The Heritage Foundation

ISSUE BRIEF

No. 4224 | MAY 19, 2014

Time to Privatize OPIC

Bryan Riley and Brett D. Schaefer

The Overseas Private Investment Corporation (OPIC) provides political risk insurance, loan guarantees, and direct loans to U.S. and foreign companies to encourage investment in developing and emerging economies. OPIC artificially lowers the cost of such investments by having the U.S. taxpayer assume a portion of the risk of the venture—a classic case of socializing risk and privatizing profits.

This practice may have been justified when OPIC was created in 1969, but it is no longer justifiable when ample private-sector alternatives exist in today's era of global markets. OPIC has become little more than corporate welfare and should not be reauthorized.

What Is OPIC?

OPIC was created in 1969 by President Richard Nixon 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."[1] OPIC offers 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

3. Supporting investment funds that make direct equity and equity-related investments in new, expanding, or privatizing emerging-market companies.

OPIC privatizes profits and socializes risk by providing government guarantees and subsidies to private businesses that retain the resulting revenues of successful ventures while shifting a significant portion of the costs of unsuccessful ventures to the U.S. taxpayer. In short, businesses get to keep the profits if their investments pay off, but if an investment goes bad, taxpayers pick up the tab.

OPIC vs. the Private Sector

In today's global economy, there are many private firms offering investment loans and political risk insurance. If a U.S. business wants to invest in an emerging market, it can approach a bank or another private lender, or it can use its own resources. Similarly, if a company wants to invest in an unstable foreign country, it can purchase private political risk insurance, which pays off in the event of loss due to war or expropriation. The costs of such services are linked to the risk of the venture, of course, which is a market-based method of helping separate good investments from bad ones.

In a significant number of cases, OPIC is likely displacing private-sector firms. For instance, OPIC

This paper, in its entirety, can be found at **http://report.heritage.org/ib4224**

Produced by the Center for International Trade and Economics (CITE)

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

is currently committed for hundreds of millions of dollars in support of projects in stable, middle-income countries such as Brazil and India, where international financial firms are active and/or robust domestic financial institutions provide financing and insurance. OPIC may provide lower cost services, but what compelling U.S. national interest is served by subsidizing, for instance, small and medium-size loans in a middle-income country with sound domestic financial institutions?

OPIC also provides services in risky environments where private services may be unavailable or prohibitively expensive. If the U.S. taxpayer is to assume risk for these ventures, however, the benefit to U.S. national interests and the unique utility of OPIC should be clear. Subsidizing Papa John's Pizza franchises in Russia does not advance U.S. interests.[2] Likewise, the 13 OPIC-supported projects since 2011 in the Palestinian territories—a commitment of over $67 million—should be questioned in light of Palestinian support for terrorism and announced intent of Fatah to form a unity government with Hamas. Regardless, providing netbooks to Palestinian school children, if pursued at all, could be done through the U.S. Agency for International Development.[3]

OPIC Rewards Bad Policies

Countries that have the best investment climates are most likely to attract foreign investors. When OPIC guarantees investments in risky foreign environments, those countries have less reason to adopt policies that are friendly to foreign investors.

The Heritage Foundation's annual *Index of Economic Freedom* evaluates 184 countries on their investment climate, with zero being the lowest score and 100 the highest.[4] Since 2011, OPIC has committed U.S. taxpayers to support $18.7 million for seven projects in Russia (Investment Freedom score: 25), $24 million for three projects in Argentina (score: 30), $642 million for 13 projects in India (score: 35), $321.5 million for eight projects in Pakistan (score: 40), and $200 million for three projects in Egypt (score: 45).[5]

OPIC's Questionable Jobs Claims

Through its activities, OPIC claims to have "supported more than 278,000 American jobs."[6] That is a simplistic and questionable assertion that assumes that OPIC-backed investments would not have occurred absent OPIC support.

First, at over $200 billion in OPIC-supported investments, that figure works out to $719,424 per job, hardly an ideal return on investment. More fundamentally, however, if the investment made economic sense, it would have taken place without OPIC support with a similar impact on U.S. jobs and exports. Some investments may not have proceeded, but the companies would not sit idle. Alternative investments might have been made with similar or better results. Without OPIC support, the investment might even have been made in Indiana instead of India with a more direct impact on U.S. jobs.

If the Fannie Mae and Freddie Mac bailouts taught policymakers anything, it should be that subsidizing loans that the private sector is unwilling to make is a poor way to create jobs.

OPIC and International Investment

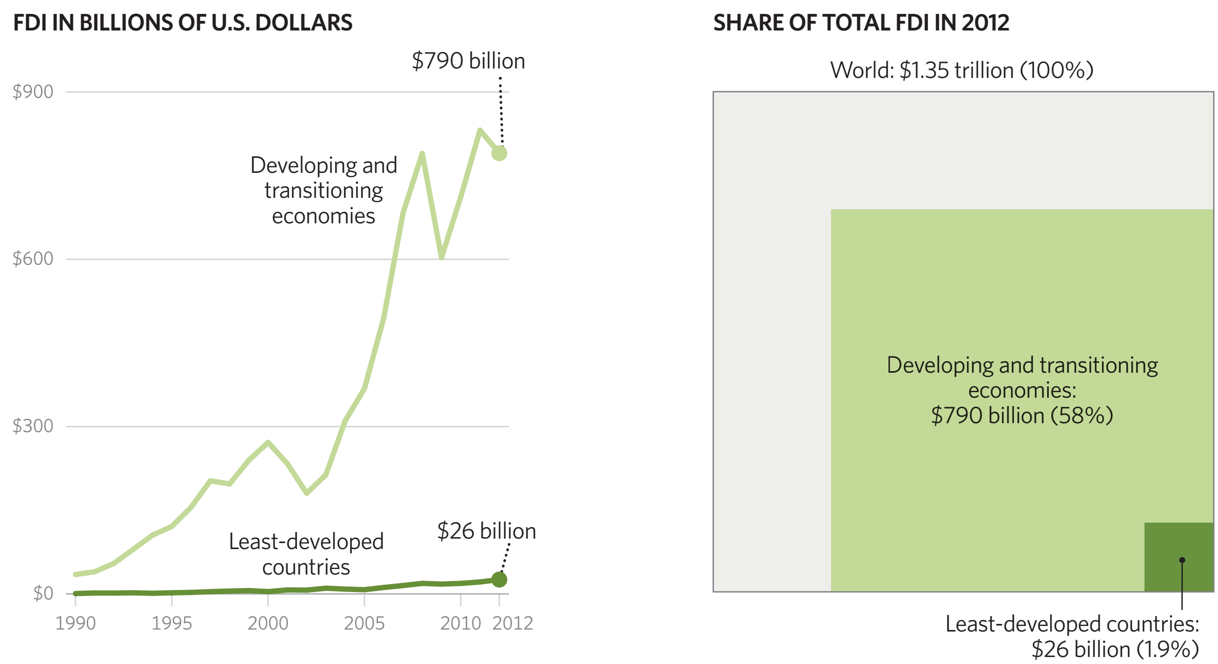
OPIC was created to encourage private-sector investment in developing countries when such investment was relatively scarce. Today, direct investment in developing countries is booming, and much of it is financed and insured privately.

1. President Richard M. Nixon, "Special Address to the Congress on Foreign Aid," May 28, 1969, http://www.presidency.ucsb.edu/ws/?pid=2073 (accessed May 16, 2014).
2. Overseas Private Investment Corporation, "Information Summary for the Public: Expand Papa John's Franchise Business in Moscow Metropolitan Area," http://www.opic.gov/sites/default/files/docs/papa_johns_russia_smef.pdf (accessed May 16, 2014).
3. Overseas Private Investment Corporation, "Non-Confidential Project Information: Netbooks for Schoolchildren in the West Bank," http://www.opic.gov/sites/default/files/partners_for_sustainable_development_west_bank_structured_finance.pdf (accessed May 16, 2014).
4. Terry Miller, Anthony B. Kim, and Kim R. Holmes, *2014 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2014), http://www.heritage.org/index/download, and Overseas Private Investment Company, *2011 Annual Report*, pp. 33–37, http://www.opic.gov/sites/default/files/docs/051912-annualreport-FINAL.pdf (accessed May 14, 2014).
5. Overseas Private Investment Corporation, "OPIC in Action: Current OPIC Projects," http://www.opic.gov/opic-action/current-opic-projects (accessed May 16, 2014).
6. Overseas Private Investment Corporation, "Who We Are," http://www.opic.gov/who-we-are/overview (accessed May 16, 2014).

CHART 1

Investment in Developing Nations

Foreign direct investment (FDI) into developing countries has increased dramatically in the past 20 years. 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 nearly 2 percent in 2012.



Source: United Nations Conference on Trade and Development, *World Investment Report 2013*, June 26, 2013, Annex Table 1, http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx (accessed May 15, 2014).

IB 4224 heritage.org

According to the United Nations, foreign direct investment in developing countries has been growing sharply since 1990, and for the first time, developing countries absorbed more foreign direct investment than developed countries in 2012.[7]

Is OPIC a Profit-Making Enterprise?

OPIC claims it generates a profit and reduces the U.S. budget deficit.[8] If OPIC is indeed a profit-making enterprise, then there is no need for taxpayer involvement. The government could simply sell OPIC to the highest bidder and demonstrate America's commitment to free markets.

The few markets where private investment options are not available are predominantly the least-developed countries (LDCs), those whose poor investment policies are a major impediment to investors, or those that are in active conflict. In the first instance, OPIC largely ignores these countries: Less than 5 percent of the value of all OPIC activity between 2011 and 2013 was dedicated specifically to the 48 U.N.-designated LDCs. In the second, subsi-

7. United Nations Conference on Trade and Development, *World Investment Report 2013*, p. ix, http://unctad.org/en/publicationslibrary/wir2013_en.pdf (accessed May 14, 2014).

8. Overseas Private Investment Corporation, "OPIC Records Net Income of $269 Million in FY2011, Helping Reduce U.S. Budget Deficit for 34th Consecutive Year," January 1, 2012, http://www.opic.gov/press-releases/2012/opic-records-net-income-269-million-fy2011-helping-reduce-us-budget-deficit-34th (accessed May 14, 2014).

dizing investment in countries with poor investment policies sends the wrong signal by shielding them from the consequences of their poor policy decisions. In the third case, the priority is to restore peace, which would incentivize investment far more than OPIC subsidies would.

What to Do About OPIC

Maxwell Kennedy, an OPIC board member, defended the agency from criticism recently: "We cannot rely on foreign aid alone to convince people in the world's lowest income countries that America offers the greatest hope for their families. Private sector investment is the best way to prove that the free market works."[9]

He is correct in this view but wrong in his conclusion that OPIC aids this mission. Companies that want to invest in emerging markets should be free to do so, but they are not entitled to taxpayer support. OPIC sends the wrong signal by implying that investment should not rely on the private sector but turn to the government.

Congress should:

- Eliminate federal support for OPIC and other agencies that socialize risks and privatize profits,
- Not reauthorize OPIC in the Electrify Africa Act or any other legislative vehicle, and
- Instruct U.S. aid agencies and representatives in international financial institutions to encourage private investment by promoting sound investment policies and the rule of law in developing nations.

Distortion of Decision Making

Unlike in 1969 when OPIC was established, today's global economy offers ample private-sector financial and insurance options for investment in developing countries. Investors should not base their decisions on whether a government agency will cover the risks but on whether investment in a country makes economic sense. Congress should end taxpayer support and terminate OPIC.

*—**Bryan Riley** is Jay Van Andel Senior Analyst in Trade Policy in the Center for International Trade and Economics and **Brett D. Schaefer** is Jay Kingham Fellow in International Regulatory Affairs in the Margaret Thatcher Center for Freedom, a division of the Kathryn and Shelby Cullom Davis Institute for International Studies, at The Heritage Foundation.*

9. Maxwell Kennedy, "Development That Works: OPIC Earns Money for the Treasury While Funding Development Throughout the World," *Huffington Post*, January 13, 2012, http://www.huffingtonpost.com/maxwell-kennedy/development-that-works-op_b_1205238.html (accessed May 14, 2014).