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President Frei's Proposed Actions Against the U.S. Copper Companies in Chile

Deputy Under Secretary Samuels

Ambassador Korry

Deputy Assistant Secretary Crimmins

A.I.D. Mission Director Weintraub

ARA—Mr. Szabo

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ARA/BC—Mr. Chapin

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(1) A.I.D. Guaranty Program and American Copper Companies in Chile

Mr. Salzman began by giving the background of A.I.D.'s expropriation coverage in Chile, particularly with respect to the investment of the American copper companies. A cardinal principle is that the A.I.D. definition of expropriation in the guaranty contracts is in general terms, rather than exact and specific terms, so that precise opinions cannot be given in advance. Many hypothetical situations will fall into a grey area, where there could be a reasonable difference of opinion. In the mining field, it is clear that a breach of the concession agreement per se is not expropriation, although it could be if the breach comes under the definition in the contract of guaranty. An across-the-board raising of taxes would also not be expropriation, as long as the increase allows the business to operate at a reasonably profitable rate. Reducing a company to the break-even point poses a moot question under law, although confiscatory taxation would probably be nationalization under another label.

With specific regard to the Anaconda copper companies, there are three political risk or expropriation guarantees, all of which are currently on a binder or "standby" basis. These total $279 million, but none of the coverage is in effect or "current." An investor, in his sole discretion, may elect only each year how much coverage he will have in effect during the

contract year and how much will be on binder or standby. The critical date for all three Anaconda contracts is December 29 of each year, and, on that date in 1968, Anaconda did not elect to place any coverage in effect. The amount invested by Anaconda as of December 1968 under the three contracts and which would be reimbursable by the United States Government, if Anaconda had elected to go current, was $206 million, and it is almost certainly higher today.

Kennecott, which is 51% owned by the Government of Chile and is therefore not a candidate for expropriation and would not involve the application of the Hickenlooper Amendment, has a total expropriation guaranty coverage of $84.6 million, all of it current. Similarly, the Cerro Corporation, 30% owned by the Chilean Government but which could pose a theoretical Hickenlooper Amendment contingency, had $14.2 million in total coverage, all of it current. Continental Copper, 30% owned by the Chilean Government, had a total coverage of $25 million, of which only $10 million was current. Thus the total political risk guaranty exposure of the American copper companies in Chile is $110 million with an additional $101 million in full effect in non-copper industries.

Finally, the question of compensation offered by the country, which is relevant to the Hickenlooper Amendment, is irrelevant for A.I.D. guarantees. Under a guaranty, the investor turns over compensation or rights to compensation to A.I.D., which is subrogated. Such subrogation does not affect the expropriated companies' rights to seek compensation from the expropriating government for other parts of the companies' assets or rights not covered by A.I.D. investment guarantees. If the factual situation were clear, an American company with an A.I.D. expropriation guaranty could walk in one day and ask to be paid the next. In practice, in order to maintain the credibility of the A.I.D. investment guaranty program in the American investing community, it has been A.I.D.'s policy to pay off promptly, where fact of expropriation was clear; a Biafran case was cited in this regard.

(2) General Outline of President Frei's Intentions Toward the Copper Companies

Ambassador Korry outlined the nature of President Frei's proposed course of action as follows:

At present copper prices, the Chilean Government hopes to obtain $40 million in CY–1969 from the American copper producing companies and has tentatively calculated this as $36 million from Anaconda and $4 million from Kennecott. While the precise basis for the increased tax receipts is not known at this time, it is understood that President Frei was considering a formula which would permit the copper companies to retain as profits, subject to current Chilean tax rates, 50% of their receipts in excess of the cost of production in Chile. The discussion and rough calculations have taken as a point of departure production costs currently estimated to average 26¢ a pound. The copper companies would currently be allowed to keep an additional 13¢ as profits but subject to current taxes on profits, which average about 54%. The remaining difference between 39¢ and the price received by the copper companies would redound almost totally to the Chilean Government. President Frei was considering the possibility of "incentive" payments to the copper companies if they reduced the cost of production and certain unspecified but relatively small payments to the copper companies if the London Metal Exchange price of copper should exceed present levels. Presumably, present sales commissions (such as the $4 a ton charged by the Anaconda sales company) would be deducted from the price received by the American companies and not be absorbed into costs in Chile.

In addition, President Frei would request the Anaconda Copper Company to turn over 51% of the shares of its two wholly-owned companies operating in Chile (exclusive of the new, not yet on-stream Exotica Company of which 25% is owned by the Chilean Government), but the timing and precise payment arrangements for this share of the companies' stock have not been determined. President Frei told the Ambassador that payment would be on international norms, i.e., prompt, fair and adequate payment, and without any element of retroactivity with regard to sales or profits. While there would be time to work out this arrangement, provided Anaconda agreed in principle to sale of 51%, President Frei wishes an immediate answer from the companies on the tax issue, because he wishes to incorporate the new measures imposed on

the copper companies in the program which he is preparing to present to the Chilean nation before May 21, when the new Chilean Congress convenes. President Frei has stated that this program will mean sacrifices by all, and the copper companies cannot be excluded.

It was Ambassador Korry's assessment that President Frei could not be dissuaded from proposing the above demands on the copper companies and that he had probably in fact already approached Anaconda, possibly within the last 24 hours. Mr. Samuels commented that he had sat next to the President of Kennecott, and the latter had seemed entirely relaxed and had not mentioned the Chilean situation at all.

(3) U.S. Government Attitude and Action

Ambassador Korry said that, in his view, the biggest stick was in the hands of the American copper companies, who could decide not to continue their five-year investment program, scheduled to reach a total of approximately $750 million, including local currency expenditures, by 1970 or 71. A cutoff of the investment program was a particularly effective weapon at the moment because the flow of investment from the American companies was currently at its peak.

(a) Effect of Hickenlooper Amendment

With regard to the specific applicability of a cutoff of aid under the Hickenlooper Amendment, Ambassador Korry outlined the relatively modest educational sector loan currently being disbursed, the technical assistance program, the proposed $10 million agricultural sector loan, and possible project loans and concluded that in the event that the Hickenlooper Amendment was invoked, there would not be much to lose from the Chilean Government's point of view. The Ambassador believed that the Government would have been more interested in this possibility had the $20 million program loan negotiations conducted since January 20, 1969 resulted in a program loan. He expressed his opinion that there was a correlation between the $20 million program loan under negotiation, the additional $20 million which had been tentatively discussed as coming from FY–70 A.I.D. appropriations, and the total amount of $40 million which President Frei was seeking to obtain from the copper companies. Had the first program loan been forthcoming, he believed that the Chilean Government would only have sought to impose additional forced loans on the American copper companies in Chile, as the Government had in 1968.

Ambassador Korry and others noted, however, that a cut-off of aid under the Hickenlooper Amendment was not really now at issue because (a) the Chilean Government would almost certainly propose compensation for any expropriation, (b) the compensation would probably be effective, (c) the six months provided by the Hickenlooper Amendment as well as the legal process in Chile would take a considerable period of time, (d) the Hickenlooper Amendment could not be invoked until such time as the legal procedure was exhausted, and (e) the Hickenlooper Amendment did not apply to Kennecott, which was already 51% owned by the Chilean Government. It was also noted that even if there was no specific Hickenlooper Amendment problem, there would be a general tendency to link this with the Peruvian case.

(b) Program Loan Negotiations

Mr. Chapin summarized the history of the program loan negotiations, the difficulty in obtaining final approval of the authority to negotiate in January, the initial and continued opposition by Treasury and the Bureau of the Budget, and the profound change in the factual situation underlying the program loan. The program loan had been predicated inter alia on an average annual copper price of 45¢ compared to the current 60¢, and a prospective Chilean balance of payments deficit of $70–$90 million.

(c) Impact of Chilean Action on U.S. Investment Guaranty Program

Mr. Samuels commented that action against one of the companies causing a payment under the A.I.D. guaranty agreement would have a very serious adverse effect on the President's whole program for investment guarantees and promotion of private American investment abroad. Mr. Salzman noted that there might be an adverse influence on the general investment climate and public opinion about American investment overseas, even if a payment did not have to be made. He also noted that informed investors who were aware of the narrow limitations and definitions in some cases of the A.I.D. guaranty program would be understanding, should there be a pay out, but this would not be true for the general public, which was not aware of the subtleties and limitations in the program.

(d) Bearing on U.S. Government Policy on Joint Ventures

Mr. Samuels said that the President was generally well disposed toward joint participation by foreigners with American companies in overseas investment, that the question of foreign government participation with American capital was a special case, and that in any event each situation must be considered on its own merits. Ambassador Korry noted that the New York Times story May 7 of Mr. Meyer's remarks before the Council for Latin America on May 6 indicated that we were opposed to joint ventures. Mr. Salzman commented that the official policy of the United States had been to be neither opposed nor publicly in favor of joint ventures, although we were able to discreetly encourage joint ventures on a case-by-case basis when approached by investors.

Ambassador Korry added that there was no question in Chile of private participation in the American copper companies or purchase by private individuals of a substantial amount of the stock. There simply wasn't yet that kind of private capital available. There were a number of people in Chile, including former Ambassador Tomic, who had long been enamored of the possibility of, in effect, purchasing a share of the American companies by using the amounts now being remitted each year to the parent companies. The proposal was that the Chilean Government would take over all or part of the operating companies, continue their operation by the American management, but deduct the annual remittances from some stated purchase price.

(e) Initial U.S. Government Position with the Copper Companies

Ambassador Korry proposed, and Mr. Samuels concurred, in an initial United States Government reaction to the American copper companies, when and if they approached the United States Government, which would emphasize that it was the companies' own decision whether they could work out a suitable arrangement on taxes which would permit them to continue to operate in Chile. The primary responsibility for decision and action should not be assumed by the United States Government, which should seek to place this burden first on the companies.

With regard to the 51% Anaconda stock, the company should be informed of the extremely limited ability of the United States Government in the very short time frame to exert leverage on the Chilean Government, either through moral suasion or in the event that action was taken which would eventually involve the Hickenlooper Amendment. Furthermore, the United States Government should point out to Anaconda that the basic decision was theirs, whether they wished to stay in Chile and continue operations or whether they wanted to, in effect, pull out. Anaconda was, of course, free to terminate its further investment, but this might only trigger an uncontrollable chain reaction. In any case, the decision to withhold further investment was undoubtedly the biggest stick, much bigger than anything which the United States Government could use. The question was whether the stick should be used if Anaconda wished to remain in the country.

(4) Timing Factors in Chile

Mr. Crimmins inquired whether President Frei could actually control the situation once the proposals were put to the company and became public. Would there not be a series of events which he could no longer control, if the present tax decrees were opened up? Ambassador Korry said that President Frei had veto powers. Moreover, he was hoping to obtain

enactment of a whole series of draconian measures by the lower house of the outgoing Congress in which his Christian Democratic Party still had a majority and then have them enacted after May 21 by the new Senate in which the PDC has almost a majority. Such a strategy (which Mr. Chapin noted was unsuccessful with regard to constitutional amendments) obviously required a very tight timetable in these waning days of the old Congress. It was unfortunate but imperative that the companies decide whether they wanted to stay in Chile or not within the next week to ten days.

(5) President Frei's Letter to President Nixon

A further time pressure was that President Frei had given Ambassador Korry a letter to deliver to President Nixon which is very general and does not contain the specific proposals which President Frei intends to make to the companies. It does assert that the President had given the Ambassador all the figures and background data so that he would be able to inform the President and the United States Government of all the background to his decision and the general nature of the proposals he planned to make to the companies. (The data that the Chilean Government is using was given to Ambassador Korry, and the proposals that will be made to the company were also conveyed orally.)

President Frei had expected this information to be conveyed to President Nixon orally by Ambassador Korry, who would be able to answer any of the President's questions. It was agreed as the meeting broke up that the President would need a more comprehensive memorandum on the options available to him and the background provided than the data now immediately at hand. It would be well to know exactly what was presented to the companies, and perhaps their initial reaction. In any event, President Nixon was leaving for Key Biscayne later that evening and would not be back until Monday.

(6) Timing and Nature of Export-Import Bank Involvement

An additional factor of considerable importance was whether the United States Government would request the Export-Import Bank to reschedule the repayment of its loans and eliminate the rapid acceleration feature. Mr. Samuels agreed to undertake this task, if necessary, but it was agreed that the Export-Import Bank should not be approached at least until after the American copper companies had been informed of President Frei's intentions. Mr. Samuels asked to see Ambassador Korry again on May 8. (The Export-Import Bank loan papers are being sought from AID/PRA.)

(7) Implications for A.I.D. Loans

Ambassador Korry said that under the present circumstances he could see no reason to proceed with the program loan, but he did recommend that nothing be done to interfere with other A.I.D. activities, notably the $10 million agricultural sector loan, which is in final stages of preparation and could be authorized within a month or certainly by the end of the fiscal year. There is also a $20 million petrochemical project loan in advanced stage of preparation.

(8) Implications of the Critical Date for Investment Guaranty Coverage

The foregoing time frame concerning the 51% equity in the Anaconda companies should be read in the context of the critical date of the Anaconda investment guaranty contracts, December 29. It is conceivable that Anaconda could decide to stall the flow of capital until the end of the year by slowly negotiating the sale of 51%, and then balk after electing full guaranty coverage at year end. This would strengthen their bargaining position and perhaps signify a decision to cash out under the guaranty.

It should also be noted that, notwithstanding a declared Chilean intention to pay for the 51% interest in dollars, Anaconda knows, and it is possible that the Chilean Government might know or come to know, that a payment in escudos for the 51% could well come under the A.I.D. inconvertibility guaranty contract. Anaconda has binder coverage against inconvertibility for the full extent of its new investment. Anaconda could opt on December 29 to make this coverage

effective. Hence, the negotiations could shift to an escudo one, with A.I.D. being called upon to pay dollars and acquiring the corresponding escudos, any time after December 29.