DOCUMENT RESUME

03514 - [A2573707]

Legislation Extending and Revising the Authority of the Overseas Private Investment Corporation. September 8, 1977. 10 pp.

Testimony before the House Committee on International Relations: International Economic Policy and Trade Subcommittee; by J. K. Fasick, Director, International Div.

Issue Area: International Economic and Military Programs (600).
Contact: International Div.
Budget Function: International Affairs: Foreign Economic and Financial Assistance (151).
Organization Concerned: Overseas Private Investment Corp.
Congressional Relevance: House Committee on International Relations: International Economic Policy and Trade Subcommittee.
Authority: Foreign Assistance Act of 1961, sec. 231(1), as amended. Overseas Private Investment Corporation Amendments Act of 1974.

Only limited success has been made by the Overseas Private Investment Corporation (OPIC) to increase private participation in its insurance programs. The private participation mandate established by the 1974 legislation probably cannot be attained. The 1974 legislation provides for OPIC's political risk insurance programs, which include expropriation, inconvertibility, and war risk, to be fully transferred to the private sector by December 31, 1980, with OPIC remaining solely as a reinsurer. The mandate established by the Overseas Private Investment Corporation Amendments Act of 1974 has placed OPIC in an unfavorable negotiating position, resulting in reduced premium income through redistribution to the private sector of substantial payments in reinsurance fees, with OPIC still remaining liable, as a reinsurer, for the bulk of its portfolio. The future of OPIC's political risk insurance program involves consideration of four alternatives: (1) continue to try for complete privatization, but provide deadlines more realistic than 1980; (2) modify the private participation provisions by recognizing the unlikelihood of ever being able to achieve 100% privatization; (3) abandon private participation; and (4) dissolve OPIC. Each of these actions would require either the repeal or amendment of the existing legislation. The dissolution of OPIC would also require that the existing contracts be assigned to another agency for liquidation. (SC)

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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D. C.

FOR RELEASE ON DELIVERY
Expected at 2 p.m. EDT
Thursday, September 8, 1977

STATEMENT OF

J. KENNETH FASICK

DIRECTOR, INTERNATIONAL DIVISION

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE

COMMITTEE ON INTERNATIONAL RELATIONS

HOUSE OF REPRESENTATIVES

ON

LEGISLATION EXTENDING AND REVISING THE AUTHORITY

OF THE OVERSEAS PRIVATE INVESTMENT CORPORATION

Mr. Chairman and Members of the Subcommittee:

We are here today at the request of your Subcommittee to discuss our recent management and financial reviews of the Overseas Private Investment Corporation (OPIC).

Our July 26, 1977, report on the Investment Insurance Program managed by OPIC discusses implementation of certain 1974 legislative directives and progress in correcting some of the weaknesses of the program that were noted in an earlier report.

As you know we are required by the Government Corporation Control Act to make financial reviews of the Corporation and we have just issued a report on our examination for fiscal year 1976.

I would like to summarize the principal observations we made in these reports.

PROSPECTS FOR PRIVATIZATION OF POLITICAL COVERAGE

Only limited success has been made to date by OPIC to increase private participation in its insurance programs and, in our opinion, the private participation mandate established by the 1974 legislation can not be attained. The 1974 ACT provides for OPIC's political risk insurance programs, which include expropriation, inconvertibility and war risk, be fully transferred to the private sector by December 31, 1980, with OPIC remaining solely as a reinsurer.

Expropriation and Inconvertibility

To satisfy the Congressional mandate for private participation in its expropriation and inconvertibility insurance operations, OPIC established the Overseas Investment Insurance Group. The Group initially consisted of 13 private companies and OPIC. The Group assumed OPIC's portfolio except for investments in Jamaica, the Dominican Republic, and Ethiopia for the first $40 million in any one country and $80 million worldwide per year.

By 1977, the Group had increased its membership to 21 insurance companies. Even though the increased membership reduced OPIC's participation in the Group by 9 percent, the Government still remains the largest Group participant sharing 74.5 percent of the risk. In addition, there has been extensive foreign participation in the Group, the largest of the participants being Lloyd's of London with 12.5 percent of the total.

OPIC's efforts to attract more private insurance companies to participate in its insurance program have been disappointing. For example, 206 companies were contacted in 1976, of which only 105 responded and then only 6 of these decided to join the 15 companies already participating. During our review, we asked 20 private insurance firms for their opinions of privatization--12 that declined OPIC's invitation to participate, 5 that are now participating, and 3 that dropped out after participating for only 1 year. Some of these companies are in the "Hartford Group"--companies located in Hartford, Connecticut, that are considered to be the leaders of the insurance industry. One former participant declined to give us its opinion.

The 12 insurers declined OPIC's invitation to join the Group generally for the same reasons. The main reason cited was their limited knowledge of political risk insurance; most of them believe that conventional insurance principles cannot be applied to expropriation and inconvertibility losses because of the political factors involved. The capacity to undertake additional markets, especially in unfamiliar areas, has also prohibited, or at least delayed participation in the Group. Recent underwriting losses and declining stock market values, in which private insurers have sizable investments, have contributed to the reduction of surpluses which governs the amount of insurance that may be written. Thus, at this time, most of the insurers prefer to limit their activities to conventional domestic coverages.

OPIC also reinsures its existing expropriation and inconvertibility policies through Lloyd's of London. Lloyd's 1972 reinsurance agreement with OPIC was the first major step toward private participation. In 1975, Lloyd's became a major participant in the Group by transferring part of its reinsurance obligation to that facility. In 1977, Lloyd's and OPIC renewed the reinsurance agreement for 3 years.

War Risk

In January 1976, OPIC established a War Risk Insurance Reciprocal to directly insure all war risk policies written since January 1, 1976, and to reinsure 40 percent of OPIC's war risk policies written between July 1, 1972, and December 31, 1975. The Reciprocal's liability will be limited to $12.5 million per country and $25 million worldwide per year. OPIC will reinsure the Reciprocal against excessive losses and will initially share 60 percent of the Reciprocal's risk. Final implementation of the Reciprocal has been delayed by its inability to obtain a license to operate as an unincorporated insurance association.

OPIC and its predecessor agencies have written war risk insurance since 1957. As of September 30, 1976, only 9 claims, totaling $1 million have been paid. It was expected that events in South Vietnam would result in war risk claims, but none have been filed to date. Four Vietnamese expropriation claims, however, have been filed. In 1976, the Caltex and International Dairy claims, valued at about $1 million, were settled for $986 thousand. The Bank of America and Chase Manhattan Bank have filed claims for about $5 million and $6 million, respectively. These latter two claims are still pending.

Conclusions and Alternatives to Current Operations

In summary, the success of private participation in OPIC's insurance programs has been limited. The progress to date is principally the result of participation by foreign insurance companies. U.S. companies are reluctant to participate in political risk insurance, even though half of the companies we interviewed expressed an interest in future participation. Many of the companies stated that OPIC should remain active as a direct insurer as well as a reinsurer. Further, some of the companies have conditioned their future participation on continued OPIC involvement as a direct insurer. As a result, the mandate established by the Overseas Private Investment Corporation Amendments Act of 1974 can not, in our opinion, be attained.

We believe that this mandate has placed OPIC in an unfavorable negotiating position, resulting in reduced premium income through redistribution to the private sector of substantial payments in reinsurance fees, with OPIC still remaining liable, as a reinsurer, for the bulk of its portfolio.

In view of the limited results to date, the future of OPIC's political risk insurance program involves considering four alternatives--<u>first</u>, continue to try for complete privatization but provide deadlines more realistic than 1980; second, modify the private participation provisions by recognizing the unlikelihood of ever being able to achieve 100 percent privatization; third, abandon private participation; and fourth, dissolve OPIC. Each of these actions would require either the repeal or amendment of existing legislation. Further the dissolution alternative would require that existing contracts be assigned to another agency for liquidation.

COUNTRY CONCENTRATION

We reported in 1973 that OPIC's predecessor, the Agency for International Development (AID) had permitted over 50 percent of its insurance coverage to be concentrated in seven countries. As you know OPIC assumed its predecessor's insurance portfolio and even though concentration levels have been reduced in some countries, over 60 percent of OPIC's insurance portfolio continues to be concentrated in a limited number of countries with Brazil, Korea, and the Philippines accounting for over 35 percent of all types of coverage. For example, the portfolio coverage in Brazil for inconvertibility, expropriation, and war risk increased from 7.9, 6.1, and 6.8 percent in 1972 to 21.9, 22.3, and 11.9 in 1976, respectively. In Korea, such coverage increased from 11.0, 8.0, and 11.7 percent in 1972 to 11.6, 14.9, and 13.9, respectively in 1976. This is due, in part, to the long-term nature of existing contracts. More importantly, even though OPIC's policy is to limit concentration in any one country, it continues to insure investments in countries of high insurance concentrations.

Since 1974, 66 percent of all new OPIC insurance has been concentrated in Brazil, China, the Dominican Republic, Indonesia, Korea, the Philippines, and Trinidad and Tobago. On the other hand, countries such as Afghanistan, Bangladesh, Costa Rica, Haiti, Honduras, and Malawi received 1 percent or less of new insurance issued. OPIC's tendency to concentrate its insurance in selected countries is influenced by factors such as the limited investment opportunities in many of the lesser developed countries and the corresponding desire by investors to start projects in more industrialized countries, such as Brazil.

OPIC is required by Section 231(1) of the Foreign Assistance Act of 1961, as amended, to give preferential consideration to insuring projects in less developed friendly countries which have per capita incomes of $450 or less as measured in 1973 U.S. dollars. As noted previously, OPIC has not been successful in shifting insurance coverage to these poorer countries. In 1974, 1975, and 1976, countries with a per capita income of more than $450 received 64.2 percent, 37.3 percent, and 71.5 percent, respectively, of the new insurance issued. The abrupt change in 1975 is principally attributable to fluctuating activities in Indonesia, Korea, and the Philippines ($450 or less) and Brazil (more than $450).

The three lesser developed countries, which accounted for the majority of activity in the category of per capita income of $450 or less, received 18 percent of the insurance in 1976 while Brazil which was the most active country in the category of per capita income of more than $450 received 32 percent of the insurance issued in 1976.

The success of OPIC's efforts to encourage investment in the lesser developed countries is minimal, principally because opportunities for viable or profitable projects are limited in such countries. Also, since the program promotes, as well, investment opportunities in more developed countries, any future success appears to depend on the willingness of potential investors to select the less desirable alternatives. It is doubtful that this will occur in most instances.

To minimize high risk areas of investment with due regard to principles of risk management, OPIC has implemented policies designed to limit insurance coverage in "large and sensitive" activities, such as extractive industries. As a result, OPIC coverage of metal mining, for example, was reduced from a total of 32.2 percent prior to 1971 to about 7.7 percent in 1976. OPIC believes that the decline in coverage is not entirely attributable to its more restrictive policies, but to changes such as host government requirements for increased local participation in projects, constraints on foreign equity ownership, and the highly capital-intensive nature of the industry. It should be noted that extractive projects have accounted for a large dollar amount of expropriation claims.

Notwithstanding these developments it is extremely important that the U.S. have access to essential raw materials. Our January 1976 1/ report addressed the problem of access to critical materials. We pointed out that OPIC, in reducing the high-risk portion of its insurance portfolio, has consequently reduced its potential economic and developmental impact in the less-developed nations and its potential contribution to assuring the supply of raw materials to the United States.

Many of these countries have valuable natural resources and need the captial and technology to mine and process them. By redefining and

1/ U.S. Dependence on Imports of Five Critical Minerals: Implications and Policy Alternatives, ID-75-82, Jan. 29, 1976.

restructuring the role OPIC could play in this regard, a mutually acceptable arrangement to both the United States and the host country could be created that would enhance and help achieve their respective needs and goals.

Large Companies vs. Small/Medium Business Participation

OPIC's policy emphasizes assistance to smaller firms to the maximum extent consistent with sound risk management principles. However, OPIC continues to provide the majority of its insurance to the larger "Fortune 500" corporations, which comprise the majority of those seeking insurance.

As of November 30, 1976, the top 100 companies using OPIC services had 2,360 OPIC contracts totaling $11.1 billion or about 90 percent of total coverage. Eighty-nine of these, accounting for $9.7 billion, were either Fortune 500 corporations or their affiliates. Since December 1973, about 83 percent of OPIC's insurance coverage has gone to Fortune 500 firms. Seven companies received 29 percent, 38 percent, and 29 percent of the total insurance issued in 1974, 1975, and 1976, respectively.

Despite disappointing progress, OPIC has, in our opinion, seriously addressed the mandates to reduce its concentration in certain countries and to encourage more small and medium firms to become involved in investment programs in the LDCs. We believe that private investment is a highly important aspect of promoting the economic progress of developing countries and that clarification of the role that OPIC plays will serve as a useful and desirable tool in furthering this objective.

FINANCIAL STATUS

We examined OPIC's balance sheet as of June 30, 1976, and the related statements of income, changes in capital and reserves, and changes in financial position for the year then ended. The Corporation's reserve for insurance losses totaled $204.7 million and its potential losses amounted to $395.5 million. While OPIC can augment its reserves with retained earnings, these earnings are not solely available for that purpose. Due to the many uncertainties affecting claims and other liabilities, we were unable to express an opinion on the adequacy of the amount reserved for losses OPIC may suffer because of its insurance and guaranty contracts. As a result, we qualified our opinion on OPIC's financial statements.

What this means is that until adequate revenues are accumulated and reserved, OPIC could face a need to either borrow funds from the U.S. Treasury or request supplementary funds from the Congress to pay claims for large losses not covered by the private insurers.

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Mr. Chairman, this concludes my statement. We shall be pleased to answer any questions that you or other members of the Subcommittee may have.