social Council (ECOSOC) created the Commission on Transnational Corporation (CTC) to serve as an advisory body to deal with issues affecting MNC's. In August 1976, ECOSOC established an Ad Hoc Intergovernmental Working Group on Corrupt Practices (IWGCP) which held its first meeting in November 1976.[156] The IWGCP held five sessions, the last in June 1978, and reported the need for early adoption of an international agreement on illicit payments. ECOSOC thereupon established the Committee on an International Agreement on Illicit Payments which held its first session in January-February 1979, a second session in May 1979, and submitted a report including a draft agreement to ECOSOC and CTC.[157] The draft agreement contains 11 articles -- at least two of which contain substantive issues still to be settled -- which may be briefly summarized as follows:[158] Governments which execute the agreement

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156. "Background and Activities of the Commission and the Centre on Transnational Corporations," CTC Reporter, Vol. 1, No. 1 (December 1976), p. 6.

157. "Illicit Payments: Progress in the Formulation of an International Agreement," CTC Reporter, Vol. 1, No. 6 (April 1979), p. 15.

158. "Illicit Payments: Draft of an International Agreement," CTC Reporter, Vol. 1, No. 7 (Autumn 1979), pp. 10-11.

must criminalize under their national laws "[t]he offering, promising or giving of any payment, gift or other advantage" by any person "to or for the benefit of a public official as undue consideration for performing or refraining from the performance of his duties in connexion with an international commercial transaction." [159] Likewise made criminal is a public official's soliciting, demanding, accepting, or receiving, directly or indirectly, a payment to influence his action in a commercial transaction.[160] Governments that do not recognize criminal responsibility of juridical persons are required to take appropriate measures designed to achieve deterrent effects comparable to the criminalization of acts by juridical persons.[161] The terms "public official," "international commercial transaction," and "intermediary" are broadly defined. A "public official" is a person working at any level

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159. _Ibid._, art. 1(a).

160. _Ibid._, art. 1(b).

161. _Ibid._, art. 1, last unnumbered paragraph.

of government "who holds a legislative, administrative, judicial or military office ... or otherwise performs a public function."[162] An "international commercial transaction means [_inter alia_] any sale, contract or other business transaction" with a governmental entity, and covers various arrangements, both contractual or proprietary, such as concessions, service contracts, and production-sharing agreements.[163] Governments would have jurisdiction over offenses committed within their territory, or by one of their public officials, or by one of their nationals "provided that any element of that offense ... is connected with the[ir] territory" or when the offense has "'effects' within their territory."[164] If an alleged offender is found in a state which has jurisdiction, it must prosecute him according to its laws unless such offender is extradited.[165] Business enterprises must maintain accurate records of pay-

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162. _Ibid._, art. 2(a).
163. _Ibid._, art. 2(b).
164. _Ibid._, art. 4.
165. _Ibid._, art. 5.

ments made by them to an intermediary or received by them as an intermediary. These records must show the amount and date of the payment, as well as the name and address of the intermediary.[166] Information concerning implementation of the agreement must be furnished bi-ennially to the U.N. Secretary-General and, upon request, to a demanding government.[167] States shall co-operate fully with each other in the investigation, prosecution, and extradition of malefactors.[168]

Outlook for international action

Events subsequent to the May 1979 meeting of the UN Illicit Payments Committee make it highly improbable that there will be early agreement even on a complete working draft.[169] It appears that recent international

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166. Ibid., art. 6.

167. Ibid., art. 7.

168. Ibid., arts. 10 and 11. For a summary of an earlier 1978 draft agreement set forth in CTC Reporter, Vol. 1, No. 5 (September 1978), pp. 13-15, see 1978 Note, pp. 1301-1302.

169. See supra note 140.

efforts aimed at stamping out bribery abroad have received negative responses from the most enlightened countries. Thus, a paper submitted in January 1979 to this UN Committee by the British Government pointed out that it was not possible in practice "for one country unilaterally to prevent corruption in other countries" -- a position which produced a sense of frustration in the U.S. State Department. This holding back by a leader among the Western democracies has created "the belief that Britain cannot afford to jeopardize its trading position overseas by subscribing to any United Nations agreement which insists on the kind of criminal code which U.S. leadership has been advocating."[170] If this be the attitude of Britain, what can one expect from other developed nations?

As noted throughout this chapter, many of the issues presented by questionable and illegal payments are international rather than national. So far, only the United States has seen fit unilaterally to enact anti-bribery legislation with consequences beyond its borders. OPIC's impact in this field is limited; realis-

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170. Alex Brummer, "Britain Angers U.S. on Business Bribery," Manchester Guardian Weekly, March 4, 1979, p. 5.

tically, the existence of OPIC insurance has had little practical effect on whether to pay a bribe or accede to an extortionate demand.[171] It cannot be gainsaid that no national legislation will as effectively, completely, and fairly regulate these payments as regulation by multilateral agreements. The United States should continue efforts in this direction.

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171. See McLaughlin, <u>supra</u> note 1, pp. 1089-1092.

CHAPTER VII

THE 1977-1978 OPIC HEARINGS AND AMENDATORY LEGISLATION WITH REFLECTIONS ON DEVELOPMENT

In the preceding chapter cursory mention was made of the enactment on April 24, 1978 of the Overseas Private Investment Corporation Amendments Act of 1978[1] in connection with the consideration of the general anti-bribery legislation.[2] In this chapter the history of this 1978 legislation will be reviewed -- the first Congressional overview of the functions and activities of OPIC since the debates of 1973-1974.[3]

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1. 92 Stat. 213 (1978), amending 22 U.S.C. § 2191 et seq. (1976). See Chapter VI, p. 390, note 94 and accompanying text.

2. See Chapter VI, p. 391, note 95 and accompanying text.

3. See Chapter III, p. 138, note 37 et seq. and accompanying text for the history of the 1974 legislation. For a historical summary of the 1978 legislation, see Steven Franklin and Gerald T. West, "The Overseas Private Investment Corporation Amendments Act of 1978: A Reaffirmation of the Developmental Role of Investment Insurance," Texas International Law Journal, 14 (Winter 1979), pp. 1-8 [hereinafter cited as Franklin and West]; "Overseas Private Investment Corporation," Law and Policy in International Business, 11 (1979), p. 321 et seq. [hereinafter cited as 1979 L&P].

REFLECTIONS ON ECONOMIC DEVELOPMENT

As noted, in the earlier debates during the Nixon administration, attention was focused on OPIC's effect upon the U.S. Treasury -- whether OPIC's operations would cost the taxpayers money or could ever be self-sustaining -- and upon U.S. relations with the less developed countries (LDC's). The resultant legislation[4] was a compromise involving future private participation in ("privatization of") OPIC's insurance programs. The statutory mandate concerning privatization, requiring the transfer of OPIC's functions to private insurers, was never, and perhaps could never have been, fulfilled.[5]

Changed conditions since 1973-1974

When the Congressional hearings on the renewal of OPIC's authority to issue political risk insurance commenced in the summer of 1977, conditions had changed

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4. The Overseas Private Investment Corporation Amendments Act of 1974, 88 Stat. 763.

5. 1979 L&P, pp. 326-330.

from those existing in 1973-1974. OPIC's financial status had improved; its Chilean problems were being solved.[6] The Republican administration of Gerald R. Ford had been succeeded by the Democratic administration of Jimmy Carter. The trade position of the United States was far from good. The multinational corporations (MNC's), whom many of OPIC's opponents deemed the real beneficiaries of OPIC's programs rather than the LDC's, were opposed by organized labor and advocates of the "human rights" espoused by the new administration. Those who had unsuccessfully advocated a strong affirmation of OPIC's developmental role in the earlier debates found an ally in the new administration. The special Subcommittee on Multinational Corporations, chaired by Senator Frank Church, which had exhibited strong opposition to OPIC in the 1973-1974 hearings,[7] had been supplanted by a subcommittee[8] more sympathetic to

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6. Franklin and West, p. 7.

7. See Chapter III, p. 135, note 29 and accompanying text.

8. Known as the Subcommittee on Foreign Assistance of the Committee on Foreign Relations, it was chaired by the ailing Hubert H. Humphrey of Minnesota and consisted of Senators Joseph R. Biden, Jr. of Delaware, Clifford P. Case of New Jersey, Frank Church of Idaho, Dick Clark of Iowa, Jacob K. Javits of New York, and Charles H. Percy of Illinois.

OPIC.

In an earlier chapter concerning the 1973-1974 hearings and debates, it was pointed out that there existed a wide range of opinions concerning the economic effects of foreign direct investment and its contribution to the economic welfare of LDC's and that the criteria used in basing one's opinion could well determine one's attitude toward the OPIC program.[9] The same conflict of opinion has continued since that time.

Views of C. Fred Bergsten

C. Fred Bergsten, a quondam senior fellow at the Brookings Institution, an adviser on international economic matters in the 1976 Carter-Mondale campaign, and currently an assistant secretary of the Treasury for International Affairs, in May 1976 rendered a report to the Agency for International Development (AID) entitled "The Impact on Development of U.S. Policy toward Foreign Direct Investment."[10] At the outset he noted

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9. See Chapter III, pp. 165-168, notes 89-91 and accompanying text.

10. C. Fred Bergsten, "The Impact on Development of U.S. Policy toward Foreign Direct Investment: A Report to AID" (May 1976). The substance of the report was incorporated in C. Fred Bergsten, Thomas Horst, and Theodore H. Moran, American Multinationals and American Interests (Washington, D.C.: Brookings Institution, 1978).

that while the meaning of "development" was clothed in controversy, he accepted the premise that foreign direct investment had a positive impact on LDC's.[11] OPIC was formed during a period of growing overvaluation of the dollar, increased important penetration in several industries and concomitant pressure for restrictions against both imports and foreign direct investment, major concern with the chronic U.S. balance of payments deficit, and declining interest in assisting LDC's. Emphasis on U.S. economic benefits inevitably reduced the focus of OPIC's program on development -- its primary purpose and function.[12] The 1974 legislation,[13] with its mandate of privatization, caused OPIC to follow more closely standard risk management practices toward a goal of financial self-sufficiency. This policy change to risk minimization operated to the detriment

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11. *Ibid.*, pp. 1-3.
12. *Ibid.*, p. 97.
13. *Supra* note 4.

of development concerns as evidenced by the decline of the share of the poorest LDC's in the entire OPIC portfolio between November 1973 and February 1976. Significantly, OPIC's much smaller finance program, with no directive toward privatization, had shifted during such period toward the poorest countries.[14] Recognizing that OPIC's "evolution mirrors the conflicting and ever-shifting premises which underlie its activities,"[15] Bergsten urged that "OPIC's mandate should explicitly place developmental concerns as the foremost criterion in the selection of projects which it will insure."[16] This policy formulation was consonant with the increased sophistication of LDC's in maximizing returns from foreign direct investment. More LDC's were accepting responsibility for an increasing number of economic and social objectives such as better income distribution

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14. Bergsten, *supra* note 10, pp. 98-100.
15. *Ibid.*, p. 100.
16. *Ibid.*, p. 101.

and the development of indigenous high technology industries in addition to such traditional goals as economic growth, full employment, and economic stability.[17]

Views of Professor Peter F. Drucker

Separation of myths from realities in the relation between MNC's and developing countries (DC's) was emphasized by Peter F. Drucker, Professor Emeritus of Management of New York University and noted management consultant.[18] There were four generally accepted but false assumptions which led to the sterility of many developmental policies: (1) DC's were important to MNC's and a major source of their growth and profits; (2) foreign capital, governmental or private, could supply the capital resources required for economic development; (3) the ability of MNC's to allocate productive resources on a global basis subordinated a DC's best national interests to global exploitation; and (4) present MNC's adhered to the earlier form of corporate organization

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17. C. Fred Bergsten, "Coming Investment Wars?," Foreign Affairs, 53 (October 1974), pp. 135-139.

18. Peter F. Drucker, "Multinationals and Developing Countries: Myths and Realities," Foreign Affairs, 53 (October 1974), p. 121.

-- the domestic parent corporation with subsidiaries abroad.[19] The realities according to Drucker were that the growth rate and profitability of MNC's businesses in DC's were generally slower and lower, respectively, than in developed countries; that lack of resources, human, capital, or physical, did not make a country underdeveloped; that while an MNC sought to allocate production according to global economics, few MNC's had a global strategy and the diffusion of production potentially permitted a DC some measure of effective control and bargaining leverage; and that the MNC would find it increasingly to its advantage to structure ownership in a variety of ways to gain access to both local capital and local talent.[20]

The Drucker thesis regarded "underdevelopment" as the inability to obtain full performance from available resources; productivity rather than so-called development should be the standard of comparison. What an LDC needed were "triggers," stimuli from abroad, to energize

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19. _Ibid._

20. _Ibid._, pp. 122-131.

the available resources with a resultant "multiplier impact." Illustrative is the instance where one job created by the original investment generated many other jobs, both directly and indirectly, and the investment produced the largest number of local managers and entrepreneurs. The proper strategy of the DC is to utilize the MNC as an effective developmental agent under a policy of encouraging participation by the domestic private sector. Foreign direct investment projects usually had a higher multiplier impact than direct governmental foreign projects.[21] In fine, the MNC "is -- or at least should be -- a most effective means to constructive nationhood for the developing world."[22]

Views of Professor Irving Kristol

A 1978 article on "The Economics of Growth" by Professor Irving Kristol of New York University advanced a thesis concerning national economic development different from that of most "growth economists."[23] According-

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21. *Ibid.*, pp. 122-127.

22. *Ibid.*, p. 134.

23. Irving Kristol, "The Economics of Growth," *Wall Street Journal*, November 16, 1978, p. 24.

ing to Kristol, unlike the views concerning "macroeconomics" -- the economics of the nation as distinct from that of the firm or individual -- held by most present day economists with a particular political ideology, the correct explanation of economic growth was offered by Adam Smith in the 18th century and Joseph Schumpeter in the 20th: where people are given the freedom to engage in economic activities to better their condition and where the entrepreneur is given the freedom to innovate, economic growth results; *per contra*, governmental restriction of those freedoms results in relatively slow or no economic growth. Even in the most favorable circumstances, varying traditions, cultures, religions, and customs will result in varying rates of growth. Economic growth is outside the purview of macroeconomics and is unconcerned with gross national product (GNP) or national income statistics. In short, it belongs to the province of microeconomics of the business enterprise, individual, or firm. Real economic growth has its roots in industrial self-interest as it responds to clear incentives, not in sophisticated governmental wisdom.[24]

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24. *Ibid.*

Change in OPIC leadership

The advent of a new Democratic administration under President Jimmy Carter in January 1977 saw a change not only in top OPIC personnel but in administration attitude toward the agency. Marshall Mays, OPIC's president, was succeeded by an acting president, Rutherford M. Poats, a career State Department official who had been associated with AID's investment guarantee program and OPIC vice president for development from 1971 to 1974 when he became an assistant Secretary of State. The administration's choice to succeed Mays had been Bruce Llewellyn, a prominent black businessman from New York, who was constrained to decline the position after months of hesitation.[25] However, in October 1978, Llewellyn finally accepted the post; at the same time Poats joined the White House staff.

The Carter administration's policy review

As noted in an earlier chapter,[26] with OPIC's au-

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25. The New York Times, July 23, 1977, p. 16.

26. See Chapter IV, p. 259, note 105 and accompanying text.

thority to issue new insurance set to expire on December 31, 1977,[27] Congressional oversight hearings were scheduled for the summer of 1977. In preparation therefor a cabinet level Economic Policy Group of the new administration conferred with OPIC directors and officials for a policy review of the agency's operations and functions.[28] From this review the Carter administration, with C. Fred Bergsten, now an assistant secretary of the Treasury for International Affairs, in a leading role, concluded that OPIC was advancing several important U.S. foreign policy objectives and its program warranted an extension until September 30, 1981. It further concluded that the privatization guidelines of the 1974 legislation could not be met by 1980 and that the privatization objectives ran counter to OPIC's developmental objectives.[29]

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27. 88 Stat. 766; see Chapter III, p. 189, note 135 and accompanying text.

28. Supra note 26.

29. U.S. Congress, Senate, Committee on Foreign Relations, OPIC Authorization, Hearings before the Subcommittee on Foreign Assistance, 95th Cong., 1st Sess., 1977, pp. 4, 7 [hereinafter cited as 1977 SOH].

The policy review further concluded that with certain new program directions, OPIC could play an even more important role in the future than it had in the past. Among these directions were (1) focusing OPIC's activities on the poorer LDC's which really needed its assistance, and (2) developing innovative risk-reducing coverage for projects in energy and other raw materials.[30] The 1974 legislation had prohibited the use of OPIC funds to assist in financing operations for the extraction of oil, gas, ores, or other minerals, or for feasibility studies and surveys for developing mineral or petroleum extraction projects. The recommendations would permit the use of OPIC funds in financing small-scale minerals exploration or extraction but continue the prohibition as regards oil or gas projects.[31]

With OPIC management support, the Carter administration in June 1977 submitted a draft bill containing

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30. Ibid., p. 1215; Franklin and West, pp. 7-8.

31. Ibid., p. 30. In January 1977, OPIC issued its first political risk insurance contract to cover oil exploration, development, and production. "Overseas Private Investment Corporation," Law and Policy in International Business, 10 (1978), pp. 297-300 [hereinafter cited as 1978 L&P].

the following significant provisions to effectuate the preceding conclusions: (1) extension of OPIC's authority to issue insurance and guarantees through September 30, 1981; (2) alteration of the private participation requirements set forth in the 1974 legislation, substituting therefor authority for OPIC to share risks with private insurers or multilateral organizations as a means of risk management and to further the development of private markets for investment insurance under equitable arrangements compatible with OPIC's basic developmental objectives; (3) authority to alter war risk insurance terms so as to permit adjustment of the insured value of assets to account for inflation in replacement costs; and (4) submission of a report to Congress by December 31, 1980, on the development of private and multilateral programs and of any participation arrangements with private insurers and multilateral organizations.[32]

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32. U.S. Congress, House, Committee on International Relations, Extension and Revision of Overseas Private Investment Corporation Programs, Hearings and Markup before the Subcommittee on International Economic Policy and Trade on H.R. 7854, 95th Cong., 1st Sess., 1977, pp. 323-326 [hereinafter cited as 1977 HOH]; 1977 SOH, pp. 1-2 on S. 1771, 95th Cong., 1st Sess., 1977.

Congressional oversight hearings

As noted, House hearings on the bill were conducted during June, July, and September 1977 by the Subcommittee on International Economic Policy and Trade;[33] Senate hearings in July and August, by the Subcommittee on Foreign Assistance.[34] Both hearings followed similar formats with testimony generally by the same witnesses. The issues and arguments were in the main similar to those presented in the earlier 1973-1974 hearings.[35]

The Senate Subcommittee had requested the General Accounting Office (GAO) to prepare a report on OPIC's effectiveness in implementing certain 1974 legislative directives and correcting some prior OPIC program weaknesses. The report, issued on July 26, 1977, evaluated the progress of and prospects for privatization; OPIC actions to increase small -- and medium -- firm participation and to overcome country concentration; and the degree to which OPIC's programs caused investors to invest in LDC's.[36]

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33. See Chapter VI, p. 382, note 73 and accompanying text.

34. *Ibid.*, p. 387, note 83 and accompanying text; 1977 SOH, pp. 1-2.

35. *Supra* note 3.

36. 1977 SOH, p. 65, summarizes the report; 1977 HOH, pp. 247-252; 1978 L&P, p. 290.

The Comptroller General's study on OPIC

The GAO study found that the success of privatization had been superficial and that the 1974 statutory mandate would not be attained. The feasibility of private participation from a cost benefit perspective was questionable in view of the premium income received by the private sector compared with the liabilities assumed. Insurance coverage continued to be concentrated in a relatively few countries with the majority of insurance going to the larger "Fortune 500" corporations. The success of OPIC's efforts in LDC's was minimal, principally because opportunities for viable or profitable projects were limited therein. The marked decline in OPIC insurance in 1976 was due partially to a worldwide recession and the tendency for major investors to consider self-insurance because of OPIC's increasingly restrictive underwriting policies. While OPIC's financial picture had improved considerably since the earlier hearings, until adequate revenue were accumulated and reserved, OPIC might have to borrow funds from the U.S. Treasury or request supplementary funds from Congress to pay claims for large losses not covered by private insurers. OPIC had shown no unreasonable involvement or influence in the claims settlement process and had evidenced ability to mediate agreements satisfactorily to the concerned parties.[37]

In both the House and Senate hearings the principal witnesses supporting the administration's proposed legislation were Rutherford M. Poats and C. Fred Bergsten.

Testimony of OPIC's acting president, Rutherford M. Poats

In prepared statements and testimony before the House and Senate Subcommittees, OPIC's acting president gave an overview of OPIC's operations since the Congressional oversight hearings in 1973 and 1974, focusing on OPIC programs in LDC's and its efforts toward privatization.[38] The statutory mandates that OPIC promote development in LDC's and yet operate as a self-sustaining business corporation were not incompatible. American investors were willing to pay reasonable, albeit

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37. Ibid.

38. 1977 HOH, pp. 2-76; 1977 SOH, pp. 16-56.

substantial, insurance premiums to cover political risks in LDC's in making a judgment of investment choice on the standard commercial considerations. Its insurance program could generate sufficient fee income without subsidy by investment of earned income in Government securities. While OPIC insurance for mineral exploration was feasible, he opposed projects with admitted developmental benefits where the risks were very high in either political or commercial terms.[39]

The impact of the oil price increases and the increasing difficulty for many LDC's to finance imports essential to their development intensified their need for development assistance.[40] In the past three fiscal years (1974-1976), OPIC had assisted 425 investment projects in 55 developing countries with anticipated total investment of $4.6 billion. In support of these projects OPIC provided $1.06 billion of investment insurance, $44.3 million in investment guarantees, and $20.1 million in direct investment fund loans. It was

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39. 1977 HOH, p. 78.

40. Ibid., p. 3.

estimated that these projects would generate over the first five years of operation a net cash flow to the United States of $2.3 billion and create 37,500 man-years of U.S. employment. These projects would help create and develop new markets for U.S. products and supply U.S. industry and consumers with raw materials and products not available from domestic sources. In addition, these projects would enable the host countries to achieve net foreign exchange gains of $1.3 billion, net additional fiscal revenues of $198 million, and 149,000 new jobs. OPIC carefully examined each proposed project and rejected those likely to cause significant adverse effects on domestic employment and economy.[41]

Poats noted that the number of OPIC-insured investments in countries with per capita income of less than $450 in 1973 dollars had increased from 41 percent of all projects in 1974 to 61 percent in fiscal 1976. Over 70 percent of the number of projects financed by OPIC had been in such countries, over one-third in countries with a per capita income of less than $200. Forty-seven percent in dollar amount and roughly half of the insur-

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41. 1977 SOH, p. 22.

ance coverage were in the LDC's.[42] An arbitrary and inflexible dollar per capita limit for all projects would hamper OPIC and result in conflict between OPIC's developmental and self-sustaining objectives.[43]

Not only did OPIC coordinate its operations and functions with such policy agencies of the U.S. Government as the State and Treasury Departments and require the express approval of the host country, but in some large projects it required a certification of approval of the fairness of the deal from an independent agency such as the World Bank.[44] The U.S. foreign policy was not a business-first orientation but was based on a variety of interests and concerns. Accordingly, OPIC did not blindly assume that U.S. business interests must always prevail.[45] With significant exception, most of the LDC's with which OPIC dealt had a favorable attitude toward it and sought OPIC-guaranteed investments as a

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42. Ibid., p. 23; 1977 HOH, p. 80.
43. 1977 HOH, p. 81.
44. Ibid., p. 83.
45. Ibid., p. 84.

means to induce additional U.S. direct investment. Those countries in South America, including almost the entire west coast, Uruguay, and to a substantial degree Argentina, which adhered to the Calvo doctrine that disputes must be settled within the jurisdiction of the host country and not be the subject of international arbitration, made OPIC's insurance program there unavailable.[46]

There were at least three reasons for the failure of the International Investment Insurance Association (IIIA) with its multilateral investment insurance program that would act as a fiduciary for the interests of participating countries,[47] to gain support. (1) Its charter provided for international arbitration, a condition rejected by the supporters of the Calvo doctrine. (2) IIIA was a subsidiary of the World Bank, a linkage many developing countries thought would hinder Bank loans to a country that had offended the IIIA. (3) The developing countries and some developed countries like Germany saw no need for an international insurance pro-

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46. Ibid., p. 94.

47. Ibid., pp. 94-95. See also Chapter V, pp. 279-291.

gram; Germany thought its existing program adequate.[48] Similar reasons were advanced against the U.S. proposal for an International Resource Bank (IRB) advanced by Secretary of State Henry Kissinger at the 1976 United Nations Congress on Trade and Development (UNCTAD), which would have established a multilateral investment insurance entity for minerals projects, minerals, and possibly energy projects. Creation of a multilateral reinsurance association affiliated with the Berne Union likewise drew very little enthusiasm from other developed countries. Complete privatization, if at all possible, of OPIC's insurance program, would place the U.S. investor at a disadvantage with competitor-nationals of countries with OPIC-like government agencies. However, this factor was not made an express conclusion of the administration's Economic Policy Group.[49]

Poats took issue with many of the conclusions of the GAO study and of criticisms by others. Private foreign investment was making important -- sometimes critical, sometimes only supplemental -- contributions to

48. Ibid.

49. Ibid., pp. 95-96.

the development of LDC's, a fact acknowledged by LDC's. It clearly supplied scarce long-term capital, technology, entrepreneurial leadership, and market access. However, LDC's frequently needed in addition public foreign assistance, and it was as an adjunct to the U.S. foreign assistance program that OPIC's three development roles should be played -- i.e., (1) increase the flow of private U.S. investment to LDC's; (2) improve the form and character of the insured investment both for the host country and the investor who could better view his long-term involvement in the investment because of OPIC's 20-year insurance coverage; and (3) increase the possibilities of avoiding international confrontation over investment relations between U.S. investors and LDC governments.[50]

According to Poats, OPIC believed it could influence the actual flow of U.S. private investment to LDC's through pre-investment surveys, participation in project planning, and financing the pilot stages of projects. Commercial bank credit, which had gone to governments

50. 1977 SOH, pp. 153-154.

and central banks, should be channeled into project finances. OPIC could be instrumental in insuring the flow of funds from U.S. banks to regional banks for use in financing small investment projects by the local private sector.[51]

Cognizant of its high concentration of particular fields of insurance in Brazil, Dominican Republic, Jamaica, and Korea, OPIC had internal policy guidelines restricting further insurance therein, or requiring the investor to take a partial coverage of his risk or, in case of large companies, join OPIC in a mutual insurance pool. OPIC sought to provide preferential consideration to smaller businesses but it must be recognized that realistically it would always be the large companies that represent the largest dollar volume of OPIC insurance. Larger companies have the resources, management, and motivation to undertake a diversification of overseas operations; smaller companies generally lack these elements especially for investment in the LDC's. OPIC had benefited from privatization, the infirmity of which was the compulsory schedule of transfer to unwilling recipients in the private insurance industry.[52]

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51. <u>Ibid.</u>, pp. 155-156.
52. <u>Ibid.</u>, pp. 157-160.

Testimony of J. Kenneth Fasick

J. Kenneth Fasick, director of the International Division of the General Accounting Office which submitted the GAO study, stated that OPIC's efforts to attract more private insurance companies to participate in its insurance program had been disappointing. In 1976, 206 companies were contacted, 105 responded, and only six joined the 15 companies already participating in the Overseas Investment Insurance Group (OIIG). The reasons for declining to participate were limited knowledge of political risk insurance and the inapplicability of conventional insurance principles to expropriation and inconvertibility losses because of the political factors involved. About two-thirds of the private participation was by foreign insurance companies. Moreover, OPIC had only made limited, if any, improvement in the efforts to reduce its concentration of coverage in certain countries and to increase the monetary coverage of firms in the medium and small business range. Such concentration was influenced by limited investment opportunities in many of the LDC's and the corresponding desire to start projects in more industrialized countries. Probably two-thirds of OPIC-insured investments would not have been made absent its insurance, even in the more developed of the LDC's. Concededly, the more developed LDC's offered greater opportunities for private investment. Two major improvements had resulted from OPIC's assumption of the AID-administered insurance program: (1) OPIC's insurance portfolio was more diversified, resulting in the spreading of potential risks; (2) risk management principles had been introduced into insurance operations.[53]

Testimony of C. Fred Bergsten

C. Fred Bergsten in prepared statements and testimony emphasized the Carter administration's objectives of greater aid to develop the poorer LDC's and special assistance to increase their production of energy and other raw materials. The limited success of privatization was effected only at a cost of diverting OPIC from the fundamental objectives of its program.[54] Private direct investment could play an important role in the economic development process through transfer of resources and of managerial and administrative expertise,

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53. Ibid., pp. 106-109, 114; 1977 HOH, pp. 247-251, 342.

54. 1977 SOH, pp. 12-13.

the expansion of productive capacity and employment, and the establishment of new export markets. While the language of LDC's had been somewhat hostile to private investment, their behavior had been more moderate because of their intense need for capital, technology, and managerial skills.[55]

It was in those LDC's which investors considered the political risk to be high that OPIC insurance was most attractive. Since investors tended to perceive higher political risk in the poorest of the LDC's, OPIC was more likely to provide additional investment therein.[56] It was difficult to fix an inflexible, arbitrary per capita income in a country as the sole criterion for OPIC activity. There were a number of variables, including the per capita income, the growth rate, and the structure of the economy. Where a country's exchange rate was overvalued, its dollar per capita income would translate higher than it should be. Accordingly, OPIC should possess a certain degree of flexibility better to accomplish statutory directives.[57]

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55. Ibid., pp. 7-9.

56. Ibid., p. 9.

57. 1977 HOH, p. 118.

According to Bergsten, the Carter administration favored expansion of OPIC's guarantee program to promote energy and non-fuel raw material projects in LDC's. More stable types of involvement, including joint ventures, management contracts, and production-sharing agreements, would be promoted.[58] In so doing OPIC would facilitate three important U.S. national objectives: (1) avoid the misallocation of important economic resources of the fuel and mineral sector; (2) diversify supply and lessen vulnerability to collusive price arrangements; (3) assist LDC's to deal directly with their own energy needs. OPIC's efforts should be coordinated with its counterparts in other industrialized nations so as to minimize their fears that the United States was unilaterally making special deals to outbid them for potentially scarce raw materials.[59]

Testimony of other witnesses

At the House Subcommittee hearing, Alexander Shakow, AID's acting assistant administrator for policy

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58. Ibid., p. 117.

59. 1977 SOH, pp. 10-11.

and program coordination, stated that OPIC was properly encouraging and facilitating private lending by U.S. banks for projects that had tangible cash flows. Lending by these banks had been concentrated in upper and middle income LDC's with rapidly growing economies. Over the 1971-1975 period the loss ratio on international loans was one-third that of the total loan portfolio.[60]

Julius L. Katz, assistant Secretary of State for Economic Affairs, stated that his Department found OPIC's activities important in U.S. development efforts abroad. Lack of incentives for foreign investment was especially critical in the least advanced of the LDC's and OPIC's program contributed significantly to correcting the imbalance in incentives between the LDC's and other countries. OPIC's insurance permitted investors to lower contingencies for loss and payback requirements so that the foreign exchange drain upon the host country was reduced once the project became operational.[61] With the reduction of political risk by OPIC

60. 1977 HOH, pp. 106, 335.

61. Ibid., p. 112.

insurance, a larger range of projects becomes attractive and longer term investment becomes more acceptable. Longer term investments both increase the investors' involvement in the overall development of the LDC and afford the LDC's nationals a better chance to gain technical knowledge and management skills.[62] Similar views were expressed by Frank A. Weil, assistant secretary of the Commerce Department for Domestic and International Business. OPIC's program had enabled the United States to increase the proportion of U.S. foreign investment that went to the LDC's.[63]

Testimony of OPIC's former president, Marshall T. Mays

In his testimony before the House Subcommittee in September 1977, Marshall T. Mays, OPIC's former president, reemphasized the necessity of private investment in the economic development of LDC's. Not only was government aid from developed countries alone insufficient but private capital was administered much more efficiently. Private investment provided one of the best

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62. Ibid., p. 336.

63. Ibid., pp. 113-114.

means for training the local populace to increase productivity by transferring technology, marketing, and management know-how. It must be anticipated that a substantial period of time would be required for the poorest LDC's to achieve a noticeable measure of development.

Mays did not deem OPIC's privatization program a failure when one recognized the private sector's inexperience in the field of political risk. While deadlines were undesirable, it would be wasteful to abandon privatization. The creation in 1975 of the Retrospective Premium Adjustment Plan (RePAP), by which OPIC's large policyholders shared on a mutual basis OPIC's risk in the eight concentration countries, was proving successful. This and other risk management practices indicated that its program could be self-supporting.[64]

There were a number of instances where OPIC had turned down anti-developmental projects. It would not insure casinos, armament manufacture, distilleries, or propaganda media facilities. While OPIC formerly frowned upon joint ventures with government entities, it had changed its policy with considerable success.[65]

64. Ibid., pp. 241-243.

65. Ibid., pp. 245-246.

Testimony of Henry A. Kissinger

At the Senate Subcommittee hearings, former Secretary of State Henry A. Kissinger, an OPIC proponent, noted that while public assistance was of great importance to the development of LDC's, private direct investment was necessary to facilitate such development by transferring resources and expertise to them. No foreseeable increase in public assistance could come close to meet their needs. A major barrier to private investment was political risk, a factor whose importance OPIC could lessen. OPIC should assume a role to facilitate investment in minerals in LDC's.

Dr. Kissinger recommended that OPIC join its counterpart agencies of other industrialized countries to assist raw material projects in LDC's. This would serve a two-fold function -- *i.e.*, (1) finance larger projects with less risk to OPIC's financial position; and (2) lessen the possibility of expropriation as a prospective expropriator would have to confront governmental institutions from several countries.[66]

When questioned about the very large increase in

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66. 1977 SOH, pp. 140-142.

commercial bank lending in LDC's, with possible strains on the credit system of the Western World, Dr. Kissinger replied that the problem was very fundamental, fraught with uncertainty, and difficult of solution. While these bank loans had been most beneficial to the LDC's and had prevented any worsening of their economic conditions brought about especially by increased energy costs, the future could find some lenders in grave difficulties. He reiterated support of a Financial Support Fund which had earlier received the approval of all the industrialized countries.[67]

Differentiating between Third World and Fourth World countries -- the latter being the poorest, non-resource countries -- Dr. Kissinger stated that emphasis in public aid should be directed to the latter; as to private investment, these countries should strive to create less risky political conditions.[68]

At these hearings, officials of OPIC clients and professors of international business and management testified that in many instances absent OPIC insurance, the private investments would not have been made.

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67. Ibid., pp. 145-146.

68. Ibid., pp. 151-152.

The opinions of academicians and others at the hearings

Stephen J. Kobrin, assistant professor of management, Sloan School of Management, Massachusetts Institute of Technology, stated that private foreign investment, the objective of which was profit maximization, was a vehicle not only for the transfer of resources needed for development but also for the transfer of institutions, values, and attitudes necessary for industrialization. There continued to exist a need for public assistance to facilitate a flow of private investment to LDC's. While U.S. MNC's had developed very sophisticated techniques for assessing ordinary business risks, they were unprepared to assess foreign political risk. Accordingly, their reaction to political risk was to avoid operations in countries deemed unstable.[69]

Concerning OPIC's insurance performance, Kobrin concluded "on very limited evidence" that the programs were less than fully effective. Research on determinants of foreign investment for manufacturing showed an overriding factor of market size or potential; for resource extraction, the situs of availability. Investment sought to follow previous export involvement; fa-

69. 1977 HOH, pp. 222-224.

miliarity through satisfactory previous experience meant increased investment. OPIC's effectiveness could be increased through seminars, consultations, or printed matter and by providing managers with some technical help in terms of analysis of foreign political environments.[70]

Franklin R. Root, associate professor of international business, Wharton School of Finance and Commerce, University of Pennsylvania, initially summarized his views as follows: The United States had a fundamental interest in promoting LDC's; private foreign investment contributed to LDC's economic development; OPIC insurance increased the flow of private investment to LDC's; the private insurance industry had neither the capacity nor willingness to assume OPIC's insurance programs; and finally, OPIC's programs should be extended. Expanding on his answers, he found that the need by LDC's for certain technologies, management skills, and marketing systems was best filled by MNC's. While OPIC was not *per se* an incentive to invest abroad, its insurance program did eliminate or reduce the deterrent

70. *Ibid.*, pp. 224-225.

of political risk and lengthen the investors' payback periods on projects in LDC's. Privatization had helped OPIC to improve its management skills. Unlike OPIC, its counterparts did not have programs explicitly directed toward developmental objectives; charged much lower rates; were not self-sustaining; and were in fact government-subsidized. These counterparts were competitive instruments and had privatization succeeded, the rates would have been even higher. There was an incompatibility of objectives between self-sustenance and development -- the choice belonged to Congress.[71]

Joseph P. Griffin, chairman of the Committee on Insurance Overseas Investment of the International Law Section of the American Bar Association, who had testified in 1976 in his personal capacity,[72] stated that this Association supported the administration bill.[73] It opposed complete privatization because the private insurance industry would be far less likely to insure

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71. Ibid., pp. 229-233.

72. See Chapter VI, p. 367, note 44 and accompanying text.

73. 1977 SOH, pp. 115-116.

risky projects, would still involve the U.S. Government in the internal politics of host countries, and would place U.S. investors at a competitive disadvantage vis-a-vis foreign investors. Nevertheless, some measure of privatization should be continued and OPIC's activities should not be arbitrarily excluded from middle or higher income developing countries.[74]

Harry Freeman, a former AID official and OPIC's vice president for finance, who had become a vice president of the American Express Company on 1975,[75] emphasized OPIC's modest finance program which was deemed to have a much greater impact on both projects and development. This program included project identification, brokering, development, and monitoring; had a much more positive stimulus than the larger insurance program ; and was chiefly utilized by smaller investors in the poorest countries. OPIC's original goal as a developmental agency should be confirmed; privatization should be recognized as incompatible with such goals.[76]

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74. Ibid., pp. 116-119.

75. See Chapter IV, p. 226, note 41 and accompanying text.

76. 1977 SOH, pp. 119-124.

Insurance company executives who had been involved with privatization testified concerning this factor under the statutory mandate. LeRoy J. Simon, a senior vice president of Prudential Reinsurance Company and chairman of the board of governors of the Overseas Investment Insurance Group,[77] supported OPIC's socially desirable objective of more concentration in the LDC's. This would improve the spread of risk and diversify the insurance portfolio. The private sector's support was conjoined with its belief that OPIC could be self-sustaining. But a mandatory privatization schedule was unwise and should be eliminated. While private insurers were wary of war damage coverage, they thought expropriation and inconvertibility insurance a feasible activity. The overwhelming size of OPIC's insurance portfolio and long-term guaranteed coverage were likewise factors against complete privatization.[78]

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77. See Chapter IV, p. 223, note 36 and accompanying text.

78. 1977 SOH, pp. 95-97, 101.

OPIC review by outside consultants

As noted, OPIC in 1976 expressed willingness to have an outside consulting agency review its insurance program from an actuarial standpoint.[79] Such review was undertaken by Tillinghast, Nelson & Warner, Inc., an international firm of actuaries and insurance consultants. Its consulting actuary, Bruce D. Moore, stated that its study was based on the assumption that privatization was desirable and the insurance program could be self-sustaining. This program did not present the type of insurance risk ordinarily susceptible to actuarial analysis; overall analysis and recommendations, accordingly, must project subjective judgments and broadly assumed conclusions. While current rates might make the program self-sustaining, improvement could be anticipated if certain reforms were instituted. Variation of rates by classification of business; greater rating differential between debt and equity investments; increasing rates in the extractive industries and decreasing them in others -- these would prove beneficial. Since greater political risk occurred in the later years

79. See Chapter IV, p. 241, note 68 and accompanying text; Chapter VIII, p. 541 , note 46 and accompanying text.

of a long-term contract, some of the premiums in the early years should be set aside as a reserve for the anticipated subsequent greater risk. Coverage should be extended both geographically and substantively as *e.g.*, insuring already existing investments or those made by foreign investors. As long as risks were insured on a self-sustaining basis, broader market coverage involved no element of subsidy.[80]

While in general agreement with the administration proposal, Moore felt that past experience militated against increased emphasis on mineral exploration and energy development unless limited to smaller investments. Moreover, increased concentration on low income countries might prove counterproductive and jeopardize the self-sustaining statutory condition. Complete privatization was not feasible both because long-term political risk insurance was contrary to the current practices of the industry and because a Government agency, with access to the State Department and a unique ability to settle claims, alone could play a substantial role in encouraging development.[81]

80. 1977 HOH, pp. 204-205.

81. *Ibid.*, pp. 205-209.

OPPOSITIONAL VIEWS TOWARD OPIC

Urging OPIC's termination, William Goodfellow, deputy director of the Center for International Policy, a project of the Fund for Peace, maintained that the main beneficiaries of OPIC's coverage were the MNC's operating in six countries which violated human rights and opposed labor unions.[82] "Each of these countries maintains a level of political stability and labor discipline attractive to multinational corporations and to OPIC."[83] It was questionable whether the needs of the investing enterprise were compatible with rational development in the host country. Moreover, OPIC's application form made no formal inquiry "to describe social or cultural dislocations, the income distribution effects of a given investment, or the host government's policies regarding the use of resources generated by the investment."[84] Through OPIC, the U.S. Government might find itself protecting the status quo of the MNC's against the wishes of the host government and its people. Moreover, the largest U.S. unions have consistent-

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82. Ibid., pp. 143-144.

83. Ibid., p. 146.

84. Ibid., p. 147.

ly claimed that OPIC was part of the package of tax incentives and subsidies that favored runaway industries. Notwithstanding the 1974 legislation, the interests of U.S. workers were not adequately protected. Many LDC's were finding MNC's intimidating. The appropriateness of the development -- more than a mere increase in the gross national product (GNP) but a more even spread of wealth -- was the basic consideration.[85]

Views similar to those of Goodfellow were expressed by George A. Chauncey, chairman of the Interreligious Taskforce on U.S. Food Policy, an interfaith group concerned with the political dimensions of global hunger. With over 75 percent of MNC investment capital in LDC's coming from local sources rather than the company's home base, he asserted that OPIC's operations were not in keeping with the "New Directions" approach to developmental policy of the United States and small business people.[86]

As it had done in 1974,[87] the American Federation

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85. Ibid., pp. 148-149, 156-158.

86. 1977 SOH, pp. 173-175.

87. See Chapter III, p. 181, note 117 and accompanying text.

of Labor and Congress of Industrial Organizations (AFL-CIO) voiced opposition to OPIC's continuance. Its prepared statement for the House Subcommittee declared that OPIC had either ignored Congressional direction about injury to domestic employment or was incompetent to assess it. OPIC's programs not only assisted small companies to leave the United States but even lent money to help develop industries to compete with U.S. exports. The acceptability and benefits of private investment to developing countries were questionable. MNC's were insured by OPIC in countries with low wage labor, tax-free benefits, and export subsidies -- all to the detriment of U.S. labor. Existing investment incentives were sufficient to attract investors to LDC's without additional taxpayer insurance. Increasingly, the U.S. taxpayer was subsidizing a partnership between a U.S. private investor and a foreign government -- often authoritarian -- for export from those countries. In fine, government insurance should not be provided for MNC's "whose power and control is [sic] already a matter of concern." Those seeking insurance for political risk should do so on the private market.[88]

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88. 1977 HOH, pp. 353-359.

Two earlier OPIC Senate opponents continued their opposition. While admitting that OPIC's financial picture had considerably improved since 1973 through the settlement of large claims; that the Carter administration's proposals were reasonable; and that privatization -- the basis for his earlier support -- had failed, Senator Frank Church doubted that MNC investment in foreign countries was beneficial, especially when domestic unemployment was very high.[89] "I cannot justify the program as being in the national interest."[90] Senator Clifford P. Case of New Jersey reiterated his view that OPIC's dual objectives of development and self-sufficiency were incompatible. Except in terms of the foreign aid program, OPIC never made sense.[91]

Rebuttal by OPIC

OPIC officials sought to rebut the contentions of its adversaries. OPIC's operations were selective, screening out negative projects which might have an ad-

89. 1977 SOH, pp. 65-67.

90. *Ibid.*, p. 68.

91. *Ibid.*, pp. 68-69.

verse effect on U.S. employment. Projects insured in 1975 and 1976 assisted domestic employment. In 1976, 7 out of 12 finance commitments and 24 percent of insurance contracts were to small business.[92] OPIC-encouraged projects transferred important technologies that upgraded the human skills and resources of the developing countries.[93] Some 90-95 percent of U.S. investment abroad had been made by 300 to 400 companies. Because of the higher risks and management costs of investing in less developed countries, only large companies could make the requisite investments. Consequently, the bulk of OPIC insurance was issued to MNC's. Recognizing that overseas investment was more difficult for the smaller companies, Congress in 1974 directed OPIC to give "preferential consideration" to projects sponsored by very small businesses. Considerable efforts had been made to attract small business, at the same time curtailing coverage in higher income developing nations like Brazil. Moreover, OPIC's insurance was not a subsidy to business since its rates were much

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92. Ibid., pp. 71-72.

93. Ibid., p. 79.

greater than those charged by its counterparts. "The very low rates charged by these countries reflect in large measure a governmental policy of subsidizing foreign investment as a means of securing export markets and access to essential raw materials." In following the standards set by the Carter administration, OPIC programs would increase both U.S. employment and opportunities for needy people elsewhere.[94]

As noted in Chapter VI, both the House Committee on International Relations and the Senate Foreign Relations Committee in October 1977 issued reports dealing with an extension and revision of OPIC's operating authority.[95] On October 11, the Senate Committee favorably reported its marked up bill, S. 1771 (SOR);[96] on October 7, the House Committee favorably reported its bill.[97]

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94. 1977 HOH, pp. 371-372.

95. See Chapter VI, pp. 386 and 388, notes 81 and 84 and accompanying text.

96. U.S. Congress, Senate, Foreign Relations Committee, Overseas Private Investment Corporation Amendments Act of 1977, S. Report 95-505, 95th Cong., 1st Sess., 1977 [hereinafter cited as 1977 SOR]. The bill was reported out by the committee by a vote of 10 to 4. U.S. Congress, Senate, Debate on S. 1771, 95th Cong., 1st Sess., Congressional Record, Vol. 123, October 25, 1977 (daily ed.), p. S1768.

97. U.S. Congress, House, Committee on International Relations, Overseas Private Investment Corporation Amendments Act of 1977, H. Report 95-670, 95th Cong., 1st Sess., 1977 [hereinafter cited as 1977 HOR].

Contrast in Congressional attitudes -- 1974 and 1977

At this point it may be of interest to contrast the views expressed by the Senate Committee on Foreign Relations as regards OPIC in February 1974 and in October 1977. In 1974, the majority of the committee was highly critical of OPIC;[98] in 1977, with pro-OPIC proposals having the support of the administration, the attitude had become favorable.

The later report recognized OPIC's mission as primarily developmental and suggested the possibility of varying its insurance rate structure to provide lower rates for the poorer LDC's. In recent years, MNC's had become more responsive to the needs of the host countries, with a concomitant tendency to judge them on a more individual basis. A study by the International Labor Organization (ILO) concluded that while it was difficult to generalize about the effects of MNC's on employment, technology, and labor skills, the flexibility and adaptability of many MNC's to operate in different countries had positive effects upon employment and meeting the basic needs in LDC's.[99] The pri-

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98. See Chapter III, p. 150, note 63 et seq. and accompanying text.

99. 1977 SOR, pp. 8-9.

vatization mandate had interfered with OPIC's developmental impact; its removal would abolish the artificial constraints that had inhibited OPIC's primary function of encouraging private investment as a means of promoting economic development.[100] Nevertheless, OPIC should not abandon its privatization effort since there were beneficial risk-sharing aspects in privatization.[101] However, the House report found little redeeming features in privatization. Private insurers were unwilling to make long-term insurance commitments. Their interests in minimizing risks and maximizing profits must run counter to the important public policy goals set forth in OPIC's legislative mandate. Moreover, the joint direct underwriting arrangements OPIC had entered into with the private insurers were costly and disadvantageous to it and should be discontinued. Only co-insurance on a project by project basis where necessary and available on equitable terms, together with reinsurance arrangements, should be permitted to continue.[102]

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100. _Ibid._, pp. 11-13.

101. _Ibid._, p. 15.

102. 1977 HOR, pp. 17-18.

The reports of both committees found the existing statutory definition of "small business" to be inappropriate in gauging international investment, as a small international investment was much different in size from a small domestic investment. A flexible definition was recommended with every effort to be made to give preferential consideration to smaller firms.[103] The House report recommended OPIC support for developing energy and raw material resources, especially in the poorer LDC's. Preference should be given to relatively small projects involving an equitable sharing of equity and output with the host country and employing innovative investment techniques such as service contracts.[104] While recognizing the desirability of increasing mineral production in the LDC's, the Senate report questioned the advisability of OPIC's using a significant portion of its limited resources in the minerals field. Since mineral projects were not always the most highly developmental, OPIC should limit itself to spend no more than $4 million annually on such projects and $200,000 an-

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103. Ibid., p. 15; 1977 SOR, p. 25.

104. 1977 HOR, pp. 13-14, 22-23.

nually for mineral surveys and encouragement.[105]

As they had done in 1974, Senators Frank Church and Clifford P. Case continued to advocate OPIC's termination. They adhered to their views that there was no convincing evidence that the type of investment insured by OPIC contributed significantly to assist economic growth in LDC's. OPIC's insurance coverage was highly concentrated in a few higher income developing countries in favor of the largest MNC's; direct foreign investment by U.S. firms resulted in the loss of 150,000 jobs annually.[106]

The Senate report recommended extension of OPIC's operating authority for three years and 9 months to September 30, 1981, so as to bring the authorization into conformity with the current Federal budgetary cycle;[107] the House report, only to September 30, 1980.[108]

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105. 1977 SOR, pp. 18-19.

106. Ibid., pp. 43-44. See William Claiborne, "House Committee Votes to Slash OPIC Role of Private Insurance," Washington Post, October 5, 1977, sec. B, pp. 1-2.

107. 1977 SOR, pp. 1, 35.

108. 1977 HOR, pp. 1, 35.

LEGISLATIVE HISTORY OF THE 1978 LAW

Two weeks after the issuance of the SOR, the bill proposed by its majority was considered by the Senate. Its principal spokesman was OPIC's original supporter, Senator Jacob K. Javits, who reiterated the arguments that OPIC programs supplemented U.S. public assistance programs; benefited the U.S. economy by increasing domestic employment, assisting small businesses to invest abroad, and with a positive effect on balance of payments. The 1974 mandate concerning privatization had proved ineffective because the private insurance industry was understandably more interested in more profitable, less risky projects than in furthering developmental goals of LDC's.[109] Similar views were expressed by Senator Charles Percy of Illinois.[110] Senator Clifford P. Case, advancing the views expressed in the minority SOR, urged OPIC's termination when its authorization expired on December 31, 1977.[111]

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109. U.S. Congress, Senate, Debate on S. 1771, 95th Cong., 1st Sess., Congressional Record, Vol. 123, October 29, 1977 (daily ed.), pp. S17687-17691. A "Dear Colleague" letter in support of the legislation, signed by seven Senators and circulated among the Senators, was printed in the Record. Ibid., p. S17691.

110. Ibid., p. S17698.

111. Ibid., pp. S17692-17694. He and Senator Frank Church also circulated a "Dear Colleague" letter. Ibid., p. S17693.

While a supporter of OPIC, Senator James B. Allen of Alabama was a foe of the Panama Canal treaties. His amendment to prohibit OPIC from making a loan guarantee to a Panamanian Government Corporation or to the National Finance Corporation of Panama was defeated by a vote of 69 to 13.[112] The Senate shortly thereafter passed the bill 69 to 12.[113] The brevity of the Senate debate[114] might be attributed to at least two factors: (1) the strong administration support; (2) the Senate's overriding concern with Panama Canal treaties' issue.

On November 2 and 3, 1977, the House took up its committee's bill which emphasized the developmental objective in behalf of the poorer LDC's and enumerated eleven non-inclusive developmental criteria for approving a project.[115] Its main floor advocate was Representative Jonathan B. Bingham of New York, chairman of

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112. Ibid., pp. S17694-17697.

113. Ibid., p. S17699.

114. The debate on October 25, 1977 occupied less than a dozen pages in the Congressional Record. Ibid., pp. S17687-17699.

115. 1977 HOR, pp. 25-26.

the Subcommittee on International Economic Policy and Trade, who stated that the strictures concerning privatization in the 1974 legislation had seriously hindered OPIC's basic developmental goals and were, accordingly, being removed. Moreover, OPIC was changing its policy with respect to insurance coverage with previous overconcentration.[116] The standard counterarguments in opposition, similar to those advanced by Senator Case in the upper chamber, were voiced by Representative Leo J. Ryan of California, a 1974 opponent of OPIC, who referred to the bill as a "Thanksgiving turkey."[117]

Numerous amendments were offered on the House floor. A provision prohibiting OPIC from insuring, reinsuring, or guaranteeing an investment likely to cause significant reduction in the number of employees in the United States, was agreed to.[118] An amendment prohibiting any loan to, or guarantee or insuring obligations

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116. U.S. Congress, House, Debate on H.R. 9179, 95th Cong., 1st Sess., Congressional Record, Vol. 123, November 2, 1977 (daily ed.), pp. H12053-12056.

117. Ibid., pp. H12054-12055.

118. Ibid., pp. H12060-12061.

of, the National Finance Corporation of Panama absent Congressional approval, was rejected 215 to 188.[119] An amendment by Representative Ryan for the orderly dissolution of OPIC by September 30, 1980 was rejected upon refusal of a recorded vote.[120] An amendment requiring at least 50 percent of all OPIC activity go to small businesses was accepted 285 to 111.[121] An original amendment prohibiting OPIC involvement in a project of a country with a consistent pattern of gross violations of human rights, was agreed to after considerable dilution.[122] However, no decision on a final bill was reached in 1977,[123] perhaps due in part to the House leadership's desire to give this legislation a lower profile in 1978 and a reluctance to collide with the opposition of organized labor.[124]

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119. Ibid., pp. H12061-12064.

120. Ibid., November 3, 1977 (daily ed.), pp. H12109-12111.

121. Ibid., pp. H12111-12119.

122. Ibid., pp. H12119-12127.

123. Ibid., p. H12128.

124. See Richard Lawrence, "OPIC May Face Suspension Soon," Journal of Commerce, November 11, 1977, pp. 1, 35.

Since OPIC's authority to issue new insurance or loan guarantee policies was to terminate on December 31, 1977,[125] its staff sought to approve as many pending applications as possible before such date.[126] Nevertheless, applications were thereafter being accepted pending anticipated Congressional extension.[127]

The House Committee on International Relations held additional OPIC hearings at the end of January and early February 1978. Rudolph Oswald, director of research of the AFL-CIO, summarized his organization's continuing bitter opposition to OPIC, stating that "OPIC has desperately concocted answers to AFL-CIO statements."[128] Jobs had been lost in the very industries OPIC had insured. OPIC's encouragement of investment only in poor countries had proved unrealistic. OPIC could not assure

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125. Overseas Private Investment Corporation Amendments Act of 1974, § 2(3)(A), 88 Stat. 766.

126. Arlen J. Large, "OPIC Loses Authority to Write Insurance that Protects U.S. Investments Abroad," Wall Street Journal, January 3, 1978, p. 14.

127. Off-the-record information furnished by OPIC staff subsequent to enactment of 1978 OPIC legislation on April 24, 1978, infra note 141.

128. U.S. Congress, House, Committee on International Relations, Extension of the Overseas Private Investment Corporation, Hearings and Markup on H.R. 9179, 95th Cong., 1st and 2d Sess., 1977-1978, pp. 60-63.

U.S. access to raw materials. OPIC had not followed Congressional mandates in the past. "[T]he United States Treasury and taxpayer should not be the insurer of U.S. firms and banks in other countries. Nor should it be helping U.S. investors move abroad or expand abroad when United States cities and towns so desperately need investment and jobs at home."[129]

In a prepared statement noting his inability to personally testify because of his overriding concern with the Panama Canal treaties, Senator Frank Church reiterated his belief that OPIC should not receive any extension of authority. Only if the U.S. economy were healthy and at full employment, and if it could be shown that OPIC served some other foreign policy interest of overriding concern, "perhaps then there would be some justification for extending its [OPIC's] authorization." On the contrary, OPIC was directly harmful to the U.S. economy. It gave foreign investment a preferred status

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129. Ibid., pp. 63-65. Organized labor submitted additional material for the record. Ibid., pp. 71-77. OPIC's acting president, Rutherford M. Poats, sought to refute labor's opposition. Ibid., pp. 85-108.

which sapped the domestic economy of needed capital and deprived U.S. workers of jobs.[130]

The House again took up the OPIC legislation on February 23, 1978. An amendment proposed by Representative Morris Udall of Arizona that because of the depressed state of the U.S. copper market, OPIC furnish no support for any project involving the exploration for or the mining or other extraction of any deposits of copper, found support.[131] Subcommittee Chairman Jonathan B. Bingham successfully offered an amendment that OPIC give preferential consideration to projects in LDC's with per capita incomes of $520 or less in 1975 U.S. dollars and restrict its activities in LDC's with such incomes of $1,000 or more. The amendment would codify the approach taken by the Carter administra-

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130. Ibid., pp. 117-121; letter of transmittal from Senator Church to Chairman Clement J. Zablocki of the House Committee, dated January 30, 1978.

131. U.S. Congress, House, Debate on H.R. 9179, 95th Cong., 2d Sess., Congressional Record, Vol. 124, February 23, 1978 (daily ed.), pp. H1439-1440.

tion.[132] An amendment affecting the National Finance Corporation of Panama, similar to one defeated in November 1977,[133] except that only House approval would be required, was again rejected 199 to 166.[134] An amendment proposed by Representative W. Hanson Moore of Louisiana, which would prohibit OPIC support for any project to establish or expand production or processing of palm oil, sugar, or citrus crops for export to the United States, was adopted 191 to 167.[135] A revised version of the bill was then passed by a vote of 191 to 165.[136]

On March 6, 1978, the Senate substituted its bill after the enacting clause of the House companion bill

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132. *Ibid.*, pp. H1440-1441.

133. *Supra* note 119 and accompanying text.

134. Congressional Record, Vol. 124, February 23, 1978, pp. H1444-1448.

135. *Ibid.*, pp. H1448-1449.

136. *Ibid.*, pp. H1449-1454.

and called for a joint conference.[137] On March 23, the Conference Committee reached agreement and issued a report on April 5 which contained provision from both bills with occasional amendments thereto.[138] The following day, the Senate passed the bill;[139] five days later the House followed suit by a vote of 216 to 185.[140] On April 24, the Overseas Private Investment Corporation Amendments Act of 1978 became law.[141]

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137. Ibid., March 6, 1978, p. S3004.

138. U.S. Congress, House, Conference Report to accompany H.R. 9179, Report No. 95-1043, Overseas Private Investment Corporation Amendments Act of 1978, 95th Cong., 2d Sess., April 5, 1978.

139. Congressional Record, Vol. 124, April 6, 1978 (daily ed.), p. S4929.

140. Ibid., April 11, 1978, p. H2744.

141. 92 Stat. 213 (1978), amending 22 U.S.C. § 2191 et seq. (1976). The statute is hereinafter cited as OPICAA of 1978.

ANALYSIS OF THE 1978 LEGISLATION

The salient provisions and principal features of this 1978 legislation may briefly be summarized.[142] Its purpose clause provided that OPIC in participating in projects should especially give preferential treatment to investment projects in countries with per capita income of $520 or less and to restrict activities in countries with per capita income of $1,000 or more in 1975 U.S. dollars.[143] Preferential treatment should be accorded to projects sponsored by or involving U.S. small business; moreover, OPIC was required to increase the proportion of insured or guaranteed projects significantly involving small business to at least 30 percent.[144] It was authorized to allocate up to 50 percent of its annual net income to assist small business.[145] OPIC was expressly required to decline any insurance, guarantee, or financing if the investment was likely

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142. See, generally, Franklin and West, _passim_; 1979 L&P, _passim_, both _supra_ note 3.

143. OPICAA of 1978, § 2(1)(2), 92 Stat. 213, amending 22 U.S.C. § 2191 (1976).

144. _Ibid._, § 2(2)(E)(1), 92 Stat. 213, amending 22 U.S.C. § 2191(E)(1) (1976).

145. _Ibid._, § 9, 92 Stat. 216, amending 22 U.S.C. § 2200 (1976).

to cause a significant reduction in the number of U.S. employees.[146]

Legislation terminated any mandatory privatization program but permitted OPIC to seek reinsurance.[147] OPIC was authorized to make direct loans of up to $4 million annually for non-fuel mineral exploration projects other than for oil and gas.[148] OPIC's operating authority was extended through September 30, 1981.[149]

In line with protectionist sentiment prevalent in the declining U.S. economy, the 1978 statute prohibited OPIC support for "any new or significantly expanded project involving the exploration for or the mining of or other extraction of copper" if the production was planned to commence before January 1, 1981 or, if production began thereafter, would cause injury to the

146. Ibid., § 2(4)(n), 92 Stat. 213, adding 22 U.S.C. § 2191(k)(1) (1976).

147. Ibid., § 3(3)(7), 92 Stat. 214.

148. Ibid., § 3(5), 92 Stat. 214, amending 22 U.S.C. § 2194(c) (1976).

149. Ibid., § 4(2), 92 Stat. 214, amending 22 U.S.C. § 2195(a)(4) (1976).

primary U.S. copper industry.[150] Similarly, OPIC was enjoined from supporting any project to establish or expand production or processing of palm oil, sugar, or citrus crops for export to the United States.[151] Employing criteria for evaluating projects developed in consultation with the Agency for International Development, OPIC must maintain a development impact profile for each project, consisting of data appropriate to measure the projected and actual developmental effects thereof.[152] In consultation with the Secretary of State, OPIC should consider the status of human rights and fundamental freedoms of a country and support no projects in a violator except where the projects directly benefited the needy people of the country or were required in the U.S. national security.[153]

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150. Ibid., § 7(3)(j), 92 Stat. 215-216, adding 22 U.S.C. § 2199(j) (1976).

151. Ibid., § 7(3)(k), 92 Stat. 216, adding 22 U.S.C. § 2199(k) (1976).

152. Ibid., § 7(3)(i), 92 Stat. 215, adding 22 U.S.C. § 2199(i) (1976).

153. Ibid., § 8, 92 Stat. 216, adding 22 U.S.C. § 2199(l) (1976).

As noted in Chapter VI,[154] section 6 of the 1978 legislation added the OPIC anti-bribery provisions which required OPIC to refuse payment of any claim for losses on any OPIC-assisted project with respect to which the insured investor had been found guilty under the Foreign Corrupt Practices Act of 1977.[155]

Following the Senate's passage of its initial version in October 1977,[156] it became evident that privatization would no longer have a place in any new legislation. However, it was anticipated that reinsurance would be continued with the private sector. Accordingly, the Overseas Investment Insurance Group (OIIG)[157] was terminated and on November 30, 1978, a successor, the Overseas Investment Reinsurance Group (OIRG) was

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154. See Chapter VI, p. 391, note 95 and accompanying text.

155. OPICAA of 1978, § 6, 92 Stat. 215, adding 22 U.S.C. § 2197(1) (1976).

156. See supra note 113 and accompanying text.

157. See Chapter IV, p. 223, notes 36 and 37 and accompanying text.

organized as a first loss insurer.[158] Fourteen private insurance companies participated with OPIC in OIRG and accounted for $5.3 million -- about 13 percent -- of the Group's $40 million per country inconvertibility and expropriation exposure.[159] The members from the private sector agreed to a three-year commitment, as contrasted with the one-year commitment in the OIIG.[160] The War Risk Reciprocal[161] was given up. Thus ended the dream of complete privatization for direct political risk insurance.

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158. Overseas Private Investment Corporation, Annual Report 1978, p. 16.

159. Ibid.

160. See 1979 L&P, p. 330, note 62 and accompanying text.

161. Ibid.; see Chapter IV, pp. 254-255, notes 95-100 and accompanying text.

CHAPTER VIII

OPIC AND POLITICAL RISK INVESTMENT ANALYSIS: IDENTIFICATION, CONCEPTUALIZATION, APPROACHES, METHODOLOGIES, AND THEIR RELATIONSHIP TO OPIC

At the time of its creation in 1969,[1] OPIC received, together with its developmental mandate, a directive to conduct its financing and insurance operations in accordance with sound business management principles on a self-sustaining financial basis[2] and "with due regard to principles of risk management" in its insurance operations.[3]

As previously noted,[4] there has always existed in OPIC legislation and its implementation -- as in that of its predecessors -- an inherent conflict between the

1. See Chapter II, p. 107, supra.

2. Foreign Assistance Act of 1969 (FAA of 1969), § 231(a), 83 Stat. 809.

3. Ibid., § 231(d), 83 Stat. 810.

4. See Chapter IV, pp. 226, 234; and Chapter VII, pp. 422-425, 435, 465.

foreign developmental mandate and the directives pertaining to business management principles. The controversy surrounding the enactment of the 1978 legislation[5] confirmed such continuing tension.

Factors in risk management

Let us consider the various factors involved in risk management and its relationship to insurance. While as a relatively new discipline, risk management is variously defined, two important points stand out: (1) it is a branch of applied economics with a primary objective to minimize the costs of pure risks; and (2) it consists of a combination of loss control (such as loss prevention) and loss financing (such as insurance) activities.[6]

For purposes of the insurance function, risk management relates to recognition of the risk, measurement

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5. See Chapter VII, pp. 435, 465.

6. Norman A. Baglini, Risk Management in International Corporations (New York: Risk Studies Foundation, 1976), p. 3.

of identifiable losses, selection of proper means of its handling, and implementation of such means -- functions performed by both the concerned management and its insurer.[7]

Speculative risk and pure risk

Insurance theory has established a dual system for risk classification. The first distinguishes between speculative risk and pure risk. Speculative risk involves the chance of gain or of loss; it may be covered by hedging but not by insurance and affords the opportunity for profit. Pure risk involves the chance of loss or no loss, but no chance of gain; it may be covered by insurance. Illustrative are physical damage to assets and losses through fraud or criminal acts.

Fundamental risk and particular risk

The second classification of risk distinguishes

7. Michael W. Gordon, "The Overseas Private Investment Corporation: Risk Management Principles," Tulane Law Review, 48 (April 1974), pp. 493-495; see also Margaret Kelly, "Evaluating the Risk of Expropriation," Risk Management, January 1974, pp. 23-24.

between fundamental and particular risks. The former is impersonal in both origin and consequence and for the individual is generally unpreventable. It is associated with major economic, political, or social changes and often generates large losses. Illustrative are risks associated with physical occurrences such as floods and earthquakes. Particular risks, on the other hand, are capable of identification with individual events of a localized nature, are usually controllable, and are typified by such common occurrences as building fires and car thefts.[8]

While theoretically all businesses are subject to obviously fundamental risks, one must recognize that the distinction between particular and fundamental risks is not always clear. Depending on circumstances, particular risks in one environment may become or be treated as fundamental risks elsewhere. This is especially true of businesses which have foreign operations exposing them to political risks unknown to their domestic operations.

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8. Ibid.

POLITICAL RISKS

The term "political risk" is difficult to define inasmuch as its definition often varies with the needs and interests of the particular definer. Some analysts consider it to be part of a broader heading of environmental risks which also include economic, administrative, and social factors. Others, using a variation of this approach, regard political risks in terms of "sovereign risks" and "cross-currency risks." The sovereign risk -- e.g., the possibility of expropriation -- is political in nature and cannot be accurately quantified or projected. The cross-currency risk -- e.g., the possibility of loss from currency devaluation -- is economic or financial in nature and is a function of overall economic situations. In theory this risk should be quantifiable and predictable; in practice it is generally otherwise. Frequently, political risks and cross-currency risks are intertwined because in a broad economic sense political risks involve any governmental action which may affect the outcome of a commercial decision. Perhaps as workable a definition of political risk is that given by the Foreign Policy Research Institute: the risk or probability of occurrence of some political event(s) that will change the prospects for the profitability of a given investment.[9]

Firms with foreign-owned operations necessarily face political risks, some of which may be more economic than political in nature. Let us consider some of the different types of political risk and political exposure. There is political instability, arising from revolution, coup d'état, or war, which affects business operations through work stoppage, strikes, distribution problems, and bureaucratic delays. Such instability can lead to a deteriorating economic climate.

The next type of political risk is expropriation and/or nationalization. In expropriation, the foreign company is expressly named in the takeover decree; in

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9. Dan Haendel, Gerald T. West with Robert G. Meadow, Overseas Investment and Political Risk (Philadelphia: Foreign Policy Research Institute, Monograph Series No. 21, 1975), p. XI [hereinafter cited as OIPR Monograph]. See also Franklin R. Root, "The Management of Political Risks in International Business" (unpublished paper, Wharton School of Business, University of Pennsylvania, 1976), p. 1; "A Primer on Country Risk," Argus Capital Research Report, June 4, 1975, pp. 1-2.

nationalization, the decree is directed against a general class of property or a whole sector of the economy which is brought into state ownership or control of nationals of the host country. In both there is confiscation without adequate compensation -- a catastrophe to a company's foreign operations wiping out in whole or in part with one fell swoop both assets and future business opportunities.

Creeping expropriation differs from outright expropriation in that it is not sudden and usually involves participation by the public or private sector in the ownership of a foreign subsidiary, limitation of activities of foreign companies, and legislation restricting transfer of shares, imports of essential materials, and repatriation of profits. Closely related are other forms of political risk including restrictions on currency inconvertibility, local borrowing and unattractive foreign exchange regulations, restrictions on foreign management personnel, and unsatisfactory corporation and tax laws.

Each of these political risks, deriving from the possibility of arbitrary action by the host government, creates an uncertainty as to whether such government will arbitrarily change "the rules of the game" so as to affect adversely the profitability of the foreign enterprise.

Each type of political risk cannot be viewed by itself or _in vacuo_; it must be considered in relation to one's particular business operation. Thus, trading organizations, raw material and extractive industries, service and manufacturing industries, whether involved in selling, lending, or investing operations, each face different political risk exposure levels depending on a number of factors.

As noted, some political risks are closely related to economic conditions; others are not. Illustrative of the former are balance of payment problems, national planning priorities, sudden drains on foreign currency reserves, protection of local industry, and socialization of the economy. In light of the dual system for risk classification considered above, most political risks, including those covered by OPIC, may generally be considered pure and fundamental: there is no chance of gain, impersonal in origin and consequence, and generally unpreventable. They also create substantial subjective doubt concerning their outcome.[10]

RISK MANAGEMENT TECHNIQUES

In recent years there has evolved a risk management decision-making process for analysis of pure fundamental risks. This process employs different strategies seeking to provide an analytical approach for the selection of optimal risk treatment techniques to attain minimal possible losses from fundamental risks. At this stage of its operations, the process admittedly is far from exact.[11]

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10. Bruce Lloyd, "The Identification and Assessment of Political Risks," Moorgate and Wall Street, Spring 1975, pp. 49-76; K.F.J. Niebling, "Business and Political Risk" (unpublished correspondence with Antoine W. van Agtmael, July 1976); Dan Haendel, "Political Risks: The Phenomena and Their Effects," in The Measurement of Political Risk and Foreign Investment Strategy: A Summary Report (Philadelphia: Foreign Policy Research Institute, Conference Proceedings, May 9-10, 1975), p. 8 *et seq.* [hereinafter cited as MPR Summary Report]; Franklin R. Root, "The Management by LDC Governments of the Political Risk Trade-off in Direct Foreign Investment," paper presented to the International Studies Association, Toronto, February 1976, pp. 2-3.

11. Baglini, *op. cit.*, p. 28; Kelly, *supra* note 7, p. 24.

While writers differ somewhat both as to nomenclature and grouping of risk management methods, for present purposes this study will consider the risk management process as involving five different techniques or strategies with a large measure of overlapping: (1) risk avoidance; (2) loss prevention; (3) risk retention; (4) risk transfer; and (5) insurance. Avoidance signifies foregoing an investment opportunity because the probability of loss is too high and the potential profit is not worth the risk. Loss prevention techniques are usually directed toward reduction of loss frequency or of loss severity. Examples of such techniques are the utilization of a joint venture or a management contract, and the maintenance of a low profile combined with assistance in the nation's economic development.

Risk retention recognizes that not all fundamental risks, political or otherwise, can be avoided, prevented, or transferred. It may involve a company with a foreign investment establishing a funded reserve to be used if the risks later develop to offset its losses. Alternatively, the company may elect to absorb as a direct expense all associated costs. A planned retention strategy would provide definite measures for absorbing the risk losses upon occurrence. The unplanned version is present for various reasons: the cost of treating the risk is too great relative to the loss exposure if left untreated; the risk is financially relatively insignificant; or there is no other viable alternative.

Risk transfer involves partially transferring a risk to others and is closely interrelated to, and sometimes indistinguishable from, loss prevention. Illustrative is financing by an international consortium of financial institutions whereby a foreign investor seeks to reduce its risks which are disproportionate to the amount of ownership it relinquishes. A joint venture project with local or other firms is another example.

Insurance is a variation of risk transfer but because of its importance in this study it is given a distinct category. Thus, the OPIC insurance program is a means whereby firms meeting its qualifications may transfer some of their political risks.[12]

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12. Baglini, pp. 26-48; Kelly, pp. 24-30, 43. Mark R. Greene, "The Management of Political Risk," Best's Review, Property/Liability ed., July 1974, pp. 72-73.

As is evident, the risk management process usually involves a combination of techniques or strategies. It is, moreover, inherently tied in with a firm's investment decision process. Since OPIC is often involved from the inception of an investment, its officials are interested in the means of risk handling selected by a potential OPIC insured or financial investment.

QUESTIONS TO BE CONSIDERED

Before deciding to do business, through investment or otherwise, in a foreign country, a company should be cognizant of numerous relevant factors. It must consider its own objectives, its relationship with the host country, and the general political and socio-economic climate of the host country. The answers to the questions are indicative of the degree of political risk exposure and of the possible means of risk reduction.

Consideration of these important factors necessitates a company's asking itself numerous questions -- *e.g.*: What level of profitability is expected; what is acceptable? Are there requirements to localize management or limit foreign workers or make equity participation available locally? If the operation is to be a joint venture, what kind of relationship should be established with local partners? How should the project be financed? Is local financing available and how much foreign exchange is required? If the latter and large sums are needed, should the project be financed by a multinational consortium of financial institutions? How well are local laws implemented? Are they loosely interpreted or precisely defined?

Concerning its general relationship with the host country, a company should ask itself: Will the proposed operation aid in the social and economic development of the host country? Will it favorably affect the latter's balance of payments? What effect will it have on local firms? Will it be regarded favorably by local nationals?

Before committing resources in a host country, a company must be greatly concerned with the latter's tax structure. Are its tax laws codified and published? Are its taxes honestly assessed and collected? Does it have tax treaties and conventions with the United States? If so, does the United States allow a credit on foreign taxes paid in the host country?

The general political and socio-economic climate of the host country is likewise of paramount concern. How politically stable has the host country been within the last 10-20 years? How homogeneous is the local society? Does it have a sense of national unity? Contrariwise, is there a history of conflicts between ethnic or religious groups? Is there any dominant ethnic group or are they of equal strength?

What type of government does the host country have? Is it effective and sensitive to public needs? Is it a one-party state; if so, what is its ideology? If run by an authoritarian leader, what would happen upon his incapacity or death? Is there an effectively organized opposition? What role is played by the bureaucracy? By the military?

With military regimes ascendant in recent years, numerous questions must be answered. Why did the military take over? Is it united or is it divided by service rivalries? Did it supplant an ineffective, unpopular democratic government? Does it command popular support? How strong is the opposition? Does the opposition include armed insurgent groups? Is a return to civilian rule contemplated for the foreseeable future?

In like manner must a company consider the host country's socio-economic structure. Does it contain any major alienated groups; if so, what is the cause of such alienation? What is its unemployment rate? Is there a great disproportion between the rich and the poor? Is class behavior significant? Is corruption rampant? Do the people feel that the government is usually ineffective and lacking in economic progress? Is there resentment against foreign influence and investment, especially against United States foreign investment?

Suppose there should occur a change in the structure of the host country. The prospective foreign investor must consider the possibility of a drastic change in its political and economic orientation. Could such change lead to economic chaos or even civil war and ultimate widespread nationalizations and a renouncement or rescheduling of foreign debt payments for ideological reasons? An affirmative answer is unfortunately confirmed by several recent government upheavals.

In today's world an awareness only of the domestic problems which could affect a company's investment and the investment climate of the host country would not suffice. Regional and global problems also have an impact on the host's investment climate. A potential investor should ask whether the host country is located in a calm or conflict-prone region. Does it have any major conflicts with its neighbors? Is it allied with any superpower or belong to a regional defense organization? Could a regional conflict impair its economy?

As regards international financial sources, a company should ascertain whether the host country has good relations with foreign financial institutions and with international credit and investment guarantee agencies such as OPIC, the World Bank, and the International Monetary Fund. Does the host country have any special trade agreements with major trade blocks such as the European Economic Community? Is it favorable to increased foreign trade and investment? What are its relations with the United States?

As is quite obvious, the preceding questions and observations are but a sampling of the legion of questions directly or indirectly related to political risk factors which can affect a foreign investment.

As noted, OPIC is very much involved in the risk management process of a project it insures or finances. However, before considering OPIC's involvement and operation, I shall examine generally what is -- or should be -- done by a company contemplating doing business in a foreign country insofar as political risk factors are of concern.

A most important initial aspect of any foreign investment decision is the anticipated rate of return. It is a truism that the greater the risks, the greater the anticipated level of profitability and the quicker the investor wants to obtain the return of his capital investment.

METHODS OF ASCERTAINING THE RELATION BETWEEN RISK AND RETURN

Various methods or formulas have been employed to ascertain the relation between risk and return.[13] The least sophisticated approach is the simple go/no-go

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13. For evaluations of the different approaches to political risk assessment, see Robert B. Stobaugh in "How to Analyze Foreign Investment Climates," *Harvard Business Review* (September-October 1969), pp. 100-108; Lloyd, *supra* note 10, pp. 65-69; Dan Haendel and Gerald T. West, "Political Risk Management: A Challenge to Multinational Enterprises," paper presented to the International Studies Association, Toronto, february 1976, pp. 4-17; Howard Blasch, Joseph Cummings, and Richard Stewart, Sr., "International Investments: A Research Report" (Columbus, Ohio, Society of Insurance Research, 1974).

method, sometimes derogatorily referred to as "the hit or miss" approach. It accepts or rejects a particular country on the basis of examining only a few characteristics -- e.g., its attitude towards United States investment or its tax system. Accordingly, while it requires a minimum of research or cost, it runs the risk of rejection or of selection on possible irrelevant factors. Nevertheless, it may be a valuable screening device for eliminating a large number of countries unsuitable to a company's objectives.

The payback method, widely used by natural resource industries, measures the time it will take the investor to get back his investment; it ignores or glosses over returns on investment after the payback period and the time value of money. Another method measures the average rate of return but likewise ignores the time value of money. Methods utilizing internal rates of return and net percent values discount future cash flows but do not solve the problems of how to discount cash flows or how to increase the discount rate because of political risk. A hybrid technique combines the payback method with the discounted cash flow approach.[14]

A more advanced approach, with many adherents and numerous variations, is the premium for risk method. It directly involves return on investment estimates and requires a higher return on investment (ROI) for operating in higher risk countries. Different companies have adapted the method to suit their particular needs. Some employ a formal rating scale; others do not. Some companies use specific cutoff points for different countries; others use a fixed percentage after-tax ROI as a minimum for a particular country. The sophistication of the risk profile for each country varies greatly among companies.

The BERI and BI-premium for risk systems

Two subscription services, whose clients include banks and companies conducting multinational business, employ premium for risk systems: Business Environmental

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14. Franklin R. Root, "Formulating Corporate Foreign Investment Strategy," MPR Summary Report, pp. 106-107; Haendel and West, *supra* note 13, p. 19.

Risk Index (BERI), directed by F.T. Haner, professor of management at the University of Delaware, and Business International Index of Environmental Risk (BI), published by a private research organization.[15] Both seek to provide a general assessment of environmental risks faced by an investor in a particular foreign country, basing their evaluation on the weighted score of their particular criteria. The higher the overall score, the more favorable is the business climate for a foreign investor.

A brief comparison of the BERI and BI systems will be useful. Both utilize the Delphi method of polling a panel of experts for their estimates of environmental risks. In BERI the experts score a country on the basis of 15 criteria or variables grouped into three environmental risk subindexes: political, operations, and financial. Some of the criteria are found in more than one subindex. In the political subindex the weightiest

15. For a detailed description of these two systems and services, see F.T. Haner, "Business Environmental Risk Index," paper presented to American Risk and Insurance Association, August 1974, reprinted in <u>Best's Review</u>, Property/Liability ed., July 1975; "Briefing Memorandum, World Forecasting Roundtable," 1974-1976; <u>ibid.</u>, 1975-1977, <u>Business International</u> (mimeographed).

variables are political stability, attitude toward the foreign investor and profits, and nationalization; in operations, economic growth and currency convertibility; in financial, currency convertibility, short-term credit, and long-term loans/venture capital. Additional factors in the political subindex are monetary inflation, balance of payments, and bureaucratic delays -- all likewise components of the financial subindex. Such overlapping is an inherent limitation upon the isolation of the political process affecting business. BERI's panelists rate its 15 criteria from zero (unacceptable conditions) to 4 (superior conditions).

In the BI system the experts utilize three subindexes of 10 factors each. The three subindexes are political-legal-social, economic, and monetary-financial factors. Among the factors in the first subindex are political stability, probability of nationalization, restrictions on capital movements, desire for foreign investment, and limits on foreign ownership. Economic factors include present market size, income per capita, and restrictions on foreign trade; monetary-financial include inflation, devaluation, balance of payments, and currency convertibility.

Each subindex in the BI index is given a maximum score of 100 with each environmental factor given a pre-established score attributing a maximum number of points to the most favorable conditions. Illustrative is the variable of political stability: a response of guaranteed long-term stability produces the greatest weight, followed in decreasing order by strong government but vulnerable constitution, active internal factions, and strong probability of overthrow (internal and external).

Each of these two systems contains factors or variables lacking in the other. However, it may be stated in general that the BI's political-legal-social subindex is more comprehensive than BERI's political subindex while the latter's operations and financial subindexes are more comprehensive than their BI counterparts. Each index makes it clear that any company subscribing to its risk evaluation method can adapt it to its own particular needs and requirements. Thus, there might be assigned different priorities for the three risk categories and different weights to the factors in each subindex.

Before considering the serious methodological problems and flaws inherent in the premium for risk system resulting from its intrinsically large element of subjectivity, one may note the method of analysis projected in limited academic pursuits at the Foundation for Business Administration at Delft in The Netherlands.[16]

The Delft program

The Delft program employs 13 subjective internal stability indicators divided into three subindexes: economic, sociological, and violence factors. The three subindexes were chosen on the basic assumptions of a strong interrelation between economic welfare and political stability; of a strong influence on the stability by the sociological structure; and of the impact of violence (as described below) on such stability. The five economic factors are national income per capita, private savings through official establishments, investments by private foreign enterprises, balance of payments (visible and invisible), and price level of consumer goods; the five sociological factors are agricultural output, private home ownership and building activities,

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16. See Niebling, supra note 10.

emigration (permanent and temporary), metropolization and urbanization, and religious attendance of the population. The three variables comprising the violence category are number of strike days, criminal offenses per 1,000 inhabitants, and frequency of anti-government incidents. The economic and sociological subindexes are deemed of equal weight (5 scores), while that of violence given 3 scores because considered a result of basic problems within a society and not itself a primary reason. It was recognized that a country's reported violence was but a fraction of its total violence.

The Delft approach measures trends in a given period by comparing the mathematical data pertaining to the 13 stability indicators in such period with those of a previous period. The comparison data point to stable, unchanged, or unstable conditions. It is assumed that the more stable the conditions, the more favorable the investment climate of the country will be.

Illustrative is the application of the Delft criteria to a country (X) for two periods, the first at the end of the 1960's, the second at the beginning of the following decade. By the end of the first period, economic conditions, except for unstable balance of payments, had greatly improved over the previous period. However, good sociological conditions had not kept pace because of large scale emigration, urbanization, and loss of religious convictions by urban youth. There was simultaneously a decrease in the violence factor. The rating was greater stability and better political climate than before, primarily because of the economic score.[17]

During the following period, there was a deterioration of economic conditions, with a worsening of balance of payments and an increase in consumer prices. Sociological conditions remained poor and violence factors showed a marked increase. Direct foreign investments fell substantially below those of the preceding period. A revolution occurred at the end of the period, followed by a new period of improved economic and foreign investment growth.[18]

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17. See Appendix I, Table I.

18. See Appendix I, Table II.

It is obvious that the Delft approach with its 13 indicators has numerous limitations and weaknesses. It is useful only for the more developed countries. Moreover, the premise of some of its indicators, especially the sociological factors, is open to question. For example, as regards emigration, cannot a government control it? Concerning urbanization, has not revolution or insurrection also arisen in rural areas? Doubt concerning index criteria necessarily affects predictive capability.

While the premium for risk method has the advantage of being uniform and straightforward, with explicitly stated criteria and the possibility of quantifying risks, it has, as noted, several inherent weaknesses. The variables are subjective and dependent upon the evaluators. Weighting and scoring procedures are inexact and arbitrary. There are difficulties in assigning proper weights inasmuch as various elements may have different effects on seemingly similar projects. While describing existing conditions, the system basically reflects but short-term projections: there can be no presumption that the degree of risk remains constant during the entire period of the investment. Moreover, there are validity problems -- e.g., what should be the minimum rate of return for a given risk; how should a country's rating score be transformed into a desired premium for risk?

The range of estimates approach

A refinement or extension of the premium for risk approach is the range of estimates approach. This method employs pessimistic and optimistic estimates of critical factors in different combinations. These variables, which could be any aspect of government policy, are integrated into a model that can produce estimates of the possible effect of changes in these factors on the profitability of a particular enterprise.

While superior to the premium for risk method, the range of estimates approach is far from flawless. How does one identify the critical variables? How does one weigh them in order to produce an estimate of all the risk factors? Furthermore, how does one take into consideration that some variables may increase or decrease the effects of others? While the method affords a range of outcomes, it does not project their probability estimates.

The comprehensive risk analysis approach

The most sophisticated method is the comprehensive risk analysis approach which contains more variables than the others. It estimates the probability distributions of important variables and then uses such distributions in a computer simulation model to obtain a distribution of the probable returns.

The common denominator of the various predictive approaches is their "postdictive" characteristic -- i.e., the estimated outcomes of later years, premised on estimated probabilities, are dependent upon events which have already occurred. In many instances information concerning particular variables is indirect and imprecise, and only sufficiently reliable to afford a general order of magnitude guide to the risks involved.

Let us illustrate a most simple application of the risk analysis approach with few variables.[19] Assume a probability estimate that a radical party may ascend to power in a country (X) within five years and then

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19. See Greene, supra note 12, p. 73; Blasch, Cummings, and Stewart, supra note 13, p. 5.

expropriate the foreign company's manufacturing plant: Among the questions the company should ask itself are: What factors or variables should be watched? What is the expected probability of the occurrence of the selected relevant factors? What are the available alternative options? What steps can it take to minimize the risks?

This approach utilizes a decision tree which is extended for each year over the life of the project. In the supposititious case, it is estimated that there is a 30% probability that the radical party will be elected as against as 70% probability for retention of the incumbents. If the radicals assume power, it is estimated that there is a 50% probability of expropriation; if the status quo is maintained, the risk of expropriation is negligible. The probability of loss by expropriation is therefore 15% (30% x 50%). The probability tree can be further utilized to estimate additional types of risks -- e.g., if expropriation occurs, what are the probabilities concerning the quantum of compensation, if any?

The probable dollar loss for each estimate is obtained by multiplying the expected cash flows for each outcome by the probability of that outcome and calculating the present values of this cash flow.

Irrespective of the particular decision-making approach adopted by a company, it must have a clear understanding of its objectives. It should define the areas it deems important and systematically monitor them.

TWO SYSTEMATIC CORPORATE MONITORING SYSTEMS

Illustrative of systematic corporate monitoring systems considering political risk factors are those of two companies, one a large diversified American manufacturing firm selling consumer goods in several dozen countries (Company A), and the other a large natural resource company with worldwide operations in the exploration, distribution, and marketing of its products (Company B).[20] Each employs a system specially designed for its needs and deemed appropriate for its investment decision process.

Company A's system assists its formulation of future business, sales, and investment plans in the coun-

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20. I appreciate the assistance concerning the general data given me by Drs. Gerald T. West and Christopher A. Geblein.

tries of its operations. It maintains a folder, divided into four sections, for each of such countries. The first section consists of a summary of its sales and return on investment levels and future estimates thereof; the second, a summary of political risk estimates based on a questionnaire; the third, a summary of past and current economic data and projections thereof; the fourth, information and memoranda by executives who have visited the country. At least an annual update and excision are required.

Company A uses a sophisticated premium for risk approach predicated in large measure upon a lengthy questionnaire listing more than 150 criteria. The questionnaire, periodically updated, is sent annually to its representatives abroad. The responses are fed into a computer with a summary of the results put into the appropriate folder.

With its worldwide operations in the natural resource field, Company B, after examining all the existing political risk assessment techniques, established a system specifically designed for its industry. Because its approach and method represent one of the current most sophisticated and comprehensive tools for political/economic analysis, a somewhat detailed description of the system will prove useful.

Company B selects a panel of country experts from diverse disciplines specifically to assess the probabilities of specific adverse political actions vis-a-vis a contemplated venture in a particular foreign country. Its monitoring system is designed to assess two general conditions which may affect its operations: (1) political risk factors which could modify its contract with the host country and alter the return on its investment; (2) such factors which could affect its repatriation of the investment and profits, and extraction of the natural resources.

Company B selected nine political risk factors or propositions, postulated in statement forms, which it deemed could affect its operations. Each proposition was then subjected to a number of different variables listed under different topics, with each variable's being postulated as either a positive or negative statement. The experts expressed their agreement or disagreement with the statements, noting their estimate preference as strong agreement, agreement, neutral, disagreement, or strong disagreement.

Each expert, including nationals of the country under study, is given a questionnaire containing the nine propositions. As regards the expropriation component of political risk, for example, the questionnaire might contain this statement: Our company, with production facilities in country X for 10 years, has suddenly been told to cease operations immediately. It does not know if it will receive adequate compensation, nor has X offered to renegotiate the contract. Under this statement would be found various possible headings involving political, economic, social, legal, regional and global, etc. factors. One or more variables might be listed under each topic -- e.g., under economic factor, the variables of economic growth and balance of payments. With each variable so listed is found a positive and negative statement. Under the balance of payments variable the positive statement could be: Country X has had and is expected to have a favorable balance of payments. Consequently, there is little likelihood X will not renegotiate its contract or refuse to pay adequate compensation for B's facilities. The negative statement would indicate that the balance of payments deficit has increased greatly in the past year and is expected to worsen. Therefore, there is no anticipation of renegotiation or of receipt of adequate compensation.

Company B's analysts have so adapted its political risk system as to facilitate change or modification of the variables and the concomitant statements to fit a particular country and its operations therein. The objective is to obtain a comprehensive probability risk estimate for each political risk factor based on the probabilities of each variable. Combining the probability of each variable statement produces the aggregate probability of the political risk factor.

The comprehensive estimate is done by computer into which is also fed the confidence estimate, weighted by analysts, of each expert. Strong agreement by an expert with a negative statement indicates great probability of the occurrence of the political risk factor within a specified time; <u>per contra</u>, similar agreement with the positive indicates non-occurrence. In sum, what the system does is to create, based on the inputs to the statements, a conditional probability scale that states the political risk factor will tend to be true if the first variable in the input is true and if subsequent variables are likewise true. The system utilizes Bayes's Rule, a mathematical formula which updates a prior probability estimate when new data are presented.

After completing the computer analysis of the experts' answers, Company B's analysts request the experts to reevaluate their responses in light of the computer results. Special interest in shown with those experts whose responses varied markedly from the computer results. Perhaps such an expert had particular information unknown to, or deemed less important by, others; or perhaps he was misinformed. This post-computer questioning of the experts constitutes a check on the efficacy of the system.

The creators of Company B's system make no claims for its reliability. It was established primarily as an evaluation tool, predicated on the comprehensive risk analysis approach, to assist the company's strategic planners better to spot trends which could modify its contract with the host country, or alter the return on the investment, or affect its production facilities. While disclaiming the system's use as a forecaster, its creators recognize its utility in alerting the decision-makers concerning relevant political risk factors as regards future operations at specified time intervals.

Unlike the two subscription premium for risk services, BERI and BI,[21] which also utilize the Delphi method of polling experts, the custom-made system of Company B does not rate one country as against another. Moreover, B's weighting of the variables, specifically adapted to the natural resource industry, is far less subjective.

THE APPROACH OF LARGE BANKS

The banking industry has its own unique political risk problems. While unlike firms with foreign-owned operations, a bank has a specific time horizon -- i.e., the term of the loan -- and generally bank loans are less vulnerable than other investments to changes by new governments, its risks with foreign loans must, nevertheless, be continuously monitored and evaluated, especially if the loans have been rolled over.

In the United States only a few of the largest banks use a standard approach to make their own risk evaluation of the creditworthiness of a foreign country

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21. See supra note 15 and accompanying text.

and its businesses. The most common decision for many international bank loan officers has traditionally been whether to participate in another bank's international financing. Smaller banks, without independent analysis, tend to rely on the judgment of the large banks in the major money centers. It is not unusual for each geographical division or even each international loan officer to employ its or his own evaluation method. As indicative of the need of most banks and multinational corporations to devise more sophisticated systems for country risk analysis was the large attendance at an Export-Import Bank-sponsored conference in April 1977.[22]

The answers to two basic questions are determinative in country risk analysis: (1) What is the long-term importance of the country as a market for lending in comparison with other potential markets? (2) Will the country be willing and able to repay its debts?[23]

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22. David R. Francis, "Banks Tighten Credit Ratings to Identify Overseas Risks," The New York Times, May 15, 1977, sec. 3, pp. 1, 13.

23. Antoine W. van Agtmael, "Evaluating the Risks of Lending to Developing Countries," Euromoney, April 1976, p. 16 et seq.

Van Agtmael's checklist approach to country risk analysis

Antoine W. van Agtmael, vice president of the Bankers Trust Company in New York, has formulated a simplified and comparative checklist approach to country risk analysis, especially for the ascertainment of the creditworthiness of developing countries. With respect to the question of priority of the country to the bank, he notes the importance of market potential dependent on such economic and quantitative factors as market size, level of economic development, rate of growth, available resources, and United States involvement. Market size necessitates examination of population and gross national product (GNP) level of development, GNP per capita, percentage of GNP from industry, percentage of population in agriculture and literacy rate, rate of growth, real growth per capita, its trend -- whether up, down, stable, erratic, or stagnant -- and industrial growth. The market potential considers its natural resource deposits and its investment ratio relationship to the GNP. U.S. involvement examines the trends of imports from, exports to, and investment by the United States.

As regards a country's creditworthiness, its willingness and ability to repay its debts, there are various economic and political indicators involving both domestic and international variables. The economic indicators are generally quantitative and objective; the political, often qualitative and subjective. Van Agtmael lists the three most important variables as (1) Can the country generate sufficient foreign exchange through the export of goods and services to pay for its imports and maturing loans? (2) Can the government attract sufficient foreign loans, aid, or direct investment to offset the shortage in foreign exchange? (3) Has it built up a cushion of reserves to deal with temporary shortages of funds? Domestic economic factors on the checklist include the inflation rate, money supply growth, government budget growth, and its surplus or deficit level. International economic factors include export/import ratio, loans received and repaid, price trends of major exports, oil bill imports, official foreign reserves, foreign assets of its banks, international fund borrowing capacity, debt service record and present burden, and past debt rescheduling.

Essential economic data can be found in source material published by, _inter alia_, the World Bank, International Monetary Fund, Organization of Economic Cooperation and Development, United Nations, U.S. and other Governments. A select few of the largest banks use computer-based information and retrieval systems to make country credit risk assessments. Two banks, Morgan Guaranty Trust Company of New York and Bank of America, sell subscription services dealing with country creditworthiness.

As noted, political indicators, often qualitative and subjective, are likewise determinants in reaching a decision by banks concerning country creditworthiness. Van Agtmael's political checklist, somewhat similar in its questions to those found in the BERI, BI, and Delft systems discussed _supra_, considers both internal and external aspects and includes such factors as political stability, homogeneity, ethnic or religious differences which might prove explosive, other sources of potential unrest, access to major markets, and possible U.S. leverage. Note is taken that political risks, also termed sovereign risks by bankers in making loans to foreign countries, are not identical for all investors:

for example, nationalization of mines or industries will affect the foreign investor but will not necessarily mean that the country will be inclined to stop its loan repayments.[24]

One major bank, in addition to using a computer-based data bank, periodically sends a questionnaire to its representatives abroad to assess trends and to express their concerns over political and economic factors affecting a country's creditworthiness. These update responses are immediately fed into the computer.[25]

As with systems employed in other fields, those

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24. Ibid. The literature concerning how banks should evaluate a country's creditworthiness is extensive. See, e.g., Robert R. Bench, "How the U.S. Comptroller of the Currency Analyzes Country Risk," Euromoney, August 1977, pp. 47-51; "We Don't Blacklist Countries: We Just Evaluate Risk: Interview with Comptroller of the Currency," Euromoney, December 1977, pp. 88-91; Henry Simon Bloch, "Foreign Risk Judgment for Commercial Banks," The Bankers Magazine, Autumn 1977, pp. 89-96; Donald R. Mandich, "Setting Loan Limits for Countries," id., pp. 97-102; Hans H. Hartlebein, "Country Exposure Guidelines," The Journal of Commercial Bank Lending (August 1972), pp. 9-14; Robert A. Bennet, "Less Developed Country Loans Pose Questions for Regulators," The New York Times, May 15, 1977, sec. 3, pp. 1, 13.

25. Off-the-record information elicited in interview with Dr. Gerald T. West.

used by banks to measure country priority and credit-worthy ratings apply a weighting system to rate each economic and political risk indicator. An inherent weakness or infirmity is that to the present time no scientific method has been developed establishing an objective and proven weighting formula. Each bank must make its own qualitative judgment; its rating results are at most guidelines.

Survey of 37 large banks

An interesting survey of 37 banks, each with deposits of over $1 billion and involved in international loans, made by the Export-Import Bank in December 1976, found that four had no systematic approach to measuring risks in international loans and only five used the more comprehensive risk analysis techniques with computerized follow-up. A recent study by the Association of Reserve City Bankers indicated that banks are influenced by such factors, among others, as confiscation, nationalization, branching limitations, earning restrictions, market conditions, and currency instability which affect equity investment profitability. Debt investments were affected by withholding and other special taxes on outstanding debt, interest rate management, government-imposed delays on liquidating external obligations, and the more common types of foreign exchange controls.[26]

Although top management officials of U.S. corporations doing business abroad acknowledge their concern with political risks, very few companies utilize the comprehensive techniques adopted by Company A or Company B or the few select major banks. Most use the simple go/no-go method; some, the premium for risk approach; a lesser number, the range of estimates system. While political risk information *per se* is deemed important, weighting of such information through comprehensive analytical techniques is apparently not so considered.[27]

What are the reasons for not utilizing the more sophisticated analytical techniques? One is the unease many corporate executives feel with computer-modelling analytical tools although greater reliance is generally being placed on computer models for economic analysis

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26. Francis, *supra* note 22.

27. Lloyd, *supra* note 10, p. 68.

and market research. Another is cost: the more sophisticated the approach, the greater the expense of gathering the data and engaging competent personnel. A third reason is the widely held belief that in the present stage of development, political risk analysis is too difficult and uncertain, and remains a subjective, qualitative operation.[28]

SOURCES OF POLITICAL DATA FOR MULTINATIONAL CORPORATIONS

It is interesting to note where multinational business enterprises obtain their foreign political data and how they evaluate such data. In a questionnaire sent in the mid-1960's to 187 companies that have investments in manufacturing facilities abroad, 79 usable replies indicated the following sources in descending order: local employees, general news sources, financial institutions, U.S. Government agencies, other companies in the area, and industry associations. The responses

28. Antoine W. van Agtmael, "How Business Deals with Political Risk," in MPR Summary Report, pp. 19-36.

of 93 companies regarding the evaluation of political data showed that 35 percent attempt continuous political forecasting, 9 percent employ political science personnel, 9 percent employ outside political consulting sources, and 43 percent have established procedures for feeding political data into the decision-making process. However, the degree of sophistication in the risk analysis techniques is not stated in the study.[29]

In a limited study based on personal interviews with executives of 18 companies some ten years ago, Franklin R. Root, associate professor of international business, Wharton School of Finance and Commerce, University of Pennsylvania, and quondam holder of the Economics Chair of the Naval War College, noted that while the interviewees stated that market opportunity and political risks are the dominant factors in most investment decisions, none "offered any evidence of a systematic evaluation of political risks, involving their identification, their likely incidence, and their spe-

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29. Dolph Warren Zink, The Political Risks for Multinational Enterprise in Developing Countries with a Case Study of Peru (New York: Praeger Publishers, 1973), pp. 37-41.

cific consequences for company operations."[30]

Dr. Root's observation is confirmed in a relatively recent ex post empirical analysis, entitled "The Environmental Determinants of Foreign Direct Investment" by Professor Stephen J. Kobrin of the Massachusetts Institute of Technology. Corporate planners are primarily interested in economic indicators affecting their market and profitability. Given a significantly attractive market, corporate management will relegate political consideration unless deemed descriptive of business and business-government relationships. Even "political violence may not pose a major risk unless it results in pressures for nationalization, increased local control or ownership, regulations preventing remission of profits or fees, limits on distribution or market penetration, etc." [31] In sum, management approach of the sig-

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30. Franklin R. Root, "U.S. Business Abroad and the Political Risks," MSU Business Topics, 16 (Winter 1968), pp. 74-75.

31. Stephen J. Kobrin, "The Environmental Determinants of Foreign Direct Investment: An Ex Post Empirical Analysis," working paper (WP819-75), Alfred P. Sloan School of Management, Massachusetts Institute of Technology, November 1975, pp. 3-4, 20-21.

nificance of political risk factors remains ill-defined and imprecise.

A factor too often overlooked by corporate planners is that the incidence of political risk is uneven over the life cycle of an investment. During such cycle the relative negotiating strength of the foreign investor vis-a-vis the host country changes. It is strongest at the initial stages of the investment and continues to decline; it is weakest after the receipt of the return on the investment. Accordingly, there should be varied operating strategies depending upon the particular stage of the investment life cycle.[32]

With this extensive discussion of the elements,

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32. There is considerable literature on strategic long-term corporate planning for multinational corporations, including the life cycle incidence. See, e.g., Ashok Kapoor, Planning for International Business Negotiations (Cambridge, Massachusetts: Ballinger Publishing Company), 1975, passim; Hans Schollhammer, "Long-Range Planning in Multinational Firms," Columbia Journal of World Business (September-October 1971), pp. 79-85; Ralph H. Kilmann and Kyung-Il Glymn, "The Maps Design Technology: Designing Strategic Intelligence Systems for MNC's," Columbia Journal of World Business (Summer 1976), pp. 35-47; Ashok Kapoor, "MNC Negotiations: Characteristics and Planning Implications," Columbia Journal of World Business (Winter 1974), pp. 121-130; Stanley Thames, "The Multinational Corporation as a Foreign Policy-Maker," paper presented to the International Studies Association, Toronto, February 1976, pp. 1-27.

role, and techniques of assessment of political risk in the foreign investment decision process, one may now turn to their applicability in the functioning of OPIC.[33]

OPIC'S MODUS OPERANDI AS REGARDS INSURING POLITICAL RISK

Whether with guaranteeing or financing a new investment, OPIC's involvement with a new project commences before, and generally lasts throughout, its life cycle. As regards OPIC's insurance operations, its insurance contract usually covers a 20-year commitment, with a policy holder's possessing an annual option of continuing, reducing, or terminating coverage. Once reduced or terminated, coverage cannot be reinstated.[34]

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33. See generally U.S. Congress, House, Committee on International Relations, Extension and Revision of Overseas Private Investment Corporation Programs, Hearings and Markup before the Subcommittee on International Economic Policy and Trade, 95th Cong., 1st Sess., 1977, pp. 393-428 [hereinafter cited as 1977 HOH].

34. See Chapter III, pp. 131, 179; Chapter V, p. 317, *supra*.

As noted, the greater the risk of an investment, the greater the anticipated level of profitability and the quicker the investor wants to obtain the return of his capital investment. With OPIC's guarantee programs limited by statute to the riskier less developed countries (LDC's),[35] the U.S. investor in such countries would otherwise seek commensurate higher rates of return and shorter payback periods. With OPIC's involvement as a risk transfer device, an OPIC client need not seek a maximum rate of return in a short payback period. Such involvement is especially beneficial to some industries -- *e.g.*, natural resources and agribusiness -- whose start-up times may be in excess of five years.

OPIC's *modus operandi* concerning applicants for coverage is as follows: It has established standard criteria for eligibility. Its application form sets forth questions concerning the nature of the project, arrangements with the host country government, incentives and other governmental regulations applicable to

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35. Overseas Private Investment Corporation Amendments Act of 1978, 92 Stat. 213, amending 22 U.S.C. § 2191 *et seq*. (1978) [hereinafter cited as OPICAA of 1978].

the project, developmental effects such as local capital mobilization, employment, wages, and personnel policies, effects on local suppliers, downstream industries and related economic activities, and environmental considerations. In addition to careful review of the applicant's answers, OPIC also solicits the opinion of the U.S. Embassy in the host country concerning the project and is privy to information gathered by the CIA and other Government agencies.[36]

After review of the relevant data consonant with its eligibility requirements, OPIC may make recommendations to the applicant to use helpful risk reduction techniques to minimize political risks. Its officials are familiar with all such techniques and their refinements. OPIC's concern continues throughout the investment life cycle coverage.

OPIC is a relatively small agency with a staff of less than one hundred fifty and a comparable low budget of approximately $8 million annually.[37] It neither

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36. 1977 HOH, pp. 348-352, 420-421.

37. Ibid., p. 382; U.S. OPIC, A Guide to the Investment Services of the Overseas Private Investment Corporation (January 1977), pp. 5-6 [hereinafter cited as OPIC Guide].

rates countries on an individual basis, engages in political risk forecasting nor employs a political risk actuarial table. In the mid-1960's, while the investment guarantee program was under the auspices of OPIC's predecessor, the Agency for International Development (AID), some AID officials undertook political forecasting. Unofficial studies showed the results to be inaccurate and no further studies of this kind have been pursued.[38]

As a Government agency, OPIC must be responsive to Congress and adhere to its mandates. It has received a directive to conduct its operations on a self-sustaining basis and its insurance operations must conform to principles of risk management. Furthermore and most significantly, it is required to serve a developmental public policy goal. The most recent 1978 legislation requires that OPIC, in determining whether to provide insurance, financing, or reinsurance for a project, shall especially "(1) be guided by the economic and

38. Interview with Mr. Harry L. Freeman, quondam high official in Agency for International Development and vice president for Finance in OPIC, on January 7, 1976. See further Chapter I, p. 83.

social development impact ... and benefits of such a project and the ways in which such a project complements, or is compatible with, other development assistance programs or projects of the United States or other donors; and (2) give preferential consideration to investment projects in less developed countries that have per capita incomes of $520 or less in 1975 United States dollars, and restrict its activities with respect to investment projects in less developed countries that have per capita incomes of $1,000 or more in 1975 United States dollars." [39]

Congressional limitations on its operations place OPIC at a disadvantage with private political risk insurers such as Lloyd's. Its rates must be lower than the others. OPIC can only insure or finance new investments; it cannot charge different rates for different countries; it cannot charge firms in the same industry different rates for comparable local insurance because

39. Supra note 35, in amending § 231 of the Foreign Assistance Act of 1961 by inserting the textual material after the first undesignated paragraph of the 1961 Act.

of their public image; it cannot insure on a short-term renewable basis.[40]

OPIC's risk management techniques

Notwithstanding such statutory limitations, OPIC does utilize various risk management techniques. Preliminarily, risk minimization occurs by its careful screening of clients, employment of detailed eligibility requirements, and approval from the host country of a project which aids the latter's development. It makes different premium charges for different estimates of risk -- *e.g.*, the industry, significant project features, and the form of the investment. Considering larger projects riskier, it has adopted policies to discourage them or reduce attendant risks. With larger or otherwise sensitive projects, it generally requires substantial co-insurance, offers shorter contract periods, assesses higher fees, and provides special monitoring services.[41]

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40. For a detailed analysis of the differences between OPIC and other national and private political risk insurers see Chapter V, pp. 310-322.

41. U.S. Congress, Senate, Committee on Foreign Relations, *Overseas Private Investment Corporation (OPIC), Hearings before the Subcommittee on Multinational Corporations*, 93d Cong., 1st Sess., Pt. 3, 1973, pp. 418-419, 451-457, 512-513 [hereinafter cited as 1973 SOH]; U.S. OPIC, *Investment Insurance Handbook, Overseas Private Investment Corporation* (June 1978), pp. 11-12 [hereinafter cited as *Insurance* Handbook 1978].

When OPIC feels that something is amiss with an insured or financed project, it seeks ameliorative steps through its client or by having U.S. Embassy personnel discuss the problems with appropriate host country officials.

In several ways has OPIC adopted risk reduction techniques. It has placed limits on the growth of its exposure in countries of heavy concentration. In 1975, it commenced broadening its facilities for publicizing appropriate investment opportunities in LDC's with the resultant diversification of coverage in more LDC's. Its reinsurance program for risk sharing with Lloyd's of London and the private insurance association known as the Overseas Investment Insurance Group (OIIG), especially as regards inconvertibility and expropriation risks, has lessened its exposure. As noted, however, the 1978 legislation has discontinued future reinsurance arrangements with Lloyd's and OIIG while retaining present coverage arrangements. As regards its financing program, it has sought the participation of the International Finance Corporation and local and regional developmental banks. [42]

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42. 1977 HOH, pp. 4-5; U.S. Congress, Senate, Committee on Foreign Relations, OPIC Authorization, Hearings before the Subcommittee on Foreign Assistance, 95th Cong., 1st Sess., 1977, pp. 27-32 [hereinafter cited as 1977 SOH].

OPIC's claims procedure

Insofar as its own operations are concerned, OPIC's claims procedure constitutes a vital risk management tool. It has established an insurance monitoring system for countries, projects, and incipient claims. The purpose of such monitoring is to detect early warning signs of possible political problems in time for a management decision to be made as to what action OPIC can take to reduce the possibility of a major investment dispute.[43]

If a dispute arises between an OPIC-insured investor and a host country, OPIC's contract requires the investor to give OPIC prompt notice of any action which may become a basis for a claim against OPIC. In most cases an investor's claim does not mature until the foreign government's challenged action has continued for a year. During this period the investor must take all reasonable measures to prevent or contest the governmental action. This includes redress through the host country's judicial system.

43. 1977 HOH, pp. 424-426; OPIC, Contract of Insurance, for Investment Insurance under Section 234(a) of the Foreign Assistance Act of 1961, as amended (December 1970), Article 1.

Since OPIC's liability to its clients does not arise until considerable time has elapsed from the inception of the dispute, OPIC's efforts during this period, frequently behind the scenes, are directed to assisting an amicable settlement between its client and the host country. In the case of expropriation, threatened or actual, direct negotiations between the client and the foreign government have proved most productive.

In several cases where its clients have negotiated OPIC-approved settlements, OPIC's assistance to the clients consisted of (1) providing financial guidelines; (2) providing some additional cash payments; (3) providing, or committing itself to provide, financial assistance to make either cash or its equivalent available; (4) furnishing the possibility of greater U.S. Government concern if the private negotiations should fail.[44]

OPIC's collection facilities

In the event direct negotiations are unsuccessful

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44. For a general description of OPIC's claim procedures see Peter R. Gilbert, "Expropriations and the Overseas Private Investment Corporation," Law and Policy in International Business, 9 (1977), p. 515 et seq.

and OPIC has paid the matured claim of its clients, OPIC has the same rights and remedies of its client. As subrogee it seeks to avoid confrontation with the host country; and not constrained to effect a quick settlement, OPIC can utilize whatever pressure on a foreign government a U.S. agency may possess. In addition, OPIC has access to third parties, such as regional developmental banks, which can be useful as intermediaries not only in negotiating a settlement but also by helping to find funds from a source not otherwise available to the parties. Such source may be a factor in a financially weak government's agreement to pay satisfactory compensation if part of the payments be deferred. Although its experience in the settlement of claims has been gained in less than a decade, OPIC has helped to convert many disputes from political to solvable economic issues.[45]

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45. Ibid., pp. 543-550; 1977 HOH, pp. 426-428.

<u>1977 recommendations of consultant concerning OPIC's operations</u>

An independent consulting firm, engaged to review OPIC's insurance program operations from an actuarial standpoint and working on a presumption that privatization was desirable and that the program could operate on a self-sustaining basis, in 1977 made several recommendations. With the caveat that OPIC's insurance program does not now present the type of insurance risk ordinarily susceptible to actuarial analysis, the consultant made several recommendations for OPIC's improving its risk management techniques. OPIC should effect greater refinement in the variation of rates by classification of business. There should be greater rating differential between debt and equity investments. Projects in some sensitive industries -- <u>e.g.</u>, mining -- should have rates increased; other projects, lower rates. OPIC's reserve procedures should be modified; instead of using a premium that is essentially constant during the life of the contract, OPIC should recognize the unevenness of the incidence of political risk, with the greater risk being in the later years of the contract. Accordingly, some of the premium in the early years should be set aside as a reserve for the anticipated subsequent greater risk. Finally, OPIC, as a means of increased spreading of risk, should consider writing insurance for a broader market, such as insuring already existing investments or investments in more developed nations.[46]

Some of the preceding recommendations -- e.g., lower premium rates for coverage of less that 20 years -- have already been effected. Others would have required express Congressional approval and in light of the 1978 legislation reinforcing OPIC's public policy developmental goals in the poorer LDC's, this seems unlikely.

OPIC's assistance to its clients

I have pointed out that OPIC may make recommendations to an applicant (and subsequent client) to use helpful risk reduction techniques to minimize political risk. OPIC's insurance coverage is obviously but a partial risk transfer device. If an investment abroad is to be successfully made, more than risk transfer is

46. 1977 HOH, pp. 204-209; see also Chapter VII, pp. 457-458.

essential. There must be a process of accommodation with the host country, described by Professor Franklin R. Root as "adaptation" -- *i.e.*, following policies in foreign operations that are thought to be congruent with the national interests of the host country. Adaptation may be either passive or active: passive when minimum steps are taken to operate within the country; active when the foreign enterprise seeks to make itself an essential part of the host economy.[47]

Professor Dolph Warren Zink, author of a previously cited study,[48] concluded from his research that in the long run the foreign-owned enterprise which gains acceptance as a legitimate entity within the host society will face the least political risk exposure therein. The attainment of legitimacy entails the harmonization of corporate objectives with the host country's interests. This can best be achieved by entry and operating level strategies participative with the latter's interests.[49]

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47. Root, *supra* note 30, pp. 76-78.

48. *Supra* note 29.

49. *Ibid.*, pp. 68-69.

Because of its developmental public policy goals and its involvement from the inception of the foreign investment, OPIC has input in the structuring and operating strategies of its clients. OPIC's eligibility requirements are so structured as to require its clients actively to adapt themselves to the participatory needs of their host countries. In scrutinizing applicants OPIC becomes aware of their long-range objectives and is vitally interested in their financial, organizational, and marketing structures and their production facilities. It asks, are these structures participative in relation to the interests of the host countries?[50]

The clients' engagement of local personnel

In carrying out its mandate and exercising its functions, OPIC seeks clients that will hire local people and train them in more advanced skills; that will open up managerial positions for them and pay all em-

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50. See 1977 HOH, pp. 393-428; U.S. Congress, Senate, Committee on Foreign Relations, OPIC Authorization, Hearings before Subcommittee on Foreign Assistance, 95th Cong., 1st Sess., 1977, pp. 16-32 [hereinafter cited as 1977 SOH].

ployees decent wages; that will not be a drain on the host country's balance of payments and will reinvest part of the profits therein; in short, that will be good corporate residents of the host country, obeying its laws and paying their fair share of taxes.

As regards extractive operations, OPIC shuns the exploitive company that will export natural resources and send the huge profits abroad, leaving the host country with but holes in the ground. With respect to marketing operations, it seeks a company whose products are not overpriced and are culturally acceptable to the host country. Where production facilities are involved without export considerations, it wants equipment suitable to the host's own needs and manufactured from local materials where possible. Through these means OPIC facilitates the adaptive and participative activities of its clients with the resultant minimizing of their political risks.[51]

Multilateralizing the project

In its concern with the financial structure of its

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51. Ibid.

client, OPIC encourages several risk reducing techniques. One of these is multilateralizing the project. OPIC may obtain a foreign partner, or secure some financing for the project from multinational institutions, or private international investment companies like ADELA [52] and PICA [53] or even from the International Finance Corporation of the World Bank.[54]

Joint ventures

Another technique is OPIC's sponsorship of, or participation in, a joint venture project with local businesses or other companies. OPIC has had considerable experience with this device. Its use depends upon the laws of the host country limiting foreign equity ownership and the type of industry involved.[55]

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52. See Chapter II, pp. 89-90, note 5 and accompanying text.

53. Ibid.

54. 1977 SOH, pp. 24-25.

55. Ibid.; 1977 HOH, pp. 420-424.

It is interesting to note the reluctance of some multinational companies to do business in any foreign country which mandates a joint venture, through equity shares or otherwise. Such companies, with products and trade names of worldwide dimensions, have a particular interest in the uniform quality of the products made and marketed under their name. Similarly reluctant have been some high technology manufacturing companies where the continuity of the operations, the integration of management, and the supervision of technical standards and labor performance are deemed essential.[56]

Illustrative of a refusal to bow to nationalistic demands is the recent actions of International Business Machines Corporation and Coca-Cola Company to close their manufacturing and marketing operations in India. They refused to comply with India's Foreign Exchange Regulation Act requiring most foreign companies, except those manufacturing strictly for export, to divest 60 percent of the equity of their subsidiaries to local

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56. Wolfgang G. Friedmann, "The Contractual Joint Venture," Columbia Journal of World Business (January-February 1972), pp. 57-59.

shareholders by the end of 1977. Neither company did much business in India. IBM has had similar problems with a few other nations.[57]

Particular forms of foreign investment

It is natural that different countries favor particular forms of foreign investments, with direct foreign investment being on the wane. In Latin America, most countries seek credit rather than direct investment since they can rid themselves of creditors by repayment, inflation, or defaulting on their obligations, while equity owners cannot be so easily eliminated. These countries favor a technique known as "unbundling," involving a variety of sources of foreign funds and investors from different nations responsible for marketing, sales, management, and other parts of a project owned by the host country. In other countries, particularly the Middle East, unbundling is frowned upon and complete investment, sales, technological support, and management packages are often sought from the same company. Many countries are agreeable to accept less than

57. N.R. Kleinfeld, "IBM to Leave India and Avoid Loss of Control," The New York Times, November 16, 1977, sec. D, pp. 1, 12.

majority control or to participate in joint ventures or management agreements.[58]

"Domestication"

In recent years many countries, especially in Latin America, have adopted measures generally encompassed in the term "domestication." In the past the option available to a host country to gain control of direct foreign investments was expropriation or severe harassing techniques. Through domestication the host country enacts legislation forcing foreign-owned enterprises to surrender various degrees of ownership and control to nationals. Among measures of domestication are installment of a larger number of nationals vested with greater decision-making powers in higher level management positions, transfer of partial or majority ownership to nationals, and use of export quotas.[59]

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58. Covey T. Oliver, moderator, "Political Risk Workshop on Latin America," in MPR Summary Report, pp. 72-73; Bill Paul and Raymond A. Joseph, "Trends in Caribbean Worry U.S. Companies with Stake in Region," Wall Street Journal, May 17, 1976, pp. 1, 22.

59. OIPR Monograph, pp. 11-12; Paul and Joseph, supra.

Different forms of joint ventures

Joint international business ventures have assumed a variety of forms. Generally, in manufacturing ventures, the host governments maintained a minority share in equity capital; in the exportation of natural resources, they sought majority control which in some instances was a prelude to complete nationalization. In the enterprise known as the contractual joint venture, generally involving large and sensitive natural resources projects, the foreign investor and the host country share the cost of the investment, the risks, and the long-term development aims. The physical ownership of the natural resources remains with the host; investment and expenses are divided according to fixed percentages. Sometimes the contractual joint venture is combined with an equity joint venture and other contractual arrangements such as management.[60]

60. Friedman, supra note 56, pp. 57-63; Lawrence G. Franks, Joint Venture Survival in Multinational Corporations (New York: Praeger Publishers, 1971), passim; Kapoor, Planning for International Business Negotiations, supra note 32, Ch. 3; James W.C. Tomlinson, The Joint Venture Process in International Business (Cambridge, Mass.: MIT Press, 1970), passim; Robert A. Fisher, "Three Management Contracts -- from a Developmental Perspective," unpublished paper in the New York University Graduate School of Business Administration, December 31, 1976, passim.

OPIC has encouraged the contractual joint venture and other non-equity forms of investment because they represent to the investor new ways of packaging valuable products and often involve considerably less financial risk and greater assurance of continuing income than formal equity arrangements. Two recent examples are the Philippine Geothermal project in which a $37 million insured investment will be made under a long-term, non-equity technical services agreement for the development of a geothermal energy project, and the Filon Exploration Company's $20 million insured investment under a production-sharing agreement with Jordan for oil exploration and production.[61]

Cognizant that joint venture participation by nationals of the host country, especially in a significant portion of the investment, assists the long-term projects of the venture, OPIC has continued to seek greater local involvement. Two-thirds of its projects in 1976 involved local co-ventures; the number of projects with at least one-half local ownership increased from 21 percent in 1974 to 43.9 percent in 1976.[62]

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61. 1977 HOH, p. 424.

62. Ibid., p. 423.

In some instances OPIC has requested potential clients to insist that the host country -- where it is unfamiliar with the value of the subject matter of the arrangement -- engage specialized outside consultants to protect its interests. Thus, in the Dominican Republic's $185 million Falconbridge nickel mining project, the sponsor insisted that the Government retain highly experienced legal counsel to represent it in negotiations.[63]

THE POLITICAL RISKS INSURED BY OPIC

We have seen how OPIC in general deals with political risks and how it utilizes risk reduction techniques for itself and its clients. As set forth in preceding chapters, OPIC's statutory mandate permits insurance coverage against three types of political risks only: (1) loss of investment or damage to tangible property as a result of war, revolution, or insurrection (war risk); (2) inability to convert to dollars local currency received by the client as profits or earnings or return of the investment (inconvertibility); (3) loss of investment through expropriation, nationalization,

63. Ibid., p. 422.

or confiscation (expropriation). In addition to its insurance programs, OPIC has a considerably smaller finance program which deals with political risks more from a banking creditworthiness perspective, evaluating the risks of direct lending to projects which meet its eligibility requirements.[64]

Amount of coverage

The three types of political risks insured by OPIC are fundamental risks. The amount of coverage since OPIC's predecessor AID began its insurance activities has been substantial. From 1961 through 1970, AID insured $3.97 billion in investment. From OPIC's commencement of operations in 1971 until 1977, OPIC insured another $2.4 billion, approximately one-half of the total amount of U.S. investment in OPIC-insured projects. The outstanding amount of insurance issued by AID and OPIC covered approximately 980 investments by over 450 investors in 79 countries.[65]

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64. In addition to the detailed consideration found in the preceding chapters, see OPIC Guide, pp. 4-5.

65. 1977 HOH, p. 411.

Let us examine in some detail OPIC's activities and experience in the three areas of insured political risks.

WAR RISK INSURANCE

Since the end of World War II, there have been more than 150 major insurrections, coups d'état, revolutions, and full-scale wars resulting in millions of deaths and injuries. The Stockholm International Peace Research Institute has estimated that at any one time there is an average of 12 wars (in the broadest sense of armed disputes) occurring in the World.[66]

In light of such statistics it is evident that OPIC's war risk insurance is seemingly the "riskiest" of the three areas of coverage. It is the one area or type which private insurance, including Lloyd's and the Overseas Investment Insurance Group, refused to reinsure.[67]

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66. Anthony Sampson, "Want to Start a War," *Esquire Magazine*, March 1, 1978, pp. 60-61.

67. See Chapter IV, p. 252, *supra*.

Because of the privatization mandate set forth in the 1974 legislation (subsequently repealed in the 1978 legislation), OPIC in late 1974 sought other means to comply with the legislative mandate. It unsuccessfully urged the creation of a War Risk Reciprocal Insurance Association, a mutual entity to write such insurance jointly with OPIC which would gradually take larger portion of the liabilities as its reserves grew. To this day only OPIC and its governmental counterparts abroad will write such war risk insurance.[68]

War risk exposure, premiums, and payments-of-claims

The statistics concerning premiums for, and payments made under, this war risk insurance are interesting. OPIC and its predecessor agencies have written such insurance since 1957. As of June 30, 1975, OPIC had a current war risk exposure of $2.2 billion in 60 countries. Since 1957 cumulative income therefrom has approximated $75 million while only $661,000 have been paid on eight accepted claims. During fiscal 1975 premium income amounted to $11.4 million.[69]

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68. *Ibid.*, pp. 254-256.

69. U.S. OPIC, *A Proposal to Form a War Risk Reciprocal Insurance Association* (September 9, 1975), p. 3. (Mimeographed.)

Extent-of-coverage

OPIC's war risk insurance coverage does not require a formal declaration of war but extends to losses from actions taken to hinder, combat, or defend against hostile action during war, revolution, or insurrection. No coverage is provided against civil strife of a lesser degree than revolution or insurrection.

Classification for compensation purposes

This insurance for compensation purposes is classified into two groups: (1) "covered property" and (2) "installment default." The former, whose basic measure of compensation is original cost and limited to the client's proportionate interest in the assets of the venture, includes equity investment, certain kinds of debt investment, and construction contracts. The latter involves coverage of debt under some forms of contract which is neither limited to nor measured by the loss sustained to such physical assets. Compensation is available if the determinative event or act directly causes a default on a scheduled payment of principal or interest for a period of three months (or for one month in the case of a subsequent, consecutive default) for institutional lenders or six months for parent company lenders. The payment covers the insured portion of the defaulted installment.[70]

Special programs for natural resource projects

OPIC has recently commenced offering special programs for mineral, oil, and gas exploration projects in addition to standard war risk coverage. In the case of mineral exploration and development projects, insurance is available to cover consequential loss due to closing of operations for a period of at least six months directly caused by war risk events in the project country or certain specified events elsewhere. As regards oil and gas exploration, development, and production, insurance is available to cover losses from cessation of operations for six or more months. The compensation for such cessation is 90 percent of the net unrecovered cost, which must be returned to OPIC without interest if within five years after payment the situation has abated and the client can resume operations.

As to OPIC's current premium rates for war risk insurance, suffice it to note that they are the same

70. Insurance Handbook 1978, pp. 10-11.

for manufacturing/service, natural resource (other than oil and gas exploration), and service contract projects.[71] In terms of OPIC's war risk exposure of approximately $2.7 billion as of May 31, 1977, more than two-thirds involved three industries -- namely, chemical ($847 million), mining ($728 million), and machinery ($441 million). Other manufacturing, food, utility, and agricultural enterprises constitute much of the remainder of such exposure.

Sixty-three countries are involved in OPIC's war risk insurance exposure. Jamaica leads with approximately $450 million, followed by South Korea with $380 million and Dominican Republic with $300 million.[72]

STUDIES ON POLITICAL INSTABILITY

The political risk inherent in war, revolution, insurrection, or coups d'état has been classified by political and other social scientists under the rubric of political instability. These conflict situations affect foreign investment in ways other than physical

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71. Ibid., pp. 11-15.

72. 1977 HOH, pp. 59, 65.

damage of tangible property. They can directly affect business operations in the form of stoppages, strikes, supply or distribution problems. Indirectly, political instability can lead to a deterioration of the host country's overall economic climate.

Studies on political instability and its components, especially revolution, have produced a variety of theories and divergent and often antagonistic approaches. There is disagreement over how to isolate underlying common variables and what should be the basic unit of analysis -- individuals, groups, or political systems.

The factor analysis study

A study[73] undertaken for the State Department under its external research program sought to use factor analysis [74] to establish different dimensions of political instability. Factor analysis involves the identification of several dimensions (factors) of conflict behavior.

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73. Michael K. O'Leary and William D. Coplin, Quantitative Techniques in Foreign Policy: Analysis and Forecasting (New York: Praeger Publishers, 1975).

74. Ibid., pp. 16-21.

Part of this study considered predicting political instability in tropical Africa. Political instability was broadly defined as "a condition affecting governments in which the established patterns of authority break down, and the expected compliance to the government is replaced by political violence. Instead of complying with government decisions out of habit, belief, or loyalty, individuals and groups in society engage in behavior characterized by the physical injury or subjection of persons or property with the intent to bring about an alteration in the structure of the government." [75]

It was further classified into two basic (conceptually distinct) and statistically unrelated types -- namely, élite and communal. The former, referring to events in which members of the political élite, or some alternative as the military, use violence or the threat of violence to remove people in authority in the national government is manifested operationally by three types of behavior: coups d'état, attempted coups, and plots.

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75. Ibid., p. 45.

Communal instability, reflected behavioristically as civil war, rebellion, irredentism, or ethnic violence, refers to events in which members of communal groups -- that is, groups whose members share ascribed characteristics of ethnicity, language, religion, or territory -- use violence to change the distribution of authority among communal groups within the general population or between the government and the group.[76]

The study analyzed African countries in terms of nine indicators of factors affecting their élite and communal political instability. These indicators were size (population), ethnic pluralism (number of spoken languages), social mobilization (percent of workers in agriculture and wage earners as percent of active population), urbanization (10-year percentage increase in city population), national integration (number of commercial vehicles), interest group size (men in armed forces), government economic performance (per capita GNP and cumulative balance of trade for 5-year period), political party unity (number of illegal parties), external support (average annual per capita assistance

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76. Ibid., pp. 45-47.

from foreign sources).[77]

Utilizing the statistical technique known as regression analysis, this study concluded that extensive communal instability exists in African states with large influential armed forces, extensive ethnic pluralism, and social mobilization. Contrariwise, promotion of national integration and economic development, aided by foreign sources, indicates both low communal instability and low élite instability. A country with a fragmented party system and an increasing degree of social mobility is most likely to experience élite instability.[78]

Continuing to employ quantitative methods, this study analyzed élite instability in these countries as regards coups d'état. Five factors were related to the incidence of coups: two, social mobilization and political party disunity, promoting instability; three, interest group size, government economic progress, and foreign support, having the opposite effect. These five factor correlates were combined with information con-

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77. Ibid., pp. 59-66.

78. Ibid., pp. 65-67.

cerning coup performance of each country during a specified period of time; and applying the computer technique of discriminant function analysis, the authors sought to establish a basis for predicting future coups in the subject countries. They perceptively observed, "What will actually happen in a given country cannot be predicted by any methodology presently available or likely to be available in the foreseeable future" (underscoring in original).[79]

The study utilizing TAGS reports

The authors of the preceding study on predicting political instability in tropical Africa made a subsequent study, entitled "Automated Information Systems Versus Specialists as Political Forecasters," utilizing the State Department's Traffic Analysis by Geography and Subject cable information system (TAGS), in operation since 1973. TAGS requires each sender to identify by enumerated category and code the contents of his

79. *Ibid.*, pp. 69-74.

cable.[80]

Using TAGS reports and also information received from country intelligence specialists in the U.S. Government, the authors applied two quantitative analysis techniques as a basis for predicting politically motivated violence in three countries (Argentina, Ethiopia, and Thailand) during the period November 1974 to June 1975. The two techniques were lagged regression of political violence scores in TAGS, and a system dynamics model of data obtained from surveys of the intelligence specialists which were also evaluated using lagged correlation analysis.[81]

The findings of the study were mixed: the procedure produced moderate to high correlations in two of the three countries but was unsuccessful in the third (Thailand). The authors concluded with the observation that the results warranted further investigation.[82]

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80. Michael K. O'Leary, Donald J. McMaster, and Wiliam D. Coplin, "Automated Information Systems Versus Specialists as Political Forecasters," paper prepared for presentation at the XVII Annual Convention of the International Studies Association, Toronto, February 25-28, 1976, pp. 2-3.

81. Ibid., pp. 1-2.

82. Ibid., p. 25.

The Hudson study

In a study completed in the late 1960's, Michael C. Hudson of Johns Hopkins University concluded that the relationship between political instability factors differs from country to country. Utilizing data gathered under the auspices of the Yale World Data Analysis Program, he analyzed 95 countries in all parts of the world except the states of sub-Saharan Africa in terms of how their political system reacted to various political violence patterns.[83]

Hudson selected as a unit of analysis a country's most violent years -- *i.e.*, the maximum number of dead in political violence -- between 1949 and 1966 and then compared patterns of violence and power transfer before, during, and after that year in a 3-year plot. While irregular changes were most frequent in Latin America, that region ranked last both in terms of demonstrations and armed attacks and next-to-last in terms of riots during the crisis year. The level of coups and attempted coups in Asia and the Middle East tended to be higher before the crisis year than in Latin America.[84]

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83. Michael C. Hudson, "Political Protest and Power Transfers In Crisis Periods," *Comparative Political Studies*, 4 (October 1971), pp. 259-263.

84. *Ibid.*, pp. 263-273.

Hudson also found that violent crises and major government changes are relatively independent of one another. Coups tend to come, if at all, during a year of some violence, but often the most violent year has no coup associated with it. The frequency of regular government transfer increases from the year before the crisis year to the latter year and continues to rise in the following year, suggesting that crises have lingering political repercussions. Armed attacks are more prevalent in new countries; riots in middle-aged countries, and protest demonstrations in the oldest countries.

Hudson found Latin America to be the most politically unstable region, followed by the Middle East and Asia. In the newer countries irregular power transfers tend to precede violent crises, while these coincide in older countries.[85]

While some political scientists as empiricists use factor analysis to establish different dimensions of political stability, others, relying upon theory, prefer to build indices based upon a particular theory.

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85. Ibid., pp. 273-278, 283.

The Gurr analysis

A leading theorist emphasizing social psychology is Professor Ted Robert Gurr of Northwestern University. In a 1968 article he asserted that measurement of political instability (his term is "civil strife") must consider three aspects: pervasiveness, the extent of participation by the affected population; duration of the strife; and its intensity, the human cost, both dead and injured.[86] Accepting as a premise that the root cause of violent conflict lies in individual discontent, in later studies he predicated his theory on the generalization of the frustration-anger-aggression principle from the individual to the social level.[87] This principle had its genesis in the earlier postulate of some social psychologists, later qualified as to other forms of responses; "'that the occurrence of aggressive behavior always presupposes the existence of frustration and, contrariwise that the existence of frustration always leads to some form of aggression'."[88]

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86. Ted Robert Gurr, "A Causal Model of Civil Strife: A Comparative Analysis Using New Indices," American Political Science Review, LXII (December 1968), pp. 1107-1108.

87. Ted Robert Gurr, "The Revolution-Social Change Nexus: Some Old Thoughts and New Hypothesis," Comparative Politics, 5 (April 1973), pp. 364-365.

88. Ted Robert Gurr, Why Men Rebel (Princeton: Princeton University Press, 1970), p. 33.

Gurr molds the frustration-aggression construct into a concept he terms "relative deprivation," the perceived discrepancy between men's value expectations -- the goods and conditions to which people believe they are entitled -- and value capabilities -- those they think they can get and keep. When the feeling of individual dissatisfaction becomes widespread, the cumulative effect is political instability.[89] Such instability is classified into turmoil and rebellion. The former consists of events with mostly limited political objectives, including riots, political demonstrations, general strikes, political clashes, and localized uprisings. All other events, ranging from plots and coups through terrorism to civil war, constitute rebellion.[90]

Gurr's main thrust is that the potential for collective violence in a nation or smaller community varies with the intensity and scope of socially induced discontent among its members. The more frustrated people become, the greater the possibility for mass political violence. Two factors affecting his concept of relative

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89. Ibid., pp. 13, 24-25, 37-39.

90. Ted Robert Gurr and Raymond Duvall, "Civil Conflict in the 1960's," Comparative Political Studies, 6 (July 1972), p. 143.

deprivation are a country's structural characteristics, termed strain, and including income distribution, ethnic pluralism, political separatism, and political discrimination; and stress indicators, including short-term fluctuations as economic recessions, and defense expenditures. He found strain to be the prime source of manifest political conflict.[91]

In an epilogue entitled "Implications for Research and Policy," Gurr observed that while his theory has potential policy uses, "[i]t does not enable anyone to predict approximately when or where any specific conflict event will occur."[92]

The Feierabend analysis

Another analytical study emphasizing the social psychological approach was conducted by Dr. Ivo K. Feierabend and associates.[93] He concurred with Gurr con-

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91. Ibid., pp. 146, 160.

92. Ibid., p. 159.

93. Ivo K. Feierabend with Rosalind L. Feierabend and Betty A. Nesvold, "The Comparative Study of Revolution and Violence," Comparative Politics, 5 (April 1973), p. 393.

cerning the importance of motivation and that aggression is the result of frustration and that the degree of frustration is decided by one's wants and how well those wants are satisfied. However, his emphasis has been on systemic frustration and systemic aggression rather than on individual acts of violence.

Feierabend's inquiry formulated four main types of systemic aggression: (1) political instability or civil strife, internal acts directed against office-holders and exemplified by strikes, riots, revolts, guerilla warfare, coups, etc.; (2) coerciveness of political regimes, violence directed by officeholders and exemplified by arrests, martial law, confiscation of property, etc., and general curtailment of civil rights and liberties; (3) conflict between groups within the political system, in such forms as ethnic, religious, and racial tensions; (4) external aggression and hostility, exemplified by such international actions as war and embargoes.[94]

Systemic frustration -- i.e., frustrations experienced collectively within societies (nation-states) --

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94. Ibid., pp. 393, 404.

according to Feierabend is the *sine qua non* leading to political violence. Systemic frustration at any given time is a function of the discrepancy (ratio) between present social aspirations and social achievements measured in terms of a number of variables. The variables measuring aspiration are literacy rate and urbanization; those measuring achievement include gross national product per capita and the distribution of radios, newspapers, telephones, and physicians.[95]

Some of Feierabend's findings are striking: Levels of socioeconomic development or of modernity are positively related to political instability. Modern countries tend toward stability; transitional, developing nations are markedly unstable; and truly undeveloped, traditional countries tend to be more stable than the immediately preceding group. Rapid socioeconomic change usually produces turmoil. International aggression is unrelated to indicators of systemic frustration but related to internal violence. Similarly, aggression and violence stemming from minority-majority tensions -- *e.g.*, religious or ethnic -- are unrelated to indicators

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95. *Ibid.*, pp. 405-409.

of systemic frustration. The higher the level of socioeconomic frustration, the higher the level of coerciveness necessary to act as a deterrent to aggression. Political instability is greatest with a combination of high levels of socioeconomic frustration, high levels of fluctuation in coerciveness, and mid-level coerciveness of political regime.[96]

It is not within the scope of this work to consider more fully than has already been set forth illustratively the studies of the two different groups of political scientists who have sought to measure political instability -- namely, the empiricists using factor analysis, and the theorists, building indices based upon a particular theory. Suffice it to note that the differences between the two groups at times seem only somewhat greater than the differences among members of the same group.

Practical utility of these studies and analyses

Of what practical utility are these various theories based on postdictive events? How valuable are these studies in forecasting political instability in

96. Ibid., pp. 409-421.

particular and international relations in general? How relevant are the findings and conclusions of these researchers to the activities of government officials and international business? Consideration of these questions is evident; definitive answers, problematical, for controversy is omnipresent.

It has been suggested that forecasting approaches may be categorized into the following classes: (1) expert estimates: projections by journalists, politicians, historians, and others based on observation and assessment; (2) normative projections: expert opinion combined with and refined by quantitative techniques; (3) trend projections: extrapolations of unchanging or slowly changing conditions; and (4) quasi-experimental projections: projections employing computer-projected models based on diachronic and synchronic propositions.[97]

It is evident that all of these approaches are subject to human biases. Political instability and other

97. Donald A. Sylvan, "Errors and Assumptions In International Relations Forecasting," paper presented to the International Studies Association, Toronto, February 1976, p. 3.

political risk factors are dependent on these human variables. Econometric theoreticians are less dependent in their research since their theories are addressed to a fairly narrow set of problems that satisfy a set of hard assumptions.

Use by Government officials

To what extent have Government officials utilized these varied studies and theories concerning political instability forecasting in their own activities? In interviews with State Department officials the following observations were made: The Department continues to employ conventional means of analysis to forecast political instability and places little reliance on sophisticated quantitative analyses or other long-range forecasting techniques. According to one analyst, conventional means were generally adequate to predict events within a short period of a few months; to another, even the more sophisticated quantitative analytical techniques require marked improvement before their utility is established. A consensus observation deprecated the present value of the studies with the concomitant recognition of anticipated improvements.[98]

Use by business and OPIC

Of what utility are these studies and theories to international business people and OPIC? At the outset one may note that very few of the studies have paid heed to the needs of the business community as contrasted with research on the factors involved generally in political instability. There have been no definitive studies on the special vulnerability of particular types of business or industry to specified events of political instability such as war or insurrection. There have been no definitive studies on the relevancy of the size or duration of the foreign enterprise in the host country as regards such vulnerability.

Controversy exists as to whether businessmen attribute great importance to the potential impact of political instability when making foreign investment de-

98. Off-the-record information elicited in interviews with officials of the Bureau of Intelligence and Research, Department of State, July 28, 1976.

cisions. Earlier studies indicated such instability a most critical factor in the decision. Recent research indicates this factor much less decisive.

Study of political instability and foreign investment in marketing

A study undertaken by professors of marketing investigated the relationship between political instability and foreign marketing investments (defined as U.S. foreign direct private investments in manufacturing and trade resulting in products and services being marketed abroad) in 46 countries.[99] The Feierabend measure of political instability, defined in terms of the type and number of politically relevant, aggressive behavior occurring within a nation over a stipulated time period, was selected as the preferred index.[100] No significant relationship was found between marketing investment and the index of political instability either for the entire

99. Peter D. Bennett and Robert T. Green, "Political Instability as a Determinant of Direct Foreign Investment in Marketing," Journal of Marketing Research, IX (May 1972), pp. 182-185.

100. Supra notes 93-95 and accompanying text.

sample of 46 countries or for developed or less developed nations individually. With the caveat that "the principal constraint of the study is the validity of applying the Feierabend index (developed from the perspective of the political scientist) to business decisions," the authors concluded: "The results suggest that political instability did not affect the overall allocation of U.S. foreign direct marketing investment throughout the World. International managers appear to have allocated their investments on the basis of other overriding factors." [101]

Study of political risk in international business

A study of the impact of political events covering approximately 15 countries in four continents in which the home country (United States or Europe) had established 30 or more subsidiaries revealed some interesting findings. [102] It is hard to make conclusions of any generality and much more research is essential. It is

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101. Supra note 99, p. 185.

102. Lars H. Thunell, Political Risks in International Business --- Investment Behavior of Multinational Corporations (New York: Praeger Publishers, 1977), p. 34.

impossible to say if and when a political event will be of importance for the foreign investor. U.S. companies increased their investments in years following years with a high level of political violence; European countries only when both the year before and the current year had a low level of mass political events. For both, government transfer was important, independent of whether this occurred through regular transfer or coups. In Europe a general stability is sufficient for investment increase; in Latin America, where political violence is a usual condition, foreign businessmen do not pay much attention to political fluctuations. While the level of disturbances often is correlated with changes in investments, such level can be low or high without any change in the investment trend. It has not been possible to demonstrate anything about the importance of policy changes through government transfers that occur independently of changes in political stability. Companies in high labor-intensive industries are more sensitive to political instability than companies in low labor-intensive industries. Companies tend to tolerate a higher level of instability and still invest in large markets rather than in small markets.

Finally, the *sine qua non* for practical forecasting, generally lacking in present research, is the time horizon for which the prediction is made.[103]

The Green studies

Professor Robert T. Green, co-author of the previously considered marketing study, has written about one aspect of political risk -- namely, radical political change -- defined as "the ascendancy to power of a person or group holding a different political philosophy than the person or group that it replaced [which] can be either evolutionary or revolutionary" -- and how it can be estimated by studying the political structure of a country.[104]

Borrowing from a classification nomenclature used by David E. Apter[105] and Gabriel A. Almond and G. Bingham Powell,[106] Green posits the thesis that a nation's

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103. *Ibid.*, pp. 47-48, 55, 61, 64, 67, 70, 96-97, 110.

104. Robert T. Green, "Political Structures as a Predictor of Radical Political Change," *Columbia Journal of World Business* (Spring 1974), p. 29.

105. David E. Apter, *The Politics of Modernization* (Chicago: University of Chicago Press, 1965).

106. Gabriel A. Almond and G. Bingham Powell, *Comparative Politics: A Developmental Approach* (Boston: Little Brown & Co., 1966).

propensity for instability is reflected in its form of government, and that an estimate of the probability of radical political change can be made by observing this variable. He classifies countries, with both economic and political characteristics, into two groups: modernized and modernizing nations. The former are further divided into instrumental-adaptive systems, democratic and responsive to the dictates of the polity, as exemplified by the United States and England; and instrumental-non-adaptive, less responsive to their populace, as France and Italy. The latter are subclassified into five categories: (1) instrumental and quasi-instrumental systems attempting adaptive politics (India, Turkey, Mexico); (2) military dictatorships (Ghana, Brazil, Burma); (3) modernizing autocracies, where modernization occurs at a controlled rate within the control of the ruler (Jordan, Spain under Franco); (4) mobilization systems, exhibiting extreme militarism, devotion to a cause, and charismatic leader (Cuba, China under Mao); (5) recently independent states -- e.g., many in Black Africa.[107]

107. Supra note 104, pp. 29-34.

Green's conclusion is that a multinational corporation can assess the risk of radical political change by using the criterion of governmental form as a general indicator of the present and future political conditions of the particular country. As the risk increases as one goes down his scales, among the modernizing nations the quasi-instrumental systems and autocracies are appropriate for long-term investment; the military dictatorship for short-term investments; and avoidance of investment in the mobilization systems and newly independent states. "However, exceptions exist to the risk probabilities associated with many of the political systems noted. Therefore, investors should employ the governmental form criterion in conjunction with other methods for assessing political risk when a nation is being seriously considered as an investment site."[108]

In another paper Professor Green examined three current political scientists' forecasting proposals available for use by businessmen to evaluate a country's investment climate as regards political instability.[109]

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108. Ibid., pp. 35-36.

109. Robert T. Green and Christopher M. Korth, "Political Instability and the Foreign Investor," California Management Review (Fall 1974), p. 23.

The first approach developed by Bruce R. Russett utilizes two measures of indicators: the number of deaths per one million population which occurred as a result of political violence, and the number of years a nation has been independent and the number of chief executives it had from 1945 to 1961. Green feels the first indicator of political deaths has some utility but the second does not in the business context.[110]

The second approach developed by Arthur Banks and Robert Textor assigns to each nation one of four governmental stability categories -- i.e., general stability since World War I or major interwar constitutional change; general stability since World War II or major postwar constitutional change; moderate stability since World War II, and instability during such latter period. Green's criticism of this approach is questioning the premise that changes in the actual institutions of government significantly affect business operations; the subjective nature of whatever factors are used to classify a particular nation; and the difficulty of determining which nations may be marginal members of each class.[111]

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110. Ibid., pp. 24-25.

111. Ibid., pp. 25-26.

The third approach, more comprehensive, complex, and sophisticated than the other two, was developed by Ivo Feierabend and Rosalind Feierabend. Its thesis is that a nation's political instability is reflected in the amount and intensity of aggressive, politically relevant behavior occurring within a society. They have constructed a seven-point scale of political instability, listing 30 types of political activity to which they have assigned different weights. The more destabilizing the activity, the higher the assigned weight. Green's observation is that while this index appears to have a major weakness in its scales placement of nations, it could contribute to decisions concerning the location of a direct investment intended to serve a regional market. [112] His conclusion relevant to the three approaches, developed by political scientists without the needs of the businessman in mind, is that "they are the best means now available" to permit comparison of the political instability risk of alternative foreign investment possibilities.[113]

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112. Ibid., pp. 26-30.

113. Ibid., p. 30.

The PSSI system

A very comprehensive system to determine a country's political instability index was developed by the Foreign Policy Research Institute of Philadelphia under the name Political System Stability Index (PSSI).[114] Its data, covering information for the period 1961-1966, were collected from 65 of the 79 countries for which OPIC insurance was under review in 1974. PSSI is composed of 15 indirect measures of political instability, classified into three equally weighted indices, all of which include indicators bearing on the stability status: (1) socioeconomic; (2) societal conflict; and (3) government processes.[115]

The socioeconomic component consists of three equally weighted indicators: (1) ethnolinguistic fractionalization based on a country's ethnic and linguistic heterogeneity -- high fractionalization is indicative of a potential for civil strife; (2) percentage growth in GNP; and (3) energy consumption per capita -- the ability for economic expansion also provides a favorable political climate.[116]

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114. OIPR Monograph, pp. 61-66.

115. *Ibid.*, pp. 63-65, 83.

116. *Ibid.*, pp. 63, 79-80.

The societal conflict component, weighing political conflict that has already disrupted the system, is divided into three indicators: public unrest, internal violence, and coercion potential. The first subindex, public unrest, is further divided into the number of demonstrations, riots, and government crises defined as follows: demonstration -- peaceful gathering of at least 100 people to display opposition to government policy; riot -- a demonstration with force resulting in material damage or bloodshed; crisis -- a situation threatening to cause the government's downfall. The second subindex, internal violence, is composed of four indicators: the number of armed attacks, assassinations, coups d'etat, and guerilla warfare incidents -- activities which are the product of deep-seated grievances that are unlikely to be pacified by mere policy changes. The third subindex, coercion potential, consists of a single variable indicative of a society's ability to punish opposition and reinforce its policy -- *i.e.*, the number of internal security forces per thousand persons in the working-age population needed to maintain order. The first subindex was accorded a weight of .2, one-half that given the other two subindices.[117]

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117. *Ibid.*, pp. 63, 80-82.

The third major component, government processes, evaluates the political system's governmental characteristics. Its four indicators are: (1) the number of annual constitutional changes evidencing basic alterations in the nation's constitutional structure; (2) the effectiveness of the national legislature, determined along a four-point scale, in relation to executive power; (3) political competitiveness, a combination of variables measuring the competitiveness of the nominating process, the presence of legislative coalitions, and the degree of party legitimacy; and (4) the number of irregular chief executive changes -- *i.e.*, those effected outside the conventional legal means.[118]

The PSSI component scores for the 65 LDC's measured in the index for the 1961-1966 period were rated so that the higher the scores, the greater the stability of the political system, and the lower the score, the lower the stability, relative only to the other countries on the OPIC list. Each of the three major components has its own score, a positive score representing greater

118. *Ibid.*, pp. 82-83.

socioeconomic development, less social conflict, and greater stability in governmental processes. There is a combined score for the three equally weighted components together with a confidence estimate score on a scale from one to five assessing the subjective accuracy and reliability of the data used to measure a country's PSSI score. Assignment of confidence estimates was partially based on non-arbitrary factors, such as the extent of missing data affecting the indicators.[119]

The authors of the PSSI have recognized its infirmities and have noted several caveats. The PSSI does not pretend to measure the stability of a particular regime or government so as to predict any particular changes or events. It does not differentiate between the political stability of a democratic country like Costa Rica and an authoritarian regime like Communist Romania which have almost identical scores. It does not directly take into account the assessment of citizens' attitudes toward the stability of their own government. The device of confidence estimates is still basically subjective. The system is very experimental

119. Ibid., pp. 66-69.

and requires constant updating of the base time period to the present.[120] To one commentator, who raises questions concerning the theoretical foundation for the index, the causal relationship between different indicators and what precisely a particular indicator measures, PSSI nevertheless can be regarded "as a good first step towards a really valid measure."[121]

As noted, PSSI covers only certain OPIC-insured countries and not others, and its data review is still many years behind. Even for OPIC PSSI's usefulness is limited: since OPIC must charge uniform country premium rates, PSSI cannot vary the rates for individual countries; moreover, since OPIC's insurance coverage lasts as long as 20 years, neither PSSI nor any other existing system can predict political stability or cognate political risks for so long a period. In fact, PSSI has not yet been tried even for short-term forecasting. In sum, the basic contribution of PSSI is its utilization of more comprehensive techniques developed by political scientists to further business enterprise at a time when

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120. Ibid., pp. 65-72.

121. Thunell, op. cit., pp. 104-105.

the business community is still generally slow in seeking the assistance of political scientists to evaluate the multifaceted political risks.

There is overwhelming evidence that OPIC as a risk transfer device has influenced foreign direct investment in LDC's in hostile regions. OPIC insurance coverage for war, revolution, or insurrection has played a significant role in the advancement of a legion of projects with material value to the international economic policy interests of the United States. Without OPIC participation many of the projects would never have been undertaken in such diverse countries as South Korea, Taiwan, Thailand, and Jordan.[122]

INCONVERTIBILITY INSURANCE

The second of the three types of political risk insured by OPIC relates to the inability to convert to dollars local currency received by the client as earnings, capital, principal, and interest, and other eligible remittances -- *e.g.*, payments under service agreements. This inconvertibility coverage is designed to

122. 1977 HOH, pp. 180-184; 1973 SOH, pp. 280-281, 327.

assure that such funds can continue to be transferred into U.S. dollars to the extent transferable under exchange regulations and practices effective when the insurance was issued. The currency inconvertibility blockage which permits the insured client to exchange local currency for dollars through OPIC may be either "active" -- *e.g.*, the exchange control authorities deny access to foreign exchange on the basis of new, more restrictive regulations -- or "passive" -- *e.g.*, the authorities fail, usually within 60 days, to act on an application for foreign exchange.[123]

This insurance covers adverse discriminatory exchange rates but not currency devaluation. Moreover, local currency held by the insured for more than 18 months is not eligible for transfer. OPIC pays its insured in dollars on an exchange rate fixed with reference to the rate in effect on a date generally 30 or 60 days prior to the date the claim is made against OPIC.[124]

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123. Insurance Handbook 1978, pp. 8-9.

124. *Ibid.*, p. 9.

<u>Inconvertibility risk exposure, premiums, and payment of claims</u>

The premium rate for this insurance -- *i.e.*, .30 percent per annum for current insured projects and .25 percent for standby insurance -- is the lowest among the three types. It is applicable to manufacturing/service, natural resource (other than oil and gas), and service contract projects. The rate is slightly lower for institutional loans.[125]

As of May 31, 1977, OPIC and its predecessor agencies had written $2.8 billion of inconvertibility insurance. From June 1966 to February 1977 it had paid out over $7 million for, and had recovered $5 million through, inconvertibility claims. Its premiums exceed its payments.[126]

In terms of its inconvertibility exposure of $2.8 billion, over 70 percent involved three industries -- namely, chemical ($1,106 million), machinery ($558 million), and other manufacturing industries ($369 million). Mining, agriculture, and food enterprises constituted much of the remainder of such exposure.[127]

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125. *Ibid.*, pp. 11-12.

126. 1977 HOH, pp. 63, 66-70.

127. *Ibid.*, p. 58.

Seventy-eight countries are involved in OPIC's inconvertibility insurance exposure. Brazil leads with approximately $380 million, followed by South Korea with $375 million and Dominican Republic with $310 million. Jamaica, which leads in war risk exposure, had approximately $50 million.[128]

The risk of inconvertibility contains both political and economic elements. The foreign exchange laws of some countries are inherently unclear and ambiguous, thus permitting arbitrary conduct. In other countries, exchange regulations are subject to administrative change with no recourse to judicial review.

Factors underlying convertibility restrictions

The factors which may trigger convertibility restrictions are both numerous and diverse and may be beyond the control of the host country. They may arise from foreign exchange shortages brought on by chronic balance of payments deficit or government financial mismanagement. The foreign exchange rates play their part. Over a long period, exchange rates are determined by the interaction of the supply and demand functions for imports and exports, services, and capital flows. For

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128. *Ibid.*, p. 63.

the short period, movements in these rates arise from a complex interplay of economic, political, and psychological factors difficult to predict.[129]

In terms of evaluating inconvertibility risks, it is easier to spot the short-term (a few months) trends evidenced by economic indicators than those for longer periods. Furthermore, the uncertainties inherent in the political factors affecting convertibility restrictions make analysis and prediction of these factors even more difficult. With respect to the economic analysis of the exchange rates factor, it has been suggested that some measure of predictability can be obtained through the application of regression analysis and the construction of econometric models.[130] How successful these techniques are remains to be seen.

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129. Keith Wheelock, "What is the Direction of U.S. Political Risk Insurance," Columbia Journal of World Business (Summer 1973), pp. 59, 62; Lloyd, supra note 10, p. 64.

130. Lloyd, p. 65.

Measures to minimize the risk

Whenever convertibility restrictions are deemed likely to be established, certain measures may be adopted to minimize the risk. Unfortunately, as has been pointed out, "In most corporations, a foreign exchange crisis is handled in an atmosphere of panic -- a last-minute estimate of potential loss is made, and some emergency financial juggling takes place." [131]

Among the minimizing-of-loss measures are the following: Development of sufficient sources of domestic and foreign exchange should be facilitated to allow the local affiliate or subsidiary to weather the control period successfully. Solicitation of additional lines of local credit should be furthered. If foreign exchange is needed to import materials essential for operations or to make remittances abroad, the local enterprise should initiate some type of export activity to earn convertibility currency. Sometimes countries imposing these restrictions permit local exporters to retain a portion of their receipts for future international transactions or to gain access to foreign exchange by earning a certain amount of foreign exchange. Mini-

131. Bernard A. Lietaer, "Managing Risks in Foreign Exchange," Harvard Business Review, 48, No. 2 (March-April 1970), p. 7.

mization by the parent corporation of the funds held should be fostered. This can be accomplished by accelerating collection of accounts receivable and by transferring as much non-essential cash and near-cash assets out of the country.

Another means is a direct request for exemption from any restrictions on the ground that otherwise the local economy would be the major sufferer.

Assuming the convertibility restrictions are imposed, the local affiliate or subsidiary must plan a course of action how best to use the local currency until the funds can be remitted to the parent. It can invest its surplus funds in inventory, capital equipment, and promotional activities, or in local ventures. However, in the long run the terms of convertibility generally are negotiable, especially if the affected company has the patience to seek an amicable solution.[132]

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132. Wheelock, supra note 129, p. 62.

OPIC's negotiation of inconvertibility disputes

OPIC, as a means of risk transfer, has exhibited the ability and patience to negotiate successfully these inconvertibility disputes. As noted, while paying out $7 million in claims, it as subrogee has recovered $5 million and has maintained the lowest premium rates for this type of political risk insurance -- the kind which has raised less international tensions than the war risk or the expropriation coverage discussed immediately below.[133]

EXPROPRIATION INSURANCE

The third type of political risk insured by OPIC relates to loss of investment through expropriation, nationalization, or confiscation. Generally referred to as "expropriation exposure," this kind of risk has been the most significant and costly in the operations of OPIC and its predecessors, and has received the most attention from the public because of events in such countries as Chile.[134]

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133. Supra notes 125, 126.

134. See Chapters I, pp. 62-67, and III, pp. 124-136, concerning Chilean expropriation.

<u>Expropriation, nationalization, and creeping expropriation</u>

At the outset of this chapter it was noted in very general terms that in expropriation the foreign company is expressly named in the takeover decree; in nationalization, the decree is directed against a general class of property or a whole sector of the economy which is brought into state ownership or control of nationals of the host country; and in creeping expropriation, an action which is not sudden, there are frequently limitations on the activities of the foreign company.

Definitions of these terms vary with their authors. One of the broadest definitions of expropriation is the formal taking of property whether or not compensation is paid. It is a recognized legal right of a sovereign country, but normally the taking of private foreign property must be for the public interest and is accompanied by effective compensation. If the taking is described as socialization, it means that the property taken has been reserved exclusively for the public sector. Creeping expropriation, in contradistinction to outright expropriation, assumes more subtle means to eliminate the foreign company. It embraces such measures as labor legislation including withholding work permits; price controls and tariff policies; increased tax rates against certain industries; and restrictions on imports of essential materials.[135]

"Expropriatory action" in OPIC insurance contracts

OPIC insurance contracts define the insurable event of "expropriatory action" to include not only classic nationalization of an enterprise or the taking of property, but also a variety of situations which might be described as "creeping expropriation." An action, "taken, authorized, ratified or condoned" by the project country government is considered to be expropriatory if it has a specified impact on either the properties or operations of the foreign enterprise, or on the rights or financial interests of the insured investor. For an action to be considered expropriatory, it must last for one year or, in the case of institutional loans, three months or less. Proper regulatory or revenue actions taken by the host government and actions

135. Robert M. Heine, "The Expropriation Climate: A Study of Dynamic Measures," working paper (WP 768-75), Alfred P. Sloan School of Management, Massachusetts Institute of Technology, February 1975, pp. 2-3 [hereinafter cited as Heine]; Lloyd, supra note 10, pp. 59-63; J. Frederick Truitt, Expropriation of Private Foreign Investment (Bloomington, Indiana: Indiana University Graduate School of Business, 1974), pp. 5-11 [hereinafter cited as Truitt]; Niebling, supra note 10, p. 3.

provoked or instigated by the OPIC client are excluded from coverage.[136]

OPIC has developed new insurance coverage for investments in oil and gas exploration, development, and production. Insurance is available for all forms of such investments including production-sharing agreements, service contracts, and traditional concessions. Expropriatory action for investment under production-sharing agreements includes abrogation, impairment, repudiation, or material breach of the production-sharing agreement which for a period of six months directly results in certain effects, including preventing the insured from effectively exercising his fundamental rights with respect to the production-sharing agreement (including the rights to take and export oil or to be paid for it). The insurance contract for concession agreements provides that unilateral changes by the host government in the terms of the agreement do not give rise to a claim unless they prevent the insured from realizing a share of the economic benefits of the project that is equitable and reasonable, taking into account all

136. Insurance Handbook 1978, p. 9.

then available information with respect to project and industry factors.[137]

In the event of expropriatory action, compensation by OPIC is based on the original amount of the insured investment, adjusted for retained earnings (or losses) or accrued interest, and for any prior recoveries of investment, as of the date of the expropriation. Except for coverage against the seizure or freezing of certain funds, OPIC pays expropriation compensation on investments only against assignment to it of the securities evidencing the entire insured investment and any related claims or rights. The coverage does not permit an equity investor both to retain his ownership interest and to be compensated by OPIC for governmental actions resulting in lost profits or reduced investment values.[138]

Expropriation risk exposure, premiums, and payment of claims

The premium rate for expropriation insurance varies with the particular industry and the period of coverage. It is generally the same or higher than that for war

137. Ibid., pp. 14, 16.

138. Ibid., p. 10.

risk coverage except in the case of institutional loans where the war risk premium is higher. With the same standby annual premium of .25 percent in each case, the annual premium for manufacturing/service projects and service contractors is .60 percent; natural resource projects other than oil and gas, .90 percent; and .30 percent for institutional loans. With institutional loans combined coverage of the three types is available at reduced rates.[139]

Over 95 percent of OPIC's resolved claims involved expropriatory action. This is understandable in light of the Chilean events of a few years ago. Since 1966 OPIC has paid or guaranteed expropriation claims of over $320 million. More than one-third of this total was paid in cash; approximately one-quarter through the sale to third parties of OPIC-guaranteed host government obligations, and the remainder by host government compensation notes payable to investors and guaranteed by OPIC.

Because OPIC has settled or anticipated settling with host governments almost all political risk claims

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139. Ibid., pp. 11-12.

which it has already paid, it expects that by 1988 it will actually receive a net gain on its claims, due to interest payments.[140]

As of May 31, 1977, OPIC and its predecessors had written more than $3.3 billion of expropriation insurance. Over 70 percent involved three industries -- namely, chemical ($1,067 million), mining ($796 million), and machinery ($522 million). Other manufacturing industries, food, agriculture, and utility enterprises constituted much of the remainder of such exposure. Of the 78 countries involved in this exposure, Jamaica leads with approximately $450 million, followed by Brazil with $420 million, South Korea with $390 million, and Dominican Republic with $320 million.[141]

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140. U.S. Congress, House, Committee on International Relations, Overseas Private Investment Corporation Amendments Act of 1977, H. Report, 95-670, 95th Cong., 1st Sess., 1977, pp. 6-7 [hereinafter cited as 1977 HOR]; 1977 HOH, pp. 66-69.

141. 1977 HOH, pp. 60, 64.

<u>The Root study of the U.S. companies' expropriation experience</u>

Since outright expropriation is frequently preceded by measures considered as part of creeping expropriation, the former can in many instances be anticipated. Professor Franklin R. Root, whose limited study on how little business executives systematically evaluate political risk was mentioned above,[142] has written about the expropriation experience of 38 U.S. companies.[143] Writing with respect to a 1966 survey that "[t]he experience of these companies is a microcosm of the expropriation experience of American companies in general," he observed that such experience was a sequence of choices, actions, and other behavior on the part of the business enterprise, the U.S. Government, and the host government, in a setting of six phases: (1) warning activity that expropriation is imminent or probable within the foreseeable future; (2) management response

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142. *Supra* note 30.

143. Franklin R. Root, "The Expropriation Experience of American Companies," *Business Horizons* (Winter 1968), pp. 69-74.

to prevent or minimize expropriation; (3) seizure of the company's properties; (4) offer or lack of offer of compensation; (5) response to phase 4 by acceptance, rejection, negotiation, legal action, or U.S. diplomatic support; (6) settlement through payment of compensation by the host government or equivalent measures. Each expropriatory action is different and in some instances certain phases may not occur, especially the first and last.[144]

The Hoskins analysis

William R. Hoskins, professor of marketing and director of international program in business at Bowling Green State University, has written that in the "pre-confiscation" period (Root's stages 1 and 2), management should discuss with the host government the advantages and benefits which have flowed and would flow from continuance of an unimpeded operation; and then present the spectre of economic reprisal resulting from outright expropriation.[145]

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144. Ibid., pp. 71-72.

145. William R. Hoskins, "How to Counter Expropriation," Harvard Business Review (September-October 1970), pp. 102-103.

In the Hoskins analysis the "postconfiscation" period carries the parties through four basic phases of confrontation, with each successive stage marked by escalating hostility and increasingly severe reactions. There are: (1) rational negotiations; (2) negotiation flavored with power tactics; (3) exploration of legal remedies; and (4) surrender by management and decision to seek only salvage value. In the first stage the expropriated business enterprise seeks to keep the lines of communication open by proposing new concessions of varying degree. In the first instance it may indicate a willingness to hire local managers, raise transfer prices to the foreign parent, and accept local interests as minority partner; under increasing host government pressure it may agree to invest more capital for expansion, release the host from concession agreements, and support its programs. The company may draw the line at demands to surrender majority control, suspend payment of dividends, or withdraw all U.S. personnel.[146]

The second stage involves the exercise of power,

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146. Ibid., pp. 103-104.

both political and economic, in varying degrees of intensity. As regards political power, presently of marginal value, emphasis should be placed on the positive approach of the host's political needs -- *e.g.*, granting additional concessions -- but occasionally the negative approach, as a threat to assist opposition parties or request the intervention of friendly powers, may prove valuable. As a practical matter, economic pressure is probably more effective, especially where the foreign company's activities involve the development of technological skill, control of export markets, supply of component parts or raw materials, and dependence on other foreign companies.[147]

The third stage involves the utilization of legal remedies. There may be recourse to local courts of the host country or, in proper case, to U.S. courts, where the doctrines of sovereign immunity and act of state may prove a complete bar. Finally, there may be actions by U.S. agencies (including OPIC), contractual international arbitration, and U.S. diplomatic intervention.[148]

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147. *Ibid.*, pp. 104-106.

148. *Ibid.*, pp. 106-111.

When all else fails, the foreign company must accept the fourth stage and final alternative, salvage whatever it can from its investment. If the animosities engendered by the expropriatory action have not remained explosive and might be ameliorated; and if the foreign investor really is important to the continued success of the enterprise, the role of such investor might be changed from proprietor to contractor or agent. For example, it could provide technical skills under a management contract, or handle exports on a commission basis.[149]

Recent analytical approach to the subject of expropriation has generally developed along two overlapping and complementary theories. One views expropriation through the characteristics of the industry to which the foreign company belongs and notes such factors as size, ownership, and technological know-how. The other views the characteristics of the host government, such as its form, its balance of payments record, and its GNP.

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149. _Ibid._, pp. 111-112.

State Department studies

There have been several recent studies, including comprehensive studies undertaken by the Bureau of Intelligence and Research of the State Department, which have examined the characteristics of the expropriation of U.S. companies by host countries since 1960.[150] Among these characteristics or factors of the takeover which were considered are the industry taken over, the geographic region of the host, and the form of the expropriation -- i.e., outright nationalization, forced sales, or otherwise.

These studies make clear that the number of expropriations of U.S. foreign direct investments have markedly increased in the past two decades. The number of expropriations in 1975 was 4 times that of 1970 and 50 times that of 1961. The State Department studies,

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150. U.S. Department of State, Bureau of Intelligence and Research, "Nationalization, Expropriation, and Other Takings of United States and Certain Foreign Properties Since 1960" (Washington: November 30, 1971) [hereinafter cited as 1971 SDS]; "Disputes Involving United States Foreign Direct Investment: July 1, 1971, through July 31, 1973" (Washington: February 28, 1974) [hereinafter cited as 1974 SDS]; and "Disputes Involving U.S. Foreign Direct Investment: August 1, 1973-January 31, 1975" (Washington: March 20, 1975) [hereinafter cited as 1975 SDS].

with data obtained primarily from diplomatic and Central Intelligence Agency sources from 1960 to 1975, detail approximately 250 instances of governmental interference which may be categorized as expropriation and includes such measures as forced sales, forced renegotiation of contracts, and requisitions. It should be noted, however, that while these expropriatory actions are significant, they represent but a comparatively small part of total U.S. foreign direct investment.[151]

The State Department studies list 51 takeover actions (defined as expropriation or negotiated sale of property), excluding Cuba, involving U.S. companies or nationals during the period 1961-1968. Between 1969 and 1971, the number was 64; 1971-1973, 87; 1973-1975, 42.[152]

Other studies

Two other studies,[153] defining expropriatory action

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151. David G. Bradley, "Managing Against Expropriation," Harvard Business Review (July-August 1977), p. 78.

152. 1971 SDS, p. 8; 1974 SDS, p. i; 1975 SDS, p. i.

153. Bradley, supra note 151; Robert G. Hawkins, Norman Mintz, and Michael Provessiero, "Governmental Takeovers of U.S. Foreign Affiliates: A Postwar Profile" (Washington: Center for Multinational Studies, 1975) [hereinafter cited as Hawkins].

somewhat differently, have listed slightly different numbers of actions. One study indicated that between 1960 and 1976, a total of 59 non-Communist, Third World countries have expropriated U.S. property in some form or another. The Latin American countries accounted for 49 percent of the expropriations; the Arab countries of North Africa and the Middle East, 27 percent; the Black African states and Rhodesia, 13 percent; and the remaining Asian countries, 11 percent. For the period from mid-1973 through January 1975, Black Africa's share more than trebled.[154]

Concentration of expropriations in few countries

A few countries account for the bulk of the takeovers. In a limited study covering the period from 1961 to 1973, it was observed that three Latin American countries -- Chile with 36, Peru with 14, and Argentina with 13 -- accounted for over one-third of the takeovers in the selected sample. Other countries, such as Algeria, Libya, Iraq, and India, each had 6-7 takeovers, while the remainder of the 38 countries represented in the

154. Bradley, pp. 78-79.

sample had five or less. The authors of this study state that over half of these takeovers were expropriations which followed due process of at least local if not international law, while the remainder were distributed among interventions, requisitions, contract renegotiations, and forced sales.[155]

Expropriations in Latin America

While Latin American countries have had a substantial portion of all expropriations, it must be borne in mind that these countries have had the largest share of U.S. foreign direct investment of any developing region. In 1973, 66 percent of all the book value of such investment in less developed countries was in Latin America ($18.45 billion of a total of $27.86 billion, or two-thirds). However, until the widespread appropriations by the Allende regime in Chile in the early 1970's, the Latin American share of takeovers had been decreasing markedly.[156]

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155. Hawkins, pp. 11-12.

156. *Ibid.*; 1975 SDS, p. 2.

At one period U.S. firms owned a large number of utilities in Latin America. From the termination of World War II until the early 1970's, the share of utilities, which represented 50 percent of the observed takeovers in all industries in the 1946-1960 period, fell to 5-6 percent, reflecting the shrinking number of U.S.-owned companies.[157]

A few studies have dealt exclusively with expropriation of U.S. firms' assets in Latin America.[158] One writer has expressed the view that the U.S.-sponsored Alliance for Progress program instituted by the Kennedy administration for Latin America as a response to the Communist takeover in Cuba, helped plant the seeds for future expropriatory actions, especially in Chile. The supporters of the Alliance for Progress assumed that accelerated economic and social development in Latin America, fostered by U.S. foreign aid and encouraged

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157. Hawkins, pp. 13, 21.

158. Eric N. Baklanoff, Expropriation of U.S. Investments in Cuba, Mexico and Chile (New York: Praeger Publishers, 1975); George M. Ingram, Expropriation of U.S. Property in South America: Nationalization of Oil and Copper Companies in Peru, Bolivia, and Chile (New York: Praeger Publishers, 1974).

with U.S. foreign direct investment, partially guaranteed, would lead to the creation of more stable political regimes friendly to this country. Unfortunately, the assumption that economic and social development would produce political stability favorable to U.S. interests proved erroneous, especially as regards Chile. There, the conservative interests represented by large landowners and businessmen, viewing the proposals for agrarian and tax reform as antagonistic and depriving, withdrew their support of U.S.-owned enterprises. They reasoned that if their properties could be expropriated, why not that of U.S. nationals.[159]

Expropriations of oil and copper companies in Peru, Bolivia, and Chile

In a study of expropriation of U.S. property in South America with special reference to the nationalization of oil and copper companies in Peru, Bolivia, and Chile, the author, Dr. George M. Ingram, lists four factors that, although not directly responsible for the expropriations, contributed to the general atmosphere

159. Baklanoff, pp. 80-81, 89, 139-140.

conducive to such actions. These factors are statism, ideology, economic situation, and U.S.-host country relations.[160]

Latin American countries, with their backgrounds of Spanish and Portuguese colonialism, have a penchant for statism -- government control and central planning -- with a concomitant rejection of the free enterprise system. This experience with and inclination towards statism produces a climate facilitating expropriation. Moreover, since these countries have continued the view of Spanish law that property rights of the individual are not absolute, there has been a receptivity to Marxism and socialism with their advocacy of state ownership.

The third Ingram factor is the unfavorable economic situation with its political implications prior to the expropriatory actions. These economic problems were significant in defeating the pre-expropriation government. Fourthly, there were increasing strained relations between the United States and the host countries in the late 1960's and early 1970's. These were due

160. Ingram, pp. 333-336.

in part -- as likewise posited in the immediately preceding study -- by general discontent over the alleged failure of the Alliance for Progress and increasing awareness that the United States was not a reliable source of economic aid. Additionally, there is the history of the evolutionary status of U.S. enterprise in Latin America. These businesses have been there longer than in any other developing regions and in many instances were established under extremely favorable entry-level agreements. With the passage of time and the entry into the second half of the twentieth century, some of these governments, cognizant of their present inability to act without considering public opinion and public interests, felt that these U.S. businesses were reaping unfair profits or had a competitive advantage over local firms. Consequently, expropriation had a popular appeal.[161]

Contrary to popular conception, the specific instances of expropriatory action analyzed by Ingram showed that such factors as increased technological gaps, domination of the enterprise by foreign managers, differences in culture, and hindering the movement

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161. Ibid., pp. 333-339.

toward regional integration (trade and tariff pacts) were absent.[162]

The past few decades have witnessed a drastic change in the relative power and role of the U.S. multinational corporations in Latin America. Not so long ago, such companies as W.R. Grace in South America and United Fruit (now the conglomerate United Brands) in the "banana" republics of Central America could influence, if not dictate, government policy.[163] Those days are gone, probably never to return. Today, the bargaining power rests in the hands of the less developed countries.

Studies of expropriations according to industry

As noted, the industry involved is clearly a significant determinant of expropriatory action. The pertinent studies establish that the most vulnerable industry is the natural resource or extractive industry. State Department studies show that of 143 disputes in-

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162. Ibid., pp. 358-359.

163. See, e.g., Thomas P. McCann, An American Company: The Tragedy of United Fruit (New York: Crown Publishers, 1976), passim.

volving U.S. foreign direct investment until August 1973, over 55 percent were takeovers of resource or resource-related investments; the percentage increased to 86 percent for new disputes arising by February 1975.[164]

Another study, using data from both the State Department studies and the Harvard Business School's ongoing Multinational Enterprise Study, shows that 18 percent of all U.S. mining concessions (38 expropriations) and 12 percent of all U.S. oil and gas properties (84 expropriations) were expropriated between 1960 and 1974. During the same period, the number of expropriations in other industries and the percentage of the expropriated property vis-a-vis total U.S. enterprise in such industries were as follows: utilities and transportation, 17 expropriations, 4 percent; insurance and banking, 33 expropriations, 4 percent. Thirty manufacturing companies, or 1.2 percent, were expropriated, but significantly 80 percent of the seizures occurred in two countries, Indonesia and Chile. Absent percentage data, the study shows 19 expropriations in agriculture, 15 in sales and service, and 23 in land, property, and construction.[165]

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164. 1974 SDS, p. ii; 1975 SDS, p. 3.

165. Bradley, _supra_ note 151, p. 79.

Another study, analyzing 170 takeovers from 1946 to 1973 by industry, time period, form, selectivity, region, and political-economic circumstances, undertook a rough evaluation of the 158 takeovers occurring from 1961 to 1973. Arbitrarily using only the book value of U.S. direct foreign investment in developing countries in 1966 and averaging the size of the takeover property, the study found the estimated total value of the takeovers at $565 million. Of this sum $459 million represented extractive industries; $72 million, manufacturing; and $34 million, finance, utilities, and others. Since significant takeovers in such countries as Chile and Venezuela were not properly weighted and other essential data of values were unavailable, the study suggested a possible more accurate valuation, perhaps in the range of $2 to $3 billion -- a range still lower than the State Department studies' "guesstimate."[166]

The regional-industry analysis of takeovers in this study shows that all public utilities takeovers occurred in Latin America; Africa had more than half of the bank takeovers; and the Middle East had a relatively high

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166. Hawkins, p. 16.

incidence in the extractive industry. The actions of particular countries in specified regions have produced disproportionate results -- e.g., India's nationalization of foreign financial institutions in 1972-1973; Algeria's and Libya's takeovers in 1967-1971. Nationalization of an entire industry with both foreign and local companies was most likely to occur in the banking field; nationalization of industries wholly owned by foreigners occurred most frequently with natural resources.[167]

Form of the takeover by industry

The study produced some interesting findings with respect to the form of the takeover by industry. For all industries outright expropriation occurred in 60 percent of the cases; intervention/requisition in 16 percent; renegotiation of contract in 13 percent; and forced sale in 11 percent. While such expropriation led for every industrial category, intervention/requisition and forced sales were frequently found in the manufacturing sector, and renegotiation in the extractive industry. Significantly, the information available concerning the 170 takeovers indicated that in over 90

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167. Ibid., pp. 13-14, 22.

percent of the cases, some compensation (whether or not adequate is unknown) occurred.[168]

Examination of a number of expropriation cases, especially those involving large U.S.-owned enterprises in the natural resources, utilities, and transportation sectors, reveals that the expropriatory actions frequently occurred after the companies had been in the host country for many years. The initial investment had already been repaid or the investment life cycle was in the declining phase.

Characteristics of corporations subject to expropriation

A previously considered study examined specific characteristics of corporations as to their proneness to expropriatory action. Contrary to popular belief that sharing equity ownership with the host government was a measure of protection against expropriation, the opposite was found: indeed the rate of expropriation increased tenfold. Joint ventures with local nationals, however, reduced the probability of expropriation. The joint venture may increase the chances of obtaining some compensation.[169]

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168. *Ibid.*, p. 22.

169. Bradley, *supra* note 151, p. 80.

The study further found that the more technologically advanced a company is, the less likelihood of its expropriation. This is because the host government lacks the know-how to continue the operation. Similarly, low technology industries with low profiles, such as food processing firms, have a low risk of expropriation. The most vulnerable have been the manufacturers operating in the middle range of technology. The host countries appear to have been able to engage technicians to continue these operations.[170]

Additional findings illustrate the significance of other particular characteristics. The greater the dollar value of the foreign property, the more vulnerable its owner. The rate of expropriation for companies with assets over $100 million was 50 times greater than for companies with assets of under $1 million. The rationale is embraced in the apothegm, if you must take, take something big and worthwhile. Moreover, companies manufacturing or assembling different parts of their products in various countries, or whose parent companies control the essential materials, are less prone to ex-

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170. Ibid., p. 81.

propriation. Similarly, companies with worldwide trademarks, popular brand names, or global marketing systems are faced with reduced risks of expropriation.[171]

Characteristics of the expropriating countries

As noted, in addition to studies analyzing the characteristics of the expropriated countries, there are studies evaluating the characteristics of the expropriating host countries. One such study (characterized as "exploratory"), combining an analysis of the characteristics of both the expropriators and the expropriated, was conducted by Dr. J. Frederick Truitt.[172] His research was based upon a study of 28 expropriated and nationalized (a practical difference, according to Truitt, involving the amount of compensation, with the expropriated investor generally obtaining more compensation) British and U.S. companies, and interviews with officials of 23 of these firms -- 15 British and 8 American. The expropriatory actions occurred in 13 less developed countries between 1950 and 1967. Twelve characteristics of the nations and nine of the companies

171. Ibid., pp. 81-82.

172. Truitt, supra note 135.

were considered in assessing the risk of expropriation. Unfortunately, the identity of the interviewed firms and their executives remains anonymous.[173]

While the thrust of the research is that the propensity and vulnerability to expropriation are determined by the interplay of the two sets of characteristics, Truitt notes that his approach did not allow for a sufficient development of the relationships among these characteristics.[174]

The Truitt study

The nine company characteristics employed by Truitt are: (1) industrial classification; (2) strategic vulnerability -- *i.e.*, the extent to which the foreign investment straddles the host economy and one or more foreign economies, and the extent to which foreign exchange is used; (3) domination in the relevant sector of the host country; (4) nationality; (5) ownership patterns; (6) specific formal protective action taken before expropriation; (7) style of management, including locali-

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173. *Ibid.*, pp. 8-9, 61, 63, 89.

174. *Ibid.*, pp. 131, 138.

zation of personnel and public relations to enhance the firm's image; (8) tactical vulnerability measured by the number of expatriate skills necessary for operation, by the visibility of the operation in the host economy, and by susceptibility to corruption, bribery, and payoffs; and (9) foreign exchange activity and its contribution to the host economy. As is evident, there is a considerable amount of overlapping in these categories.[175]

Truitt's research indicated that the first, second, and ninth characteristics were high weight (risk) factors; fourth, fifth, seventh, and eighth, medium weight factors; and the third and sixth, low weight factors. The sectors most vulnerable to expropriation were the natural resource and public utilities, and the service -- i.e., trade, commercial banking, export-import trade, and insurance. The British takeovers, which occurred for the most part in former British possessions, were especially severe in the insurance field and the petroleum industry; United States takeovers, in the petroleum, public utilities, and manufacturing sectors.[176]

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175. Ibid., pp. 90-139.

176. Ibid., pp. 90, 164.

The 12 characteristics of the host nations considered by Truitt are: (1) gross national product; (2) ideology of ascendant elite, the personnel of the government in power; (3) proportion of public to private sector; (4) political stability -- colonial heritage and independence: period of formal and continuous colonization; (5) political stability during the post-independence period, using the Feierabend's scale; (6) internal legal system; (7) external legal system -- the level of a country's international activity, especially as it concerns the protection of foreign investment; (8) balance of payments; (9) supply and quality of available domestic entrepreneurial talent; (10) attitude and view towards foreigners; (11) internal political crisis; and (12) Communist bloc economic assistance.[177]

This study indicated that the first, second, third, ninth, and eleventh characteristics were high weight factors; fourth, fifth, eighth, and tenth, medium weight factors; and the seventh and twelfth, low weight factors. The sixth characteristic, the internal legal system, was found not relevant in practice.[178]

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177. Ibid., pp. 63-88, 128-129.

178. Ibid., pp. 77-78, 132-133.

Admittedly exploratory, Truitt's study is not very sophisticated. No claim is made for the statistical validation of the importance of the selected characteristics. The relationship among these characteristics; the effect of changes in these factors prior to expropriatory actions; effective responses to the threat of such actions -- these are desiderata which must await future analyses.

The Heine study

A study by Robert M. Heine, analyzing 49 separate expropriation actions in 30 countries between 1960 and mid-1971 as catalogued by the State Department, examined a set of host nation economic and political characteristics in specified time periods preceding the expropriation event. The central concept guiding the selection of the characteristics or variables, five economic and one political, split into four dimensions, was the premise that expropriations are carried out by governments when they are weak or feel threatened.[179]

The five economic factors chosen by Heine are:

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179. Heine, *supra* note 135, pp. 8-9.

(1) gross national product per capita (GNP) -- economic performance measured by its annual percentage change at constant prices; (2) rate of inflation in the consumer price index -- the assumption, high and increasing rates increase the risk of expropriation; (3) percentage change on a yearly basis of the balance of payments -- the assumption, worsening trade situation increases the risk of expropriation; (4) annual rate of change of foreign direct and long-term investment coming into the country -- the assumption, high rates of inflow are indicative of foreign domination and expropriatory risk determinant; and (5) unrequited government transfers -- *e.g.*, direct grants but not loans to the host country. Some of these indicia were also selected by Truitt.[180]

The Heine political variable is a change in government leadership or regime. The change may be either regular (peaceful) or irregular (employment of force of arms); and left or right ideologically.[181] It may be noted that in the study of the 170 takeovers, pre-

180. *Ibid.*, pp. 10-14.

181. *Ibid.*, p. 14.

viously mentioned, almost one-half were effected within the first three years after a left wing change in government, less than five percent occurred after right and center nationalist changes in government.[182]

Heine's findings concerning the significance of the selected characteristics or variables may be summarized as follows: As regards the political factor of regime change, out of 71 such changes, in the five years preceding the expropriations, the number of changes peaked the year before the expropriations. Percentagewise, 27 percent of the governments acted within their first year in office, 49 percent within the first two years, and the remainder thereafter. Accordingly, as confirmed by Dr. Franklin Root and others that expropriations do not occur suddenly, the foreign investor has considerable time after regime change to determine his pre-expropriation course of action. While the number of changes was almost equally divided between regular and irregular (hence a neutral factor vis-a-vis predictability), leftist shifts in the changeover outnumbered rightist by almost 4 to 1. Because of the time lag between regime change and expropriation, Heine

182. Hawkins, p. 7.

doubts the significance of political instability as a variable.[183]

The finding concerning the GNP per capita growth over the five years preceding the expropriations is somewhat ambivalent. While the aggregate figures point to economic slowdown as a basis for governmental action, division into long-term (over 2 years) regime types and short-term (under 2 years) types with their concomitant growth rate improvement appears to support the hypothesis of expropriatory action from a position of strength. Similarly, Heine's inflation figures decreased in each of the three years preceding the expropriations -- another support for the position of strength hypothesis. The factor of the percentage change on a yearly basis of the balance of payments produced mixed results: the short-term regime cases showed a steady improvement in the trade situation; the long-term, deterioration. Accordingly, a new regime might expropriate in light of an improving trade picture.[184]

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183. Heine, p. 17 and Tables VII-IX.

184. Ibid., pp. 18-22 and Tables X-XII.

With respect to his fourth and fifth economic factors, private foreign capital and foreign aid, Heine observes that although the general trend of the former is down and that of the latter is up as the year of expropriation approaches, he cannot attach any particular weights to them as expropriatory risk variables. His conclusions are that the particular factors selected by him lend only limited support to the hypothesis that expropriations are carried out from a position of weakness and partially negate their underlying assumptions, as noted above. The contrary hypothesis that expropriating governments act from a position of strength finds some support in portions of the data. The subclassification into short-term and long-term regime countries appears to be relevant.[185]

The studies which have been made, several of which have been considered herein, on the determinants of expropriation must at the present time be characterized as exploratory and inconclusive. Indeed, their authors frankly recognize the limitations of these studies and urge additional continuous, intensive research. Nevertheless, certain comments and observations now appear

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185. Ibid., pp. 22-24 and Tables XIII-XIV.

relevant. The use of different sets of expropriatory actions as bases for analysis may result in disparate findings. Compare Truitt's general hypothesis that expropriations are carried out from a position of weakness with Heine's -- i.e., that of action from a position of strength. The factors or variables used by particular researchers are instinct with subjective propensities and judgments -- in short, assumptions whose verification is to be found in future research. Nevertheless, certain generalizations are in order. The industry involved is clearly a significant factor in expropriatory action. Leftist shifts in the changeover of governments greatly outnumber rightist. The great majority of expropriations do not occur suddenly. It is easier to make predictions -- at best probability estimates -- for the short period of time; most difficult, if not improbable, for the longer period. In sum, the forecast of expropriatory actions involves not only the problems found in predicting political stability but numerous others.

Universal recognition that a tremendous amount of comprehensive research is mandatory before practical forecasting of expropriation can attain the status of an art (its status as a science is still in the dim future), does not militate against the various techniques recommended and employed by risk analysts. Many advocate the risk analysis technique which involves the determination of a probability for the outcome of various events. The process of enumerating possible outcomes and of assigning estimates of the probabilities of their occurrence has the beneficent effect of refining the crucial variables. The construction of a probability tree and its use through computer technology will facilitate the decision process. However, the caveat persists -- namely, the subjective element in the selection of variables.

I have previously discussed risk reduction techniques to minimize political risks in general. Those actions and strategies are equally applicable to reduce the prospects of expropriatory actions in particular. Basic is the consideration that the investor should be a good resident of the host country.

Summary of recommendations to reduce the risk of expropriation

Individual studies on expropriation have made the following specific recommendations for reducing the risk of expropriation: (1) Adopt a low profile and seek to blend into the business of the host country. This can be partially accomplished by seeking in varied manner joint ventures with local nationals. (2) Conform to local government economic policies and maintain a close relationship with government officials. (3) Avoid plant closures, mass employee dismissals, and disruption of existing wage and seniority practices. (4) Maintain technological superiority over local firms by concentrating on proprietary research, product development, and process technology in the United States. (5) Avoid geographic and investment concentration in specific areas and industries. It is best to adopt multiplant strategy with a number of small investments spread throughout several countries. (6) Make certain that each new investment remains economically dependent on the U.S. parent and that the affiliate or subsidiary cannot operate successfully by itself. (7) Avoid domination of local companies; utilize local industries to supply parts and raw materials. (8) Maintain global trade names and trademarks; host countries generally hesitate to expropriate multinational corporations manufacturing these trademark products. (9) When possible contribute to the host country's balance of payments by exporting the products or services. These actions, even though not fully preventive, may still be palliative.[186]

In the face of impending expropriation, there are steps which may be taken to minimize prospective losses. These include: (1) Stop new investment in the foreign affiliate or subsidiary. (2) Stop shipments to the host country. (3) Cut back inventories, receivables, production, and cash holdings. (4) Pay all debts owed U.S. suppliers. (5) Borrow heavily from local sources. (6) Reduce the parent company's guarantee on local borrowings. (7) Increase remittances to the parent company.[187] Unfortunately, some of these measures are not always available, as in the case of exchange restrictions greatly antedating the expropriatory actions.

As noted, the State Department studies showed a marked decline in expropriations for the period 1973-

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186. This summary is a distillation of the thinking of the author and of numerous commentators, some of whom have been considered <u>supra</u>.

187. <u>Ibid.</u>

1975 compared to earlier periods of similar duration. The reasons for such decline are many and some have already been delineated. Most of the LDC's have become more sophisticated in dealing with foreign investors. Instead of outright expropriations, they prefer the measures embraced by creeping expropriation and the equally effective techniques of unbundling and domestication. On the other hand, the more vulnerable industries have either curtailed their investments in LDC's or accepted alternative forms, such as joint ventures or minority control.[188]

<u>Policy of international lending institutions towards expropriating countries</u>

An additional basis for the decline is the unclear policy of the international lending institutions to withhold loans to countries failing to grant compensation for expropriation of foreign property. In 1971 the International Bank for Reconstruction and Development (World Bank) declared: "Where the Bank is contemplating lending to a member country whose credit is

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188. See <u>supra</u> pp. 607, 615.

impaired by the existence of a dispute over a default on its foreign debt or over compensation for foreign-owned property which has been expropriated, it must first be satisfied that the government is making serious efforts to reach a fair and equitable settlement and that there are good prospects that the matter will be cleared up satisfactorily." [189]

Many LDC's, in the market for sovereign country loans from U.S. banks and international financial consortiums to sustain or improve their economies, fully recognize how expropriation without adequate compensation imperils their creditworthiness. Accordingly, they will hesitate long before taking expropriatory actions. Confirmation is found in the changing economic philosophies under new regimes in such former well known expropriating countries as Chile, Peru, and Egypt. However, notwithstanding the recent decline in the number of new expropriation disputes involving U.S. firms, the risk of expropriation is still regarded as a most serious deterrent to foreign investment.[190]

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189. International Bank for Reconstruction and Development, Policies and Operations: The World Bank, IDA, and IFC (Washington: IBRD, June 1971), p. 31 as cited in Ingram, op. cit., p. 367.

190. The following articles are representative: Jonathan Kandell, "Takeover Adds to Peru's Economic

OPIC's influence in foreign direct investment

As noted, there is overwhelming evidence that OPIC as a risk transfer device has influenced foreign direct investment in LDC's. It has utilized risk reduction techniques not only for itself but also for its clients. As previously detailed, commencing with its eligibility requirements for applicants, OPIC is both mentor of and monitor to its clients.

A hypothetical example of how OPIC's involvement in a proposed foreign investment may be the determinative factor in the decision-making was given in the 1977 OPIC House hearings by Dr. Gerald West, an OPIC official who was formerly with the Foreign Policy Research Center. His example, with tables, is as follows:[191] A potential investor is considering investing one million

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Trouble," The New York Times, May 1, 1976, pp. 29, 38; Juan de Onis, "Marcona: A Takeover Without Retaliation," The New York Times, October 18, 1976, pp. 47, 49; Juan de Onis, "Peruvians Swing Away from Left," The New York Times, December 24, 1976, pp. A1, A6; "Chile," Business Week, April 4, 1977, p. 40; Henry Tanner, "Egypt Plans to Ease Business Curbs," The New York Times, February 23, 1974, p. 9; "Cairo Embarking on Liberalization," The New York Times, February 3, 1974, p. 1; Ann Crittenden, "Sadat's Investment Program Slowed," The New York Times, October 29, 1975, pp. 59, 63.

191. 1977 HOH, pp. 434-438. The Tables are set forth in Appendix II *infra*.

dollars either in developed country A or in less developed country B. The investment hurdle rate is 15 percent; the time horizon is ten years, when there is no salvage value from initial capital outlay. Through various techniques it is estimated that the likelihood of expropriation by A is negligible; that by B, significant.

Before considering the elements of possible expropriation and discounting, one would view investment in B as more attractive since the example assumes B's undiscounted payback period in six years compared to A's seven and B's accumulated cash flow at $1.85 million compared to A's $1.15 million. However, once adjustment is made for expropriation risk and discounting, B's attractiveness recedes. Its cumulative net present value, based on cash flows, is an unhealthy substantial negative; A's, a mild positive. Absent the qualifying factor of OPIC's involvement through insurance, the investor would then select A over B.

With OPIC's expropriation risk insurance available for the investment in B at a modest cost, the investor need no longer fear the consequences of investing in B. This insurance eliminates any risk adjustment of the cash flow for the probability of expropriation loss. If B takes no expropriatory action during the ten-year period, the investor's gain is much greater than had he invested in A. Even if expropriation is carried out at any time after the fifth year, the gain is still better than what the investment in A would have achieved at the end of the ten-year period. This betterment is based on the assumption that OPIC, as insurer, will pay full compensation to its expropriated client one year after the expropriation and that the amount is appropriately discounted.

While the preceding example refers to OPIC expropriation insurance, its rationale similarly covers the other political risks of inconvertibility and war.

I have previously described in detail OPIC's risk reduction techniques; its claims procedure as a vital risk management tool; its input in the structuring and operating strategies of its clients; and its enviable record in settling disputes with the host countries. As noted, over 95 percent of its resolved claims involved expropriatory action, much resulting from the Chilean events of a few years ago.[192] Even with the

192. See <u>supra</u> pp. 609, 615.

political risk of expropriation OPIC has done well. Objective observers may say that OPIC's insurance record speaks well for itself.

COMMERCIAL BANK LENDING TO LESS DEVELOPED COUNTRIES

In recent years there has been a very large increase in commercial bank lending to LDC's, with the concomitant questioning about possible strains on the credit system of the Western World. When queried about this at an August 1977 OPIC hearing of the Senate Subcommittee on Foreign Assistance, former Secretary of State Henry A. Kissinger, an OPIC proponent, replied that the problem was very fundamental, fraught with uncertainty, and difficult of solution. Major Western financial institutions were obtaining as deposits large amounts of surplus funds on a short-term basis. At the same time they have been lending considerable funds to LDC's on a long-term basis. Because of their growing balance of payments deficits, doubled since 1973 with the tremendous crude oil price increases, LDC's have been forced to borrow. These bank loans have been most beneficial to the borrowers and have prevented any worsening of their economic conditions.[193]

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193. 1977 SOH, pp. 145-146.

The proposal of a Financial Support Fund

With short-term deposits and long-term loans, these financial institutions are faced with a built-in problem. Dr. Kissinger reiterated his support of a Financial Support Fund which had earlier received the approval of all the industrialized nations other than the United States. The resources of such fund were to act as a safety net in case money of the Oil Producing Exporting Countries (OPEC) was not available or was being manipulated in a politically disruptive way. In place of such fund, it was suggested that a new facility be created in the International Monetary Fund which would enlist a 50 percent contribution from the OPEC countries. Unfortunately, until the present no such fund or its equivalent has been established.[194]

The problem presented to Dr. Kissinger has received the attention of government officials and other concerned parties. The following situation is illustrative: In 1975 the largest depositor in Citibank, the nation's second largest bank, was the government of Kuwait with $1.7 billion -- or one dollar of every $25

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194. Ibid., p. 146.

then on deposit with the bank. For many years the bank has enjoyed a special relationship with Kuwait and its citizens -- inter alia, it has given Kuwaitis one-sixteenth of one percent extra interest compared to the interest on similar funds deposited by other customers.[195]

Federal bank examiners in 1975 expressed concern that the Kuwaiti depositors could adversely affect Citibank by withdrawing their money, and questioned whether a country such as Kuwait could put pressure on the bank by using large deposits as leverage. The bank assured the examiners that any attempt to pressure it would be resisted and any withdrawn funds could be replaced, although higher interest rates would have to be paid to obtain them.[196]

The increase of bank loans to less developed countries

Such special creditor-debtor relationship between Kuwait (but one member of the rich OPEC) and Citibank

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195. Ronald Kessler, "Banks Holding Huge Foreign Deposits," Washington Post, January 19, 1976, pp. A1, A6.

196. Ibid.

is a prelude to a consideration of the obverse -- *i.e.*, the recent tremendous increase of loans to LDC's by major commercial banks. According to the World Bank, by 1970, 86 "developing" countries owed but $6 billion of government-backed debt to foreign private banks, out of a total external debt of $74 billion; by 1975, the figures were $28.7 billion and $151.4 billion, respectively.[197]

A year later, the indebtedness to banks was $40 billion, more than half due to U.S. institutions. Of this amount Citibank reportedly had $8-9 billion, or 15 percent of its total assets; Chase Manhattan Bank $4-5 billion, or 10 percent of assets; Bank of America, approximately $6.5 billion; Manufacturers Hanover, approximately $2 billion; and Morgan Guaranty Trust nearly $1 billion. Other major lenders overseas included Chemical Bank, Bankers Trust Company, and First National Bank of Chicago.[198]

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197. Charles N. Stabler, "Developing Debt: Emerging Nations Use Private Lenders More, Causing Some Worries," *Wall Street Journal*, September 28, 1976, pp. 1, 26; Ann Crittenden, "Loans Abroad Stir Worry, U.S. Bank Write -Offs High," *The New York Times*, January 15, 1976, pp. 1, 56.

198. Crittenden, *ibid.*

<u>The impact of oil price increases</u>

The upsurge in external debt of the LDC's was caused largely by the impact of tremendous oil price increases in 1973-1974 by OPEC. There was an increased cost not only of imported energy fuels but also of much needed fertilizer. Before 1973, major commercial banks generally extended credit only to facilitate or to develop specific revenue-generating projects. Much of the new lending, however, has been for the general purposes of the borrowing government, mainly to finance deficits in its balance of payments.[199]

By mid-1976, five countries (Argentina, Brazil, Mexico, Peru, and Indonesia) accounted for $32.6 billion in loans made by U.S. banks. In several of the heaviest borrowers the indebtedness was so large that interest and debt repayments exceeded 20 percent of the total foreign exchange receipts. In Brazil the percentage approximated 35. Several borrowers were constrained to seek restructure or postponement of foreign debt payments for reasons as varied as declines in the world price of their exporting metals, such as copper,

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199. Stabler, *ibid.*; International Bank for Reconstruction and Development, World Debt Tables, Vol. I; External Public Debts of LDC's, Document EC167/75, October 31, 1975, pp. IX-XVIII.

or national economic mismanagement.[200]

In a joint report issued in January 1978 by the Federal Reserve Board, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, it was stated that 119 U.S. banks with assets of one billion dollars or more had $37.7 billion of unguaranteed loans outstanding in non-oil-producing LDC's. Half were in maturities of one year or less. Only 5 percent of the loans were guaranteed. Outside the leading non-Communist industrial nations, five countries (Spain, Venezuela, Brazil, Mexico, and South Korea) owed the lending banks more than 10 percent of their aggregate capital -- which, of course, is not the equivalent as lendable funds. Peru and Turkey, experiencing problems with their debt service payments, each owed some 5 percent of the aggregate capital of $36 billion. Mexico and Brazil accounted for more than half the total debt of

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200. Ann Crittenden, "Loans to Developing Lands by U.S. Banks on Increase," The New York Times, November 10, 1976, pp. D1, D7; Crittenden, supra note 197, p. 56; Robert A. Bennett, "Less Developed Country Loans Pose Questions for Regulators," The New York Times, May 15, 1977, sec. 3, pp. 1, 13; "A Lesson for Bankers Who Lend to LDC's," Business Week, April 4, 1977, pp. 32-34.

the non-oil countries, over $21 billion. Indonesia and Iran, oil exporters, each had debts of close to $2 billion. Since the study combined the loans of all 119 banks in the survey, the risk exposure of the largest lending banks could not be individually delineated.[201]

The tremendous increase in these U.S. bank loans to developing countries in this decade has been a source of concern to Federal and state banking officials, Congressional critics, and others. Bank examiners have cautioned certain banks to be more careful in making unguaranteed loans, while a recent ruling by the Comptroller of the Currency barred banks from lending more than 10 percent of their capital to a single foreign government. Bankers, on the other hand, deny these international loans carry any unusual degree of risk. They note that losses therefrom are lower than those related to domestic loans and that even in politically unstable countries, the losses have been minimal. Moreover, higher short-term interest rates afford a cushion against inordinate risk and profits have been high enough to provide adequate insulation against foresee-

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201. Clyde H. Farnsworth, "Unguaranteed Loans to Poorer Countries by U.S. Banks Listed," The New York Times, January 17, 1978, pp. 43, 45.

able loan losses.[202]

THE WORLD BANK REPORT

In August 1978, the World Bank issued the first of a series of annual reports providing a comprehensive assessment of global development issues.[203] Entitled the World Development Report, 1978, the study deals with a number of fundamental problems confronting developing countries and explores their relationship to the underlying trends in the international economy. It defines developing countries, on the basis of 1976 GNP per capita, into low income countries -- income per capita of $250 and below -- and middle income countries -- above that figure. It merits extensive examination.[204]

The report notes the needs of the developing countries, especially the middle income, to obtain capital from the private commercial banks. From 1971 to 1976,

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202. Farnsworth, ibid.; Crittenden, supra note 197, p. 56.

203. International Bank for Reconstruction and Development, World Development Report, 1978 [hereinafter cited as WDR].

204. Ibid., pp. iii, ix.

net lending by these banks grew very rapidly; estimates of their loans to governments and to the private sector against government guarantees indicate increases by about 50 percent a year. Notwithstanding a slowing down in 1977, "the rate of increase in outstanding claims reported by banks is still high."

This rapid growth has caused problems. "The first is that the bulk of the increased lending has gone to about a dozen developing countries, leading to sharp increases in their debt service obligations and making the lenders particularly sensitive to developments in these countries. Debt problems in any one of these countries could easily affect the willingness to lend to all developing countries."[205]

As noted, several borrowing countries were constrained to seek restructure or postponement of their foreign debt payments. While the report does not name specific countries having serious debt problems, it is known that Turkey, Peru, Jamaica, and Zaire have come under strict supervision of the International Monetary

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205. Ibid., pp. 11-12, 23-24.

Fund. So far no country has defaulted outright, especially since it is recognized that such default will jeopardize economic growth and political stability by halting or severely curtailing the inflow of essential foreign capital and investment.

Recognizing that repayment problems by heavy borrowers from private sources necessarily affect the attitude of the lenders toward other LDC's, the report observes that "a number of analyses have concluded that there is no general problem of developing countries being unable to service debt ... Expansion in the resources of the International Monetary Fund would enhance the capacity to deal with such [specific] liquidity crises." [206]

A second problem created by the rapid growth of private loans to LDC's, according to the report, is the potential for instability created by the projected rapid growth in the gross disbursements from commercial banks. This is due largely to the relatively short maturity of private commercial lending, leading to high amortization requirements which must be financed by additional gross borrowing.[207]

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206. <u>Ibid.</u>, p. 24.

207. <u>Ibid.</u>

With an eye to the future the report states, "More than half of the increased financing requirements [for middle income developing countries] from 1975 to 1985 represents the payment of interest and the amortization (i.e., repayment of principal) of external debt, the latter reflecting the growing share of medium-term private debt at maturities that are less than half as long as those of official loans. Another 15 percent of the increase is needed for the accumulation of international reserves in line with the growth of imports." It forecasts that during this 10-year period "the projected increase in gross disbursements is nearly three times the increase in net disbursements." It suggests that measures that would be helpful in gradually reducing the instability of the lending structures are lengthening the average maturities of the external borrowing, improved access to long-term bond markets, and a better balance between the lending from private and official sources. It notes with satisfaction recent increases in the number and nationality of the private lending institutions. While over half of all outstanding claims on developing countries are held by about 30 major banks, primarily large U.S. banks, banks in Europe (especially West Germany) and Japan have been increasingly active in lending to developing countries in the immediate past, and appear to have the potential for considerable future growth.

However, a caveat is added: "Mandatory diversification among borrowers, however, poses a potentially serious threat to the projected flows of commercial bank lending. In this connection, changes in the regulatory environment could be critical. The danger is that regulatory measures designed to assure the stability of the banks in industrialized countries could inadvertently cause abrupt changes in the availability of finance to individual developing countries, thereby triggering the sort of debt crisis that the regulatory measures are intended to prevent." [208]

Compared to the 50 percent annual growth rate of lending in recent years, the report estimates that between 1975 and 1985, net annual lending from private sources to developing countries would need to grow at the much slower rate of 12 percent annually in nominal terms (assuming an annual rate of inflation of nearly 7 percent). "Though this rate of expansion could be

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208. Ibid., pp. 24, 30.

accommodated by the growing capacity of developing countries to service debt, there is considerable uncertainty whether the supply of private lending will grow so rapidly." [209]

It cannot be gainsaid that these foreign loans have been most profitable to the major bank lenders. In 1976, the 10 largest U.S. banks, as a group, made more money from their foreign than from their domestic operations. During 1977, Citicorp, the parent of Citibank, looked abroad for more than 80 percent of its profits. [210] In the circumstances, these banks would prefer to continue loans to the developing countries without stringent restrictions.

Formerly, when commercial banks extended credit abroad, it was done primarily to facilitate trade or to develop specific revenue-generating projects -- areas where the means of repayment were definite and the overall risks fairly predictable. Much of current lending to the borrowing government is to finance deficits in

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209. Ibid., p. 23.

210. Mario A. Milletti, "Regulation Lagging for U.S. Banks Abroad," The New York Times, December 20, 1977, p. A1.

its balance of payments. The ability to repay depends not only on the general economy of the borrower but also on the disposition of the leaders in power who may not be those who negotiated the loan.[211]

Conclusions of the World Bank report

In its chapter entitled "Conclusions," the World Bank report pointedly observed, "The developing countries not only are important customers for the exports of industrialized countries, they are an important element in the world capital markets, and have helped to invest the vastly expanded supply of savings productively."[212] It notes that if the least developed countries cannot meet the requirements of the private lenders, then Official Development Assistance (ODA) -- *i.e.*, government to government and multilateral credits at concessional terms -- must be substantially increased. The net disbursement of ODA is projected to rise from $19 billion in 1975 to $57 billion in 1985, with a gradually rising share of the total going to low income countries. ODA assistance from the 18 members of the

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211. Stabler, *supra* note 197.

212. WDR, p. 68.

Development Assistance Committee (DAC) of the 24-member Organization for Economic Cooperation and Development (OECD) -- the wealthier, democratic industrialized countries -- is projected to rise from $14 billion in 1975 to $44 billion in 1985. The success of the projection depends in large measure upon substantial increases in the commitments of the United States, West Germany, and Japan.[213]

Recognizing that private risk capital, which in the past has been a major source of financing energy development, is now less readily available, the report recommends that "governments should consider whether expanded insurance and guarantee provisions could augment the flow of private capital."[214] OPIC's experience mandates an affirmative answer.

OPIC's finance program

As we have seen, OPIC is not involved in sovereign country loans nor does it make sovereign country risk analyses *per se*. However, through its finance program,

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213. *Ibid.*, pp. 67, ix.

214. *Ibid.*, p. 68.

it continues to expand its joint efforts with the International Finance Corporation (IFC) and local and regional development banks. In 1975-1977, OPIC helped to finance four projects with the IFC; worked closely with development banks especially in Africa and Central America; and insured six clients in six IFC projects. It also insured four projects, partially financing two of them, in conjunction with the Private Investment Corporation of Asia (PICA).[215]

OPIC has also been involved in the controversy surrounding increased private bank lending to the LDC's. It concedes that it has encouraged and facilitated such lending through its finance program. It has noted that of $45 billion of claims held at the end of 1976 by U.S. banks on non-oil LDC's, loans to Mexico and Brazil accounted for one-half of the total, with the balance dispersed among Korea, the Philippines, Taiwan, and a few other major Latin American countries. These borrowing nations constitute the upper or middle income LDC's whose economies, in OPIC's view, have been growing rapidly in recent years, giving rise to an added capacity to service their debts. Most of them have favor-

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215. 1977 SOH, p. 25.

able long-term economic prospects, have the potential to generate adequate export earnings, and retain the confidence of private bankers. In 1976, when loan losses rose sharply on all types of loans, the loan loss ratio on international loans remained substantially below that for domestic loans. The record over the 1971-1975 period was even better. Moreover, when the nominally large values of outstanding debt are adjusted for factors of inflation and trade expansion, the growth of outstanding debt and debt service is not so great.[216]

OPIC's insurance for institutional lenders

OPIC insurance for institutional lenders is a small but significant part of its activities. Such insurance is considered as a *sine qua non* for making a loan only for use in highly developmental projects. The coverage is deemed low risk because of the unlikelihood of a default occurring both because of the status of the lender and the nature of the project.[217]

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216. 1977 HOH, pp. 335, 337.

217. *Ibid.*, p. 337.

<u>OPIC's project financing</u>

OPIC frequently engages in "project financing" (also known as "non-recourse lending" or "off-balance sheet financing") -- loans secured by the viability of a particular project rather than reliance upon the sponsor's creditworthiness or repayment guarantee. This is especially the case where the OPIC client has but a minority interest in the project. For this type of project, commercial banks are extremely reluctant to make loans. OPIC's commitment is preceded by a complete technical and financial examination with assistance by specialists. OPIC's financial staff carefully examines the loan applicant's papers and conducts a full range of sensitivity analyses using specially developed computer programs.[218]

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218. Harry L. Freeman, "Project Development and Structuring: The Metamorphoses of the Financing Facilities of the Overseas Private Investment Corporation," <u>Law and Policy in International Business</u>, 7, No. 3 (1975), pp. 747-748 [hereinafter cited as Freeman].

OPIC'S NON-INSURANCE ACTIVITIES

The non-insurance areas of OPIC's activities may be classified as follows: (1) investment guarantee (as used in this context, "guarantee" excludes insurance provided against political risks); (2) direct investment, including local currency loans; (3) pre-investment survey and investment encouragement. Frequently, the first and second areas are used together in various combinations depending on the particular needs of the project.[219]

These finance and financial guarantee programs, which are profit-making, are much smaller than and have been overshadowed by OPIC's insurance programs. As of May 31, 1977, the former programs of OPIC and its predecessors involved a portfolio of $201,202,038, with 55.3 percent going to East Asia; 20 percent for Latin America; 17.3 percent for Africa; and 7.4 percent for

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219. U.S. OPIC, Investment Financing Handbook, Overseas Private Investment Corporation (June 1978), passim; U.S. OPIC, International Investment, A Guide for Executives of Smaller Companies (October 1978), passim; OPIC Guide, supra note 37, passim.

the other Asian countries. On the same date, OPIC had 46 current finance projects, distributed by industry as follows: agribusiness, 16; manufacturing, 12; forestry, developing financial institutions, and tourism, each 4; mining, 2; and utilities, metals processing, leasing, and leather, each 1. [220]

OPIC's investment guarantee authority

OPIC's principal manner of obtaining capital investment funds from private financial sources has been through its investment guarantee authority. [221] These guarantees may be either for equity or for loans but in recent years, only the latter have been provided. [222] OPIC is authorized to issue a maximum of $750 million in guarantees but can issue new guarantees only if it maintains a reserve equal to 25 percent of outstanding liabilties.[223] As of September 1, 1977, total outstanding guarantees were $146.8 million with a reserve of

220. 1977 HOH, pp. 61-62.

221. 22 U.S.C. § 2194(b) (1976).

222. 1977 HOR, p. 4.

223. 22 U.S.C. § 2195(a)(2) (1976).

$101 million. OPIC charges an annual fee of 2.25-3 percent of the guarantees.[224]

OPIC loan guarantees generally may not exceed 75 percent of total project financing, including debt and equity, but usually the percentage is 50 percent or less. The guarantee covers 100 percent of the obligation to which it relates, including principal and interest.[225]

The cost of making and administering a guaranteed loan has made it uneconomic to OPIC to use its guarantee authority for loans of less than $2 million. In fiscal 1974, 1975, and 1976, OPIC provided $46 million in investment guarantees to eight projects. In fiscal 1976, the average size of its loan, including guaranteed loans, was $2.3 million with an average project size of $6.5 million.[226]

While commercial banks provide a substantial amount of funds for exports, short-term credits, and loans

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224. 1977 HOR, p. 4.

225. 22 U.S.C. § 2194(b) (1976); Freeman, pp. 743-744.

226. 1977 HOR, p. 4; 1977 HOH, pp. 407-409.

directly to LDC governments, their LDC financing is quite limited and then for short-term maturities. To complete a financing plan for a particular project, OPIC through its investment guarantee authority will guarantee repayment of the necessary additional years of maturities. Thus, if a commercial bank will normally lend for no more than five years and the project sponsor needs a 9-year loan, OPIC will guarantee repayment of the additional four years of maturity. In addition, OPIC may use its direct loan program to fill a "dollar gap" in the project financing.[227]

OPIC's Direct Investment Fund

For projects involving smaller amounts of financing, often less than $1 million and sometimes as low as $200,000, or those requiring long-term financing, OPIC increasingly has made direct loans through its Direct Investment Fund (DIF). DIF, a revolving fund of $50 million, is funded by a $40 million appropriation when OPIC was created and a further $10 million added in 1976 from OPIC income. For the three fiscal years mentioned in the preceding paragraphs OPIC provided $26

227. 1977 HOH, p. 406; Freeman, p. 762.

million in such loans to 23 investment projects. Interest rates are negotiated on the basis of risk assessment and current market rates. OPIC may use these funds to purchase debentures, convertible into capital stock of the borrower, and sell them as soon as it can find someone, especially local investors, willing to buy the investment. As of September 1977, OPIC's direct loans totalled $42.5 million, of which $4.565 had been sold to the private sector. [228]

OPIC is also authorized to make loans from excess foreign currencies to U.S. foreign investors. These currencies are presently available in only a few countries with the result that very few loans are being made from this source. [229]

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228. 1977 HOH, pp. 407-408; HR 95-670, pp. 4-5; Freeman, p. 744.

229. 22 U.S.C. § 2194(c) (1976); 1977 HOR, p. 5; Freeman, p. 745.

OPIC's pre-investment survey and investment encouragement program

OPIC's pre-investment survey and investment encouragement program involves such activities as pre-investment surveys, project brokering, investment missions, seminars, and counseling.[230] The program seeks to assist qualified firms to find suitable investment opportunities abroad. In connection with surveys OPIC will underwrite a portion of the cost (usually 50 percent) of the feasibility study. If the prospective client undertakes the project, it reimburses OPIC for its share of the survey. While OPIC spent but a little more than $1 million on surveys between 1971 and June 1977, this part of the program remains a tool for promoting investments[231] in LDC's by small and medium-size U.S. companies.

OPIC's project brokering

Project brokering by OPIC, commenced in 1975, is designed to match potential projects with qualified U.S.

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230. OPIC, A Guide for Executives, *supra* note 219.

231. 1977 HOR, pp. 5-6.

investors. Once OPIC concludes a project is suitable, it sends descriptive literature to potential clients and makes no charge for this particular brokerage service. The success rate of this brokering has been limited but perhaps improving. Between 1975 and 1977, 45 new projects were selected for brokering. Of the 31 projects in the first year, 12 U.S. investors were found, of whom five entered into ongoing serious negotiations. The following year, 14 projects were selected, 11 investors were located, three made positive investment decisions, and two entered into ongoing serious negotiations. Of the three brokered projects, two received finance guarantees and one registered for OPIC insurance. Feasibility survey loans were granted two others. In sum, project brokering has brought several spin-off benefits to OPIC, including enhanced reputation for reliability in evaluating projects and increased knowledge of business conditions and practices in LDC's.[232]

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232. Ibid., p. 5; 1977 HOH, pp. 441-443.

OPIC's investment missions

In recent years OPIC, in conjunction with the State and Commerce Departments and U.S. Embassies, has organized investment missions, escorting small groups of businessmen, at their own expense, to ascertain investment opportunities. For the period 1975-1977 OPIC sponsored four investment missions with 100 businessmen to 18 countries, and one agribusiness mission to six countries.[233]

OPIC's activities are conducted in accordance with its statutory purpose of complementing the development assistance objectives of the United States and operating on a self-sustaining basis. Accordingly, it takes pains to insure that an OPIC-involved project will be self-sustaining and self-liquidating. It is concerned with such factors as the adequacy of materials and labor; the competency of management; adequacy of power, transport, and marketing facilities; and the sufficiency of insurance coverage relating to economic and political risks. To protect itself against cost overruns and to insure that there will be no lack of working capital,

233. 1977 HOR, pp. 5-6.

OPIC requires its client to agree to invest sufficient equity or subordinated debts to cover unanticipated escalation in construction costs.[234]

OPIC's advancement of U.S. balance-of-payments

One of OPIC's statutory mandates is to advance U.S. balance of payments objectives.[235] This is accomplished by a project's spending a sum equal to the financial assistance it has received for procurement of goods or services in the host country or the United States. Accordingly, OPIC will engage in local cost financing to the extent the host country will accept foreign exchange loans to pay for its goods and services.[236]

As noted, OPIC encourages joint ventures, as a risk management technique, through its pre-investment survey program and its use of convertible loans. Since it is unable to convert the loans to equity, it will seek to

234. Freeman, pp. 748-759.

235. 22 U.S.C. § 2191(i) (1976).

236. Freeman, p. 748.

sell any such investments as soon as reasonably feasible to buyers, preferably local interests, who may then convert the loans to equity. In addition to the traditional joint venture structure, OPIC assists newer forms of investment -- *e.g.*, management, marketing, and service contracts. Not only do such newer forms entail less money outlay, they are politically more attractive to the host country and reduce the incidence of political risk. [237]

ADDENDUM

In recent months, cataclysmic, if not catastrophic, events have occurred in Iran, formerly a staunch U.S. ally. In place of the ousted Shah, whose suppression of dissidence was well known, there now exists a fundamentalist Islamic revolutionary regime under the leadership of Ayatollah Ruhollah Khomeini. In view of the daily political executions and the continuing turmoil, the probability of a change of regime or civil war in that country in the foreseeable future appears great.

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237. 1977 HOR, p. 5; 1977 HOH, pp. 30-31; Freeman, pp. 755-756.

One element in this complex Iranian picture is evident: neither the U.S. State Department nor the Central Intelligence Agency anticipated the upheaval, with the resultant tremendous losses to both the U.S. Government and U.S. companies. Indeed, over 50 U.S. diplomatic personnel are being held hostage.[238]

The Iranian revolution cannot be considered in isolation. As the respected International Institute for Strategic Studies in London pointed out in its annual Strategic Survey for 1978, this revolution reflected basic problems of development common to a wide range of countries, and the conditions that led to the Shah's downfall threaten their stability as well.[239]

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238. There were those who felt that the risks in Iran, political and economic, were too great. See Peter T. Kilborn, "Business Lessons, Learned in Iran," The New York Times, January 14, 1979, sec. 3, pp. 1, 4. The financial losses to U.S. business in Iran may run into the billions of dollars. See Leonard Silk, "Business Wary of 'Next Iran'," The New York Times, February 14, 1979, sec. D, p. 2.

239. The New York Times, May 16, 1979, p. 4, col. 2.

These happenings in Iran have resulted in renewed interest by corporate executives in the field of political risk analysis and of political risk insurance coverage, including that of OPIC. This heightened interest is also evidenced by a proliferation of so-called political risk consultants and experts drawn from the ranks of academia, retired military and intelligence officials, and others.[240] Because the lesson of Iran may yet prove productive, certain observations obtained from the preceding material may be briefly noted.

At this juncture, political risk analysis remains quite subjective but the more sophisticated, and necessarily complex, political risk analysis techniques are pointing in the direction of quantifiable ascertainment. As OPIC's varied operations and insurance coverages demonstrate, there are several different types of political risk. These risks vary depending on the nature

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240. See, in addition to Kilborn and Silk, _supra_ note 238, Frank Vogl, "Protection Against Political Upheaval," _The New York Times_, January 28, 1979, sec. 3, pp. 1, 11; A.O. Sulzberger, Jr., "Data on Terrorism Is New Venture's Product," _The New York Times_, January 15, 1979, sec. D, pp. 1, 5.

of the company and its business, the governmental structure of the host country, the stage of the investment's life cycle, and the structuring and financing of the investment. Before making its decision the investing company must combine prudent risk management principles with strategic planning. Continual updating of relevant data -- as is done by the two companies (A and B) described above, and by our largest banks with respect to sovereign country loans -- is a sine qua non for successful operation.

Even small companies with foreign direct investments should utilize basic prudent risk management principles. Whenever possible, they should utilize OPIC's insurance and other programs or seek political risk coverage from private insurers.[241] They must effect the principles of "adaptation,"[242] harmonizing their objectives with the host country's interests.

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241. Vogl, supra note 241, noting that National Union Fire Insurance Company of Pittsburgh, Pa., a member company of the American International Group, Inc., now offers a full range of political risk coverage.

242. Supra notes 47 and 49 and accompanying text.

Restatement of OPIC's expertise with political risk and its concomitant services to its clients would be supererogatory. It is both ironic and tragic that only a small percentage of eligible U.S. foreign investment in Iran was covered by OPIC or other insurers. As of October 1978, OPIC's exposure for inconvertibility, expropriation, and war ranged between $50 and $75 million.[243] It is too early to tell what the actual claims and payments will amount to.

A brief update of commercial bank lending to LDC's and attendant interests may be instructive. The area of sovereign country risk analysis has been one of the most utilized fields for political risk analysis, with political factors frequently being as important as, if not more important than, purely economic factors.

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243. U.S. OPIC, 1978 Annual Report, pp. 15-16. Later statistics are as follows: inconvertibility insurance -- $75 million, 38 projects; expropriation -- $57 million, 57 projects; war -- $53 million, 25 projects. Telephone interview with Dr. Gerald T. West, May 18, 1979.

For several years and until a short while ago, many of the middle and upper income LDC's have had much higher growth rates than the developed nations with the result that sovereign country loans and foreign commercial loans were very profitable to the lending banks.[244] In recent months, with a slowing down of the growth of some of the more dynamic LDC's and with increased surveillance by the Comptroller of the Currency and the Federal Reserve System, foreign loans by U.S. banks, especially to foreign governments, has decreased percentagewise but not in the aggregate.

The turmoil in Iran has made some commercial bankers jittery.[245] During the past year conditions in Peru, which adopted stringent measures and harsh remedies and was aided by higher metal and oil prices, im-

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244. "New World Economic Order," Business Week, July 24, 1978, pp. 68-79; "International Banking: A Survey," The Economist, March 31, 1979, pp. 28, 39-40, 65.

245. "Bankers Fear Iran Will Sour Their Fee Business," Financial Times of London World Business Weekly, April 23, 1979, pp. 21-22.

proved greatly. It was able to negotiate a new aid pact with the International Monetary Fund.[246] Turkey has also taken initial steps to improve its credit rating.[247] Zaire's finances still remain perilous.[248] The basic consideration remains that unless countries with substantial debts follow the recommendations proposed by the International Monetary Fund, they will not be able to obtain foreign financial assistance.

The business community has been slow to utilize the constantly improving techniques for predictability of political risk. As research in this area grows apace, the multinational corporation will be best served thereby.

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246. "U.S. Banks Rewarded for Letting Peru Solve its Problems," Financial Times of London World Business Weekly, May 7, 1979, pp. 21-22.

247. "Meeting the IMF Quarter Way," The Economist, April 14, 1979, pp. 80-81.

248. "Copper-bottomed Confusion," The Economist, March 17, 1979, pp. 85-86.

Appendix # 1 Table 1

Country X 1968–1970

13 SUBJECTIVE STABILITY INDICATORS

	INDICATORS	PERIOD OF TREND TREND 1968 – 1970	RESULTANT EFFECT OF TREND STABLE	 INDIFFERENT	 UNSTABLE
A.	ECONOMIC FACTORS				
1.	NATIONAL INCOME PER CAPITA	STRONG INCREASE	X		
2.	PRIVATE SAVINGS THROUGH OFFICIAL ESTABLISHMENTS	MODEST INCREASE	X	X	
3.	INVESTMENTS BY PRIVATE FOREIGN ENTERPRISES	INCREASE	X		
4.	BALANCE OF PAYMENTS (VISIBLE AND INVISIBLE)	DETERIORATION			X
5.	PRICE LEVEL OF CONSUMER GOODS	MODERATE INCREASE		X	
		SUBSCORE	3	2	1
B.	SOCIOLOGICAL FACTORS				
6.	AGRICULTURAL OUTPUT	INCREASE	X		
7.	PRIVATE HOME OWNERSHIP AND HOME BUILDING ACTIVITIES	INCREASE	X		
8.	EMIGRATION (PERMANENT AND TEMPORARY)	CONSTANT		X	X
9.	METROPOLIZATION AND URBANIZATION	INCREASE			X
10.	RELIGIOUS ATTENDANCE OF POPULATION	SLOW DECREASE		X	X
		SUBSCORE	2	2	3
C.	VIOLENCE FACTORS				
11.	NUMBER OF STRIKEDAYS	DECREASE	X		
12.	CRIMINAL OFFENCES PER 1000 INHABITANTS	SLOW INCREASE		X	X
13.	FREQUENCY OF ANTI-GOVERNMENT OCCURRENCES INSIDE THE COUNTRY	DECREASE	X		
		SUBSCORE	2	1	1
		TOTAL SCORE	7	5	5

Appendix # 1 Table 2

Country X 1971-1973

	13 SUBJECTIVE STABILITY INDICATORS	PERIOD OF TREND TREND 1971 - 1973	RESULTANT EFFECT OF TREND STABLE	INDIFFERENT	UNSTABLE
A.	ECONOMIC FACTORS				
1.	NATIONAL INCOME PER CAPITA	SLOW INCREASE		X	
2.	PRIVATE SAVINGS THROUGH OFFICIAL ESTABLISHMENTS	LOW INCREASE		X	
3.	INVESTMENTS BY PRIVATE FOREIGN ENTERPRISES	INCREASE	X		
4.	BALANCE OF PAYMENTS (VISIBLE AND INVISIBLE)	DETERIORATION			X
5.	PRICE LEVEL OF CONSUMER GOODS	STRONG INCREASE			X
		SUBSCORE	1	2	2
B.	SOCIOLOGICAL FACTORS				
6.	AGRICULTURAL OUTPUT	INCREASE	X		
7.	PRIVATE HOME OWNERSHIP AND HOME BUILDING ACTIVITIES	SLOWER INCREASE		X	
8	EMIGRATION (PERMANENT AND TEMPORARY)	DECREASE	X		
9.	METROPOLIZATION AND URBANIZATION	INCREASE			X
10.	RELIGIOUS ATTENDANCE OF POPULATION	SLOW DECREASE		X	X
		SUBSCORE	2	2	2
C.	VIOLENCE FACTORS				
11.	NUMBER OF STRIKEDAYS	INCREASE			X
12.	CRIMINAL OFFENCES PER 1000 INHABITANTS	SLOW INCREASE		X	X
13	FREQUENCY OF ANTI-GOVERNMENT OCCURRENCES INSIDE THE COUNTRY	INCREASE IN LATTER HALF			X
		SUBSCORE	0	1	3
		TOTAL SCORE	3	5	7

CONCLUSION: LESS STABLE THAN PERIOD 1968 – 1970

Appendix # 2

Table 1

Cash Flow Comparison of Projects in Two Countries

	Country A			Country B		
End of Year	Net Post-Tax Cash Flow	Cum. Cash Flow	Expròp Risk	Net Post-Tax Cash Flow	Cum. Cash Flow	Exprop. Risk
1	-500	-500	0.0	-500	-500	0.0
2	-500	-1000	0.0	-500	-1000	0.0
3	100	-900	0.0	150	-850	0.0
4	150	-750	0.0	300	-550	0.0
5	250	500	0.0	400	-150	0.2
6	250	-250	0.0	400	250	0.1
7	350	100	0.0	400	650	0.4
8	350	450	0.0	400	10[illegible]	0.[illegible]
9	350	800	0.0	400	1[illegible]	0.[illegible]
10	350	1150	0.0	100	1850	0.6

Table 2

Net Present Values of Projected Cash Flows for Country A at 15% Rate of Discount (thousands of dollars)

End of Year	Net Post-Tax Cash Flow	Risk-Adjusted Net Cash Flow*	NPV	Cumulative NPV
1	- 500	- 500	-435.0	- 435.0
2	- 500	- 500	-378.0	- 813.0
3	100	100	65.8	- 747.2
4	150	150	85.8	- 661.4
5	250	250	124.2	- 537.2
6	250	250	108.0	- 429.2
7	350	350	131.6	- 297.6
8	350	350	114.4	- 183.2
9	350	350	99.4	- 83.8
10	350	350	86.4	2.6

* Note that it is the same as the Net Cash Flow.

Table 3

Net Present Values of Projected Cash Flows for Country B at 15% Rate of Discount (thousands of dollars)

End of Year	Net Post-Tax Cash Flow	Risk Adjusted Net Cash Flow	NPV	Cumulative NPV
1	-500	-500	-435.0	-435.0
2	-500	-500	-378.0	813.0
3	150	150	98.5	-714.5
4	300	300	171.6	-542.9
5	400	320	159.0	-383.9
6	400	210	103.7	-280.2
7	400	210	90.3	-189.9
8	400	200	65.4	-124.5
9	400	200	56.8	67.7
10	400	160	39.5	- 28.2

Table 4

Net Present Values of Projected Cash Flows for Country B at 15 Rate of Discount Assuming the Investor has Purchased OPIC Insurance

End of Year	Net Post-Tax Cash Flow	OPIC Insurance-Adjusted Cash Flow	NPV	Cumulative NPV** (No Expropriation)
1	-500	-500	-435.0	-435.0
2	-500	-500	-378.0	-813.0
3	150	150	98.5	-714.5
4	300	300	171.6	-542.9
5	400	400	198.8	-344.1
6	400	400	172.8	-171.3
7	400	400	150.4	- 20.9
8	400	400	130.8	+109.9
9	400	400	113.6	+223.5
10	400	400	98.8	+322.3

* The cost of OPIC expropriation insurance is not factored in, its tax-deductible nature further reduces its impact on the firm.

** Even if an expropriation occurs at the end of Year 5 or any succeeding year, the NPV would be positive--assuming full compensation (90%) is paid one year subsequent to the expropriation.

CONCLUSION

More than 30 years have passed since the inauguration of the investment guarantee program to guarantee U.S. investors against losses from political risks in other countries. Almost a decade has passed since the Overseas Private Investment Corporation (OPIC), whose major function is the administration of this program, commenced its operations. In these circumstances, basis exists for determining the effectiveness of OPIC in assisting the U.S. investor for development investment abroad. In addition to an evaluation of OPIC, the author offers some recommendations for its improvement.

The investment guarantee program has always been intimately connected with U.S. foreign policy and until OPIC was created, the program was administered by several successive foreign aid agencies. Originally established as an adjunct to the Marshall plan to assist in the economic recovery of Western Europe, in 1951 the administration of the program was transferred to the Mutual Security Agency and the geographic coverage of the guarantees widened from Europe to countries in Asia, Africa, the Pacific, and the American Republics. The program was utilized as part of the Cold War strategy to assist in the containment of Communism. In 1953, the program was transferred to a new agency, the Foreign Operations Agency; three years later, administration of the program was again transferred to the International Cooperation Administration of the Department of State. By the end of the 1950's, investment guarantees were concentrated in four European countries -- Italy, France, West Germany, and the United Kingdom -- with large U.S. multinational corporations (MNC's) as the client-beneficiaries.

In 1959, amendatory legislation provided that insured projects must further "the development of the economic resources and productive capacities of economically underdeveloped areas." Further legislation in 1961 established a new, all-encompassing foreign aid agency, the Agency for International Development (AID) in the Department of State, to administer the investment guarantee program as well as other grants, loan, and technical assistance programs. AID sought to retain as much discretion as possible, passing on each application on an individual basis, but making the basic standard for issuance of a guarantee the extent the project would further U.S. foreign policy objectives. Accordingly, AID adminstered the program in a very liberal manner, not concerned with risk management principles, and permitting heavy concentrations of guarantee contracts in certain industries and in certain countries, especially Latin America. It was these heavy concentrations with the concomitant exposure which OPIC inherited when it undertook administration of the program in 1971.

The 1969 enabling legislation which created OPIC provided that its operations were to be conducted "under the policy guidance of the Secretary of State." In addition, OPIC received a directive -- not found in any prior legislation and unknown to the investment guarantee programs of other nations -- to conduct its financing and insurance operations in accordance with sound business management principles on a self-sustaining financial basis and "with due regard to principles of risk management" in its insurance operations.

The opposition which has existed to the investment guarantee program since its inception was intensified during OPIC's first few years of operation. The 1974 legislation, reflecting the Congressional desire that OPIC gradually transfer its insurance functions, other than those of reinsurer, to the private insurance industry, seemingly utilized the factor of privatization as a ploy to terminate OPIC's existence. But in the face of the comparatively unsuccessful efforts toward privatization during the next four years, the proponents of an OPIC grounded in a mission primarily developmental, were able in 1978 to enact legislation favorable to the poorer developing countries. Preferential treatment was to be accorded to projects in countries with per capita income of $520 or less and activities were to be restricted in countries where such income was $1,000 or more in 1975 U.S. dollars. Moreover, U.S. small business was similarly to be given preferential treatment. In view of the protectionist sentiment prevalent in the declining U.S. economy, OPIC was prohibited from supporting projects involving foreign copper, palm oil, sugar, or citrus crops for export to the United States. Furthermore, OPIC could not consider an investment likely to cause a significant reduction in the number of U.S. employees. It is evident that like most controversial subjects, the most recent OPIC legislation in 1978 was the product of numerous compromises. (N.B.: the House vote was only 216 to 185.)

In light of this background, how should one judge OPIC's effectiveness? Assertions have been made by

OPIC's opponents that OPIC's encouragement of investment only in the poorer countries has proved unrealistic; that the chief beneficiaries of the program have been the largest multinational corporations whose need for political risk insurance is less than that of the small businessman; that foreign investment is given a preferred status which has sapped the domestic economy of needed capital and deprived U.S. workers of jobs; and that the host countries have, unfortunately, frequently been undemocratic, dictatorial, or military. Despite these claims, the writer believes that notwithstanding the statutory limitations and restrictions upon its operations, OPIC has done a creditable job and has advanced the foreign policy objectives of the United States. Many beneficial investments abroad would not or could not have been made unless the projects were insured by OPIC. To the writer's knowledge none of the host countries in which OPIC has insured projects has indicated antipathy to the United States because of OPIC's operations. (Pre-OPIC ventures in Chile and the concomitant catastrophic expropriations there are almost sui generis; premature are predictions concerning the approximately $50 million insured projects in turbulent Iran.)

In the consideration of the 15 other national investment guarantee programs, one notes that almost all recognize a positive correlation between exports and selectively encouraged foreign investment. Unlike OPIC, none of the other larger programs emphasizes the developmental factor as a complement to governmental assistance programs. Indeed, the Japanese program, whose growth in recent years has been phenomenal in contrast to that of OPIC, makes acquisition of raw materials a major objective. Moreover, OPIC's program is alone mandated to be self-sustaining and to be operated in accordance with risk management principles. This is reflected in its higher and more complex premium rates. On mineral investment, for example, U.S. premiums may be four or more times as high as in other programs which apply a uniform lower fee regardless of the type of investment.

While Japan and five other national programs permit coverage of insured investments worldwide, OPIC is the only agency required to give preferential treatment to small business and applies a rigorous per income test in determining the eligibility of the host country.

One may well question whether the paramount national interests of the United States are best served by the restrictions and limitations imposed on OPIC by statute. OPIC's program is most restrictive as regards investor eligibility and host country eligibility. The requirement that OPIC be self-sustaining cannot be but a deterrent to its expansion -- a direction that this writer approves. In actuality, the two-fold objective of OPIC, developmental and self-sustaining, must at times be viewed as inconsistent and contradictory. If increased foreign investment be a basic consideration for OPIC's existence -- as the Japanese program makes clear for its people -- then perhaps it might be well to emulate the Japanese program and deemphasize both the developmental impact on the host country and the dependency upon a self-sustaining operation.

We have seen that the various proposals for a multilateral investment guarantee agency have been unsuccessful because of the opposition or indifference of both industrial and developing countries. We have seen the traditional reluctance of the private insurance industry to enter the field of political risk except for the recent limited entry with respect to expropriation losses by Lloyd's of London and the American International Group. In these circumstances, the writer favors the expansion of OPIC's activities along the following lines: (1) creation of a separate developmental division giving preferential consideration to the poorer developing countries and to U.S. small business. This division would operate along lines similar to those presently conducted by OPIC but with the elimination of the requirement that the activities be self-sustaining; (2) creation of a separate commercial political risk division which would give worldwide coverage and would be self-sustaining except as to projects deemed in the national interest, such as natural resources. The present Japanese investment guarantee program could serve as a general model. This division would work closely with the private insurance industry and would initiate reforms similar to those recommended in 1976 by the outside consulting agency of Tillinghast, Nelson & Warner, Inc. These reforms would include variation of rates by classification of business; greater rating differential between debt and equity investments; variation of rates on an annual basis depending upon the duration of the insurance; extension of coverage to already existing investments; and the issuance of insurance for periods shorter than the current 20-year period; (3)

creation of a separate political risk analysis division utilizing OPIC's expertise in this field. Its services would be available not only to the other divisions of OPIC without fee but also to private industry and the private insurance sector on a profit-making basis.

The 1978 legislation contained anti-bribery provisions which required OPIC to refuse payment of any claim for losses on any OPIC-assisted project with respect to which the insured investor has been found guilty under the Foreign Corrupt Practices Act of 1977. So far, only the United States has seen fit unilaterally to enact anti-bribery legislation with consequences beyond its borders. While OPIC's impact in this field is limited, and realistically, the existence of OPIC insurance has had little practical effect on whether to pay a bribe or accede to an extortionate demand, there remains the question whether the Foreign Corrupt Practices Act and the cognate OPIC provisions serve the national interest. None of the allies and business competitors of the United States -- the industrial nations of Western Europe and Japan -- has similar legislation. On the contrary, countries like West Germany and France permit payoffs to be tax-deductible. An English royal commission a few years ago rejected reform. Japan's exporters have no domestic law to forbid questionable foreign payments. U.S. attempts to get the industrial nations to enact anti-bribery legislation have not proved successful. In these circumstances, the question continually arises: Can the United States be the sole policeman of the morality of global business? In the writer's opinion, considering the turbulence of the times, one must on balance view the anti-bribery legislation as statutes whose timing was premature.

OPIC has become the preeminent agency or institution with the greatest expertise in insuring U.S. investors in friendly underdeveloped countries against the perils inherent in political risk. Since political risk has been OPIC's life blood, the final chapter of this work was devoted to an in-depth analysis of the various factors involved in risk management and its relation to insurance. While the inevitable conclusion is that unlike other forms of insurancec, political risk insurance has as yet no actuarial basis, progress is being made and the need for continuous studies ever present.

What one learns from these numerous studies is that at the present time it is almost impossible to forecast with any degree of accuracy future events, political and economic, in many parts of the world. Indeed, political instability appears to be the rule rather than the exception in the developing countries as well as in some of the more established countries. In the face of such instability, principles of prudent risk management and corporate strategic planning require preparation for swiftly changing circumstances. Employing a comprehensive risk analysis approach, a multinational corporation must develop both short- and long-term scenarios for both its worldwide and its individual country operations. Among the various means of minimizing risks is the utilization of political risk insurance issued by OPIC or the few private insurers.

That part of the international banking industry engaged in sovereign country loans has learned that evaluation of country risk remains an art rather than a science. It is for this reason that these banks have improved their monitoring systems, employing the most sophisticated risk analysis approaches. Since defaults of international bank loans to countries are infrequent, the problem often resolves itself into rescheduling of payments.

The author views optimistically the future of both OPIC and political risk analysis.

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