ISSUE BRIEF

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Congress Should Support the Trump Administration's Proposal to Close Down OPIC

Bryan Riley, Brett D. Schaefer, and James M. Roberts

Among the controversial elements in its fiscal year 2018 budget proposal, the Trump Administration proposed eliminating the Overseas Private Investment Corporation (OPIC). OPIC is a wholly U.S. government-owned corporation that provides political risk insurance, loan guarantees, and direct loans to U.S. and foreign companies with the purpose of encouraging private investment in developing and emerging economies. These services are available in the private sector even in many developing countries, but OPIC offers them at lower cost by having the U.S. taxpayer assume a portion of the risk of the venture.

Such activities may have been justified as necessary to fill gaps 50 years ago—when international financial markets were less pervasive—but the number of countries today that lack access to financial markets or pose substantial political risk to investors are far fewer than the 160-plus countries around the world where OPIC is authorized to do business.

By providing government subsidies to favored businesses, OPIC can displace other private sector actors and create disincentives for countries to improve economic policies, such as those measured by the annual Heritage Foundation *Index of Economic Freedom,* which would make them more attractive to private investors.[1] That is the opposite of what America's development priority should be—namely, to encourage developing countries to adopt economic reforms, good governance, and other policiesv that contribute to long-term economic growth and development. Congress should work with the Trump administration to eliminate OPIC. The Millennium Challenge Corporation (MCC) would be a logical entity to assume responsibility for winding down OPIC's portfolio, both because it already assesses economic policies in developing countries and is well placed to promote reform in low-income countries that lack the rule of law and suffer from a bad investment climate.

What Is OPIC?

OPIC was established by President Richard M. Nixon in 1969 and began operations in 1971 with instructions to "contribute to the economic and social progress of developing nations" by encouraging venture capital to pursue investments that might normally be deemed too risky by placing "the credit of the United States Government behind the insurance and guaranties which the Corporation would sell to U.S. private investors."[2] President Nixon likened this activity to those of the Federal Housing Administration in the domestic housing field that similarly backed high-risk loans with the faith and credit of the U.S. government. OPIC provides three types of services:

1. Providing loans and loan guarantees for investments in developing and emerging markets;

2. Offering "political risk insurance" covering losses resulting from events such as coups, terrorism, or expropriation; and

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214 Massachusetts Avenue, NE
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3. Supporting investment funds that make direct equity and equity-related investments in new, expanding, or privatizing emerging-market companies.[3]

Supporters of OPIC dispute that its activities amount to corporate welfare, noting that "[b]etween 2000 and 2014, Fortune 500 companies accounted for 30 percent of OPIC project commitments by value."[4] This is interesting but unpersuasive. Commitments to Fortune 500 companies like Citibank remain a significant share of OPIC's portfolio and companies outside the Fortune 500 can be quite large, too. Noble Energy and Dunkin Donuts, for instance, are large companies outside the Fortune 500 that currently benefit from OPIC.[5]

More fundamentally, however, the size of OPIC's partners is not what determines whether they are receiving government "welfare" through subsidies. Indeed, OPIC's policy is to "complement, rather than compete with, the private sector, i.e., transactions that would otherwise be impossible or unlikely without its support."[6] By definition, if an investment could not proceed without U.S. government support, it is receiving government assistance either by providing financing at a lower cost than would otherwise be available or having the U.S. taxpayer assume a portion of the risk through the use of the full faith, credit, and influence of the U.S. government.

One would assume that the countries where private insurance and financing were scarcest would be least developed or unstable countries. But OPIC's commitment to low-income countries over the past decade has rarely climbed over 20 percent of its total commitments.[7] Analysis of OPICs current projects for this report shows that only 17 percent of active projects (comprising 7 percent of the dollar value) were directly located (not inclusive of regional projects) in least developed and low-income countries as defined by the World Bank.[8]

OPIC's portfolio raises questions about the rigor with which OPIC is applying its policy of complementing rather than supplanting the private sector. Specifically, in recent years OPIC has financed or insured large projects in high and upper middle-income countries like Brazil, Chile, Hungary, Israel, Mexico, and Romania.[9] These countries have well-developed financial markets and sound investment

1. Terry Miller and Anthony B. Kim, "Chapter 2: Defining Economic Freedom," chap. 2, in Terry Miller and Anthony B. Kim *2017 Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2017), http://www.heritage.org/index/book/chapter-2.
2. President Richard M. Nixon, "Special Address to the Congress on Foreign Aid," May 28, 1969, http://www.presidency.ucsb.edu/ws/?pid=2073 (accessed July 11, 2017).
3. Overseas Private Investment Corporation, "What We Offer," http://www.opic.gov/what-we-offer/overview (accessed July 11, 2017).
4. Benjamin Leo, "Is OPIC Corporate Welfare? The Data Says . . .," Center for Global Development, April 19, 2016, https://www.cgdev.org/blog/opic-corporate-welfare-data-says (accessed July 11, 2017).
5. Overseas Private Investment Corporation, "Information Summary for the Public," https://www.opic.gov/sites/default/files/files/9000026082.pdf (accessed July 13, 2017); and Overseas Private Investment Corporation, "Information Summary for the Public," https://www.opic.gov/sites/default/files/files/jsc-db-georgia-info-summary.pdf (accessed July 13, 2017).
6. Shayerah Ilias Akhtar, "The Overseas Private Investment Corporation: Background and Legislative Issues," Congressional Research Service, December 22, 2016, p. 7, available at https://www.everycrsreport.com/files/20161222_98-567_1d50a9d6a907d7cb9ea2f9f36533559e2a102721.pdf (accessed July 11, 2017).
7. Jared Kalow and Ben Leo, "Encouraging Signs that OPIC is Stepping Up in Poorer Countries," Center for Global Development, August 30, 2016, https://www.cgdev.org/blog/encouraging-signs-opic-stepping-poorer-countries (accessed July 13, 2017).
8. Analysis conducted by Heritage Foundation researchers based on OPIC data available as of July 6, 2017. See Overseas Private Investment Corporation, "OPIC in Action: OPIC Active Projects," https://www.opic.gov/opic-action/active-opic-projects (accessed July 13, 2017); and World Bank, "World Bank Country and Lending Groups," https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups. (accessed July 11, 2017).
9. Overseas Private Investment Corporation, "Annex B: Information Summary for the Public," https://www.opic.gov/sites/default/files/files/9000031690.pdf (accessed July 13, 2017); Overseas Private Investment Corporation, "Non-Confidential Project Information," https://www.opic.gov/sites/default/files/files/Parque%20Sol%3Bar%20Fotovoltaico%20Luz%20Del%20Norte%2C%20SpA%20Project%20Summary.pdf (accessed July 13, 2017); Overseas Private Investment Corporation, "Section I: Non-Confidential Project Information," https://www.opic.gov/sites/default/files/files/Negev%20Energy.pdf (accessed July 13, 2017); Overseas Private Investment Corporation, "Section I: Non-Confidential Project Information," https://www.opic.gov/sites/default/files/files/Tres%20Mesa%201%20and%202%20Project%20Summary(1).pdf (accessed July 13, 2017); and Overseas Private Investment Corporation, "Citibank Europe Plc: Romania Branch," Project note, https://www.opic.gov/opic-action/active-opic-projects (accessed July 13, 2017).

policies by global standards that should permit private financing and insurance options either from U.S. or foreign firms. Indeed, U.S. businesses are very familiar with these markets, as evidenced by the billions of dollars in non-OPIC backed U.S. private direct investment in those countries.[10] In addition, OPIC's portfolio includes many projects that lack a possible secondary justification of supporting core U.S. national security or foreign policy interests, such as "financing the establishment and operation of a chain of up to 22 Wendy's branded franchise restaurants" in Georgia[11] or "development of Century 21 brand real estate franchising in Brazil."[12]

These investment decisions seem more consistent with the argument that the U.S. should fight fire with fire with other countries (e.g., China) by subsidizing favored U.S. investments through expanded U.S. government intervention even if private sector options are available. This is a race to the bottom that the U.S. cannot win—nor should it desire to. America cannot outstrip Chinese willingness to use government resources to subsidize its businesses without abandoning the nation's core economic principles and implicitly endorsing China's state-led economic approach as a model for the developing world.

Uncertain Costs

Supporters of OPIC highlight that it is a net contributor to the U.S. budget through the interest and fees garnered in return for services. As OPIC notes, "2016 marked the 39th straight year that OPIC has generated money for American taxpayers and helped reduce the federal deficit. Over the past 10 years, OPIC has contributed a total of $3.7 billion for deficit reduction."[13]

Another government corporation called the Ex-Im Bank makes similar claims.[14] However, a 2013 Congressional Budget Office study found that the "Ex-Im Banks's six largest programs would generate budgetary savings of $14 billion under [Federal Credit Reform Act of 1990] accounting but cost $2 billion on a fair-value basis."[15] In other words, Ex-Im's profits were due to government-mandated accounting procedures and, if private sector accounting standards were used, Ex-Im would actually cost money. CBO has not conducted a similar study focused on OPIC, but a 2012 study indicated that applying a fair-market approach may result in OPIC activities being a net budgetary cost.[16]

Several years ago, an OPIC executive described the agency's role in the following way: "It's not unlike when you were younger and you wanted to buy a car and your dad signed the bank note. He guaranteed that you would pay it back. Well, we operate an awful lot like that."[17] Except, in the case of OPIC, the role of "dad" is played by American taxpayers who will be on the hook if things go poorly. A history of positive earnings by a federally funded financing entity is no guarantee of future success—something that was vividly demonstrated by Fannie Mae and Freddie Mac during the 2008 credit crisis.

Indeed, OPIC activities should be inherently risky if OPIC is actually fulfilling its charge to not supplant or compete with the private sector. OPIC's boast that it wrote off "only 1 percent of total outstanding direct loans on average each year between

10. Derrick T. Jenniges and James J. Fetze, "Direct Investment Positions for 2015: Country and Industry Detail," July 2016, https://www.bea.gov/scb/pdf/2016/07%20July/0716_direct_investment_positions.pdf (accessed July 13, 2017).
11. Overseas Private Investment Corporation, "Wenegeoria: Public Information Summary," https://www.opic.gov/sites/default/files/files/wengeorgia-information-summary-2013.pdf (accessed July 11, 2017).
12. Overseas Private Investment Corporation, "Information Summary for the Public," https://www.opic.gov/sites/default/files/docs/c21_brazil_smef.PDF (accessed July 11, 2017).
13. Overseas Private Investment Corporation, "Who We Are: Frequently Asked Questions," https://www.opic.gov/who-we-are/overview (accessed July 11, 2017).
14. Export-Import Bank of the United States, "The Facts About Exim Bank," http://www.exim.gov/about/facts-about-ex-im-bank (accessed July 11, 2017).
15. Congressional Budget Office, "Fair-Value Estimates of the Cost of Selected Federal Credit Programs for 2015 to 2024," May 2014, http://cbo.gov/sites/default/files/cbofiles/attachments/45383-FairValue.pdf (accessed July 11, 2017).
16. Congressional Budget Office, "Fair-Value Estimates of the Cost of Federal Credit Programs in 2013," June 2012, https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/06-28-fairvalue.pdf (accessed July 11, 2017).
17. Donald L. Barlett and James B. Steele, "Fantasy Islands: And Other Perfectly Legal Ways That Big Companies Manage to Avoid Billions in Federal Taxes," *Time*, November 16, 1998, http://www.cnn.com/ALLPOLITICS/time/1998/11/09/coporate.taxes.html (accessed July 11, 2017).

2001 and 2013"[18] should raise eyebrows. Private venture capital firms often see their investments fail and U.S. commercial bank delinquency rates have ranged between 2 and 7 percent since 2010.[19] Why private insurers and financiers would shy away from a portfolio that has only a 1 percent failure rate is a mystery. Congress should question why OPIC has, apparently, been so successful despite a mission that should focus its activities on investments too risky for the private sector to support.

Changing Investment Patterns

When OPIC was created to encourage private-sector investment in developing countries, funding for such investments was relatively scarce. U.S. businesses seeking to invest in developing and emerging markets have many more options today. Indeed, direct investment in developing countries is booming, and much of it is financed privately. According to United Nations data, annual net inflows of foreign direct investment to even the world's least-developed countries were six times (611 percent) higher in 2016 than in the year 2000.[20]

Similarly, private political-risk insurance is widely available now. That shift is reflected in OPIC's portfolio. As noted by the Congressional Research Service,

> Historically, OPIC's insurance activities accounted for the bulk of its portfolio. In recent years, however, the share of insurance in OPIC's total portfolio has declined to around 20% [sic]. This shift is due to a number of factors, including the greater role of the private sector in providing PRI [political risk insurance] for developing countries as well as the rise of other development finance institutions in this space, including the World Bank's Multilateral Investment Guaranty Agency (MIGA).[21]

The bottom line is that options for financing and insuring investments in developing countries are increasingly numerous—casting doubt on the future need for U.S. government-supported investments in many of the countries that may, in the past, have required those services.

Part of this is due to international financial markets becoming larger and more sophisticated in assessing risk and opportunities in places that would not have been considered in previous decades. Part is also due to the increasing ease with which individuals and smaller businesses can transfer capital internationally. But the decisions of developing countries to adopt policies to improve their business climate to attract private capital, as tracked in the World Bank's *Doing Business* reports, has been instrumental as well.

Businesses are more likely to invest in countries that are politically stable, that protect property rights, and that allow investors to repatriate their profits. They are less likely to invest in countries where their investments could be expropriated by the government or otherwise threatened. Countries that have the best investment climates are most likely to attract foreign investors. When OPIC guarantees investments in risky foreign environments at rates subsided by the full faith and credit of the U.S. government, those countries have less reason to adopt policies that are friendly to foreign investors.

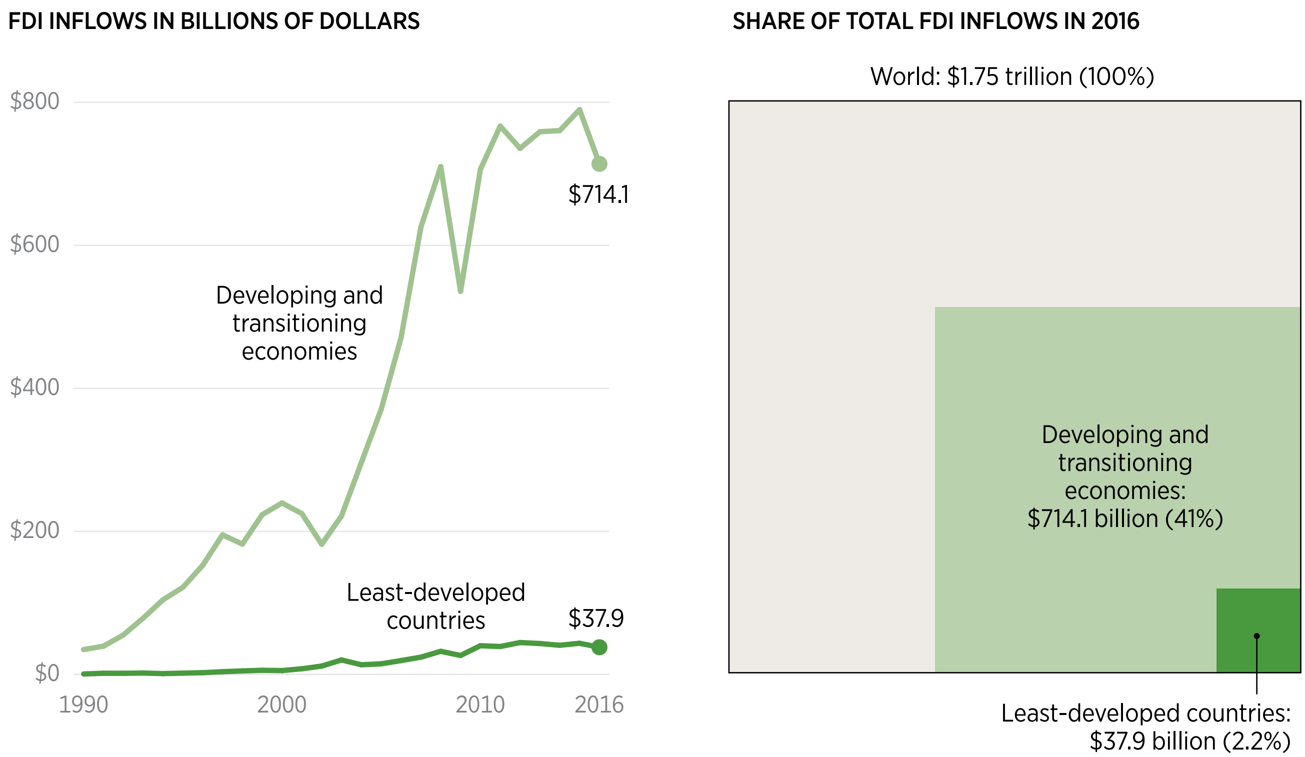
The U.S. has an interest in encouraging developing nations to improve economic growth and living standards, both to reduce risk of instability and conflict and to forge economic ties. But the U.S. also has an interest in encouraging free-market principles that are the most likely to attract private investment, encourage entrepreneurship, and promote sustainable economic growth and development. The Administration and Congress should pursue a development finance policy that straddles these competing inter-

18. Center for Global Development, "Foreign Assistance Agency Brief: Overseas Private Investment Corporation (OPIC)," April 11, 2017, https://www.cgdev.org/publication/foreign-assistance-agency-brief-overseas-private-investment-corporation-opic (accessed July 11, 2017).
19. Deborah Gage, "The Venture Capital Secret: 3 Out of 4 Start-Ups Fail," *The Wall Street Journal*, September 20, 2012, https://www.wsj.com/articles/SB10000872396390443720204578004980476429190 (accessed July 11, 2017); and Board of Governors of the Federal Reserve System, "Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks," https://www.federalreserve.gov/releases/chargeoff/delallsa.htm (accessed July 11, 2017).
20. United Nations Conference on Trade and Development, "World Investment Report 2017: Annex Tables: Annex Table 01. FDI Inflows, By Region and Economy, 1990–2016," June 7, 2017, http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx (accessed July 11, 2017).
21. Shayerah Ilias Akhtar, "The Overseas Private Investment Corporation: Background and Legislative Issues," Congressional Research Service, September 25, 2013, https://fas.org/sgp/crs/misc/98-567.pdf (accessed July 11, 2017).

CHART 1

Investment in Developing Nations

Foreign direct investment (FDI) into developing countries has increased dramatically since 1990. And while comparatively small, gains for the least-developed countries have also been strong, rising from 0.3 percent of total FDI in 1990 to more than 2 percent in 2016.



SOURCE: United Nations Conference on Trade and Development, "World Investment Report 2017: Annex Tables," Annex Table D1, http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx (accessed July 7, 2017).

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ests by restricting U.S. support only to politically unstable or low-income countries where U.S. interests require such activities. The goal should always be to transition them to the point at which they "graduate" and can stand on their own.

With this in mind, U.S. investment promotion efforts in developing countries should focus on incentivizing improvements in the investment climate, as is done by the Millennium Challenge Corporation (MCC). The MCC is charged with assessing potential partners on policies relating to access to credit, business climate, corruption, governance, trade, and the rule of law. All of these policies directly impact investment risk. Thus, the MCC is uniquely qualified among U.S. government entities both to identify those countries where private investors face significant impediments in accessing financing and insurance and to advise and incentivize those governments on policy changes needed to address those problems. The MCC would be a prudent and logical choice to inherit OPIC's investment promotion mission and assume responsibility for winding down OPIC's portfolio. This would allow for the closure of OPIC and emphasize the shift in U.S. approach from the provision of subsidies for individual investments to the promotion of policy reform in order to make developing countries more attractive and profitable places for investment in general.

What to Do with OPIC

In today's global economy, private investment by U.S. businesses in developing countries has increased to the point that further U.S. government support is no longer warranted. The Trump Administration is therefore correct to question the need for OPIC. Congress should work with the Administration to:

- Instruct the Congressional Budget Office to 1) conduct a fair-value analysis of OPIC to discern the true cost of OPIC activities; and 2) examine OPIC practices in determining when projects are written off as compared to private-sector practices.
- Support President Trump's proposal to wind down OPIC by prohibiting new transactions and reducing staff to "monitor and maintain OPIC's existing portfolio, allowing for repayments to be collected and minimizing the risk to the taxpayer from OPIC's outstanding exposure."[22]
- Charge the MCC with winding down OPIC's portfolio, while emphasizing its mission to address challenges to investment and promote policy reforms in developing countries through its operations.

Conclusion

In today's globalized international trading and investment environment, foreign investors should not base their decisions on whether a government agency will cover their risks but on whether investment in a country makes economic sense on its own merits. While U.S. government subsidies for such investments may have made sense in an earlier era when private financial markets were smaller and less interested in developing-country investments, changing investment patterns illustrate that they are increasingly unnecessary.

It is time, as President Trump has proposed, to end new OPIC activities and wind down its existing portfolio. The MCC is well placed to handle residual OPIC activities, while emphasizing continued U.S. support for policy reform in developing countries aimed at making them more attractive destinations for foreign investment, including from the U.S.

*—**Bryan Riley** is Jay Van Andel Senior Policy Analyst in Trade Policy in the Center for Free Markets and Regulatory Reform, of the Institute for Economic Freedom, at The Heritage Foundation. **Brett D. Schaefer** is the Jay Kingham Senior Research Fellow in International Regulatory Affairs in the Margaret Thatcher Center for Freedom, of the Kathryn and Shelby Cullom Davis Institute for National Security and Foreign Policy, at The Heritage Foundation. **James M. Roberts** is Research Fellow for Economic Freedom and Growth in the Center for Free Markets and Regulatory Reform.*

22. Office of Management and Budget, "Major Savings and Reforms: Budget of the U.S. Government Fiscal Year 2018," p. 102, https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/budget/fy2018/msar.pdf (accessed July 13, 2017).