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THE OVERSEAS PRIVATE INVESTMENT CORPORATION: MYTHS AND REALITIES

In the coming weeks, Congress will debate the future of the Overseas Private Investment Corporation (OPIC), a government corporation founded in 1971 to extend political risk insurance, loan guarantees, and direct loans at subsidized rates to U.S. companies that invest abroad. According to Nobel laureate Milton Friedman, OPIC fails to justify its own existence: "I cannot see any redeeming aspect in the existence of OPIC. It is special interest legislation of the worst kind, legislation that makes the problem it is intended to deal with worse rather than better.... OPIC has no business existing."[1] Congress should close down this government corporation to prevent it from continuing business as usual.

In an attempt to convince Members of Congress to maintain this wasteful organization, OPIC officials and their supporters are advancing a number of myths.

Myth #1: OPIC creates a net increase in U.S. jobs. This is a curious myth because OPIC activity does not lead to any net increase in U.S. employment. OPIC subsidies merely shift employment from certain sectors of the economy to subsidized businesses.

Myth #2: OPIC creates a net increase in U.S. gross domestic product (GDP). In fact, subsidies to businesses like those provided by OPIC distort the market-driven distribution of capital and labor resources. Therefore, OPIC subsidies are most likely to have no effect—and may even have a detrimental effect—on overall national income.

Myth #3: OPIC reduces the deficit by earning a profit. Over 80 percent of OPIC's "profits" is made up of paper transfers from the U.S. Treasury that do nothing to reduce the deficit. The remaining 20 percent is lost to the taxpayer in government appropriations for OPIC. In fact, according to the Congressional Budget Office (CBO), preventing OPIC from engaging in new activities would save U.S. taxpayers more than $500 million over a ten-year period.

1 Milton Friedman, letter to Representative John R. Kasich (R–OH), chairman, Committee on the Budget, U.S. House of Representatives, September 5, 1996.

Myth #4: OPIC is needed to encourage U.S. firms to invest in the developing world. In 1996, sources other than OPIC provided 93 percent of the financing and 75 percent of the political risk insurance for businesses in countries in which OPIC has a presence.

Myth #5: OPIC is needed to combat the export and foreign direct investment subsidies of other countries. In fact, OPIC's portfolio is concentrated in regions in which foreign countries have little interest. Furthermore, many countries have been reducing their role in providing export and investment assistance. Finally, OPIC assistance plays only a minor role in U.S. exports and foreign direct investment: 1 percent of U.S. exports in 1996, less than 2 percent of financing for foreign direct investment, and less than 10 percent of political risk insurance for U.S. investment abroad.

Myth #6: OPIC emphasizes assistance to small businesses. Using the standards set by the Small Business Administration, only 5 percent of the firms that did business with OPIC in 1996 could be classified as small businesses. Moreover, only 3 percent of OPIC-assisted projects in 1996 involved small businesses.

It is clear that if Congress is to make an informed decision on the fate of OPIC, the truth about OPIC's ineffectiveness must be understood.

LEGISLATIVE HISTORY OF OPIC

The legislation creating OPIC was signed into law by President Richard Nixon in 1969, and the agency began operation in 1971. OPIC was envisioned as a more market-oriented alternative to traditional foreign aid programs, which transfer income to foreign governments in unsuccessful attempts to spur development. At the time, some were concerned that OPIC would become just one more way to provide a government handout to business; others questioned OPIC's potentially negative impact on the federal budget and on private-sector international lenders and insurers.[2] Despite these concerns, Congress approved the creation of OPIC and has allowed it to continue since 1971 with only minor changes in operational emphasis, such as legislation in 1974 and 1978 requiring OPIC to focus on poor and developing countries.

Last September, the House unexpectedly failed to pass the Exports, Jobs and Growth Act of 1996 (H.R. 3759), which would have reauthorized OPIC through 2001 and doubled its political risk insurance and financing statutory limits. Instead, the program was allowed to continue for one more year only. Congress appropriated $72 million for OPIC in FY 1997, the same as the amount appropriated for FY 1996, and refused to expand the program's statutory limits on financing and political risk insurance.[3] As a result of this one-year extension, OPIC will cease to exist in September 1997 unless it is reauthorized by Congress.

The Clinton Administration has indicated in several public statements that it wishes to see OPIC continue. The proposal favored by the Administration would authorize OPIC through 2000 and expand its ability to extend insurance and loans by 38 percent over a three-year period.[4] An alternative to the Administration's proposal has been offered in both the House and the Senate. This legislation, the OPIC Termination Act, has been

2 Congressional Research Service, Memorandum to U.S. House of Representatives Budget Committee, 105th Cong., 1st Sess., May 19, 1997, pp. 3–4.

3 James K. Jackson, "The Overseas Private Investment Corporation: Reauthorization and Funding," *CRS Report for Congress*, Congressional Research Service, updated February 14, 1997, p. 1.

introduced by Representative Robert Andrews (D–NJ) as H.R. 387 and by Senator Wayne Allard (R–CO) as S. 519. Essentially, it would forbid OPIC from issuing new insurance or loans.[5]

EXPLODING THE MYTHS OF OPIC

Fearing a replay of Congress's surprising refusal in September 1996 to reauthorize OPIC, the corporation's proponents continue to conduct a strong lobbying effort on Capitol Hill to preserve it. To support their efforts, they have circulated a number of myths. At best, these myths distort the facts about OPIC and its impact.

Myth #1: OPIC creates a net increase in U.S. jobs.

Proponents claim that OPIC creates jobs. In its 1996 annual report, OPIC claimed to have created 225,000 American jobs since its founding in 1971. Proponents also contend that OPIC has a positive impact on job growth in the export sector but no detrimental effect on existing employment in the other sectors of the economy.

Reality: Not true.

Numerous studies have concluded that government subsidies to business have little impact, no impact, or even a detrimental effect on net job creation.[6] When the government takes labor and capital from the economy through taxation and then gives it to private companies in the form of export or foreign direct investment subsidies, it merely shifts resources from one sector of the economy to another.

In other words, OPIC creates nothing; it merely reshuffles existing resources within the U.S. economy. Therefore, it causes no net increase in jobs. In the words of the Congressional Research Service (CRS), there is "little theoretical support or empirical evidence that supports claims that subsidizing exports or overseas investment offers a positive net gain in jobs to the U.S. economy."[7]

Furthermore, the methodology employed by OPIC to determine its effect on employment is questionable. The first flaw in this methodology is that assertions of job creation are based on the estimates of U.S. firms that are applying for OPIC insurance or loans. Because firms must demonstrate that they are creating (or at least not reducing) domestic employment in order to receive OPIC assistance, self-interest encourages them to skew their estimates favorably. The second flaw is that OPIC makes no effort to estimate the effect of its activities on the entire job market. Firms reporting increased employment due to OPIC assistance may be hiring workers away from other employers, but all this means is that jobs are shifted from one employer to another. These flaws in OPIC's methodology led the CRS to conclude that there is "no way of verifying the employment effects of the individual OPIC transactions."[8]

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4 Statement by former OPIC president Ruth Harkin before the Subcommittee on International Economic Policy and Trade, Committee on International Relations, U.S. House of Representatives, 105th Cong., 1st Sess., March 18, 1997.

5 Under this legislation, OPIC would continue as caretaker of its existing functions and be eliminated after they have been fulfilled or canceled. Although OPIC offers long-term loans and loan guarantees and 20-year contracts for political risk insurance, few recipients of its assistance maintain their contracts for the entire term. On average, OPIC insurance policies are maintained for ten years. At the current rate of project cancellation, all OPIC insurance and financial commitments would be eliminated in less than ten years.

6 James K. Jackson, "Effects of Trade on U.S. Jobs and Wages," *CRS Report for Congress*, January 28, 1994, pp. 1, 6.

7 James K. Jackson, "OPIC: Employment and Other Economic Effects," *CRS Report for Congress*, May 23, 1997, p. 6.

Myth #2: OPIC creates a net increase in U.S. GDP.

OPIC's 1996 annual report asserts that projects supported by the corporation created $9.6 billion in exports in 1996. Supporters claim that the corporation increases the overall economy by creating these exports.

Reality: Not true.

The belief that OPIC can increase the overall U.S. economy by subsidizing exports contradicts accepted economic wisdom. By lowering costs through subsidies, OPIC may make selected exports and investment more attractive, but these subsidies shift domestic capital and labor resources to the subsidized firms away from other sectors of the economy. With resources diverted from activities to which they would be allocated under market-driven conditions, the economy operates less efficiently.

Moreover, the costs of reducing efficiency in the economy offset the benefits garnered from subsidizing exports and investment. CRS researchers note that most economists oppose subsidized credit to promote trade or foreign direct investment abroad "because such actions negatively affect the efficient allocation of resources, thereby lowering the overall standard of living."[9]

Therefore, while overall exports may be increased, there is no net benefit to GDP or to the American people generally. In fact, according to *The Economist,* such subsidies as those provided by OPIC result in taxpayers' "subsidizing exporters to produce goods, while paying foreigners to take them away."[10] Far from benefiting Americans in general, OPIC subsidies transfer income away from taxpayers to selected U.S. exporters and foreign consumers.

Myth #3: OPIC reduces the federal deficit by earning a profit.

The financial statement in the 1996 OPIC annual report indicates that the corporation earned nearly $209 million in profits. Because OPIC profits must be invested in government bonds, proponents claim that they reduce the U.S. deficit.

Reality: Not true.

Although this argument looks good on the surface, it collapses under scrutiny. In 1996, 80 percent of OPIC's profits was derived from interest earned on holdings of government bonds. These "profits" are merely a transfer of paper from the U.S. treasury to OPIC; nothing is done that would reduce the deficit. Moreover, money appropriated to OPIC (some $72 million in 1997[11]) is not fully accounted for in the corporation's financial statements. If these revenues and appropriations were counted correctly, it is unlikely that OPIC could be shown to be making any profit at all.

This conclusion is supported by two independent studies. The first is a CRS analysis of OPIC financial data. Despite OPIC's claims of prosperity, this study shows that it actually operated at a deficit in two of the past five years. Further, the study estimates that OPIC will run a deficit of $39 million in FY 1997.[12] The second study, a revised

8 *Ibid.*
9 *Ibid.*, p. 14.
10 "Don't Be Salesmen," *The Economist*, February 1, 1997, p. 17.
11 Jackson, "The Overseas Private Investment Corporation: Reauthorization and Funding," p. 1.
12 Jackson, "OPIC: Employment and Other Economic Effects," p. 13.

budget accounting by the CBO, is even more damning. It examines what would happen if OPIC were forbidden to engage in any new insurance, loan, or investment fund activity as required in the bills sponsored by Representative Andrews and Senator Allard. The CBO finds that taxpayers would save $296 million in the first five years, and over $500 million in ten years, after the legislation was adopted.[13]

Myth #4: OPIC is needed to encourage U.S. firms to invest in the developing world.

Proponents claim that OPIC's subsidized insurance and loans are needed because private financing and political risk insurance are unavailable or carry prohibitive rates in emerging markets.

Reality: Not true.

Numerous private-sector businesses—including American International Group, Exporters Insurance Company, Ltd., and Mid Ocean Ltd.—specialize in political risk insurance, international business loans, and market analysis. These firms are active in nearly all of the countries to which OPIC extends insurance and financing, but OPIC enjoys an unfair advantage because its insurance and financing are backed by the power and faith of the U.S. government.[14]

The evidence shows that the private sector will insure and finance foreign direct investment in developing countries if OPIC is not present. For example, over $285 billion in private foreign direct investment flowed into the developing world last year from the United States and other Western countries—largely without benefit of government subsidy.[15] Total U.S. private foreign direct investment increased by over $89 billion in 1995, with nearly $26 billion of this going to the developing world.[16] Of this total, $24 billion was invested in OPIC-eligible countries, while $67 billion went to OPIC-ineligible countries.[17] Even if one considers only countries eligible for assistance, OPIC provided financing that was equivalent to only 7 percent of U.S. investment, and its share of the political risk market in these countries was equivalent to only 36 percent of total U.S. foreign direct investment.[18]

Moreover, OPIC is not active in many of the most desirable destinations for foreign direct investment in the developing world, such as Mexico, the People's Republic of China (PRC), and the Republic of Korea (South Korea). Yet, by 1995, Americans had invested over $21 billion in these three countries.[19]

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13 Congressional Budget Office estimate of the budgetary effect of implementing the proposals outlined in Representative Andrews's bill, as provided to the House Budget Committee, January 29, 1997.

14 See Brett D. Schaefer, "OPIC-ing the Taxpayer's Pocket," Heritage Foundation *Executive Memorandum* No. 458, September 3, 1996.

15 David Wessel, "Flow of Capital to Developing Nations Surges Even as Aid to Poorest Shrinks," *The Wall Street Journal*, March 24, 1997, p. A5.

16 U.S. Department of Commerce, *Survey of Current Business*, September 1996, pp. 124–125, and April 1997, p. 33.

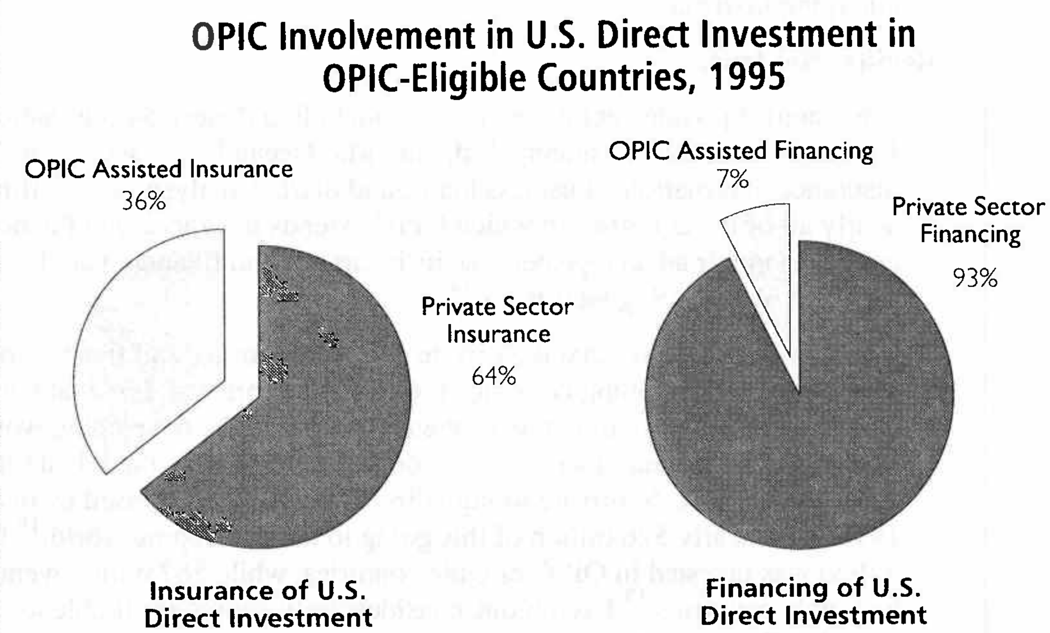
17 *Survey of Current Business*, September 1996. See also "A Message from the President of OPIC," *Overseas Private Investment Corporation 1996 Annual Report*.

18 "A Message from the President of OPIC," *op. cit.* OPIC will not release data on OPIC-assisted investment. Therefore, this paper compares OPIC activity for one financial year with total U.S. direct investment activity for that year in order to demonstrate the relative value of OPIC assistance.

19 *Survey of Current Business*, September 1996, pp. 124–125.

Colombia is the one country in which OPIC has ceased its activity,[20] but this has had no negative impact on U.S. foreign direct investment. If proponents of OPIC were accurate in their claims, U.S. investment in Colombia should have declined (or at least leveled off) after OPIC's withdrawal. The opposite, however, occurred. The private sector filled the sudden vacancy left by OPIC, and foreign direct investment continued apace, increasing by $351 million (10 percent) from 1995 to 1996.[21] Clearly, OPIC is not essential to U.S. foreign direct investment.

Chart 1



Sources: *Survey of Current Business*, U.S. Department of Commerce, September 1996, pp.124-5; "A Message from the President of OPIC," *1996 Annual Report*, The Overseas Private Investment Corporation.

Finally, the fact that the private sector is willing—even eager—to assume OPIC's current portfolio defies OPIC's claims that it operates only in places in which the private sector will not. Exporters Insurance Company, Ltd., has offered to buy out OPIC's insurance portfolio, assuming up to $5 billion of OPIC's outstanding insurance policies immediately and possibly the entire portfolio by 2002. According to its proposal, "All policies would be reinsured to their natural date of expiry or termination, all countries would be included, and all terms and conditions of the policies would remain as originally issued by OPIC."[22]

20 When Colombia failed to receive presidential certification of its cooperation in combating the drug trade, OPIC was forbidden to continue operations in the country. In 1995, Colombia was decertified but received a national interest waiver allowing continued OPIC activity; in 1996 and 1997, however, it failed to receive certification and national interest waivers, and OPIC assistance was ended.

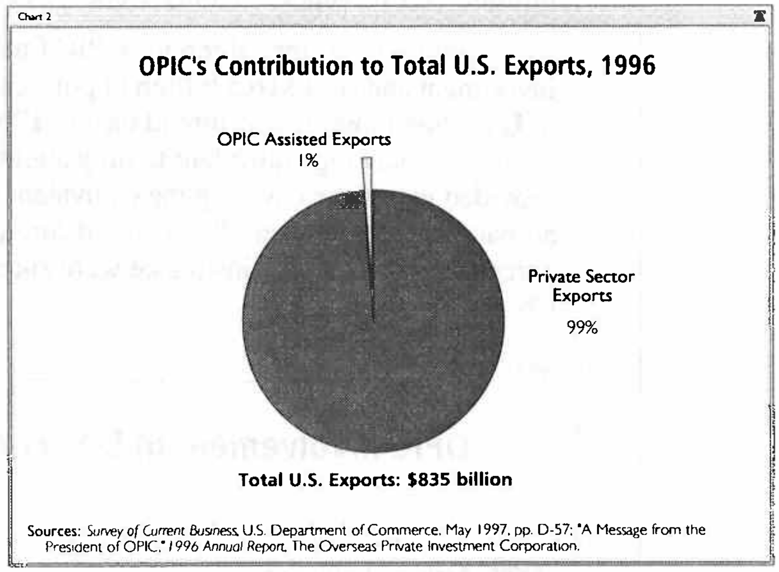
21 Investment figures for 1995 from *Survey of Current Business*, September 1996, pp.124–125. Investment figures for 1996 are an estimate provided by the U.S. Department of Commerce, Bureau of Economic Analysis.

22 Exporters Insurance Company, letter to Representative John R. Kasich, chairman, House Budget Committee, summarizing the company's proposal to privatize OPIC's insurance portfolio, May 1997.

Myth #5: OPIC is needed to combat the export and foreign direct investment subsidies of other countries.

Proponents of OPIC claim that subsidies provided by foreign governments are far greater than those provided by the U.S. government and that, without OPIC, American exporters and investors would be at a disadvantage.

Reality: Not true.



Even though other countries do provide some OPIC-like subsidies, they commonly do not compete with U.S. exports and foreign direct investment.[23] For example, Japan, the only country with a subsidy program comparable in dollar terms to OPIC's, has focused on Asia in general and China in particular.[24] OPIC is not active in a large portion of Asia, including the Democratic Republic of Korea (North Korea), Myanmar, the PRC, Pakistan, the Republic of Korea, Taiwan, or Vietnam; 70 percent of its portfolio is in Latin America and the former Soviet Union and its allies—regions in which Japanese investors have shown much less interest.[25]

In addition, many countries are reducing government involvement in export and foreign direct investment subsidies. For example, the three largest economies in Western Europe are working to privatize their export credit facilities. England's Export Credit Guarantee Department has sold its short-term credit portfolio to NCM Credit Insurance, Ltd., a private-sector business from the Netherlands. France's Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE) has hired a private-sector company to manage its investment insurance underwriting and insurance portfolio. Finally,

23 Moreover, even the small portion of foreign competition supported by export and foreign direct investment subsidies is being constrained. Numerous existing agreements already limit the ability of countries to subsidize trade or foreign direct investment, and more are under consideration. In 1978, for example, the Organization for Economic Cooperation and Development (OECD), which includes most potential U.S. export or investment competitors, adopted the Arrangement on Guidelines for Officially Supported Export Credits. This agreement, which outlined the circumstances and limits under which governments could extend export loans, has been strengthened regularly since its inception. In addition, numerous restrictions on export subsidies were adopted in the Uruguay Round of negotiations under the General Agreement on Tariffs and Trade (GATT). GATT, the General Agreement on Trade in Services, and other international provisions are enforced by the World Trade Organization, which has 131 member countries and encompasses over 90 percent of the world's trade. Although a multilateral restriction on investment subsidies has yet to be adopted, one is being considered by the OECD in its discussions on the Multilateral Agreement on Investment.

24 U.S. Department of Commerce, *Survey of Current Business*, May 1997, p. D–57.

25 *Overseas Private Investment Corporation 1996 Annual Report*, p. 18, and memorandum from Congressional Research Service to the House Budget Committee, April 3, 1997, p. 2.

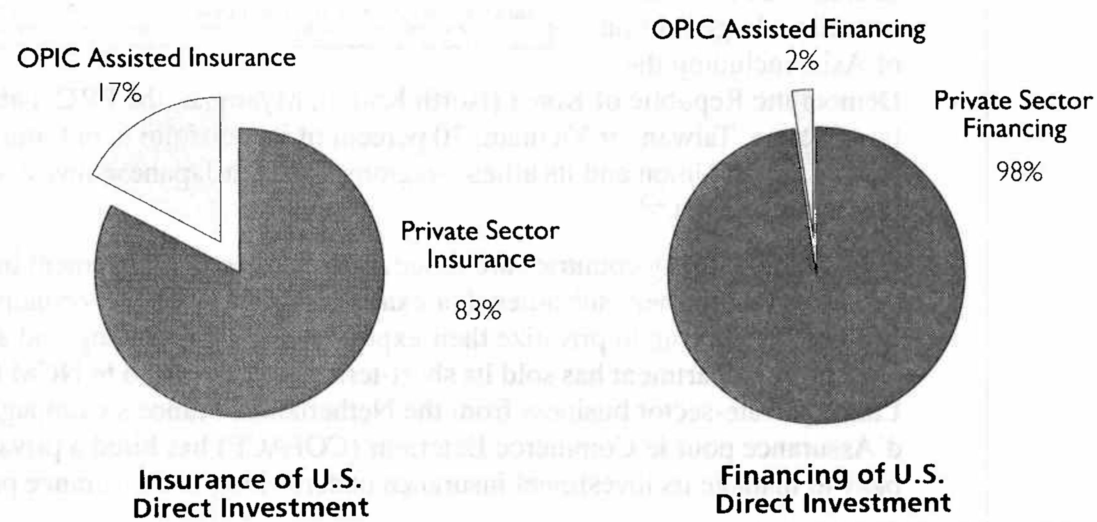
Germany's export credit facility, HERMES, also utilizes the private sector to reinsure and underwrite its insurance.[26]

Furthermore, OPIC operates at the margins, involving only a very small portion of the exports, foreign direct investment, and foreign direct investment insurance of the United States. In its annual report, OPIC claims to have created $9.6 billion in exports in 1996. Total U.S. exports of goods and services during 1996, however, were nearly $835 billion.[27] OPIC supported only 1 one percent of total U.S. exports in that year.

According to its annual report, OPIC financed $2.2 billion in U.S. foreign direct investment and sold $16.5 billion in political risk insurance in 1996.[28] The total net gain in U.S. direct investment abroad during 1996, however, was $96 billion. Thus, OPIC extended financing equivalent to only about 2 percent of U.S. investment abroad, and provided insurance covering the equivalent of only 17 percent of U.S. direct investment abroad, in 1996.[29] Over 98 percent of foreign direct investment financing and over 83 percent of political risk insurance were successful with no assistance from OPIC (see Chart 3).

Chart 3

OPIC Involvement in U.S. Foreign Direct Investment, 1996



Sources: *Survey of Current Business*, U.S. Department of Commerce, April 1997, September 1996; "A Message from the President of OPIC," *1996 Annual Report*, Overseas Private Investment Corporation.

The fact is that OPIC is not active in the primary country destinations for U.S. exports and foreign direct investment. OPIC-eligible countries constituted less than 25 percent of the net increase in foreign direct investment in 1995; most of the growth in U.S.

26 Based on information provided by Malcolm Stephens, Secretary General of the Berne Union.

27 *Survey of Current Business*, May 1997, p. D–57.

28 Figures on OPIC support of investment are for 1995 because of a lack of country-specific data on U.S. direct investment for 1996.

29 See note 18, *supra*.

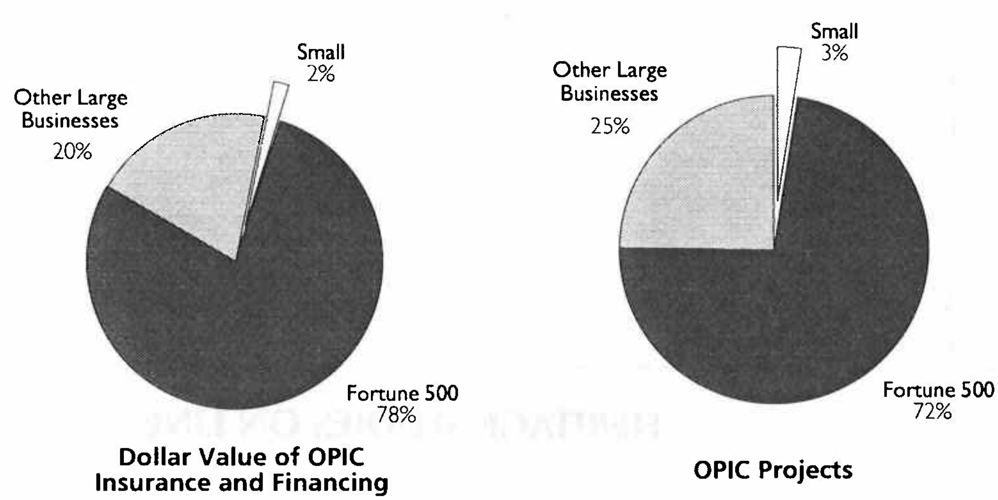
foreign direct investment is occurring in countries—both developed and developing—that are ineligible for OPIC assistance. For example, the two largest developing country destinations for global foreign direct investment are the PRC and Mexico, which together represent 33 percent of total foreign direct investment from all countries in the developing world during 1996.[30] If OPIC is supposed to combat the subsidies of foreign countries, it logically should focus on countries in which competition for foreign direct investment and export opportunities is the fiercest. Obviously, however, OPIC is doing little or nothing to counter the export and foreign direct investment subsidies of foreign governments.

Myth #6: OPIC emphasizes assistance to small businesses.

Proponents claim that small businesses will suffer if OPIC is eliminated. OPIC's acting administrator, Mildred Callear, insists that a "large portion of OPIC clients are small businesses—not big corporations."[31]

Chart 4

OPIC Activities by Size of Business Involved, 1996



Note: Companies for which financial data were unavailable were excluded from this chart.
Sources: *1996 Project List, 1996 Annual Report*, Overseas Private Investment Corporation. Information on annual revenues of OPIC recipients from *Fortune* magazine, at *http://www.pathfinder.com/@@GG9J3QUAXdWffvPB/fortune/*; *The Value Line Investment Survey – Expanded Edition*, Value Line Publishing, Inc., May 16, 1997; or from the companies.

Reality: Not true.

An examination of OPIC insurance, loan, and loan guarantee activity listed in the 1996 annual report clearly refutes this myth. OPIC extended insurance or financing to 95 businesses involving 146 projects in 1996. Only 5 percent of the businesses for which financial data were available could be qualified as small businesses.[32] Moreover, these small businesses received only 2 percent of OPIC's insurance and no OPIC financing,[33] and benefited from only 3 percent of all OPIC projects, in 1996 (see Chart 4).

30 World Bank, *Global Development Finance 1997: Vol. I, Analysis and Summary Tables*, Washington, D.C., 1997, p. 7.
31 Mildred Callear, Statement before the Subcommittee on Tax, Finance, and Exports, Committee on Small Business, U.S. House of Representatives, 105th Cong., 1st Sess., May 15, 1997.

CONCLUSION

Congress should heed the advice of noted economist Milton Friedman as it debates the future of the Overseas Private Investment Corporation. The defense of OPIC presented by its proponents consists largely of myths with no basis in reality.

OPIC does not benefit the United States. It does not create jobs or exports or help combat foreign business subsidies: It creates distortions in the overall U.S. economy by encouraging a misallocation of capital, labor, and resources that is likely to reduce national income. Moreover, the private sector is eager to assume OPIC's niche in the private foreign direct investment insurance market, a beneficial development that would render one of OPIC's main functions superfluous. Instead of perpetuating this counterproductive program, Members of Congress should recognize the seriousness of its flaws and work to eliminate it.

Brett D. Schaefer
Jay Kingham Fellow
in International Regulatory Affairs

32 Because OPIC does not provide its definition of "small business," this paper used the definition provided by the Small Business Administration (SBA) at *http://www.sba.gov/regulations/121ind.html*. The SBA definition, measured by annual receipts in dollars, differed depending on standard industrial classification code, which separates businesses into industrial categories. In most cases, a business was considered a small business if it did not earn more than $5 million annually. Some industrial categories had a much higher ceiling. In no industry, however, was a business earning more than $25 million annually considered a small business. Therefore, for purposes of this paper, only businesses with annual receipts of less than $25 million are considered small businesses.

33 Information on OPIC insurance and loan activities and recipients is drawn from *Overseas Private Investment Corporation 1996 Annual Report*, pp. 20–25. Information on annual revenues of OPIC recipients was derived from "The Fortune 500," *Fortune*, available at *www.pathfinder.com/@@GG9J3QUAXdWffvPB/fortune/*; from *The Value Line Investment Survey—Expanded Edition*, Value Line Publishing, Inc., New York, N.Y., May 16, 1997; or directly from company sources.