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OFFICE OF
NATIONAL ESTIMATES

# MEMORANDUM

## *Implications of Economic Nationalism in the Poor Countries*

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CENTRAL INTELLIGENCE AGENCY

OFFICE OF NATIONAL ESTIMATES

29 June 1971

MEMORANDUM

SUBJECT: Implications of Economic Nationalism in the Poor Countries*

NOTE

Economic nationalism in the less developed countries has led to a spate of nationalizations of private foreign firms in the past few years, and to a series of other measures designed to assert more control over such investors. This memorandum examines some of the reasons for economic nationalism, and its domestic political and economic effects, particularly when it takes the form of nationalization. The memorandum then assesses the impact this trend towards nationalism can have on future interest in investing in less developed countries, the potential effects on our balance of payments, and on relations between rich and poor countries in general.

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* *This memorandum has been prepared by the Office of National Estimates and coordinated within the CIA.*

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> "In retrospect, the history of our time is likely to be recorded as the conflict between ethnocentric nationalism and geocentric technology."
> (Rolfe & Damm, *The Multinational Corporation in the World Economy*, p. 32)

## I. THE TREND TOWARD ECONOMIC NATIONALISM

1. Nationalism is on the rise among the less developed countries (LDCs) and, to an increasing extent, is being translated into economic terms: nationalization of foreign-owned enterprises, reservation of key economic sectors for government or local control, demands for employment of indigenous personnel in foreign-owned firms, increasing controls over new foreign investment, restrictions on profit remittances, rising tax rates, demands for reinvestment of a rising share of profits, and so on. This economic nationalism poses some difficult problems for foreign private investors, most of whom are from the developed countries, and for their governments. It will also have longer range effects on trade and investment patterns in the free world and on relations between the LDCs and the rich countries.

2. Such nationalism is by no means a new phenomenon among the LDCs, nor is it confined to them. It exists practically everywhere, and historically has ebbed and flowed -- remaining

latent for a period and then becoming active. Overt manifestations have spread and intensified over the past few years, however, particularly in Latin America and Africa. Recent examples of countries which have nationalized or asserted more controls over foreign-owned assets include Peru, Bolivia, Chile, Venezuela, Guyana, both Congos, Zambia, Tanzania, Sierra Leone, Sudan, Somalia, Uganda, Libya, Algeria, and India, and the list grows longer by the month.

3. These actions stem primarily from a desire to assert national independence and sovereignty over decisions that can affect the country. Resentment over foreign control and the fear of foreign manipulation are everywhere deep. The economically weak, particularly, fear exploitation by stronger foreign interests. Servan-Schreiber's book *The American Challenge*, for example, has been widely interpreted in Latin America as a treatise on the power of American firms to dominate even relatively strong countries like France. And many Latins feel their countries must, in effect, fight against economic enslavement. Such fears of foreign economic control are equally strong in many African countries, though more often stated in terms of the battle against neo-colonialism and racism. The vision of economic independence and the felt need to control major decisions affecting the local economy are much the same.

4. Such feelings seem somewhat weaker in much of Asia today, or at least they are less frequently directed against Western interests. This may be due in part to the fact that attitudes in a number of these countries have been conditioned by their dependence on the West for protection. Perhaps, too, their elites are more sophisticated and their older more established cultures induce greater self-confidence vis-a-vis the foreign economic presence. Moreover, many East Asian countries, such as Taiwan and South Korea, have made rapid economic progress with the help of foreign private investment. Others, such as Indonesia and Burma, nationalized most foreign holdings in the early post independence period and thus have fewer targets; India and Pakistan had relatively little foreign investment to begin with. Finally, in most of the area, the economic villains are usually the overseas Chinese, omnipresent in commerce, whose success is bitterly resented. As the Japanese presence expands, they too are likely to experience difficulties arising from economic nationalism directed against them.

5. In many LDCs, the economic benefits of foreign investment are not very visible to the inhabitants, and seem far outweighed by the political costs. Attacks on foreign interests are generally popular and politically gratifying and the greater the role of foreign enterprises in a given country, the more tempting a

target they are likely to be. Latin American nationalizations have often occurred in periods of domestic political tension.* This has also been the case in other areas, e.g., Iran's nationalization of the oil companies, Zambia's sudden move against the copper companies and the Sudan's expropriation of practically all foreign-owned interests in the past year or so. These moves were primarily responses to internal political pressures.

6. Economic nationalism, particularly when it takes the form of nationalization or severe restrictions on foreign enterprises, is rarely based on dispassionate economic calculations but consideration is sometimes given to potential gains or losses. Latin Americans, for example, complain that US investors annually repatriate over a billion dollars in profits and invest very little either from earnings or fresh capital. They say they can eventually pay off long-term loans but that foreign equity investments are, in effect, a continuous drain on foreign exchange. Loans, rather than direct investment, have greater appeal for LDCs during times of fairly rapid growth because they are easier to pay off and cost less than allowing foreign owners to repatriate their rising profits.

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* *Bolivia in 1938, 1952, and 1969; Mexico during the revolution and in 1938, Peru in 1968, and Chile in 1970 and 1971.*

7. Moreover, it is widely believed in the LDCs that precious natural resources, especially minerals, have been exploited for the benefit of the rich countries and not for the local economies. Indeed, it is sometimes asserted that the whole wealth and achievement of the developed countries is based on exploitation of the natural and human resources of the poor countries. Many in the LDCs think that the profits earned by foreign investors have been unconscionably high, and even that markets and terms of trade are rigged by the rich countries to the detriment of the poor.* As this theme is reiterated by propagandists in the LDCs, the emotional content of economic nationalism grows apace.

8. Moreover, there appears to be a fairly general disillusion with, and loss of respect for, the advice and formulas for economic development offered by the developed countries. This probably stems from growing LDC desires for self-reliance, for working out their own formulas and policies, and perhaps from the

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* *In May 1971 for example, Venezuelan President Caldera at a press conference with US journalists defended his country's recent oil-price hike saying "Venezuela has as much right to influence the price of its oil as a manufacturer in the United States has to set prices for his products." It is the buyer who sets the price of raw materials, he argued, but the seller who sets the price of manufactured goods. He further stated that the price of oil had not risen in a decade while the cost of imported manufactures had increased sharply.*
*(Reported in the Christian Science Monitor, May 14, 1971, Unc.)*

loss of earlier illusions about the possibility for easy and rapid development. There are exceptions, of course, especially among the more successful of the LDCs like Iran, the Ivory Coast and South Korea. But, in general, when net bilateral aid and foreign private investment level off, arguments advanced by the developed countries in support of the benefits to be derived from foreign investment become less persuasive to the LDCs. Then their tendency to assert their "independence" and sovereignty by nationalizing foreign interests or otherwise restricting their role is likely to grow.

9. Thus, assuming that net aid and private investment from the developed countries continue to stagnate or decline*, and that rapid population growth and urbanization contribute heavily to social and economic problems among the LDCs, it seems likely that only certain strong governments, perhaps only highly authoritarian governments, will be inclined to welcome and protect the private

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* *In recent years, the flow of funds from the developed non-communist countries has risen. In 1966 it totalled about $10.3 billion; by 1969 it amounted to nearly $13.6 billion. But contributions to multilateral agencies like the UN and IBRD and export credits (both government and private) account for much of this increase. Net bilateral aid and net private investment rose more slowly: bilateral aid from about $6.1 billion to about $6.3 billion and direct private investment (net) from about $2.2 billion to nearly $2.6 billion between 1966 and 1969.*
*(OECD, Development Assistance Committee, 1970 Annual Aid Review, Jan 1971, Unc.)*

foreign investor over the next decade. Even they will probably have to repress popular manifestations of economic nationalism. Other strong governments will undertake nationalistic measures against foreign concerns primarily to promote or protect national interests, only secondarily because such moves are popular. The weaker governments are also likely sooner or later to succumb to the political pull of nationalization or to exert increasingly onerous controls over foreign investors.

## II. IMPACT OF ECONOMIC NATIONALISM ON THE LESS DEVELOPED COUNTRIES

10. Private venture capital from Western countries and the management, technical and marketing skills that accompany it have contributed greatly to the output and exports of the LDCs. For example, few of the oil producing countries would have been anywhere near their present levels of production without the capital and technology provided by the privately owned major oil companies. Almost all the major mines in the poor countries were opened up by foreign firms. And many of the cash crops upon which a number of LDCs depend, e.g., cocoa, rubber, coffee and tea, were established and promoted by private foreign capital. Foreign-owned enterprises also built roads, railroads, schools, and ports in many countries. More recently they have trained locals for an increasing number of skilled positions and, in a number of countries, are expanding into manufacturing and service industries. Such activities have helped develop many of the poor countries, and have made major contributions to government revenues as a by-product of the foreign investors' efforts to earn profits for themselves.

11. What, then, is the internal impact of economic nationalism when it takes the form of nationalization or otherwise severely reduces foreign enterprises' freedom of action? Most important

politically, perhaps, is the psychic satisfaction derived from the assertion of sovereignty that such acts demonstrate. They have almost always increased the government's popularity with the people and contributed to domestic political unity, at least for a time. They have served, often, to distract attention from domestic problems as in Chile, Zambia, Peru, Congo (Kinshasa), and Bolivia. In this sense, such nationalistic decisions have been a political plus for many rulers in the LDCs, regardless of the economic impact. Perhaps few, if any, of the poor countries are so imbued with a drive toward economic development as we, of the developed world, often think they are. Pride and the need to establish national identity and sovereignty mean more to many of them than the prospect of economic achievement, particularly if this seems to require adopting new values.

12. The longer-term political effects of nationalization and/or restriction of the foreign role in the LDCs are unclear. Reducing the visible foreign role in the local economy is highly popular in most LDCs. But when such scapegoats have been thrown out, popular grievances are more likely to focus on the government in power. Labor unrest, for example, may be much more difficult to handle if the employer is the local government. It is

probably too soon to tell whether the positive political gains -- in self-confidence and cohesion -- will outweigh these potentially negative effects.

13. In recent years a policy of nationalization or other attacks on foreign-owned commerce has usually been accompanied by other policy changes tending toward a greater government role in the economy as a whole. The Indonesian experience under Sukarno, Egypt under Nasser, Algeria, Zambia, Peru and Chile are good examples of this. It is impossible to sort out the economic impact of nationalizations or other manifestations of economic nationalism from the more general effects of such policy changes.

14. Nationalization itself can produce economic benefits. For some countries, nationalization of foreign enterprises, even when compensation is paid, can provide a positive effect on the balance of payments. Egypt's foreign currency earnings from the Suez Canal are a prime example: before it was closed in 1967, Canal earnings were over $200 million a year; nearly 10 times the pre-nationalization level.* This is particularly true for enterprises or industries that are profitable, essentially complete,

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* *The increase was not due solely to nationalization, Canal traffic also soared during this period.*

enjoy an assured market after nationalization, and where no significant new investment would normally be expected for a number of years. Guyana apparently decided to move against the Aluminium Company of Canada's (ALCAN) subsidiary DEMBA after it became clear that ALCAN could not be persuaded to build more plants to process bauxite in Guyana; it is fortunate for Chile that it is taking over the copper mines *after* a major round of investment had been made by the companies.

15. Moreover, in some countries, hopes for significant new private foreign investment are dim in any event. In these cases, profit remittances and capital repatriation sometimes represent a real burden to the balance of payments. Thus nationalization might produce a net foreign exchange gain for the economy -- especially if any compensation were small or stretched out. Although difficult to prove, this is probably the case for Uganda and Somalia. But nationalizations in such comparative backwaters cause fewer ripples in any case, primarily because they never attracted much investment.

16. The impact of nationalization on output and profits of the enterprises involved generally depends on the attitude the government takes. Usually, the move itself causes at least a short-term disruption, but if the government wants its acquisition

run in a "businesslike" fashion, with emphasis on profitability, and can hire the necessary technical and management skills, then nationalization has little effect. This appears to be the case for the copper industry in Zambia and Congo (Kinshasa), where the former owners continue to manage these enterprises for a fee. In Zambia, for example, the chronic labor unrest has been damped down, and the mines are still efficiently run. In Congo (Kinshasa) the terms of the management contract are so attractive to the foreign ex-owners, that the copper operation has proceeded smoothly, to the benefit of both the government and the management.

17. On the other hand, if a nationalizing government is more interested in creating jobs for its nationals regardless of qualifications or in enhancing welfare, then the enterprises it takes over are likely to show less profit and production may decline. The Bolivian tin mines are an outstanding illustration. Employment rose rapidly after nationalization. Where there had been equal numbers of above and below ground workers before, there came to be twice as many working above ground as below. Costs rose, output declined, and the mines incurred large losses.

18. Can the LDCs pay "fair value"[*] for nationalized assets? It will depend on a variety of factors including the terms agreed to, the amount of foreign exchange available, and the strength of competing domestic resource requirements. For example, if demand for petroleum remains high, oil assets could be paid for relatively easily by such countries as Libya or Kuwait whose revenues from the industry are enormous relative to their populations, total output, and foreign exchange requirements; less easily by such countries as Nigeria or Algeria where oil is a less significant factor in relation to total output and foreign expenditures; and only with difficulty and over a longer time by such countries as Bolivia. Where profits were low or negligible before nationalization, or where the nationalizing government is already deep in debt and relatively poor, reasonable compensation is probably out of the question, as in Uganda or Guyana for example.

19. Will the LDCs pay reasonable compensation when it is economically possible? Here too, the answer will depend on a

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* *Defined in US statutes as the value and terms that would be agreed to by a willing seller and a willing buyer acting independently. Even in theory, this is a difficult figure to arrive at since, once the nationalization is imminent, there is no "willing buyer". The problem of discounting future profits is also thorny.*

variety of factors: their fear of sanctions or other forms of reprisal; their assessment of their need for foreign loans or investment in new fields; and on the plausibility of counter-claims they might make for back taxes or fines. Most importantly, the decision to pay compensation will probably depend heavily on the domestic political situation at the time.

20. The LDCs seem increasingly less afraid of economic sanctions. Many are aware, however, that the World Bank and other international lending institutions will probably not extend new loans so long as there is a major outstanding dispute over compensation. This appears to apply pressure towards working out an agreement with the former owners but seems to have little effect on the decision to nationalize. Moreover, many LDCs apparently think that there are a multitude of would-be investors anxious to explore their highly attractive opportunities. Thus they are often not afraid of scaring off prospective investors by applying nationalistic measures to existing foreign firms.

21. In general, the outlook for actual payment of fair and prompt compensation is poor. Thus far, practically all the countries that have nationalized foreign assets have acknowledged that some compensation is appropriate. In most cases, however, depreciated book value,typically considerably below "fair value", is the most

that the former owners can hope for. Nationalizing governments have begun to set the price unilaterally, often at book value less retroactively applied taxes or other charges. In addition, payments are being stretched out over a long term with inadequate interest allowances. While the former owners are likely to complain loudly, and to press their claims through their own governments or against government guarantees, many if not most foreign investors appear resigned to something well under market value. Indeed, many are probably prepared to settle for whatever they can get because, having included this risk in their original calculations, they have already recovered their investment.

22. The major short-term economic drawback of nationalistic policies, especially nationalization or measures which abruptly restrict foreign investors' freedom of action, is its effect on the investment climate. Credit, even bank loans and trade advances, may dry up as it did for Peru and is doing for Chile, as potential lenders back off or delay pending an assessment of their prospects. Even less stringent measures have a similar effect. Millions of dollars of planned new foreign investment in Argentina, for example, have been suspended in recent months as that country has manifested increasing economic nationalism and political uncertainty.

In this instance the investors' hesitancy was caused more by the vacillation and uncertainty of the Argentine government than by any specific act against foreign business. Probably the greatest long-term adverse effect of nationalization and other manifestations of economic nationalism is that future economic development may be hurt by the lack of foreign funds and the scarcity or absence of entrepreneurs willing to take risks.

23. Nationalistic measures that restrict the freedom or the profits enjoyed by foreign investors will not necessarily destroy the climate for foreign investment, so long as the new rules are moderate and consistently applied, and uncertainty is minimized. Where existing profit margins are higher than the minimum required to attract or keep investment, host countries can demand and get a greater share, and still leave investors relatively content to do business.* In other cases, former owners of nationalized enterprises have been satisfied with lucrative management or service contracts, as part of compensation agreements, and the general investment climate was not too greatly impaired.

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* *If, for example, the market outlook is such that a potential investor must foresee a net return of 20 percent a year before he will commit himself, measures which reduce his potential take from 30 percent to 25 percent will not necessarily inhibit him.*

24. In the more advanced and self-confident of the LDCs, the Japanese-type of investment is likely to be attractive to both investor and host country, so long as world markets continue to expand. Here, the investor loans money, often to pay for machinery and equipment which the investor supplies, takes little or no equity, may or may not supply managerial skills on a contract basis, but contracts to buy the enterprise's output for a long term during which the loan is paid off. The Japanese have used this sort of arrangement in Indonesia, Thailand, South Korea, Australia, Chile, Brazil, and Zambia. In Taiwan, they not only have supplied machinery and raw materials but have made arrangements to sell approximately half of that country's exports to third countries.

25. Some poor countries, however, are likely to go so far in their search for economic independence that their nationalism will frighten away all foreign funds. If they are forced to rely solely on their own resources, economic growth will be even slower than would otherwise be the case. These will be the "losers" in the growth game. Possible candidates are numerous: Bolivia and Tanzania may be examples.

26. At the other extreme, a few strong governments will see an advantage in continuing to welcome foreign investors -- although

their terms and conditions may be less attractive than at present -- and will obtain capital and use it to further development. The successful ones are more likely to be conservative or export-oriented economies like Taiwan, South Korea, Gabon, Ivory Coast, and possibly Mexico and Brazil. None of these "potential winners" is currently suffering from rampant economic nationalism, though even they are not immune, and all have relatively strong and authoritarian governments whose policies towards foreign investors are relatively clear *and* consistent.

27. The majority of the LDCs will probably fall somewhere in between. Their ability to attract risk capital for development will depend on their assets, the relative stability of their regimes, and how well they and potential foreign investors can work out acceptable arrangements.

28. Thus the long-term impact of growing economic nationalism in the LDCs which possess resources that might attract investment will depend heavily on what happens to the investment climate: whether they establish clear and workable rules for foreign investors, and whether they apply them consistently. Mexico is the outstanding example of success in these terms. Foreign investment is welcomed on Mexican terms, the rules of the game are well known

and consistently applied, and investors continue to find attractive opportunities there. If, on the other hand, foreign investors are discouraged, government aid and domestic capital will become even more important to economic development. Few of the LDCs appear capable of rapid growth without foreign aid or investment.

III. IMPACT ON THE DEVELOPED COUNTRIES

29. Compensation payments for nationalized properties are rarely going to be as high as the former owner's profits, although compensation is likely to be offered in some form. It will usually be paid out over fairly long periods. Moreover, as the LDCs assert more controls over the foreign-owned enterprises, taxes will probably be raised or the foreigners' share of profits lowered through dilution of ownership. Profits may also be decreased by restraints which lower efficiency. Thus the net effect of economic nationalism on the developed countries' balance of payments with the nationalistic LDCs will tend to be negative.

30. The petroleum and mining and smelting industries account for nearly half of developed country investments in the LDCs,*

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* *DAC estimates of the direct foreign investments (book value) of the major developed countries in 1966 were as follows in billions of dollars.*

| | *World Total* | *LDCs* | *LDCs as a % of Total* | *LDCs as a % of Total US Foreign Investment* |
|---|---|---|---|---|
| *Petroleum* | *25.9* | *11.9* | *46* | *42* |
| *Mining & Smelting* | *5.9* | *2.8* | *47* | *44* |
| *Manufacturing* | *36.2* | *8.0* | *22* | *19* |
| *Other* | *21.5* | *7.2* | *33* | *32* |
| *Total#* | *89.6* | *30.0* | *33* | *31* |

*# May not add because of rounding.*
*Source: Rolfe & Damm, "The Multinational Corporation in the World Economy", Praeger, 1970, p. 7. (Unc.)*

and these extractive industries are usually among the first to feel the impact of nationalistic sentiment among the LDCs. Many of the large mines have already been taken over and the oil producing countries have recently increased their share of profits from petroleum. Because of their size and relative importance, these industries are likely to continue to be major targets either for complete nationalization or of demands for greater shares of profit, and greater local control over key management decisions including reinvestment, prices, and employment. In any case, the share or profits remitted to the foreign owners is almost certain to decline.

31. In round terms, US direct investment in less developed countries* is valued at about $20 billion (book value) and income remitted from it totalled almost $3.3 billion in 1969. The petroleum industry accounted for about $7.8 billion or just over a third of total value, but about $2.3 billion in income, or over two-thirds of total income.

32. In terms of income from investments in the LDCs, the fate of the oil industry is thus of major importance to the US. It is also, in all likelihood, a special case because of the LDCs

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* *Excluding international, unallocated investment.*

enjoy a sellers' market for their product. The oil producing states are already exerting demands for greater revenues and greater control over production as evidenced by the recent rounds of negotiation which raised their take substantially. Algeria, Venezuela, and Libya have been most assertive, but Nigeria and the others are not likely to be far behind. Producer governments will almost certainly insist on a share of all new concessions granted and parts of existing industries, are likely to be nationalized. Within the next decade, a large share (perhaps the bulk) of LDC oil production is likely to come under still greater government control. The role of the major oil companies will shift more towards service contracts or joint ventures in which they provide the expertise and some of the development capital in return for a share of the oil and/or a negotiated fee. This, in turn, is almost certain to reduce US (and other developed countries) share of profits from oil, and to shift the terms of trade for oil further in favor of producer countries.

33. There are few, if any, other industries in which such a drastic change in ownership *and* terms of trade seems possible. Most mining and many if not most financial, transportation, and

communication enterprises in the LDCs are likely to be under local ownership (either through nationalization or other mechanisms) by the end of the 1970s. But it is unlikely that the LDCs will be able to take successful concerted action to raise the prices the developed countries must pay for their products. This applies even to the copper industry where four LDCs (Chile, Zambia, Peru and Congo Kinshasa) produce a large share of internationally marketed copper. The LDC producers have grown accustomed to high and rising revenues from copper and their continuing need for these revenues is so great that they will probably make some attempt to cooperate in restricting output or holding it off the market long enough to affect the world price materially. However, because of the diverse policies and problems of these four nations and the fluctuating market demand for copper, it is unlikely that they will be successful. Moreover, as time passes their leverage over the market is likely to decrease, since their increasingly nationalistic policies have slowed expansion of their mines and will cause investors to turn more towards comparatively safe countries -- Canada and Australia for example.

34. The overall impact of rising economic nationalism on the US balance of payments is, of course, impossible to predict. Much will depend on the forms this trend takes -- nationalization

with little or no compensation or less dramatic measures that reduce the foreign owners' share of profits and ability to control management decisions -- and on the speed at which LDCs move. Much will also depend on how well the US-owned companies can adapt to the changing atmosphere in the LDCs and find mutually acceptable forms of new investment. But the Table below gives an indication of the general magnitude of investment and income flows potentially at stake.

DATA PERTAINING TO DIRECT US INVESTMENT ABROAD
(In Million US Dollars)

| | 1960 | 1966 | 1967 | 1968 | 1969 |
|---|---|---|---|---|---|
| In Less Developed Countries* | | | | | |
| Book Value, Year End | 12,546 | 18,138 | 19,421 | 21,484 | 23,060 |
| Net Capital Outflow | 220 | 474 | 874 | 1,334 | 1,076 |
| Income | 1,511 | 2,379 | 2,695 | 2,995 | 3,571 |
| Difference Between Outflow & Income | +1,290 | +1,905 | +1,821 | +1,661 | +2,495 |
| In Developed Countries | | | | | |
| Book Value, Year End | 19,319 | 36,661 | 40,070 | 43,499 | 47,703 |
| Net Capital Outflow | 1,454 | 3,186 | 2,264 | 1,875 | 1,993 |
| Income | 844 | 1,666 | 1,823 | 1,977 | 2,067 |
| Difference Between Outflow & Income | - 610 | -1,520 | - 441 | + 102 | + 74 |

Source: US Department of Commerce, Survey of Current Business, October 1970, (Unc.)

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* *Includes international investments, unallocated by country -- much of which is accounted for by international petroleum affiliates and foreign registered shipping.*

35. Even if many LDCs nationalize the bulk of existing foreign-owned enterprises and apply increasingly restrictive measures to new investment, as seems likely over the next decade, the overall effect on the investor countries probably will not be very great. Management contracts, joint-ventures, and similar arrangements between investors and recipient countries are likely to replace the older forms of investment in many cases, and will continue to produce income for the developed countries.* But investors will pay more attention to relatively welcoming areas, especially Australia, Canada, and other developed countries. Since the bulk of foreign investment already flows between developed countries, this will not represent a major shift in emphasis.

## IV. RELATIONS BETWEEN DEVELOPED AND LESS DEVELOPED COUNTRIES

36. Over the next decade or two, rising economic nationalism in the LDCs will certainly result in greater friction between them and the developed countries of the free world. The US, as the largest single investor, is in for some difficult times especially in Latin America. But it will not be alone in this. Disputes

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* *Although the developed countries' share of profits will be reduced, the absolute level of their earnings from LDCs is unpredictable.*

over compensation for nationalized properties will be almost unavoidable. The outcry raised by important firms whose properties are taken over will tend to lessen existing enthusiasm for aid to underdeveloped countries on the part of the major donors. This may also diminish their willingness to offer better trade concessions to the exports of the LDCs. And friction is likely to rub off on other matters under discussion between rich and poor. Differences over the law of the sea, for example, can only be heightened if the major maritime nations appear to be pushing their claims of narrow territorial waters and fishing rights while simultaneously reducing their aid to poor maritime countries and demanding "full" compensation for nationalized properties.

37. This friction will probably offer the communist powers increasing opportunities to improve their position in a number of LDCs. They are not likely to rush into many breaches, however, because in addition to their own political and economic constraints they too are leery of fluctuating policies among the LDCs. For some LDCs, loans and technical assistance from communist powers may take the place of private foreign investment, as has already happened, to a large extent, in Egypt. Romania has offered Nigeria help in establishing a national oil company. There may be many

more such instances. Trade between LDCs and the developed free world countries, however, is unlikely to be greatly affected by such developments. Within the next few years, the communist countries are not likely to absorb much of the LDC products that are now sold in the free world, nor are the LDCs likely to shift to the communist countries for the bulk of their import requirements.

38. In the longer run, perhaps a much longer run, some aspects of the relations between the rich and the poor countries are likely to improve. The bitterness of seizures, punitive laws, and protracted negotiations will fade in time and there will be fewer causes of friction when the role of the foreigner in the LDCs is reduced. A hired expert who can be fired if he does not please the government, for example, is much less an offense to nationalistic sensibilities than is an owner-manager of an independent company. Moreover, if employment and investment decisions are made locally, the fear of foreign manipulation is greatly lessened, though not eliminated so long as the relatively weak must deal with the economically powerful.

39. Other sources of friction between rich countries and poor will remain, however, and some are likely to worsen. Trade

arrangements -- tariffs, quotas, and prices in particular -- will be salient points of disagreement. Population pressures and their ramifications will also cause great problems in many of the poor countries, hindering advancement in numerous ways. The gap in levels of living between rich and poor is certain to widen, whether or not the poor countries act to reduce the inflow of foreign funds. Growing awareness of this gap among inhabitants of the LDCs will add to these frictions between developed and less developed countries.

40. As economic nationalism grows in the LDCs and the foreign presence is reduced, the relative importance of the developed countries' relations with the LDCs is likely to continue to decline. Trade will continue to expand, but the rich will come to focus increasingly on economic relations among themselves. The bulk of their trade and investment is already with others in the developed world.* Economic and political

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* *The share of the less developed countries in US trade, for example, has declined steadily over the past few years. About 34 percent of our exports went to these countries in 1964; only 30 percent in 1970. Imports from LDCs dropped from 36 percent of total US imports in 1964 to 26 percent in 1970. The same trend appears in direct investment by US companies. Nearly 35 percent of the book value of US direct investment was in less developed countries in 1960; by 1969 it had dropped to about 28 percent of a much larger total. The value of US investment abroad rose from nearly $32 billion in 1960 to nearly $71 billion in 1969. (US Department of Commerce, Survey of Current Business, and Overseas Business Reports, 1970 and 1971. Unc.)*

ties can only increase as the multinational companies extend their activities across national boundaries.

41. Thus, the economic nationalism of the LDCs is likely to achieve its primary aim -- reduction of the role of foreigners in their economies -- but often at the expense of economic growth and technological linkages with the advanced countries. In the eyes of many LDCs, the gains in self-confidence and national pride will outweigh the cost.