The Merits of Forced Divestment:
The Experience of the Andean Group *

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Introduction

A new generation of economists and officials in the less developed countries is deeply convinced that their natural resources and major industries should not be controlled by foreigners and that matters of national importance should not depend on decisions made abroad by foreign corporations. This conviction has brought about a critical reexamination of the role of foreign investment in economic development and a search for new solutions to the economic and political problems engendered by foreign investment.

As a means of reducing the tensions between less developed countries and foreign investors, proposals for the transfer of the ownership of foreign subsidiaries to local control have received considerable attention in recent years. Government policies in the less developed countries aimed at insuring local participation in the equity of foreign subsidiaries have been operative for a number of years. The policies of "Mexicanization" and "Chileanization" under President Frei stand out as prime examples in Latin America. In Asia, India and Ceylon have had similar policies encouraging joint ventures.

In the last few years, this desire on the part of the less developed countries for greater local ownership of foreign subsidiaries has been incorporated into "forced divestment" proposals, which are designed for a compulsory and systematic transfer of ownership. Generally, forced divestment (sometimes referred to as "fade-out") proposals require foreign companies with subsidiaries in a less developed country to sell either the majority or
totality of ownership to nationals of that country within a stipulated period. What differentiates a forced divestment policy from policies which apply pressure on the foreign investor to share ownership of his subsidiary with locals is that in the former all foreign investors (in a given sector or sectors) are required to divest a certain proportion of equity (usually 51%) under the same terms and conditions, whereas in the latter direct negotiations between the government and the foreign investor determine whether or not the foreign investor is required to divest as well as the terms of divestment (i.e., percentage of equity to be divested, the time period allowed, manner of sale and selection of buyers).

Chief among the proponents of forced divestment have been Professor Albert Hirschman of Harvard and Dr. Raul Prebisch, formerly Director General of the United Nations Conference on Trade and Development. Hirschman proposes the establishment of an Inter-American Divestment Corporation, which would buy up existing foreign investments in Latin America in order to transfer the equity later to Latin American investors. The Inter-American Divestment Corporation would be financed by contributions from the industrial advanced nations.\(^1\) Another variation of the divestment proposal has been suggested by Professor Rosenstein-Rodan of MIT, in a work submitted to the Inter-American Development Bank,\(^2\) and by Professor Raymond Vernon of Harvard. Their version

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would allow foreign investors to enter a country and maintain complete
ownership of their subsidiaries for a period of no less than seven and no
more than twenty years, at the end of which time they would transfer either
the majority or complete ownership to national investors. Professor Vernon
sees this formula as a means of gaining the participation of those foreign
enterprises which are unwilling to enter joint ventures. In all versions,
forced divestment is seen as means of alleviating the economic and political
problems caused by foreign investment, since control of foreign enterprises
passes to local hands. The Inter-American Economic and Social Council of the
Organization of American States expressed its support for forced divestment
as a possible remedy for the problems created by foreign investment at a meeting
in 1969.

The first application of a forced divestment scheme is Decision
No. 24, the 'Common Treatment on Foreign Capital, Trademarks, Patents, Licensing
Agreements, and Royalties,' adopted by the Andean Group countries--Bolivia,
Chile, Colombia, Ecuador, and Peru. These countries committed themselves in the
Cartagena Agreement of May 1969 to take the necessary steps to form an Andean

3 Paul N. Rosenstein-Rodan, "Multinational Investment in the Framework of Latin
American Integration," in Multinational Investment in the Economic Development
and Integration of Latin America, pp. 74-80.

4 Raymond Vernon, "Private Long-Term Foreign Investment in Latin America," in
CIES, The Role of Foreign Private Investment in the Development of Latin America
(CIES/1371).

5 Peru's Law of Industries (1970) was the first application by any country of
a forced divestment scheme. Peru's law was superseded by Decision 24.
Common Market by 1965. As one of the measures contemplated at the time of the signing of the Cartagena Agreement, the Andean foreign investment code, implemented as Decision 24 on June 30, 1971, represents "a precedent of consequence." It was the first common policy toward foreign investment ever adopted by a group of nations and the first major test of a policy of forced divestment. Decision 24 obligates foreign investors with existing holdings who wish to take advantage of the enlarged five-country market as well as all new foreign investors to sell equity over a period of fifteen years to become joint ventures with a minority ownership position (49%).

Ever since the provisions of Decision 24 were revealed in December 1970, it has been enveloped in controversy, both from within the Andean countries and from groups without, particularly foreign business interests. The intensity of the debate surrounding the Andean foreign investment code has threatened the survival of Decision 24 and even the continued unity of the Andean Group. The adoption of Decision 24 has led to a reduction of foreign investment, especially from U.S.-based multinational corporations; many executives of multinational corporations view Decision 24's forced divestment provisions as a potentially dangerous precedent for other less developed countries. In the next few years, reduced foreign investment flows will exacerbate domestic political opposition to Decision 24, causing pressure for the Andean countries to modify or abandon Decision 24. At present it is not certain whether the Andean countries will be able to maintain Decision 24 in its present form.

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7 Twenty years in the case of Bolivia and Ecuador.
The experience of the Andean countries with Decision 24 provides valuable lessons for other less developed countries considering forced divestment as a formula for reconciling their needs with those of foreign investors. Before examining the record of Decision 24 up to the present, an analysis of the merits of forced divestment is necessary in order to determine whether it represents a policy desirable for and applicable to most less developed countries, as well as to determine the underlying basis of the disagreement with Decision 24 within the Andean countries. The arguments advanced by the proponents of forced divestment can be divided into two categories — economic and non-economic rationales.

The economic rationale for forced divestment

One of the chief arguments for forced divestment is that the value of a foreign investment for the host country declines over time. After the initial contributions of management, entrepreneurship, technology, and capital are made by the foreign enterprise, foreign investment becomes less essential as the capacity of the local economy increases. The original technology becomes commonspread and knowledge diffused. In time the foreign investment may become a retarding influence, inhibiting the development of local entrepreneurs and local savings. \( ^8 \) Divestment is seen as a solution, since it "reduces the economic costs to the host country by setting a terminal payment lower than the equivalent value of the future flow of payments from the subsidiary to the parent"; \( ^9 \) and enables the gradual development of entrepreneurship through sharing in the management of the foreign subsidiary.

\(^8\) Hirschman, op. cit., pp. 5-8.

\(^9\) Vernon, op. cit., p. 266.
The argument that the value of a foreign investment declines over time is based on the assumption that the foreign enterprise remains the same over time. However, this is a questionable assumption. As Raymond Vernon indicates:

Stimulated by opportunity or pushed by local government pressure, enterprises in such industries have commonly responded by continually upgrading their technological and managerial contributions. \(^{10}\)

In many cases, foreign corporations that originally established subsidiaries to replace imports have moved to exporting from their subsidiaries. \(^{11}\) Based on the empirical study of the actual behavior of multinational corporations, there seems little justification for the assumption that "the benefits to the host country have declined in time; The contrary could just as well be true." \(^{12}\)

Perhaps the most compelling economic argument in the minds of those who advocate forced divestment is that "The existence of a local partner affects the style in which a subsidiary is used, with results that benefit the local economy." \(^{13}\) The argument maintains that a local partner would not allow decisions to be made which were at variance with its own interests, and hence indirectly with the national interest. Furthermore, nationals are believed to be more responsive to governmental economic policies and controls.

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\(^{10}\) Ibid., p. 180.

\(^{11}\) Vernon, Foreign Investor's Motivations in the Less Developed Countries, p. 23.

\(^{12}\) Vernon, Sovereignty at Bay, p. 267.

\(^{13}\) Ibid., p. 140.
Less than a handful of studies provide data to support this position. Based upon an empirical study of the behavior of multinational firms in the pharmaceutical, chemical, rubber, electronics, and textile industries in Colombia, Constantine Vaitsos in *Transfer of Resources and Preservation of Monopoly Rents* maintains that significant monopoly and oligopoly elements are created in input and factor markets by multinational firms due to the fact that resource transfers take place in "package form." 14 In the absence of a local partner, who is interested in maximizing profits in the subsidiary, the foreign firm uses transfer prices, royalties, technical fees, etc., to reduce the reported profitability of the subsidiary so that accusations of exploitation are less likely. Vaitsos cites evidence that in the Colombian pharmaceutical industry intermediate products purchased by the subsidiary from the parent company were "overpriced" 15 by 155%. 16 In comparisons of joint ventures with wholly-owned subsidiaries, Vaitsos finds the margin of overpricing to be significantly lower in the former. In brief, Vaitsos affirms that local control can be vitally important in reducing the economic costs of foreign investment; as he writes:

> What are relevant here are not only the "psychological insecurity" of "national ideology" and "fears of foreign domination", but the very real facts of loss of control which could have overwhelmingly important economic repercussions. 17

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14 Constantine Vaitsos, *Transfer of Resources and Preservation of Monopoly Rents*, p. 3.

15 "Overpricing" he defines as the margin between the world market price for a good and price charged by the parent to its subsidiary.


Although Waitsos' data are not generally disputed, there is some disagreement as to their general significance. Raymond Vernon, for example, does not feel that the Colombian data can be generalized; he writes:

"Multinational enterprises, therefore, transfer goods and services among affiliates at prices that are often at variance with the results that independent buyers and sellers would reach. But the cases so far uncovered do not create the basis for assuming that there is a systematic bias in favor of assigning the largest profit to the parent."^{18}

Louis Wells, who has done extensive research on joint ventures at Harvard Business School, feels that the data "comes out slightly on the side" of those who claim that transfer prices for joint ventures are generally lower than to wholly-owned subsidiaries.^{19} However, he points out that charges for the provision of know-how and tradenames, profit remittances, royalties, technical service fees, etc., "appear to be higher for joint ventures than for wholly-owned subsidiaries."^{20}

Moreover, the evidence indicates that multinational corporations refrain from exporting from joint ventures.^{21} This fact can have serious consequences given the magnitude and importance of the exports of multinational corporations in less developed countries. For example, in 1968, 40% of Latin America's exports of manufactured goods were from U.S. controlled subsidiaries;

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18. Vernon, Sovereignty at Bay, p. 139.


20. Ibid., p. 25.

21. Ibid., p. 28.
two-thirds of the exports of U.S. subsidiaries were sold to affiliated enterprises, showing the importance of access to the multinational corporation's marketing network. Thus, the adoption of forced divestment could have the effect of aggravating a less developed country's balance of payments problems.

From the foregoing examination of the behavior of multinational corporations toward their wholly-owned subsidiaries and toward their joint ventures, the available data support the contention that local ownership changes the behavior of foreign subsidiaries. But the corollary assumption that such a change results in benefits to the local economy cannot be as clearly supported. Both Wells and Vernon maintain that the evidence in terms of economic benefits rests on the side of the wholly-owned subsidiary. As Vernon indicates:

Systematic comparisons between joint ventures and wholly-owned subsidiaries suggest that, from the point of view of host countries, wholly-owned subsidiaries may be a slightly more attractive bargain.  

**The non-economic rationale**

Although the economic arguments for majority local ownership in foreign subsidiaries may not be compelling, the various non-economic arguments concerning the value of asserting greater control over foreign investment provide a different rationale for forced divestment. It is clear that a rapid GDP growth rate is not the only goal of the less developed countries. Also important are a greater degree of political autonomy, a lessening of dependence on the advanced nations, and a more equitable distribution of income within and among

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22 Council for Latin America, *The Effects of United States and Other Foreign Investment in Latin America*, pp. 36-37.

countries. Foreign investment often is viewed as an obstacle to the achievement of these goals.

Of central importance in the literature since World War II on the costs of foreign investment in the less developed countries is the issue of dependency. Concerned with the impact of foreign investment on the host economy, dependency can be characterized as the direct or indirect loss of the ability by the host country and its citizens to influence and control the vital decisions affecting their economy and their future course of development. When foreign enterprises are perceived as hindering the government's legitimate prerogative to implement economic, political, and social policies in what it decides are its best interest, then dependency becomes a critical problem. The sense of dependency is especially acute in the less developed countries because of their relative weakness in the face of multinational corporations. Obtaining greater control over foreign subsidiaries through majority ownership is thought to be an effective means to reduce the degree of dependency; for the government's capacity to carry out policy is felt to be increased when its important industries are in the control of nationals rather than foreigners.

Closely related to the issue of dependency is that of economic nationalism. Although frequently belittled as irrational and wasteful, nationalism in the less developed countries may be a constructive force for development. As an ideological force, nationalism can perform an integrative function in the establishment of a cohesive nation-state. Moreover, nationalism has functioned as "the driving force responsible for the urge of the less

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developed countries to accelerate their economic development by economic planning. Nationalists often view foreign investment as a threat to national sovereignty and to the achievement of important national goals. As long as they continue doing so, any normative judgments on the value of economic nationalism are apt to be pointless; as one authority on foreign investments in less developed countries writes:

Rising Latin American nationalism is not likely to be eliminated by pointing to its possible economic costs. Stable and responsible governments can minimize such costs and harness nationalistic feelings to the task of development, perhaps turning costs into gains, while a massive presence of direct foreign investments can weaken national solidarity, impairing the government's ability to coax sacrifices from the public.

The national ownership of those important industries that are controlled by foreign subsidiaries may have the character of a collective consumption good; for the "psychic satisfaction obtained by the community at large from gratification of the taste for nationalism" can be enjoyed by all. Whether beneficial or harmful in terms of the economic growth of the country, the desire of leaders in the less developed countries to gain control over foreign subsidiaries for nationalistic reasons is a sufficient justification for a forced divestment policy. As Harry Johnson writes:

It is quite possible that the psychic enjoyment that the mass of the population derives from the collective consumption aspect of nationalism suffices to compensate them for the losses of material income imposed on them by nationalistic economic policies, so that


26 Carlos F. Díaz-Alejandro, Direct Foreign Investment in Latin America, p. 344.

27 Johnson, op. cit., p. 127.
nationalistic policies arrive at a quite acceptable result from the standpoint of maximizing satisfaction. It may even be that nationalistic policies are in the long run the cheapest and most effective way to raise real income in the less developed countries.\textsuperscript{28}

The Experience of Decision 24

The forced divestment provisions of Decision 24 were from the outset the principal basis of the controversy that occurred within the Andean countries. A lack of consensus on the non-economic rationale for forced divestment, coupled with sharply divergent estimates of the effect that the forced divestment provisions would have on the level of foreign investment, were the mainsprings of the dissatisfaction with Decision 24. An analysis of the major events surrounding Decision 24 from mid-1970 to the present will be undertaken in order to understand the underlying dynamics of political conflict that took place in the Andean countries.

The formulation of decision 24

From the inception of the Andean Group, the formation of a common policy toward foreign investment was considered an integral and important part of the Andean integration scheme. The fundamental objectives of the common policy were to avoid excessive intraregional competition for new foreign investments; to obtain an equitable distribution among countries of new investment projects; to strengthen the negotiating position of the region in regard to foreign investment; and to obtain greater national control over their economies and a lessening of external dependence. It was this last objective

\textsuperscript{28} Ibid., p. 184.
that gave rise to the forced divestment provisions. In accord with these objectives, the Cartagena agreement in Article 27 set a deadline and procedure for formulating a common policy.

Before December 31, 1970, the Commission, at the proposal of the Junta, shall approve and submit for consideration of the Member Countries a common system for treatment for foreign capital, and among other things, for trademarks, patents, licenses and royalties.

The Member Countries commit themselves to adopt the provisions that may be necessary in order to put the system into practice within six months following its approval by the Commission.29

The Junta began its preparatory work on the proposal in April 1970. A memorandum issued by the Junta on April 6, 1970, to the member governments outlined the nature of the investigations to be carried out in drafting the Junta proposal.30 As the document provides insight into the type of considerations which were most important in producing the Junta proposal, a brief consideration of it will be useful in understanding the genesis and evolution of the forced divestment provisions of Decision 24: For aside from this document, the nature of the deliberations leading to Decision 24 remain confidential information of the Junta.

Perhaps the most striking aspect of the Junta document is its explicit emphasis on the political dimensions involved in formulating a common policy toward foreign investment. Contrary to the concentration on economic

29Article 27 of the Cartagena Agreement.

30Junta del Acuerdo de Cartagena, Memorando Regimen Corran Sobre Tratamiento a los Capitales Extranjeros; Marcas, Patentes, Licencias y Regalías y Regimen Uniforme de las Empresas Multinacionales (JUN/UI/di/1) 6 de abril de 1970, passim.
arguments by Junta spokesmen and government officials in the Andean countries in their defense of Decision 24 during the ensuing controversy, the common policy was conceived of by its formulators as a blend of political and economic rationales within the constraint of political feasibility. The political aspects enumerated in the document included the nature of economic nationalism in the Andean countries; the official position of the member governments in regard to foreign investment; the attitudes and tendencies of the governments, of political parties, and other pressure groups in regard to foreign investment; and the political feasibility of different alternatives for a common policy. 31

A further indication of the thinking of the Junta formulators can be gained by examining the investigation of foreign investment in the Andean countries carried out for the Junta by Miguel Wionczek of the Centro de Estudios Monetarios Latinoamericanos (CEMLA). 32 In forming a common policy, Wionczek advises against merely harmonizing existing national legislation on foreign investment in the Andean countries, given its insufficiency and the fact that such an approach would ignore the critical 'political economic implications' of foreign investment in less developed countries. 33 He suggests that the existence of the Andean market should be taken as a 'starting point' for foreign investors

31 Ibid., Anexo, pp. 4-5.


33 Ibid., p. 2 (Unpublished English translation of above work).
are more willing to accept strict regulations when they perceive greater opportunity.\footnote{Ibid., p. 40.} Furthermore, a common policy should take into consideration that the characteristics of foreign investment as well as the conditions that may be imposed upon it "reflect the relative power of negotiation" of the two parties; thus, the common policy should seek to augment the Andean countries' bargaining strength.\footnote{Ibid., p. 4.}

As for harmonization of the treatment of foreign investment in the traditional extractive sectors, Wionczek feels that it should receive lower priority than the harmonization of the treatment in the industrial sectors, mainly because "efforts to establish a common agreement in such sectors as mining could create serious intraregional difficulties of a political order."\footnote{Ibid., p. 11}

Cited as prevalent attitudes toward foreign investment throughout the subregion are a preference for joint ventures, rather than wholly-owned subsidiaries, and a disillusionment with the type and costs of technological contributions by foreign enterprises.\footnote{Ibid., p. 3.} In general, Wionczek is critical of the performance of foreign enterprises in the Andean countries in the past and sceptical of their future contributions to the economic development of the subregion. Nevertheless, for political reasons, he does not feel that the Andean countries should formulate a common policy which would exclude foreign investment.
It would be politically naive and unrealistic to use the criticism on the behavior of the foreign subsidiaries already established in the countries of the Andean Group as a base for a highly restrictive regime on manufacturing foreign investment in the future Andean Common Market. The problem rather lies in these terms: how to eliminate the past abuses of the private foreign investors in the area and how to create, at the same time, the conditions under which private capital and technology of external origin could make an important contribution to the economic growth and industrialization of the subregion.38

During the period between April 1, 1970, when the Junta began work on the common policy, and October 30, 1970, when the Junta proposal was released, significant political and economic changes occurred in the Andean countries which would later have great impact on the nature of Decision 24. In Peru, the ruling 'revolutionary nationalist' military government under General Juan Velasco Alvarado announced in July 1970 a new Law of Industries, which dealt with both foreign and national enterprises. As the first legislation ever to incorporate the 'fade-out' formula of forced divestment in which foreign investors must sell the majority share of their investments to local investors over a specified time period, the Peruvian Law of Industries was both hailed as a major advance in the treatment of foreign investment and severely criticized as an example of negative economic nationalism which would break down the already strained relationship between foreign investors and the Peruvian government. The law required foreign companies to reduce their equity positions in their Peruvian subsidiaries to 33.49%. Both the amount of equity that foreign investors would be allowed to retain plus the time period over which divestment would take place were to be determined on a case-by-case basis through negotiation between the government and the foreign enterprise. In basic and extractive industries,

38 Ibid., p. 39.
foreign companies could participate in the Peruvian economy on a contractual basis only, but sell their ventures back to the state at the end of a mutually agreed upon period. Another novel aspect of the Peruvian Law of Industries is the requirement for both foreign and domestic firms that 15% of pre-tax profits be given to the workers each year for the purchase of stock in the company. Eventually the workers, or the "Comunidad Industrial" as they are collectively termed, are to hold 50% of the ownership of the company. 39

Shortly after the release of the Law of Industries, President Velasco stated that the Andean Group's common policy toward foreign investment when formulated would take precedence over Peru's new law. 40 But it was clear that for reasons both of convenience and national ideology Peru would attempt to influence the Andean Group to adopt a policy toward foreign investment which would incorporate a forced divestment formula similar to hers. As evidence of the conception of the role of foreign investment which Peru would bring to the December negotiations of Decision 24, the following excerpt from a speech by President Velasco before the VI Congreso Latinoamericano de Industriales, meeting in Lima on April 5, 1970, is representative:

The present form of foreign investments makes them mechanisms to absorb our riches and leave very few benefits to our countries,


40 Business International Corporation, op. cit.
intensifying our condition as dependent countries. This must not continue any longer. If with realism and calm it is recognized that foreign capital comes obeying an inevitable economic imperative and that our economic development requires the contribution of foreign capital and technology, it will be possible to find formulas to reconcile the necessities of foreign investment with our needs.

In Chile the leader of the Socialist Party, Salvador Allende, was elected president in August 1970. His Marxist coalition, the Unidad Popular, had made the issue of foreign domination of the Chilean economy a central part of its party platform during the election. The Unidad Popular maintained that Chile was "dependent upon imperialism and dominated by the sectors of the bourgeoisie structurally tied to foreign capital." It was clear when Allende was elected that he would nationalize Chile's foreign-controlled copper mines and take steps to reduce significantly the power and scope of foreign enterprises in the Chilean economy.

The third major change in the political situation in the Andean countries occurred in October 1970 when General Juan Jose Torres came to power through a military coup which overthrew President Alfredo Ovando. Upon assuming power, Torres pledged to "struggle against Colonialism and Imperialism" and promised that the state would take over "strategic sectors of the economy from foreign interests." Although foreign investors had been staying away

\[\text{Camara de Comercio de Bogota, El Pacto Andino: Su Desarrollo y Perspectivas, p. 140. (author's translation).}\]

\[\text{Ibid., p. 141. (author's translation).}\]

\[\text{"The Andes: A Nationalist Surge," Time, July 26, 1971.}\]
from Bolivia since Ovando's regime nationalized Gulf Oil Company's Bolivian holdings in 1969, the Torres' coup was significant for the common policy toward foreign investment in the Andean Group in that it tipped the balance of power in the Andean Group in favor of nationalistic and leftist regimes. The more conservative governments in Colombia and Ecuador began to feel increasingly isolated from the predominant political philosophy in the Andean Group; certain sectors and groups in Colombia began to express publicly their uneasiness at having contracted commitments at the time of the signing of the Cartagena Agreement in 1969 with partners of similar persuasion and then having to implement these commitments with new and ideologically incompatible bedfellows.

The Junta proposal, when it was released at the end of October, was unexpectedly harsh from the point of view of foreign investors. A publication by Business International expressed the viewpoint that "the Junta came up with the most stringent and controversial controls ever drawn up in Latin America (excluding Cuba)."\(^{44}\) The Junta proposal required the forced divestment of 51% of equity of all foreign investments, new and existing ones, those serving national markets as well as those taking advantage of regional markets. Concerning credit, this original Junta proposal was similarly strict: Article 14 of the original proposal stated:

As regards domestic credit, foreign enterprises shall only have access to that of suppliers and only for the acquisition of national goods or services.\(^{45}\)


\(^{45}\)Junta del Acuerdo de Cartagena, Propuestade la Junta Para el Regimen Comun Sobre Tratamiento a las Capitales Extranjeras en los Paises del Acuerdo de Cartagena. (author's translation).
Furthermore, absent from the original Junta proposal was the escape clause represented by Article 44 of the present Decision 24, which allows each country to follow its own rules in basic and extractive industries, public services, insurance, banking, etc. This original version prescribed uniform treatment for these sectors.

Although it is impossible to determine conclusively what effect the political changes in the Andean countries had upon the nature of the Junta proposal, it seems certain that they did influence the type of restrictions which the Junta proposed. The Peruvian Industrial Law undoubtedly served as a precedent and an inspiration for the forced divestment provisions of the Junta proposal. Moreover, the assessment of what would be "politically naive and unrealistic" in a common policy toward foreign investment probably changed in light of the political events in Bolivia and Chile. Although the nature of the provisions of the Junta proposal were not inconsonant with the thinking of many in the Andean countries, changes in the Andean political environment must have altered the Junta's evaluation of the constraint of political feasibility. A statement by Miguel Wionczek in the fall of 1970 tends to confirm this view:

The work of elaborating a common policy toward foreign investment is perhaps less difficult now than it was at the time of the signing of the Andean subregional agreement. Recently in some member countries of the zone there have occurred important changes in official attitudes toward foreign investment. All this suggests that the coordination of policies and attitudes implies to a larger degree non-economic factors.  

46 Wionczek, op. cit., p. 39.

From the moment of its release at the end of October, the Junta proposal was met with opposition from both the government and the private sectors in Colombia and Ecuador as well as from certain groups in the other countries. Opposition to the foreign investment code focused primarily on three aspects—the forced divestment provisions, the restrictions on credit, and the treatment in the basic and extractive sectors.

The commission negotiations

Clearly, the opposition to the Junta proposal was directed toward the December session of the Commission, which was to vote on the Junta proposal in establishing the common policy. The beginning of the session on December 14, 1970, was accompanied by solemn editorials in the Andean countries which emphasized the importance of the negotiations that would take place on the common policy toward foreign investment. An editorial in the leading newspaper in Colombia, El Tiempo, warned that: "Upon the results of the meeting in Lima will depend a great part of the future history of our nation." There was strong feeling that the differences of opinion between Colombia and Ecuador, on one hand, and Peru, Chile, and Bolivia on the other, could lead to a breakup of the Andean Group; for the controversy over the common policy toward foreign investment was the first major internal conflict in the Andean Group since the signing of the Cartagena Agreement in 1969. The negotiations on the common policy were considered a crucial test of whether the Andean Group would be able to maintain unity in the difficult tasks ahead.

The internal conflict among the Andean countries centered primarily on the Junta's requirement of forced divestment of foreign enterprises to

minority ownership positions. Colombia's position on forced divestment was that the time period for the completion of conversion to joint ventures by foreign enterprises should be eliminated and that each country should be allowed to offer incentives to foreign enterprises to encourage their transformation into joint ventures. Essentially, the Colombian government wanted the divestment provisions to be a statement of principle of the Andean countries, rather than a requirement for foreign enterprises. In contrast, Peru insisted upon the approval of the Junta proposal without modification.

In the Peruvian case, the earlier statement by Velasco that the Andean common policy would take precedence over its Law of Industries had made it imperative that the Commission approve a set of rules similar to Peru's; substantial modification of the Law of Industries would be a setback for the Peruvian military government's attempt to gain widespread popular support from the Peruvian people for its revolutionary programs. 49

Although Chile and Bolivia clearly supported the Peruvian insistence on a strict forced divestment requirement, they had much less at stake during the negotiations in terms of domestic political opinion. If a less restrictive common policy were approved, they could still enforce their own stringent rules, since the common policy only set forth a minimum set of regulations. A possible additional reason why socialist Chile did not play an important part in the negotiations was that it did not want to lend support to the fears and suspicions in Colombia and Ecuador that Chile would try to impose its ideology on the other Andean countries. Bolivia attempted diplomatic logrolling—a representative

insisted that Bolivia was against the adoption of any kind of common policy toward foreign investment, but would assent if she was granted special concessions on the reserve list of tariff reductions.\footnote{The Bolivian position was made possible by the rule that the Commission vote had to be unanimous on matters of harmonization of member countries' legislation.} The position of Ecuador was somewhat ambiguous; although she supported the position of Colombia, she also tried to obtain tariff concessions as Bolivia did in exchange for her vote.\footnote{"Se Perfila Enfrentamiento Entre Colombia y El Peru," \textit{El Tiempo}, December 19, 1970.}

A compromise between these conflicting positions was reportedly reached at 3 a.m. on December 24.\footnote{"Intimidades de las Negociaciones en Lima," \textit{El Tiempo}, December 28, 1970.} As far as the most contested issue—the forced divestment provisions—Decision 24 extended the fade-out deadline from 10 to 15 years (20 years in Bolivia and Ecuador) and permitted existing foreign enterprises the option not to fade-out provided that they not take advantage of the regional market. As in the earlier version, all new foreign investors were required to divest 51\% of equity. The restrictions on credit were relaxed somewhat, with foreign companies now eligible for short-term credit in "exceptional" cases. Furthermore, early in the session agreement was reached that the regulations governing mining, banking, public utilities, etc., (Chapter III of Decision 24) would be optional.\footnote{Perhaps Wionczek's advice on the political impossibility of reaching agreement in these sectors was heeded.} Article 44 of Decision
24 provided that 'when in the opinion of the receiving country special circumstances exist, said country may apply rules different from those contemplated.'\textsuperscript{54} Another significant difference between Decision 24 and the original Junta proposal was the addition of Article 35 which gave 'a priority option in favor of the state' for purchasing the shares put up for sale by divesting foreign enterprises. This addition was to be significant in the controversy that followed in the next six months.

In attempting to understand how a reconciliation between the polarized positions of Peru and Colombia was reached, one is drawn into the realm of speculation. A reasonable supposition, however, is that the desire of the Andean countries, and particularly of Colombia, to maintain the unity of the group was decisive in bringing about a compromise. Many within the Andean countries believed that the inability to reach an agreement would signal the failure of the Andean Group. For if the Andean Group countries steadfastly refused to yield national interests for the sake of regional goals, then the difficult negotiations to come on sectoral development plans—the core of the Andean integration scheme—would surely be doomed to failure. Although none of the Andean countries felt completely satisfied with the form of Decision 24, the successful conclusion of the December negotiations was followed by official proclamations in the various countries expressing pleasure that agreement had been reached. Among government circles at least, it appeared that the Andean Group had emerged from the December negotiations stronger and more committed to

\textsuperscript{54} At the present time all the Andean countries except Chile have utilized Article 44.
integration.

Reactions Within the Andean Countries Over Decision 24

Few of the participants in the rather turbulent nine month process that gave birth to Decision 24, however, anticipated the stormy events of the next six months. It soon became clear that the controversy over the common policy toward foreign investment had not ended with the Commission compromise that produced Decision 24. Although officials in the Colombian and Ecuadorean governments may have been relatively content that they had achieved a satisfactory solution to the conflicting goals of preserving Andean unity and of accommodating the interests of influential domestic groups, their feelings of contentment were not shared by the latter.

Colombia

In Colombia there was considerable sentiment among influential members of the elite economic and political groups that the government had "sold out" the national interest to the leftist ideology of Peru, Chile, and Bolivia. Decision 24 began to be referred to as the Statute of Lima, with the connotation that the Peruvian influence was the dominant one in the Decision 24. The opposition to Decision 24 by private sector groups in Colombia had as its objective the prevention of the scheduled June 30 ratification of Decision 24 by the Colombian government. On February 4, 1971, the powerful manufacturing association, the Asociacion Nacional de Industriales (ANDI), approved a declaration in which it requested the government to postpone the ratification of Decision 24.\textsuperscript{55} Shortly thereafter the Federacion Nacional

de Comerciantes (FENALCO) issued a statement criticizing Decision 24 as having a "marked tendency toward state control" and leading to the "destruction of the system of private enterprise." On February 12 FENALCO and ANDI together with the Asociacion Bancaria de Colombia (ASOBANCARIA) submitted a resolution to the government requesting that the government not ratify Decision 24, pointing out that "some of its articles tend to weaken private enterprise and the private enterprise system." An ex-minister Joaquin Vallejo Arbalaez stated that "the harmonization of policies with socialist regimes leads to the adoption of those systems"; he felt that Decision 24 should be submitted to Congress for approval.

The major arguments advanced by the opponents of Decision 24 were a curious mixture of political and economic reasoning. The economic criticisms concentrated on an evaluation of the effects that Decision 24 would have on the future flow of foreign capital to Colombia and on her rate of economic development. The forced divestment provisions of Decision 24, it was believed, would result in a loss of future foreign investment, which was desperately needed by Colombia for her development. Furthermore, the investment of scarce resources to buy up existing enterprises was felt to be wasteful from the point of view of

development. The political criticisms centered on the "underlying philosophy" of forced divestment and on the fear that the preferential option in favor of the state contained in Article 35 could lead to an "estatización" of the private sector.

The defense of Decision 24 by the Colombian government was led by the Minister of Development, Jorge Valencia Jaramillo, who had headed the Colombian delegation at the December negotiations of the Commission. During the first few months of the controversy in Colombia, the government defended Decision 24 using various economic arguments. When juxtaposed, the government arguments often appear contradictory. On one hand, it was argued that foreign investment was unimportant to Colombia's economy, so that the economic consequences preducted by the opponents of Decision 24 would have little effect on Colombian development. On the other hand, it was asserted that Decision 24 would stimulate, rather than deter, foreign investment, because of the stability provided by its rules and because of the opportunities offered by the enlarged Andean market; in a speech on March 13, 1971, in Medellin, Valencia Jaramillo made the somewhat cryptic statement that "Decision 24 will not be an obstacle in any way to good foreign investment in Colombia."

As an indication of the intensity which the controversy in Colombia reached, over 30 articles appeared in the Colombian newspapers, El Tiempo, El Espectador, La Republica, El Siglo, El Correo, and El Colombiano, on the subject of Decision 24 in the period between January and April 1971. After the middle of March, the language and tactics of the parties in the controversy

became progressively more dramatic and bold. In a reply to Valencia Jaramillo, Joaquin Vallejo Arbelaez, the ex-Minister of State, made the statement that, by adopting Decision 24, Colombia was committing "economic suicide." 60

ANDI attempted to gain popular political support for its position by asserting that Decision 24 would have negative effects on employment in Colombia. 61

But the important factor that affected the nature of the controversy in Colombia after the middle of March was the reaction of foreign investors. Although it was known that foreign investors, especially those from the United States, were dissatisfied with Decision 24, it was not certain in the Andean countries exactly how they would react to it in the short and medium term. This lack of knowledge explains in part the inconclusive debates of the first part of 1971 between the government and the private sector over what effect Decision 24 would have on the future flow of foreign investment to Colombia. The feeling of U.S. investors soon became known, however, adding another important dimension to the controversy in Colombia over Decision 24.

On March 18, 1971, seven representatives of the Council of Americas, a U.S. business interest group of over 200 companies representing approximately 85% of U.S. investment in Latin America, personally visited President Pastrana Borrero. 62 According to available information, they talked privately with him

60 "Es un Suicidio Economico," La Republica, April 12, 1971.


in respect to their concern over the loss of control of new investments because of the forced divestment provisions. A few days later the Council of Americas released a statement which severely criticized Decision 24. The Council of Americas maintained that Decision 24 would deter U.S. private foreign investment in the Andean countries, thus retarding the process of development in the region due to the loss of the capital and technology provided by U.S. enterprises. The report listed three principle reasons why Decision 24 would deter foreign investors: that the "fade-out" joint venture formula is an unworkable and unrealistic proposal on the basis "that investors do not go into business to go out of business"; that Decision 24 augments bureaucratic interference; and that the "code is unclear on a number of important points." The document concluded with the recommendation that "the foreign investment code be carefully reconsidered."

Although it is difficult to determine exactly what effect this first report of the Council of Americas had on the thinking of private sector groups in Colombia, it seems reasonable to assume that it tended to confirm their position that foreign investment would be reduced as a result of Decision 24. Government officials, however, resented pressure from the foreign interests. The following words of Valencia Jaramillo evidence the nationalistic response that the Council of Americas' letter produced in Colombia:

I would like to ask these gentlemen of the Council of Americas upon what assumption they base their opinions that Decision 24 is not in the best interests of the

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63 Ibid.
Andean subregion? To say this is simpleminded for the Andean Creek countries do have a well defined conception of the true interest of the subregion; it is completely unacceptable for foreign investors to try to define the authentic interests of our country.

He continued:

I would like to point out that the right of the State to control foreign interests is sanctified in the Fundamental Law of the Nation, a point which has never before been put into doubt by foreign investors. To have to establish at this time the sovereign right of each nation to control its economy and resources is like having to justify the independence which our nations obtained in the past century. 65

A second press release by the Council of Americas on April 13, 1971, caused an even greater reaction than had their previous one. Based on a survey of its membership, the Council of Americas asserted that 84 U.S. foreign investment projects or plans were being held in abeyance in the Andean countries. According to the report, "the investment postponement falls most heavily on Colombia, where 37 actual or potential ventures are being delayed." The majority of respondents to the Council of Americas' survey referred to the "fade-out" provisions of Decision 24 as those that most affected their investment decisions in the Andean area. 66

The second statement by the Council of Americas produced a renewed outburst from the Minister of Development Valencia Jaranillo. He termed the Council of Americas report "economic terrorism," asserting that "the forces of


reaction are waging a war to eliminate Decision 24 and destroy the Andean Group." 67 Valencia Jaramillo went on to tie domestic opposition to Decision 24 with foreign investors, calling the opposition to Decision 24 with foreign investors, calling the opposition "those Colombians who act as servile agents of foreign interests." 68

These appeals to Colombian nationalism undoubtedly were disquieting to the private sector in Colombia, who disliked being equated with foreigners in a conspiracy to undermine the Colombian national interest. It is perhaps significant that the day following Valencia Jaramillo's remarks, the President of ANDI stated that "in part the Minister of Development Valencia Jaramillo was right, because as far as the 37 projects I do not believe they have a very concrete position." 69 This was to be one of the last major public statements made by ANDI on the subject of Decision 24.

Although the report by the Council of Americas was the only one that received much attention in Colombia, there were official reactions to Decision 24 by other foreign groups. The International Chamber of Commerce released a statement in early June which was critical of Decision 24:

The ICC fears that the overall effect of Decision 24 will be to deter rather than to attract the inflow of

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68 Ibid.
foreign resources; to lead to the slowing down, if not interruption, of the transfer of technology; to adversely affect the balance of payments; and to result in a wasteful utilization of local capital resources. The ICC further fears that Decision 24, instead of contributing toward the attainment of its stated objectives, will impede rather than promote progress toward development, national participation, and regional integration.  

Ernst Keller of the Asociacion para Ayudar al Desarrollo Economico de Latinoamerica (ADELA), a private multinational company based in Europe that invests as a joint venture partner in Latin America private enterprises, thought Decision 24 to be unwise for the economic development of the subregion. Jacob Javits of the U.S. Senate Foreign Relations Committee publicly criticized Decision 24, pointing out the forced divestment provisions as being the ones likely to contribute to a reduction of foreign investment. He also felt that the use of scarce domestic resources to buy up equity in existing enterprises was unwise due to the need to increase the rate of capital formation in the Andean countries.  

Not all the reactions from abroad were negative. At the annual luncheon of the U.S. Chamber of Commerce in May 1971, the President of Business International, Orville Freeman, urged U.S. multinational corporations to establish a new relationship with Latin America, working in joint ventures with Latin American partners. Business International had all along advised U.S. investors to be flexible in dealing with the Andean Group in order to avoid

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arousing nationalistic feelings as a vice-president of Business International wrote:

It is most important for anyone dealing with the question of AMCO and its harsh foreign investment rules to be flexible. Any negative action or attempt to subvert the flow to AMCO will only confirm the suspicions that the nationalists in the region have of foreign investors, particularly those from the U.S.  

Interviews with U.S. embassy officials revealed that U.S. foreign policy in relationship to Decision 24 was officially one of neutrality. However, it was being quietly revealed that the U.S. government regarded Decision 24 as harmful to the development of the Andean countries because its restrictiveness would result in a decreased flow of foreign investment, which was considered useful and necessary for the development of Latin America. The U.S. government had advised U.S. investors not to criticize severely Decision 24. The Council of Americas' action was felt to have caused a setback in U.S.-Andean relations. In fact, as revealed in the author's interviews with U.S. multinational corporations, there is a great deal of sentiment among U.S. businessmen that the forceful reaction by the Council of Americas had been ill-conceived and counterproductive.

The results of the controversy on decision 24

The controversy in Colombia caused a great deal of concern in the other Andean countries that Decision 24 might not be ratified on schedule by Colombia. On March 17, 1971, representatives from each Andean country met in Cusco, Peru, where they publicly reaffirmed their intention to put Decision 24 into effect at the end of June.\(^\text{73}\) In May another meeting was held in Cucuta,\(^\text{72}\)

\(^\text{72}\)Diaz, op.cit., p. 28

Mexico, where official representatives from Colombia, Chile, Venezuela, and Mexico held a seminar in which they examined Decision 24, especially its forced divestment provisions.\textsuperscript{74} It is not known what the conclusions were of this meeting.

Within Colombia the government apparently felt that it had to take steps to quiet the fears of the private sector. Toward the end of May, the Colombian government stated that it definitely would not exercise its preferential option under Article 35 to buy up existing foreign enterprises. Furthermore, the national government expressed its willingness to accept suggestions from the private sector as to how Decision 24 should be regulated within Colombia.

Finally, toward the end of June, Colombia requested a special session of the Commission, which began in secret on June 24 in Lima. From this meeting emerged Decision 37, produced only a few days before the scheduled ratification of Decision 24. Decision 37 modified Article 35 by eliminating the preferential option for the state. Article 17, concerning access to domestic credit, was changed so that foreign investors are given normal access to short-term credit. Furthermore, the deadline for new foreign investment subject to forced divestment was moved from December 31, 1970, to June 30, 1971.

Interviews in August with Colombian government officials revealed that the modifications of Article 35 contained in Decision 37 were made for political reasons, for the government had no intention of buying up private

\textsuperscript{74}\textsuperscript{United Press International wire release, May 22, 1971.}
enterprises. The modification was intended to alleviate the fears of the Colombian private sector. This view was confirmed in an interview with Dr. Vidal of the Junta who stated that Decision 37 was made at the request of Colombia for political reasons.

On June 30, 1971, Decision 24 (with the modifications of Decision 37) was officially put into effect in the Andean countries. Each country was allowed 90 days to draw up national regulations for the implementation of Decision 24. As there was considerable latitude for interpretation in many of Decision 24's provisions, the efforts of the private sector turned from actively opposing Decision 24 to trying to influence and work with government officials to obtain a more liberal interpretation and administration of Decision 24.

Significance of the controversy in Colombia

In order to understand the reasons why private sector groups in Colombia so strongly opposed Decision 24, one must look at the underlying beliefs and fears that motivated their actions. First of all, an almost axiomatic assumption in their thinking was that foreign investment benefits Colombian economic growth and development. As it was their opinion that the forced divestment provisions of Decision 24 would deter needed foreign investment, they sincerely believed its adoption would be harmful for Colombia. Secondly, and probably more important, was their underlying fear that Decision 24 would lead to greater state control vis-a-vis private enterprise. An editorial in Colombia pointed to this fear as a central factor in the controversy:
The true basis of the conflict, whether it is admitted or not, is in the intuitive comprehension on the part of the private sector, that, under the present economic, social, and political conditions in the country, national control can only imply state control. This is something that no one wants to publicly recognize, but without whose honest and frank discussion it will not be possible to arrive at agreement upon the national convenience of Decision 24 in its present form.75

The members of groups like ANDI were concerned that Decision 24 would lead to greater control of the Colombian economy by the government and a loss of their political and economic power. Their concern centered primarily on Article 35 of Decision 24, which gave a preferential option to the state in the purchase of the shares of foreign enterprises forced to divest. The fear was that, either by deliberate intention or by lack of private buyers, the state would acquire majority control in foreign enterprises—usually the more dynamic and important industries in the Colombian economy. Furthermore, if the state purchased the foreign equity, private groups would lose the potential economic rewards to be reaped from the purchase of the stocks of foreign companies at "bargain rates."76

In general, their fears were not directed toward the Pastrana government, which had declared repeatedly that it did not intend to exercise its preferential option, but toward what could happen in the future. Private sector groups were greatly disturbed by the recent events in Peru, Chile, and Bolivia, which led to leftist governments bent on exercising greater control

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76 The conditions of the Colombian capital market are such so as to probably depress the value of foreign shares to a fraction of their price in the investing country.
over the economy and redistributing national wealth more equitably. The example of Allende's government in Chile showed how the interpretation of a law on the books in a new manner could result in a different outcome than that intended by its lawmakers. In a similar manner, if the political situation in Colombia changed substantially in the future, they did not want the government to take over all the foreign enterprises that divested majority ownership according to Decision 24's provisions. The decline of the political and economic power of their counterpart groups in Chile and Peru was a sobering lesson for the private sector groups in Colombia. They feared that, with the termination of the Frente Nacional in 1974, the possible assumption of power of the Rojistas could lead to the same results in Colombia. Thus, the modification of Article 35 by Decision 37 quieted their fears and neutralized one of the factors responsible for the opposition to Decision 24.

The other important factor in the controversy in Colombia was the impact of the actions by the Council of Americas. To many Colombians, the statement by the Council of Americas that 37 investment projects were being held up confirmed their worst suspicions of the imperialistic nature of the United States; it appeared that U.S. investors were deliberately boycotting the Andean countries, and particularly Colombia, in order to cause the abandonment of Decision 24. This alleged form of economic blackmail, or "economic terrorism," aroused strong nationalistic feelings in Colombia which probably strengthened the resolve of the government to ratify Decision 24 on schedule. Furthermore, the position of the opposition groups in Colombia was weakened and undermined, rather than strengthened, by the Council of
Americas. After Valencia Jaramillo linked the private sector opposition with foreign investors, the task of Colombian private sector groups became more difficult, for they had to disassociate themselves from foreign interests and prove their loyalty to Colombia by making clear that their opposition to Decision 24 was solely motivated by a concern with Colombia's best interests.

As regards the motivations behind the Council of Americas' actions in the spring of 1971, the most plausible explanation is that a "forceful stating of their position" was felt to be necessary to help defeat Decision 24—a potentially dangerous precedent from the point of view of U.S. multinational corporations. As a representative of the Council of Americas, indicated in an interview in January 1972, Decision 24 represented "an important test" of the new trend of economic nationalism in the less developed countries. It was important for U.S. businessmen not to stand idly by, but to make known their disagreement with forced divestment and to emphasize the contributions of foreign investment to economic development.

The present status of Decision 24 in Colombia

Although it appeared that the controversy in Colombia had effectively ended after the ratification of Decision 24, an unexpected decision by the Colombian Supreme Court in December 1971 ruling Decision 24 unconstitutional has left the present status of Decision 24 in Colombia unclear. The constitutionality issue in Colombia began shortly after the December 1970 approval of Decision 24 by the Commission. In January 15, 1971, James Raisbeck, a Colombian lawyer, petitioned the Supreme Court and the Council of State to

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77 The words of Dr. Estebon Ferrer of the Council of Americas in an interview held in New York on January 27, 1972.
invalidate the decree which put into effect the Cartagena Agreement. He claimed that it was unconstitutional, since it required the approval of Congress as an international treaty.\textsuperscript{78} In 1969 the government had maintained that the law which approved the Treaty of Montevideo (LAFTA) provided justification for approving by decree the Cartagena Agreement, as it established a subregional grouping within LAFTA. In March, the Council of State ruled that it had no jurisdiction to rule on Raisbeck's claim. An appeal by Raisbeck was overridden in June. Similarly, the Supreme Court decided that it was unable to rule on the constitutionality of the Cartagena Agreement because it lacked jurisdiction.\textsuperscript{79} On August 3, 1971, Raisbeck presented the Supreme Court with a new petition, this time alleging that Decree 1299 by which Colombia ratified Decision 24 on June 30, 1971, was unconstitutional.\textsuperscript{80} When the Supreme Court ruled in December that Decree 1299, which ratified Decision 24, and Decree 2153, which implemented the national regulations of Decision 24, were unconstitutional, the government, the private sector, and foreign investors were taken by surprise.

President Pastrana immediately assured the other Andean countries that the Colombian government would honor its obligation in regard to Decision 24 in spite of the Supreme Court's decision.\textsuperscript{81} Pastrana would


\textsuperscript{79} Asociacion Nacional De Industriales (ANDI), \textit{Boletin}, August 3, 1971.


\textsuperscript{81} Junta del Acuerdo de Cartagena, \textit{Carta Informativa Oficial}, December 1971.
seek Congressional approval of Decision 24 in the session beginning July 20, 1972. However, as Congress was likely to act slowly on the controversial issues surrounding Decision 24, the administration would set forth various executive decrees in order to bring existing Colombian foreign investment laws more in harmony with Decision 24.

Accordingly, the Pastrana government issued two measures which reinstate portions of Decision 24. Decree 1234 of July 13, 1972, deals with transfer of technology rules and Resolution 17 of July 19, 1972, with criteria for evaluating foreign investment proposals. In contrast to Decision 24's forced divestment provisions, Resolution 17 requires only new companies wishing to take advantage of the Andean market to divest 51% of equity over fifteen years. Resolution 17 is unclear as to whether existing foreign enterprises wishing to take advantage of Andean trade liberalization or new companies established to serve only the Colombian market will be required to divest.

Whether or not Decision 24 will be reinstated in its entirety depends on the outcome of the Congressional debate on those provisions of Decision 24 that the Pastrana was not constitutionally empowered to include in Decree 1234 and Resolution 17. The private sector groups have expressed their intention of using the opportunity of the congressional debate to make modifications and additions to Decision 24. The government is placed in an extremely difficult position in that it does not want to alienate private sector groups, whose support it needs for various reform programs that it

83 Ibid.
considered crucial. The success of many of the government's domestic programs could depend on the vote over Decision 24, in this situation:

However strong Pastrana's support for Andean regional integration may be, it is likely to be abandoned, at least temporarily, in the name of domestic expediency. 85

It is unlikely that the Congress will not approve major portions of Decision 24, however, in regard to the controversial forced divestment provisions of Decision 24, it is difficult to predict whether they will ultimately be implemented in Colombia beyond the limited extent set forth in Resolution 17. The Andean Group has not yet taken a position on Colombia's failure to ratify Decision 24. 86

The reaction in Ecuador

Ecuador was the only other Andean country in which the adoption of Decision 24 produced an organized reaction from the private sector. The reaction was mild in comparison to that occurring in Colombia, never reaching serious proportions, because Ecuador lacks a well established industrial class and has received very little foreign investment in manufacturing industries in the past. Although there was known to be discontent among part of the small Ecuadorian elite with Decision 24, it was not publicly expressed until the middle of June. A letter signed by the six presidents of Ecuador's Chambers of Commerce and sent to President Velasco Ibarra on June 15, 1971, outlined the principle objections of the Ecuadorian private sector to Decision 24. As Ecuador


had only recently started her industrial development in the early 1960's, her need for foreign investment to contribute to her development was much greater than that of any of the other Andean countries. In view of Ecuador's special circumstances, they urged the President to call a special session of the Commission before June 30 in order to allow Ecuador to apply more flexible rules, especially on forced divestment. They also called for the elimination of Article 35.87 Although this letter produced some controversy within Ecuador, the main criticism of it was that the private sector had waited until too late to make its opinions known.88

Although the special session of the Commission on June 24 which produced Decision 37 was called at the request of Colombia, it seems that the letter sent by the presidents of Ecuador's Chambers of Commerce influenced the decision to honor Colombia's request for a special session. Within Ecuador the release of the letter was followed by the forced resignation of Gomez Izquierda, in charge of the Institute of Commerce and Integration, the institution responsible for the national regulations of Decision 24. The replacement of Gomez Izquierda, who favored a hard line on foreign investment, with Edgar Teran Teran was welcomed by the private sector. Teran favored a close relationship with the private sector in order to establish the most lenient national regulations of Decision 24 possible. Although the overthrow of Gomez Izquierda was attributable largely to personal antagonism between him and President Velasco Ibarra, it was felt by many in Ecuador that the Chambers of Commerce letter was the catalyzing force that led the President to


act; for it was known that the private sector was unhappy with Gomez Izquierda's attitude toward foreign investment. An interview with one of the signers of the letter revealed that the replacement of Gomez Izquierda was believed to have been influenced by the letter. He indicated that the private sector was working closely with the new Minister Teran to draw up a favorable Ecuadorean interpretation of Decision 24 in the hopes of attracting those new foreign investors intending to export to the Andean market to locate their production facilities in Ecuador.

Although on February 16, 1972, a military coup overthrew President Velasco Ibarra, installed a three-man military Junta, and proclaimed a "revolutionary and nationalist" government, it seems that there has not occurred any substantial change in the position of the government in regard to Decision 24.

Peru, Chile, and Bolivia

There was little or no public criticism in Peru by the private sector concerning Decision 24. In fact, there was expression of support for Decision 24; Carlos Zuzunaga Flores, President of the Accion Para el Desarrollo, a private sector group in Peru, thought Decision 24 to be a "conciliatory, realistic and flexible" instrument. The most obvious reason for this lack of controversy in Peru is that Decision 24 was an improvement over the Peruvian Law of Industries in its treatment of foreign investment. In accordance with the pledge that Decision 24 would take precedence, Peru's Law of Industries was


modified so that only those existing foreign investors who wished to take advantage of the Andean market were required to divest, in contrast to the previous stipulation that all foreign investments in Peru must divest. Moreover, a guaranteed buyer as well as a fair price for the divested shares of foreign investors were provided in the form of the "comunidad industrial." Thus, a chief worry of foreign investors concerning Decision 24's divestment provisions—that the only buyer for their shares would be the state or that the price they received would be a fraction of the worth of the divested equity—was alleviated in the Peruvian case.91

Similarly, in Chile there was no criticism of Decision 24. In the Chilean case the 51% divestment provisions of Decision 24 appeared mild in comparison with the complete nationalization of the foreign copper companies and banks taking place. The issue of foreign investment undoubtedly was of little importance to an elite struggling to maintain its own economic and political power in the face of a government intent on redistributing wealth and transforming Chile into a socialist country. Furthermore, in order to be able to recapture political power in the future, elite groups would be unwilling to risk the accusation by Chilean nationalists of having close ties with foreign interests.

In Bolivia, where new foreign investment had been nonexistent for over two years, there were some manifestations of concern on the part of the private sector. Their concern was not so much that Decision 24 would deter needed foreign investments, but that the preferential option for the state would lead to state control over those existing foreign enterprises

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which chose to divest. However, their worries were alleviated when the Torres government was overthrown on August 25, 1971, by a right-wing military coup led by Coronel Hugo Banzer. In one of its first proclamations, the Banzer government announced that it would offer all kinds of incentives to foreign capital and would study the possibility of modifying Decision 24 to permit greater flexibility in the treatment of foreign investment. This statement caused a great deal of anxiety in the other Andean countries that the new Bolivian government might act unilaterally by not enforcing Decision 24.

Although President Banzer in September 1971 declared Bolivia's support for the Andean Group and the fulfillment of all her obligations, there still exists some concern in the Andean countries that Bolivia may act unilaterally in the future. Furthermore, the change of government in Bolivia was significant in that it tipped the Andean balance of power back in favor of more conservative regimes and lessened somewhat the fears in Colombia that leftist nationalism was sweeping the Andean countries. The new political alignment of Andean regimes increased the possibility of the Commission voting for more modifications of Decision 24, in line with the precedent set by Decision 37. At a meeting of Andean foreign ministers in Lima in July 1971, the Bolivian minister, Mario Gutierrez, said that Decision 24 had increased Bolivia's difficulties in attracting foreign investment; he urged the Andean countries to reevaluate Decision 24.  


93 Junta del Acuerdo de Cartagena, Carta Informativa Oficial, September 1971.

The Response of U.S. Investors to Decision 24

A crucial aspect of the experience of Decision 24 is the reaction of foreign investors. Although most LDC's desire greater national control over foreign investment, few are completely willing to forsake foreign investment in order to guarantee control over their economies. As the previous discussion has indicated, the effect of Decision 24 on the future flow of foreign investment to the Andean countries was one of the principal issues in the controversy in Colombia. The actions of business groups such as the Council of Americas indicated that foreign investors were dissatisfied with the forced divestment provisions of Decision 24. However, interviews with Andean government officials revealed that they expected foreign investors to adapt to forced divestment, although a short-term reduction in foreign investment was thought possible, attributable to an "emotional reaction" to the perceived nationalism of Decision 24. An economist with the Junta, termed the reaction of U.S. investors to Decision 24 a "bluff"; when U.S. companies realized their "bluff" was a failure and that opportunities represented by the five-country Andean market were substantial, they would resume investment.

In order to determine the plans of U.S. corporations as a result of the adoption of Decision 24, confidential interviews were conducted during January and February of 1972 with executives of ten U.S. corporations. Carefully selected to represent a variety of firms in terms of type of industry, diversity of product line, and degree of technological innovation, the companies interviewed are all listed in the Fortune 500 and all have substantial investments in the Andean countries. Furthermore, to obtain a more general assessment of the

95 The companies interviewed were Phelps-Dodge, Bank of America, Chase Manhattan Bank, American Cyanamid, Westinghouse, Union Carbide, Sterling Drug, Celanese.
reactions of U.S. corporations to Decision 24, interviews were held with representatives of Business International Corporation, and the Council of the Americas, and with officials in the U.S. embassies in Bogota, Quito and Lima.

From the interviews as well as from an examination of all relevant published material, the conclusion emerges that there will be a drastic reduction of new U.S. investments in manufacturing in the short-run. In general U.S. companies with existing Andean investments intend to continue their present operations of serving individual national markets, but do not plan either new investments or "rationalization schemes" among their existing plants to serve the Andean market. In the immediate future none anticipate any new investments, except those planned before the adoption of Decision 24 or those minimal reinvestments needed to maintain present investments.

The major reason that U.S. multinational corporations do not plan to invest in the near future in the Andean countries is that the uncertainties involved are too great. One of the declared purposes of Decision 24 was to provide foreign investors with a more certain environment in which to plan; as Decision 24 declares: "The rules of the common treatment...must be sufficiently stable for the mutual benefit of the investors and the member countries." However, all the executives interviewed stated that the uncertainties created as a result of Decision 24 are greater than those existing in the Andean countries before its adoption. Frequently cited by U.S. businessmen as reasons why

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96 How will Multinational Firms React to the Andean Pact's Decision 24? Inter-American Economic Affairs, pp. 55-65. (A group of Harvard Business School students conducted interviews with 20 U.S. multinational corporations in April, 1971, to determine their reactions to Decision 24.)


97 Decision 24.
Decision 24 did not reduce the uncertainty of investment in the Andean countries were the following: 1) that because its provisions were ambiguous, its interpretation and administration could vary considerably between countries and within the same country under succeeding governments; 2) that possibilities existed for modifications of Decision 24 by the Commission, of unilateral action by individual countries not to apply Decision 24, and of abandonment of Decision 24 by the Andean countries; and 3) that Decision 24 did not provide certainty because the Andean Common Market itself was not viable and would soon break up.

If the uncertainties connected with Decision 24 and the Andean Common Market are overcome, the position of U.S. multinational corporations rests on their assessment of the forced divestment provision. The future response of U.S. multinational corporations to forced divestment will depend upon their organizational strategy in regard to joint ventures. Those companies that have firm policies of 100% ownership of their subsidiaries are unlikely to consider divestment for the purpose of serving the Andean market or of making new investments. Corporations that prefer or are amenable to joint ventures may be willing to divest in the future, if their perception of the opportunity presented by the Andean Common Market increases and their assessment of the risks involved decreases.

The major reasons cited by those firms interviewed that require 100% ownership of their subsidiaries are the loss of control over decision-making and over the ability to pursue global strategies and "rationalization schemes" among subsidiaries, the desire to maintain technological secrets and to reap the full benefits from their technological innovations, the differences in business practices between U.S. corporations and Latin American
business (i.e., over the desired level of dividends vs. reinvestment of earnings),
the difficulty of finding suitable partners, etc. Among those companies
favoring joint ventures, the main advantages are felt to be the contribution
of the local partner in knowledge of the local environment and of marketing
methods, more favorable treatment by national governments, and a reduction
of the capital investment required.

Various studies have identified the major characteristics of those
multinational corporations which do not tolerate joint ventures in terms of their
product line, organizational structure, and strategy. Firms with a narrow
product line or an undiversified group of products have been found to react in
a similar manner as their product line ages.\textsuperscript{98} As the price competition
becomes more intense, these firms centralize decision-making in the organization
and carry out global rationalization schemes in order to reduce costs. They
also use marketing methods to differentiate standard products. As for
organizational structure, such firms tend to organize their international
divisions geographically (i.e., a Latin America division) in order carefully to
control standardized marketing and production strategies. Plants are specialized
by product models or parts and a great deal of cross-shipping among affiliates
occurs. Each subsidiary is not an autonomous unit, but rather important for
its contribution to the total system. Centralized decision-making allocates
production and markets in such a way as to maximize the total output of the
system. This means that potential conflicts with a local partner are frequent,
arising over transfer pricing, market segmentations, quality standards, etc.

\textsuperscript{98} For a description of the product cycle concept as it relates to the multi-
national corporation, see Vernon, \textit{Sovereignty at Bay}, pp. 65-77.
Another type of firm that tends to avoid joint ventures is one that concentrates on research and development of new products for familiar markets. Usually these companies have had experience in the international field for several years and do not need the marketing knowledge of local partners. Potential conflicts over royalties and technical fees with the local partner are great and these firms tend to insist on total control of their subsidiaries.\footnote{\textit{Wells, op. cit.}, pp. 13-19.}

Characteristic of those multinational corporations that tolerate or prefer joint ventures is a broad product line of diversified products. Usually these firms are ones that continually introduce new products, abandoning old products as they mature and introducing new ones. They do not feel the need to maintain careful control over production and marketing and find the contributions of a local partner useful in terms of marketing skills and management. Such firms usually evidence a high level of research and development, but, unlike the similar firms mentioned in the preceding paragraph, they are normally not as experienced in the international field. A decentralized decision-making structure is adopted in which important marketing and production decisions are taken at the local subsidiary level of the corporation.

Firms that are small in their fields also evidence preference for joint ventures. If a small firm develops a new product, it tries to exploit its monopoly advantage over the largest area possible. The contributions of local partners in terms of management, marketing skills, and capital are vital, for these firms lack sufficient capital and management resources to exploit adequately its advances with its own resources.\footnote{\textit{Tbid.}}
The discussion so far has concentrated on identifying the major characteristics of multinational firms with different corporate policies toward ownership of subsidiaries. The static description, however, overlooks the importance of the dynamic aspects of corporations' selections of strategies. It is clear that strategies change over time. A study by Lawrence Franko indicates that nearly one-third of the joint ventures of U.S. multinational corporations have been converted back into majority or wholly-owned subsidiaries. In explaining the reasons for "joint venture instability," Franko found that "a multinational corporation's toleration for joint ventures appears to vary with identifiable organizational stages of its multinational growth and development." Although many corporations entered joint ventures early in their experience in international operations, as their products mature and price competition becomes more intense, they tend either to diversify their product line or to centralize decision-making and rationalize production and marketing on a global basis. When the latter happens, multinational corporations usually attempt to eliminate their joint venture partners. Franko's conclusion is that only those firms that pursue a consistent, long-term policy of product diversification have a high probability of joint venture survival.

Franko's research on the dynamic aspects of corporate strategy toward joint ventures has important implications for a forced divestment scheme

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102 Ibid., p. 18.

103 Ibid., p. 22.
like Decision 24. The divestment provisions of Decision 24 might deter more investors than the investigation by Wells and Vernon would indicate; for a multinational corporation that might prefer a joint venture where it was free to change its ownership position later if it adopted a different corporate strategy, would probably refrain from entering a situation where its flexibility was severely limited, as is the situation under Decision 24's forced divestment provisions.

Of the ten companies interviewed, three indicated that they would be willing to adapt to Decision 24's forced divestment provisions in the future if the Andean Group proves to be viable. This finding is in accord with a survey conducted by Guy Meeker concerning the attitudes of U.S. companies toward forced divestment (which he refers to as "fade-out joint venture"). Meeker found that:

Depending on the conditions involved, 35.6 per cent of the companies surveyed indicated that they might find FOJV to be an acceptable formula for investment in Latin America.104

Thus, roughly two-thirds of U.S. corporations are likely to abstain indefinitely from further investments in the Andean Group as a result of its forced divestment requirement.

The Lessons of Decision 24

The most important lesson to be gained from the experience of the Andean countries with forced divestment is that there is a tradeoff between the policy objective of greater control over foreign investment and the objective of

maintaining existing levels of foreign investment. In the first six months of 1972, approved foreign investment in Colombia totaled only $5 million, as compared to $14.2 million during the same period in 1971. \(^{105}\) Where a consensus on the need for exercising greater control over foreign investment is absent as in Colombia and Ecuador, the adoption of a forced divestment policy may be resisted by important groups within the country who are convinced that maintaining a steady inflow of foreign investment is in their interest and the interest of the country. For those nations such as Peru and Chile where the value of control is widely accepted, forced divestment may prove to be a desirable policy as long as policy-makers are willing to accept a lower inflow of investment.

As the experience of Decision 24 demonstrates, there are wide variations among developing nations in their need for foreign investment in terms of quantity and type, in their historical experience with foreign investors, in their political and cultural attitudes toward foreign investors as well as in their bargaining strengths. Although nationalism and the desire to reduce dependency provide a rationale for greater control over foreign investment, the importance of nationalism and the degree of dependency which is acceptable to national policy-makers will differ between countries and within the same country over time. Each individual country must weigh the objectives of control versus inflow in light of its own particular situation and needs in order to determine whether forced divestment offers an appropriate policy for foreign investment.

Whether forced divestment will be adopted by a growing number of less developed countries depends in large part on the future of economic nationalism in the developing world. Although the trend toward greater assertion of the national interest over international economic matters is bound to vary in intensity over the next few years, it is doubtful whether it will be reversed. Governments in the less developed countries, whether they be of the right, left, or center, share a common desire to accelerate and shape their economic development through planning. Few are willing to entrust the future of their nations to the free play of international economic forces as they have done in the past. Greater control over foreign investment is a necessary concomitant to their goals.

The forced divestment requirement of Decision 24 strikes at the very heart of the modern multinational corporation. The organization of these private economic institutions is based upon the integration of the production and marketing functions among their worldwide network of subsidiaries in such a way as to maximize the global output of the system. A majority of multinational corporations maintain that 100% control of their subsidiaries is essential for their operation. Most less developed countries want the contributions that multinational corporations can provide for their development, yet they resent the loss of control over vital decisions affecting their economies. The forced divestment provisions are intended as solutions to this problem. They are only viable solutions, however, if they are accepted by the multinational corporation and bring about a change in its basic mode of operation. Such a change will take time. At any rate, multinational corporations are not likely seriously to consider altering their behavior unless they perceive it necessary
as the result of a fundamental change of attitudes and policies toward foreign investment in the world environment. Until that time, forced divestment is a viable solution only for those countries willing to accept its cost— that the achievement of greater control over foreign investment may mean less investment.
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