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The Challenge of Administration by Regulation: Preliminary Findings Regarding the U.S. Government's Venture Capital Funds

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ABSTRACT

This article assesses the ability of elected officials to control public policy as implemented by public/private hybrid organizations, specifically, government venture capital funds. The study reveals greater control over OPIC investment funds than Enterprise Funds despite the existence of more traditional administrative tools of control for Enterprise Funds. This finding suggests that the regulatory infrastructure for hybrid organizations is more determinative of control than the existence (or lack) of traditional administrative control tools. Thus the challenge of hybrid government centers on the development of regulation as a substitute for administration.

Hybrid organizations, entities that mix characteristics of private- and public-sector institutions, are increasingly popular as solutions to policy problems. They perform a wide range of functions—from the financing of dormitory construction to the disposing of weapons-grade uranium—that touch the lives of virtually every American. Promising efficient operation at low cost, hybrids are proliferating at the local, state, national, and international levels (Seidman and Gilmour 1986). This article considers hybrids used as instruments of American foreign policy: the U.S. Government's venture capital funds.[1] It considers the relationship between the structure of the funds and the ability of elected officials and their appointees to control their activities.

The consequences of the expanding quasi government are uncertain. Collectively, hybrids embody an alternative relationship between elected officials and public bureaucracies or, to use the language of public management, principals and agents. Many tools traditionally utilized by principals to control their agents are not part of quasi government (Smith 1975; Musolf and Seidman 1980; Moe and Stanton 1989). Proponents argue that this freedom from

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[1]Although the subject matter of this article is confined to American venture capital funds, there are scores of similar funds sponsored by other countries and multilateral development banks (e.g., International Finance Corporation [IFC], Inter-American Development Bank [IADB], and European Bank for Reconstruction and Development [EBRD]).

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constraint endows hybrid organizations with the flexibility that is necessary for success. Critics counter that hybrids are unaccountable—a serious charge. Democratic theory suggests that insulating government from the public and their elected representatives threatens the legitimacy of a democratic political system (Krislov and Rosenbloom 1981; Gruber 1987).

In this article, I will investigate the extent to which hybrid organizations are beyond the control of elected representatives by examining two sets of hybrids with similar objectives: Enterprise Funds and investment funds sponsored by the Overseas Private Investment Corporation (OPIC). Although they are structured somewhat differently, both venture capital fund programs were created to bring equity investment to emerging markets by investing in new and expanding private businesses. Both sets of funds operate free of most traditional administrative limitations placed on government agencies. In place of these administrative structures, the two sets of venture capital funds are subject to regulation by other governmental entities. As a result, they provide excellent subjects to evaluate the substitution of intragovernmental regulation for traditional tools of administrative control.

Thus this article has two objectives: to evaluate the extent of control over the two sets of venture capital funds and to consider the substitution of regulation for traditional tools of administrative control while seeking lessons for future hybrid arrangements.

ADMINISTRATION BY REGULATION: THEORETICAL OVERVIEW

In the following section I will provide a theoretical foundation that describes the structural tools of control that are traditionally used to give elected officials control over public bureaucracies. This provides a base line for evaluating the regulatory substitutes used to control government venture capital funds and other hybrid organizations. A brief review of typical regulatory objectives distinguishes the nature of regulation as a substitute for administration.

The Concept of Control in Political Science

The ideal of control in public administration extends from Weber through the work of Wilson and Goodnow who offered the normative ideal of a politics/administration dichotomy. This conceptualization of accountability demands that bureaucrats carry out politically determined orders.

The plausibility of control among governmental organizations has been a subject of debate from the early days of political science.

The Challenge of Administration by Regulation

Recent attempts to determine the extent of congressional control over federal agencies utilize formal models (Weingast and Moran 1983; McCubbins, Noll, and Weingast 1987; Ferejohn and Shipan 1990; Hill and Brazier 1991). The ability of presidents to control bureaucrats also has been evaluated (Heclo 1978; Wilson 1989) and others have sought to demonstrate quantitatively a connection between changes in presidential administrations and policy shifts (Aberbach and Rockman 1988; Eisner and Meier 1990; Wood and Waterman 1994).

The Tools of Bureaucratic Control

Hybrid organizations often are distinguished by the absence of the administrative control *tools* that are used to manage traditional agencies. A rough sketch of these traditional tools for control gives a sense of the functions to be fulfilled by regulation of government venture capital funds.

Congress, as principal, has the appropriations and authorization processes as control mechanisms. Congress can specify levels of spending (by program), numbers of employees, and policy objectives. A less direct congressional tool for control is the Senate's power of confirmation. Not only is this directed at specific nominees but, more generally, at the executive branch, which must clear personnel decisions through committees and the Senate as a whole. Thus the ability to hold up nominations can compel bureaucratic compliance with a Senator's will (see Helms, Jesse). Finally, Congress' power to hold oversight hearings and call for audits guarantees access to agency records and personnel when issues arise.

The president's constitutional power to appoint personnel to executive positions in the agencies is his primary structural tool for control. It is bolstered by centralized authority over the budget and rule-making processes. As the clearinghouse and coordinating arm of the president, the Office of Management and Budget is a bulwark against freelance agencies making independent deals with Congress and/or interest groups. Finally, the most direct tool of control at the president's disposal is the ability to issue executive orders. These legally binding declarations can be utilized to move the bureaucracy in a desired direction notwithstanding objections from competing principals (i.e., Congress). Inspectors general can prove both a help and hindrance to presidential control of the bureaucracy by monitoring the activities of federal agencies and employees.

Federal bureaucracies are also subject to a wide range of requirements to ensure general accountability if not direct control. For example, the Administrative Procedures Act creates opportunities for interest groups to bring legal challenges to bureaucratic actions on procedural, and in some cases, substantive grounds. Ethics codes and professional standards also limit government employees. For example, trade and professional organizations generate guidelines for appropriate behavior. Oaths create a moral obligation for fidelity to constitutional principles.

Agencies are required to solicit and receive feedback from citizens, interest groups, and others through public hearings, advisory committees, ombudsmen, and, more formally, public comment periods on regulations and proposed rules. Market-oriented structures such as explicit performance standards and voucher systems are increasingly popular as links between government and the public (Osborne and Gaebler 1992). The Freedom of Information Act and regulations that guarantee access to government documents guarantee opportunities for review to the public.

As exhibit 1 makes clear, many traditional control tools are not in place with respect to the venture capital funds. Instead, the venture capital funds and many other hybrid organizations are subject to oversight by federal agencies that employ regulatory tools as a

Exhibit 1
Structural Tools of Control

Accountability Tool	Applicability to Enterprise Funds	Applicability to OPIC Funds
appropriations	Indirect	Indirect
authorization	No	Indirect
confirmation	No	No
appointment power	Modified	Indirect
budget	Yes	No
opportunities for public litigation	No	No
oaths	No	No
professional norms	No	No
associations	No	No
market mechanisms	No	Yes
ombudsman	No	No
casework	No	No
FOIA	Yes	Limited
public hearings	Yes	No
scrutiny	Limited	Limited
review/audit	Yes	Yes
inspector general	Yes	No

This exhibit presents the structural tools of control used by the president and/or Congress to monitor and influence policy implementation at federal agencies. Most of these tools are not available (in their typical form) with respect to Enterprise Funds or OPIC investment funds.

substitute for the traditional administrative arrangements described above. The discussion of the two venture capital fund programs includes a description of the control tools specific to each. A brief review of regulatory control tools provides background.

Regulation as Substitute for Traditional Tools of Control

Justifications for regulation generally fall into one of the following six broad categories (Breyer 1982). A quick review of these arguments provides a good starting point for evaluating the suitability of regulatory mechanisms as substitutes for administrative tools.

- *Control of Monopoly Power*. When a market can support only one firm, governments frequently step in to control price, ensure fair treatment of all customers, and limit the power of controllers of essential products.

- *Control of Rents*. When a limited mismatch in production costs and market prices (as opposed to wise investment strategy or investment of equity) allows for individuals to make extraordinary profits, governments may regulate prices.

- *Compensation for Spillovers*. Market prices may not reflect true social costs. Regulation can prevent the social wastefulness caused when individual firms adopt inexpensive behavior that is collectively costly.

- *Inadequate Information*. Regulation is often justified by the need for access to information.

- *Excessive Competition*. Governments prohibit predatory pricing and other practices that quash competition, lead to business failures, and produce unwanted monopoly conditions.

- *Other Justifications*. Governments invoke less frequently the need for rationalization (coordination in planning and operation to maximize efficiency), paternalism, and protection from scarcity (when rising prices might result in serious hardship).

Thus the general form of any justification of regulation is that some feature or deformation of the market requires interference in the name of the public interest. Any given policy may contain elements of several justifications.

To achieve the objectives of regulation, government relies upon legal mechanisms. This requires crafting of detailed law and regulation that define the nature of impermissible activities (e.g., predatory pricing), appropriate remedies, sanctions for noncompliance, opportunities for mediation or appeal, and protocols of compensation for unjust impositions of regulatory burdens. Regulation inevitably draws both the regulator and regulated into a legal system that places a premium on finely articulated standards, controlling precedents, and binding obligations.

Intragovernment regulation justified by the first rationale—regulation of a monopoly—draws agencies into this system. The U.S. Postal Service and electric utilities are prominent examples. Additionally, some government self-regulation results from government undertaking a regulated private-sector activity. For example, housing authorities are subject to safety requirements imposed on all landlords, and federal agencies are subject to EEOC review.

Regulation intended to guarantee that a quasi-public entity *fulfills its public policy purpose*, however, does not fit easily into Breyer's scheme. Barry Mitnick (1980) has noted that governments sometimes resort to "regulation by directive," pulling institutions into the governmental orbit to bring them under the authority of administrative command. The proliferation of hybrid organizations, in contrast, necessitates *directive by regulation*.

As I will discuss in the following section, the absence of traditional tools of administrative control requires the overseers of the fund programs to rely on regulation to manage implementation of policy at these hybrid organizations. The experiments with government venture capital funds test the adaptability of regulation for this application.

America's Venture Capital Funds

The fall of the Berlin Wall in 1989 posed an unprecedented foreign policy challenge. The desire to help Eastern Europeans establish democratic political regimes and market-based economies was universal, but the strategy was uncertain. With industrial experience, skilled and educated workforces, and physical infrastructure, these nations were already *developed* in the traditional sense of the term. American development agencies were not practiced in the transformation of state-controlled economies into vibrant free markets. Nor, for that matter, was there a standard approach to the transition from single-party Communist rule to competitive multiparty democracy.

The Support for Eastern European Democracy (SEED) Act of 1990 provided American aid to Poland and Hungary and set the template for future programs (Public Law 101-179). In addition to extending several traditional aid programs to these countries, the SEED Act created Enterprise Funds to develop the private sector through "loans, grants, equity investments, feasibility studies, technical assistance, training, insurance, guarantees, and other measures" (22 USCA §5421(a)). The Enterprise Funds were to be chartered as private nonprofit corporations but funded by government appropriation: $240 million for the Polish American Enterprise Fund, $60 million for the Hungarian American Enterprise Fund (§5421(b)(1),(2)). The first director was designated in 1990. The two funds incorporated and began operations shortly thereafter.

At about the same time, the Overseas Private Investment Corporation (OPIC) was confronting a challenge of a different sort. Originally part of the United States Agency for International Development (AID), OPIC was spun off under President Nixon when many felt that the agency was ill-suited to cultivate private investment in underdeveloped markets (interviews 32, 17, 19; see appendix). OPIC is itself a type of hybrid, a wholly-owned government corporation that generates revenues to cover its expenses by charging fees for its services. OPIC's principal activities are providing political risk insurance for American companies that make investments abroad (in select markets) and providing loan guarantees to businesses that are involved in large, capital-intensive initiatives in developing countries.

Neither of these programs addressed the need for capital investment in developing markets. OPIC is prohibited by statute from making equity investments, but a creative solution was implemented with the creation of the Africa Growth Fund—the first OPIC investment fund. OPIC guaranteed loans to this private, profit-seeking venture capital fund to induce private participation. Twenty-six investment funds now serve countries all over the world. The outstanding OPIC commitment is to guarantee about $1.5 billion in loans to the funds, of which about $600 million has been disbursed to cover approximately 250 investments (interview 28).

What Venture Capital Funds Do

Both sets of funds aim to spur economic development by channeling money to new private enterprises. Private venture capital funds are essentially pools of money assigned to a management team that looks for promising new businesses. Fund managers typically will invest in less than 5 percent of the businesses that present proposals, hoping to generate at least a 25 percent return in ten years or less. At that time, the venture capital fund will sell its equity stake either to another investor or in public stock offering. The overhead of the fund management is paid for by fees charged as a percentage of the capital pool. The fund managers also earn a share of the profits generated by the fund investments (Fox 1996).

The OPIC investment funds more closely resemble this model than do the Enterprise Funds. OPIC investment funds seek typical venture capital returns on a pool of capital that includes OPIC-guaranteed debt and private investment. Enterprise Funds are funded with government appropriations[2] and combine their venture capital function with delivery of technical assistance and other aid not intended to generate economic return. These differences influence the government's oversight responsibilities and abilities.

Control Tools for Government Venture Capital Funds

Of particular interest in the context of this inquiry are the differences in the control tools available for Enterprise Funds and OPIC investment funds. The following section provides greater detail regarding the structure of the two types of venture capital funds and catalogues the control mechanisms available to executive and legislative branches.

ENTERPRISE FUNDS: Bush administration officials and Republicans in Congress did not have faith in AID's ability to develop the private-sector institutions seen as the key to economic and political development in Eastern Europe (interviews 5, 4, 2, 24). This attitude, reminiscent of the feelings that led OPIC to be separated from AID years earlier, prompted creation of the independent Enterprise Funds in the SEED Act. The level of financial commitment to the eleven current funds varies as does the extent to which each has disbursed funds. Moreover, due to varying economic, legal, and political conditions, each fund has taken a different approach to the mission specified in legislation.

The Enterprise Funds have a common skeletal structure that substitutes a set of different control tools for those applied to traditional agencies or the largest class of hybrids, government-owned corporations. Indeed, the law allows the funds to carry out their activities in accordance with the SEED Act "notwithstanding any other provision of the law" (§5421(c)). This clause has been interpreted, after some agitation, to exempt the funds from all federal management laws including the Government Corporation Control Act (Cox 1990). This leaves essentially four tools of control that apply to the Enterprise Funds: presidential designation of directors; coordination by the State Department and AID; audit/reporting requirements; and negotiated grant agreements, corporate by-laws, and fund policies and procedures.

[2]Some EFs have raised private capital.

Exhibit 2
Enterprise Funds

Enterprise Fund	Created	Total Commitment
Polish-American Enterprise Fund	1990	240
Hungarian American Enterprise Fund	1990	60
Slovak American Enterprise Fund	1991	65
Bulgarian American Enterprise Fund	1992	55
Romanian American Enterprise Fund	1994	50
Albanian American Enterprise Fund	1995	30
Baltic American Enterprise Fund	1994	50
US Russia Investment Fund	1995*	440
Central Asian American Enterprise Fund	1995	150
Western NIS American Enterprise Fund	1995	150
South African American Enterprise Fund		
Defense Enterprise Fund	1994	72

Control Tools: Boards of Directors. The president designates Enterprise Fund directors who must be citizens of the United States or the host country after "consult[ing] with the leadership of each House of Congress" (22 USCA §5421(d)(1)). Consultation is informal without hearings or votes. The choice of director, as a result, is largely a matter of presidential prerogative; the president does not appoint in the traditional sense. Since the funds are private corporations, the original designees charter the funds and new members are elected by the board following presidential designation. Directors, the majority of whom must be American, must have "relevant expertise" and commitment to establishment of "democracy and a free market economy" (22 USCA §5421(d)(3)(B)).

The first Enterprise Fund directors, John Whitehead of the Hungarian Fund and John Birkelund of the Polish Fund, are highly respected senior members of the investment banking community to whom the president was deferential on the selection of additional directors. The early boards were bipartisan (or nonpartisan) and included persons with distinguished records either in financial pursuits or in matters pertaining to the host country. Critics have noted that recent appointments have been more political in nature, handled through the White House personnel office unlike selection of the Polish and Hungarian Enterprise Fund directors (interviews 4, 5, 8).

There are no formal reporting requirements or liaisons for the fund directors. Many of these individuals do have frequent informal contact with administration officials, but board members, even chairmen, are not involved in regular foreign policy discussions, even those concerning the regions in which their funds operate. Board members are generally not involved in the day-to-day operations of the funds. Enterprise Fund directors select a president who oversees in-country operations. Some funds have U.S. offices that allow greater involvement of the chairman, who is usually more interested than other directors. All major proposed investments must be approved by the board's investment committee, which meets more frequently than the board itself (typically four times per year).

Control Tool: Oversight and Coordination. The first Enterprise Funds had expected to receive a lump payment of their entire allotted sum, which they could invest to cover start-up costs (interviews 5, 8, 4). Instead, AID disburses money in chunks as needed until the total allocation is disbursed. The funds make annual requests, based on their anticipated slate of investments, that come out of the AID budget for that year (and region). Thus there can be tension between the Enterprise Funds and other AID operatives in a given region (interview 13).

Enterprise Fund overseers at AID and the State Department SEED coordinators are informed of pending deals by the funds, but they do not have the right to veto any particular deal or force a fund to proceed on a particular proposal. They do raise questions regarding proposed projects, suggesting their doubts, reservations, or enthusiasm.

In the SEED Act, Congress made a few specific suggestions for Enterprise Fund projects, including encouragement of stock ownership plans for employees, establishment of credit unions, and modernization of telecommunications. The legislation makes clear that the funds are not restricted to investments; they can make grants and deliver technical assistance related to their mandate. Indeed, one clause explicitly permits the Polish Fund to channel money to the Solidarity Party (§5421(f)).

Congress did place some limitations on fund activities in the limply worded "Matters to be Considered by Enterprise Funds," but provided no enforcement mechanism:

"[E]ach Enterprise Fund shall take into account such considerations as internationally recognized worker rights and other internationally recognized human rights, environmental factors, United States economic and employment effects, and the likelihood of commercial viability of the activity receiving assistance from the Enterprise Fund" (22 USCA §5421(g)).

Finally, a vague limitation that compensation for fund personnel be "reasonable" was subsequently translated to a more concrete $150,000 cap (Atwood 1993).

Control Tool: Reporting and Audit Requirements. Enterprise Funds are required to produce public annual reports that provide aggregate data on their activities. However, the reports do not provide detailed financial information on specific investments, as that might reveal proprietary business information. Although project-specific information is available to AID, the material included in annual reports of Enterprise Fund activities make public evaluation of each portfolio difficult.

To buttress the oversight, Enterprise Funds are required to submit to independent private audits and report the results. The General Accounting Office (GAO) also may conduct periodic reviews. Finally, the inspector general of AID has authority to review the funds' compliance with their own policies and procedures (described below).

As the Enterprise Fund program has matured, the reporting requirements have expanded as a result of negotiation between the funds, the administration, and Congress. AID fund overseers conduct a semiannual review, which includes an extensive report on the status of new and existing investments as well as meetings with Enterprise Fund boards and management (interviews 3, 11; USAID 1998).

Control Tool: Negotiated Terms of Incorporation, By-laws, and Policies. Before the chairman of the first fund had been designated by President Bush, AID personnel took the first steps toward establishment of the funds. They engaged lawyers, who began drafting incorporation papers and put out a request for proposals (RFP) from contractors who would run the funds for the boards (interviews 17, 10, 5). When the boards *were* named, the chairman quickly abandoned the AID efforts and informed the agency that they would be setting up new, independent organizations. Many within AID favored and encouraged this approach. The SEED coordinator, a position established within the State Department, also favored the independence of the funds. Thus, even though some career AID staff were wary of the funds, the image of a resistant bureaucracy vainly struggling to hold onto power is misplaced (interviews 17, 5).

Nevertheless, the independence of the funds created a need for negotiations regarding the terms of grant agreements, corporate by-laws, and policies and procedures. Negotiated by AID officials and counsel engaged by the Enterprise Funds, these documents added flesh to the skeleton provided by the SEED Act and defined the regulatory relationship between the funds and the United States Government. A brief explication of their terms is helpful:

- Corporate by-laws and the certificate of incorporation formalize the requirements of the legislation. This includes selection procedures for directors and other matters, including nonprofit status, distribution of assets, and other procedural issues. Almost no attention is given to the fund's mission other than a general statement that its purpose is development of the private sector.

- Grant agreements focus on the distribution of funds from AID to the Enterprise Funds and the requirements placed upon both the agency and the fund to facilitate payment. These requirements are largely driven by budget rules and do not include any imposition of policy direction as condition for obligation of funds.

- Policies and procedures lay out guidelines on managerial matters including procurement, expenses, salaries, hiring, and other administrative matters. These requirements generally call for reasonable behavior and documentation rather than establish strict rules.

The structure and practice of control over the Enterprise Funds has evolved since the creation of the first two funds. Driven in part by problems with two funds, both the administration and Congress have gradually asserted more authority in the form of beefier reporting requirements. This type of oversight creep is neither unusual nor unexpected (interview 24). In a system that emphasizes fire alarm oversight, the discovery of a fire frequently results in the creation of additional alarms (McCubbins and Schwartz 1982) and lessened resistance to their installation.

OPIC Investment Funds: The OPIC investment funds were structured to facilitate equity investment utilizing OPIC's statutory authority to provide loans and loan guarantees. The first few funds, experiments created on an ad hoc basis, proved to be popular and were replicated. The creators of the funds acknowledge that the development of oversight capacity trailed the creation of the funds. Only after OPIC brought in personnel with extensive private-sector venture capital experience did the process for creating funds and the form of future funds take on structure (interview 23). This story is significant in that development of the investment fund concept did not involve contemplation of an oversight mechanism.

Although Congress has subsequently included language in foreign assistance legislation that instructs OPIC to create investment funds to serve particular regions, the OPIC statute has not been

Exhibit 3
OPIC Investment Funds

Fund	Created	Maximum Fund Size (in $ millions)	Status (as of 11/1/98)
Africa Growth Fund	1991	25	Divesting
Agribusiness Partners International	1995	95	Investing
AIG Brunswick Millennium Fund	1996	300	Investing
Allied Capital International Small Business Fund	1995	20	Divesting
Aqua International Partners	1997	300	Investing
Asia Pacific Growth Fund	1992	75	Divesting
Bancroft Eastern Europe Fund	1996	100	Investing
Caucasus Fund	1998	92	Raising Capital
Draper International India	1996	55	Investing
Emerging Europe Fund for Sustainable Development, L.P.	1996	60	Investing
First NIS Regional Fund Audley Investments	1994	200	Investing
Global Environment Emerging Markets Fund	1994	70	Fully invested
Global Environment Emerging Markets Fund, II	1997	120	Investing
India Private Equity Fund	1995	140	Investing
InterArab Investment Fund	1996	45	Investing
Israel Growth Fund	1994	40	Investing
Modern Africa Growth and Invest. Fund	1997	150	Investing
New Africa Opportunity Fund	1996	120	Investing
Newbridge Andean Capital Partners	1996	160	Investing
New Century Capital Partners, L.P.	1995	250	Investing
PBO Property Fund (Reorganized, formerly CEENIS Property Fund)	1998	240	Investing
Poland Partners, L.P.	1994	63.5	Fully Invested
Russia Partners	1994	155	Investing
S. America Private Equity Growth Fund	1995	180	Investing
South Asia Capital	1996	150	Investing
West Bank/Gaza & Jordan Fund	1997	60	Raising Capital
Total		3,272	

altered to include explicit provision regarding the fund program (22 USCA §2194, §2194b). Thus there are two levels of controls to consider as substitutes for traditional tools: those utilized by the administration and Congress with respect to OPIC and those tools used by OPIC to manage the investment funds.

Control Tools: OPIC as Part of the Administration. OPIC is subject to most federal management laws, including the Government Corporation Control Act. Its employees are compensated on the same scale as federal employees, they must comply with ethics requirements, and they must abide by the Freedom of Information

Act among other management requirements. One important caveat involves the shielding of private business information. OPIC personnel cite their legal obligation not to divulge any proprietary information of entities with which it does business when describing the activities of investment funds (interview 31). This means that the private fund managers do not divulge the names of their investors, the companies in which they are investing, or the returns on these investments.

Appointments. OPIC is governed by a fifteen-member board of directors—chaired by the administrator of the Agency for International Development—that includes as ex officio members senior presidential appointees from the State Department, the Commerce Department, the office of the U.S. Trade Representative, the Treasury Department, and the Labor Department as well as seven other presidential appointees (22 USCA §2193(b)). The board is not intimately involved in the day-to-day activities of OPIC and functions like a corporate board, reviewing and approving major policy decisions (interviews 22, 34). OPIC's president/CEO and senior officials are appointed by the president of the United States with advice and consent from the Senate (§2193(c)).

Interagency Coordination. OPIC is represented in presidential administration working groups and discussions related to its mission. It is part of the Trade Promotion Coordinating Committee (TPCC), a toothless entity created to coordinate American trade activities across agencies. The TPCC prepares a national export promotion strategy report and overseas interagency working groups on policy matters that cut across trade-related agencies. The countries in which OPIC operates are limited by foreign policy constraints. For example, OPIC does not operate in China, because of post-Tianemen sanctions.[3]

Budget. OPIC is included in the federal budget. Its appropriations request is submitted through the Office of Management and Budget where interagency negotiation of demands takes place. Although OPIC is net positive in terms of its overall effect on the budget, an appropriations request is required and the amount is set by the administration, as OPIC's credit reserve for the year can be a constraint on its activities.

Control Tool: Congressional Oversight of OPIC. OPIC historically enjoyed a low profile on Capitol Hill until it was targeted by Rep. John Kasich in his crusade against corporate welfare two years ago. After a bruising reauthorization battle, OPIC narrowly survived by the unusual step of reauthorization through the

[3]This contrasts, to some extent, with the Export-Import Bank of the United States, the export credit agency that functions as an independent entity. ExIm, as the bank is known, is intended to promote American exports rather than function as a foreign policy instrument. One telling distinction is in the congressional oversight of these two related organizations; responsibility for OPIC is vested in the foreign relations committees of Congress while the banking committees oversee ExIm.

appropriations bill. OPIC has experienced heightened levels of attention since.

Philosophical objections aside, OPIC is *not* controversial for budgetary reasons. Indeed, it usually costs nothing in net appropriations although this is not readily apparent based on budget statements, particularly after implementation of the Credit Reform Act of 1990. As guarantors of debt, OPIC must request an appropriation to cover a reserve amount representing a percentage of its total potential obligation. The guarantee on loans to OPIC investment funds is scored this way for budgetary purposes. For each loan dollar guaranteed, a proportionate reserve is set aside, in effect, on paper. This money is only obligated (paid out of the treasury) when and if a deal goes bad. OPIC generates enough income in fees to cover operating expenses and fund the reserves.

The periodic reauthorization and yearly appropriations processes include congressional hearings. OPIC also submits annual reports and communicates regularly with congressional staff. Relatively little information is transmitted regarding the investment funds. Each annual report includes new investment funds with the amount of loan guarantee committed to that fund along with other projects financed in a given year. That does not reveal the *actual* amount of loans drawn upon by those investment funds or the total investment in the funds program. Committee staff members do not display a strong interest in the activities of the investment funds or a particular thirst for additional information. As one staffer put it, "We'll wait for something to blow up and then take a look" (interview 16).

OPIC's Control Tools for Investment Funds: Negotiated Terms of Loan Guarantees. The process for soliciting bids for new investment funds has gradually been formalized. OPIC typically advertises its desire to start a fund for a particular country or sector to interest potential fund managers although OPIC also evaluates unsolicited proposals. All proposals are judged on the fund manager's ability to attract private investment, identify and manage equity investments, and apply substantive knowledge of the proposed target country, region, or sector (interviews 23, 31).

Once a fund manager is selected, the terms of the loan guarantee are hammered out in a process that resembles the negotiation of charter and by-laws of Enterprise Funds. OPIC is guaranteed a pre-set return on its loan regardless of the profit (or lack thereof) generated by the investment fund. Equity contributed by private investors is combined with the OPIC guaranteed loan to create the pool of investment capital. This leverage provided by the OPIC guaranteed loan is the enticement for investors to put money in funds that target risky areas. There are numerous details to be determined such as the length of payment grace periods, profit stages, and interest rates. OPIC also earns a portion of the *management carry*, the fund manager's profit, that is related to the risk of each arrangement.

Policy restrictions on the funds are drawn from the restrictions placed on all OPIC programs. OPIC cannot undertake programs that have harmful effects in the United States (i.e., that export jobs), that fund companies or countries that violate worker rights, or that contribute to the degradation of the environment (22 USCA §2191(3)). Additionally, the programmatic purpose of a particular fund imposes restrictions (e.g., a small business fund is limited by size of potential investment company). OPIC fund overseers review proposed investments for compliance with these requirements and periodically check on the investments in person.[4]

Control Tool: Market Pressure. Private investors hold a financial stake in the management and performance of the OPIC investment funds. Generally, these investors are large financial institutions including banks, insurance companies, pension funds, and other experienced, savvy market participants. Representatives of these institutions sit on the fund committee, of which OPIC is generally a nonvoting member, participate in the selection of the investment committee and monitor their investments carefully. This provides a significant barrier to abuse of the OPIC guarantee. These private equity investors only recover money in the event of fund collapse *after* all OPIC-guaranteed loans are repaid (Stillman 1996).

Demands of Regulation

The limited presence of traditional administrative controls forces AID and OPIC to rely upon the negotiated agreements, bylaws, and policies to assert control. This administration by regulation has two objectives. First, the overseers must prevent financial malfeasance by the fund managers. This could include fraudulent investments, misuse of fund dollars, or insufficient screening and monitoring of investments. Second, the overseers must ensure policy compliance. That is, AID and OPIC must ensure that the funds are performing the functions for which they were created and abiding by applicable U.S. foreign policy.

EVALUATING CONTROL OF AMERICAN GOVERNMENT VENTURE CAPITAL FUNDS[5]

Evaluating the effectiveness of control suggests an ability to divine a set of preferences against which measurable behavior can be compared. This is difficult in several senses. First, preferences are

[4]Some critics note that the restrictions placed on the investment fund limit the quality of professionals willing to manage OPIC investment funds. Capable venture capital experts, say those who accuse OPIC of steering deals to unqualified persons, will not work under these terms.

[5]These findings represent preliminary results of a study that includes government venture capital funds among other hybrid organizations. As the research is ongoing, these results may not reflect the final conclusions regarding venture capital funds or hybrids in general.

not always revealed by principals. Second, in the governmental context there are multiple principals, including administration officials and various committees and members of Congress. Third, even finding correlation in organizational outputs and the preferences of principals only constitutes circumstantial evidence. The outputs might have been the same *regardless* of the principal's preferences.

These challenges are particularly acute with respect to the government venture capital funds. Much information regarding the funds' operations is not public, the outputs are difficult to measure, and preferences are difficult (if not impossible) to identify. In some sense, this is what makes the project interesting.[6] However, through examination of available documents and interviews with current and former employees of the funds, their overseers, and congressional committee staff responsible for the fund programs, I have been able to draw distinctions between the two types of funds that yield insight into the experiments with these novel organizations. I continue to develop quantitative measures of fund behavior to complement this qualitative research.

Existing Studies of the Fund Programs

Both fund programs operate largely out of the limelight and have not been studied extensively. There have been a few critical newspaper articles that generally claim either that the funds constitute corporate welfare, exposing the U.S. taxpayer to risk while allowing rich businessmen to make lots of money (Bandow 1996; McTague 1996; Wayne 1998), or that the funds operate as political patronage mills channeling prestigious and profitable positions to politically connected individuals (Burstein and Shields 1997; Hendrie 1998). Although there may be elements of truth in each set of charges, these criticisms are generally based on superficial analysis or exaggeration of horror stories.

In general, journalistic reports on the fund programs do not consider the matter at the heart of this article: Can these organizations be controlled as instruments of public policy? This question has been considered to a limited degree in studies of the Enterprise Funds by GAO and Development Assistance International (Nathanson 1995).

The GAO report pointed out the many limitations in AID's oversight authority but noted that this was by design in the legislation (GAO 1994). As a result, GAO concluded that the Enterprise Funds have a great deal of latitude and it is difficult to even evaluate their performance. DAI focused more on the performance of the Enterprise Funds as development instruments (as did an internal AID

[6]Or to borrow a sentiment from President Kennedy encouraging the American lunar program: "We choose to go to the moon in this decade and do the other things, not only because they are easy, but because they are hard . . ."

report) and found them promising in some regards but limited as developmental tools (Nathanson 1995). More relevant to this study, the evaluators concluded that the monitoring performed by AID was not sufficient to generate good information. All the reviews were very early in the fund program, and they examined only the first four Enterprise Funds.

Preliminary Findings

This study of the two fund programs and the effectiveness of the regulatory controls applied to the various venture capital funds yields two interesting findings:

- Negative control is more effective than attempts at positive control. That is, the regulating agency has some ability to prohibit or restrict certain activities but has very limited power to prompt any specific action.

- OPIC has created an oversight scheme better suited to monitor venture capital funds and compliance with the terms of loan agreements than AID is able to supervise the Enterprise Funds.

After briefly elaborating these two findings, explanations will be offered as well as interpretation regarding the effectiveness of regulation as administrative substitute.

Negative More Effective Than Positive. Both types of venture capital funds face restrictions on their investment opportunities. First, the funds' parameters are defined by the area of focus (country, region, or sector). Second, there are general restrictions on the types of businesses in which the venture capital funds can invest. Experience with both fund programs indicate that these negative controls are more effective than attempts at positive control. For example, bans on investment in armaments have been honored but emphasis on telecommunications investment has not yielded results.

As I have noted previously, the SEED Act suggested boundaries for Enterprise Fund investments that were included in grant agreements. Although neither the AID overseer nor the State Department's SEED coordinator can veto a deal, even in the event that an investment appears to violate one of these suggestions, a reviewer can raise a red flag. Congress also reserves this right of review, but by their own admission the committee staff assigned to perform this function have little time to engage in such matters (interviews 16, 3, 6, 2). Fund officers have little to gain by ignoring congressional proscriptions. In contrast, direction to invest in a particular region or sector depends upon the existence of sound investment opportunities. In some cases, such opportunities are simply unavailable.

OPIC's authority is more formally incorporated in the loan agreements signed with investment funds. The restrictions placed by Congress on OPIC are extended to the funds (no business in restricted countries, no detrimental effects on American workers, no project can result in environmental degradation, all projects must guarantee full protection of worker's rights).

The loan agreements also stipulate that each deal must be cleared by OPIC for compliance with these requirements before funds are disbursed for the investments. This gives OPIC overseers significantly clearer formal authority over the investment funds than AID and the State Department have over the Enterprise Funds. Moreover, as a nonvoting member of the fund committee the OPIC fund manager is aware of fund activities.[7] The Enterprise Funds have been unwilling to open up board meetings to AID overseers (interviews 11, 13).

OPIC's review process is not described as adversarial; OPIC fund managers will negotiate with the fund personnel for a particular deal to pass muster. A manufacturing plant may be required to install exhaust scrubbers, for example, before OPIC clears the fund's investment. Every deal goes through OPIC's hands, however, a requirement that does slow down the process and can cost investment funds good deals (interview 27).

Many of the negotiated loan agreements do create aspirations for the OPIC fund's investment committee that are positive. For example, the Modern Africa Fund limits the fund to no more than 15 percent in any investment, no more than 20 percent in any country, no more than 33 percent in any sector, and no more than 49 percent in members of the Southern Africa Development Community (Modern Africa Fund 1999).

Although the OPIC funds face more stringent negative controls than the Enterprise Funds do, it should be noted that their sole examiner is OPIC. Any control to be exerted by other agencies or Congress must be routed through OPIC. Most administration officials and congressional staff either admit they know little about the funds and their operations or make this fact clear in the course of interviews. Moreover, limited public access to materials related to the investment funds make dependence on OPIC review and regulation more critical. Breakdown in OPIC oversight leaves the investment funds essentially unsupervised.

[7]This is *not* the investment committee that evaluates the soundness of proposed investments.

The extent of the government's control over venture capital funds has become an issue in only a limited number of incidents. Most notable perhaps was the investigation of the Hungarian American Enterprise Fund (HAEF) led by Rep. David Obey. Skeptical of the fund concept from the outset, Obey got word of a HAEF project that involved 100 percent financing of a Hungarian merchant bank run by two Americans earning $350,000 salaries (Maas 1993b). This ignited controversy that was fueled further by the disclosure that the fund was paying a portion of the salary of a Hungarian-American running the Hungarian government's privatization program (Maas 1993a). In neither case is it clear that the fund violated any rule (recall that there are almost no rules to violate, only suggestions). Still, Obey provoked a firestorm of attention that ultimately led the fund's president to resign (Denton 1993).

More significantly, Obey's investigation affected the management of the Enterprise Fund program. AID overseers, caught offguard by the controversy, insisted on better oversight after they were held partially responsible for the alleged misdeeds (interviews 19, 13). As a result there is now more reporting but no more authority in the hands of AID regulators. The funds successfully resisted the most dramatic proposals for increased oversight authority despite the HAEF problems and the more dramatic meltdown of the Czech and Slovak fund.

Moreover, even these controversies did not raise any issues about positive control. Most interviewees note that the funds have never been directed to approve a specific project, notwithstanding the occasional application of congressional pressure on behalf of a constituent or the unsolicited call to a fund director. There may be occasional informal efforts by administration officials to move an Enterprise Fund in one direction or another. For example, the Polish fund undertook a successful microlending program, by most accounts, at the urging of AID and State overseers.

Although such instances of positive influence can be identified, most similar attempts at such influence resulted in little or no activity. One illustrative example concerned an effort to have funds use common environmental impact review procedures by holding a conference with experts in the field. The funds simply refused to attend, and the conference was scuttled (interview 11).

The OPIC funds are less well-suited to positive control than the Enterprise Funds are. Loan agreements rarely include provisions for such direction, and private investors would be deterred from investing funds that could have goals imposed by government other than maximizing return. Thus attempts at positive control might undermine the program (interview 31). Enterprise Funds do not face this constraint, because they are funded entirely by government appropriations.

Two caveats should be added on this point. First, OPIC does utilize policy-related criteria in evaluating competing bids for a proposed fund. An example offered by a senior OPIC official: Two prospective managers competing for an Africa fund pitched their proposals by highlighting an investment strategy targeting businesses owned by women, on the one hand, and investment focus on labor-intensive businesses, on the other (interview 31). The selection process provides an opportunity for OPIC to give direction to the investment fund. Second, OPIC is generally passive in that the companies must make a proposal before the agency can act. The fund program gives the agency an opportunity to be more proactive. Both the administration and Congress have recognized this and called for the creation of at least three funds (including the West Bank/Gaza fund and the Caucasus fund). As with Enterprise Funds, the *creation* of the fund is the most positive aspect of the program.

Interpreting Results

Observations regarding the two venture capital fund programs offer broader lessons about the consequences of altering the structural tools for organizational control:

- Neither source of funds, degree of public scrutiny, nor appointment power accounts for the differential in control between the types of funds.

- Effectiveness of regulation as a substitute for administration depends on clear definition of the organizational mission for the regulated organization and clear statement of powers for the regulator.

Explanatory Power of Traditional Control Tools. The comparison of Enterprise Funds and OPIC investment funds highlights the limits of several structural features as explanatory variables. This is not to suggest that the differences in funding, scrutiny, and appointment are insignificant. But these three obvious differences would suggest *greater* control of *Enterprise Funds* than of OPIC investment funds (the opposite of the findings just presented):

- Enterprise Funds rely upon government appropriations. OPIC investment funds mix OPIC-guaranteed loans from private lenders with private capital. One would expect a strong relationship between the ability of a political principal (Congress or the president) to control an organization and that organization's source of funds.

- OPIC investment funds are not subject to nearly the same level of public scrutiny as are Enterprise Funds. They do not produce annual reports or submit audited financial statements for congressional review. Even members of Congress have complained that the funds resist even modest requests for information.[8]

- Enterprise Fund directors are designated by the president. OPIC fund managers are selected by OPIC under a formal review process and must subsequently solicit private investors for capital.[9] Thus the Enterprise Fund directors more closely resemble the political appointees relied upon as agents of the president.

Not only do the findings fail to confirm these expectations, they reveal exactly the opposite. This is not to suggest Enterprise Funds run amok. The Enterprise Funds have regular, sometimes daily, contact with the coordinators. In some cases, there is regular communication with the in-country AID missions and embassies. But unstructured communication does not provide any certainty regarding the compliance with preferences.

In the context of hybrid government, these three traditional administrative tools are not reliable instruments of control because the relationship between government and hybrid is essentially regulatory. In such a relationship, the dominant variable is the structure and character of the regulation, not the vestigal administrative linkages.

The Variable Strength of Regulatory Arrangements. The OPIC fund program has a stronger regulatory framework in two ways: OPIC has formal regulatory powers of enforcement with legal sanction and OPIC investment funds have clearly articulated missions to which the fund managers can be held accountable.

Formal Enforcement Powers. As lenders to the investment funds, OPIC has legal rights and remedies should the terms of the loan agreement be violated. Indeed, OPIC investment funds could be legally compelled to divest a particular investment if it is found to violate any of the strictures of the loan agreement (interviews 15, 27). OPIC managers visit the investments and express discontent when failings are noted. It has not been necessary for OPIC to formally invoke these rights and privileges, but the action has been threatened. AID has no equivalent stick to wield over the Enterprise Funds.

OPIC's advantages have origins in the negotiation of terms for the venture capital funds. Investment funds generally are created at the discretion of OPIC, and in all cases fund managers are selected

[8]Experiences of this researcher confirm the difficulty in obtaining information from the OPIC investment funds.

[9]Some critics have argued that the fund manager selection process is entirely political and a means of rewarding political cronies (Mother Jones, etc.).

from a group of prospective managers. Unhappy with the terms proposed by prospective fund managers, OPIC can simply walk away. Enterprise Funds, in contrast, begin with a board of directors designated by the president.

Unlike OPIC, AID and State negotiators have no choice but to work out a deal with the Enterprise Fund directors. This gives AID considerably less leverage in negotiating the terms of the agreement. That is not to say OPIC simply dictates its terms. Private fund managers must be able to solicit investment. If the terms imposed by OPIC seem to make profitability less likely, this will be difficult if not impossible.

Clear Organizational Objectives. The goals of OPIC funds are less ambiguous than the mixed objectives of the Enterprise Funds. Profit-seeking OPIC funds are motivated by a desire to earn a return on their investors' capital commensurate with the risk of the investments. Enterprise Funds, from the outset, have cloudy missions. They are part venture capital fund but also part development assistance agency, a schizophrenia embodied in the initial legislation that provided for the Polish Fund to channel funds to the Solidarity Party. This confusion has been amplified as AID has requested appropriations for technical assistance dollars—separate from the capitalization appropriation—that the Enterprise Funds use to run programs not expected to earn a profitable return or any return at all.

The current controversy surrounding the Polish American Enterprise Fund is telling. Some have argued that the profitable fund should return the U.S. government's $240 million investment money to the U.S. Treasury. Others argue that the fund constituted a gift to Poland promised by President Bush. The money, they say, should be transformed into a permanent endowment to foster democracy in Poland. A compromise is likely, but the conflict underlies the lack of definition regarding the Enterprise Funds' purpose.

This makes the task of controling the funds that much more difficult for the State Department and AID. While these government agencies claim to set policy as it relates to the funds, but keep their hands off financial decisions, there is a tremendous gray area. For example, Enterprise Funds that serve multiple countries were urged to open offices in each country, even though this makes no economic sense. The funds complied, recognizing the importance of demonstrating American commitment to each market. Yet the pitfall of this "successful" control is that any AID or State Department claim to the fiscal high ground with regard to an investment strategy or a particular proposal is undermined.

Moreover, the mixed mission of the funds creates potentially conflicting incentives. One of the most consistently reported pressures placed on the Enterprise Funds was for quick disbursement of money (interviews 19, 15, 21). There was tremendous need for assistance, and a shared American desire to demonstrate concern and cooperation with action. Starting a fund and identifying sound investments in emerging markets, however, can be a time-consuming process. Doling out cash quickly is often at odds with prudent fiscal management. Indeed, the very extension of the Enterprise Fund concept to nations that, by many accounts, simply were not ready for venture capital investment embodied this inherent conflict. Thus it is not simply the structural mechanisms that allow greater negative control over OPIC funds, but the clarity of regulatory purpose.

CONCLUSION

The basic lesson of the American experience with government venture capital funds is that the relationship between fund management and the government overseers should not be conceived as *administrative*. Despite its intragovernmental nature, it is truly regulatory in character. As a result, the strength of OPIC vis-à-vis the investment funds is a function of its superior regulatory infrastructure, notwithstanding the absence of traditional tools of administrative control. The Enterprise Funds, in contrast, have more of the traditional administrative linkages in place, but those ties only give the illusion of control because AID does not have sufficient regulatory powers. Extending this lesson to future hybrid organizations suggests greater attention to development of well-conceived regulatory frameworks rather than insistence upon token appointment of directors or audit requirements.

Moreover, the demands placed upon regulation of hybrids must be consistent with the limits of this tool. The experience with venture capital funds indicates that regulation is better suited to imposing negative control than to providing positive policy direction to independent organizations. This suggests another lesson for those who are contemplating creation of hybrid organizations. Unless clear, unambiguous policy objectives can be stated at the outset, hybrid organizations will largely follow their own paths. This is not necessarily a disparaging assessment. Many proponents of quasi government claim this is the strength of hybrid organizations. Nevertheless, this tendency should be a consideration when hybrids are proposed to meet a public policy need.

APPENDIX
Venture Capital Fund Interview Subjects

This appendix lists interview subjects cited in this article by identification number listed in the textual citations with an anonymous descriptor that gives a sense of the interviewees' position and source of expertise with respect to the subject.

ID	Identifier	Interview Date
1	Senior AID official for EFs	12/09/98
2	House Majority Appropriations staff	01/08/99
3	House Minority Appropriations staff	01/08/99
4	Counsel to EFs	01/19/99
5	Counsel to EFs; fmr State Department EF staff	01/18/99
6	House Majority IR staff	01/25/99
7	EF evaluator	01/26/99
8	Fmr EF counsel	01/27/99
9	State Department EF Oversight staff	01/27/99
10	Fmr EF counsel to AID	02/03/99
11	Senior AID staff for EFs	02/04/99
12	AID EF Oversight staff	02/04/99
13	AID EF Oversight staff	02/04/99
14	EF staff	02/13/99
15	EF director	02/17/99
16	House International Relations Majority staff	02/17/99
17	Fmr senior AID official	02/22/99
18	EF staff	02/22/99
19	Fmr EF senior official	02/02/99
20	EF director	03/08/99
21	EF director	03/12/99
22	Senior OPIC official	02/01/99
23	Fmr senior OPIC IF official	02/11/99
24	Fmr Senate Majority Appropriations staff	02/17/99
25	Senior OPIC official	02/18/99
26	Senior IF official	02/22/99
27	Fmr OPIC IF staff; IF manager	02/24/99
28	Senior OPIC staff	02/26/99
29	Fmr OPIC IF staff	03/01/99
30	Fmr senior OPIC staff	03/04/99
31	Senior OPIC official	02/26/99
32	Fmr senior OPIC official	03/09/99
33	Senior AID official	03/22/99

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